

403(b) Learning Series Webinar

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Agenda

- I. Final 403(b) Regs – Highlights
- II. Final DOL 5500 Requirements
- III. Why Should I Care?
- IV. 3 Common Mistakes
- V. What Do I Do?
- VI. Fiduciary Roles/Responsibilities
- VII. Implications for Employers
- VIII. Questions

Overview

Final 403(b) regulations affects **all** 403(b) ERISA and non-ERISA programs

DOL final 5500 regulations make 5500 requirements more complex for ERISA 403(b) programs

Both generally effective January 1, 2009

Final 403(b) Regs – Highlights

403(b) plans now more similar to 401(k) plans

- Employers will be “plan sponsors”
- Employers are responsible (and liable) for plan administrative functions
- True even for non-ERISA plans

Final 403(b) Regs – Highlights

Employers can assign duties to a third party, but ultimately retain responsibility

- DOL Field Assistance Bulletin No. 2007-02 states...

A formerly non-ERISA plan of a 501(c)(3) may become subject to ERISA if the employer has any discretionary involvement in administering plan provisions.

- **Implication:** A third party **MUST** be hired for such functions to avoid ERISA.

Final 403(b) Regs – Highlights

Question: If you are a 501(c)(3) organization (non-church/government), and want to maintain a non-ERISA 403(b) after January 1, 2009...

- **Recommendation:** Review with counsel with specific 403(b) expertise, as the final regulations are yet another hurdle in maintaining non-ERISA status.

Final 403(b) Regs – Highlights

New Change: *All* programs will be required to have a written plan. Previously, only ERISA plans were required to meet the plan document requirement.

- **Revenue Procedure 2007-7:** Model written plan language available, but issues remain.
- **Recommend:** Seek counsel with expertise in 403(b) issues.

Final 403(b) Regs – Highlights

90-24 Transfer Rule - allowed participants to transfer funds between 403(b) vendors of their own choice - **repealed.**

- Participants can transfer funds between vendors within the same plan **only if** the employer enters into an “information sharing” agreement with vendors.
- Vendors required to share information such as loan limits so that employer (or third party) can ensure that plan sponsor satisfies Code provisions.

Final 403(b) Regs – Highlights

Immediate Employer Action:

- Decide on vendors with which to enter into an information sharing agreement
- Request confirmation from vendors that transfers will only be permitted with “approved” list of vendors.
 - New restrictions are not an issue for ERISA plans, as transfers were always limited to approved vendors in such programs, since ERISA requires plan fiduciaries to be in control of all plan assets.

Final 403(b) Regs – Highlights

Universal Availability Rule: Employers must provide “meaningful notice” of right of employees to make elective deferrals to the 403(b) plan.

- **Cannot exclude** collectively bargained employees – other limited exclusions still apply
- Employers should confirm they provide meaningful notice (e.g., new employee package, e-mail, newsletter, etc.) to all employees at least annually.

Final 403(b) Regs – Highlights

Employers must ensure that salary deferral contributions are deposited into the plan in a timely manner.

- As soon as administratively feasible.

Example: 15th business day of the month following the month of payroll withholding.

- ERISA plans already subject to the requirement:

Salary deferrals must be deposited no later than the date such amounts can be reasonably segregated from payroll, typically within 7 days for most situations.

Final 403(b) Regs – Highlights

Other key provisions:

- Nondiscrimination rules for employer contributions will now mirror those for qualified plans (**no more 89-23**)
- 403(b) plans may be terminated for the first time in history
- New 80% controlled group rule for 501(c)(3) organizations
- Possible recordkeeping issues for plans with vesting schedules for employer contributions
- Clarification of groups eligible to use 15-year catch-up election
- New withdrawal restrictions for employer contributions
- Severance from employment definition expanded

Final 5500 Regs – Highlights

Major change for ERISA plans: DOL's final 5500 reporting requirements for ERISA 403(b) plans will mirror 401(k) plans, **beginning with 2009 filings** due in 2010.

- ERISA 403(b) plans will be subject to the same reporting rules as 401(k) plans; full 5500 Form, including all schedules.
- Plan **must be audited** by an independent accountant.
- All returns must be filed electronically.

Why should I care?

