INVESTMENT COMPANY INSTITUTE

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May 5, 2010

Mr. Robert J. Doyle
Director of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Room N-5655
Washington, DC 20210

Re: Transition Issues for Safe Harbor 403(b) Plans

Dear Mr. Doyle:

I am writing on behalf of the Investment Company Institute (the "Institute")[1] and its members to urge the Employee Benefits Security Administration ("EBSA") to provide transition relief to nonprofit organizations maintaining 403(b) arrangements that are meant to be exempt from the Employee Retirement Income Security Act of 1974 ("ERISA").

As you know, the last few years have been a period of enormous upheaval for 403(b) plans, particularly for arrangements meant to fall within the safe harbor exemption from ERISA at 29 C.F.R. § 2510.3-2(f). The final 403(b) regulation published by the Internal Revenue Service in July, 2007 fundamentally restructured the manner in which 403(b) plans are administered. EBSA has since issued two field assistance bulletins ("FABs") – FAB 2007-02 and FAB 2010-01 – that illuminate the safe harbor regulation, providing important new guidance on the ongoing viability and scope of the regulation in light of the new tax rules.

As the dust has started to settle, it is apparent that some plans meant to be safe harbor plans exempt from ERISA may not be exempt. Some programs may have crossed the line into ERISA inadvertently in attempting to comply with the tax regulation, for example, by entering into information sharing agreements that impose responsibility on the employer for authorizing distributions. Others may have engaged a third-party administrator ("TPA") to manage tax compliance, which FAB 2010-01 indicates is inconsistent with the safe harbor exemption. Others may

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.94 trillion and serve almost 90 million shareholders.

find that the program they thought was compliant with the safe harbor has never been within the safe harbor, for example, because FAB 2010-01 concludes that, absent special circumstances, a single-vendor plan is outside the safe harbor unless it permitted 90-24 transfers in the past and, after publication of the tax regulation, allows exchanges.

We believe that EBSA should provide relief to nonprofit employers from the severe consequences associated with an inadvertent ERISA plan, which range from fiduciary liability to monetary penalties for failure to file Form 5500 annual returns.[2] Private charitable organizations often have modest budgets and limited staff, a situation particularly common among those relying on the ERISA safe harbor regulation.[3] Resources dedicated to plan administration are also resources that are diverted from charitable purposes so that charities are often forced to make difficult resource allocation choices. The last few years have been especially tough on nonprofit organizations as the steep decline in the stock markets in 2008 wreaked havoc on endowments and charitable giving plummeted.

The evolving law of 403(b) plans and the safe harbor exemption has taxed even the most compliance-minded of employers. The interaction between the safe harbor exemption and the tax regulation has been particularly challenging simply because the two regulations point in opposite directions. The core concept underlying the safe harbor exemption is that a 403(b) plan is not "established or maintained by an employer" to the extent the employer has very limited involvement in plan design and operation. However, the fundamental notion underlying the tax regulation is that employers are responsible for the administration and operation of the plan. Put simply, charitable employers cannot fairly be blamed for not managing their affairs differently in this environment.

The upheaval and confusion has had, and continues to have, significant adverse consequences for participants. As the nonprofit community has become sensitized to the possibility that their plans may in fact be subject to ERISA, some employers have become very wary of coordinating with the vendors for fear of losing the safe harbor exemption. These employers have refused to authorize distributions and have indicated that the vendors should be responsible for authorizing distributions. The vendors, however, may be reluctant to do so in the absence of either a contractual agreement to that effect or a means of obtaining necessary information relating to contracts with other vendors. The sad result is that some participants have not been able to access their retirement savings, even though

[2] One particularly difficult issue relates to the application of the qualified joint and survivor annuity requirements of section 205 of ERISA. While a non-ERISA custodial account arrangement will ordinarily satisfy the minimum requirements of section 205, for example, by providing that the spouse must be the participant's beneficiary absent consent to the contrary, there may be questions about whether a tax-sheltered annuity arrangement that was in fact subject to ERISA satisfied the requirements of section 205.

[3] We note that EBSA has provided large ERISA 403(b) plans with much-needed transitional relief from Form 5500 reporting and audit requirements with respect to contracts and custodial accounts issued prior to January 1, 2009. In contrast, many of the employers relying on the safe harbor are small and thus have even more limited resources, so it would be a logical step for EBSA to grant transition relief in this context.

they are otherwise entitled to receive their benefits. While the employee may ultimately be able to pressure the employer into authorizing the distribution, affected employees have suffered, and continue to suffer, significant delays in accessing their accounts.

