

# Choices for 403(b) Plan Sponsors



## Choices for 403(b) Plan Sponsors

This document is formatted to provide plan sponsors basic background about 403(b) compliance challenges and identify various choices employers must make concerning their 403(b) plan.

### Contents

403(b) Basics .....	2
403(b) History .....	2
What Is Required of Plan Sponsors? .....	2
What Options Are Available to Plan Sponsors? .....	4
Who Can Perform Services? .....	8
Fees .....	8
How Can National Benefit Services Help? .....	9
Who Is National Benefit Services? .....	10
NBS Contact Information .....	11

## 403(b) Basics

A 403(b) plan, also known as a Tax-Sheltered Annuity (TSA) plan, is a tax-deferred retirement plan for employees of certain tax-exempt or governmental organizations. An employer may sponsor a 403(b) plan to provide a benefit to its employees of the opportunity to save for retirement on a tax-deferred basis. Benefits of participation in a 403(b) plan include:

- Income tax is generally not paid on allowable contributions to the plan or on earnings or gains of the account until withdrawn at retirement.
- Someone who makes eligible contributions to the plan may be able to receive a tax credit, which could reduce the federal income tax paid.

## 403(b) History

The involvement of governmental entities, school districts, churches, and some 501(c)(3) organizations that sponsor 403(b) plans has traditionally been limited to making payroll deductions and forwarding contributions to the plan's investment providers. In years past, the federal government has not exercised significant oversight of 403(b) plans. However, in 1994 IRS audit activity began holding school districts and other 403(b) plan sponsors accountable for plan compliance. Many employers that became the subject of an IRS audit found themselves forced to either gain the competencies necessary to run the 403(b) plan in accordance with the Internal Revenue Code (IRC) or engage the services of a third party administrator (TPA).

The "hands-off" approach of many employers also resulted in frequent abuse of 403(b) plan participants by high-cost investment providers and insurance companies. In fact, some state laws require governmental employers to allow virtually any investment provider or insurance company to have access to employees. This environment further discouraged employers from taking active steps towards ensuring the 403(b) plan was a quality benefit to employees.

In 2007, the IRS issued new 403(b) regulations for the first time in over 40 years. The new regulations shift the traditional 403(b) plan model toward that of 401(k) plans maintained by private employers. Previously, 403(b) plans required less employer involvement than 401(k) plans, however, the new regulations reinforce certain employer responsibilities and create new burdens for the employer.

## What Is Required of Plan Sponsors?

Complying with the new IRS regulations may be a bewildering challenge for many employers. In essence, the IRS requires two things—that the plan comply with the IRC in both "form" (design) and "function" (operation).

### *Plan Design*

The form or structure and design of a plan are dictated by the plan document. The plan document consists of a single written document or a collection of documents that together outline the nature, features, and operation of a retirement plan. Not all 403(b) plans were previously required to maintain a plan document. Instead, each plan participant entered into an agreement or contract with his or her

investment provider. The individual contract or agreement dictated the specific nature of each 403(b) plan account.

As of January 1, 2009 all 403(b) plans must be maintained according to a written plan document that meets the legal requirements of Section 403(b) of the IRC. The IRS has provided sample language that can be used to construct a basic 403(b) plan document. (Please note that only public school districts may fully rely on the sample IRS language.) However, the sample document language provided by the IRS is simplistic and may not meet the needs of all employers. Professional advisors may be required to assist in creating a plan document.

***Plan Operation***

In addition to maintaining a plan that complies with the IRC in form, the actual function or operation of the plan must be compliant with the IRC *and* with the plan document; unfortunately, this is easier said than done. The difficulty of ensuring compliant plan operation is magnified when the plan has permitted contributions to be made across multiple investment providers.

