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ADVISORS

# TechUpdate

## Special Edition

## IMPORTANT INFORMATION REGARDING YOUR 403(b) PLAN!!

**PLEASE READ IMMEDIATELY!**

**September, 2007**

NFP: Vol. 43

Dear 403(b) Plan Sponsor:

As you know, the Internal Revenue Service ("IRS") released final 403(b) regulations on July 23, 2007 (see Diversified's August 2007 *TechUpdate*, Volume 42). While the regulations are generally not effective until taxable years beginning in 2009, the new rules regarding contract exchanges are effective for all 403(b) plans beginning on September 25, 2007.

### **Restrictions on Transfers**

On or prior to the September 24, 2007 cut-off date contained in the final regulations and in accordance with IRS Revenue Ruling ("Rev. Rul.") 90-24, a participant's 403(b) account is eligible for a direct transfer to another 403(b) contract provided that the benefit was not reduced and the transferee contract imposed restrictions on distributions no less stringent than those imposed by the transferor contract. 403(b) account transfers are not considered distributions and may be made while still working for the employer and prior to a distributable event, such as severance from employment.

In general, the rules applicable to post-September 24, 2007 403(b) contract exchanges will be subject to more stringent requirements under the final regulations.

### **403(b) Contract Exchanges Within the Same Plan (effective September 25, 2007)**

Under the final regulations, participants may transfer (or exchange) their account balance from one 403(b) contract to another 403(b) contract ( e.g., group annuity contract or custodial 403(b)(7) mutual fund agreement) **within the**

**same 403(b) plan** if after the exchange, the accumulated benefit transferred is at least equal to the amount of the benefit prior to the exchange, the receiving contract has the same or greater distribution restrictions as the transferring contract and the plan under which the contract is issued provides for the exchange.

The final regulations also require that the employer enter into an information sharing agreement with the issuer of the receiving contract to share information (on an ongoing basis), including whether benefit limits, severance of employment, loans, hardship and required minimum distribution rules are met. This requirement applies to contract exchanges that occur after **September 24, 2007**. [Contract exchanges made prior to September 25, 2007 are grandfathered and therefore, do not need to satisfy the new requirements.] Contract exchanges not made in accordance with these new provisions can become fully taxable to the participant beginning on January 1, 2009.

The purpose of the information sharing agreement is to enable the 403(b) employer (or another designated party) to monitor the IRS requirements (such as those referenced

above) that continue to be applicable to any transferred plan assets. The IRS has stated that the information sharing agreements are not required to be in place until January 1, 2009 (i.e., signed no later than December 31, 2008).

It is our current understanding from comments made by a key IRS representative that, under the final regulations, approved service providers do not have to enter into formal information sharing agreements. Service providers who are receiving payroll-based ongoing contributions for the employer's 403(b) program are considered approved plan service providers. Existing agreements of approved service providers such as 403(b) group annuity contracts, 403(b)(7) custodial agreements, vendor service agreements, documentation to the employer concerning participant transactions, etc., can be viewed as satisfying the general concept of an information sharing agreement for purposes of any exchanges completed on or after September 25, 2007. Employers should not allow contract exchanges to providers who are **not** receiving payroll-based ongoing contributions unless the receiving provider will agree to timely sign an information sharing agreement. Employers who permit contract exchanges to 403(b) providers that do not receive ongoing plan contributions, may make it more difficult for themselves to ensure that the transferred plan assets meet the requirements of the IRS at a plan-level (many of the IRS rules require an aggregation of all of the individual participant account balances associated with the employer's 403(b) plan).

## **Employer Actions (*what should I do now to comply with the post- September 24, 2007 403(b) contract exchange rules?*)**

