MetLife Resources

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The New World of 403(b) Plan Administration

IRS guidance sheds light on information sharing requirements

why MetLife Resources prepared this paper on

403(b) Plan Administration

Employers, vendors and benefits practitioners in the 403(b) market have been poring over the final 403(b) regulations since their release in July 2007. Many in the 403(b) community are still trying to sort through the rules on transfers, exchanges, and orphan accounts. In addition, many are still trying to determine the true impact of information sharing agreements on plan administrators and contract providers now that the new rules are generally in effect. The final regulations are generally effective on 1/1/09. However, there are numerous special effective dates, including delayed effective dates. This paper refers to the effective date as 1/1/09 for convenience of presentation.

At MetLife, we're committed to providing you with ongoing communications to help you make decisions regarding your 403(b) plan. We hope this white paper will assist you.

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The IRS guidance sheds light on an issue that has generated some potential confusion – what employers should do about outstanding annuity contracts and custodial accounts that are not authorized to receive contributions.

On November 27, 2007, the Internal Revenue Service ("IRS") released Revenue Procedure 2007-71, which provides follow-up guidance on the final 403(b) regulations. The IRS guidance sheds light on an issue that has generated some potential confusion – what employers should do about outstanding annuity contracts and custodial accounts (collectively, "contracts") that are not authorized to receive contributions.

In general, there are two situations in which a financial institution that provides 403(b) contracts (a "provider") will hold amounts attributable to an employer's 403(b) plan but will not be eligible to receive contributions:

- The provider received plan amounts in a contract exchange (formerly known as a "90-24" transfer) from a provider that received contributions; or
- The provider received contributions in the past but the employer no longer makes contributions to the provider.

The purpose of this paper is to discuss the status of certain categories of these contracts, which we call "orphan contracts." We discuss the final regulations and the IRS Revenue Procedure 2007-71 guidance as they affect orphan contracts. We also identify some of the issues an employer should consider in dealing with orphan contracts, including whether the employer should enter into information sharing agreements with the providers of orphan contracts.

There needs to be a connection between the financial institution and the employer.

The Final Regulations

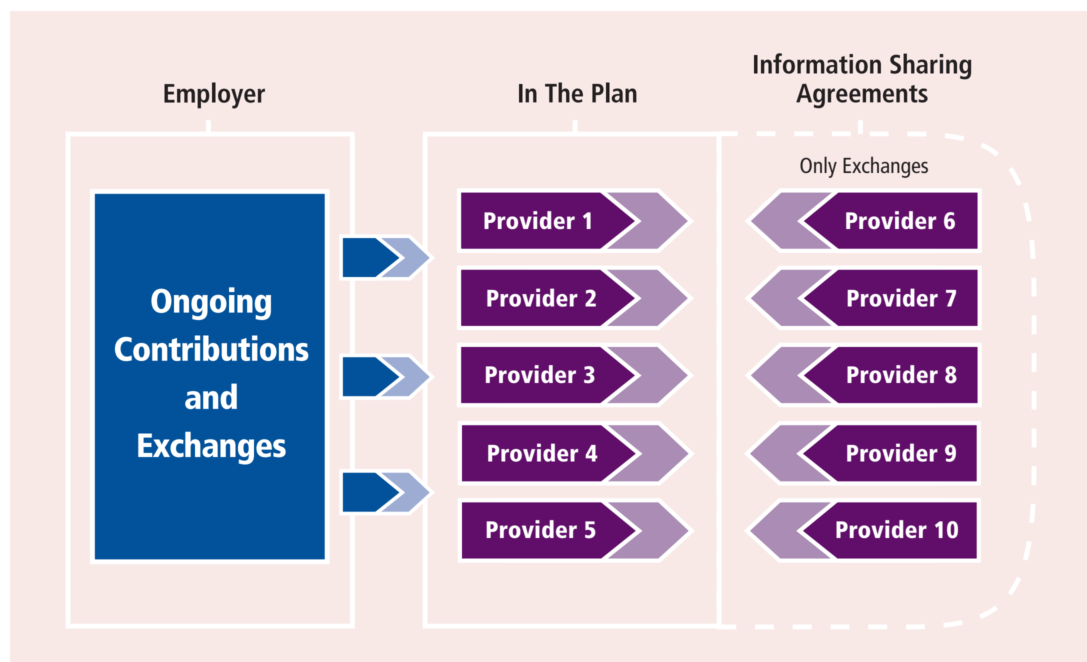
Under the final 403(b) regulations, contracts are generally considered tax-compliant 403(b) contracts only if the contracts are maintained pursuant to an employer's plan. One aspect of the plan requirement is that there needs to be a connection between the financial institution that provides the contract and the employer that maintains the plan.