Some of the significant areas of operational focus include:

Contribution Limitations	Employers must ensure that employee and employer contributions do not exceed annual plan or statutory limits. Coordination with other plans maintained by the employer may be required.
Coordinated Catch-up Rules	The Age 50 Catch-up and Special 15-Years of Service Catch-up must be carefully coordinated to ensure contribution limits are not violated.
Central Coordination of Transactions	Employers whose plans include multiple investment providers will need to provide central coordination of certain transactions if hardships and loans are permitted.
Information Sharing Agreements	Employers must ensure that certain information is shared between investment providers and the employer if transfers are permitted among investment providers.
Orphan Accounts	Employers whose plan has dropped investment providers since 2005 may be required to take certain action and have procedures in place to handle so-called “orphan” accounts.
Timeliness of Contributions	Employers must ensure that employee deferrals to the plan are forwarded to investment providers within specified timeframes.
Universal Availability Notification	Employers must provide annual notification of eligibility to participate in the plan.
Eligibility Restrictions	Employers may exclude certain employees from participating in a 403(b) plan under certain conditions.
Discrimination Testing	Employers that sponsor certain types of 403(b) plans may be required to prove the plan does not discriminate in favor of certain classes of employees.

***What If There Are Failures?***

Failure to meet the form or function requirements set forth by the IRS could result in the loss of tax-qualified status of the entire plan or of individual accounts, creating adverse tax consequences for the employer or participants. Other IRS or DOL penalties may also apply.

***What About ERISA?***

The Employee Retirement Income Security Act ("ERISA") was enacted in 1974 with the purpose of protecting employees' retirement plan interests. ERISA imposes numerous fiduciary responsibilities on the employer including the careful selection and monitoring of investments offered to employees. Plans of governmental employers and most churches are exempt from ERISA rules. Plans of 501(c)(3) organizations may or not be covered by ERISA. 501(c)(3) organizations that wish to avoid ERISA coverage must carefully structure and operate the plan.

Generally, to avoid ERISA coverage, a plan should meet all of the following conditions:

Deferrals only (no employer contributions)
Voluntary participation
All rights under annuity contract enforceable by participant (no group contracts)
Employer compensation limited to covering expenses
Employer involvement limited to:
Letting annuity/investment companies publicize and sell products
Requesting information
Summarizing or compiling information provided for employees
Collecting deferrals and forwarding to annuity/investment companies
Maintaining records

Note that while federal regulations exempt governmental employer plans from ERISA rules, some state laws may impose regulations upon governmental plans similar to those of ERISA.

**What Options Are Available to Plan Sponsors?**

Numerous alternatives are available to a plan sponsor based on the type of employer (i.e. governmental entity or 501(c)(3) organization) and the employer's objectives and resources. In this section, six possible plan structure alternatives are described, including pros and cons of each. Other alternatives exist, but the plan types shown in the following pages are among the most common.

## Terminated Plan

Employers are not required to sponsor a 403(b) plan. An existing plan may be terminated. Complete termination of a plan generally eliminates all the employer’s future obligations concerning the plan.

However, terminating a plan may be difficult or impractical for many employers. Plan termination requires all plan assets be liquidated and distributed to participants. If all plan assets are held in a group account, liquidation may be performed at the direction of the employer. But, if plan assets are held in individual, participant controlled accounts, the employer may not be able to exercise authority over the accounts. Instead, each plan participant would need to voluntarily agree to receive a distribution or to rollover the assets to an IRA or other qualified plan. To make matters worse, plan participants include active employees as well as former employees or beneficiaries that maintain a balance.

Additionally, premature liquidation of accounts may trigger fees or penalties for the participants depending on the nature of the accounts.

### Summary

- Plan ceases to exist
- All plan assets are liquidated and become taxable unless rolled over

### Pros

- Employer has no future plan obligations
- Simplest possible plan structure (no plan at all)
- No responsibility for orphan accounts

### Cons

- Unpopular with employees
- Eliminates tax-deferred savings opportunity for employees
- Some accounts may incur early withdrawal penalties
- Not feasible for many plan sponsors

### Who Can Help?

- Vendor (if all assets held in group accounts)

## Frozen Plan

Plan termination is not feasible for many employers. Those employers that wish to minimize their administrative and compliance burdens may choose to freeze the 403(b) plan. Like a terminated plan, ongoing contributions are no longer allowed but freezing does not require liquidation of plan assets. In fact, participant accounts are not adversely impacted. Participants simply lose the ability to continue making contributions to the plan.

