Written Comments from the National Tax Sheltered Accounts Association on The 403(b) Proposed Regulations

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I. Introduction

The NTSAA recognizes the magnitude of the work of Treasury and the Service in developing the first proposed regulations specifically related to 403(b) arrangements in well over forty years and thanks Treasury and the Service for the effort to provide guidance in a single source. While much of the content of the proposed regulations provides clarity in areas that were previously not clear, we are concerned that there are some elements of the proposed regulations that can not be complied with in certain segments of the 403(b) marketplace. To assist Treasury and the Service in understanding why 403(b) arrangements will most often not fit into the rules that generally govern qualified plans, this section is devoted to explanation.

<u>Market Segmentation.</u>

Large 501(c)(3) Employers and State Universities. In today's 403(b) marketplace, larger 501(c)(3) Employers (which primarily include national charitable organizations, large hospitals and research centers, and private colleges and universities) generally use 403(b) arrangements for both employee and employer contributions. Employers select 403(b) plans in lieu of a 401(k) plans because employees are more familiar with 403(b) plans in this marketplace and because of the reduced administrative burden and costs for the 403(b) program compared to other types of plans. These 403(b) arrangements are based on a written plan document because they are generally subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), which includes a written documentation requirement. Even in the public higher education marketplace, employer matching contributions are routinely being made to 403(b) arrangements. Often these arrangements are designed as Optional Retirement Plans and are made available to faculty members as an alternate to the state retirement system defined benefit plan. Because there are specific rules imposed by employers beyond the requirements of the Code and related regulations, many higher education employers do establish and maintain a written plan, despite being exempted from ERISA. For these two types of employers, the new written plan document requirement required under the proposed regulations will not present as many problems as for other types of employers.

Public Education (K-12) and Community College Employers. In today's 403(b) marketplace, public education organizations, including community colleges, typically offer employees the opportunity to participate in a voluntary 403(b) salary reduction arrangement under which the employer simply makes the program available, establishes compliance procedures (generally through the various vendors that have approved payroll slots with the employer), collects and remits the voluntary salary reduction contributions to each participant's selected insurance company or mutual fund vendor, and, reports the salary reduction contributions on each participant's paycheck and Form W-2. Employers also build safeguards into their payroll systems to monitor the flow of elective deferrals to avoid excess deferrals. This segment of the marketplace represents a very significant number of participants in 403(b) programs. Almost all 403(b) arrangement in this market segment are funded with individual 403(b)(1) annuity contracts and 403(b)(7) custodial accounts (the "accounts") in which the accounts are governed by the terms of the contractual language of the respective annuity contracts or the custodial agreements. The employer is not a party to the relationship between the issuer of the accounts and the participant, and has no legal rights or authority with respect to these 403(b) accounts.

To assure compliance with the Code and related regulations, employers and providers work together to satisfy compliance requirements. Typically, employers in this marketplace require approved providers to sign "service provider" or "hold harmless" agreements as a condition of offering the accounts to employees of the employer. Under these contracts, the providers agree to assume responsibility for the compliance requirements over which they have control, such as loans, distributions and tax reporting. Employers generally are responsible for satisfying the universal eligibility requirements of IRC 403(b)(12)(A)(ii), for monitoring the 402(g) elective deferral limits, and for notifying employees about the 403(b) program. Also, employers cooperate in correcting excess deferrals under the terms of the Self-Correction Program for excesses that were not timely corrected under the terms of IRC 402(g)(2). This compliance alliance between employers and product providers was developed in response to the IRS audits of 403(b) programs and the guidelines issued to direct those audits.

Employers in the public education market are funded exclusively by tax-payer dollars, and are, in these times, faced with growing budget problems. Most public school organizations do not have sufficient staff, nor do they have the funds to hire third party administrators to assume the new responsibilities in their 403(b) arrangements under the proposed regulations. These employers do not generally have "benefits departments," but rely on employees with other responsibilities to process and monitor the 403(b) contributions and product providers. These responsibilities often fall to the payroll clerk, school business official, risk manager or human resource department.

Small to Mid-size 501(c)(3) Organizations. These organizations generally include locally funded charitable organizations such as animal shelters, abuse and protection centers, social welfare agencies, or health/medical support agencies. Typically, the smaller 501(c)(3) organizations offer a 403(b) arrangement in lieu of the more complex and expensive 401(k) plans. In prior years, these organizations often sponsored money purchase pension plans, but most of the money purchase plans have been terminated due to the inconsistent funding these types of organizations experience. Statistics reveal that some 87% of 501(c)(3) employers do sponsor defined contribution plans, with a full two-thirds of those employers using 403(b) arrangements because of the easier funding obligations, simpler administration and reduced costs.

These organizations are funded primarily through donations or grants, and as in the public education segment, are often faced with budget shortfalls. Many employers in this segment of the market offer 403(b) arrangements funded only with elective deferrals to provide employees with an opportunity to participate in a retirement savings program. The employers cannot afford the increased burdens, costs, and responsibilities that would fall upon employers under the proposed regulations.

As in the public education market segment, most 403(b) assets in the small to mid-size 501(c)(3) market are held in individual annuity contracts or individual custodial account to which the "new model" envisioned in these regulations will simply not fit. In addition, the written plan documentation requirement is particularly problematic for this group because of the potential loss of the ERISA exemption.

The net result for two of the three market segments discussed above is that employers may determine that elimination of the 403(b) program is necessary. NTSAA has already received reports of that reaction by many employers. There appears to be no intention to replace the 403(b) program with another program, and in fact, most public education employers have no other payroll based "retirement program" available to offer employees. If, in fact, employers do determine that they can no longer provide the support necessary to maintain a 403(b) program, millions of public education, charitable and health care workers will lose access to the ability to accumulate pre-tax dollars for their retirement – and, for some, will lose the *only* access they have to pre-tax retirement savings.

NTSAA does not believe that Treasury or the Service intended this result.

