

## The Changing World of 403(b) Plans – Understanding Plan Governance, ERISA Compliance and Fiduciary Responsibility



**Recommended reading for plan sponsors, plan fiduciaries, board members and  
business managers.**

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## Introduction

Sponsors of 403(b) plans should, by now, be aware that the rules and regulations related to the administration of their plan have significantly increased in recent years. The immediate effects felt by most have thus far been in the area of simple document compliance- creating a written plan document, filing a yearly form 5500 tax return for their plan and having a plan audit performed, if necessary. However, the effects reach much deeper than documentary compliance. Their real impact will be on the governance structure those organizations will need to establish in order to oversee and administer the plan on behalf of their participants in a compliant manner.

The date that marked the end of the 'old' 403(b) world and the beginning of the 'new' is July 26, 2007. For almost 40 years before then the 403(b) world was a fairly straight-forward one for plan sponsors. Most non-profit organizations sign up with a vendor (or several vendors) to allow their employees to defer some of their salary into tax-deferred investments. Payroll would forward employee contributions to the vendor as directed by the participant. Other primary administrative functions were typically handled at the vendor level- loans, distributions, roll-overs, contribution limits, etc.

However, the IRS, starting in the late 1990s (and at full-boil by 2004), was seeing problems with this type of plan structure. COMPLIANCE problems: their least-favorite kind. Advocates for plan participants saw problems as well and pressed for change both through the IRS and especially the DOL. The primary issues that drove the situation all the way to new regulations were<sup>1</sup>:

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<sup>1</sup> NACUBO Business Officer Magazine.  
[http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/April\\_2012/Mastering\\_the\\_403\(b\)\\_Universe.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/April_2012/Mastering_the_403(b)_Universe.html)

1. Exceeding maximum contribution limits. That limit was to be monitored by the company providing the investment product. Significant problems arose when an employee had more than one plan provider accepting his or her contributions. Those companies typically had no process to aggregate contributions that account holders might make to any number of other companies for purposes of monitoring the limits.
2. Violating loan amount limits. Each vendor monitored loan amounts but only for loans included in accounts on its own books. Consequently, for most plans, compliance with rules for repayment of loans was practically non-existent.
3. The DOL, in its role as an advocate for participants, was concerned about investment quality and cost. Because most 403(b) arrangements were structured as individual annuity contracts between the participant and the investment company, plan-level economy of scale was not achieved and investment costs were typically higher than those of similar-sized 401(k) plans. They were further aggravated by long surrender charge periods and 'proprietary', often low-quality investment choice offerings.

Thus, driven by these concerns, on July 26, 2007 the IRS made the first significant changes to regulations regarding code section 403(b) in over 40 years under IRS 72 FR 41128. The changes affected all 403(b) plans effective January 1, 2009. Welcome to the 'new' 403(b) era. Those regulations are what mandated the added compliance tasks your organization likely undertook for plan year 2009:

1. Have a written plan document
2. File an annual form 5500 (with plan audit, if required)
3. Monitor contribution limits
4. Ensure compliance with rules for participant loans

Obviously, the IRS was following the 401(k) model, as the requirements are nearly identical. What was less well understood by 403(b) plan sponsors is that the DOL, at the same time, made a point to reemphasize that the same *FIDUCIARY* standards apply to them, as they do to sponsors of 401(k) plans. With the increased involvement now required of plan sponsors, more 403(b) plans became subject to the Employee Retirement Income Security Act (ERISA) either by choice or by default, even if they were not subject before. *Under new IRS regulations almost all 403(b) plans fall under and are subject to ERISA, aside from Churches and Governmental organizations.* It is exceedingly difficult to avoid being an ERISA-covered 403(b) plan since the 2009 regulation changes. This is new territory. And many 403(b) sponsors are not familiar with their newly-discovered role as an ERISA fiduciary to their plan or what that requires of them and their organization.

