

# Navigating Compliance Standards for 403(b) Plans



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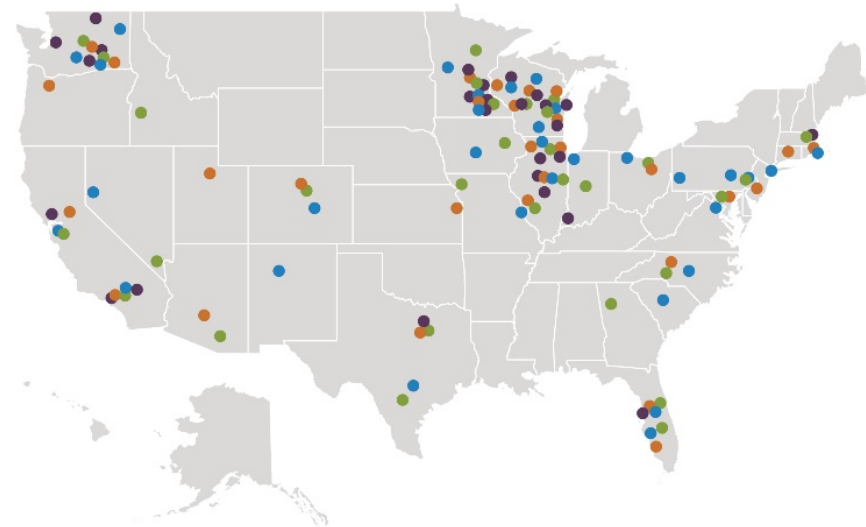
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- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 6,100 employees
- Offices coast to coast
- CLA is *the leading provider* of employee benefit plan audits in the country\*



Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC. \*According to the most recent data from the Department of Labor (2017)



# Learning Objectives

- At the end of this session, you will be able to:
  - Determine if your organization requires an updated 403(b) pre-approved plan document
  - Recognize what you should be doing to maintain your 403(b) plan's compliance
  - Identify if a 401(k) or 403(b) plan is best suited for your organization



# Speaker Introduction

## Denise Falbo

- Director, TPA Operations
- More than 18 years of qualified retirement plan experience
- Leads CLA's national third party administration practice



# What We Will Cover?

- Written Plan Requirement
- Pre-Approved Documents
- ERISA
- 403(b) vs. 401(k)
- Required Participant Notices
- Universal Availability
- Required Testing
- Regulatory Developments



# A Brief History

- 1958–403(b) plans made available to certain Sect. 501(c)(3) organizations
- In 1961, 403(b) plans extended to employees of public education institutions, including colleges and universities.
- Operated similar to a group of IRA's rather than an employer-sponsored retirement plan.
- Since 1974, no longer limited to annuity contracts
- Tax Reform Act of 1986 imposed limits, non-discrimination, and other requirements similar to other qualified retirement plans.



## 403(b) Statistics

- About One in Five U.S. employees are covered by a 403(b) plan
- Approximately one trillion dollars of savings are in 403(b) plans
- Cover approximately 8 million educators and 11 million nonprofit employees in the U.S.
- Approximately 68% of 403(b) retirement plans offer annuities (only 6% of 401(k) plans do)



# Final 403(b) Regulations

Issued July 23, 2007 – first time in 43 years

- Written plan effective no later than January 1, 2009, or plan is not qualified as a 403(b) contract, and:
  - Contributions fully taxable
  - Who is exempt from the written plan requirement?
  - Church plans with custodial or annuity accounts are exempt



# Deadline for Adopting Written Plan Requirement

Per IRS, a 403(b) written plan was timely adopted if the plan sponsor:

- Adopted or amended plan by December 31, 2009 (effective no later than January 1, 2009)
- Operated the plan during 2009 using a reasonable interpretation of the 403(b) final regulations, and
- Made its best efforts to retroactively correct, by the end of 2009, any operational failures occurring in 2009 to conform to the written plan