Compliance and administrative responsibilities for a frozen plan are significantly reduced compared to an active plan. Existing accounts become so-called “orphan” accounts—requiring less employer involvement compared to active accounts. Unfortunately, compliance requirements associated with orphan accounts will likely linger for many years into the future.

### Summary

- No future contributions permitted
- Existing accounts become orphans

### Pros

- Minimal employer responsibilities remain
- Existing accounts not adversely affected
- Feasible for most plans (unlike plan termination)

### Cons

- Unpopular with employees
- Eliminates tax-deferred savings opportunity for employees
- Responsibility for orphan accounts remains

### Who Can Help?

- Few (if any) service providers will assist

### Non-ERISA Single Vendor Plan

The plan sponsor selects a single investment provider for the plan—similar to most 401(k) plans. Plan administration will be immediately simplified. Consolidation of plan assets into a single provider over time will further streamline administration and reduces compliance complexity. While existing accounts are not negatively impacted from the participant perspective, the accounts gain “orphan” status and will continue to demand attention from the employer for many years.

Completely consolidating plan assets with a single provider may be impractical in many instances as it could involve voluntary cooperation of participants. Certain accounts may be subject to fees and penalties resulting from early liquidation—further obstructing consolidation. However, over time, consolidation should ease administrative and compliance burdens. Please note that state laws may preclude certain employers from adopting a single provider plan.

A benefit of a single provider is that the collective bargaining power of many accounts may be leveraged to secure reduced fees for plan participants. Another benefit is that the single vendor will generally provide (or at least support) investment and savings education for employees.

<b>Summary</b>
<ul style="list-style-type: none"> <li>• Single investment provider chosen by sponsor</li> <li>• No negative impact to existing accounts</li> </ul>
<b>Pros</b>
<ul style="list-style-type: none"> <li>• Maximum employer control over plan</li> <li>• Moderately simplified compliance and administration</li> <li>• Potential leverage to improve pricing</li> <li>• Access to employee education support</li> </ul>
<b>Cons</b>
<ul style="list-style-type: none"> <li>• Loss of vendor choice for participants</li> <li>• Employer responsibility for orphan accounts remain</li> <li>• Not permitted in all states</li> </ul>
<b>Who Can Help?</b>
<ul style="list-style-type: none"> <li>• Vendors</li> <li>• Bundled providers (non-independent TPA's)</li> <li>• Independent TPA's</li> </ul>

### Non-ERISA Preferred Vendor Plan

A plan sponsor selects a “preferred” investment provider while retaining a full range of vendor choices. The sponsor could encourage participants to utilize the preferred vendor and to consolidate plan assets with the preferred provider on a voluntary basis. Because of its preferred status, the preferred vendor should experience consolidation of plan assets over time. The employer will benefit from a small degree of simplified administration and reduced coordination among investment providers as a result.

The collective bargaining power of many accounts may be leveraged to secure reduced fees for plan participants. The preferred vendor may also provide or at least support investment and savings education for employees.

<b>Summary</b>
<ul style="list-style-type: none"> <li>• Multiple investment provider options available to participants</li> <li>• One provider is given preferred status</li> </ul>
<b>Pros</b>
<ul style="list-style-type: none"> <li>• Preserves vendor choice for participants</li> <li>• Slightly simplified administration</li> <li>• Potential leverage to improve pricing</li> <li>• Access to employee education support</li> </ul>
<b>Cons</b>
<ul style="list-style-type: none"> <li>• Compliance and administration must be performed across full spectrum of providers</li> <li>• More complex than single vendor</li> </ul>
<b>Who Can Help?</b>
<ul style="list-style-type: none"> <li>• Bundled providers (non-independent TPA's)</li> <li>• Independent TPA's</li> </ul>

### Non-ERISA Open Vendor Plan

A “business-as-usual” approach is to preserve an open-vendor environment. An open vendor plan offers multiple investment providers and no provider is given preferential treatment. This approach results in minimal impact to employees and preserves a large range of participant choice.

