At Last, Clarity—DOL Q&A on 403(b) 5500 Rules and Bonus Guidance on Non-ERISA Safe Harbor

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On February 17, 2010, the Department of Labor issued Field Assistance Bulletin (“FAB”) 2010-01 http://www.dol.gov/ebsha/regs/fab2010-1.html, which may be one of the most important pieces of guidance the DOL has issued with respect to 403(b) plans. The guidance, in the form of a user-friendly Q&A format, provides not only important information regarding the applicability of the new 5500 annual reporting and audit rules to 403(b) plans, but also clarifies the 30+ year old guidance that some private tax-exempts utilize to avoid ERISA coverage for their 403(b) plans (29 CFR 2510.3-2(f)). (ASPPA and NTSAA-ASPPA filed comment letters, and engaged in discussions with DOL officials, and appreciates that the FAB addresses some of the major concerns raised in those letters and discussions.) The key issues addressed in the Q&A are discussed below.

Assets that are Included/Excluded in the 5500 Annual Report/Plan Audit

Last year, the DOL issued FAB 2009-02 (see ASPPA asap 09-27), which exempted certain fully vested 403(b) contracts to which contributions ceased prior to January 1, 2009, from the 5500 financial reporting and audit requirements for 2009. The guidance was important in that information for these types of contracts, primarily contracts owned by individuals as opposed to the employer, was often difficult or impossible for the plan sponsor to obtain. However, the guidance was unclear in many aspects; it was silent as to how common transactions such as loans and exchanges would affect the exemption, and defined an exempt contract as an agreement under which all rights of the contract were legally enforceable against the investment provider only by the individual owner of the contract. This provision implied that any employer action taken to enforce the provisions of the contract, no matter how minor, might eliminate the contract exemption from 5500 reporting/audit, an undesirable outcome.

Fortunately, the FAB clarified that not every employer enforcement action will eliminate the exemption. For example, if the employer simply provides information with regard to employment status to an investment provider so that an employment termination distribution can be processed, a contract that otherwise satisfies the FAB 2009-02 exemption will not fail to satisfy the exemption due to this employer action. Though not specifically stated in the FAB, employers who provide additional information sharing to a vendor, at the request of a vendor, in order to enforce the provisions of a contract (such as loans/account balances with other investment
providers), would presumably not be disqualifying affected contracts from the FAB 2009-02 exemption.

The DOL also clarified that loans and contract exchanges can, and do, affect the FAB 2009-02 exemption. Payroll deduction loan repayments give the employer an “ongoing role” and invalidates the exemption, and such contracts, and related participants, if not otherwise reported, would now be reportable for 5500 and audit purposes. Coupon or ACH deduction repayments directly paid to the investment providers, however, do NOT invalidate the exemption, and contracts exempt under FAB 2009-02 would remain exempt from the 5500 and audit requirements. In addition, contract exchanges that require employer approval remove such contracts from the FAB 2009-02 exemption.

Under the new FAB, the exemption is NOT an “all or nothing” contract exemption; the employer can pick and choose among contracts that qualify for the exemption as to which contracts they wish to report as plan assets in the 5500/audit. This guidance is especially welcome where exempt and non-exempt contracts exist at the same investment provider. In addition, the DOL clarified that the ability to locate and identify a contract is not a barrier to the FAB 2009-02 exemption (some practitioners assumed that the FAB only applied to contracts that could not be identified or located), and stated that the exemption applied to both large and small plans (and, indeed, in the determination of the number of participants in ascertaining whether a plan is large or small). Finally the DOL formally extended the exemption beyond the 2009 plan year, and clarified that the exemption applied to otherwise exempt contracts where 2008 contributions were actually deposited in 2009.

Addressing Audit Firm Concerns with the FAB 2009-02 exemption

Many accounting firms that perform plan audits expressed almost immediate concern with FAB 2009-02 when it was issued, since exclusion of plan assets in the manner that the DOL/EBSA described was inconsistent with generally accepted accounting principles. In addition, in many situations, the employer is unable to even obtain a copy of a contract that might qualify for the plan asset exemption, never mind determine whether a contract qualifies for the exemption. Thus, many auditors were uncomfortable with the exemption to the extent that the issuance of adverse or disclaimed opinions appeared to be likely where such contracts are involved.

To address these concerns, the DOL provided several points of clarification regarding audit opinions in relation to such contracts, as follows:

1. The DOL stated unequivocally that contracts exempt under FAB 2009-02 MAY BE COMPLETELY DISREGARDED for 5500 and plan audit purposes. If the auditor disagrees, and a qualified, adverse or disclaimed opinion is issued solely due to the fact that exempt contracts were not included in the plan audit/financial statements, the DOL will NOT reject a filing (as they normally would) due to this opinion.

