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Advisory Council on Employee Welfare and Pension Benefit Plans
Employee Benefits Security Administration
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Attn: Larry Good

Subject: Current Challenges and Best Practices for ERISA Compliance for 403(b) Plan Sponsors

Greetings:

Thank you for the opportunity to appear before the ERISA Advisory Council at its July 21st hearing on "Current Challenges and Best Practices for ERISA Compliance for 403(b) Plan Sponsors." To assist the Council in its preparations for the hearing, the American Council of Life Insurers ("ACLI") has prepared the following responses to the Council's questions as well as some thoughts regarding issues raised by the Council in its outline for the topic of this hearing.

Questions for the Witnesses

1. <u>How does the administration and structure of a 403(b) plan compare to that of a 401(k) plan or IRA? What are the similarities and what are the differences?</u>

First, it should be noted that, unlike 401(k) plans, 403(b) plans do not have "trusts." Instead, annuity contracts and custodial accounts are issued to employers or directly to employees. As for other differences, the answer depends upon the extent of employer involvement with its 403(b) plan.

If the employer's only involvement is to offer employees an opportunity to defer compensation to an annuity or mutual fund custodial account product, such plan is not an employee pension benefit plan, is not subject to ERISA and is more akin to an IRA. The participants work directly with the providers to exercise their contractual rights.

For arrangements in which the employer plays an active role, ERISA clearly applies. For ERISA arrangements, some plans use a single investment provider and others use multiple providers.

When a single provider is used, the administration and structure are similar to the typical 401(k) plan. The employer engages one company to fund the plan with a group annuity contract, a group custodial account or both. Participants then select from the investments offered under that contract or custodial account.

A multiple provider arrangement may include group annuity contracts and group custodial accounts issued to the plan. It may also include individual contracts and accounts issued to participants that provide participants all contractual rights. Prior to the Treasury's final 403(b) regulations, it was common for multiple provider arrangements to afford participants the opportunity to transfer their benefits from the plan's providers to a provider of their own choosing via a Revenue Ruling 90-24 transfer. Under the final Treasury regulations, the employer determines whether and to what extent other providers' contracts are available for transfers.

Under a 401(k) plan, the employer can move assets held in the 401(k) plan's trust from one provider's contract to another. For 403(b) plans with individual annuity contracts and individual custodial accounts, these contracts are like IRAs. Here, it's the employee not the employer with control over the contract or account. For these employees, the employer controls the investments and contract options available for new contributions and for transfers under the plan, but not the individual contracts.

2. <u>What is the role of the plan sponsor in the administration of an ERISA-regulated 403(b) plan? How has this changed over time, if at all? Is there a need for change?</u>

A plan sponsor's role in maintaining a 403(b) plan under ERISA does not differ from the role of a 401(k) plan sponsor. For example, whether a plan has a single provider or multiple providers, the employer determines the core investment offering. The key change for plan sponsors has been the new rules under the Final Treasury Regulations which led many plan sponsors to change their ERISA plans and others to move from safe harbor to ERISA regulated plans. For plans that were not originally established or maintained by the employer, employers need additional guidance as to their role with respect to contracts and custodial accounts not treated as plan assets under FAB 2009-02 ("FAB") and other contacts under which it has no authority or control.

FAB 2009-02 provided reporting relief for certain annuity contracts and custodial accounts. Contracts and accounts meeting the conditions of the FAB need not be treated as a part of the plan for reporting and audit purposes. The conditions include (1) that the contract was issued to the current or former employer prior to January 1, 2009; (2) the employer ceased making and had no obligation to make contributions to the contract before January 1, 2009; (3) all rights and benefits are legally enforceable against the insurer by the individual owner without employer involvement and (4) the individual owner of the contract is fully vested.

The relief provided by the FAB did not extend to other obligations of the fiduciary under ERISA. The Department should clarify that these contracts are not plan assets for any reason under ERISA. A fiduciary should have no obligations under the plan for these contracts given the fiduciary's complete lack of control over and in many cases lack of knowledge of these contracts.