II. Written Plan Requirement.

The introduction of this new requirement is perhaps the most problematic issue in the proposed regulations. In addition to the difficulties many employers would have satisfying this requirement, numerous additional problems arise from the implementation of this requirement. For over 40 years, 403(b) programs have been implemented and maintained using primarily individually-owned annuity contracts or custodial accounts.[1] Under this arrangement, there are no "gatekeepers" or administrators to monitor and perform many of the tasks required under the proposed regulations. Conversely, group annuity contracts, which are owned by the employers, permit employers to control the contract and its disposition. However, because most 403(b) arrangements are funded through individually issued annuity contracts and custodial accounts, the employer has no legal standing to impose additional contractual provisions or responsibilities. The attempt to aggregate these individual contracts under a written documentation requirement does not provide the employer with a "plan" over which it can exercise authority. The employer cannot, through a plan document,[2] modify the terms of a custodial account or annuity contract, because the employee is the legal owner of that contract, which has been approved by either a state insurance regulator or federal securities regulator. Accordingly, the employer cannot accomplish many activities assigned to employers in the proposed regulations. Other problems encompassed in the proposed regulations relating to the plan documentation requirement include the following:

a. *Lack of Statutory Authority.* 403(b) programs were not intended to be "qualified plans." Imposing rules that make them more like qualified plans may satisfy a Treasury Department goal to make all tax deferred programs similar, but the statute establishes that 403(b) programs are very different from other qualified plans. While Congress has introduced some qualified plan concepts to 403(b) programs, they have not extended the requirement that such arrangements be reduced to writing, despite numerous opportunities to do so. There is no support in the Congressional Record or other administrative history to suggest that a written documentation requirement for 403(b) programs is recommended. 403(b) programs that extend beyond mere "payroll accommodations," as defined by the Department of Labor, already have a written plan document requirement under ERISA, with statutory exclusions for governmental and church plans. There is no authority or necessity for imposing an additional requirement under the Code.

b. Historical Perspective Does Not Support Change: 403(b) programs were created to provide certain nonprofit organizations and public education organizations with a simple arrangement that allows employees to supplement their retirement income. The 403(b) programs were not intended to be qualified plans and special rules regarding funding, contributions limits, eligibility, and establishment were included to recognize that these employers could not always provide comparable benefits for employees. The plans were intended to minimize the employers' administrative burdens and expenses and, in exchange for lack of employer involvement, to provide the employee with personal control over his or her account. The employers' obligations were limited to offering the plan to eligible employees, processing the contributions through the payroll system and performing appropriate withholding and tax reporting. Over time, more compliance obligations were added to Section 403(b) of the Code,[3] but those requirements have generally been satisfied by the product providers, or through the joint efforts of the employer and the product providers servicing the employers' plans.

c. *Impact on ERISA Exemption.* While it is unclear how a written documentation requirement would affect employers seeking to avoid ERISA, it is very clear that such employers would probably become subject to ERISA by including in the plan document some of the requirements set forth in the regulations. For example, an employer would probably exceed the "limited involvement" exception[4] to ERISA if its plan provided that the employer would distribute assets upon the plan's termination,[5] establish repayment safeguards for loan repayments, follow the hardship withdrawal requirements by suspending deferrals for 6 months, or restrict transfers/exchanges to specific investment products, etc. The requirements for active involvement by the employer in many tasks currently handled by the product providers may significantly erode the ERISA exemption for many 403(b) programs. The unfortunate consequence of this will likely be that such 403(b) plans are terminated to avoid ERISA liabilities and responsibilities.

d. State Law Issues. In addition to state law insurance regulation problems discussed later in this letter, there are several states' laws affected by the requirement that an employer's written plan documentation include a listing of the contracts available under the plan. Several states have "any willing provider" statutes that require public education organizations to permit any product provider that is duly licensed and/or registered with the state to offer 403(b) products to the employees of the public schools. For example, in Texas, that is some 80 possible "contracts" that an employer would have to include under its plan! In California, that number may well be over 100 in larger districts. The employer's monitoring responsibilities included in the regulations would make it very difficult for a public education organization in one of these states to continue to offer 403(b) plans to their employees.

e. *Impact on Employers and Participants*. By requiring a listing of the contracts available under the plan, the document requirement forces employers to name all authorized insurers or mutual fund companies. However, current 403(b) arrangements generally permit employees to transfer all or any portion of their 403(b) accounts to any 403(b) product provider, so long as the contract or custodial account does not restrict transfers.[6] Thus, current "plans" have 403(b) accounts that are not known to the employer, yet are part of the employer's "plan." How are these accounts affected by the proposed regulations? Are employers going to be held responsible for the compliance on these accounts that has currently been assumed by the involved product providers? How would product providers identify the relationship to an employers plan? The current product provider does not know under which employer's plan the account was established. Are these accounts "grandfathered?" Would employees have to establish new accounts that could be tracked under a plan? Would vendors have to establish "pre-regulation contracts" and "post regulation contracts" to enable them to identify "plan based" relationships? Again, the absence of a common owner makes the implementation of the proposed regulations based on "plan level" compliance difficult, if not impossible, for the employer and employees.

NTSAA Suggestions for Modifications to Plan Documentation Requirements:

1. <u>*Eliminate Plan Document Requirement*</u>. *Our primary recommendation is to eliminate the requirement for a written plan document since its implementation creates too many complications and does not improve administration or compliance efforts. As pointed out in the introduction to this document, employers that are exempt from ERISA requirements may elect to use plan documents where appropriate, as in Optional Retirement Programs, when employer contributions are made to the arrangement or when the college or university wishes to exercise some level of control over the 403(b) program. Employers that are not exempt from ERISA requirements are required to establish a written plan whenever their involvement in the plan exceeds the exempted activities. As was explained, the imposition of a written plan document requirement creates compliance and administrative problems for employers who have no control over the management of the underlying custodial contracts and annuity contracts, or the relationship between the participant and 403(b) product provider.*

   In the alternative, we suggest that the requirement be modified to:

   A. <u>Exclude Governmental Plans From the Written Documentation Requirement</u>. Based on information provided by our public education organizations[7] *and municipal hospital representatives, we strongly recommend that such organizations be excluded from the requirements for a written plan document. These taxpayer-supported organizations simply do not have the personnel or budget to direct away from providing essential services to the public. These organizations have established 403(b) programs primarily as supplemental payroll based programs requiring minimal administrative support by the employer. The participants are usually covered by a defined benefit plan which is established and administered by the state or local government. The public education organization or hospital does not have administrative responsibilities toward these programs and has no personnel* *or systems support to provide such services for either the defined benefit plan or the 403(b) program. Creating administrative requirements for such organizations under the proposed 403(b) regulations will probably result in the elimination of most 403(b) arrangements by these types of organizations,*

B. Exclude Elective Deferral Only 403(b) Arrangements that are Exempt from Coverage Under Title I of ERISA. Small to mid-size 501(c)(3) employers generally do not make employer contributions to the 403(b) arrangement. They are usually local charitable organizations with uncertain funding and very restricted budgets. The implementation of a written document requirement and the probable consequent ERISA inclusion would discourage these employers from offering any retirement program to their employees, or

C. Provide a Model Form Similar to Other Model Forms: In recognition of the need to provide a notice to employees of their rights to participate in the 403(b) arrangement, the NTSAA recommends that Treasury and the Service provide two versions of an IRS model form for employers to use to adopt their 403(b) arrangements and to provide model language that satisfies the universal availability notice requirements (further clarified in the section on Universal Availability). The forms envisioned by the NTSAA will be similar to the 5305-SEP model form.

