The final regulations also define "health and welfare agency," a type of employer whose employees might be eligible for increased contribution limits under Code section 402(g)(7) (discussed above). The definition would include:

- Agencies that provide medical care as defined in Code section 213(d)(1), such as a hospice
- A section 501(c)(3) organization that prevents cruelty to individuals or animals
- An organization that provides substantial personal services to the needy as part of its primary activities [such as a section 501(c)(3) organization that offers meals to needy individuals]

Finally, continuing the theme of plan-level compliance, it continues to be the case that contribution limits must be applied at the plan level. Thus, if a participant contributes to more than one provider in any year, the contributions are aggregated for the purposes of the limits monitoring.

Distributions and loans

Current law does not subject nonelective contributions to a 403(b) annuity contract to withdrawal restrictions under the Code, even though they are frequently subject to withdrawal restrictions under the employer's plan. The final regulations will only permit these contributions (and related earnings) to be distributed when:

- Separating from service
- Experiencing a specific event such as a fixed number of years, attainment of a stated age or becoming disabled

The final regulations also provide that hardship distributions under 403(b) plans are subject to rules applicable to 401(k) plans.

Finally, as was the case before the final regulations, rules governing distributions and loans apply across providers under the plan. The IRS has made clear that an employer has an obligation to ensure that there is coordination in place to ensure that withdrawals and loans in the aggregate do not violate applicable rules. As discussed under "written plan," it is up to the employer to determine how the responsibilities are divided.

However, it seems fairly clear that the plan cannot solely rely on certain information provided by the participant to satisfy the requirements. For example, it likely will not be sufficient for the participant to be the sole provider of information on defaulted loans, or the existence of other loans, under the plan, whether that information relates to:

- Investment providers within the plan
- Investment providers with information sharing agreements with the employer, including pre-existing contracts that do not qualify for grandfathering from the requirement

Plan termination

The final regulations allow 403(b) plans to be terminated if specific requirements are satisfied, such as an employer's decision not to contribute to another 403(b) plan at the time of termination and distribution of all assets, and for 12 months thereafter. The plan allows the participant at termination to receive distribution of an individual annuity.

Life insurance in 403(b) plans is no longer allowed

Life insurance and similar incidental benefits are no longer permitted in 403(b) plans. The final regulations include a transition rule for policies issued before February 14, 2005.

Use of vesting schedule still available

The regulations preserve a plan's ability to impose a vesting schedule on contributions if other requirements are met, but only if the nonvested contributions are made to an annuity contract. Nonvested contributions to an annuity, and contributions to an annuity that otherwise fail the requirements of section 403(b), are treated as contributions to an annuity described in section 403(c), which generally would be taxable to participants unless they are subject to a substantial risk of forfeiture. Make sure your plan meets the tax requirements to impose such a vesting schedule.

Contact your information source on 403(b) regulations at 1-877-403bREG (2734) or 403bREG@aigretirement.com

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Final 403(b) Regulations — Setting the Story Straight

Solutions for Public 403(b) Organizations

Final 403(b) regulations have been released and generally become effective on January 1, 2009. There's been plenty of buildup, discussion, information and misinformation talked about while plan sponsors and plan providers waited for the final word. Now that the final word is here, what now?

This is not intended to be an exhaustive summary of the final regulations or of any provision of the proposed regulations; however, it will highlight some important themes. In many respects the regulations simply reflect the current state of the law and the current practices of many 403(b) plan sponsors and investment providers. The final regulations make some significant changes to 403(b) plans. Let's take a closer look at some of the key final changes.

Written plan

One significant change is the creation of a plan document requirement for all 403(b) plans, whether the plan consists of employer contributions, employee deferrals or a combination.

Final regulations permit the written plan requirement to be satisfied in a number of ways, depending on what works best for the plan sponsor. So, for example, an employer could maintain separate plan documents for employee deferrals and employer contributions (such as properly structured special pay contributions in lieu of accumulated sick and vacation time). Further, certain of the written plan requirements may be satisfied by the written terms of the providers' contracts and need not be replicated in the employer's plan documents. A collection of documents could potentially constitute the written plan.

Employers can expect many of their providers, and other parties as well, to offer up sample plan documents. NOTE: Any references to "prototype documents" would be inaccurate, as there is no program today for the IRS to approve prototype 403(b) documents. However, stay tuned, because that could change. Documents offered by providers and other parties should be vendor-neutral to work with multiple 403(b) contracts and accounts.

The IRS has also published model plan language for "public schools," a term which appears to include public colleges, universities, and community colleges, as well as public K-12.

In any case, the requirement to have a written plan document should not of itself be a significant burden. In most instances, it should require nothing more than the one-time adoption of a document, then occasional updates for changes in tax law.

Plan sponsor: fiduciary?

There is nothing in the final 403(b) regulations that states or implies that employers are fiduciaries with respect to the 403(b) products purchased for their employees. Quite the contrary, the final regulations confirm that even voluntary 403(b) plans of private tax-exempt employers, which do not enjoy the governmental plan exemption from Title I of ERISA, may still be maintained with very limited employer involvement.

The Department of Labor confirmed this point in a Field Assistance Bulletin that discussed plans of private tax-exempt employees, noting that the continued availability of an existing exemption for voluntary deferral plans depends on the extent of the employer's involvement. However, depending on state law and the scope of the responsibilities that a public employer has elected to assume under the plan, that employer may take on new responsibilities (whether or not characterized as fiduciary responsibilities) that are greater than those imposed under the 403(b) regulations.

