

## COMMENT LETTER

June 1, 2009

# ICI Submits Comments to IRS Regarding 403(b) Prototype Program and Sample Plan Language

June 1, 2009 VIA ELECTRONIC DELIVERY CC:PA:LPD:PR (Announcement 2009-34) Internal Revenue Service Room 5203, POB 7604 Ben Franklin Station Washington, DC 20044 Re: Request for Comments on Revenue Procedure for §403(b) Prototype Plans and Sample Plan Provisions Dear Sir or Madam: I am writing on behalf of the Investment Company Institute (the "Institute")<sup>1</sup> and its members to provide comments on the draft revenue procedure for obtaining an opinion letter on a 403(b) prototype plan, as set forth in Announcement 2009-34, and the draft sample plan language published concurrently with the Announcement. We are pleased that the Service has decided to establish an opinion letter program for 403(b) prototype plans and a retroactive remedial amendment period for years after 2009. These new features will enhance the ability of employer plan sponsors and plan service providers to satisfy new obligations under the 2007 Code section 403(b) final regulations and subsequent guidance. Draft Revenue Procedure Section 5.02 provides that certain provisions must be included in every 403(b) prototype plan, regardless of the terms of any investment arrangements under the plan, but states that different investment arrangements (annuity contracts or custodial accounts) under the plan may have different features or additional provisions. Section 5.03 describes an example: a "403(b) prototype plan may offer both investment arrangements that permit loans and investment arrangements that do not. In this case, the basic plan document and adoption agreement, as completed by the employer, must (1) provide that participant loans are available, depending on the choice of investment arrangements..." (emphasis added). Section 5.03 goes on to refer to the Listing of Required Modifications "[f]or sample 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 \$10.18 trillion and serve over 93 million shareholders. CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 2 of 11 language that satisfies these requirements." We note that the sample plan provisions, or "LRMs," relating to plan loans (section 8.42) do not include language reflecting the italicized language above. In fact, the sample plan language generally omits references to Individual Agreements for many features, in addition to loans, that could vary depending on the particular provider. We strongly recommend that the prototype program and sample language be revised to more explicitly incorporate the terms of Individual Agreements, in

cases where the agreements will contain operative language on whether certain features are available. As a guideline, the Service may want to consider section 4.1 of the model plan language published in Revenue Procedure 2007-71, which states that “Loans shall be permitted under the Plan to the extent permitted by the Individual Agreements controlling the Account assets from which the loan is made and by which the loan will be secured” (emphasis added). In our specific comments on the sample plan language below, we note several instances where language referring to the terms of the Individual Agreements would be advisable. We recommend clarifying section 6.02, regarding standardized plans, to reflect that subsections 6.02(1), (2), and (3) do not apply to governmental plans described in section 414(d) or nonelecting church plans. Section 3.08 makes clear that employers sponsoring those plans may generally rely on the opinion letter regardless of whether the plan is a standardized or a nonstandardized plan. We are concerned that certain employers may have confusion about the label “nonstandardized” and may believe that it has a negative consequence for them. Therefore, it may be helpful to reiterate the statement from section 3.08 in section 6. Section 8.04 requires a prototype sponsor to have a procedure for adopting employers to acknowledge receipt of plan amendments. We respectfully request that this standard be changed to conform to the language from Revenue Procedure 2005-16 (section 5.01), which requires sponsors of 401(a) prototype plans to make reasonable and diligent efforts to ensure that adopting employers actually receive and are aware of all amendments. Requiring a prototype sponsor to obtain acknowledgement from employers could involve significant work and runs contrary to the negative consent approach permissible in this context for 401(a) prototype plans. As a general matter, we also believe that the 403(b) prototype program would be improved if it expressly allows custodial account agreements to incorporate certain plan provisions by reference. The 403(b) regulations require that certain provisions be included in the custodial account agreement. Many of the provisions currently required to be included in a custodial agreement are provisions that may also be included in the employer-maintained plan documents, such as required minimum distribution provisions and the section 402(g) limit. As a result, there is potential duplication between the custodial account agreements and the employer-maintained plan document. By allowing these provisions to be housed in the employer-maintained document and incorporated into the custodial account agreement by reference, it would be possible, for example, for changes to the minimum distribution rules to be made at the plan level, without the potential for inconsistency with the terms of the custodial account or annuity contract. This would also allow the custodial agreement to become the functional equivalent of a trust agreement, which generally would not contain operative plan provisions. We think the uniformity resulting from a flexible approach to incorporation by reference CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 3 of 11 would benefit providers, employers and participants alike, by reducing uncertainty over whether custodial agreements are compliant and enhancing coordination with other plan documents. Sample Plan Provisions For ease of reference, specific revisions suggested below are indicated with deleted language crossed out and proposed new language underlined. Part I Sections 1.1, 1.11, 1.12, and 1.19 – Account, Funding Vehicle, Individual Agreement, and Vendor. In our view, there is no clear distinction between the terms “Funding Vehicle” and “Individual Agreement” and the two seem to be used interchangeably throughout the document. To eliminate this confusion, we propose using the following three terms to replace the current definitions for “Account,” “Funding Vehicle,” “Individual Agreement,” and “Vendor”: 1) “Recordkeeper/TPA” – the entity/entities responsible for performing certain recordkeeping duties and processing or authorizing certain transactions under the plan, typically pursuant to a separate written agreement with the employer; 2) “Custodian/Insurer” – the entity/entities custodying the account(s) under the plan or the insurance company/companies issuing the contract(s)

