Final 403(b) Regulations

A Look at the Changes Made by the New Rules
Today’s Discussion

- A Brief History of 403(b) Plan Guidance
- Final Regulations for 403(b) Plans
- Effect of Final 403(b) Regulations on Plan Requirements
- Other Changes for 403(b) Plans
- Sources for More Information
# A Brief History of 403(b) Plan Guidance

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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</thead>
<tbody>
<tr>
<td>1964</td>
<td>Last comprehensive 403(b) regulations</td>
</tr>
<tr>
<td>1974</td>
<td>ERISA</td>
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<tr>
<td>1986</td>
<td>Tax Reform Act of 1986</td>
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<tr>
<td>1989</td>
<td>Notice 89-23</td>
</tr>
<tr>
<td>1990</td>
<td>Revenue Ruling 90-24</td>
</tr>
<tr>
<td>1996</td>
<td>Small Business Job Protection Act</td>
</tr>
<tr>
<td>2001</td>
<td>Economic Growth and Tax Relief Reconciliation Act (EGTRRA)</td>
</tr>
<tr>
<td>2004</td>
<td>First comprehensive 403(b) regulations in 40 years issued in proposed form</td>
</tr>
<tr>
<td>2006</td>
<td>Pension Protection Act of 2006 (PPA)</td>
</tr>
<tr>
<td>2007</td>
<td>IRS Issues Final 403(b) Regulations – July 26</td>
</tr>
</tbody>
</table>

For plan administrator use only. Not for use with participants.
Effective Dates

- Final 403(b) regulations are generally effective January 1, 2009
  - Can rely on final regulations now if on a consistent and reasonable basis
- Direct Transfers to unapproved vendors (under Rev Rul 90-24) permitted only until September 24, 2007
- Life Insurance issued before September 24, 2007 grandfathered
- Restrictions on employer contributions in a 403(b)(1) annuity apply only to contracts issued after December 31, 2008
- Special effective date for collectively bargained plans
Regulation Highlights and Requirements

The regulations will narrow certain key differences between 403(b) plans and 401(k) plans. Here are the key areas affected by the regulations:

1. Written plan requirement
2. Relationship between written plan documents and annuity contracts
3. Transfers and exchanges
4. Nondiscrimination testing
5. Controlled group rules
6. Withdrawal restrictions on employer contributions
7. Plan terminations
8. Ordering rule for catch-up contribution limits
9. Funding arrangements
10. Timing of contribution transmittals
All 403(b) plans must have written plans by 1/1/2009

- No exemptions for governmental, church, or non-ERISA salary reduction plans
- Regulations do not require a single document

Written plan must include:

- Material plan provisions, e.g., plan eligibility, benefits, limitations, time and form of distribution options
- Annuity contracts and mutual funds offered

*TIAA-CREF will provide specimen plan documents that will be designed to meet the requirements of the new regulations*
Salary reduction plans:
- A written plan will not necessarily cause a non-ERISA 403(b) plan to become subject to ERISA

IRS to publish model plans for public schools
DOL guidance for non-ERISA salary reduction 403(b) plans

- DOL Regulation 2510.3-2(f) Safe Harbor
- Field Assistance Bulletin 2007-2
- Facts and circumstances:
  - Participation voluntary
  - Rights enforceable only by participants and beneficiaries
  - Limited employer involvement
  - Employer receives no compensation other than reimbursement of expenses incurred in implementing salary reduction agreements

For plan administrator use only. Not for use with participants.
403(b) plans must have a written plan document and must operate in compliance with its terms.

If conflict between terms of plan and contract, regulations provide that plan terms control **BUT**

Annuity contract provisions:
- Govern the relationship between insurance company and participants
- Determine the form of benefits
Annuity contract provisions need to coincide with plan provisions. If they differ, the contract provisions will override plan provisions AND
- The contract could be disqualified for tax purposes
- All funds in the contract could become currently taxable

Conflicts between plan documents and annuity contracts usually involve the timing or nature of distribution options

*TIAA-CREF makes sure that sample plan language it provides is consistent with the provisions of TIAA-CREF annuity contracts.*
Requirements Affected
Relationship of Written Plan Documents to Annuity Contracts

CAVEATS:

- Plan Sponsor must ensure that TIAA-CREF annuity contracts do not conflict with plan terms if they use documents that are not based on sample language provided by TIAA-CREF.