You may have read or heard analysis on this topic recently. In some cases the analysis addresses individual states, while in other cases the topic is addressed only very generically. It is always possible that a specific state's laws, regulations or common law could impose broad fiduciary or fiduciary-like responsibilities on a public employer sponsoring a 403(b) plan. Plan sponsors should consult legal counsel for specific advice regarding their plans. However, as a general matter, this topic presents several opportunities for confusion and misdirection. For example:

- It is true that most state-defined benefit pension and retirement systems, and some state 457(b) plans, are subject to explicit fiduciary duties under the governing state statutes and regulations. It is also true, however, that these same statutes and regulations generally do not apply to a public employer's 403(b) plan. Of course, specific duties and considerations may apply to the handling and timely remittance of contributions. State or local procurement rules and similar rules may govern the process of provider review and selection. Identifying such duties, rules and considerations, however, generally is very different from imposing broad ERISA-like fiduciary duties on a public employer 403(b) plan sponsor.
- In a few states – including California, Texas and Ohio – a school district is specifically prohibited from excluding a provider or product from receiving new contributions under the plan as long as the provider and product satisfy applicable state requirements. As a general matter, those state requirements include satisfying the requirements of Code Section 403(b). In California and Texas, the requirements also include participation in a state registry of eligible providers and/or products. As a general matter, however, a school district is normally permitted to exclude a product which does not satisfy the requirements of Code Section 403(b).
- In some states, an employer that takes a more active role in reviewing the underlying products, over and above its review of the product's compliance with the requirements of Section 403(b), might itself trigger a heightened level of duty to participants. However, any discussion of potential liability that might be associated with narrowing the field of available products within the 403(b) plan should also consider the potential application of sovereign immunity principles to a public employer's plan, particularly in the absence of specific legal rules imposing a defined set of fiduciary obligations to that function.

In any case, if and to the extent state law imposes responsibilities on employers, those responsibilities are not changed or enlarged by the 403(b) regulations.

Of course, public employers are free to voluntarily assume fiduciary, or fiduciary-like, responsibilities under their 403(b) plan, assuming no restrictions on the assumption of such responsibilities under state law. However, it is important to distinguish among a public employer's tax compliance responsibilities, its legal responsibilities to employees under state law, and whatever nonlegally mandated actions it chooses to take to provide a quality program for its employees. Fiduciary status could increase a plan sponsor's potential liabilities, and an employer should not take action that assumes or implies that it has such responsibilities without careful consideration and unbiased legal advice.

Transfers

Final regulations restrict future 403(b) transfers to those specific products that are authorized under the employer's plan, including:

- Products from providers approved to receive ongoing contributions and transfers
- Providers that have entered into information sharing agreements to assist with plan compliance and are thus eligible to receive transfers

This situation makes it important for an employer to know whether a provider will restrict such transfers to the employer's approved list. If participant accounts are maintained on an individual basis, without reference to an employer, that may be a very difficult requirement for a provider to apply. However, if accounts are systematically aggregated at the employer group level, enforcing these new restrictions is much simpler.

Although the ability to transfer between 403(b) contracts/accounts was restricted as of September 25, 2007, final information sharing agreements are not required until 2009. Thus, a grandfathered contract which receives a new transfer or exchange after September 24, 2007, will forfeit that grandfathering.

The IRS has indicated, in Revenue Procedure 2007-71, that a transfer to an unapproved product (i.e., not in the plan, and no information sharing agreement) after September 24, 2007, and before January 1, 2009, generally can be corrected by retransferring to an approved product by June 30, 2009. The IRS has also provided additional guidance regarding accounts of former employees and beneficiaries, as well as accounts of current employees, with previously deselected providers.

Universal availability opportunities announced

Plan sponsors that allow any employee to make elective deferrals are required to allow all employees the same option, with limited exceptions. One such exception allows employers to exclude employees who normally work fewer than 20 hours each week. However, there is currently no bright-line test for this exclusion, particularly for contract employees, whose schedules can be irregular.

The final regulations establish a bright-line test of 1,000 hours. A new employee who is expected to work fewer than 1,000 hours in the first year of service could be excluded. So could a current employee who worked fewer than 1,000 hours in the preceding year. Such a test should greatly simplify the ability of employers to comply with the universal availability rule.

Certain employees may no longer be excluded, including temporary professors, employees covered by a collective bargaining agreement and governmental employees who make an irrevocable election to participate in a governmental plan under section 414(d). However, the IRS has provided a delayed effective date of January 1, 2010, for the purpose of including these employees.

Also consider the "effective availability" requirement. This means that if an employee is not made aware of a plan, it can't be considered "available," even if he or she could have asked (and been allowed) to participate. Notices to new and current employees about the plan, an annual opportunity to change contributions and daily access to employees by plan investment providers can go a long way toward addressing this requirement.

Finally, if a plan sponsor allows an excludible employee to make elective deferrals to the plan, then the organization must make the plan available to all similarly excludible employees.

Contributions timing and limitations

The final regulations introduce a new rule requiring that contributions be remitted to the eligible annuity contract or custodial account within a reasonable time. The regulations also provide an example of how this requirement can be satisfied, if contributions are forwarded not later than 15 business days after the end of the month in which the contributions are withheld from the employee's pay.

The final regulations also clarify how post-separation and catch-up contributions must be applied. They restate that a participant must exhaust all contribution limits, including the increased contribution limit under Code section 402(g)(7) (which generally allows certain participants who have 15+ years of service with a qualifying employer to contribute up to an additional $3,000 per year up to a maximum $15,000 during the course of their employment) before benefiting from the 50 or older age-based catch-up provision.

(continued on the back)