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403(b) Plan Readiness

Getting Your 403(b) Plan Ready Begins with a Documented Plan

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Third Edition

why MetLife Resources prepared this paper on

403(b) Plan Readiness

On July 26, 2007, the Treasury Department and the Internal Revenue Service ("IRS") released final regulations under section 403(b) of the Internal Revenue Code of 1986. The final regulations are the first comprehensive rewrite of the tax rules affecting 403(b) arrangements since 1964. The general effect of the final regulations is to require a greater level of employer involvement in the documentation and operation of 403(b) arrangements.

At MetLife, we're committed to providing you with ongoing communications that will help you make decisions regarding your 403(b) plan. We have prepared in-depth discussions covering topics ranging from the impact of Information Sharing Agreements to the "Universal Availability" requirement as they may impact an employer's 403(b) plan. We hope this white paper will assist you in managing your 403(b) plan according to current 403(b) regulations that generally went into effect January 1, 2009.

You can view a copy of our previously released white papers at our 403(b) Resource Center at www.metlife.com. For more information, please contact your local MetLife representative.

About The Authors

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Plan Communication

The final 403(b) regulations that were released in July 2007 contain a number of key provisions affecting employers that offer 403(b) plans to their employees. Among the most prominent changes was the new written plan requirement, which had the most impact on employers with governmental or voluntary elective deferral-only plans not subject to ERISA. This is because such plans were not previously required to have a written plan in place.

Originally, plan sponsors had until January 1, 2009 to adopt a written plan. An employer's written plan must describe how it intends to comply with both statutory and regulatory requirements of §403(b). Plan sponsors need to design a plan that can be enforced and they are also accountable for the proper operation of the plan.

The written plan need not be a single, consolidated document, but may incorporate other documents by reference, such as annuity contracts, custodial accounts and salary reduction agreements. The written plan must specify certain basic terms, including:

- eligibility to participate
- available investments
- the delegation of administrative responsibilities

Although a single written plan document may not be required, it could be very useful in coordinating and controlling the participation of multiple vendors and other service providers. A consolidated plan document would certainly provide a more consistent reference point for all aspects of the operation of the plan.

Plan Adoption - Alternatives

Employers might look to several sources in order to draft a written plan. These sources include the Internal Revenue Service ("IRS") as well as product vendors and service providers.

The IRS provided a sample plan document intended for use by public school employers in its Rev. Proc. 2007-71. The IRS sample written plan is a simple "elective only" plan in that the only contributions contemplated are employee elective salary deferrals. The IRS document, however, does describe various optional provisions which may be included or omitted, such as loans and hardship distributions.

The Revenue Procedure indicates that, if the sample written plan and its optional provisions are used to create a document essentially verbatim by public school employers, then the resulting plan will be considered comparable to a "prototype" document as in the 401(a) qualified plan world, i.e. automatically "qualified" as to form.

Although the sample written plan was created for public school employers, the IRS indicated that the form may be adaptable for use by a non-governmental 403(b) employer. However, non-governmental groups cannot assume that the IRS would automatically approve their use of the sample form. Additionally, the use of some optional provisions may actually cause the plan to become subject to ERISA.

The IRS does not currently approve prototype 403(b) plan documents, but is expected to open a program in the future, pursuant to which providers such as MetLife will be able to offer pre-approved prototype documents. MetLife intends to offer more information when that happens. The IRS has indicated that an employer that timely adopts a prototype 403(b) plan will be able to rely on the plan's pre-approved status retroactive to January 1, 2010.

Absent in a "pre-approved" plan, employers can focus their attention on the design decisions of the plan. It is recommended that employers seek individual tax and legal advice regarding the adoption of a plan. Plan sponsors are required to operate their plans in compliance with the final regulations, effective as of January 1, 2009.

Plan Design Decisions: Required And Optional Provisions

The written plan must fully describe the features of the plan, including required features as well as optional provisions. In addressing both required and optional plan features, there is room for the employer to make proactive plan design decisions.

Required	Optional
Eligibility	Automatic Enrollment / QDIA
Contributions & Limitations	Exchanges and Incoming Rollovers
Timing & Form of Distributions	Loans
Investments Available	Hardship Distributions
Delegation of Administrative Responsibilities	Roth Accounts and In-plan Roth rollovers

Required Provisions

Eligibility

The final regulations require that 403(b) plans must provide "universal availability" whereby essentially all employees have the opportunity to make employee elective deferrals. The final regulations narrowly define those employee groups that may be excluded from participating in the 403(b) plan. The current standard replaces the former rule of "good faith" non-discrimination.