(i) *Model Form for Employers Exempt from Title I of ERISA. This form would replace the current board resolution language used by the majority of employers in that it would contain language signifying that the employer is making a 403(b) arrangement available to employees, that such arrangement is intended to satisfy the requirements of Section 403(b), and that the arrangement is available to all employees eligible under IRC 403(b)(12)(A)(ii). The meaningful notice of employee rights to participate or make changes would be included in the form in which the employer could establish the frequency under which salary reduction agreements would be accepted, and would further signify whether any employees (within the excludable categories) would be excluded through the use of blanks for completion, or a check off list. The notice would further refer to the annuity contracts and custodial accounts for a description of the employee's rights and features under those contracts.*
(ii) *Model Form for Employers Not Exempt From ERISA. The second version of the form (which could be distinguished from the exempt employers form through the use of an identifying number such as xxxx-501(c)(3)) would include all of the language of the first form, except that it would make reference to the adoption of a 403(b) arrangements that is intended to be exempt from Title I of ERISA under DOL. Reg. 2520.3-2.*

Removal of the written plan requirement and development of the model forms will meet the needs of the Service and the employers without the punitive effects of the current written plan requirement contained in the proposed regulations. If Treasury and the Service would like additional insight into the model form concept, the NTSAA will be more than willing to discuss and provide any additional insights as might be needed.

2. *<u>Clarify Treatment of Existing Accounts Under New Regulations.</u> The final regulations should clarify how existing 403(b) annuity contracts and custodial accounts are affected by the plan documentation requirements, particularly with respect to accounts that have been transferred under Rev. Rul. 90-24, "grandfathered" features, the segregation of employer and employee contributions, vesting, and distributions of employer contributions from annuities and plan terminations. Current contracts and accounts will have features or rights that are affected by the proposed regulations. The regulations should provide guidance to the employer and product provider how compliance with the new requirements can be accomplished for registered products already issued, over which the employer has no control or authority. (Necessary only if the written plan requirement is included in the final regulations.)*
3. *<u>Modify the Plan Termination Requirements.</u> Since the employer cannot cause the distribution of individually owned contracts or custodial accounts, the regulations should be modified to permit distributions from the plan upon plan termination, but not require such distributions. Since most employees already own their 403(b) accounts, there is no need, nor is there a mechanism, to require distribution of such accounts. Issuance of an individual certificate of insurance under a group annuity contract could serve as a viable "distribution" mechanism for group annuity contracts, but would have no affect on 403(b)(7) custodial accounts or individually owned annuities.*
4. *<u>Clarify Independent Authorities</u>. Final regulations should clarify that the new plan document requirement does not conflict or interfere with underlying state and federal regulation of annuity contracts and custodial accounts or with those provisions of the statute that expressly establish requirements on contracts or custodial accounts. Those regulators do not recognize a "plan" or its superiority over their requirements. For example, final regulations should acknowledge that the contract providers are responsible for administering the terms of their contracts, as approved by the appropriate regulatory agency, and that the employer is not responsible as the plan sponsor for such actions. This would include such contract features as loans, hardship withdrawals, QDROs, transfers or exchanges, required minimum distributions, distributions and proper tax reporting. Plan sponsors should be responsible only for plan requirements such as contribution limitations, satisfaction of universal eligibility requirements and nondiscrimination requirements. Regulations should also clarify that individual contract failures do not affect other participants under the " plan" and should also clearly identify plan level failures and their consequences.*

III. Operational Failures.

Under current guidance, an operational defect in a 403(b) arrangement will generally cause only the individual contract or custodial account or a portion of a participant's account in which the defect occurred to be disqualified, depending on the nature of the defect. This result recognizes that individual 403(b) accounts are owned and controlled by the participant. Further, current guidance generally establishes complete plan failure only where the sponsor of the program, the employer, fails to satisfy the applicable nondiscrimination requirements. Again this result recognizes that the employer controls the eligibility and employer contributions, if any, to the 403(b) arrangement. Thus, there is recognition that

403(b) arrangements are "managed" by an alliance of employers, product providers and participants, and the appropriate party is assigned liability based on responsibilities. The proposed regulations attempt to shift responsibilities to the employer by creating a single "plan," notwithstanding the marketplace realities that employers often do not control the contracts or accounts established by the participant with selected 403(b) product providers. Accordingly, under the proposed regulations, it appears that operational defects could, indeed, cause the entire 403(b) "plan" to be disqualified. This risk will likely cause sponsoring employers to discontinue sponsoring the 403(b) arrangement.

NTSAA Suggestions for Modifications to Operational Defect Sanctions

1. *There is no statutory authority for disqualifying the contract as a result of operational failures. Section 403(b) of the Code creates an exclusion from income. Failures should not result in "disqualification," but should result in no exclusion from income to the extent the requirements of Section 403(b)(1) are not satisfied.*
2. *Final regulations should recognize the statutory distinctions from other "qualified plans" inherent in 403(b) programs and isolate operational requirements, other than eligibility and nondiscrimination requirements, by individual contract. Compliant participants should not have the status of their 403(b) accounts affected by failures of other participants or their product providers with whom the participant has no relationship.*
3. *Specific operational requirements should be identified and corrective mechanisms should be provided so that such provisions could be included for regulatory review when reregistering the underlying contracts and custodial accounts.*

IV. Failure to Satisfy "Qualification" Requirements.

The proposed regulations establish "qualification" requirements under Prop. Reg. 1.403(b)-3(a) and state that amounts are excluded from income to the extent that such requirements are satisfied. As part of those qualification requirements, Prop. Reg. 1.403(b)-3(b)(2) states that a 403(b) contract that does not create a separate 403(c) account to hold excess annual additions shall not "qualify" as a 403(b) contract.[8] However, IRC 403(b)(1) clearly states that the exclusion from income applies "to the extent that the aggregate of such contributions and additions…does not exceed the applicable limit under section 415." Thus, the statute is clear in its intent to exclude from income only those contributions that do not exceed the annual addition limitations of IRC 415(c). This requirement in the proposed regulations to maintain a separate account for the sole purpose of holding excess annual additions fails to recognize the legal and structural requirements of individually owned annuity contracts and custodial accounts. State insurance regulators would have to permit the establishment of a 403(c) annuity contract which would "spring" into existence only upon the deposit of an excess contribution. State law would determine whether, in fact, that contract could be part of the 403(b) contract or would have to exist as a separate 403(c) contract since different endorsements would have to be approved for 403(b) and 403(c) contracts. If state law mandated separate 403(c) and 403(b) contracts, then each participant would be required to establish two contracts, one of which may never hold any assets. In addition, the contract/endorsement would have to address fees and expenses for supporting the separate contracts. Finally, the regulations simply do not contemplate the legal and regulatory barriers for 403(b)(7) custodial accounts to establish separate "accounts" under IRC 403(c).