The final regulations provide two basic ways that a contract can be connected to the employer that maintains the plan.

- First, the employer can include the provider in its plan, which ordinarily means that employees may direct contributions to an authorized provider;
- Second, if the provider is not authorized to receive contributions, the employer and the provider can enter into an information sharing agreement to share information necessary to satisfy the 403(b) requirements.

An information sharing agreement might be appropriate where the employer decides that it will not make contributions to a particular provider, but it will allow employees or other participants to move all or a portion of their plan amounts outside the plan to the provider (referred to in the final regulations as an exchange). [See Illustration 1.0]

Illustration 1.0: Requirements of New 403(b) Regulations



The illustration shows the relationship of authorized providers within a 403(b) plan and those with information sharing agreements. The employer's plan may allow employees to move their plan amounts between authorized providers. Additionally, the employer's plan may allow employees to move all or some of their plan amounts in an "exchange" to a provider that is outside the plan but that has entered into an information sharing agreement with the employer.

While this landscape is relatively straightforward for employers considering how to design their 403(b) plans for the future, the final regulations provide little guidance on how to transition from the current 403(b) landscape to the new 403(b) world. Over the years, many employers that sponsor 403(b) plans have changed the providers that are authorized to receive contributions. Others have permitted employees to move their plan amounts to providers that are not authorized to receive contributions in a transaction commonly referred to as a "90-24" transfer. As a result, many 403(b) plans have contracts issued by providers that do not have a current connection to the employer.

IRS Revenue Procedure 2007-71 provides guidance on the treatment of orphan contracts.

Orphan Contracts

There are four general categories of orphan contracts:

- Contracts issued by providers that ceased receiving contributions before 1/1/05;
- Contracts issued by providers that ceased receiving contributions with respect to all employees on or after 1/1/05 but before 1/1/09;
- Contracts issued in a 90-24 transfer before 9/25/07; and
- Contracts issued in a 90-24 transfer after 9/24/07 and before 1/1/09.

Contracts Issued Before 1/1/05

For the first category – contracts issued by providers that ceased receiving contributions with respect to all employees before 1/1/05 – IRS Revenue Procedure 2007-71 suggests that a contract will be exempt from the plan requirement and will continue to be a tax-compliant 403(b) contract even if it is not part of the employer's plan or covered by an information sharing agreement (assuming the contract otherwise satisfies all of the applicable 403(b) requirements). Although this conclusion is not perfectly clear from the face of the guidance, IRS officials have informally confirmed this reading on numerous occasions. As a result, employers generally do not need to take any steps for contracts issued by providers that were discontinued as authorized providers before 2005.

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Contracts Issued 2005-2008

For the second category of orphan contracts, the IRS Revenue Procedure 2007-71 generally provides that a contract will continue to be tax-compliant on 1/1/09 if either the employer or the provider of the contract makes reasonable, good faith efforts to satisfy applicable 403(b) requirements. This relief generally has two components:

1. Establishing a connection between the employer and the provider of an orphan contract and;
2. Sharing of information.

The guidance does not shed light on what the employer and the provider should do once a connection has been established. The guidance states that contracts covered by the good faith relief should be "included" in the employer's plan. However, the good faith relief for providers makes clear that the orphan contract does not need to be reflected in the employer's written plan document. Similarly, it is clear that the relief need not involve a formal information sharing agreement but may instead involve a more informal and transactional sharing of information. As a result, it appears the IRS generally expects the employer and the provider to share information necessary for the contracts to be administered in a manner that satisfies Section 403(b).