Administration and compliance responsibilities of an open vendor plan may be challenging without competent outside assistance. However, an experienced and independent TPA, such as National Benefit Services, can assist the employer in the performance of most its duties.

<b>Summary</b>
<ul style="list-style-type: none"> <li>• Business as usual</li> <li>• Multiple investment provider options available to participants</li> </ul>
<b>Pros</b>
<ul style="list-style-type: none"> <li>• Preserves vendor choice for participants</li> <li>• Minimizes changes to plan</li> </ul>
<b>Cons</b>
<ul style="list-style-type: none"> <li>• Compliance and administration must be performed across full spectrum of providers</li> <li>• More complex than single vendor</li> </ul>
<b>Who Can Help?</b>
<ul style="list-style-type: none"> <li>• Independent TPA's</li> </ul>

### ERISA Single Provider Plan

ERISA imposes numerous fiduciary responsibilities on the employer, including the careful selection and monitoring of investments offered to employees. Plans of governmental employers are exempt from ERISA rules (however, some state laws may impose regulations upon governmental plans similar to those of ERISA). Non-governmental employers can generally choose whether to adopt an ERISA plan. Employer responsibilities are weightier for an ERISA plan than for a non-ERISA plan.

In addition to all the responsibilities unique to non-ERISA plans, ERISA plans include additional fiduciary obligations, including the careful selection and monitoring of investment options.

<b>Summary</b>
<ul style="list-style-type: none"> <li>• Same as non-ERISA plan but with additional fiduciary responsibilities</li> </ul>
<b>Pros</b>
<ul style="list-style-type: none"> <li>• None (No advantages for employer over a similar non-ERISA plan)</li> </ul>
<b>Cons</b>
<ul style="list-style-type: none"> <li>• Additional fiduciary obligations</li> </ul>
<b>Who Can Help?</b>
<ul style="list-style-type: none"> <li>• Vendors</li> <li>• Bundled providers (non-independent TPA's)</li> <li>• Independent TPA's</li> </ul>



Comparison of Plan Types	Terminated Plan	Frozen Plan	Non-ERISA Single Vendor	Non-ERISA Preferred Vendor	Non-ERISA Open Vendor	ERISA Single Vendor
Feasibility	Varies*	Available to all plans	Varies*	Generally feasible*	Available to all plans	Varies*
Level of Complexity	Simplest	Simple	Moderate	Complex	Complex	Complex
Potential to Improve Participant Pricing	NA	NA	High	Varies	None	High
Impact on Participant Vendor Choice	High	High	High	None	None	High
Independent TPA Help Available	No	No	Yes	Yes	Yes	Yes
Help from Vendors or Bundled Providers Available	Varies	No	Yes	Yes	No	Yes

\* State laws may preclude certain employers from adopting this type of plan

## Who Can Perform Services?

403(b) plan sponsors may choose to handle administrative and compliance activities in-house. Employers that do not have sufficient resources or expertise may turn to outside service providers, which may work on behalf of the employer. Most service providers can be lumped into one of three categories: vendors, bundled providers, and independent third party administrators. Different plan sponsors may find value in each type of provider depending on the type of plan and the employer's objectives.

Vendors	An investment provider's (vendor's) primary role is to supply annuity or custodial services and an investment platform. Some investment vendors will support other operational aspects of the plan. However, vendor support tends to be limited unless the vendor is the plan's sole investment provider.
Bundled Providers	Bundled providers are usually vendors that provide compliance and administrative services in addition to traditional vendor services. The vendor may maintain a separate arm or division that provides administrative services. Some third party administrators also sell investment products. These organizations are considered bundled providers or non-independent TPA's.
Independent TPA's	Independent third party administrators do not sell investment products and are not affiliated with vendors. (National Benefit Services is an independent TPA.)

## Fees

There are always fees associated with engaging the services of a third party administrator or investment provider (even if those fees are sometimes hidden). Fees may be based on a percentage of assets, participant count, or employee count, depending on the service provider. Investment providers frequently assess asset-based fees but may also charge fixed, per-participant fees. Bundled providers

have sometimes been known to indicate that compliance services are provided at no cost. However, fees to cover these services may be built into the overall pricing structure. Independent third party administrators commonly assess per-participant fees though per-employee fees are not unheard of.