For terminated employees who hold contracts or certificates under which all rights and benefits are legally enforceable against the insurer without employer involvement, the Department should issue guidance that makes clear such contracts are not assets of the plan. A fiduciary should have no further obligations for these contracts.

3. <u>For those 403(b) plans that recently became ERISA-regulated plans, what actions did plan sponsors and third parties take that you believe were most successful? What opportunities still exist for plan sponsors in fulfilling their ERISA duties?</u>

Many multiple provider 403(b) plans were originally arranged with minimal employer involvement. These plans have not been treated as established or maintained by the employer and thus have not been subject to ERISA. The final Treasury regulations led many if not most of these employers to take on greater duties. Some have chosen to freeze their multiple provider "safe harbor" plans and established new plans. However, others chose to modify their multiple provider plans to maintain them as ERISA plans, leading to a number of issues. For example:

- Plans that previously permitted 90-24 transfers may not know the disposition of amounts transferred and were not sure which contracts should be considered plan assets. Thus, employers were not confident as to the opening balance for the 2009 plan year, the first plan year to which the complete Form 5500 reporting requirement applied.

- For plans subject to ERISA's audit requirements, employers remain unsure as to what is a reasonable examination period for years prior to 2009, for example, how many years back should an examination go? Many of these plans go back 20, 30, 40 years or more.

- For terminated employees, employers need guidance that confirms that former employees are no longer plan participants, particularly for contracts or certificates under which all rights and benefits are legally enforceable against the insurer without employer involvement.

The Department should ensure that there are reasonable paths for ERISA compliance for multiple provider plans that recognizes permissible pre-Treasury Regulation activities, considers the extent to which participants and beneficiaries have effective control over assets held in annuity contracts, and recognizes the requirements applicable to terms of the annuity contracts under the Internal Revenue Code as well as the protections afforded contract owners under federal securities law and state insurance law. For example, under Internal Revenue Code §403(b), the employee's rights under the terms of the contract must be nonforfeitable.

4. <u>What issues are unique to large 403(b) plans? What issues are unique to smaller 403(b) plans? What issues are common to both large and small plans?</u>

For any ERISA 403(b) plan sponsor, it should be noted that these employers operate on a not for profit basis. There is no tax incentive to encourage these employers to offer a plan. It is typical for these employers to have limited funds to dedicate to employee benefits. Implementing the new plan audit requirement has been a concern. These audits have been time intensive and costly, particularly for plans with multiple providers including previous safe harbor arrangements. The Department should examine the information it has received to determine whether the application of the audit requirement to 403(b) plans was beneficial given the time and costs expended by all of the affected employers and whether the current requirement should continue to apply.

5. <u>What challenges do plan sponsors face in obtaining information for purposes of meeting compliance requirements? Do the challenges arise mainly from the number of providers of investment products to 403(b) plans?</u>

For the plan's core investment providers, plan sponsors have ongoing relationships in which information sharing is routine. However, if a plan previously permitted unrestricted transfers to individual annuity or individual custodial accounts under Revenue Procedure 90-24, the employer may have no record of these contracts. Likewise, the providers of these contracts and accounts may not have records of the plan or employer. It is possible for an individual to have combined the assets of a number of plans into their individual arrangement prior to the Final Treasury Regulations. This poses significant challenges for plan level reporting and compliance related activities including Form 5500 reporting, plan audits, 408(b)(2) and participant fee disclosure compliance, etc.

7. What is the impact on a 403(b) plan's ERISA safe harbor status on information sharing agreements between the plan sponsor and investment product providers? How does this affect participants and their decision making regarding investment products? How is this affected, if at all, where the plan sponsor maintains both an ERISA 403(b) plan and a safe harbor 403(b) plan, and information is shared across these plans?

