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403(b) Retirement Plans: It's a New World

By Stephanie Reagan & Catrina Blackwell

Plan Sponsors should take note, beginning January 1st, 2009 there will be significant changes to the Internal Revenue Code regulations that will affect 403(b) plans. Here is some insight on what those changes are, how they will affect 403b plans, and how plan sponsors can prepare now to ensure compliance when the new regulations take effect.

To summarize the overhaul to the 403(b) regulations, all 403(b) plans will be treated more like 401(k) plans. Meaning, employers will be responsible for the administration of their 403(b) plans, whether or not the plan is considered an ERISA plan. Employers may delegate the administrative responsibilities for their 403(b) plans, but not the liability.

The new regulations include:

(1) *A Written plan document requirement* - Every 403b plan must have a written plan document which describes all of the plan benefits and lists vendor contracts with the plan. Any delegation of responsibility for administrative functions must be detailed in the plan document and the plan document must stipulate whether plan-to-plan transfers or contract exchanges within the plan are allowed. Employers can exclude vendor contracts from the plan where the employer has not sent contributions to the vendor since 12/31/04. If plan contributions to a vendor have ceased between 1/1/05 and 12/31/08, a reasonable good faith effort must be made to notify vendors to include such contracts in the plan.

(2) *Stricter exchange and transfer rules* - Open-ended contract-to-contract transfers are effectively eliminated. To receive a transfer, the vendor must be listed in plan document or have an Information Sharing Agreement with employer.

(3) *An 'Annual notice to participants' requirement* - The notice must include rights to participate, timing of elections, methods for making or changing elections, and other conditions and information that the participant needs in order to make election decisions under the plan.

(4) *Other significant regulation changes* - Controlled group rule clarification; changed and clarified "Universal Availability" rules; timing of deposit parameters and plan termination availability.

There are new Form 5500 reporting rules for ERISA 403(b) Plans. For plan years beginning in 2009, the same extensive reporting and independent audit requirements as apply to 401(k) plans will be required for ERISA 403(b) plans. A full Form 5500, including financial information, is required for Large plans (in general >100 participants) – in Schedule H, and for Small plans – in Schedule I.

Financial statements and footnotes of large plans must be audited by an independent auditor. Plan sponsors need to make decisions now and get plan records pulled together in an "auditable" state.

So why is this important to Employers? Non-compliance with the 403(b) requirements jeopardizes the favorable tax treatment of the 403(b) contracts, potentially causing significant additional taxes to plan participants and large penalties to employers. Form 5500 filings without a required audit report will be rejected by the Department of Labor and subject to significant penalties to be paid by the plan sponsor.

Plan sponsors may be sued by participants of the plan. 403(b) plan fees scrutiny is a new focus of litigation. Major class action suits are starting to surface, such as one filed against National Education Association's 403(b) plan in July 2007. Employers must consider the costs of defending law suits and non- compliance issues.

Plan fiduciaries have a very high degree of personal responsibility whether or not the 403(b) plan is an ERISA plan. Anyone who has control or influence over the plan operation or its assets, including officers and board of directors of the employer, is a plan fiduciary.

Plan sponsors that have multiple vendors should consider whether to change to a single vendor relationship. The regulations impose responsibility on employers to oversee plan compliance among all of the vendors for which they process payroll deductions. For some employers, eliminating vendors may be a public relations issue with employees or may require the plan to comply with ERISA. However, limiting the number of vendors can mean: Lower plan costs for participants; Reduced complexity for plan compliance and administration; Clearer vendor responsibility for plan compliance; Higher plan administration service quality; and More knowledgeable selection and monitoring of plan investments.

Plan sponsors should begin NOW to attain compliance with these regulations by January 1, 2009. To accomplish this, employers should appoint a committee and engage experts as needed to:

- Additional steps for ERISA 403(b) Plans:
- Establish/streamline administrative controls and procedures, including documentation
- Evaluate reasonableness of plan costs
- Select and monitor vendors and investment alternatives
- Prepare Form 5500 Annual Return/ Report of Employee Benefit Plan including compilation of financial information

Additional steps for Large ERISA 403(b) Plans (over 100 participants):

- Compile plan financial information into ERISA and GAAP basis financial statements, footnotes, supplemental schedules required by the Form 5500
- Determine if a limited scope audit may be performed
- Identify an audit firm with 403(b) plan expertise to perform the annual audit of the plan's financial statements

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