NTSAA Suggestions for Modifications to the Separate Account Requirement for Contract Qualification

1. *The requirement for separate accounts to hold excess annual additions should be eliminated. Excess annual additions should continue to be treated as not eligible for exclusion from income. Contrary to statements in the proposed regulations, the final sentence of IRC 415(a)(2) does not require the 403(b) contract to include provisions that physically segregate excess contributions into accounts to which IRC 403(c) apply. As under current guidance, that sentence can be interpreted in conformity with IRC 403(b)(1) to eliminate the exclusion from income for such excess contributions. Amounts not excluded from income under IRC 403(b)(1) should either be returned to the employer as an excess contribution or treated as a corrective distribution as permitted under the current SCP and VCP correction program; or*
2. *Final regulations should clarify whether the "separate account" requirement means separate accounting under a single contract or separate contracts. State insurance authorities have historically been reluctant to permit contracts that "spring" into existence based solely upon a contingent event in another contract, such as an excess contribution to a 403(b) contract. However, such authorities have been willing to permit contracts to accommodate multiple tax type accounting; and,*
3. *Final regulations should provide guidance on how custodial accounts can establish 403(c) contracts within the terms of the custodial account. It is not at all clear that the securities regulators would permit 403(b)(7) custodial accounts to create 403(c) "subcontracts" by operation of an excess contribution. Ownership rights and registration issues on the subcontracts would have to be addressed.*
4. *To clarify some of the problems inherent in requiring the maintenance of "separate accounts" as required under the proposed regulations, the following issues must be addressed in the final regulations before new endorsements or SEC registrations can be prepared. Does the new 403(c) contract remain part of the original 403(b) contract, subject to 403(b) requirements? Would 403(c) subcontracts be subject to the "distributable events" requirements of IRC 403(b)(7)? If not, are there any withdrawal restrictions on employer contributions treated as excess contributions and held in a 403(c) subcontract? Could 403(c) subcontracts be "transferred" to another 403(b) annuity or 403(b)(7) custodial account (since such contracts would be required to maintain separate accounts to hold excess contributions)? If not, what happens to the subcontract when the participant transfers the original 403(b) contract? Does the balance in subcontract count as part of a participant's "accumulated benefit" for purposes of loans, hardships, or in-service withdrawals? Can the 403(c) portion of the contract be used to offset defaulted loans? Are amounts held in the 403(c) contract subject to applicable 403(b) nondiscrimination requirements, such as the IRC 401(m) requirements on after-tax contributions? Must product providers' systems be modified to support 403(c) contracts as separate contracts independent of 403(b) requirements, or are 403(c) contracts subject to all of the requirements applicable to 403(b) contracts?*

V. Vesting Issues.

The NTSAA membership is very concerned with the 403(c) account requirement for 403(b) contracts that accept contributions that are subject to vesting schedules. Current guidance does not indicate that amounts held in 403(b) accounts could not be subject to vesting. Certain products do not accept contributions that are subject to a vesting schedule, however, that has been a business and marketplace decision made by the respective product providers. Because of this, the marketplace has structured its own solutions to issues related to vesting in 403(b) programs and there is no consistency in approach. The requirement in the proposed regulations that unvested contributions must be treated as if held in an IRC 403(c) contract creates similar ownership and compliance issues to those discussed in item IV. Further, the proposed regulations illustrate how an insurance company would treat the unvested portion of any contribution, but do not address how a custodial account would establish a 403(c) account to hold nonvested contributions. Based on responses from our membership, neither custodial accounts nor annuity contracts, as currently approved by state or federal regulators, bifurcate 403(b) annuities or custodial accounts into 403(b) and 403(c) contracts based on vesting status. In addition, several state Optional Retirement Programs ("ORPs") using 403(b) contracts to fund the programs, include a one or two year "waiting period" before participants are entitled to the proceeds of the accounts, thus creating a vesting schedule. These ORP programs are established by state law and would require enabling legislation to modify the "waiting periods" or to "rebid" for product providers that could comply with new regulations. In either event, these ORP programs would probably not satisfy the new "bifurcation" requirements by the proposed effective date. Finally, the requirement for separate account treatment of vested and nonvested amounts fails to distinguish between legal requirements applicable to variable annuities and custodial accounts under applicable securities laws and regulations and "tax treatment." Securities regulators impose very stringent disclosure and registration requirements on such "securities." These requirements generally do not allow the issuer of a security to move amounts from one contract into another contract based on possible federal income tax treatment.

NTSAA Suggestions for Modifications to the Vesting Requirements

1. *Eliminate the requirement that amounts subject to vesting are not treated as deposited into a 403(b) contract. For over 40 years, 403(b) programs have accepted nonvested contributions and treated such amounts as subject to all of the rules applicable to 403(b) programs. Creating a requirement for a separate 403(c) contract unnecessarily complicates the administration of vested plans and fails to recognize the inherent problems when trying to apply this requirement to individually owned 403(b) contracts; or*
2. *Clarify that the requirement for establishing separate 403(c) contracts to hold forfeitable amounts is an accounting requirement only and that there is no requirement for insurers and custodians to establish 403(c) accounts or contracts within or in tandem with their 403(b) products to hold amounts that are subject to forfeiture. This would simplify the re-registration process and administrative support requirements for providers of custodial accounts and annuity contracts. The distinction between requiring separate accounting and establishing separate*

accounts is very significant for product providers both to satisfy the regulators and for internal systems and operational support.