Contributions

A basic 403(b) plan provides employees with the opportunity to make elective deferrals from their own compensation. Adding other contribution types makes plan design decisions more complicated. Possible plan contribution types include the following:

- Elective deferrals
- Roth
- Rollover
- Employer match
- Employer non-elective
- Post-severance

Definition of Compensation

Depending on the contribution type, the employer must take into consideration such things as definition of compensation and potential vesting issues. Choosing to include employer matching or non-elective contributions in the plan will require design decisions to be made by the employer regarding how the contribution is calculated and allocated for each employee. Options include:

- as a percentage of elective deferral
- "integrated" with Social Security (which allows a limited higher match for higher-paid employees)
- by formula
- discretionary each year

Since there are further technical details to be decided with matching contributions, it is recommended that employers seek individual tax and legal advice in this area.

Post-severance Compensation

An additional "compensation" issue in plan design consideration is whether to include post-severance compensation. A plan may provide for compensation for up to two and one-half months following the year of severance to count as compensation for purposes of continuing an employee's opportunity to make elective deferrals. In addition, the plan may provide that the employer will continue to make non-elective contributions on behalf of an employee on the basis of his compensation at severance, for up to the end of the fifth calendar year following severance.

The written plan is to describe how plan administration and compliance responsibilities will be delegated.

Plan Contribution Requirements

The various 403(b) contribution levels and limitations must be included in the written plan:

- 402(g) limit - $16,500 for 2011
- 415 limit - lesser of 100% of compensation or $49,000 for 2011
- 403(b) and 401(k) contributions must be aggregated
- Excess elective deferrals must be refunded by April 15 of the following year

Vesting

For employers that make non-elective contributions, a plan can indicate vesting provisions. An employee's own elective deferrals are always fully vested, but a plan may provide that employer matching and other non-elective contributions are subject to a vesting schedule. Vesting raises a number of complexities in plan design where the employer must then decide upon a vesting schedule and the application of forfeiture amounts. The employer's plan cost can be reduced with vesting because forfeited amounts by short-service employees can be applied to offset future employer plan contributions.

Distributions

Under the final regulations, any limitations on distributions from 403(b) plans must be included in the written plan. There are limited choices to be made in plan design because the distribution limitations are largely prescribed by law or regulation. Permitted distributions include:

- Severance
- Death
- Disability
- Financial Hardship*
- Mandatory Distribution
- Purchase Government Pension Service Credit
- Attainment of age 59½
- Rollover
- Required Minimum Distribution

**if permitted by plan*

In addition to the above, employer contributions to a non-custodial account may be distributed after a certain number of years or attainment of a certain age. This more liberal distribution restriction is strictly an employer's design decision.

In addition to specifying the limitations on plan distributions, the plan must also incorporate the usual Required Minimum Distribution requirements ("RMD") that generally impact former employees upon reaching age 70½.

Investment arrangements

All investment options available to employees must be specified in the written plan and, as such, are considered "under" the plan. In addition, the acceptance of rollover accounts into the plan is a design decision for the employer.

Delegation of administration and compliance responsibility

One very important function of the written plan is to describe how plan administration and compliance responsibilities will be delegated to various parties, including the employer, the investment providers, and any service providers. The final regulations make it clear that compliance responsibilities may be allocated in any fashion the employer desires, with one critical exception: they may not be allocated to the participant. This means none of the parties mentioned here may rely exclusively on information provided solely by the participant.

A loan request from a 403(b) participant provides an important example of how 403(b) plan administration should work under current IRS rules. Previously, a participant who had accounts with multiple providers could certify that he or she did not have loans with other providers that would cause the requested new loan to exceed applicable limitations. Under the final regulations, such reliance would be tantamount to assigning compliance responsibilities to the participant. As a result, someone on behalf of the plan must now determine whether the loan, when aggregated with other loans under the plan, and loans under other plans of the employer, is within applicable limitations.

An employer has essentially two alternatives when it comes to deciding how it will handle the administration of its 403(b) plan: self-administer or hire a third party.

