The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

September 12, 2007

ICI Letter to Treasury Requesting Guidance and Extension under 403(b) (pdf)

September 12, 2007 Mr. W. Thomas Reeder Benefits Tax Counsel Department of the Treasury 1500 Pennsylvania Ave., NW, Room 3120 Washington, DC 20220 Re: Final Regulations Under Code Section 403(b) Dear Mr. Reeder: The Investment Company Institute1 appreciates this opportunity to comment on the final regulations governing 403(b) arrangements issued in July. We commend the Department of the Treasury and Internal Revenue Service for undertaking a comprehensive review and codification of the guidance issued under Code section 403(b) over the last 40 years. On behalf of Institute members, who offer investments and provide services to 403(b) participants,2 we write to request a delayed effective date with respect to one aspect of the regulations – the elimination of transfers and exchanges made pursuant to Revenue Ruling 90-24. We also seek certain additional guidance on several issues relating to the regulations. Extension of Rev. Rul. 90-24 Transfers The final regulations make significant changes to the ability of participants to transfer their investments, as previously permitted under Revenue Ruling 90-24. Under a grandfather rule, the new rules for contract exchanges, which include certain plan provision requirements and an information sharing agreement, do not apply to contracts received in an exchange on or before September 24, 2007 (60 days after publication of the regulations). While we appreciate the goals that underlie the decision 1 ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately $11.140 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households. 2 According to Institute estimates, $363 billion (53 percent) of 403(b) assets were invested in mutual funds as of December 31, 2006. The U.S. Retirement Market, 2006, Research Fundamentals, Vol. 16, No. 3, Investment Company Institute (July 2007). Mr. W. Thomas Reeder Page 2 of 4 September 12, 2007 of the Treasury and IRS to eliminate unfettered transferability, 60 days does not provide enough time for providers, employers, and participants to react to this major policy change. Providers of 403(b) investments have designed their systems around this transferability and individuals have grown to rely on it. We urge the Treasury and IRS to extend the deadline until December 31, 2008 to coincide with the general applicability date of the regulations. Participants and employers in the education field are particularly disadvantaged by the timing of this change. Most schools start their school year mere weeks before the change takes effect, and the resources needed to explain the new rules to

participants will be limited at this critical time. As a result, participants may be blindsided by the abrupt cut off of their ability to move assets to investment choices not offered by their employer. As employers and service providers analyze the new regulations, they must make decisions about how to proceed once the new rules go into effect, including whether to permit exchanges or transfers as part of their plan or business model. Many considerations enter into these decisions and providers need more time to fully understand the regulations and their implications for providers and employers.3 As described below, our members already have identified several issues as having immediate relevance during the transition period beginning after September 24, 2007. More generally, providers that determine to continue to permit transfers from existing contracts after September 24, must be given ample time to develop systems to track the transfers (for reporting purposes) and develop any new forms necessary for approving the transfer. Providers also need time to train processors, who must be able to comprehend the subtle differences between transfers, exchanges, rollovers and taxable distributions. We urge you to consider the practical realities facing sponsors, providers and participants as they adapt to the new 403(b) landscape by delaying the effective date of the new transfer rules until December 31, 2008. Additional Guidance Although the final regulations are extremely helpful in codifying prior guidance and providing certainty with respect to many areas of 403(b) plan operation, we believe additional guidance in several areas would help employers and service providers meet the requirements of the regulations. In the short period of time since the final regulations were published, Institute members have identified several points that would benefit from immediate clarification. Many of these issues relate to the uncertain landscape after September 24, 2007 and are further evidence of the need for an extension of that deadline. As the new rules are put into practice in the coming months, we may communicate additional issues on which guidance is needed. 3 Some providers may determine that they are bound to permit exchanges under existing contracts. We note that under state law, annuity contracts may be required to provide for ongoing transfers. Providers must have time to evaluate how the new requirements interact with their existing contract and state insurance law obligations. Mr. W. Thomas Reeder Page 3 of 4 September 12, 2007 1. Reporting and Withholding for Exchanges For contract exchanges taking place between September 24, 2007 (or such later date specified in future guidance) and January 1, 2009, the transferring vendor may not know whether the information sharing agreement and/or other required documentation will be in place by January 1, 2009, the compliance date of the regulations. This has significant implications for a vendor’s reporting and withholding obligations. For all exchanges under the new rules, including exchanges after January 1, 2009, we request confirmation that a transferring vendor may rely on the employer’s representation that the exchange will be legitimized by either an information sharing agreement or the requisite plan and contract provisions, as the case may be. 4 If the transferring vendor receives no such representation, the vendor must determine how to report the transaction and whether to withhold income taxes on the amount distributed or transferred. Guidance would be helpful particularly on whether the transaction should be reported on Form 1099-R, and if so, how it should be coded. If a new code is provided, systems must be reprogrammed to accept the new code. 2. Accumulated Benefit One of the requirements for a qualifying contract exchange or plan-to-plan transfer is that the participant’s accumulated benefit immediately after the exchange or transfer be at least equal to the accumulated benefit immediately before the exchange or transfer (satisfaction of Code section 414(l)(1) is deemed sufficient). Mutual fund redemptions from 403(b)(7) custodial accounts may involve contingent deferred sales charges or redemption fees (which apply in a variety of contexts and are disclosed to investors). Similarly, some mutual funds involve front-end charges. Vendors would like comfort that these types of charges, which are otherwise permissible and serve legitimate purposes, would not violate the