# Written Plan Requirement

- Must contain terms and conditions for:
  - Eligibility
  - Benefits
  - Limitations
  - Form and timing of distributions
  - Which contracts are available under the plan
  - The party who administers the plan

# Which Contracts Are Excluded from the 403(b) Written Plan Requirement?

- Contracts issued before December 31, 2004 to which contributions have ceased
- Contracts issued between January 1, 2005 and December 31, 2008, if:
  - No longer receiving contributions
  - The employer has made a good faith effort to include as part of the employer's plan by collecting available information about the issuers, and
  - The employer has notified the issuers of the plan administrator's name and contact information to coordinate information necessary to satisfy the requirements of Code Section 403(b)



# Brief Timetable of Events

1. IRS Revenue Procedure 2013-22 established a program for issuing opinion and advisory letters for 403(b) plans
2. Document providers submitted for IRS approval new pre-approved 403(b) plan documents
3. IRS opinion letters, and documents, released in 2017

# IRS Pre-Approved Documents

- Adoption of the prototype document allows employers to retroactively correct defects in form and operation back to the first day of the remedial amendment period!
- When does the remedial amendment period begin?
  - Begins the later of:
    - ◇ January 1, 2010, OR
    - ◇ The plan's effective date



**Deadline for adoption of the prototype documents  
is March 31, 2020**

**IRS Revenue Procedure 2017-18.**



# Impact of Pre-Approved 403(b) Documents



Makes compliance easier

Establishes similar compliance standards

Plans have IRS reliance now, with an IRS advisory or opinion letter

*Previously, 403(b) plans had implicit reliance, but no certainty plan was IRS-qualified.*

# Excerpt from IRS Advisory Letter

*Dear Applicant:*

*In our opinion, the form of the plan identified above is acceptable under section 403(b) of the Internal Revenue Code for use by eligible employers for the benefit of their employees. This opinion relates only to the acceptability of the form of the plan under the Internal Revenue Code. It is not an opinion of the effect of other Federal or local statutes.*

*You must furnish a copy of this letter, a copy of the approved plan, and copies of any subsequent amendments to each eligible employer who adopts this plan.*

*This letter considers the changes contained in the final regulations under Code section 403(b) (sections 1.403(b)-1 through 1.403(b)-11) that were published on July 26, 2007 (72 FR 41128) and the applicable requirements of the 2012 Cumulative List of Changes in Plan Qualification Requirements contained in Notice 2012-76, 2012-62 I.R.B. 775 . . . . .*



# Some Features Available in 403(b) Pre-Approved Documents

- Roth
- Safe harbor features
- Automatic enrollment
- QNEC forfeiture addendum – forfeitures may be used toward safe harbor contributions

*Likely will be required to restate every six years (guidance coming)*



# What If No Written Document Was Ever Adopted Prior to December 31, 2009?

- Submit the document using the IRS Voluntary Correction Program

# Is My Plan Subject to ERISA?

Exempt from ERISA if:

- Governmental plans (state, county, municipality or their agency, schools, or instrumentalities)
- Church plans, unless retirement income account.
- 403(b) elective deferral arrangements sponsored by tax-exempt organizations, if there are NO employer contributions

No audit of plan is required if plan is not subject to ERISA.

# Church Plans - Retirement Income Plans

- Adopted by churches
- Allows retired pastors to take their distributions as housing/rental allowances
- Plan document is required
- Church 403(b) plans with custodial or annuity contracts – no written plan document is required



# Church Plans and Some Other 403(b) Plans May Elect ERISA

- ERISA pre-empts state laws. Lawsuits filed by employees.
- Compliance problems less likely as employer is in control/has oversight, with document guiding.
- Employer is protected from liability for investment losses arising from participant investment decisions, if the plan satisfies ERISA Sect. 404(c) standards for investment diversification, participant transfer rights, and participant financial education.
- ERISA protection from creditors and bankruptcy.