- Plan Sponsor must ensure that contracts of other carriers do not conflict with sample plan document language provided by TIAA-CREF.

Your institution’s legal counsel must ensure that plan documents and all 403(b) contracts (annuity and mutual fund) do not conflict.
The rules for direct transfers or exchanges between 403(b) contracts within a 403(b) plan, or from a 403(b) plan to another 403(b) plan are outlined below:

- **Under Revenue Ruling 90-24**, a participant is entitled to make a contract-to-contract transfer of 403(b) assets even if the contract to which the transfer is being made is not an approved option under the plan.

- **For intra-plan contract exchanges**, the final regulations prohibit participants from transferring 403(b) assets to a contract issued by a vendor that does not agree to share information with the employer.

- **Under Revenue Ruling 90-24**, a current or former employee could make direct transfers to any annuity contract or custodial account that meets 403(b) requirements, either intra or inter plan.

- **The proposed regulations prohibited former employees from making direct plan to plan transfers**. The final regulations permit transfer by either current or former employees.

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Contract Exchanges

- Effective for transfers after September 24, 2007, Revenue Ruling 90-24 has been repealed

- Final regulations require the employer and vendors approved by the employer’s plan (“payroll slot vendors”) to share information related to tax compliance requirements to ensure plan’s operational compliance

- Vendors cannot rely on employee representation for loans, hardships and termination of employment.
Information Sharing Agreements

- Intra-plan contract exchanges to unapproved vendors prohibited by regulations after September 24, 2007 unless the employer and unapproved vendor agree that they will have an information sharing agreement (ISA) in effect by 1/1/2009.

- ISAs are not needed for approved vendors because the regulations presume that the information necessary for proper plan administration will be shared.

- This will not impact plans that limit transfers to approved vendors only.
Repeal of Notice 89-23

<table>
<thead>
<tr>
<th>Now</th>
<th>Final Regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary contributory 403(b) plans are subject to the matching test, but the elective deferrals are not subject to the ADP Test that applies to 401(k) plans</td>
<td>No change</td>
</tr>
<tr>
<td>Elective plans are exempt from the ADP test, but must generally be made available to all non-excludable employees (“universal availability”)</td>
<td>Notice 89-23 provided additional excludable categories of employees. These additional excludable categories employees are no longer available</td>
</tr>
</tbody>
</table>

continued…
Requirements Affected
Nondiscrimination Testing – Universal availability

- Universal availability applies to 403(b) salary reduction plans
  - Generally all employees must be permitted to make elective deferrals (of $200 or more)
    > Applies separately to each 501(c)(3) organization, or in the case of a plan that covers the employees of more than one state entity, to each entity that is not part of a common payroll.
    > Certain categories of employees may be excluded
The universal availability rule only permits certain categories of employees to be excluded from participating in the plan.

For salary reduction plans, the categories of employees who are excludable from the plan under the Code include those who are:

- Eligible for a governmental 457(b) plan;
- Eligible for a 401(k) or another 403(b) plan of the employer;
- Non-resident aliens;
- Student employees; or
- Employees who normally work fewer than 20 hours per week.
Part-time Employees

- For determining if an employee works less than 20 hours/week
  - On date of hire, employee must be expected to work less than 1000 hours in the ensuing 12 month period AND
  - For each subsequent year, the employee actually worked less than 1000 hours in the preceding 12 month period.
• Notice 89-23 included additional categories of employees that can no longer be excluded
  - Collectively bargained employees
  - Visiting professors
  - Vow of poverty
  - One time election to participate in governmental non-403(b) plan
  - Continued exclusion for certain visiting professors and individuals who have taken a vow of poverty
  - Delayed effective date
In general, 403(b) retirement plans are subject to the same nondiscrimination requirements as qualified plans with a few exceptions:

<table>
<thead>
<tr>
<th>Now</th>
<th>Final Regulations</th>
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<tbody>
<tr>
<td>Noncontributory 403(b) plans that satisfy one of the disparity safe harbors under Notice 89-23 are deemed to satisfy all statutory nondiscrimination requirements</td>
<td>The 89-23 safe harbors will no longer be available to noncontributory 403(b) plans as an alternative to the statutory nondiscrimination requirements</td>
</tr>
<tr>
<td>Notice 89-23 permits a good faith reasonable standard for purposes of nondiscrimination testing</td>
<td>Regulations do not permit good faith reasonable testing standard</td>
</tr>
<tr>
<td>Example: Matching 403(b) plans that are age- or service-graded do not have to test each grade for nondiscriminatory availability under reasonable good faith compliance standards of 89-23</td>
<td>Matching 403(b) plans that are age- or service-graded will have to test each grade for nondiscriminatory availability</td>
</tr>
</tbody>
</table>
Controlled group rules for tax-exempt entities

- Members of a controlled group must be aggregated for testing purposes, including nondiscrimination testing of all non-elective plans of tax-exempt employers and 415 limits.

- Institutions with 80% of the directors or trustees being either representatives of, or directly or indirectly controlled by, an exempt organization are considered to be part of a controlled group under final regulations.

- These rules do not apply to governmental or church employers.

- The final regulations provide that, until further guidance is issued, governmental plans and churches can continue to rely on the rules in Notice 89-23 for determining the controlled group.
Requirements Affected
Withdrawal Restrictions

Triggering Events – Current Law

- All salary reduction contributions (annuity and mutual fund) and employer contributions to a 403(b)(7) mutual fund can generally be withdrawn only after one of the statutory triggering events:
  - Severance from employment
  - Attainment of age 59½
  - Disability or death

- Only salary reduction contributions (not earnings) can be distributed on account of hardship

- Withdrawal restrictions currently do not apply to employer contributions to a 403(b)(1) annuity or to pre-1989 salary reduction accumulations

Continued
Requirements Affected
Withdrawal Restrictions on Employer Contributions

- The final regulations impose withdrawal restrictions on employer contributions to 403(b)(1) contracts issued after December 31, 2008
  - Employer contributions to 403(b)(1) annuity contracts issued after 12/31/08 will be subject to withdrawal restrictions similar to qualified profit sharing plans
  - Contracts issued prior to 1/1/2009 are grandfathered
  - Plans that currently allow unrestricted, in-service cash distributions or annuitization of employer contributions to a 403(b)(1) annuity will have to be amended

Continued
Withdrawal Restrictions
Hardship Distributions

- 403(b) regulations provide 403(b) hardship distributions will follow 401(k) rules

- Under 401(k) guidance, safe harbors are available for either or both of the basic requirements for hardship distributions:
  - An immediate and heavy financial need exists and
  - The distribution is required to satisfy that need

- Availability of safe harbors that permit employee self-certification of hardship to 403(b) plans is uncertain
The final regulations also permit 403(b) accumulations to be distributed to participants when a plan is terminated.

Currently, there is no statutory basis for terminating a 403(b) plan and termination does not constitute a triggering event that would permit distributions to participants.

The final regulations make it clear that termination of a 403(b) plan is permitted provided the employer does not establish another 403(b) plan within 12 months. They also require assets of the terminated plan to be distributed to participants. Distribution of annuity contract to participant or beneficiary is acceptable.
For participants eligible for both the Special 15-year Catch-up and Age 50 Catch-up contributions who wish to defer the maximum under both, the total deferral that may be allowed in 2007 is as follows:

<table>
<thead>
<tr>
<th>402(g) Rule for 2007</th>
<th>Additional $ Deferral</th>
<th>Maximum $ Deferral</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>----</td>
<td>15,500</td>
</tr>
<tr>
<td>15+ years of service</td>
<td>3,000*</td>
<td>+ 3,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>18,500</td>
</tr>
<tr>
<td>Age 50 years or older</td>
<td>5,000</td>
<td>+ 5,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>20,500</td>
</tr>
<tr>
<td>Combined 15 years of service and age 50+</td>
<td>8,000</td>
<td>23,500</td>
</tr>
</tbody>
</table>

*Subject to a lifetime cap of $15,000. May be subject to a lower limit depending upon prior contributions.
The Ordering Rule

According to the regulations, for participants who are eligible for both the Special 15-year Catch-up and the Age 50 Catch-up and wish to defer less than the combined maximum of $23,500, the ordering rule states that the 15+ year Catch-up is applied first, thereby reducing the lifetime cap.