Self-Administer	Hire a Third Party
Single administrator	Third party processing all transactions
Employer maintains plan records and makes all determinations	Common remitter services
Employer or its service provider approves all transactions	Coordination of loan requests
Employer confirms key data when necessary for individual transactions	Hardship distribution processing
	Plan-level & participant-level reporting

Employers must evaluate the range of alternatives available to them and choose the solution that fits their individual circumstances. And of course, the employer's selections may be significantly influenced by applicable state laws and collective bargaining unit concerns.

Optional Provisions

In addition to the required plan element, the employer has the option of including the following provisions:

- Automatic enrollment/Qualified Default Investment Alternative (QDIA - applicable to ERISA plans)
- Exchanges and rollovers
- Loans
- Hardship distributions
- Roth accounts

Automatic Enrollment / Qualified Default Investment Alternative

A technique known as automatic enrollment has evolved in the context of 401(k) plans to encourage employee participation. Essentially, a deemed deferral "election" or "negative election" is stipulated in the plan on behalf of each new employee. Employer decisions about this feature include:

- Initial deferral rate
- Optional automatic increase in the deferral rate
- Default investment allocation

Employees can subsequently decide to increase, decrease or stop their deferrals. In addition, employees are free to change the investment allocation at any time.

It's important to note that automatic enrollment was made possible in many states only after ERISA was amended to preempt state payroll statutes which limited garnishment of wages. Since governmental and voluntary 403(b) plans are not subject to ERISA, ERISA would not preempt laws applicable to these types of employers. Accordingly, it may not be possible in some jurisdictions for these types of employers to adopt an automatic enrollment provision.

With automatic enrollment, the employer must specify a default investment allocation where contributions are allocated in the absence of employee action; otherwise referred to as a Qualified Default Investment Alternative. The Department of Labor adopted rules for this purpose and described in the 401(a) context how employee deferrals in ERISA plans could be allocated in the absence of an employee decision.

Exchanges And Transfers

As noted earlier, the written plan must specify what investments are available to employees under the plan. In addition, the employer may optionally provide for contract exchanges with other providers. Investments are generally considered to be "under the plan" if the provider is specified in the written plan.

If exchanges from one 403(b) vendor to another within the plan are allowed, they must be provided for by the employer's written plan and the vendor receiving the exchange must either be part of the employer's plan or must enter into an information sharing agreement with the employer prior to the exchange. Information sharing agreements are intended to help the employer comply with 403(b) requirements. Exchanges, if permitted by the plan, can only be made between 403(b) plans – not 401(a) or 457(b) plans.

Loans

The availability of loans is an optional plan design choice of the employer. It is generally believed that the loan feature in 403(b) plans has historically been an important element in encouraging employees to participate. For the employer, however, a provision for loans can add significantly to plan administration responsibilities, including:

- Approvals
- Determining amortization periods and payment frequency
- Limiting repayments to payroll deduction
- Use of appropriate interest rates

If the plan permits more than one loan at a time, then the employer (or its designated administrator) must be able to determine the highest outstanding loan balance for the 12 months prior to the new loan in order to determine the new loan limit. If the prior loan took place more than 12 months prior to the current application, the administrator would need to be aware of the highest unamortized balance in the prior 12 months.

It's important to note that loan monitoring activities must take into account all of a participant's 403(b) contracts. Failure to properly limit loan amounts can cause all the participant's contracts to become taxable.

An employer's 403(b) plan must specifically provide for hardship distributions and loans; otherwise, they are not available.

Hardship

A plan may optionally provide hardship distributions of elective contributions (employer contributions are not included). The final 403(b) regulations essentially refer to 401(k) rules on distributions for a deemed financial hardship. The "safe-harbor" definition of hardship under the 401(k) regulations is an immediate heavy financial need, such as: necessary medical expenses; the purchase of a principal residence; tuition for 12 months of post-secondary education for an employee or the employee's spouse, children or dependents; expenses to prevent eviction or foreclosure; and funeral expenses for the employee or the employee's close relative.

The distribution is "necessary" if the funds are not reasonably available from another resource (e.g., by taking plan loans). After a hardship distribution is taken by the participant, all future elective deferrals must be suspended for the sixth-month period following the hardship distribution.

An employer's 403(b) plan must specifically provide for hardship distributions; otherwise, they are not available. The administration of a plan can be considerably simplified by not providing for hardship distributions, but an employer must also consider the potential impact on participation.

