

## Department of Labor Issues Additional Guidance on 403(b) Plan Form 5500 Reporting

The U.S. Department of Labor (DOL) has issued its third Field Assistance Bulletin (FAB) regarding issues associated with Internal Revenue Code Section 403(b) retirement plans. Over the last few years, the DOL has issued three Field Assistance Bulletins (FAB 2007-02, FAB 2009-02 and FAB 2010-01) regarding 403(b) Plans.

A Field Assistance Bulletin is not regulatory guidance, so it does not have the authority of a regulation. Nonetheless, a FAB does indicate what the DOL is thinking on a topic. Accordingly, employers and their advisors should take note of these pronouncements, as it is (a) reasonable for employers to take actions and make decisions in reliance on the information provided in the FAB and (b) likely imprudent to ignore the content of these Bulletins.

Historically, 403(b) plans have featured limited employer involvement and maximum participant flexibility. For example, in most 403(b) plans, the individual employee rather than the employer owns the investment contract, and under prior rules had the almost unfettered ability to move or otherwise access the funds in the account. In issuing new regulations, the IRS and DOL have set their sights on bringing some order to what had been a chaotic corner of the retirement plan marketplace. However, in doing so, the IRS and DOL have turned the world upside down for the employers that sponsor these plans. The DOL FABs and other similar post-regulation guidance from the IRS serve to clarify the rules and ease the transition for employers to the new requirements.

The first Bulletin (FAB 2007-02) was in response to the Internal Revenue Service issuing updated income tax regulations with respect to 403(b) Plans. That FAB discussed whether complying with the IRS's new regulations would cause a 403(b) Plan that was otherwise exempt from ERISA (the Employee Retirement Income Security Act of 1974) to become subject to ERISA.

The DOL issued FAB 2009-02 to provide further clarification with respect to its own update to the annual Form 5500 reporting requirements for such plans. These new DOL regulations changed the annual reporting requirements for those Code Section 403(b) plans covered by Title I of ERISA. The final regulations eliminated the special limited reporting for Code Section 403(b) plans, in essence requiring a Code Section 403(b) Plan to file an annual report with substantially the same level of detail as a Code Section 401(k) Plan does.

FAB 2010-01 is in a question and answer format, and mostly speaks to the DOL guidance in FAB 2009-02, although it also addresses a remaining area of concern with respect to FAB 2007-02. The guidance in FAB 2010-01 provides employers as well as employee plan advisors with many favorable answers, though there are many, many issues still in need of further clarification from the DOL.

You can categorize the DOL's advice in FAB 2010-01 into four general groups of questions:

- *Is the plan exempt from ERISA?*
- *Who counts as a participant in the Plan?*
- *When is an annuity contract or custodial account a plan asset for reporting and disclosure purposes?*
- *How does the employer account for plan assets?*

**Note:** All references in this article to Questions (Q) are references to the Questions and Answers in FAB 2010-01.

## ERISA Exemption

To be subject to ERISA, a 403(b) plan must be a plan established or maintained by an employer. ERISA does not define either term; accordingly, the DOL issued a safe-harbor regulation, for plans funded only with employee contributions, regarding how much involvement an employer can have before exceeding the established or maintained threshold. To meet the non-involvement safe-harbor, participation must be completely voluntary, all rights under the contract must be enforceable solely by the employee, the arrangement must limit employer involvement to such tasks as forwarding contributions to the insurer, *etc.*, and the employer must receive no compensation other than reasonable reimbursements for its services.

The IRS regulations called into question whether an employer can meet the requirements of the IRS regulations (*e.g.*, written plan documents) and still not be an employer that has established and maintained an employee plan. The DOL issued FAB 2007-02 in response to that issue, yet questions remained.

FAB 2010-1 provides further clarification that a plan can be ERISA exempt if it provides for loans, hardship distributions, *etc.*, provided that the investment vendor or other third party makes the determinations as to the employee's eligibility to use the feature (Q14). The same question also indicates that an employer can eliminate such loan and distribution provisions if to maintain the provisions would require it to make determinations that, while consistent with the IRS regulations, exceed the no discretionary decisions aspect of the DOL employer non-involvement safe-harbor. However, one disappointing answer is that FAB 2010-01 also makes it clear that the employer cannot hire a third-party administrator to make those determinations (Q15). The rationale (which seems reasonable) is that the hiring of an independent administrator is in itself a sufficient act of employer involvement for the plan not to qualify for the non-involvement exemption.

Another area of concern that FAB 2010-01 addresses is whether employers can limit the choice of vendors to an administratively feasible number (even one vendor). This has been an area of confusion ever since the DOL issued the original employer non-involvement exemption, and FAB 2010-01 does not entirely resolve the issue. FAB 2010-01 does recognize that it may be difficult for a small employer to maintain a plan with multiple investment vendors. In this regard, FAB 2010-01 requires the

employer to make a determination, based on its facts and circumstances, that the costs of maintaining an open investment vendor program justify the employer opting for a single investment vendor solution (Q16). One very interesting comment in Q 16 is that the DOL may consider a decision to use a single vendor that offers an open architecture mutual fund arrangement to be permissible. Unfortunately, while the wording of FAB 2010-01 does provide helpful hints on this issue it does not ultimately provide the clear bright line employers are seeking. As a result, the obligation for making the decision as to whether an arrangement qualifies for the employer non-involvement exemption remains entirely with the employer.

