

COMING SOON: 403(B) PROTOTYPE PLANS

By: *Newton Kershaw*
Email: nkershaw@devinemillimet.com
Phone: 603.695.8571

MAY 15, 2009

We are in the midst of a sea change. I am not talking about the collapse of the global financial system, or the potential swine flu pandemic, or the election of a black president of the United States, or the rise of suicide terrorism and piracy, or climate change, or the advent of gay rights, or global media, or anything else, although so many aspects of these “interesting” times might qualify to be referred to as a sea change, no, I am talking about 403(b) plans. Because I am a pension practitioner, 403(b) plans are part of my life, as they are for virtually all the educational institutions in the United States. 403(b) plans, most notably 403(b) plans offered by TIAA-CREF, are part of the educational landscape, and have been for a long time, going back almost a century, to not long after the 16th Amendment to the U.S. Constitution, empowering Congress to tax income, was ratified in 1913. The Teachers Insurance and Annuity Association was created by Andrew Carnegie Foundation in 1918 (CREF was added in 1952).

403(b) plans are the retirement delivery system for educational institutions and for 501(c)(3) tax-exempt organizations. By Internal Revenue Code mandate a 403(b) plan must utilize one of two possible financial products: tax sheltered annuities or custodial accounts. In either version, they must comply with the rules enunciated in Section 403(b) of the Internal Revenue Code. TIAA-CREF was the pioneer. Indeed, through much of the 20th century, TIAA-CREF enjoyed a competitive advantage, as it was itself a tax exempt organization, as against all the financial competitors who began to covet the profits that were available through its business model. Congress ultimately changed that, taking away its own tax exempt status. Now the Fidelitys and MetLifes and Principals of the world compete on an equal footing with the behemoth that TIAA-CREF became. It is against this historical background that we can appreciate the 403(b) sea change that we confront today.

ERISA is a relative late comer to this scene, enacted on Labor Day, 1974. And ERISA was surely a sea change. Pension plans

Labor, Employment & Employee Benefits

Mark Broth, Chair
603.695.8558
mbroth@devinemillimet.com

Aaron Gilman
978.475.9100
agilman@devinemillimet.com

Newton Kershaw
603.695.8571
nkershaw@devinemillimet.com

Karen Levchuk
603.695.8618
klevchuk@devinemillimet.com

Patricia McGrath
603.695.8537
pmcgrath@devinemillimet.com

Anthony Augeri
978.475.9100
aaugeri@devinemillimet.com

Margaret O'Brien
603.695.8631
mobrien@devinemillimet.com

Anne Scheer
603.410.1708
ascheer@devinemillimet.com

Laurel Van Buskirk
603.695.8565
lvanbuskirk@devinemillimet.com

Anne Trevethick
603.695.8725
atrevethick@devinemillimet.com

DEVINEMILLIMET.COM

EMPLOYMENT@DEVINEMILLIMET.COM

would ever after be forced to play by its rules. And surely, things began to change. My goodness, we pension practitioners have a keen awareness of the sea change inflicted by ERISA. ERISA was in effect an evolutionary graft onto the Internal Revenue Code. Fiduciaries would henceforth be responsible to the participants and beneficiaries because the law said so. And from 1974 on, there was an inevitable accretion, brought about by guidance and refinement, edicted by the custodians of the public welfare: Congress, the IRS, and the DOL.

But what guidance was there about 403(b) plans? Virtually none. 403(b) plans were a historical fact when ERISA was enacted, and they were generally left alone, until more and more people became aware that there were interesting questions about 403(b) plans, and why they should be allowed to operate outside the scheme that was put in place by ERISA for pension plans—defined benefit plans were the historical ancestors of them all, and eventually morphed into defined contribution plans, target benefit plans, money purchase plans, Keogh plans, and ultimately the coup de grace, 401(k) plans. ESOPs are still a special case. But I wander from my topic, which is the sea change that is happening for 403(b) plans. The powers that be at the IRS have observed that 403(b) plans deserve no special exemption from the rules that are now becoming natural law under ERISA. Did you know this most astonishing fact, that 403(b) plans did not even have to be in writing? They didn't, not until now. As of January 1, 2009, each and every 403(b) plan, for the first time since their inception shortly after World War I, must be in writing. We have until December 31, 2009 to get it done.

And now, let there be prototype 403(b) plans! That is the latest news, and the spur for me to devote this Friday email to this historical rehash. Bob Architect, Senior Tax Law Specialist and the legal voice of the IRS, gave an employee plans phone forum on April 16, which I dialed into, and during which he announced the publication of guidance about the 403(b) prototype program. And this development is obviously the right development. How else can pension practitioners manage a life without prototype plans? At least the form of the plan document must be blessed by the powers that be. And so it shall be. And a business model, and a huge financial industry, shall morph into its next evolutionary embodiment.

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Office Locations:

111 Amherst Street
Manchester, NH 03101
T 603.669.1000
F 603.669.8547

300 Brickstone Square
Andover, MA 01810
T 978.475.9100
F 978.470.0618

43 North Main Street
Concord, NH 03301
T 603.226.1000
F 603.226.1001