Failure to comply with the new IRS and DOL regulations would have extreme consequences:

- Disqualification and **IMMEDIATE TAXATION** of **ALL** plan assets, regardless of vendor or contract.
- For failure to file complete 5500 returns, Plans can be subject to:
 - **UNCAPPED DOL** penalties up to \$1,100 per day, and
 - IRS penalties of \$25 per day, capped at \$15,000

Grandfathering Opportunity

Under the 403(b) regs. as originally published, **ALL** program assets, active and inactive, were subject to the same compliance rules.

- Thus, if an employer utilized a vendor 10, 20 or even 30 years ago, the employer retained compliance responsibilities for assets with such inactive vendors.
- If assets are part of the same plan, defects from vendor discontinued long ago could cause entire plan to fail to be a 403(b) plan , with **IMMEDIATE TAXATION** of assets!

Grandfathering Opportunity

IRS provided grandfathering opportunity in Rev. Proc. 2007-71.

- Contracts to which **no new contributions** have been made since 12/31/2004 – grandfathered, no compliance responsibilities, not part of current plan.
- Any vendor to which contributions ceased 1/1/2005-12/31/2008, a **reasonable good faith effort** must be made to include vendor in current plan. Good faith effort consists of notifying vendor of employer contact for information necessary to satisfy 403(b); does not require vendor response!

What do I do?

Whatever you do, don't commit one of the **three most common mistakes...**

➤ **Mistake #1:** Treat the 403(b) plan as if the employer has no involvement, and the relationship was between the employee and the service provider.

- This position is no longer tenable
- Employer **will be responsible** for vendor/participant errors, and must exercise control over the process or hire someone to do so.

Common Mistakes

Mistake #2: Offer as many service providers and/or investments as possible.

- Once thought to be desirable, providing a multitude of choices has usually meant a lack of access to quality choices and higher costs to participants.
- A plan sponsor can generally expect to multiply its compliance responsibilities by the number of vendors that are part of the plan.

Common Mistakes

Mistake #3: Placing compliance responsibilities in the hands of the service provider(s).

- Unless a provider is willing to fully indemnify employer for their mistakes (unlikely), the plan sponsor is responsible and liable for failure to comply with the Code and ERISA (if applicable).
- The provider has business interests that are often in conflict with what is best for the plan sponsor and participants. This distinction will be especially important as entities hire TPAs and other third parties, ostensibly to assume responsibilities for compliance.

What do I do?

If you are a 501(c)(3) non-ERISA plan sponsor with multiple vendors:

- Maintain current plan, but hire third party to coordinate compliance with Code among vendors
 - Consolidation may be an impossible task, especially where contracts are individual vs. group and state privacy laws are at issue.
 - If current plan is maintained, counsel with 403(b) expertise should be consulted re: non-ERISA status.
- Consolidate vendors which will “ERISAFy” plan, but might be only viable option to ensure Code compliance.

What do I do?

If you are a School District:

- Vendor consolidation can be achieved without ERISA coverage (governments are exempt from ERISA), but SDs often lack dedicated HR departments and budget to take necessary actions (e.g., RFP). State laws may also prevent.
- State education associations may step in and provide consolidated vendor solutions.
- Where vendor consolidation is not an option, SDs will need to hire third party for compliance. SDs should understand the cost borne by participants under such arrangements.

What do I do?

If you are a 501(c)(3) ERISA plan sponsor with multiple vendors:

- Vendor consolidation should be strongly considered

Both the Code and new 5500 requirements (which would include an audit of plan assets with ALL plan vendors) will create an administrative burden that is not likely to be overcome, even with the use of a third party.

- Consolidation has several practical advantages as well

Generally, lower fees and better service offerings can be obtained with a single provider.

What do I do?

If you are a 501(c)(3) ERISA plan sponsor with a single service provider:

- Make certain that you are addressing the inactive assets issue; prior assets may exist that are not subject to ERISA that may be eligible for grandfathering.
- All ERISA vendors, active and inactive, should be identified in the current plan document/SPD for transfer purposes.

What do I do?

If you are a religious organization:

- Your plan can **NEVER** be subject to ERISA unless you elect coverage (few sponsors do), so if multiple providers are present, you can consolidate without subjecting the program to ERISA.
- Some of the provisions of the final regs., such as the universal availability requirement and nondiscrimination rules, do not apply to “steeple” churches.

What do I do?

