THE NEW 403(b) REGULATIONS and
THE PLAN DOCUMENT REQUIREMENT

This article is aimed at tax-exempt nonprofit employers described in section 501(c)(3) of the Internal Revenue Code who sponsor or wish to sponsor an employee pension benefit plan pursuant to section 403(b) of the Internal Revenue Code.

Introduction to the Updated Regulations and General Q's & A's:

In July 2007, the IRS issued final regulations governing 403(b) plans, which were generally effective January 1, 2009. The new regulations require employers to make extensive changes to their 403(b) plan designs and operations, including adopting a written plan document.

In Notice 2009-3, published late last year, the IRS extended the deadline for written plans to be in place, making the new deadline December 31, 2009, provided, however, that employers operate their plans throughout 2009 according to a reasonable interpretation of the final regulations. Notice 2009-3 also requires the employer to make its "best efforts" to make retroactive correction of any 403(b) plan operational failures in 2009.

Despite the partial extension, the final regulations impose a challenging transition period on employers, since the *regulations are already in effect*. Therefore, employers have no time to lose in reviewing their plans and bringing them into operational compliance, as soon as possible.

This article addresses some common questions a typical 403(b) plan sponsor might ask in connection with the updated regulations. While it is the purpose of this article to raise awareness about the new regulations and to point out issues of general applicability, it would be impossible to give legal advice for any particular entity or individual in an article. Please do not consider this general information to be legal advice. For legal advice on your own situation, consult an expert employee benefits attorney.

Q: Why are there new regulations?

A: The updated rules reflect the gradual changes made to the law since the regulations were last updated over 40 years ago.

In the past, section 403(b) plans were seen by the regulators less as formal pension plans than as individual arrangements under which an annuity or other permissible investment contract was established for an employee's retirement benefit; but over the years since the last major revision of the regulations was published (in 1964), amendments to Code Section 403(b) have gradually lessened the differences between 403(b) plans and other types of employer-

based pension plans, such as 401(k) plans. As the Code has changed, so too must the regulations; the rationale for the updated regulations is to bring them more in line with the current requirements of section 403(b) of the Code.

Q: As an employer, what do I have to do to comply with the new regulations?

A: The regulations require employers to take action in a number of areas of plan operations. The following Q's & A's in this article relate to the requirement that a 403(b) arrangement be operated in accordance with a written plan. Other aspects of plan operations are addressed in a separate article.

In this article, you will find a general summary of the regulatory changes in each area of plan operations. You should review your plan operations to identify changes you need to make right away in order to comply with the operational requirements already in effect (January 1, 2009); this, in turn, will prepare you to adopt a new or amended plan document by the end of the year.

An attorney will help you identify and implement specific plan activities so that you minimize your exposure to legal liability under the new regulations.

Answers to Some Common Questions About the Plan Writing Requirement:

Q: What's all this I hear about our plan having to be in writing? We have been running our pension program for years without a written plan.

A: The updated regulations require every 403(b) plan to be set forth in one or more documents that reflect the current law and final regulations.

You may have always managed just fine without a written plan in the past (if your plan was not subject to the requirements of ERISA), but the new regulations call for all 403(b) plans to have a written document in place on or before December 31, 2009. If you already have a written plan, review it to be sure it's in compliance with the operational changes required by the regulations and amend it if necessary by December 31. While the regulations require compliance in plan operations as of January 1, 2009, you have the rest of 2009 either to finalize and adopt your first plan document or to amend your existing plan document as necessary to be in compliance by the deadline.

The plan is not required to be contained in one single document. As long as the essential elements of the written plan are set forth in writing, in compliance with the regulations, then various aspects of the plan may be covered in several different documents; of course, if your plan is set forth in more than one document, make sure they do not contradict one another.

In practice, having the plan comprised of several documents may be confusing. Drafting one overarching plan document is probably the most efficient way to ensure that plan is in compliance in form as well as in operation.

Q: When does the written plan have to be in place?

A: On or before December 31, 2009. (But plan *operations* must already be carried out in compliance with a reasonable interpretation of the final regulations *from January 1, 2009*, regardless of the date you adopt a written plan.)

Originally, the regulations required the written plans to be in place as of January 1, 2009, but in response to the concerns of many plan administrators, the IRS extended the deadline to January 1, 2010. However, this additional grace period for putting into place the document itself does *not* give employers a free pass not to comply operationally during 2009. Be aware that even though you need not sign a plan document until December 31, 2009, *you are already obligated to run the plan according to a reasonable interpretation of the operational provisions of the new regulations, as of January 1, 2009.* And, to the extent that your plan was not operated properly in 2009, you must exercise best efforts to correct any errors that occurred during the year by the end of 2009.

Even if you already have an existing plan document, if it was adopted before 2009, it may need to be amended by December 31, 2009 in order to bring it into compliance with the new regulations.