Costs of plan administration may be borne by the employer, participants, or investment providers. Although, some state laws prohibit costs to be passed to participants or investment providers.

## How Can National Benefit Services Help?

National Benefit Services, LLC is a leader in 403(b) plan administration. As an independent third party administrator, NBS does not sell investment products and works in the best interest of our client plan sponsor. NBS has provided comprehensive 403(b) compliance and administrative services to employers since 2002. Current clients range in size from small charter schools with only a few employees to state departments of education with over 60,000 eligible plan participants. NBS' programs are proven and effective. We aim to minimize the burden and liability of the employer, while improving the value of the 403(b) plan for the participants.

NBS can assist an employer in managing an ERISA or non-ERISA plan, single vendor plan, preferred vendor plan, or open vendor plan. NBS' 403(b) services include:

<b>Compliance - Contribution Limits</b>	
<ul style="list-style-type: none"> <li>• Maximum Allowable Contribution (MAC) gathering from participants</li> <li>• MAC database maintenance</li> <li>• Limit testing (i.e. 402(g), 415, annual catch-up limits)</li> <li>• Coordination of limits across plans as necessary</li> </ul>	<ul style="list-style-type: none"> <li>• Excess deferral prevention</li> <li>• Excess deferral communication to participants</li> <li>• Excess deferral communication to employer</li> <li>• Excess deferral correction coordination</li> </ul>
<b>Compliance - Vendor</b>	
<ul style="list-style-type: none"> <li>• Obtain service provider/information sharing agreements</li> <li>• Due diligence to ensure vendor compliance</li> <li>• Review/approve hardships</li> <li>• Facilitate communication of hardship approval to vendor</li> <li>• Review/approve distribution/rollover (including QDRO's)</li> <li>• Facilitate communication of distribution/rollover approval</li> <li>• Communication to participants</li> </ul>	<ul style="list-style-type: none"> <li>• Review/approve loans</li> <li>• Determine loan eligibility and calculate maximum loan amount</li> <li>• Loan approval communication to vendor</li> <li>• Exchange and transfer approval (formerly known as 90-24 Transfers)</li> <li>• Notification to employer</li> </ul>
<b>Compliance - Other</b>	
<ul style="list-style-type: none"> <li>• Plan document design</li> <li>• Summary Plan Description (SPD)</li> <li>• Compliance with State and Federal law</li> </ul>	<ul style="list-style-type: none"> <li>• General compliance advising and consulting</li> <li>• 70 ½ required minimum distribution notices</li> </ul>
<b>Salary Reduction Agreement Management</b>	
<ul style="list-style-type: none"> <li>• Receive SRA data from participants</li> <li>• House and manage SRA data</li> <li>• House vendor allocation data</li> </ul>	<ul style="list-style-type: none"> <li>• Forward SRA data to employer for payroll</li> <li>• SRA problem resolution with participants</li> </ul>

<b>Communication and Education</b>	
<ul style="list-style-type: none"> <li>• Sponsor-branded website</li> <li>• Customized to sponsor-specific needs</li> <li>• Online forms</li> <li>• Online participant account history</li> <li>• General program communication to employer</li> </ul>	<ul style="list-style-type: none"> <li>• General program communication to employees and participants</li> <li>• Support in creating educational materials and resources</li> </ul>
<b>Administration of investment platform</b>	
<ul style="list-style-type: none"> <li>• Please note that NBS does not sell investment products</li> <li>• Low-cost, high quality investment provider options</li> </ul>	<ul style="list-style-type: none"> <li>• Integrated 403(b)/Roth 403(b)/457(b)/401(a)</li> <li>• Expansive range of mutual funds</li> </ul>
<b>Common remittance</b>	
<ul style="list-style-type: none"> <li>• Same day forwarding of funds available</li> <li>• Electronic remittance available</li> </ul>	<ul style="list-style-type: none"> <li>• Reporting back to sponsor</li> </ul>
<b>Audit support</b>	
<ul style="list-style-type: none"> <li>• DOL</li> <li>• IRS</li> </ul>	<ul style="list-style-type: none"> <li>• CPA</li> </ul>