2. The DOL clarified that exempt contract assets should specifically NOT be reported on the Schedule of Assets Held for Investment nor the Schedule of Reportable Transactions on Schedule H for large plans, addressing specific accounting concerns.
3. The DOL appears to anticipate that there will be disagreements between auditors and plan sponsors as to whether contracts qualify for the exemption under FAB 2009-02. Though stopping short of stating that accounting firms would be required to audit contracts to determine whether such contracts are exempt, the DOL states that audit firms should alert the plan administrator if they believe that contracts have been improperly excluded from plan assets based on the exemption and should note any disagreements between plan sponsor and auditor in this area in the audit report. As an aside, best practice would dictate that all contracts/custodial agreements that can be obtained should be reviewed by counsel with specific 403(b) plan expertise in order to determine treatment under FAB 2009-02.

This guidance should provide audit firms with a comfort level when they approach contracts that are potentially excludable from plan assets for 5500 reporting and audit purposes.

An Added Bonus: Guidance on the Safe Harbor Exemption from ERISA for Certain Tax-Exempt 403(b) plans

The DOL also provided extremely welcome clarity to 29 CFR 2510.3-2(f), the regulation addressing an exemption from ERISA for private 501(c)(3) tax-exempt employers who make available elective-deferral only plans where employer involvement is minimal. (It should be noted that governmental plans and the vast majority of church plans are exempt from ERISA regardless of employer involvement.) The original regulation was issued in 1979 and there has been little in the way of formal guidance issued to clarify what was intended in the intervening 30 years. FAB 2007-02, which was designed to assist plan sponsors in determining whether their plans could remain exempt from ERISA in light of the final 403(b) regulations issued by the IRS, created as many questions as it answered, resulting in frustration for plan sponsors who wish to fit within the exemption.

The DOL has provided some answers in the current FAB, by providing concrete examples of exactly what actions are prohibited under the non-ERISA safe harbor. For example, limiting the number of investment contractors/providers to a single vendor, would generally subject a plan to ERISA. The FAB acknowledges “…that the cost of permitting employees to make contributions through payroll deductions may be significantly affected by the number of providers to which the employer must remit contributions. This may be particularly significant for small employers…” The FAB goes on to say that consistent with the safe harbor, one provider may be sufficient “…if employees are permitted to transfer or exchange, in accordance with IRS regulations, their interest to a 403(b) account of another provider.” In addition, the FAB provides that in certain circumstances, allowing only a single investment contractor/provider may be consistent with the exemption if the employer can demonstrate that the cost and complexity of adding additional contractors/providers “would be sufficient to cause the employer to stop making its payroll system available to collect and remit payroll deduction contributions to any 403(b) contractor.” In such cases, the FAB suggests a single contractor with a wide variety of investment offerings (such as an “open architecture” custodial platform or a single insurance company’s variable annuity) may be sufficient to maintain the exemption. Another example in the FAB states that hiring a TPA to make discretionary...
decisions regarding plan transactions (e.g. loans or hardship distributions), would also disqualify a plan from the safe harbor and subject such a plan to ERISA. It is noted however, that under the documents governing the arrangement, discretionary decisions can be allocated to an identified product provider “or other responsible third party selected by a person other than the employer”. Employer-directed movement of account balances from one investment provider to another would also subject a plan to ERISA coverage.

The DOL, however, also appears to be sensitive in FAB 2010-01 to plan sponsor concerns about complying with the IRS’ final 403(b) regulations, yet remaining in compliance with the safe harbor. To that end, the DOL will permit employers to ban problematic transactions such as loans and hardship distributions from vendor contracts without subjecting the plan to ERISA. In addition, if transactions such as loans and hardships are permitted, the employer may limit vendor selection to those who are bound by contract to make discretionary determinations with respect to such transactions. As a result, an employer is essentially permitted to remove vendors who do not comply with any aspect of the final 403(b) regulations and not run afoul of the safe harbor.

**Conclusion**

With FAB 2010-01, we commend the DOL for providing guidance in an easily understandable format on the complex issues that 403(b) plan sponsors and auditors face when addressing comprehensive 5500 filing and audit issues for the first time. While the guidance doesn’t address all issues associated with the new requirements, it is an important step in the right direction.

In addition, the clarity of guidance regarding the safe-harbor exemption from ERISA for private tax-exempt plan sponsors is appreciated and breathes new life into a regulation that many practitioners had written off as “dead” in light of the final 403(b) regulations issued by the IRS.