# What is Universal Availability?

- Applies to salary deferral contributions only
- A non-discrimination requirement with respect to elective deferrals (both pre-tax and Roth after-tax)
- Does not apply to church or church-controlled organizations



# Universal Availability: Who May be Excluded Without Violating the Rules?

- Employees eligible to defer under another 403(b) plan of the same employer, or under a 457(b) eligible governmental plan of the employer
- Employees eligible to defer under a 401(k) plan of the employer
- Employees who are non-resident aliens
- Employees whose maximum deferrals would be less than \$200
- Certain employees who are students performing services
- Employees who normally work fewer than 20 hours per week. If one of these employees is allowed to participate, then all must be allowed.
- Once an employee has worked at least 1,000 hours in a 12-month period, that employee may no longer be excluded from plan participation



# Types of Catch-up Contributions and Who May Use These

- **Over Age 50 Catch-Up Contribution:**
  - May be used by any 403(b) plan. Allows participants who reach age 50 in the current calendar year to contribute an additional \$6,000 in 2019 - \$6,500 in 2020.
- **Special Long Service Catch-Up Contribution:**
  - 15 years of service required
  - Allowed if employer is a 'qualified organization'. Available to certain educational organizations, hospitals, health and welfare service agencies, church related or church controlled organizations.
  - \$15,000 lifetime limit above the annual salary deferral limits.



# Minimum Distribution Requirements Apply

- Minimum distributions (RMD's) required by April 1 following the later of:
  - Attainment of age 70-1/2 or
  - Retirement from the organization

# What is Non-Discrimination?

The plan may not discriminate with respect to contributions and benefits, rights and features, in favor of Highly Compensated Employees (HCE).

ACP Test

Coverage Test

Benefits, Rights and Features Test



# Average Contribution Testing (ACP) Requirements in 403(b) Plans

- No testing of salary deferral contributions as in 401(k) plans.
- Employer matching contributions must be tested for non-discrimination unless a safe harbor feature is used.
- Are there Highly Compensated Employees who are eligible for the plan? If no, then no need for testing.
- HCE definition: For 2019 plan year testing, compensation must exceed \$120,000 in lookback year (2018).
- Lookback year is previous 12 months (prior plan year). Non-calendar year plans – limit applies differently



# ACP Testing Basics

- Determine rate of matching contribution for each employee.
- Divide employees between HCE's and NHCE's (non-highly compensated employees).
- Add the match rates for each group and divide by total in that group (average).
- Compare the averages
- In general, the test fails when the HCE average exceeds the average of the NHCE's by a certain threshold.



# SAMPLE ACP TEST

**SAFETY TESTING ORGANIZATION  
ACP NON-DISCRIMINATION TEST  
FOR THE PLAN YEAR 1/1/2019 THROUGH 12/31/2019**

Census Data			Deferrals		Matching Contributions	Matching Contribution %
Name	Earnings	Att Age	\$\$	%	\$\$	%
HIGHLY COMPENSATED EMPLOYEES:						
Chief Tester	\$180,000	49	\$19,000	10.56%	\$9,500	5.28%
Average Contribution Rate:						5.28%
NON-HIGHLY COMPENSATED EMPLOYEES:						
Average Contribution Rate of 7 Non-Highly Compensated Employees:						2.25%

FAIL

Chief tester receives refund of approx. \$1,400 of her matching contributions plus earnings



# ACP Test Failure

- Taxable refunds of matching contributions to the affected Highly Compensated Employees
- May this be rectified?
  - Capping the amount of salary deferrals contributed by Highly Compensated Employees.
  - Prior year testing.



# Benefits and Considerations of Safe Harbor Formula

- ‘Free pass’ on non-discrimination testing of matching contributions. May be advantageous in situations of failed tests and for smaller employers.
- Adopt no later than 30 days prior to start of the next plan year – amendment and notice required
- Contributions are mandatory, and subject to 100% immediate vesting
- No hours requirement may be imposed
- Typical formulas are:
  - 3% non-elective contribution to all eligible employees, or
  - Matching formula (different formulas)
  - Eligibility is a factor



# To (b) or not to (b)?

Which employers may adopt a 403(b) plan?