- Identify the 403(b) plans/program(s) your organization currently sponsors.
- For each separate 403(b) program, create a list of all approved service providers (service providers that currently receive payroll-based ongoing contributions).
- If you strictly limit post 9/24/07 exchanges to only the list of approved service providers, the immediate need for a formal information sharing agreement document from each approved provider may be reduced or eliminated.
- If you currently permit Rev. Rul. 90-24 transfers to any "outside" providers (those that do not currently receive ongoing plan contributions), and decide to allow post 9/24/07 exchanges to such providers (proceed with caution), you should contact these providers and obtain a commitment from each such provider that they will have a signed information sharing agreement in place with you no later than December 31, 2008. Note: Employers that sponsor ERISA-covered 403(b) plans have a fiduciary obligation to oversee ERISA plan assets; thus, participants cannot transfer ERISA plan assets to any providers other than the service provider(s) approved for the exchange by the employer for the ERISA-covered 403(b) plan.
- Once the 403(b) service providers that will be permitted to receive post 9/24/07 exchanges have been identified, a list of all such providers should be communicated to all of your employees currently eligible to participate in your 403(b) program. This communication should briefly explain the new IRS requirements for contract exchanges and should identify the service providers who are eligible to receive contract exchanges for your 403(b) program. Your employees should be instructed to initiate future contract exchanges only to the service providers on that list. (Diversified has included a sample employee communication. See enclosed Attachment A). The same communication should be provided to all new employees who are eligible to participate in the 403(b) plan.
- The list of service providers eligible to receive post 9/24/07 contract exchanges (either because they are receiving payroll-based ongoing contributions for your 403(b) program or because you have entered into an information sharing agreement with them) should be sent to every service provider on the list in order to (1) notify them that they are permitted to accept post 9/24/07 exchanges from participants in your 403(b) program; and (2) instruct them to transfer participant 403(b) assets as a post 9/24/07 contract exchange **only** to another service provider that appears on the list of eligible service providers.
- Service providers that were previously associated with, or are holding assets relating to your 403(b) program, who will **not** be permitted to receive post 9/24/07 exchanges, should be notified that they should not accept any post 9/24/07 exchanges from your participants. Furthermore, these providers should be instructed to transfer 403(b) assets (as a post 9/24/07 contract exchange) **only** to service providers that appear on the list of eligible service providers (this list should be sent to the service providers).

## Diversified Actions

Diversified will honor any requests to process contract exchanges (to Diversified as well as to other service providers) in accordance with instructions we receive from you with respect to your 403(b) plan(s). Diversified will continue to accept contract exchanges for the 403(b) plans for which we are an approved service provider. Diversified will process contract exchange requests only to service providers eligible to receive contract exchanges for your 403(b) plan. If we do not receive a list of your 403(b) plan's authorized service providers, Diversified will ask the receiving provider if they are an authorized service provider of your 403(b) plan before we process the contract exchange.

## Diversified Commentary

**ERISA-covered 403(b) employers (and employers who sponsor church or governmental 403(b) plans):** if you currently permit ongoing plan contributions to multiple 403(b) service providers, you should consider revising your existing agreements, if possible, so as to send all future 403(b) contributions to one exclusive provider. Utilizing one provider for your 403(b) program (and to the degree possible, consolidating all 403(b) assets with that one provider) will significantly enhance your ability to monitor and manage (at the plan-level) the IRS' 403(b) rules previously alluded to in this communication.

**Non-ERISA employers who rely on the Department of Labor's ("DOL") safe harbor regulation [Treas. Reg. 2510.3-2(f)] for salary deferral-only 403(b) programs:** consider reducing the number of 403(b) providers who currently receive 403(b) contributions for your plan. Also, consider limiting the providers who will be permitted to receive

post 9/24/07 contract exchanges to your list of approved service providers (only those who currently receive ongoing contributions). Restricting the number of providers who receive ongoing contributions and contract exchanges will put you in a stronger position to ensure compliance (at the plan-level) with the IRS 403(b) rules discussed in this communication.

Any decision made to submit 403(b) contributions to a sole provider should be discussed in advance with your legal and/or tax advisor, to insure that he or she believes such action will not cause you to fall outside the protection of the DOL safe harbor regulation for non-ERISA-covered 403(b) programs contained at Treas. Reg. section 2510.3-2(f).

## Conclusion

We recognize that these new rules for 403(b) contract exchanges are complicated and the IRS has not allocated a great deal of time to interpret the new rules, make considered choices and put the necessary new processes in place. If you would like to discuss these new rules in more detail or have additional questions, please don't hesitate to contact your Diversified Representative.

Note: The information provided in this memo is intended to provide you with information regarding current regulatory developments affecting your 403(b) plan/program. It is not intended as legal advice, since Diversified Investment Advisors is prohibited from giving legal advice outside the Company. A Plan Sponsor should consult its own legal counsel about the application of any law or regulation discussed herein to its 403(b) plan/program.

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