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Department of Labor Supplements 403(b) Annuity Plan Guidance for Tax-Exempt Entities: Where Does Your Plan Stand?

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The Department of Labor (the "DOL") recently clarified that tax-exempt entities (such as non-public schools or charitable hospitals) offering 403(b) annuity programs subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") **must** file an Internal Revenue Service Form 5500 Annual Report ("Form 5500") for the 2009 plan year and thereafter. The new guidance, Field Assistance Bulletin (FAB) No. 2010-01 (February 17, 2010), also details which employee annuity contracts must be reported on the Form 5500 and what types of annuity contracts are grandfathered from the reporting requirements.

403(b) Annuity Programs Subject to ERISA Must File a Form 5500

A "403(b) annuity program" is a retirement program governed by Section 403(b) of the Internal Revenue Code of 1986, as amended (the "Code"). DOL regulations provide a "safe harbor" exclusion for 403(b) annuity programs from the definition of a plan under Title I of ERISA (which excludes qualifying programs from almost all plan requirements, including reporting and disclosure). The safe harbor applies to 403(b) annuity programs when the employers have very limited involvement and the benefits are provided through salary-reduction-only contributions and offered by insurers or mutual fund providers directly to employees. Any 403(b) annuity program that meets the safe harbor requirements will not be an ERISA plan and, therefore, will not be required to file a Form 5500.

The new DOL guidance, FAB No. 2010-01, has clarified prior guidance on what makes a 403(b) annuity plan eligible for the safe harbor:

- The employer cannot exercise any discretion in the operation of the program, such as by approving loans or distributions.

- The improper exercise of discretion includes the employer choosing someone else (such as a third-party administrator) to make all the discretionary decisions of day-to-day administration.

- An employer can limit the number of providers to which it will forward employee salary deferrals, even to a sole provider, provided that employees are allowed to transfer withheld funds to another provider, or the employer can demonstrate increased administrative burdens or costs from using a number of providers. The guidance also confirms, however, that a sole provider also must offer a broad range of investment choices.

- An employer cannot unilaterally move investments between annuity contracts or mutual funds.

- Any payment by a provider to the employer, or to another person or entity for the employer's benefit, that is not limited to the actual cost of employer-provided services (such as payroll deductions) is inconsistent with the safe harbor.

403(b) Annuity Contracts Must Be Separately Reported on the Form 5500

FAB No. 2010-01 has made it clear that, effective for the 2009 plan year and thereafter, 403(b) annuity programs subject to ERISA must include financial reporting on Form 5500 for **all** annuity contracts or custodial accounts under the plan. (Small plans, generally with fewer than 100 participants, need only report summary data.)

There is a transition exception for certain "grandfathered annuity contracts." Because administration of 403(b) annuity programs traditionally was handled by the annuity provider, employers were concerned that they may not be able to identify every previously issued 403(b) annuity. To address these concerns, the DOL issued transition guidance FAB No. 2009-02 excluding vested annuity contracts from the Form 5500 reporting requirements if the contracts were issued prior to January 1, 2009, and no further contributions were made. Grandfathered annuity contracts are not required to be reported on Form 5500 (or the audited financial statements) and their owners are not counted for purposes of meeting the small plan exception.

The latest FAB No. 2010-01 provides further guidance on the exception for grandfathered annuity contracts. If an employee wants to exchange an annuity contract for a different annuity contract (for instance, switching from a variable to a fixed-interest annuity), or if an employer is forwarding loan repayments into an annuity contract, the annuity contract will not be a grandfathered annuity contract, even if no new contributions have been made. The DOL did confirm, however, that a contribution made in 2009 attributable to 2008 elections would not cause an annuity contract to lose its grandfathered status.

The new DOL guidance on 403(b) annuity programs reinforces the idea that an employer needs to be very thorough and cautious in determining whether a 403(b) annuity program is subject to ERISA and the Form 5500 reporting requirements.

Furthermore, as separate reporting of 403(b) annuity contracts is required for Form 5500 effective with the 2009 plan year, additional time and resources may be needed to identify all 403(b) annuity contracts and to prepare the requisite Form 5500 filings.

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