## What Does Being an ERISA Fiduciary Mean?

If your 403(b) plan is subject to ERISA law, someone (or several people) in your organization is a Fiduciary to the plan. The conduct of a Fiduciary is governed by standards that are “the highest known to the law” *regardless of whether he or she has knowledge of his or her status*<sup>2</sup>. The primary duties of an ERISA Fiduciary are<sup>3</sup>:

<sup>2</sup> Marcia S. Wagner, The Wagner Law Group, “Evolving Best Practices for 403(b) Plan Fiduciaries”, June 2011.

<http://www.erisa-lawyers.com/documents/A0057600.PDF>

<sup>3</sup> 403\*B Advisors, “Navigating your Fiduciary Responsibilities Across the New 403(b) Frontier”, January,

1. Duty of Loyalty. Plan fiduciaries must act solely in the best interest of the plan participants and beneficiaries.
2. Duty of Prudence. Plan fiduciaries must act with the skill and diligence of a PRUDENT PERSON. If a fiduciary does not have the expertise and experience to make fiduciary decisions they must seek the help of a PRUDENT EXPERT in that area.
3. Duty of Diversification. Plan fiduciaries must sufficiently diversify plan investments to allow participants to adequately diversify their portfolios and minimize the risks of a large loss.
4. Duty to pay only Reasonable Expenses. Plan fiduciaries must understand all plan costs and service provider compensation and determine if they are reasonable *for the services being provided*.
5. Duty to follow the Plan Document. Plan fiduciaries must administer the plan in compliance with all plan documents.

Implicit in these duties is a further critical obligation: Duty to Monitor- regular, formal reviews of plan service providers and other fiduciaries. These obligations are ongoing, not one-time.

Since this standard of care is “the highest known to the law” the penalties that may be imposed for breaching those duties are also very stiff<sup>4</sup>:

- *Personal liability* to restore to the plan any losses that it suffered because of a fiduciary’s breach.
- 15% excise tax on the value of any amounts used for the breaching fiduciary’s benefit.

2012. <http://www.cutlerinsurance.com/event/pdf/403b-Webinar-Presentation.pdf>

<sup>4</sup> The Standard, “A 2010 Wakeup Call for 403(b) Plan Fiduciaries”, [http://www3.standard.com/net/public/Employers/RelatedInfo/Content?WCM\\_GLOBAL\\_CONTEXT=/en\\_SIC\\_public/home/homecontent/retirementplanning/rp\\_emp\\_finpro\\_relatedmultiple\\_wakeup\\_call\\_403b\\_fiduciaries](http://www3.standard.com/net/public/Employers/RelatedInfo/Content?WCM_GLOBAL_CONTEXT=/en_SIC_public/home/homecontent/retirementplanning/rp_emp_finpro_relatedmultiple_wakeup_call_403b_fiduciaries)

- Equitable relief as may be required by the court.
- A civil penalty of 20% of the amount recovered from a fiduciary for a breach.
- Criminal sanctions for intentionally engaging in a fiduciary violation.
- Disqualification for the person from ever serving as a fiduciary for an ERISA plan.

These penalties apply whether the fiduciary caused the breach themselves, failed to take action upon learning of another fiduciary's breach, or if they failed to monitor another fiduciary when required.

For example, if an institution simply continues on their same non-compliant path and ignores these obligations, that could be considered a fiduciary breach. ERISA does not offer a comprehensive exemption from these responsibilities for "having always done it this way!"<sup>5</sup>

## Congratulations, You Are a Fiduciary! (And Probably Always Were)

ERISA defines fiduciaries at the plan sponsor level in several ways. The first way a member of an organization can be considered a fiduciary to the plan is the most obvious- by naming them outright. They are called "named fiduciaries." Their name may appear in the Plan Document or in another document created specifically to list the plan's fiduciaries.