under the plan; and 3) "Individual Agreement" – the agreements establishing the custodial accounts or insurance contracts with the individual or the employer, which include required provisions (e.g., nontransferability, section 402(g) limits, section 401(a)(9) requirements, and the direct rollover provisions of section 401(a)(31)) and disclosure of the mutual funds available through the custodial accounts or insurance contracts available for deposits. At any rate, we believe the Adoption Agreement language under subsection 1.11 (Funding Vehicle), requiring employers to indicate whether they will use annuity contracts, custodial accounts, or both, should be eliminated. The list of approved Vendors can be maintained outside of the plan, and there is no reason to specify in the Adoption Agreement whether annuity contracts and/or custodial accounts will be used, especially since a change to the approved Vendors could necessitate a plan amendment under this section.

Section 1.2 – Account Balance. We request that separate accounts be permitted to have more than one beneficiary. It is common practice for participants to designate multiple beneficiaries to meet their estate planning needs and many custodians accommodate multiple beneficiaries of a single separate account. More generally, separate accounts are advantageous to beneficiaries under the section 401(a)(9) rules.

Section 1.4 – Annuity Contract. The definition of Annuity Contract does not conform to the definition of Custodial Account, because it is missing the following language: "established for each Participant by the Employer or, by each Participant individually". We recommend adding this language to the definition of Annuity Contract. CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 4 of 11

Section 1.5 – Beneficiary. We suggest revising the definition of Beneficiary to read as follows: "'Beneficiary' means the persons or entities designated person who is entitled to receive benefits under the Plan after the death of a Participant, the terms of the Individual Agreements." Vendors typically maintain beneficiary designations under 403(b) plans. Further, it is not uncommon for a participant to designate a non-natural person, such as a trust, charity or estate, and the reference to an entity as beneficiary would be appropriate. This definition also has implications for section 3.23, which requires the participation election to include designation of a beneficiary.

Section 1.7 – Disability. We recommend that the sample language conform to the definition of disability under Code section 72(m)(7).

Section 1.10 – Employer. We propose eliminating the option to name Related Employers in the Adoption Agreement, as this will require an amendment each time a Related Employer is added or deleted.

Section 1.15 – Plan Year. We believe additional options should be provided in the Adoption Agreement. For example: Plan Year means the calendar year unless the following is selected: [ ] the 12-consecutive month period commencing on \_\_\_\_\_ and each anniversary thereof. [ ] the 12-consecutive month period ending on \_\_\_\_\_ and each anniversary thereof. [ ] other (e.g., for first plan year) \_\_\_\_\_

Section 2.21 – Plan Administration and Allocation of Duties. It appears that the sample language, including the Adoption Agreement provisions, would allow an employer to unilaterally designate as plan administrator or allocate administrative responsibilities to other parties without the consent or agreement of those parties. For example, section 2b (Allocation of Duties) of the associated Adoption Agreement language, referencing a Memorandum of Understanding between the parties, appears to be an optional provision. We note that the term "Memorandum of Understanding" is not defined anywhere in the document, and it is unclear what type of agreement would be encompassed by this term. If it refers to the service agreement entered into between a Vendor and employer, we do not believe the agreement should be incorporated by reference into the plan. Otherwise, an error in administering the service agreement would constitute an operational error. Further, we are concerned that the reference to a "Memorandum of Understanding" could lead to a spate of requests for vendors and employers to enter into agreements titled "Memorandum of Understanding," notwithstanding the presence of service agreements and information sharing agreements