Transition Relief Requested

We believe that EBSA should take steps to provide for a more orderly transition. There are three particular issues. First, 403(b) plans that are meant to fall within the safe harbor should not be treated as ERISA plans solely because the employer assumed responsibility for authorizing distributions. EBSA's evolving guidance on the safe harbor exemption draws a fine distinction between sharing information and making discretionary determinations. Thus, for example, under the existing guidance, an employer may communicate to a vendor that an employee does not have any outstanding plan loans but may not communicate that an employee is eligible for a plan loan. This distinction puts enormous pressure on the form in which the vendor and the employer agree to coordinate. As a practical matter, there is very little, if any, substantive difference between approving a distribution and providing the factual predicate for a distribution. Benefit payment provisions in 403(b) plans rarely provide for truly discretionary determinations. To pick up on the example above, if a participant does not have other plan loans outstanding, the plan must provide a loan. There is no discretion to do otherwise.[4]

Many employers did not appreciate the significance of this distinction when they entered into services agreements and information sharing agreements. Rather than draft the agreements to state that the employer provides the necessary information and the vendor then approves the transaction on a ministerial basis, the agreements provide that the employer is responsible for authorizing distributions. This distinction has become a trap for the unwary.

Second, single-vendor 403(b) plans that do not fall within the four corners of FAB 2010-01 should also be provided transition relief. FAB 2010-01 describes for the first time what specific single-vendor situations would satisfy the reasonable choice requirement. Some employers reasonably interpreted the existing guidance to contemplate single-vendor arrangements if the vendor simply afforded employees a reasonable choice of investments, for example, through an open architecture custodial account.[5] The new FAB, however, indicates that a 403(b) plan will ordinarily fall outside of the safe harbor exemption if the program only remits contributions to a single vendor and exchanges –

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[4] Hardship withdrawals present similar issues. Most 403(b) plans use the safe harbor hardship standards in Treasury regulation § 1.401(k)-1(d)(3), which do not involve discretionary determinations.

[5] The existing regulation on the safe harbor exemption from 1979 does not provide that a safe harbor plan must offer a choice of more than one 403(b) contractor. 29 C.F.R. § 2510.3-2(f). It can very reasonably be read to require only that a participant have access to a reasonable choice of investments, such as the choice typically found through a mutual fund custodial account. Similarly, the preamble to the regulation explicitly holds out the notion that a single vendor may constitute a reasonable choice in some circumstances. 44 Fed. Reg. 23,525, 23,526 (Apr. 20, 1979).

the contemporary equivalent to 90-24 transfers – are not permitted.[6] As you may expect, the limits in this interpretation has cast doubt on whether many 403(b) programs are in fact exempt from ERISA, and it is only fair that employers have an opportunity to restructure in light of the new guidance.

Third, employers that selected a TPA to manage tax compliance and other plan administration should be covered by transition relief. The new FAB indicates that an employer may not select a TPA to make discretionary decisions under the plan consistent with the safe harbor exemption. The notion is apparently that the selection of a TPA results in too much employer involvement. However, it was reasonable to read FAB 2007-02 to allow an employer to select a TPA. FAB 2007-02 specifically noted that the documents governing the arrangement could identify parties other than the employer as responsible for administrative functions. Moreover, the notion reflected in the new FAB is subtle. An employer may make a vendor available who takes on responsibility for making discretionary determinations but cannot select a TPA to perform the same function. It is not clear why a distinction in these two contexts is appropriate merely because the vendor is also providing investments. We also note that a TPA could be particularly useful to facilitate information sharing across different vendors, and at the very least, EBSA may want to reconsider allowing employers to engage a TPA for data aggregation and information coordination services without exceeding the safe harbor, as long as the TPA is not acting in a discretionary capacity on the employer's behalf.

Accordingly, we believe EBSA should provide that it will not assert a 403(b) plan is subject to ERISA solely because (i) the employer assumed responsibility for authorizing distributions after publication of the tax regulation, (ii) the program offers a single vendor that does not permit exchanges or transfers, but offers access to a reasonable choice of investments, or (iii) the employer selected a TPA to administer tax compliance or other administrative responsibilities after publication of the tax regulation, provided that the employer restructures its arrangement to comply with EBSA's new interpretation of each of the foregoing issues by the first day of the plan year beginning at least 12 months after the transition relief guidance is published. The relief should further provide that employer involvement in the restructuring of the arrangement, for example, terminating the TPA relationship and transitioning to a new administrative system, will not taint the safe harbor exemption.

The relief we propose would recognize that FAB 2010-01 is effectively new guidance and it should therefore have a prospective effective date. More generally, the transition relief we suggest will provide for a more orderly transition to the new world of 403(b) plans. It will allow employers and vendors to structure their arrangements in light of a clear legal backdrop. It will also ensure that participants are not denied access to their plan benefits solely because of an employer's fear of falling outside of the safe harbor.

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[6] Alternatively, FAB 2010-01 provides that the employer may justify offering only one vendor by demonstrating that increased administrative burdens and costs to the employer in offering multiple vendors would cause the employer to stop making its payroll system available to collect and remit 403(b) salary deferrals.

We greatly appreciate your attention to these issues and look forward to working together.

Sincerely,

/s/ Elena Barone Chism

Elena Barone Chism
Associate Counsel – Pension Regulation

cc: Joe Canary
Lisa Alexander
Susan Rees