3. *Create an exception for governmental plans or extend the effective date compliance deadline to permit governmental plans to pass enabling legislation and select or confirm product providers that can satisfy the new contract requirements for vesting.*

VI. Nondiscrimination Rules

The proposed regulations make significant changes to the nondiscrimination requirements applicable to 403(b) arrangements. The major concerns of the NTSAA relating to such changes follow:

a. *Meaningful Notice Requirements*. The proposed regulations require one annual meaningful notice to be provided to inform employees of their right to participate in the 403(b) arrangement, change contribution limits, or change the selected product provider to another. This position is contrary to previous guidance provided by the Service during the 403(b) audit initiative which required immediate participation for most employees. Similarly, this guidance is contrary to recent legislation which removed the "once per year" limitation on salary reduction elections. Participants, who are responsible for selecting and monitoring investment options will need access to other investments more often than once per year, particularly if performance is problematic.[9] While the proposed regulations do not specifically say that choice can be given only once each year, it is a fact that the regulations, if finalized as written will cause employers to follow that guidance precisely – an unfortunate result. While the specificity in the proposed regulations is helpful in providing guidance to employers in areas that have not before been made clear, the change will tend to restrict access rather than broaden access, which is a result the NTSAA does not believe was intended by Treasury.

b. *1,000 Hour of Service Exclusion*. The proposed regulations also modify the requirement permitting exclusions of employees that "normally work less than 20 or more hour per week" to also permit exclusions of employees that work less than 1,000 hours per year. This standard is common in qualified plans and plans subject to ERISA, but has never been acceptable for 403(b) arrangements. Further, many employers do not track situational or temporary employees by "hours of service." In the 403(b) marketplace, many employees work under contracts based on jobs, assignments, "day work," or profession, such as substitute teachers or day nurses. Hours for such services are not monitored as salary and benefits are often contractual. Finally, the 1,000 hours per year standard does not take into consideration the fact that many educational institutions and related support organizations operate on a 9 or 10 month calendar. This would allow an employer to exclude many employees who normally do work more than 20 hours per week.

c. *Repeal of IRS Safe Harbor Notice 89-23.* The proposed regulations anticipate the repeal of Notice 89-23, which has provided safe harbor protection to 403(b) arrangements with employer contributions since 1989. Nondiscrimination requirements applicable to other qualified plans would become the new standard for employer contributions to 403(b) programs. This proposal fails to recognize that Notice 89-23 was originally provided, and extended, because 403(b) programs are not the same as qualified plans and the guidance issued to such plans often could not readily be applied to 403(b) programs. For example, corrections of excess contributions can not be made by the employer since the employer does not control the underlying annuity or custodial account. Also, there is no "suspense account" option under IRC 415 for 403(b) programs. Failing to correct a nondiscrimination requirement could cause the entire plan to become disqualified because it is a plan failure, not a contract level failure. That is one reason why a "contribution based" safe harbor was developed to provide protection to the plan. Also, the repeal of the safe harbor protection under Notice 89-23 would eliminate the employer's ability to exclude employees subject to the collective bargaining process and employees that have taken a vow of poverty. Treasury and the Service have specifically asked for comments on the groups of employees that are excludable under those safe harbor rules.

d. *Use of Section 414(s) Compensation for Testing Purposes.* The regulations contemplate requiring employers to use compensation as defined in IRC 414(s) for purposes of nondiscrimination testing. This is contrary to the specific language of IRC 403(b)(3) which requires compensation for all purposes of IRC 403(b) to be determined under IRC 403(b)(3). Again, this appears to be an attempt to apply standard requirements applicable to qualified plans to 403(b) arrangements despite specific statutory language to the contrary. The administrative burden for employers would be significantly increased because employers would have to keep records with multiple definitions of compensation for their 403(b) programs. Aside from this proposed change, employers have no reason to determine compensation under IRC 414(s). Payroll systems, software programs and calculation worksheets have all been designed to rely on IRC 403(b)(3) compensation, which is unique to 403(b) plans in recognition of the special compensation needs of the nonprofit and governmental plan marketplace.

NTSAA Suggestions for Modifications to the Nondiscrimination Requirements

1. *The intent of "meaningful notice" of the right to participate or make changes requires further clarity, and it is suggested that Treasury and the Service develop a standard IRS form (similar to the 5305 SEP) that employers can utilize to both adopt their 403(b) arrangement and to notify employees of their right to participate in the 403(b) arrangement as previously covered.*
2. *The minimal requirement that the right to begin participation or make changes only once each year should be changed. The NTSAA is concerned that the previous position of the Service that there can be no waiting period imposed upon employees is being reversed in these proposed regulations. Most employers have already amended their program policies based on the earlier guidance to permit frequent entry or change in contribution levels or investment selections in order to comply with those requirements. This change is confusing and may encourage employers to restrict participation and access in a misguided belief that the minimal requirement is mandated by the regulations. Thus, we propose that the regulations be amended to require employers to provide an annual notice, but extend that requirement to each employee's commencement of employment and require that the notice include the information that employees are permitted to begin participation or make changes no less frequently than quarterly.*

3. *The NTSAA is concerned that 1,000 hours per year may cause employers to adopt that precise rule excluding many employees currently eligible to participate. Equating a "1,000 hour per year" definition to conform to the less than 20 hours per week standard will cause many employers to believe that they are not permitted to include employees who normally work less than the stated hour requirement.*
4. *The NTSAA believes that employers should be permitted to exclude members of collective bargain units where retirement benefits were a part of good faith negotiations and employees who have taken a "vow of poverty" as is often seen in religious organizations (whose plans may not be exempted from the nondiscrimination requirements).*
5. *The NTSAA strongly recommends that the relaxed nondiscrimination requirements of Notice 89-23 be incorporated in the regulations when they are issued in final form. The application of the same nondiscrimination rules that apply to qualified plans does not take into consideration the unique needs of 501(c)(3) employers to which the lack of safe harbor protection would be a disincentive to the continued sponsorship of the 403(b) plan. Notice 89-23 has provided customized nondiscrimination requirements which recognize the nature of the tax-exempt employers that are organized for and contribute to the general public welfare. We urge Treasury and the Service to continue to permit those employers to follow a reasonable good faith effort to comply with the nondiscrimination rules as currently provided in Notice 89-23 which permit them to sponsor 403(b) retirement plans without the undue costs and administrative burdens inherent in the qualified plans generally used in the private sector.*
6. *The NTSAA strongly urges Treasury and the Service to eliminate the use of Section 414(s) compensation in the final form of the regulations, and, instead make it clear (as indicated in the statute) that Section 403(b)(3) is the compensation definition to be used for all purposes of 403(b).*

VII. Repeal of Revenue Ruling 90-24

The proposed regulations provide for the repeal of Rev. Rul. 90-24, and the imposition of a limitation on transfers and exchanges *only* to vendors that are authorized under the current employer's "plan," or to the vendors of a new employer if the participant leaves the employment of one employer and begins work for a new 403(b)-eligible employer. The new limitation completely eliminates the ability of 403(b) participants to transfer one 403(b) account to another 403(b) account of a provider that is not part of the employer's 403(b) arrangement, and eliminates the ability for 403(b) participants to transfer the account values after they are no longer working (either retired, or working for an employer that is not eligible to sponsor a 403(b) arrangement).