On a much more positive note, FAB 2010-01 provides that an employer may stop sending future deposits to vendors who do not comply with applicable IRS regulations (Q17). However, even in that case, the employer cannot unilaterally move accounts from one provider to another (Q18).

## Participant Count

If the plan is an ERISA plan, then determining the number of participants is critical in the preparation of an accurate Form 5500 Annual Report and in the determination of whether the annual report is for a large plan (generally 100 or more participants) that must include as an attachment an audited financial statement. FAB 2009-02 seemed to say that an employer did not have to count as participants those employees or former employees who are not currently eligible to make salary deferrals to the plan provided any account they have related to the plan met the following criteria:

1. The contract or account was issued to a current or former employee before January 1, 2009;
2. The employer ceased to have any obligation to make contributions (including employee salary-reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009;
3. All of the rights and benefits under the contract or account are legally enforceable by the individual owner of the contract or account without any involvement by the employer; and
4. The individual contract owner has a 100% nonforfeitable (vested) interest in the contract.

In FAB 2010-01, the DOL affirmed that this relief applies beyond the 2009 plan year (Q11) and that a final contribution in 2009 for the 2008 plan year would not cause the plan to fail to meet the requirements of condition 2 above (Q13). However, FAB 2010-01 also clarified that if the employer were to continue to forward loan payments, then the employer would have to count the employee as a participant and include the contract as a plan asset (Q2).

### Plan Assets

The individual nature of most 403(b) plans makes the question of what is and what is not a plan asset extremely problematic. FAB 2009-02 certainly helped with the exclusion of contracts that meet the four conditions identified above. However, many questions remain, and the DOL used FAB 2010-01 to provide employers with additional guidance - some good, some bad, and some ugly:

#### *The Good*

- Contracts that meet the exclusion under FAB 2009-02 are not plan assets for purposes of ERISA's reporting and disclosure requirements (Q6). However, the DOL made no comment as to what fiduciary standards may apply to these contracts.
- With respect to contracts that meet the FAB 2009-02 exclusions, if an employer provides the insurer or mutual fund with information about the contract owner's employment status with the employer, that will not make the contract a part of the plan for 2009 and later years (Q1).
- If a contract does not meet the FAB 2009-02 exclusion standard, the DOL recognizes that information on some contracts will not be obtainable. FAB 2010-01 indicates that a plan's annual report will not be deficient if the plan sponsor has made a good faith effort to obtain the information (Q12). An item to note is the potential for a plan administrator to be personally liable for the expenses necessary to recreate missing records.
- The employer can exclude a contract that meets the FAB 2009-02 exclusion requirements even if the employer has the ability to report on the contract; essentially the employer is able to choose which contracts to include or exclude under FAB 2009-02 (Q3 and Q4).
- The relief in FAB 2009-02 applies to both large and small plans (Q5).

#### *The Bad*

- As mentioned above, if an employer forwards a loan repayment to a contract, that contract no longer meets the exclusion provided in FAB 2009-02 (Q2).

#### *The Ugly*

- If the employer authorizes the exchange of an old contract excluded under FAB 2009-02, the new contract and the old contract become plan assets. In this case, even though the employer is merely completing a ministerial act, that act is enough to lose the FAB 2009-02 exemption with respect to such contract (Q10).

### Financial Reporting

FAB 2010-01 does not relieve the tension between plan auditors, 403(b) plan advisors, and plan sponsors. Field Assistance Bulletins are still simply enforcement guidance. Thus, they do not have the force of regulation to eliminate the qualifying contracts from the definition of plan assets. The plan auditor still faces the issue of possibly being unable to audit the *entire* plan as that plan would be defined in accordance with accounting principles generally accepted in the United States (GAAP). The plan sponsor's decision to exclude some or all of the contracts and accounts in reliance on these DOL non-enforcement positions presents a potential material departure from GAAP with respect to the plan's financial statements. Further, the plan sponsor's decision to exclude some or all of the contracts and accounts potentially creates a limitation on the scope of the audit sufficient to preclude the plan auditor from issuing an opinion on the plan's financial statements. This means that the plan auditor is likely to issue a modified opinion on the plan's financial statements or possibly totally disclaim an opinion on the plan's financial statements. FAB 2010-01 continues to provide comfort that such opinions (or disclaimers of opinion) will not result in rejection of the Form 5500 filing. It further recognizes that these modified opinions or disclaimers of opinion may apply for many years (Q11).

FAB 2010-01 also raises a new issue with respect to the auditor's duties with respect to this transition program, which requires plan auditors to bring to the plan administrator's attention any questions that the auditor may have with respect to the administrator's determination as to which contracts are excludable (Q7).

## Conclusion

As plan sponsors accumulate the documents supporting their books and records with respect to this new filing requirement, careful consideration should be applied to their future expectations with respect to contracts that they are considering excluding under the provision of FAB 2009-02. Are there circumstances such as participant loan programs or contract exchange programs where contracts currently excludable contracts could lose that exclusion? If yes, would it be more cost effective to include those contracts at this time, rather than having to accumulate the relevant reporting data in a later year? Alternatively, should the employer revise the plan so that such transactions cannot occur?

For detailed information see:

<http://www.dol.gov/DOL/regs/fab2007-2.html>

<http://www.dol.gov/DOL/regs/fab2009-2.html>

<http://www.dol.gov/DOL/regs/fab2010-1.html>

Contact your McGladrey & Pullen/RSM McGladrey Retirement Resources client service representative with additional questions on these matters.