403(b) Regulations:
An Overview for Employers
“Whatever got you where you are today is no longer sufficient to keep you there”

-Stephen E Heiman
Co-Founder, Miller Heiman, Inc
403(b) Regulations: Overview

- Released July 24, 2007
- General effective date: January 1, 2009
- Plans may adopt earlier: must adopt all the new regulations together
Written Plan: Overview

- Required by January 1, 2009: even for early adopters
- Can be single document or collection of documents
- Required provisions
- Optional provisions
- Coordination with underlying contracts and accounts
Written Plan: Some Key Requirements

- Eligible employees
- How eligible employees participate
- How responsibilities are allocated
- Distribution issues
- Products available under the plan: includes any contract and account that has received contributions in the plan, unless grandfathered
403(b) Regulations:
3 Sets of Contract and Accounts

- Grandfathered contracts and accounts
- Contracts and accounts under the plan
- Contracts and accounts outside the plan that are subject to information sharing agreements
General definitions:

Grandfathered contracts and accounts:

Established by a 90-24 transfer (or 1035 exchange) prior to September 25, 2007. Subject to new requirements other than requirement for connection to written plan

Transfers to grandfathered contracts after 9/24 subject the contract to the final regulations i.e. no longer grandfathered.
General definitions:

Contracts and accounts under the plan:

Generally, any contract or account that has received any direct employer or employee contributions since the beginning, and still holds amounts that have not been distributed.

• Older contracts sometimes referred to as “legacy” contracts.
• Will require some reasonable effort to identify before January 1, 2009
General definitions:

Contracts and accounts outside the plan that are subject to information sharing agreements:

Contracts established by a transfer (referred to in the regulations as an exchange) after September 24, 2007 that are not part of the plan.
Transfers

- Rev. Rul. 90-24 revoked
- Rule change: effective September 25, 2007
- Under new rules: two kinds of transfers
  - Transfers within plan called “exchanges”
  - Transfers to another plan called “transfers”
  - Subject to permission (from both plans if to another plan)
  - Accumulated benefit requirements
  - Withdrawal restrictions must be as stringent in the receiving product as in the transferring product
Transfers

- What does this mean?
  - On September 24, 2007: must anticipate status on January 1, 2009
  - The key question is: on and after January 1, 2009, will the contract be attached to the plan
    - As part of the plan, or
    - Through information sharing agreement
  - NOTE: If part of the plan today, will be part of the plan on January 1, 2009 even if no longer receiving contributions by then (unless the IRS issues further guidance)
Transfers: Information Sharing

- Is employer required to permit? No
  - Possible exception: plans with narrow ERISA exception
- No information sharing: no transfer starting September 25, 2007
- Grandfathered status for contracts or accounts containing only 90-24 funds
- What is an information sharing agreement?
  - No substantive definitions
  - Purpose is to facilitate plan-level compliance, *i.e.* loan and distribution requirements
Transfers: Information Sharing

- What is an information sharing agreement? (cont’d)
  - Examples:
    - Information regarding loan balances, to permit application of limitations at a plan level
    - Confirmation of severance of employment
    - Hardship withdrawals and cessation of deferrals if applicable
    - Basis sharing information
Written Plan: Severe Consequences for Failure

- Failure to connect contracts to plan on January 1, 2009
  - Applies to all contracts other than grandfathered contracts
  - Puts them outside the plan
  - IRS view: makes them taxable January 1, 2009
Universal Availability: What is it?

- Non-discrimination rule for 403(b) deferrals: admit any employee-admit all eligible employees
- Rule does not apply to churches
  - “Steeple church” (and synagogue, mosque, etc…) and certain church-controlled organizations only – not identical with broader ERISA church plan exemption
- IRS Notice 89-23 revoked – no more good-faith compliance standard in most cases
- 1,000 hour rule for applying 20-hour/week exclusion
- Annual notice of eligibility: roadmap for compliance or noncompliance
Contribution Timing

- Rules today:
  - Deadlines already exist for ERISA plans
  - No deadlines for non-ERISA plans, including governmental plans
- Under the final regulations
  - Deferrals must be remitted to the account within a reasonable time
    - Deemed reasonable: if remitted by 15th of month following the month amounts were withheld from pay
  - ERISA plans: need to satisfy more restrictive of DOL, IRS limitations
Excess Contributions

- **Today:** excess 415(c) contributions
  - Taxable only to the extent of the excess
  - If not timely corrected
- **Final regulations**
  - Contract ceases to be a qualifying 403(b) contract unless the 415(c) excess is either:
    - timely corrected, or
    - separately accounted for consistent with 403(c) from the outset
Fiduciary Discussion

- Final 403(b) regulations do not impose fiduciary duties
- Question: is there another source of new fiduciary obligations in light of final 403(b) regulations?
  - ERISA plans: Title I of ERISA imposes
  - Certain plans of private sector employers can become subject to Title I of ERISA, based on level of employer involvement; DOL Field Assistance Bulletin: addressed a private employer’s ability to satisfy final 403(b) regulations without triggering Title I of ERISA
  - Churches and church-controlled plan sponsors: look to governing documents
  - Public employers: also consider state law: state pension plan fiduciary rules frequently do not apply to voluntary 403(b) plans
  - Always important to consult counsel
Distributions and Loans

- New distribution restrictions for employer contributions to an annuity
  - Many plans: already apply restrictions
- New regulatory rule for hardships:
  - follow 401(k) rules
- Limits on reliance on participant-provided data
  - Ties back to written plan: can’t assign compliance responsibility to participants
- Coordination across multiple providers within the plan, and those governed by information sharing agreements
Consequences of Defects

- Final regulations provided clarification
  - Individual defects do not infect accounts of innocent participants. Individual’s contract can cease to be a 403(b) contract.
  - Example: single violation of withdrawal restrictions
  - Contrast: universal availability applies to all
Investment Products

- Annuities and custodial accounts still permitted
  - Certain additional annuity features may be subject to incidental benefit restrictions
- Life Insurance: no longer permitted as a stand-alone 403(b) product
  - Grandfather date: September 24, 2007
Summing up

- Many requirements in the final regulations are not new
- Many that are new are not effective before January 1, 2009, or later
- One important requirement is new and becomes effective September 25, 2007
Questions?
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