The NTSAA would like to remind Treasury and the Service that Revenue Ruling 90-24 was issued in February of 1990 because a major provider in the higher education market had contractual restrictions on transfers that the SEC determined did not satisfy the federal securities laws. Rev. Rul. 90-24 came into existence to force certain annuity contract providers to make their products more portable and to permit partial tax-free transfers without affecting the income tax deferral of installment payments "transferred" directly into a new 403(b) account. The compromise of Rev. Rul. 90-24 was that employers could *elect* to impose restrictions on transfers if they chose to do so, but the terms of variable annuity contracts, which are subject to the federal securities regulations, could not. This change, if enacted as part of the final regulations, would severely disadvantage all 403(b) participants, many of whom have begun a series of annual "transfers" established to avoid costly surrender charges and product expenses. Treasury and the Service are also reminded that installment payments over periods of ten years or more are *not* eligible for rollover treatment. Transfers are the only mechanism available to participants seeking to change their investments if distributions are not eligible for direct rollover.

Additionally, the proposed regulations imposition of limited transfer capabilities will have the following adverse effects:

a. *Administrative Burdens for Employers*. Employers will be burdened with the need to respond to queries from employees and providers for information on the status of product providers authorized to receive transfers under the plan. For public education employers, this would probably cause elimination of 403(b) programs as these employers have historically refused to be involved with participants' investment choices. They fear being held responsible for the investment performance of the products and simply refuse to do more than send the salary reduction contributions to the selected product providers and establish compliance practices in a cooperative effort with the providers.
b. *Reduction in Investment Choices*. Employees will be limited to the authorized product providers only, and may not select from other qualified products that might better meet their needs. This is problematic because, in plans not subject to ERISA, the employer has no fiduciary duty to monitor and evaluate investment performance of the authorized products. In such plans, the selection of product providers is usually based on the availability of payroll "slots" and products that satisfy certain criteria based on the number of contracts and participants each respective vendor has. Thus, it would be likely that employees' investment options would be restricted to those product providers that make it more convenient for the employer, such as those that offer common remitting or other services, rather than for the quality or diversity of the product mix. Most employers offering 403(b) programs will not be subject to ERISA requirements that offer participant protection and enforcement rights.
c. *Less Portability for Retirees.* Retired employees will be forced to take distribution and rollover their accounts to IRAs in order to take advantage of investment options that meet changing goals, when, in fact, they might be better served to retain the 403(b) status of their savings, such as qualifying for the exception to the 10% early distribution penalty by retiring after attaining age 55. IRA distributions are not eligible for this exception.
d. *Loss of "Ownership" by Participants*. Employees will no longer be in control of their retirement planning strategies in accounts that were and are intended to be owned and controlled by each. As recent political rhetoric has shifted to promoting an "ownership" society, this action moves in the opposite direction by eliminating personal control and management. (Treasury and the Service are again reminded that the vast majority of 403(b) accounts are individual accounts, not group annuity contracts.)
e. *Significant Expense for Product Providers*. Providers must rebuild their systems to shift from an individual account platform to a structure that will support both

individual account information and plan level information. Typically, 403(b) systems are built upon IRA platforms with all account information tracked by an individual identification number, such as a social security number. Generally, there is no mechanism on these systems to link current employers (or former employers) with individual identification numbers on existing accounts. Without this type of system modification, product providers will be unable to determine plan level transfer restrictions as applied to any individual contract. Of course, the cost of developing and supporting these system modifications will contribute to less attractive product features, increased fees, and/or reduced interest rates.

f. *Impact on Fess and Expenses*. With the provision in the proposed regulations that the account balance after the transfer must be at least as great as it was before the transfer, providers will not be permitted to recover product costs. Therefore, the up front costs of the product will probably increase or the annual fees will increase to support the costs of transfers. In all likelihood, many product providers will simply restrict transfers to the extent that the securities laws permit them to do so!

NTSAA Suggestions for Modifications to the Repeal of Rev. Rul. 90-24

1. *The NTSAA strongly urges Treasury and the Service to incorporate the current guidance contained in Revenue Ruling 90-24 into the final regulations, or alternatively, to leave Revenue Ruling 90-24 intact to provide that guidance.*
2. *We understand that Treasury and the Service have expressed concern about compliance issues relative to tax-free transfers to vendors. However, imposing restrictions at the plan level will not address those compliance concerns. State insurance and federal securities regulations require the issuers of those products to follow the terms of the individual annuity contracts and custodial accounts. Thus concerns should be alleviated with the recognition that the underlying contracts must adhere to the contract's terms relating to transfers, withdrawal restrictions, required minimum distributions, direct rollover rights, proper administration of loans, and the accurate income tax reporting of distributions. We remind Treasury and the Service that most "plan level" compliance issues, such as complying with the contribution limits and universal availability, are not relevant to transfers of 403(b) account values to other vendors.*

VII. Mandatory Timing on the Remittance of Contributions

The NTSAA is pleased to see a requirement in the proposed regulations that addresses the timing of contribution deposits. However, the standard proposed is not set out in terms that permit the employer to know precisely when those contributions should be remitted. Most employers can conform their deposits of collected contributions to specific timing requirements if they know what the requirements are. The NTSAA is concerned that a "reasonable" standard based on facts and circumstances does not provide sufficient guidance for compliance purposes. Employers follow payroll tax withholding deposit requirements and feedback from our members indicates that employers would prefer specific time requirements for depositing 403(b) deferrals.

NTSAA Suggestions for Modifications to the Mandatory Remittance Requirements

1. *The NTSAA urges that Treasury and the Service modify the mandatory remittance requirement to include a fixed maximum time limit. For example, the provisions might read as follows:*

   "Amounts deferred under a section 403(b) arrangement must be transferred to the insurance company issuing the annuity contract, or the entity holding the assets of any custodial or retirement income account within a period that is not longer than is reasonable for the proper administration of the plan, but, in no event later than fifteen business days following the month in which these amounts would otherwise have been paid to the participant."

VIII. Elimination of Life Insurance in 403(b) Arrangements

The proposed regulations anticipate the elimination of life insurance in 403(b) arrangements with a proposed effective date of February 14, 2005. This is problematic since the proposed regulations clearly state that there can be no reliance on them prior to finalization. Additionally, the NTSAA points out to Treasury and the Service that the elimination of life insurance in 403(b) arrangements disadvantages 403(b) when, in fact, life insurance is permitted in both qualified plans and in 457(b) deferred compensation plans. There is no reason, nor is it fair to apply more restrictive rules to 403(b) arrangements than is applied to other types of retirement and deferred compensation plans.