If these good faith standards are satisfied, then the IRS will continue to treat any affected contracts as tax-compliant under Section 403(b). [See Illustration 2.0] If good faith efforts are not attempted by either the employer or the provider, employees with these types of contracts may suffer adverse tax consequences. One caveat on all of the transition relief is that the relief may be lost if contributions resume or are otherwise made to a previously orphaned contract.

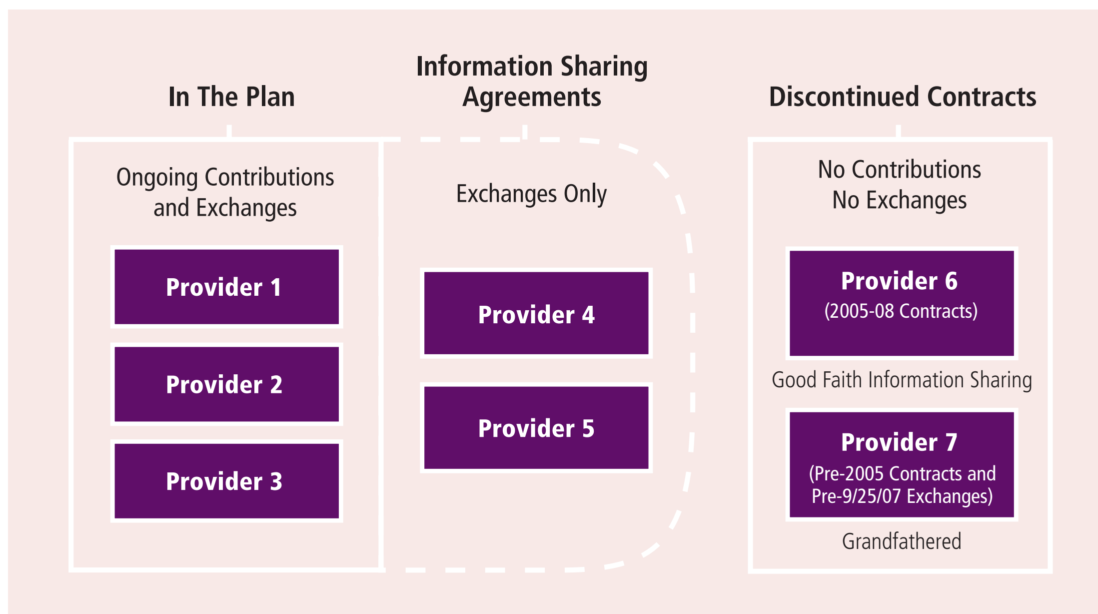
90-24 Transfers Before 9/25/07

The only category of orphan contract that the final regulations explicitly address is a contract that was issued in a 90-24 transfer before 9/25/07. According to the final 403(b) regulations, these contracts are exempt from the plan requirement and will continue to be tax-compliant 403(b) contracts even if they are not part of the employer's plan or covered by an information sharing agreement on 1/1/09 (assuming the contracts otherwise satisfy all of the applicable 403(b) requirements). A 90-24 transfer is a transfer of a participant's 403(b) account to another provider in accordance with IRS Revenue Ruling 90-24. IRS Revenue Ruling 90-24 is now obsolete.

90-24 Transfers After 9/24/07

Strictly speaking, the last category of orphan contracts are not really orphan contracts at all. This is because contracts in this category must be connected to the plan to remain tax-compliant 403(b) contracts. Contracts issued in a 90-24 transfer after 9/24/07 and before 1/1/09 must be connected to the plan by the employer entering into an information sharing agreement with the provider before 01/01/09 or, alternatively, by the employee that holds such a contract moving the account back to a provider authorized to receive plan contributions before 7/1/09.

Illustration 2.0: Relationship of Discontinued Contracts and 403(b) Plans



This illustration shows the 403(b) plan relationship of grandfathered contracts and contracts subject to "good faith" information sharing. Contracts from providers in each of these categories will be considered tax-compliant even though they are not part of the employer's plan (assuming they otherwise satisfy the applicable requirements). The IRS has informally indicated that many of the new rules will not apply to grandfathered contracts.