- Public schools, state colleges and universities.
- Code Section 501(c)(3) tax-exempt organizations
- Churches
- Not all nonprofit organizations may maintain a 403(b) plan – must operate for religious, charitable, scientific, educational, literary, or safety-testing purposes.
- Code Sect. 501(c)(3) organizations may instead adopt a 401(k) plan
- Some schools or governmental employers may have a 401(k) plan in place – allowed if adopted prior to May 6, 1986.



# To (b) or not to (b) – Primary Differences

## 403(b)

- 403(b) plans are not required to test salary deferrals for non-discrimination
- 403(b) plans – must allow immediate eligibility for salary deferrals – ‘Universal Availability’
- No trust for assets
- Most other plan provisions are available in either type of plan
- Both types of plans have bankruptcy protection (403(b)’s since 2007)
- 403(b) plans may not merge with 401(k) plans

## 401k

- 401(k) plans must test salary deferrals for non-discrimination (unless safe harbor feature is used)
- 401(k) plans – eligibility requirements allowed – no more stringent than age 21, one year of service
- Assets held in a trust



# Coverage Testing



# The Concept of Coverage Testing

- Another required non-discrimination test
- Added to tax code in 1942 to expand coverage of rank and file workers in pension & retirement plans.
- Who is benefiting?
- Does plan sufficiently *cover* a significant number of non-highly compensated employees, compared with highly compensated employees who are covered?



# What is Minimum Coverage Under the Ratio Percentage Test?

- The percentage of non-highly compensated employees (NHCE) benefiting under the plan must be at least 70% of the percentage of benefiting highly compensated employees (HCEs).
- If 100% of the HCEs are eligible, then at least 70% of the NHCEs must be eligible for the plan. Only 60%, test fails.
- Deferral portion likely to pass, with immediate eligibility
- Match portion may be more difficult.



# Employee Exclusions

- The plan may exclude certain groups, or classifications, of employees from plan participation (contributions made by the employer)
  - However, if the excluded participants have crossed the eligibility threshold for those contributions, may affect coverage testing
- If coverage testing fails, then additional employees may have to receive employer contributions