The elimination of life insurance also raises issues for participants who are already funding life insurance in their 403(b) accounts. For example, employers would be required to discontinue payroll privileges for vendors that offer 403(b) qualified life insurance; thus placing participants in the position of losing both the accumulated benefit and the potential death benefit due to the non-payment of premiums. Similarly, employers' plans are not likely to permit transfers to products with life insurance, so employees would have no way to protect their previous investments in life insurance. For some individuals who are no longer "insurable," due to health or medical reasons, their estate planning and financial future would be permanently affected. In addition, it is likely that litigation would arise where participants, who have had their death benefit arbitrarily taken away, meet an untimely death.

It has long been a well established position that life insurance that meets the incidental death benefit requirements is, indeed, permitted in a 403(b) arrangement, and the reversal of that long-established position is not merited.

NTSAA Suggestions Related to the Elimination of Life Insurance for 403(b) Arrangements

1. *The NTSAA respectfully asks that Treasury remove the elimination of life insurance from the final regulations.*
2. *Obviously, if this portion of the regulations is included in the final version of the regulations, the effective date will need to be prospective, not retroactive.*

IX. Counting Years of Service Under the IRC 402(g)(7) Catch Up Option

Years of service in 403(b) arrangements are important only in the application of IRC 402(g)(7) which permits an increased elective deferral limit for certain employees who have achieved 15 or more years of service. That section specifically provides that years of service have the same meaning as years of service as described in IRC 403(b)(4), which provides that "…In determining the number of years of service for purposes of this subsection, there shall be included …one year for each full year during which the individual was a full-time employee,…and "a fraction of a year….for each full year during which such individual was a part-time employee…and for each part of a year during which such individual was a full time or part-time employee…"

1. *Calculation Period.* The proposed regulations provide that the employee's work period, not the taxable year will form the basis of the counting of years of service. As a practical matter, the effort on the part of Treasury and the Service to provide guidance on how to count years of service appears to have missed the mark and might simply create new confusion. The NTSAA believes that years of service are better counted based on the employee's tax year, rather than the "work period."
2. *Determination of 15th Year of Service.* The proposed regulations do not address when an employee has completed the 15th year. Currently, most software vendors and calculation worksheets count years of service through the current tax year. Thus, for example, any individual that achieves the anniversary of the 15th year of service during the tax year has achieved 15 years of service and would be eligible to utilize the increased limit (subject to the other conditions of IRC 402(g)(7). For example, a fulltime employee with a hire date of September 1, 1990 and continuous full-time service would achieve 15 years of service on September 1, 2005 and assuming eligibility based on IRC 402(g)(7) would be eligible to use the increased deferral limit for the 2005 taxable year.
3. *Year in Which Contributions are Considered.* Currently, when calculating whether an individual has contributed, in the past years of service, an average of $5,000 or more in elective deferrals with the current employer, most software and calculation worksheets include contributions made through December 31 of the year *preceding* the affected year. Contributions made in the current year are not counted.
4. *Definition of Health & Welfare Agency.* The NTSAA very much appreciates guidance in defining the meaning of "health and welfare agency" as one of the five groups eligible to utilize the 15 year of service limit under IRC 402(g)(7). However, the NTSAA is concerned that the definition in the regulations is entirely too narrow and eliminates large groups of deserving community services agencies. We believe that the definition should be expanded to include any organization that provides public services that contribute to or promote improved health, prevents or protects against abuse to animals or children, promotes or contributes to the general well being of the elderly, provides aid to the homeless, or aid in the event of extraordinary personal or natural disaster. We recognize this broader definition will include most community services agencies; however, we believe that is the result that Treasury and the Service surely would be seeking in view of the needs that these agencies fill. There would still be some 501(c)(3) employers, such as museums, zoos and symphonies ineligible to use the catch up, however, the NTSAA acknowledges that

those employers, while contributing to the community in which they operate do not provide services that help sustain needy people.

NTSAA Suggestions Related to the Years of Service Calculation

1. *The final regulations should address and affirm that the achievement of 15 years of service at anytime in the affected tax year permits utilization of the increased limit, if the other conditions of IRC 402(g)(7) are satisfied.*
2. *The final regulations should clarify that years of service will be based on the calendar year and not on the annual work period.*
3. *The final regulations should affirm that, for purposes of calculating prior contributions under IRC 402(g)(7), it is appropriate to only consider contributions made prior to the current tax year.*
4. *The final regulations should provide a broader definition in which "a health and welfare agency" is any agency which provides to the general public services that contribute to or promote improved health, prevents or protects against abuse to animals or children, promotes or contributes to the general well being of the elderly, provides aid to the homeless, or aid in the event of extraordinary personal or natural disaster*.

X. The Application of Withdrawal Restrictions to Non-Elective Contributions to Annuities

IRC 403(b)(11) applies pre-59 ½ withdrawal restrictions to salary reduction contributions in Section 403(b)(1) annuities, but not to non-elective contributions, and Section 403(b)(7) applies withdrawal restrictions to the entire value in custodial accounts. The withdrawal restrictions applicable under IRC 403(b)(7) and 403(b)(11) are consistent, which consistency aids in monitoring the restrictions. The proposed regulations would apply a new and different set of withdrawal restrictions to non-elective contributions to annuities which would add yet another standard, and create both systems and product problems for insurers and mutual fund companies (for example, new annuity contractual language would need to be prepared and filed with state regulators and systems would have to be developed to track and monitor the different criteria.) This is problematic because the industry costs of re-registration and redesigning and restructuring systems to support this requirement are significant, particularly when there is no statutory authority for the imposition of withdrawal restrictions on non-elective contributions to annuities.

NTSAA Suggestions Related to Withdrawal Restrictions on Nonelective Contributions to Annuities

1. *The new withdrawal restriction should be eliminated since there is no statutory authority for its implementation and the costs of complying with the requirement would be prohibitive.*
2. *An alternative to the application of withdrawal restrictions that apply a different standard to non-elective contributions to 403(b)(1) annuities would be to simply impose precisely the same restrictions to those contributions as are currently applied to salary reduction contributions under IRC 403(b)(11). This alternative would apply*

consistency to withdrawal restrictions and prevents the systems issues mentioned above.

XI. Significant Omissions In the Proposed Regulations

The NTSAA is concerned that the proposed regulations fail to provide guidance on certain important issues affecting 403(b) arrangements. Final regulations should include guidance on the following:

1. *Post-Employment Contributions.* There is need for guidance regarding IRC 403(b)(3) which permits employers to make non-elective contributions for up to 5 tax years following the tax year in which the affected employee severs employment, particularly relating to the methodology for making such contributions following the death of the participant. The Service has introduced, in public forums, several "concerns" that it has with respect to these post-employment contributions without providing acceptable solutions to the problems raised. Employers and employees are negotiating these contributions into employment contracts and collective bargaining agreements but are uncertain as to whether or not their agreements satisfy the requirements of IRC 403(b) and other applicable tax doctrines. Guidance is necessary or the marketplace will structure its own solutions.