accumulated benefit restrictions in §1.403(b)-10(b). 3. Significance of September 24, 2007 and Grandfathering We request confirmation that the date of September 24, 2007 (or such later date specified in future guidance) relates solely to the elimination of the current transfer rules under Rev. Rul. 90-24 and the grandfathering of transfers and exchanges made on or before that date. There is confusion surrounding whether certain other new rules might apply immediately after September 24, 2007, rather than on January 1, 2009. For example, certain verbal statements made by representatives of the IRS and Treasury after release of the final regulations imply that employer authorization requirements under the 4 Clarification would be helpful on whether the information sharing agreement requirement applies in all cases, or only to exchanges to outside vendors. The regulations are written in a way that applies this requirement to any exchange treated as being “within the same plan.” Staff have suggested orally, however, that it applies only to exchanges to outside vendors. If the information sharing agreement does not apply to vendors “approved” by the plan (in which case information sharing presumably would be reflected in the service agreement or plan document), then it would be helpful to clarify what constitutes an approved vendor. For example, approved vendors could include only accounts to which salary deferrals may be directed, or additionally, accounts to which deferrals are not permitted, but that are designated in the plan document as "approved vendors" for exchanges. Mr. W. Thomas Reeder Page 4 of 4 September 12, 2007 final regulations apply to distributions taken from non-grandfathered accounts after September 24, 2007.5 In addition, further guidance on what it means for a contract to be grandfathered would be helpful. For example, it is unclear whether distributions from grandfathered contracts will be subject to employer approval once the distribution rules become applicable. Similarly, there have been verbal indications that loans from grandfathered accounts will require an information sharing agreement. These interpretations are not expressly stated in the regulations and appear to be inconsistent with the notion of grandfathering. 4. Orphaned Accounts Guidance on how the regulations apply to so-called “orphaned” accounts will be most helpful. Particularly when the employer no longer exists, the employer authorization requirement will be impossible to meet. Similarly, where the individual account-holder is no longer employed by the sponsoring employer and the vendor does not know the identity of that employer, compliance will be difficult. One option for dealing with orphaned accounts is to roll over the accounts into IRAs during the transition period, but providers would like comfort that this would entail no adverse consequences to participants. * * * The Institute appreciates your consideration of these matters. We would be happy to discuss any of the issues raised in this letter at your convenience. Please contact the undersigned at 202-326- 5821 if you have any questions. Sincerely, /s/ Elena Barone Elena Barone Assistant Counsel – Pension Regulation cc: William Bortz, Department of the Treasury Robert Architect, Internal Revenue Service John Tolleris, Internal Revenue Service Lisa Mojiri-Azad, Internal Revenue Service 5 Applying these rules earlier than January 1, 2009 would create significant compliance burdens, particularly when a third party has been used as a clearinghouse for remitting contributions and the account was never linked to an employer. It will take some time for providers to identify the correct employers.
