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The Impact of New 403(b) Regulations

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Most are already aware of the final Internal Revenue Service regulations as they relate to 403(b) retirement plans, particularly the significant increase in plan oversight. Fortunately, for some unprepared plan sponsors, the IRS delayed the implementation of certain requirements of the final 403(b) regulations that were otherwise effective as of January 1, 2009 until as late as December 31, 2009.

The 403(b) Marketplace Today

The new regulations bring a unique opportunity for not-for-profit employers to dramatically improve the quality and cost of their 403(b) plan. As of 2006, approximately 80% of the \$652 billion held in 403(b) plans was housed in high-fee insurance-based annuity products. Of this amount, 34% was invested in variable annuity products (source: 403bwise.com). According to the Variable Annuity Research Data Service and Morningstar, Inc., the average variable annuity expense is 2.27%, whereas the average managed mutual fund charged 1.08%. If an employee were to contribute \$250 a month for 35 years and earn an annualized rate of return of 8%, the average variable annuity would grow to only \$334,787 while the managed mutual fund would grow to \$441,774, a difference of almost \$107,000. This is just one example of why we see the legacy annuity-based structures giving way to a mutual fund-based structure common within the 401(k) landscape.

Impact of New Regulations on Plan Sponsors

Employers will be required to become intimately involved in the oversight of their 403(b) program as a result of the new regulations because with greater fiduciary responsibilities comes the possibility for greater liability. First, if one isn't already in place, a written plan document that spells out the rules of the Plan must be created and adopted by December 31st, 2009. We would also suggest implementing an Investment Policy Statement with guidelines for evaluating plan investment options, monitoring plan expenses and reviewing employee education practices. Second, there must be notification of universal availability. All employees must be regularly notified of their ability to participate in the Plan. Third, plan sponsors must coordinate compliance with all IRS limitations, including contribution limits, loans, distributions and salary deferral among all providers. Plan sponsors will also need to designate specific providers and products as participant transfers will only be allowed between these approved vendors and vehicles.

Plan Sponsor Action Items

Written plan documentation is foremost among the new 403(b) plan regulations. Naturally, once written terms are in place, the adherence of these terms is of equal importance. But if a Plan currently utilizes multiple providers with numerous and varying investment options, this predicts to be an overwhelming task.

Consider the following action items to add structure to the process:

- Take inventory of your current providers. For each, determine what products and services are being offered, assess investment performance and also what fees and penalties are in place.
- Create a benefits committee consisting of human resource, treasury and management personnel to review the current Plan and also design an optimal future plan.
- Consider scaling down to a single provider. With most of today's providers offering "open architecture" and greater investment flexibility, Plans that adopt a single bundled provider significantly decrease their administrative and compliance burden while using the combined asset values as leverage to reduce costs.
- Assess the current employee education program. The universal availability notifications will increase employee awareness of the 403(b) program. This will only add to the need to provide robust participant education materials and meetings.

Establish a formal process to review the Plan's investment options. This includes creating an Investment Policy Statement to outline the procedures in place for selecting, monitoring and evaluating investment options as well as creating an investment committee to regularly review investment performance, plan expenses and employee education.

The Ultimate Goal

As a plan sponsor, the new IRS guidelines will require more involvement in maintaining the organization's 403(b) plan. However, we encourage all employers to embrace the change for the long-term benefit of the organization and most importantly the Plan participants. When followed, the regulatory changes provide greater control over all aspects of the Plan and offer better protection to your employees by maintaining a fully compliant 403(b) plan. In an era where employees are being asked to make their own investment decisions, this is another step towards improving participants' ability to retire comfortably.

For more information on this subject please contact Jim at jjensen@dimeoschneider.com.