Legal counsel

Retirement Plan CHANGES:

Don't Be a Day Late and Thousands of Dollars Short

The new law goes into effect January 1. Be sure you're in compliance.

By Rick Unser

Nonprofits will soon face new responsibilities in managing employee retirement plans. By January 1, 2009, nonprofit organizations must have a plan in writing for administering 403(b) retirement plans. This is the greatest change in 403(b) laws in 40 years.

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What It Means for You

The new law requires nonprofits to ensure that their plans meet heightened IRS rules for plan documents, employee transfers, nondiscrimination compliance, and plan terminations. You must make certain that participants aren't contributing or borrowing more than legally allowed from retirement accounts. You must also be sure that money withheld from paychecks is deposited in a timely manner.

Organizations that fail to comply with these regulations will pay a big price. They'll be subject to IRS penalties of $25 a day (capped at $15,000) and Department of Labor (DOL) penalties of up to $1,100 a day (with no cap). Penalties may also be brought against individuals within the organization who are responsible for the plan's management. Plan participants will suffer the consequences, too: Employee deferrals, which were generally made on a pre-tax basis and have accumulated tax-deferred earnings, would be immediately taxable.

What You Need to Do

Steps to meet compliance requirements will vary depending on the type of 403(b) plan you offer your employees: "non-actively-sponsored" or "actively-sponsored" plans. While each plan provides a similar salary deferral opportunity for participants, your involvement as the "sponsoring entity" differs dramatically.

Non-actively-sponsored plans don't have a plan document, don't file a Form 5500, and allow for employee payroll deductions to be invested with the 403(b) provider chosen by the participant.

Actively-sponsored plans are generally administered by a single service provider. There are no participant balances outside of the primary service provider's contract. As the plan's sponsor, you choose the plan's investments. Actively-sponsored plans typically have a plan document in place and file a Form 5500.

Once you determine which type of plan you have, review the appropriate checklist on page 23. Then follow these five steps to chart a path to meet the requirements by January 1.

1. Follow New 5500 Filing Requirements.

When filing a Form 5500, it's important to determine whether you need to submit an audited financial statement. If your 403(b) plan has 100 or more eligible participants, you'll need to do so. Hiring an experienced employee benefit plan auditor will be important in remaining in compliance with the new regulations.

The Department of Labor requires that financial statements report prior year financial information. If you've never filed a 5500, then the year 2009 deadline will be July 15, 2010. You'll need to provide the current value of plan investments, the amounts of employer contributions made to the plan, accounts payable, and accrued expenses as of the end of the plan year.

2. Limit the Choices.

Next, identify all service providers and plan participants. While a plan may include multiple service providers and former employees that

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Non-Actively-Sponsored-Plan Checklist

The new requirements for nonprofits offering a non-actively-sponsored 403(b) plan are more complex than those for actively-sponsored plans. Here are items to review:

Compose a document. Since most plans in this model won't have a plan document, you must develop a written plan and put it in place no later than January 1, 2009. Review existing plans to ensure the necessary information is included to meet the new requirements. Develop or review the document for language specific to:

• *Eligibility*. Due to changes to the universal availability rules, certain classes of employees who were previously excludable may no longer be. The requirements will be satisfied if everyone is eligible to participate.

• *Policies* for distributions, loans, and transfers.

• *Responsible parties.* Identify the individuals responsible for compliance with the various aspects of the 403(b) arrangement.

Review operations. Ensure that day-to-day administrative and operational practices are in line with the language in the new or modified plan document.

Check 5500 requirements. For the 2009 plan year, all 403(b) plan managers must file a full Form 5500 and recognize all assets under the plan. Plans with more than 100 participants must also meet 5500 audit requirements. Start well ahead of the filing deadlines to prevent last minute surprises, which could create delays and subsequent penalties.

Verify service providers. Determine which vendors will be approved under the new plan design. Ensure that operations and service agreements are current. Establish information-sharing agreements with vendors who won't be "approved vendors" under the new plan but still have balances for participants.

Create information-sharing arrangements with all vendors who cover items such as employment status, plan loans, and hardship distributions. Without these sharing agreements, complying with the new regulations will be next to impossible and could jeopardize the preferred tax status of the plan.

are inactive, plan sponsors are obligated to include them in the Form 5500. Information-sharing agreements, while not required, are most likely your only realistic choice to become compliant and stay that way.

Keep it simple by limiting the number of vendors and investment choices you offer participants. While having multiple providers was once the desirable approach, this will only lead to problems under the new regulations, since the complexity of compliance increases with every vendor approved. From now on, less is more.

3. Establish Internal Controls.

As a plan sponsor, you must implement practices, procedures, and policies designed to safeguard the plan's assets from fraud or error and ensure accurate recordkeeping. A plan audit includes careful examination of internal controls, so prudent nonprofits are working now with their auditors to establish proper controls this year.