An employer can choose whether or not to allow employees to move their plan amounts to a provider that is not authorized to receive contributions.

What Does Revenue Procedure 2007-71 Mean for Plan Design?

The guidance should mean that employers can turn their attention away from concerns about adverse tax consequences for orphan contracts and focus on designing their 403(b) plans to meet the new 403(b) requirements. Perhaps the most fundamental design question employers face is whether to allow participants to move their plan amounts to a provider that is not authorized to receive contributions.

Some employers will choose to limit investment exchanges to authorized providers. Others will allow plan amounts to be exchanged to a select group of providers that are not authorized to receive contributions or to be exchanged to any provider that is willing to meet certain basic criteria. These decisions, however, have implications for the employer and need to be carefully considered.

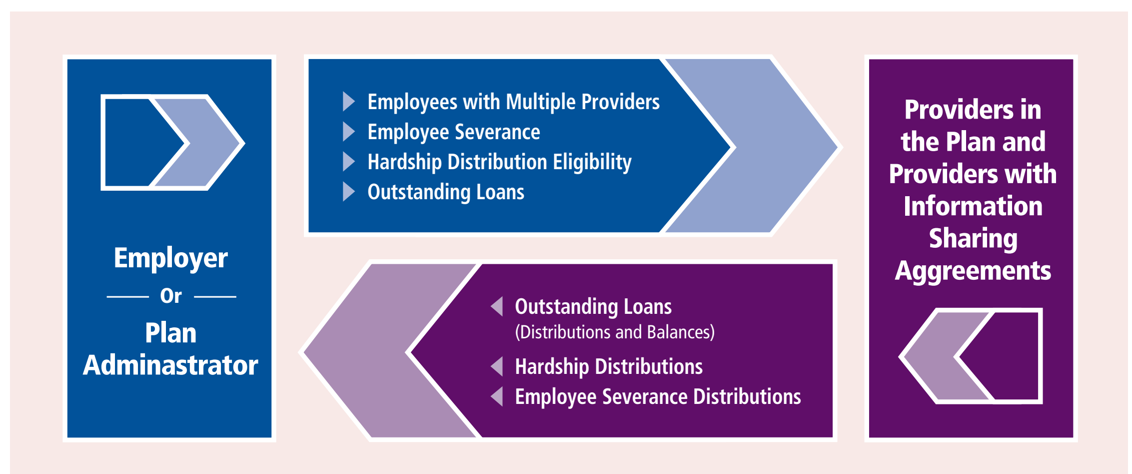
Information Sharing

As discussed above, if exchanges are permitted to providers that are not authorized to receive contributions on or after 1/1/09, the employer will need to enter into an information sharing agreement with each provider before such an exchange. Under a typical information sharing agreement, the employer agrees to inform the provider when certain events occur, such as:

- When an employee has had a severance from employment;
- Whether the employee is eligible for a hardship distribution;
- Whether the employee owns other contracts under the plan;
- Whether there is a loan outstanding under another contract.

The provider in turn agrees to share information with the employer about the participant's contract, such as whether the employee has a loan outstanding. [See Illustration 3.0]

Illustration 3.0: Requirements of Information Sharing



In short, the typical information sharing agreement imposes administrative burdens on the employer (or a third-party administrator that is hired for this purpose). The employer must share information about its employees with each provider covered by an information sharing agreement. The employer must also share information about outstanding contracts with other providers. In effect, the employer must serve as (or hire) a plan administrator with respect to all contracts that are either part of their 403(b) plan or covered by information sharing agreements.

The typical information sharing agreement imposes administrative burdens on the employer.

Conclusion

Orphan contracts have been a source of some potential confusion under the final 403(b) regulations. IRS Revenue Procedure 2007-71, however, significantly clarifies the landscape for orphan contracts, and employers will welcome having guidance that addresses how orphan contracts should be treated. This will help employers to shift their focus from the old world of 403(b) contracts to the new world of 403(b) plans.

For more information

Please contact your local MetLife representative if you have additional questions.

Notes

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