All organizations:

- Be aware of all of your administrative and fiduciary responsibilities in the new world of 403(b), and comply with same!

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Leo
Cullen

"Every day I ask myself, 'Am I embezzling enough for retirement?'"

Who Are Fiduciaries?

Start with ERISA

- Functional definition vs. status
- Named fiduciaries
- Anyone who possesses or exercises
 - Discretionary authority over plan administration or
 - Control over assets

Who Are Fiduciaries?

Non-ERISA

- State law controls
 - Government plans are exempt from ERISA
- Clearly, the “board” that controls the plan
 - School board or specific “retirement board”
- But who should be worried?
 - Anybody with authority over investments or operation of the plan

Key Fiduciary Duties

Generally, fiduciaries are required to discharge their duties for the exclusive purpose of providing benefits to participants and defraying reasonable expenses.

NOTE: Much of this discussion is drawn from ERISA – which is a guide to best practices – though the plans and fiduciaries are governed by state law.

What are the Duties?

Generally, the same for ERISA and non-ERISA

- Duty of loyalty
 - Interests of participants come before the employer's
 - Avoid conflicts of interest
- Exclusive purpose requirement
 - To provide retirement savings
 - To defray only “reasonable” expenses
- Conduct measured under “prudent person” standard

The Standard Of Care

The Prudent Person Rule: Fiduciaries must discharge their duties.

“ . . . with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. . . . ”

The Prudent Person Standard

- Focus is on process
- Which means:
 - ✓ Determine what's relevant
 - ✓ Gather information
 - ✓ Analyze information
 - ✓ Make a reasoned, informed decision
 - ✓ Get help from experts
 - ✓ Keep good records
 - ✓ Re-examine decisions periodically (the “duty to monitor”)

However, results do matter.

Prudent Person Standard

- Applies to selection and monitoring of advisers, providers and investments
- Key issues in a savings plan are:
 - Participation
 - Deferral rates
 - Investments
 - How participants are using the investments (“investing”)
 - Fees and expenses

Level of Participation

- The fiduciaries should prudently implement and monitor enrollment and eligibility
- What does it take to be prudent?
 - Analyze information regarding non-participants
 - Review effectiveness of existing programs and services
 - Investigate other available programs and services
 - Set goals for improvement
 - Then monitor for whether improvement occurs

Adequacy of Deferrals

➤ What should a fiduciary do? **Look at...**

- Participant needs and current status
- Areas of, and goals for potential improvement
- Possible methods for improvement, such as re-designed enrollment forms, financial education, gap analysis and targeted communications

Quality of Investments

- Options constitute a broad range
 - Fiduciaries should take into account generally accepted investment theories and prevailing industry standards
- Options in the aggregate should be prudent and suitable
- Each option prudently selected
 - Quantitative and qualitative factors
- And then monitor, remove and replace

Quality of Investing

- Participant “investing” will rival “investments”
- Why?
 - Studies show that many (most?) participants are making serious mistakes..
 - Many fail to rebalance – or even look at their accounts
 - One study shows that about 25% invest in only one or two asset classes – hardly enough to constitute prudent and diversified investment portfolios.

Quality of Investing

- If the participants are not investing prudently, fiduciaries should
 - Investigate
 - Determine the cause of the problems
 - Take steps to correct the problems
- Especially, monitor the **quality** and **effectiveness** of participant education...**the proof's in the investing.**

Expenses

- Expenses are a significant issue because of their impact on the level of participant benefits.
- Recent events have brought them to the fore:
 - Congressional hearings
 - Litigation
- Fiduciaries have a duty to investigate and monitor.

Expenses

- Need to “check under the hood” for ALL indirect expenses
 - 12b-1 fees
 - Sub-TA fees
 - Finders’ Fees
 - Trading Costs
- Fees paid to third parties are especially important (and required to be comprehensively disclosed under the final 5500 regulations)
 - Commissions
 - Revenue Sharing
 - Other incentives (bonuses/overrides based on volume)

Implications for Employers

- 403(b) regulations will **REQUIRE** employer involvement

If you must be involved anyway, why not translate the effort into a program that can be used as part of the overall benefits package to attract and retain employees?

- Employer involvement will be a more difficult task at school districts without dedicated HR staff

Some large districts are already performing RFPs, and perhaps third parties, such as state associations, will assist the remainder.

Questions?

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