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Executive Compensation Law Alert

A Corporate Department Publication

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Final 403(b) Regulations Require Action by January 1, 2009

The Treasury Department issued final regulations under Internal Revenue Code Section 403(b), which are effective beginning January 1, 2009. The regulations essentially bring 403(b) plans in much closer alignment with other deferred salary reduction arrangements, such as 401(k) and 457(b) plans, and make employers more responsible for the administration of their 403(b) plans than they were in the past. The following discussion summarizes the new regulatory requirements and lists what an employer needs to do in the coming months to prepare for the January 1, 2009 effective date.

__Written Plan__. All employers with 403(b) plans, including non-ERISA plans, must adopt a written plan document. The plan document must contain all the material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions will be made. Plans may, but are not required to, provide optional features such as hardship distributions, loans, contract exchanges, plan-to-plan transfers, Roth contributions, employer contributions, and acceptance of rollovers. Additionally, the plan document may allocate responsibility for some administrative functions. Finally, plans may incorporate by reference other documents, such as an insurance policy and custodial account, although a governing plan must nonetheless be adopted.

__Universal Availability__. In general, under the universal availability requirement, if an employer offers the opportunity to make salary deferrals to one employee, the employer must offer that opportunity to all employees. Under the final regulations, permitted exclusions are now limited to (1) student employees, (2) employees eligible for another 403(b), 401(k), or 457(b) plan of the organization, (3) nonresident aliens, and (4) certain employees who normally work less than 20 hours per week. The employer also must provide employees, at least once each plan year, with an opportunity to make or change an elective deferral by providing notice of the availability of the election, the time period during which an election may be made, and any other conditions on elections.

__Contract Exchanges and Transfers__. Under the final regulations, exchanges among providers authorized under the plan and transfers to other plans maintained by the participant's current and former employers may, but need not, be permitted by the plan sponsor. After September 24, 2007, exchanges to funding vehicles issued by providers not approved to receive contributions under the sponsor's plan will not be permitted unless both parties agree to enter into an information sharing agreement by January 1, 2009. Additionally, contract exchanges and transfers must not diminish the accumulated benefit or have less stringent distribution restrictions.

Catch-Up Provisions. A 403(b) plan can provide for (1) an additional special catch-up contribution for an employee who has at least 15 years of service with the same employer and (2) a catch-up contribution for an employee who is age 50 or older (up to $5,000 in 2008). The final regulations provide that, if an employee is eligible for both catch-up contributions, the special 15 years of service catch-up should be applied first.

Employee Contribution Timing. The regulations require plan sponsors to transmit all contributions to plan providers as soon as administratively feasible.

Roth 403(b). The final regulations confirm that Roth contributions may be made to a 403(b) plan. Provided certain requirements are met, Roth contributions will be made after-tax, and distributions will be tax-free. An employer that provides for Roth 403(b) contributions will need to communicate the availability of such an option to employees.

Action Points. To implement these regulatory requirements, employers should consider taking the following steps by January 1, 2009.

- Create a written plan document or amend a previously established 403(b) plan document.
- Determine who will be responsible for administration of the plan.
- Determine the number of vendors that will be offered within the plan.
- Review communication materials to make sure that, at least once per year, they provide meaningful notice to all eligible employees of the availability of the 403(b) plan and how employees can begin making elective deferrals under the plan.
- Ensure that contributions are remitted to plan providers as soon as administratively feasible.

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