Roth Contributions

An employer may choose to allow employees to make non-deductible Roth contributions under the plan, which are employee contributions from after-tax compensation. Distributions, including earnings, are not subject to Federal income tax as long as they meet certain requirements.

Other Compliance Considerations

Non-Discrimination

Under the final regulations, all 403(b) plans must comply with the "universal availability" requirement for elective deferrals. Under prior rules, a 403(b) plan was required to simply meet a "good faith" standard. The final regulations clarified this requirement and other non-discrimination rules, making the employer or plan administrator responsible for compliance. Failure by the employer to comply could jeopardize the tax-deferred status of the plan.

The nondiscrimination rules applicable to both governmental and non-governmental 403(b) plans vary depending on whether the plan is restricted exclusively to elective deferrals or not, as seen in the following table.

	Governmental		Non-Governmental / Non Church	
	Elective Only	Other Than Elective	Elective Only	Other Than Elective
Universal Availability Requirement	✓		✓	
403(b) Compensation Limit	✓	✓	✓	✓
401(a) Eligibility and Coverage Rules				✓
401(a)(4) General Nondiscrimination				✓
Actual Contribution Percentage (ACP) Test				✓

As in the 401(k) context, there are design choices by which an employer can simplify compliance with the ACP test. The employer could design the plan as a "safe harbor" plan under which the employer contributes a 100% match up to 3% of compensation, plus 50% match up to the next 2% of compensation. Alternatively, the employer could commit to a non-elective contribution of 3% for all participants. Apart from adopting a safe harbor design, employers must decide how the ACP test is applied (e.g., to current or prior year data for non-highly compensated employees, the definition of highly compensated employees, etc.). The employer or plan administrator is responsible for assuring that its plan meets the above plan discrimination tests, and may do so itself or outsource to a third party.

Interaction with ERISA

Governmental employers, public schools, public hospitals and many church organizations are not subject to Title I of the Employee Retirement Income Security Act (ERISA). For non-governmental employers that are not church or church related employers, avoidance of ERISA requires that there be very minimal involvement of the employer with the plan—generally nothing more than authorizing payroll deductions.

Pursuant to Field Assistance Bulletin 2007-2 ("FAB 2007-2") issued by the Department of Labor, if an employer does only what is necessary to comply with the new regulations, the plan will not be subject to ERISA.

	Exempt from ERISA	Proceed with Caution*
Written Plan Requirement	Adopting a written plan does not subject a plan to ERISA.	Including optional provisions in the plan such as employer contributions, hardships or loans may subject the plan to ERISA.
Delegation of Administrative Duties	The employer cannot delegate plan administrative duties to participants or beneficiaries. A plan can avoid ERISA coverage by identifying the parties who are responsible for administrative functions, including tax compliance. The plan should accurately describe the employer's limited role and its delegation of discretionary determinations such as loans or hardship determinations, to the annuity provider or other third party.	An employer's exercise of discretion concerning plan administration (for example, determining eligibility for participant loans and/or hardship distributions or hiring a third party administrator) may result in ERISA coverage.
Selection of Approved Providers	The employer may limit the number of providers to a number designed to give employees a reasonable choice.	An employer's negotiation with annuity providers or account custodians to change terms of their products (such as conditions for hardship withdrawals) would be a form of employer involvement that could subject the plan to ERISA.

**There may be substantial consequences if an ERISA covered plan is improperly administered as though it was not covered by ERISA. Employers are encouraged to seek legal advice.*

Summary

The new regulations forced employers to take a more active role in the design of this important employee benefit. Employers should not view these changes as an added administrative burden, but more as an opportunity to take control of their 403(b) plan and develop a program for their participants with much more value.

Employers have a number of important decisions to make when it comes to designing a 403(b) plan. This is the perfect time to evaluate the type of providers you want in your plan and define what the employee experience should be. Beyond the type of providers you choose to include in your plan, there are other equally important decisions:

- What form of written plan will I adopt?
- Which optional features will my 403(b) plan include?
- What provider(s) will I include as part of the plan?
- Can I self-administer my plan or should I delegate all or some of the plan administrative duties to a third party?

The answers to these questions will help you design a program that will help attract and retain the type of employees you want while still meeting current 403(b) compliance and administrative requirements.

Notes

Notes

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