The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

March 17, 2009

ICI Letter to DOL on Issues Affecting 403(b) Plans Under ERISA

Via Electronic Delivery

March 17, 2009

Lisa M. Alexander
Chief, Division Of Coverage, Reporting & Disclosure
Office of Regulations and Interpretations
Employee Benefits Security Administration
200 Constitution Avenue, NW
Room N-5669
Washington, DC 20210

Re: Follow-Up on Transition Issues for 403(b) Plans

Dear Ms. Alexander:

On behalf of the Investment Company Institute (the "Institute") 1 and its members, thank you for meeting with us in December 2008 to discuss issues affecting section 403(b) plans under the Employee Retirement Income Security Act of 1974 ("ERISA"). This letter follows up on several questions raised during the meeting.

We discussed the circumstances in which section 403(b) annuity contracts and custodial accounts (collectively, "contracts") are considered plan assets. As you know, we recommended in our letter dated November 12, 2008, and in the meeting, that the Department of Labor issue guidance clarifying that contracts held by vendors that are no longer authorized to receive contributions under a plan after January 1, 2009 are not ERISA plan assets, if the employer or other plan fiduciary does not retain any material rights under the terms of the contracts. This guidance would be consistent with the Department's regulation defining a "participant covered under the plan" and guidance defining plan assets based on ordinary notions of property rights. It would also have the virtue of reflecting the underlying economics of 403(b) contracts where the employer or plan fiduciaries have no material role or authority over contracts. Further, this approach would conform closely to transition guidance that the Internal Revenue Service has issued for so-called orphan and grandfather contracts. Finally, this guidance is urgently needed in light of the new 2009 Form 5500 filing requirements for 403(b) plans, including the new Schedule C, as well as other pending regulatory projects that will impact contracts that are

considered plan assets.

You and others from the Department asked a number of questions about how such a rule would operate. In particular, you asked whether the substantive rights of a participant would be materially affected if a contract ceased to be subject to ERISA because the employer discontinued contributions before January 1, 2009. You asked whether spousal consent requirements, rights under domestic relations orders, or bankruptcy protections would be affected if a contract that was a plan asset ceased to be a plan asset, for example, because a vendor was no longer authorized to receive contributions.

Consequences for Participants

In general, the only parties to a section 403(b) contract that does not reserve rights to the plan sponsor or other fiduciary are the vendor and the participant. Pursuant to state and federal law, the custodians of section 403(b)(7) custodial accounts and the issuers of section 403(b)(1) annuity contracts are obligated to honor the terms of the contracts (including terms relating to ERISA rights) regardless of whether the contracts remain subject to ERISA. Moreover, in general, it is well-settled that a contract could not be amended to eliminate any rights that would have been protected while the contract was part of an ERISA plan, because the anti-cutback rule appears to apply to distributed contracts. 2

With respect to the specific issues you raised in our meeting, there is authority that the spousal consent provisions of ERISA, to the extent otherwise applicable, continue to apply to a contract that has been distributed from an ERISA plan. 3 Further, although a non-ERISA section 403(b) plan is not required to accept a qualified domestic relations order ("QDRO"), these orders are binding under state law and our experience is that vendors honor QDROs whether or not the plan is subject to ERISA. Finally, as a result of amendments to the bankruptcy code in 2005, a debtor's 403(b) contract may be exempted from the debtor's bankruptcy estate without regard to whether the contract is subject to ERISA. 4

Consequences for Plan Sponsors

As described above, there would appear to be very little difference in the rights of a participant after a contract ceased to be part of the employer's plan, at least where the plan fiduciary has no control over the contract or its terms. At the same time, guidance confirming the status of such contracts as outside of ERISA would have a very significant and beneficial effect for employers. As we discussed, it would mean that these contracts would not need to be reported on the Form 5500 annual return, thus resolving the myriad of issues related to assembling the necessary information on these contracts. Further, the requested guidance would resolve the potential quandary of a plan fiduciary having obligations with respect to assets over which the fiduciary has no control. For example, it would make little sense to apply the proposed service provider disclosure regulations under ERISA section 408(b)(2) to contracts for which the employer has no supervisory authority or control. Finally, as we discussed, the scope of the rule we are proposing is appropriately limited – it would apply only to contracts that were discontinued from receiving new contributions under a plan prior to January 1, 2009. For contracts receiving contributions after that date, the new IRS 403(b) regulations would appear to require that plan fiduciaries retain at least some rights over the contracts.

We note that employers do have some familiarity with the different status of various

section 403(b) contracts. As you know, it is not uncommon for a nonprofit employer to maintain both a section 403(b) or section 401(a) program that receives employer contributions and is subject to ERISA, while also maintaining a section 403(b) program that is exempt from ERISA under the safe harbor for programs with limited employer involvement. We are not aware of issues arising because of the differential status of the two classes of contracts. Also, as we discussed, the notion of plan assets migrating in and out of the ERISA system is not a novel one, with rollovers between ERISA plans and IRAs being the most common change in status.

In recognition of the fact that some employers maintain separate 403(b) plans with differing ERISA status, the guidance we request on plan assets clearly should apply where an employer formerly maintained a non-ERISA 403(b) arrangement in the past, freezes that plan, and establishes or continues an ERISA-covered 403(b) plan going forward. Assets held in contracts solely within the confines of the frozen non-ERISA plan should retain their non-ERISA status, even though employees may contribute to separate contracts with the same vendor under the ERISA plan.

Other Relief

We also discussed the possibility of a delay in the effective date of the changes to the Form 5500 annual return for 403(b) plans. We understand, however, from our conversation that this is very unlikely to be a workable solution, in part because of the Form 5500 change to electronic filing for 2009 and the related systems work that has been done. Further, we understand that providing relief from the audit requirement may be challenging because of professional responsibility concerns of the auditing profession. We believe the challenges of finding a vehicle for providing relief from the Form 5500 audit requirement argue strongly for the plan asset relief we suggest. More generally, however, we will continue to consider other avenues for relief from the Form 5500 audit requirement.

We greatly appreciate your attention to these issues and look forward to continuing to work together on them.

Sincerely,

/s/ Elena C. Barone

Elena C. Barone
Associate Counsel – Pension Regulation

cc: John J. Canary
Elizabeth Goodman
Susan Rees

endnotes

[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 $9.88 trillion and serve over 93 million shareholders.

2 Treas. Reg. § 1.411(d)-4, Q&A-2(a)(3)(ii).

3 Treas. Reg. § 1.401(a)-20, Q&A-2.

4 See 11 U.S.C. §§ 522(b)(3)(C) and 522(d)(12).