Taking a "hands off" approach to offering a 403(b) retirement plan under the new regulations is the easiest way to fall out of compliance and could result in large taxes and penalties. Remember, the fiduciary responsibility now falls on plan sponsors. So don't rely solely on a vendor to be responsible for your compliance with ERISA (if applicable) unless the vendor is willing to provide full indemnification.

4. Decide How the Plan Will Operate.

Since the federal government is driving all retirement plans into similar-looking vehicles, more like

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Actively-Sponsored-Plan Checklist

Actively-sponsored plans are subject to the Employee Retirement Income Security Act (ERISA) and are already with one provider who is coordinating the plan data. Thus, requirements are fewer than with non-actively-sponsored plans. But there's still work to be done:

Review the plan document to ensure the rules under the final regulations have been satisfied. Check the following:

• *Eligibility*. There have been changes to the universal availability rules, so certain classes of employees who were previously excludable may no longer be. If everyone is eligible to participate, you have satisfied the requirements.

• *Policies* for distributions, loans, and transfers.

• *Responsible parties.* Identify the individuals responsible for compliance with the various aspects of the 403(b) arrangement.

Review operations. Ensure that your day-to-day administrative and operational practices are in line with the language in your plan document.

Check 5500 requirements. For the 2009 plan year and beyond, all 403(b) plan managers must file a full Form 5500 and recognize all assets under the plan. In addition, plans with more the 100 participants must also meet 5500 audit requirements.

Perform a review with your service provider to assure that your document and operational procedures are aligned with the terms of your service agreement and investment arrangement.

The Driver Behind the Changes

The Department of Treasury is the primary driver behind the changes in regulations. Over the years, oversight of 403(b) retirement plans hasn't been as strong as regulators would like. The current regulations were written so that nonprofits could make arrangements with vendors with minimal effort. The nonprofit often had little involvement other than forwarding payroll contributions to the vendors chosen by their participants.

No Information Sharing Among Multiple Vendors

Many of the problems stemmed from plans with multiple service providers who weren't sharing participant information. With no arrangements to share data, there are no checks and balances on loans, distributions, contribution limits, and other activities. Let's look at a prime example.

An Example

John Smith, a long-time employee of ABC Nonprofit, has balances with three 403(b) vendors in a non-actively-sponsored plan. His balances break down as follows:

- Vendor 1 $100,000
- Vendor 2 $150,000
- Vendor 3 $175,000

John decides to withdraw money to purchase a home. He borrows $50,000 from Vendor 1, then borrows another $50,000 from Vendor 2, and takes a hardship distribution of $100,000 from Vendor 3 (hardships are permissible when buying a primary residence). In addition, John makes his annual payroll contribution of $15,500 to Vendor 1.

From the perspective of each vendor, no rules have been violated. Loans are permissible up to $50,000, John qualifies for a hardship distribution, and the pre-tax payroll contribution is allowable even though John had a loan outstanding.

However, if the vendors had shared information about John, they would have discovered that John had already withdrawn the maximum allowable loan amount of $50,000 from Vendor 1. Subsequently, Vendor 2 would have denied the loan request. Furthermore, if administrators at Vendor 1 knew John had requested a hardship distribution from Vendor 3, they might not have allowed his payroll contribution, because an employee is prohibited from making contributions for at least six months after taking a hardship distribution.

What's even more troubling is that under many current 403(b) arrangements, the nonprofit wouldn't even know these activities were taking place. Going forward, the burden will be on nonprofit employers to ensure systems are in place to monitor their participants' activities and take corrective action as needed.

401(k) plans, many nonprofits that weren't offering an actively-sponsored 403(b) plan with a single vendor have now decided to do so. The relative ease of running one plan versus coordinating vendors doesn't have the strong appeal it did before the change in regulations.

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Transferring into plan-level ownership, similar to the way 401(k) plans function, can make administration and recordkeeping simple. It can also give better service and pricing to plan participants though economies of scale on their assets. Once assets have been moved to plan-level ownership and adhere to the ERISA standards, there will no longer be a question as to their tax-qualified status under the new regulations. Using this structure has a number of advantages, including automated recordkeeping, generally lower fees, improved service, and more objective investment information, in addition to compliance with IRS and DOL regulations.

Organizations that fail to comply will pay a big price.

5. Find an Advisor.

If you haven't yet complied with these requirements, you should quickly and aggressively work with a trusted financial advisor to become compliant by the January 1 deadline. You may have a financial advisor for your existing plan who can manage the process, or you can consult one of your vendors' in-house 403(b) experts and take advantage of their resources. Your CPA firm may also have internal resources and contacts to guide you. And perhaps a local ERISA attorney can help you draft the language in the plan document.

Now is the time to change the way you view your role. With proper counsel, you can ensure the integrity of your 403(b) plan and avoid adverse consequences to your organization and your plan participants. ■

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