

# IRS Regulations for 403(b) Plans

## “A Best Practices Approach”



# Historical perspective



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- 1988: IRS imposed withdrawal restrictions, 10 percent excise tax, and loan repayments
- 1990: Issued Revised Ruling 90-24 for intra-plan transfers
- 1996: Announced audit program for 403(b) plans
- 2002: EGTRRA provisions eliminated many differences between 401(k), 403(b), and 457 plans
- 2004: Introduced new regulations governing 403(b) plans

# Executive summary



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- Major changes in the operation of 403(b) Plans
- Generally effective 1/1/09
- Written defined contribution plan required
- “Universal Availability”
- 90-24 Transfers - new requirements
- 403(b) plan terminations

# Written defined contribution plan



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- The final regulations require that all 403(b) plans be maintained pursuant to a “written defined contribution plan.”
- The plan should include provisions regarding eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made.
- IRS recently issued model plan language

# Plan issues



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- Plan language takes precedence over contracts and custodial account provisions.
- Written plan could permit or prohibit
  - Loans
  - Hardship withdrawals
  - Transfers
  - Roth contributions
  - Employer contributions, including post-employment contributions

# Non-discrimination rules



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- The “Universal Availability Rule” provides that all employees of the eligible employer must be permitted to 403(b) elective deferrals.
- Employees who normally work less than 20 hours per week may be excluded.
- Age and service conditions are not permitted for the salary reduction portion of the 403(b) plan. However, these requirements are permitted for Employer contributions.

# 90-24 transfers



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- The Final Regulations require employer consent to a transfer or exchange.
- The employer must enter into an agreement with the issuer of the other contract under which the employer and the issuer will from time to time in the future provide each other with certain information.

# The ISA



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This Information Sharing Agreement includes information concerning the participant's employment and information such as whether a severance from employment has occurred and whether the hardship withdrawal rules in the regulations are satisfied or loan rules are followed.

# Catch-up contributions



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- **The Traditional catch-up rule:**

403(b) plans may provide additional catch-up contributions for participants who are age 50 or older. In addition, plans maintained by certain qualified organizations (schools, hospitals, health and welfare service agencies and church-related organizations) may also provide for special catch-up contributions for participants with at least 15 years of service.

# Catch-up contributions



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The final regulations clarify the “ordering requirement” for catch-up contributions as follows: Any catch-up contribution for an employee who is eligible for both an age 50 catch-up and the 403(b) catch-up is treated first as a §403(b) catch-up contribution, to the extent permitted, and then as an age 50 catch-up contribution (to the extent the catch-up amount exceeds the 403(b) catch-up).

# Plan termination



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- Historically, employers found it difficult to terminate their 403(b) arrangements. 403(b) vendors maintained employees owned their accounts, and therefore the primary relationship between vendor and employee had to continue.
- 403(b) plan terminations are now considered a distributable event and a plan may be terminated if the employer does not contribute to another 403(b) plan within 12 months before or after the termination.

# Impact of new regulations



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- Substantial reduction in the number of providers for a plan or utilization of a single provider.
- Introduction of RFPs and TPAs to marketplace
- Provider flexibility will be required – contract must conform to written plan
- Employer obligation to monitor loans, hardships, investment options and fees

# Fiduciary concerns



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- Public schools
  - Conflict with new regulations and state laws
  - Blanket ERISA exemption does not eliminate fiduciary responsibility regarding investments
- 501(c)(3) organizations
  - The final regulations and fiduciary concerns require monitoring of plan and investments

# The challenge



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Fidelity commissioned a survey of 300 403(b) plan sponsors regarding the impact of the new regulations.

- Two major concerns were greater fiduciary responsibility and increased administrative duties



# Best Practices



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- Form an advisory committee
- Seek out assistance from a qualified advisor
- Review existing provider investment options, fees, and administrative services
- Seek proposals from current provider(s) as well as other defined contribution plan providers
- Create standard for ongoing monitoring of the plan

# To employers



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- Seize the Opportunity – leverage your strengths
- Outsource your weaknesses
- Embrace the regulations as an opportunity for plan improvements – RIA services, full fee disclosure, open architecture, investment advice, and technology

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