## Who Is National Benefit Services?

National Benefit Services, LLC is a fee for service business outsource firm established in 1986, with offices in Salt Lake City, Utah. NBS services initially focused on Cafeteria Plan administration and qualified plan document design. NBS' culture and philosophy proved very successful and NBS began providing full administration for retirement plans for private employers. In 1999 NBS started servicing 403(b) plans of governmental and non-profit employers. By 2002 NBS was building relationships with consortiums of school districts in Southern California and expanded 403(b) services to encompass comprehensive plan administration in multiple vendor environments. NBS now administers over 3,700 benefit plans for employers all over the U.S. and specializes in the design and administration of all types of retirement and welfare plans. Plan sizes range from single owner/employee plans to plans with over 200,000 eligible employees.

The mission of NBS is to help employers provide the finest benefits for their employees and help their employees increase peace of mind through financial security. To achieve this mission, NBS maintains three primary focuses: Customer Care, Knowledge and Expertise, and Organizational Excellence. We believe that through providing superior customer service, being the most knowledgeable and capable partner in the industry, and in achieving excellence in our organizational process, we will achieve our mission together with our partner clients. This philosophy has enabled NBS to become a leader in benefits administration, which is manifest by our high level of customer satisfaction and continued company growth.

### *Customer Care*

NBS has provided 403(b) plan administration and consulting services to school districts since 2002. NBS understands the needs and demands of educational and non-profit employers. NBS recognizes that each individual school district has specific and unique objectives that require an administration strategy tailored to the employer's circumstances and employee needs. NBS' philosophy of Customer Care stresses the importance of creating solutions with our client partner.



NBS staff is committed to providing superior customer service. Regular training to improve customer service skills is provided and we pride ourselves on exceeding our client's expectations.

### *Knowledge and Expertise*

NBS staff is knowledgeable in their area of benefits expertise. NBS' Governmental Plans Team services governmental employers and non-profit entities—the majority of which are school districts. The team exclusively supports administration of 403(b), 457(b), 401(a), GASB, and FICA Alternative plans. Several team members are active in and maintain professional designations with the American Society of Pension Professionals and Actuaries or the Western Pension and Benefits Conference.

NBS has been at the leading edge of 403(b) plan compliance for school districts and has developed, operated, and consulted plans since 2002. NBS clients now include many of the largest school districts in California and Hawaii. NBS currently provides compliance and consulting services to over 175 school districts with nearly half a million eligible participants. Additionally, NBS maintains in-house legal counsel with extensive 403(b) experience.

### *Organizational Excellence*

NBS employees demonstrate discipline by fulfilling our promises accurately and timely. We stress planning, organization, execution, and continual process improvement in order to better serve our clients. We excel at our ability to deliver service and industry expertise.

NBS annually arranges for an independent SAS70 audit of system and operational procedures that include control reviews of both 403(b) administration and common remittance services. This report provides NBS valuable information, which is used to increase efficiencies and improve processes. It also ensures that systems and controls function at the highest level and provide protection to the employer, participants, and plan assets. A copy of the auditor's report can be provided upon request.

## **NBS Contact Information**

### **Kim Stephens**

Email: [kims@nbsbenefits.com](mailto:kims@nbsbenefits.com)

Phone: (800) 274-0503 ext. 119

### **Dave Smith**

Email: [davids@nbsbenefits.com](mailto:davids@nbsbenefits.com)

Phone: (800) 274-0503 ext. 129

8523 S. Redwood Road

West Jordan, UT 84088

[www.nbsbenefits.com](http://www.nbsbenefits.com)

**IRS Circular 230:** Any tax advice contained in this document (including any attachments) was not intended by the author of this document to be used, and cannot be used by the audience of any other person, for the purpose of avoiding any Internal Revenue Code penalties that may be imposed on such person. Any tax advice contained in this document was not intended by the author of this document to be used or referred to, and cannot be used or referred to, in promoting, marketing, or recommending the transaction(s) or matter(s) addressed herein.