# Benefits, Rights & Features Testing

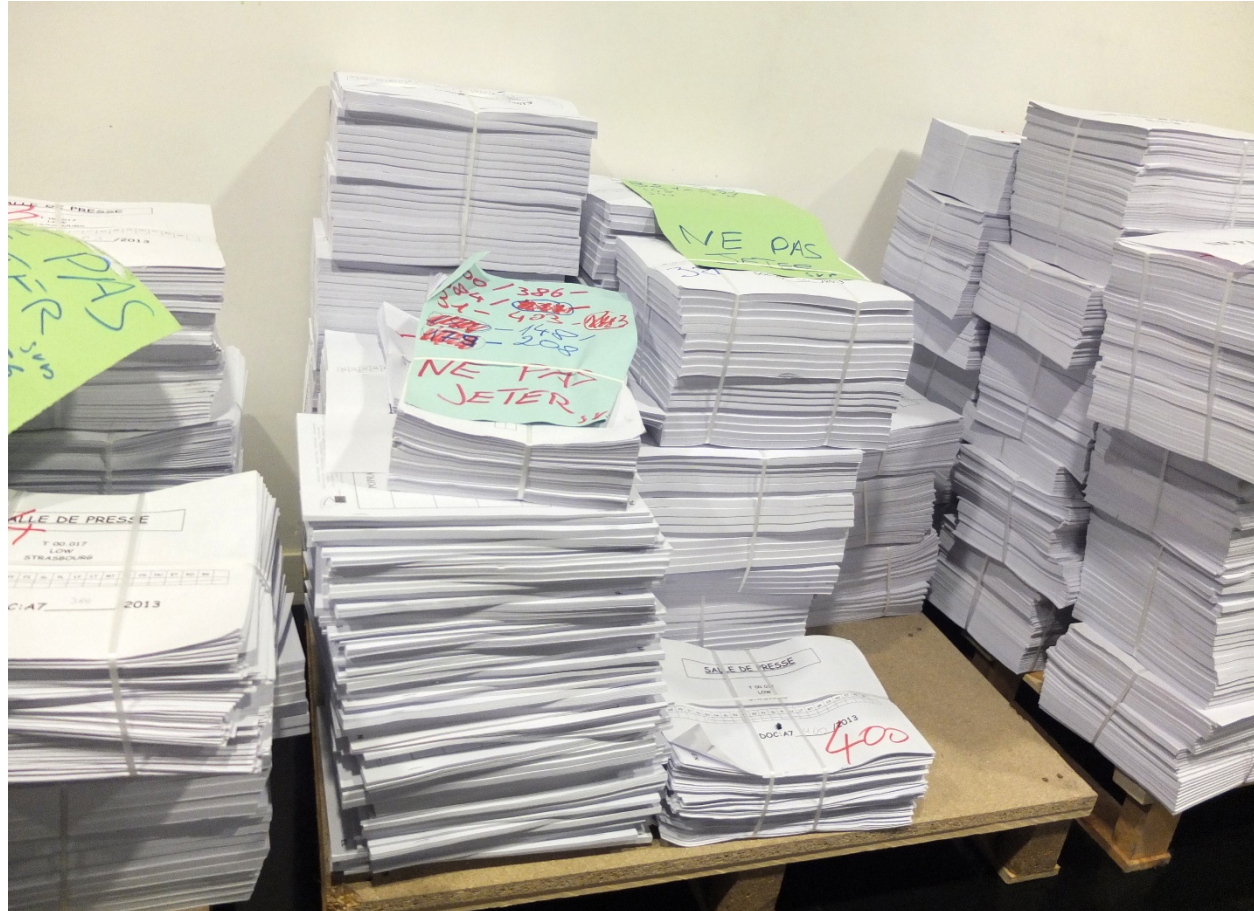
Additional testing may be required if:

- Varying rates of matching contributions based on years of service
- Certain plan provisions only available to certain groups of employees

All benefits, rights and features available to any employee under the plan must be currently and effectively available to all plan participants.



# Annual Notice Requirements



# Required Annual Notices

- Universal availability notice
  - Section 415 notice
  - Participant fee disclosure notice
  - QDIA notice, if applicable
- 
- Due date: 30 days prior to beginning of plan year, and at date of employee's hire. Exception: annual fee disclosure notice

# Rollovers from 403(b) Plans

- May roll over to:
  - Individual Retirement Arrangement (IRA)
  - Roth IRA
  - New employer's 403(b) or 401(k)
  - Or, retain in the 403(b) plan if the asset value is above a certain threshold, in order to retain ERISA protection (if applicable)

# Annual Limits – 2020 Per Individual

Employee salary deferrals	\$ 19,500
Over Age 50 Catch-up Contributions	\$ 6,500
Annual Compensation Cap	\$285,000
Annual Addition Limit	\$ 57,000

# Regulatory Developments

- IRS private letter ruling may allow qualified retirement plans to match student loan repayments
- New IRS self-correction procedure for certain plan loan failures
- Hardship distributions – primary changes: elimination of six-month waiting period and loan requirement



## Action Items

- Does your plan have a written plan document?
- If a document is in place, when was it adopted (effective)?
  - Is it a prototype document with an IRS opinion or advisory letter?
- Does your organization have Highly Compensated Employees?
  - If so, is proper annual non-discrimination testing being conducted?
- Is your 403(b) plan subject to ERISA?



# How Can CLA Help?

- Prototype 403(b) plan document design and preparation – deadline March 31, 2020
- Annual non-discrimination testing
- Compliance reviews
- Review of plan's investments and fee benchmarking (CLA Wealth Advisors)
- Implementation of new student loan benefit when available.
- IRS and DOL audit assistance
- Plan corrections
- Annual ERISA plan audit services





## Questions?

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