IRS, DOL Increase Scrutiny of Section 403(b) Plans

June 17, 2011

Tax-exempt organizations are now two and a half years into a major overhaul of the tax regulations and other rules governing Internal Revenue Code Section 403(b) retirement plans. Final regulations under Section 403(b) that issued in 2007, and were effective for most plans on January 1, 2009, for the first time required that all Section 403(b) arrangements – not just those that are subject to ERISA – be set forth in writing. Department of Labor ("DOL") guidance also expanded the annual reporting duties of Section 403(b) plans effective in 2009, including for the first time the requirement that Section 403(b) plans with more than 100 participants obtain annual audited financial statements. These changes are part of an effort by the Internal Revenue Service ("IRS") and DOL to bring Section 403(b) plans more into line with Section 401(k) and other plans maintained by for-profit employers.

Against this background, the IRS and DOL recently have increased their scrutiny of 403(b) plans and their sponsors. This increased scrutiny takes several forms.

A. Questionnaire re: "Universal Availability" in College, University Plans

I earlier wrote about an IRS questionnaire being sent to institutions of higher learning, to determine the extent to which they comply with the universal availabilty rule. Under that rule, if a Section 403(b) plan permits any employee to make salary deferrals to the plan, then it must offer the same opportunity to all employees (with limited optional exclusions). Colleges and universities often have many different categories of academic staff with widely varying work schedules, some of which end up classified as benefit-ineligible, at least with regard to group health coverage. Once an employee is classed as ineligible for group health coverage, it is not uncommon that they not be offered enrollment in other benefit plans, even those, such as Section 403(b) plans, that may have less restrictive eligibility. This is the kind of oversight that the questionnaire project is targeting. The Service will offer closing agreements to institutions that appear to be complying with the universal availability rule, and for those that improperly are excluding employees from making deferrals under the plan, it will extend the opportunity to self-correct. Self-correction would entail allowing impro9perly excluded employees to enroll in the plan and restoring (with employer money) missed deferrals the employees would have made if timely enrolled, plus earnings.

B. Increase in EBSA Audits of Tax-exempt Employers

In addition to the questionnaire project, there is at least anecdotal evidence that tax-exempt employers may also now be subject to increased plan audit activity from the DOL's employee plans division, the Employee Benefits Security Administration. The Ryding Company, a long established administrative firm, reports an uptick in "full-blown" plan audit letters sent to its tax-exempt clients in Southern California.

According to Patricia Neal Jensen, J.D. , the company's Senior Vice President, Marketing, EBSA inquiries have focused on timely deposit of salary deferrals (which is as soon as they reasonably can be segregated from payroll, or within 7 days for plans with fewer than 100 participants), and compliance with the written plan document rule. In addition to these issues, however, Ms. Jensen is noting for the first time inquiries about rates of return on plan investments, plan/investment committee agendas and minutes, investment policy statements, and due diligence reports on plan investment vendors and other service providers.

In Ms. Jensen's experience, 403(b) investment vendors have not traditionally assisted clients with plan/investment committee guidance, or provided investment policy statements. Even now, when some vendors might be extending such services, plan sponsors should be wary of conflicted advice, particularly from vendors that have had a monopoly on plan investment options. Third party advisors who work in this area are offering fiduciary training for the plan/investment committee members, and helping employers put in place the procedural steps and documentation needed to demonstrate proper

fiduciary functions.
I asked Ms. Jensen for her top recommendations to a tax-exempt employer, based on the audit activity she is seeing, and she replied as follows:

• Deposit employee salary deferrals and loan repayments within the 7-day safe harbor (small plans) or as soon as reasonably possible;
• Make sure your plan document is up to date and that you are administering the plan in compliance with the document;
• Hire a qualified, third party advisor who can work at the plan level... not from the perspective of the investment vendor;
• Have him or her take the plan out to bid to check on investment costs and performance
• Maintain investment/plan committee agendas and minutes; and
• Have an Investment Policy statement and do what it says.

http://eforerisa.wordpress.com/2011/05/20/irs-questionnaire-sent-to-college-university-plans-does-not-put-plans-%e2%80%9cunder-examination%e2%80%9d-but-epcrs-availability-remains-unclear/