

Final 403(b) Retirement Plan Regulations

The Internal Revenue Service has issued final regulations (“Final Regulations”) for 403(b) retirement plans which update and supersede many of the prior regulations governing 403(b) plans. The Final Regulations mean that 403(b) plans are now subject to many more of the requirements that apply to tax-qualified plans such as 401(k) plans. Plan sponsors of both ERISA and non-ERISA¹ 403(b) plans must take action to ensure their 403(b) plans are in compliance with the Final Regulations by January 1, 2009.²

Because it is likely your organization may require board approval to make the necessary changes to comply with the Final Regulations, it is advisable to begin assessing your 403(b) plan’s compliance with the Final Regulations as soon as possible. Note that failure to follow the Final Regulations may result in adverse tax consequences for plan participants as well as your organization’s 403(b) plan itself. We strongly recommend that once you have reviewed this memorandum, you contact us or your own legal adviser to determine how to best ensure that your organization’s 403(b) plan is in compliance with the Final Regulations by the January 1, 2009 effective date.

The following is a brief summary of the main items in the Final Regulations that are of interest to plan sponsors:

FORMAL WRITTEN PLAN DOCUMENT

The Final Regulations for the first time require that a 403(b) plan be maintained pursuant to a formal, written plan document that spells out all the material terms

of the plan including terms and conditions for eligibility, timing of distributions, what parties are responsible for administering the various tasks associated with plan operation, and provisions for loans and hardship distributions. This is a new requirement for 403(b) plans and until now many plans have been maintained without a separate written plan document. If your organization does not have a 403(b) plan document already, one will need to be drafted. If a plan document is already in place, it should be reviewed to ensure it contains all provisions necessary under the Final Regulations. This is also a good time to confirm that written documents for the plan correspond with each other and the plan’s underlying annuity contracts.

CONTROLLED GROUP DETERMINATION

The rules under which related tax-exempt entities, and related tax-exempt and for-profit entities, are examined to determine whether they are part of the same controlled group have been clarified in the Final Regulations. These rules may have a significant impact on 403(b) plans that are maintained by an employer that is a member of a controlled group. It is advisable that your organization consider examining its controlled group status in light of these rules.

COMPLIANCE WITH NONDISCRIMINATION RULES

403(b) plans providing for employer contributions must comply with nondiscrimination requirements. This means that plans may no longer rely on “good faith” compliance with the nondiscrimination rules and that discrimination testing must be performed on 403(b)

¹ The Department of Labor has issued corresponding guidance that plan sponsors should follow to ensure their non-ERISA plans do not become subject to ERISA because of the increased employer oversight and involvement that may arise due to the Final Regulations.

² Note that church plans may have an extended effective date and some items described in this memo are not applicable to church plans.

plans in the same manner as other types of qualified retirement plans, taking all employer plans into account. Further, your organization's 403(b) plan should be reviewed to determine whether any changes in plan design may be required in order to comply with the nondiscrimination rules.

Further, a 403(b) plan may not discriminate with respect to who is eligible to make elective deferrals under the plan. With limited exceptions, if an employer maintains a 403(b) plan, the plan must be "universally available" to all the employer's employees and each employee must be given meaningful notice of the right to participate.

SPECIAL CONTRIBUTIONS

The Final Regulations clarify the rules that permit eligible 403(b) plan participants to make one or more types of catch-up contributions to the plan. Namely, participants in certain 403(b) plans with 15 years of service with a qualifying employer may be permitted to make a limited "special" 403(b) catch-up contribution. Second, participants age 50 and over may also be permitted to make an additional catch-up contribution.

A former employer may make a contribution to a former employee's 403(b) plan account for up to 5 years after the employee's severance from employment, subject to certain dollar limitations and nondiscrimination testing.

TIMING OF ELECTIVE DEFERRAL DEPOSITS

Employee elective deferrals must be contributed to the plan within 15 days after the end of the month the deferrals are withheld from a participant's pay. Your organization should review its procedures for depositing elective deferrals to ensure they are reasonable under the Final Regulations.

VESTING STATUS OF ACCOUNTS

A 403(b) plan must account for vested and nonvested portions of an account separately.

Rollovers, Distributions and In-Service Withdrawals

The Final Regulations clarify that 403(b) plans must provide that participants may make a non-taxable rollover of their 403(b) distributions to an IRA or certain other retirement plans, and participants must be given written notice of their right to rollover their 403(b) accounts.

Distributions of a participant's account may only be made pursuant to certain permissible events. The Final Regulations clarify that these distribution rules apply to employer contributions as well as employee elective deferrals. These events include the participant's severance from employment, death, reaching age 59½, or disability.

Participants may request that they receive a distribution from their plan account due to a financial hardship in the same manner as permitted under tax qualified plans. A participant may receive a hardship distribution because of qualifying medical, funeral, and education expenses, to repair damage to the participant's home, to purchase a home, or to prevent eviction. The distribution must be limited to the amount necessary to satisfy the hardship and may be made only from employee elective deferrals, exclusive of earnings.

NON-ERISA PLANS

To the extent a 403(b) plan is intended to be exempt from the reporting and other requirements of ERISA, the plan should be re-examined to confirm that its provisions, including those made to comply with the requirements of the Final Regulations, do not cause the plan to fail to satisfy the ERISA exemption.

ADDITIONAL PROVISIONS

1) Qualified Domestic Relation Orders

All 403(b) plans must comply with the rules related to qualified domestic relations orders (“QDROs”) regardless of whether the 403(b) plan is considered an ERISA or non-ERISA plan. For example, all 403(b) plans must describe the terms under which QDROs are available and the when distributions pursuant to QDROs may be made. Plans must also maintain QDRO procedures for determining the status of QDROs and administration of distributions made pursuant to QDROs in the same manner as qualified plans.

2) Severance From Employment

The Final Regulations state that for plan distribution purposes, a severance from employment occurs when an employee is no longer employed by the employer maintaining the 403(b) plan, regardless of whether the employer continues employment with another controlled group member.

3) Plan Terminations

The Final Regulations provide that a 403(b) plan may be terminated. Two plan termination conditions that the employer (and all members of its controlled group) must follow are (i) for at least one year following the plan’s termination, no further contributions may be made to any 403(b) plan on behalf of plan participants who participated in the terminated plan; and (ii) all plan assets must be distributed as soon as administratively feasible following plan termination.

Once you have reviewed this memorandum, please contact us using the below contact information to discuss what steps your organization may need to take to be in compliance with the Final Regulations:

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