The sharing of information between an employer and a provider should not be viewed as an ERISA plan maintenance activity. Parties engaged in information sharing do so voluntarily to ensure the tax qualified status of the participants' and beneficiaries' contracts. The Department should confirm that information sharing alone does not lead to the maintenance of an ERISA plan. Providers may inquire as to the employment status of an individual so that the provider may determine whether the terms and conditions necessary for a distribution have been met. While information shared between an employer, its ERISA plan, and a provider under its safe harbor plan may have a bearing on benefit eligibility under the ERISA plan or safe harbor plan, the status of the safe harbor plan should not be affected. Providing information is not directing an activity nor is it managing, per se, a plan.

403(b) Plan Issues

Regarding safe harbor 403(b) plans: the limitations on a plan sponsor's ability to administer a requirement imposed by an investment provider which requires no discretion to be exercised by the plan sponsor, such as repayment of loans by payroll deduction, where neither the plan sponsor nor the terms of the written plan impose the requirement.

It is common for employers to agree to requests from employees to remit all or a portion of their paychecks to a bank or other financial institution. When an employee elects to take a loan from a safe harbor 403(b) plan under the condition, imposed by the investment provider, that such loan be repaid via payroll deduction and such employee requests and her employer agrees to make such remittance, these actions should not be viewed as the maintenance of an ERISA plan by the employer.

Regarding independent audits: the extent to which a plan fiduciary and plan auditor may rely on year-end 2008 data to establish a starting balance for audits of 2009 and later years; the ability of a plan that becomes newly subject to Title I of ERISA (whether voluntarily or as a result of one or more acts of control inconsistent with the safe harbor) to disregard contracts and accounts that were properly excludable from the plan, in accordance with IRS rules, prior to becoming subject to Title I of ERISA.

Regarding the 2009 plan year opening balance, the Department should find it acceptable for employers as well as auditors to rely on the 2008 plan or contract year reports prepared and certified by the insurer(s) and/or custodian(s) of the plan's contract(s) to establish the plan's 2009 opening balance. In addition to the relief provided in the Field Assistance Bulletin 2009-02 (the "FAB"), the Department should make clear that it will not reject a Form 5500 on the basis of a "qualified," "adverse" or disclaimed auditor opinion if the accountant expressly states such opinion is due to the fact that the opening balance for the first plan year subject to the ERISA reporting rules was based solely on certified statements from the insurer(s) and/or custodian(s) for the previous plan or contract year.

As for plans that become subject to ERISA, the FAB removed, for reporting and audit purposes, a key group of contracts. These contracts predate the effective date of the final 403(b) Treasury Regulations. In summary, the contracts identified by the FAB are those in which the sponsoring employer no longer has any active involvement, obligation, authority or control. Control over the benefits under these contracts rests with the employee or former employee. For example, while an insurer or custodian may confirm certain information with the employer (e.g., that the individual has severed employment) to determine whether, under the terms of the contract, the individual is entitled to a distribution, the insurer looks to the individual, not the employer, for direction as to whether to make payment. No other party has a right or benefit legally enforceable under the contract. We agree with the Department's analysis and findings in the FAB concerning these contracts. It is appropriate that they be disregarded for plan purposes.

Regarding the distribution (in accordance with IRS requirements) of annuity contracts out of the plan, including distributions upon severance from employment (or other distributable event) and distributions in the event of plan termination: the conditions under ERISA for such distributions; the status of any spousal rights upon such distribution.

The distribution of an annuity contract or the issuance of a certificate to an annuitant under a group annuity contract is appropriately treated as a distribution of plan benefits to a participant. It is understood that the consent of the spouse must be obtained prior to the commencement of payments in a form other than joint and last survivor. When deferred annuities are distributed, these spousal rights are incorporated into the terms of the contract.

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On behalf of the ACLI member companies, thank you for opportunity to assist the Council in its efforts. ACLI welcomes the opportunity to discuss our responses and engage in a productive dialogue with the Council on these important issues.

Sincerely,

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Taxes & Retirement Security