For example, the employee wishes to contribute $20,000 (rather than the combined maximum of $23,500):

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<tbody>
<tr>
<td>1</td>
<td>Basic deferral</td>
<td>$15,500</td>
</tr>
<tr>
<td>2</td>
<td>15-year Catch-up</td>
<td>+ 3,000</td>
</tr>
<tr>
<td></td>
<td>Subtotal</td>
<td>$18,500</td>
</tr>
<tr>
<td>3</td>
<td>50+ age Catch-up</td>
<td>+ 1,500</td>
</tr>
<tr>
<td></td>
<td>Total contribution</td>
<td>$20,000</td>
</tr>
</tbody>
</table>

This is consistent with the guidance that TIAA-CREF has been providing.
Funding 403(b) Plans

- Only annuity contracts and mutual funds are approved investments under 403(b)
- Life insurance, endowment contracts, not permitted investments under the final regulations
- Incidental death benefits still allowed
- Life insurance contracts issued before 9/25/07 grandfathered
Other Changes
Final regulations require that 403(b) contributions be transmitted to the carrier within the period reasonably required for plan administration, such as transferring elective deferrals within 15 business days after the month withheld.

**ERISA Plans**
- Generally, no changes will be needed since DOL regulations already require employee elective deferrals to be remitted within more stringent time frame.
- The 15-day deadline should not apply for employer contributions. Should remit within deadline for the 415 limit.

**Non-ERISA 403(b) Plans**
- They will have to conform to the new remittance schedule for employee contributions.
Requirements Affected
Salary Reduction Elections

- It was not clear how often employees must be allowed to make or change salary reduction elections to 403(b) plans

- Final Regulations – Effective Opportunity
  - The regulations specify that each eligible employee must be allowed to make or change salary deferral elections to 403(b) plans at least once each plan year
  - Meaningful Notice

This conforms to the current rule for 401(k) plans
The IRS issued temporary FICA regulations at the same time as the proposed 403(b) regulations in 2004

- All salary reduction contributions to 403(b) plans are to be treated as wages for FICA tax purposes even if made under “one-time irrevocable salary-reduction agreements” or “mandatory” plans
- Temporary Regulation will expire on November 15 unless finalized

These temporary regulations are currently effective, but are consistent with TIAA-CREF’s previous guidance on these issues
Vesting of Employer Contributions

Delayed Vesting

- Permitted by final regulations
- Must separately account for the unvested accumulation
- 415 limit applies in year of contributions even if not vested
Severance from Employment

- Severance from employment occurs when employee
  - No longer works for an eligible employer
  - Works in a capacity that is not employment with an eligible employer

- Transferring within the same controlled group is not a severance if both employers are 501(c)(3)

- Transferring from one public school to another public school within the same State is not a severance
403(b) Contributions for Former Employees

- Employer contributions can continue for five years, subject to nondiscrimination testing
  - Regulations provide guidance on contributions after death
  - Not available to qualified plans

- Elective deferrals can continue after termination as permitted by the final 415 regulations
  - Regular pay, accrued sick and vacation pay
  - Can’t defer severance pay received after termination
  - Same rule applies to 401(k) and 457(b) plans
Compliance with Regulations – Next Steps

- Review your written plan documents and contracts for completeness and consistency of terms
- If no written plan document, review what you have to determine if it is enough to satisfy the written plan requirement
- Review nondiscrimination testing if currently using Notice 89-23 to satisfy requirements
Achieving Operational Compliance -- Information Sharing with unapproved and approved vendors is required by 1/1/09

Information sharing agreements will be required by 1/1/09 with unapproved vendors

Contract transfers to unapproved vendors not permitted after September 24, 2007 unless information sharing agreement is in effect on 1/1/09

Confirm the approved vendor lists with your approved vendors before 9/25/07

Communicate changes to your employees

Discuss your options with your legal counsel
Additional information about the regulations is available from the following sources:

- **Internal Revenue Service**
  

- **Link to DOL Bulletin EBSA Releases "403(b) Plans" Guidance:**
  

- **TIAA-CREF Administrator Website**
  
  [www.tiaa-cref.org/administrators/index.html](http://www.tiaa-cref.org/administrators/index.html)

We will continue to update you on regulatory changes important to your plan.
Thank you for joining us

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