NTSAA Suggestions for Clarifications on Post-Employment Contributions

1. *The NTSAA requests that the final regulations provide that amounts payable into 403(b) accounts following the death of a participant (during the five-year post-employment contribution period) be permitted to be deposited into the 403(b) contract or account of the deceased participant. Since the statute essentially extends the contribution period by five year, the death of the participant need not affect the contract rights to such contributions. The NTSAA suggests that such contractually obligated contributions be permitted to continue into the inherited accounts of the named beneficiaries of the 403(b) account until all promised contributions are completed. This ability provides assurance to employers, collective bargaining groups, employee associations and participants that their beneficiaries will, indeed receive that which had been promised to the participant who dies prior to receiving the entire benefit.*
2. *The NTSAA requests that the final regulations include examples that provide clarity to employers who need assistance in the avoidance of providing a cash option. While it is clearly understood that individual employees cannot be given a choice between the non-elective contributions or cash, employers do need guidance on some specifics with respect to the meaning of "no cash option can be given". The NTSAA suggests that examples include guidance on the employer's ability to exclude certain classes of employees on the receipt of non-elective contributions, and instead, pay those employees a cash benefit, for example an amount based on accumulated leave pay. Examples should provide guidance on whether employers can structure the contributions to be paid to employees with accumulated leave in excess of certain dollar amounts, while the value of other employees leave payments may be minimal and therefore paid as cash. Guidance should also be given on the inclusion of only retirees or employees who have satisfied specific service requirements. Since these*

programs are often used as part of early retirement incentive programs, examples should address common issues related to such incentive programs.

2. *Ownership and Control of 403(b) Accounts Following Retirement.* Previously, problems relating to the issue of shifting control and ownership of 403(b) accounts from participants to the employer were identified. As a reminder, problems related to the written plan requirement, which usurps the long-standing ownership and control of the individual 403(b) accounts by the participant, and problems with the distribution requirements related to plan terminations were addressed. Under current rules and practices, where there is no governing written document, we are not concerned with what happens to a 403(b) account following severance from service. Employees simply depart. Since they own and control their 403(b) accounts, they make their own decisions about their accounts and otherwise manage their retirement savings just as they can do in an IRA. This feature has been one of the most attractive and valued features of a 403(b) arrangement. The NTSAA is concerned about ownership and control of 403(b) accounts following severance from service because the proposed regulations are ambiguous on this issue. If the plan documentation requirement is not eliminated, final regulations must address whether the employer, the contract, or the participant "own and control" the 403(b) arrangements. While the NTSAA is urging that the written plan requirement be eliminated from the final regulations and trusts that compelling arguments have been presented to achieve that elimination, there remains the issue of "what happens once an individual leaves the current employer?"

NTSAA Suggestions for Clarifications on Post-Employment Ownership and Control

1. *The NTSAA suggests clarification that former employees be permitted to request distribution of their individual annuity contract or custodial account from the issuer of the 403(b) contract and that no cash distributions will be mandated under the regulations.*
2. *Further, if the "plan" requirement is not eliminated under the final regulations, NTSAA requests that the regulations provide that following distribution from the "plan," the employee continues to have all the rights of ownership including the rights to take loans, hardship withdrawals and other distributions notwithstanding the terms of any "plan," and to rollover the 403(b) account into another 403(b) account notwithstanding that employee may not have an employment relationship with an eligible employer (such as a retiree).*

XII. Proposed Effective Date Problematical:

The proposed effective date of the regulations is listed as January 1, 2006 for most employers; however, that effective date presents a problem most specifically for the insurance companies and mutual fund companies for which significant systems modifications would be required. Additionally, the new separate account requirements would require product filings with state regulatory authorities that, as previously explained, may or may not be willing to approve annuities that would qualify under Section 403(c) in which certain portions of Section 403(b) amounts are required to be reallocated. Both insurance companies and mutual fund companies would further be required to meet registration and disclosure requirements of securities regulators.

In view of the fact that the proposed regulations cannot be relied upon, and, likely will not be finalized as written, Treasury and the Service cannot expect the companies to begin the lengthy and expensive process of 1) changing computer systems, 2) changing processes and procedures, 3) attempting to develop new separate account vehicles and 4) begin the filing and approval processes, the complexity of which is exacerbated by potential barriers to approval (as previously explained).

The NTSAA, therefore, recommends that the effective date of final regulations not be earlier than the first date of the next full calendar year following finalization of the regulations. Additionally, in recognition of the fact that some of the proposed changes may, indeed, conflict with state statutes, a transition rule will need to be included in the final regulations (perhaps similar to the transition rule contained in Announcement 95-48 in which nondiscrimination rules were not to be applied until 90 days after the opening of the first legislative session taking place after the general effective date of the regulations).

In the case of the approvals required by state insurance departments and securities regulatory authorities, the final regulations should provide that any changes required in current annuity contracts to comply with final regulations be deemed to satisfy the final regulations as long as the contract changes have been filed with regulatory authorities no later than six months after the general effective date of the regulations.

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[1] As specifically permitted under Section 403(b)(1) and 403(b)(7) of the Code and discussed in the Introduction.

[2] Whether the plan consists of a single instrument or multiple documents, the employer cannot satisfy many of the requirements of the proposed regulations, as discussed hereafter.

[3] For example, the requirement that the distributions be made following termination of the "plan."

[4] See DOL Reg. 2510.3-2

[5] See specific provision of DOL Reg. 2510.3-2 that states that all rights under the 403(b) arrangement must be enforceable solely by the employee, his or her beneficiary or any authorized representative of the employee or beneficiary. If the employer can force a "distribution" of a participant's account, then the employee rights under the arrangement are not enforceable solely by the participant.

[6] In plans not subject to ERISA.

[7] This recommendation is particularly true for the K-12 public schools and community colleges that operate under significant budget constraints and are primarily funded through local taxes.

[8] See Prop. Reg. 1.403(b)-3(b)(2) which reads in part…"Thus, the entire contract fails to be a section 403(b) contract if an excess annual addition is made and a separate account is not maintained with respect to the excess."

[9] Refer to Section 404(c) of ERISA which establishes, at a minimum, for qualified plans a requirement that such access be made available no less frequently than quarterly.