While it certainly takes a lot of administrative effort and preparation to properly comply with the writing requirement, there is an upside—the writing you end up with will become a guiding blueprint and master reference for ongoing plan activities.

Q: What does the written plan have to contain?

A: The written plan must contain all the material terms and conditions for benefits under the plan. At a minimum, the material terms and conditions are the following:

- **Who is eligible,**
- **What benefits are provided,**
- **The dollar limitations on contributions,**
- **The investments that are available, and**
- **The timing and form of distributions.**

These five elements are the heart of a 403(b) plan. Making sure that they are correctly expressed in your written plan will ensure that your employees get the maximum benefit from the plan and that the plan really qualifies for the tax benefits you expect. Appropriate language

for each of these provisions must be included in your written plan document(s). (Each element is discussed at greater length in other Q's and A's below.) If your plan offers any features or elements beyond the above fundamentals, those also must be described in the written plan. See the following Q & A below for more on optional features.

Technically, the written plan may be made up of more than one document, but in practice this may not be feasible or advisable. It would likely be more efficient and present fewer opportunities for inadvertent breaches in compliance if you drafted and adopted one controlling document.

When drafting the plan document, make sure is it is consistent with all funding vehicles as well as with the new regulations. If any documents are inconsistent with the plan, the plan is usually the controlling instrument for regulatory compliance purposes; but, of course, other legal difficulties may arise from contradictory provisions in connected documents, so work with legal counsel to review all elements of your plan and to address inconsistencies.

Once you have a written plan, it's a good idea to keep it and all relevant plan documents together in one place, for future reference.

Q: What are some of the optional provisions that a plan may provide?

A: If you wish, you may choose to include certain optional provisions in your plan. Any provisions you do include in your plan must be set forth in your written document. Here are some of the possible features you may wish to consider:

- Loans to participants from their accounts,
- Hardship distributions,
- Automatic enrollment,
- Roth features,
- Elective deferral catch-ups for 15+ years of service or for age 50 or older,
- In-service contract exchanges,
- Transfers of investments,
- *Plan termination

As you see, there are a number of optional features to think about. If you are interested in incorporating any of them into your plan, check with the new regulations for relevant provisions, and with your benefits attorney, to be sure you understand how the features and applicable regulations work. Then make sure the applicable provisions are drafted correctly in the plan document.

*Although it is not required for the plan to provide the right to terminate the plan, it's strongly recommended. Absent such a provision it's not necessarily clear that the plan may *ever* be terminated.

You will find some more detail about particular provisions, and about the interaction between the regulations and the features, in other Q's and A's in this article.

Q: What are the best provisions to have in a plan document?

A: The answer depends on your organization's needs and goals. Within the constraints of the regulations, there is still plenty of leeway to customize your plan to meet your employee benefits goals.

You may hear about some other employer's favorite investments or particular plan strategies, but each organization is different. After being sure to include the minimum required plan provisions, you need to design the plan that's appropriate for your entity, naturally with the advice of qualified experts.

What is absolutely essential is that your decision makers go through the drafting process mindfully; it is also imperative to start right away, if you haven't already, as it appears extremely unlikely that there *will be a further extension of time* to put a written plan in place after December 31, 2009.

Q: Our plan is subject to ERISA. Are there any special provisions we need to include in our plan document under ERISA?

A: There are a variety of provisions that apply to ERISA-covered plans that do not otherwise apply to non-ERISA plans. Most notably, an ERISA-covered plan funded with annuities must provide participants and their spouses with certain rights to benefits and notices of those rights. In addition, ERISA imposes a regime of fiduciary rules that govern the operation of the plan and the conduct of plan fiduciaries, and imposes extensive disclosure requirements. (The fiduciary rules are discussed further in a separate article on this website.)

For a plan that is funded with annuities, as many 403(b) plans are, ERISA requires that the plan document set forth the annuity-related rights of married participants and their spouses. Generally, the participant and a spouse, if any, must have the right to receive an annuity for the life of the participant and a survivor annuity for the spouse that is not less than 50% of the amount payable to the participant. These annuities are calculated based on the life expectancy of the participant, and if the participant is married, on both the participant's life and the life of the spouse. However, the participant and his/her spouse have the right to waive their rights to the joint and survivor annuity and to elect to receive the benefit under the plan in another form. The application of these rules involves extensive notice requirements and, if a waiver of spousal rights occurs, specific waiver procedures are mandated.

Q: We have a plan that is exempt from ERISA under section 2510.3-2(f) of the Department of Labor (DOL) regulations—a "safe harbor plan." Will preparing a plan document violate the safe harbor conditions and subject our plan to ERISA?

A: The new 403(b) tax regulations present a special challenge for safe harbor plans. The DOL has stated that compliance with the new 403(b) regulations, and in particular the adoption of a written plan, will not necessarily take a plan out of the safe harbor exemption. Nevertheless, in many cases it will be tricky for an employer to operate a 403(b) arrangement that complies with the 403(b) regulations while not violating the safe harbor conditions.