The other type of fiduciary is a "functional fiduciary." Regardless of a person's official title or position in the organization, they may be considered a fiduciary to the plan to the extent they exercise discretionary authority or control over the disposition of plan assets or have the

power to make decisions concerning plan management, administration or interpretation<sup>6</sup>.

Certain decisions are not considered fiduciary decisions, however. For instance, typical administrative functions such as forwarding payroll contributions to a vendor are not fiduciary-level actions.

Most other functions, however, like a decision on what vendor(s) to use, what investments to include, how to structure the provisions of the plan, approving loans or hardships, etc. fall under the heading of fiduciary-level decisions. As such, it is easy to see that multiple people in an organization could be considered a "functional fiduciary," even without their explicit knowledge. This net can easily drag in business managers, administrators, finance committee members and even board members unless a proactive fiduciary management process is in place.

As a practical example, many non-profits designate most or all operations of the plan to the business office or business manager. While generally a business manager with administrative functions would not be considered a fiduciary, because the plan management lies solely within the jurisdiction of the business office, those managers may LOSE their administrative exemption and become "functional fiduciaries." Therefore, it is recommended that the business office be tasked with the non-fiduciary operations of the plan and a (board appointed) committee assumes the fiduciary responsibility for plan governance and plan management.

<sup>5</sup> John Hare, "What your need to know about ERISA 403(b) plan in 2012." <http://fhdfinancial.com/sites/all/files/flautt/erisa2012.pdf>

<sup>6</sup> Mark A. Daniele, Esq., McCarter & English Attorneys at Law, "Understanding your Fiduciary Role" January, 2012. [http://www.mccarter.com/files/Publication/b7f8dfed-92f2-402e-b11a-b090ef11b1ed/Presentation/PublicationAttachment/6d57fcc9-ab58-4ea7-8eb0-b6399f3d2a46/understanding%20your%20fiduciary%20role%20\(1%2026%2012%20daniele\).pdf](http://www.mccarter.com/files/Publication/b7f8dfed-92f2-402e-b11a-b090ef11b1ed/Presentation/PublicationAttachment/6d57fcc9-ab58-4ea7-8eb0-b6399f3d2a46/understanding%20your%20fiduciary%20role%20(1%2026%2012%20daniele).pdf)

## 403(b) vs. 401(k) Fiduciaries- An Issue

According to the DOL/ERISA the duties of a plan fiduciary are absolutely identical between 401(k) and 403(b) plans. However, the organizations themselves are culturally and financially different in many ways. This can cause issues in a 403(b) environment if not managed proactively.

In a for-profit business everyone involved in the 401(k) plan is an employee of the company- they are “on the payroll” in one form or another. Acceptance of fiduciary-level responsibilities is often just a part of doing their job for the organization. The responsibilities and risks are understood and accepted.

In a non-profit 403(b) world where boards, committees and other groups are often comprised of volunteers, the (perhaps unwitting) acceptance of fiduciary-level liability exposure by those members may come as a bit of a shock, to say the least. Proactive management of the plan’s fiduciary process is imperative to protect those valuable individuals from unnecessary risk.

Clear and specific designation of who makes plan decisions is paramount to managing the ERISA liability throughout the organization. Although fiduciary liability insurance is available for institutions it will have limited or no coverage in the event of a fiduciary claim if proper governance is not adhered to.

### Prudent Steps Forward

There are a number of steps that a 403(b) plan sponsor can take to begin proactively managing their ERISA fiduciary process. In our experience as plan advisors we recommend and have had success implementing the following:

- *Accept that a change is required in how sponsors view and manage their plans.*

- Establish an official Retirement Plan Committee. This should be done by an adoption agreement by the Board. Committee members will be “named fiduciaries” to the plan and meet regularly. As members come and go from the committee keep a fiduciary acknowledgement document so that the list of named fiduciaries on the committee does not become outdated. Consideration should obviously be given to the members that comprise this committee relative to their skill, knowledge and commitment to this role.
- Establish an Investment Policy Statement for the plan’s investments and follow it. The most important “Duty to Monitor” is the duty to monitor plan investments. DOL best practices say they must be based on a prudent process:

*“Most importantly, the courts and the DOL will look to see if a prudent process was used and documented- regardless of the outcome- when determining if a breach occurred”<sup>7</sup>.*

- Understand all of your plan’s fees and what services your plan is receiving for them. Prepare to prove their reasonableness relative to other alternatives and service providers on the market.
- Document everything. Not just the Plan Documents, 5500s and your shiny-new Investment Policy Statement. Everything. Retirement committee meeting minutes, attendance, what was reviewed, what process was used to evaluate it, what decisions were made (and why). This is your “fiduciary file” and it is the only way the DOL will recognize the process you have put in place. DOL will not recognize nor evaluate what was not documented.

<sup>7</sup> TIAA-CREF, “Fiduciary Responsibility Series: Governance- a framework for sustaining fiduciary responsibility” February, 2013

A critical and honest evaluation should be undertaken to determine what fiduciary responsibilities are capable of being executed to the “Prudent Expert” standard by in-house talent. Properly evaluating dozens or even hundreds of different investment choices can be a daunting task. Building a comprehensive fiduciary management process and documenting it is a challenge for even the best staffed organization.

As a practical matter, from time to time, board and committee members who may have certain expertise and skills that can help manage the plan in these respects may exist. However, they may also move on or finish their board or committee term. The plan sponsor would then be left with the challenge of replacing that committee member and their skill set. As non-profits manage their board rotations, identifying candidates with specific ERISA expertise (and willingness to serve as a fiduciary) can be very challenging. All boards experience a “hole” in the talent pool at some point.

Seeking out expertise in these areas is often advisable and displays prudence by the plan sponsor. It is best if that expert is willing to take a role as a co-fiduciary to your plan to further mitigate risk. Plan vendors such as TIAA-CREF will never accept such a role. In fact, they provide ample educational material to prove they are NOT a fiduciary. Fortunately, in recent years a new breed of ERISA-savvy advisors have arisen to meet these exact challenges. Not only will these special advisors accept a role as an ERISA-recognized 3(38) co-fiduciary to the plan (they would act as a member of your Retirement Plan Committee), but they have the specialized tools necessary to meet fiduciary-level investment monitoring standards and have expertise in administering and documenting a comprehensive fiduciary management plan. BCM Retirement Solutions is such an advisor.

## One More Very Important Suggestion.....

### Prepare to change your plan’s structure.

As advisors who have expertise in the ERISA world, it is impossible to avoid mentioning a glaring problem built into many 403(b) plans at a structural level. It arises in plans where individual annuity contracts are the contract structure -most traditional TIAA-CREF plans.

As a fiduciary you now know you have a duty to monitor the investments in your plan. You adopt an Investment Policy Statement to show your “prudent process” in this area and begin using it diligently, as you should. So what happens if (when) one of the investments in that annuity contract fails to meet the standards you set in your Investment Policy Statement? The individual contract structure provides no or very limited capacity to manage investments. Sponsors and fiduciaries may have limited ability to add some funds and no ability to remove others. Structurally, there is no way to execute on your fiduciary duties, although you are still responsible for them. And while you may have other quality investments, ERISA case law has clearly fallen on the side that “one bad apple spoils the bunch”<sup>8</sup>. Having other acceptable investment choices available in your plan *does not relieve you from your responsibility to remove bad ones.*

This subject of 403(b) structure with individual contracts has not been given any clear guidance in DOL documents. Intentionally so, we believe. One is left to wonder how such a situation would be resolved. The direction can probably be predicted, however. Starting with the 2009 regulations there was a push to bring 403(b) plans into harmony with the more compliant 401(k) standards- that much is obvious. Also, many of the 403(b) vendors who offer these “individual annuity” contracts have recently begun to offer a much more 401(k)-like

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<sup>8</sup> Pfiel v. State Street Bank and Trust Company 2012.

group contract vehicle that allows for a wide range of investment choices by the plan sponsor with full ability to add/delete/move funds within it. In other words, full fiduciary-level investment control over plan assets. And those 403(b) vendors are actively encouraging plan sponsors to move to these updated contract vehicles.

