Issue Brief

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REQUIREMENTS OF THE 403(B) REGULATIONS FOR PUBLIC SCHOOLS

Overview

A 403(b) plan is a type of retirement plan that allows employees to save their own money on a tax favored basis. Employees can make independent decisions as to how much they want withheld from each paycheck and contributed to the plan. In most cases, employees can change their contribution amount during the year to go higher or lower as their needs dictate. Employers can also make non-elective contributions to 403(b) plans on behalf of their workers.

The Department of Treasury and Internal Revenue Service issued long awaited regulations that formalized the way in which 403(b) plans must be administered. Although the regulations generally became effective in 2009, many plan sponsors are still addressing the issues they raised.

Key Requirements of the 403(b) Regulations

The 403(b) regulations made a number of significant changes to the way in which public school 403(b) plans are operated, including:

- ***Written Plan Document*** **-** The regulations require 403(b) plans to have a written plan document that describes all of the material provisions of the plan, including eligibility, vesting, contributions, distributions, etc.
- ***Administering the Plan*** **-** Plan sponsors must operate their plans in accordance with their plan documents and the applicable law. They can contract with service providers to help them with their administrative and compliance duties.
- ***Transferring Assets*** **-** Participants previously could transfer their account or contract with an "approved" vendor to any other vendor without the school's involvement. Under the regulations, transfers are only permitted if the plan document allows them, the participant's benefit is not reduced, the distribution restrictions under the new account or contract are at least as stringent as those under the old account or contract, and the school and the vendor enter into an information sharing agreement.
- ***Loans and Hardship Withdrawals*** **-** The regulations provide that 403(b) plans must follow the same rules for loans and hardship distributions that apply to 401(k) plans. For example, hardship withdrawals can only be made if the employer certifies that there is a financial hardship and loans cannot exceed certain limits.
- ***Distributions*** **-** Restrictions apply as to when employer contributions can be distributed. Common distributable events include termination of employment and if the plan provides, after a stated age or upon disability.

403(b) Regulations Do Not Require Plans to Reduce the Number of Investment Providers

Although the regulations require public schools to have a written plan document and accurately administer their plans, they do not require a reduction in the number of the plans' investment providers. Under the 403(b) regulations, public schools will need to make sure they coordinate with investment providers to make sure that the plan is being operated properly.

Before eliminating investment providers, public schools will want to carefully consider recently published research that found that participation in 403(b) plans declined significantly when the number of investment providers was reduced.[1] The research found reductions in participation by school district employees of over 50% in Southern California and Colorado and nearly 40% in Pennsylvania.

For example, many schools decide to hire third party administrators (TPAs) to help them comply with the regulations and coordinate information with their investment providers.

Conclusion

Although the 403(b) regulations initially brought about significant changes for plans, most public schools have been operating under the regulations for several years now. While there remain some unresolved issues, the majority of public schools have adjusted to the changes brought about by the regulations. Schools that want help with the regulations may want to consider hiring a TPA to assist them.

1 Debra Davis, Geralyn Miller, and Judy Miller, *Protecting Participation: The Impact of Reduced Choice on Participation by School District Employees in 403(b) Plans,* ASPPA Pension Education and Research Foundation, available at http://savemy403b.org/wp-content/uploads/2011/10/ASPPAWhitePaper-ProtectingParticipation.pdf.