The main advantage of a safe harbor plan in the first place is not having to comply with the numerous exigencies of ERISA and its regulations. In order to meet the requirements of the ERISA safe harbor, the employer must not exercise discretionary authority over the operation of the plan. However, safe harbor plans are subject to the tax regulations, including the new written plan requirement. In attempting to comply with the various new tax regulatory requirements, an employer must take special care to avoid inadvertently accepting responsibilities that would take it out of the safe harbor.

Particularly, an employer must take care not to give itself, either in the plan document or in the operation of the plan, any discretionary responsibility or decision-making about plan administration, such as over participant loans or hardship provisions, which would violate the safe harbor conditions. Therefore, you need to be careful when drafting your plan and revising your procedures to comply with the new regulations that you do not inadvertently cause it to lose its status under the ERISA safe harbor. The Department of Labor (DOL) has stated that the manner in which an employer complies with the section 403(b) regulations would need to be analyzed on a case-by-case basis to determine whether or not the arrangement would be exempt from ERISA.

Q: What's the best process for developing our written plan?

A: There are a few general things to keep in mind as you plan to formulate a satisfactory plan document.

Each organization is unique in some way, but the following general pointers will get you started in the right direction as you prepare to adopt an updated, written 403(b) plan to meet your goals:

1- **Start now!** There is no time to lose, since the review, research and drafting process will take any organization *at least a few months* from start to finish. Remember, the

signed document must be in place by December 31, and *your plan operations are already subject to new regulations*.

2- **Who will be carrying out the crucial process of reviewing and updating your plan?** If you don't have dedicated resources to carry out the review and research and drafting required to inform your decision-making, hire outside help—have an expert consultant or attorney work with you

3- How will the drafting process be carried out? The Board is generally the ultimate decision maker regarding the plan. Appropriate decision makers in the organization should be assigned the task of reviewing and updating the plan, bearing in mind the deadline of December 31, 2009.The Board of Directors must review and adopt the final plan after appropriate examination.

4- **Assess the state of your plan as it is now.** If you find errors or noncompliance, now is the time to take any steps necessary to make corrections. Ask yourself:

- When was the last time you reviewed the plan for compliance? Do you have a procedure for doing so? Are problems being identified and, if so, how are they addressed?

- Are the plan provisions being carried out? For example, if your plan provides for matching contributions, are they being made in the right amount and on a timely basis? Are you conducting regular non-discrimination testing, and has your plan complied with the non-discrimination rules?

- Have all participants received the Summary Plan Description and other required communications about the plan?

5- **Now look to the future: Which plan features do you want to include in your plan going forward?** The new regulations may be imposing an unwelcome burden on you this year, but the upside is that the regulations are providing you an excellent opportunity to re-design your plan—as long as you act according to the regulations, you can put in useful provisions, eliminate unwanted or obsolete provisions and arrive at a plan that is up-to-date and tailored satisfactorily.

Q: I heard that the IRS is going to implement a prototype plan program for 403(b) plan sponsors to use. Should we wait for a prototype rather than draft one on our own?

A: No. An approved prototype or model plan will not be ready in time to meet the deadline this year.

The IRS has just begun developing the prototype approval program for most 403(b) employers. Unfortunately, any approved prototype will not be available for use in time to meet the December 31 deadline this year.

Q: Can our organization use the model plan document issued by the IRS in Revenue Procedure 2007-71?

A: The model plan issued by the IRS is designed for use by public schools and is for salary reduction contributions only. If your entity is not a public school, the model plan will need to be revised to reflect your own particular context and goals.

While it may be a helpful starting place, the model plan for public schools is rather basic. Your drafting committee would have to adapt the model plan to your entity's particular needs and goals, so having a model to work from does only part of the work for you.

Q: Should we purchase a model document offered by a service provider?

A: A ready-made document can be a valuable resource, saving you time and money in drafting the plan document. However, it's important to review the plan document to ensure it matches your circumstances and goals.

Some pre-drafted plans are overly complex for smaller plans, while others may not be sufficiently flexible for more complicated arrangements. Whatever your particular situation, remember to make the model plan work for you—start with the model and customize it as necessary in order to arrive at a plan that you understand and that really suits your organization.

Q: What do we have to do after the plan document is signed? Do we have to send it to the IRS?

A: The plan must be made available to participants who want to see it, but does not need to be distributed to them. You do not have to submit it to any regulatory agency unless requested.

If your plan is subject to ERISA, once you have a written plan document, you must communicate the plan provisions to all participants in a written summary plan description and make the full plan document available for examination by participants. Be prepared to answer participants' questions about the plan. Even for plans that are not subject to the summary plan description requirement, it is a good practice to provide your employees with an explanation of the plan's terms.

It’s a good idea to keep the plan document on hand together with all other relevant plan documents for future reference.