It seems clear that this change of contract structure from the old 403(b) “individual contracts” to the more robust and compliant 401(k)-like “group contract” is all but inevitable. It is not likely a question of “if” but “when” you will be moving to it. The old structure is simply incompatible with executing today’s defined fiduciary duties with respect to investment monitoring.

## Harness the Opportunity

These kinds of change, however daunting they may appear, are best looked upon as a unique *opportunity* to dramatically improve the overall quality of your retirement plan while also providing for a sound fiduciary management and protection structure. Plan participants have almost universally recognized and appreciated this augmentation to their retirement plan as well, in our experience.

A recent study by LIMRA shows that 85% of 403(b) plan sponsors say “the primary objective of their plan is to help employees save enough to retire. In contrast, only about half of 401(k) sponsors reported that [as the plan’s primary objective].”<sup>9</sup>

ERISA has as its core the goal of helping participants save enough to fund their retirement. There is a natural harmony of purpose and a common goal. By following the DOL’s lead through ERISA best practices, not only can plan sponsors minimize potential pitfalls, they can maximize the

chances of achieving the primary plan goal for their participants.

## Conclusions

The changes to IRS and DOL regulations relating to non-profit 403(b) plans starting with the 2009 plan year affected far more than just surface-level “documentary compliance”. The deeper effect of those changes was to begin to move 403(b) plans into harmony with more sophisticated and compliant 401(k)-like structures. This has numerous advantages including moving away from proprietary investment products, providing access to a much wider array of investments, allowing for greater fee transparency and offering the tools to build a much higher quality plan customized to the needs of a particular organization. However, these plan improvements do come with challenges.

In particular, the Boards of many non-profits are unaccustomed to dealing with their (sometimes newly discovered!) fiduciary responsibilities. This can cause friction and even liability exposure for those involved in their organization’s 403(b) plan. Since these responsibilities are clearly defined by ERISA and are not likely to be reduced over time, the best option is to embark on a comprehensive and proactive plan review with emphasis on fiduciary management process. Plan sponsors should proactively seek out expert advice if they feel their internal resources are inadequate to bring their plan into compliance with ERISA fiduciary best-practices.

In the past an ERISA compliance and governance structure may have been a daunting task for a plan sponsor to create by themselves. Fortunately, as the bar has been set higher, there is increased capability to meet those standards from various sources, including independent ERISA-savvy retirement plan experts and advisors.

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<sup>9</sup> LIMRA, Growth in 403(b) Plans Make Them More Attractive to Plan Service Providers.  
[http://www.limra.com/Posts/PR/News\\_Releases/LIMRA\\_Study\\_Growth\\_in\\_403\(b\)\\_Plans\\_Make\\_Them\\_More\\_Attractive\\_to\\_Plan\\_Service\\_Providers.aspx](http://www.limra.com/Posts/PR/News_Releases/LIMRA_Study_Growth_in_403(b)_Plans_Make_Them_More_Attractive_to_Plan_Service_Providers.aspx)



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BCM Retirement Solutions regularly advises nonprofit organizations on ERISA compliance and plan management. For additional information please contact us at 888-369-2261 or visit our web page at [www.bcmwealth.com](http://www.bcmwealth.com)

**Please contact us for a copy of the following resources:**

- ❖ Sample Fiduciary Self Evaluation
- ❖ Sample Retirement Committee Charter
- ❖ Sample Committee Fiduciary Acknowledgement Forms
- ❖ Sample Investment Review