that already delineate the obligations of the stakeholders. At any rate, Institute members are concerned that this sample language will allow employers to designate a Vendor as the plan administrator or allocate administrative responsibilities to a Vendor without its knowledge or consent. In addition, having to list the duties allocated to each entity could be CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 5 of 11 cumbersome due to the possibility of complex arrangements between Vendors, employers, and third-party administrators. Furthermore, these arrangements could change from time to time, which would appear to necessitate amending the adoption agreement. We strongly recommend eliminating items 1 and 2a from the Adoption Agreement language because this information should not be required to be in the prototype documents if contained in other documents. Item 2b should be revised to provide for flexibility, including use of an "Information Sharing Agreement," a services agreement, or any other agreement that describes the relative allocation of administrative responsibilities under the plan. In this regard, we suggest the following changes:

**Allocation of Duties.** Administrative duties are allocated among the persons specified above according to a Memorandum of Understanding executed by each of the parties among the parties as specified in a separate written agreement or agreements. Such Memorandum of Understanding is incorporated herein by reference into the Plan. In addition, in subsection 21.2 of the sample plan language, we recommend including the determination of whether a participant is eligible for a distribution (e.g., due to a disability or termination of employment) among the list of provisions and requirements that the Plan Administrator is responsible for coordinating. It is very important for employers and providers to clearly allocate this responsibility in their service agreements.

**Section 3.23 – Compensation Reduction Election.** The definition of Compensation for purposes of the Compensation Reduction Election should include deferrals under Code sections 125, 132(f), 401(k), 403(b) or 457(b). These deferrals were included in the definition of compensation in the model plan language published in Revenue Procedure 2007-71, and therefore are already included in many plans. If an employer subsequently adopts a prototype plan that incorporates the new sample plan language, inconsistent provisions could lead to cutbacks or inadvertent operational errors. In addition, we suggest the following revisions to subsection 23.1 to provide flexibility for Vendors to accept election forms:

1. An Employee elects to participate by executing an election to reduce his or her Compensation (and have that amount contributed as an Elective Deferral on his or her behalf) and filing it with the Plan Administrator or its designated agent. This Compensation Reduction Election shall be made on the through an agreement provided by the Plan Administrator or its designated agent under which the Employee agrees to be bound by all the terms and conditions of the Plan. The Plan Administrator may establish an annual minimum deferral amount no higher than \$200 as specified in the Adoption Agreement, and may change such minimum to a lower amount from time to time. The participation election shall also include designation of the Funding Vehicles and Accounts therein to which Elective Deferrals are to be made and a designation of Beneficiary. Any such election shall remain in effect until a new election is filed. Only an individual who performs services for the Employer as an Employee may reduce his or her Compensation under the Plan. The election shall take effect as CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 6 of 11 soon as administratively practicable following the date applicable indicated under the Employee's election. The compensation reduction election should not include designation of the Funding Vehicles and Accounts to which Elective Deferrals are to be made, or designation of a Beneficiary. Many custodians do not obtain compensation reduction elections but do obtain beneficiary designations as well as employee investment elections. There are many ways to obtain employee investment elections and beneficiary designations, such as through a plan or vendor website. We believe that the prototype plan document would result in confusion and possible inconsistencies if it expresses a

preference or bias for a particular method of obtaining investment elections and beneficiary designations. Section 3.24 – Automatic Enrollment. Although this section is under development, we note that automatic enrollment cannot be utilized if the default funding arrangement is an individual custodial account or individual annuity contract, because the employee’s signature is required to open the account or issue a contract. Section 3.25 – Information Provided by the Employee. This section requires Participants to provide the Plan Administrator any information necessary to administer the plan, including information required by the Individual Agreements. In our view, it makes little sense for the Plan Administrator to get certain information more naturally required by Vendors, because it could lead to inconsistent records at the Plan Administrator and Vendor levels. As explained elsewhere, it is important for the prototype program to ensure consistency between the plan document and custodial accounts and annuity contracts. Section 3.27 – Timing of Contributions. We recommend specifying that contributions must be transferred within 15 business days. The current language omits the word “business.” Section 5.31 – Limitations on Annual Additions. We request that subsection 31.1.7, Correction of Excess Annual Additions, be revised to permit any correction method permissible under EPCRS. Vendors should not have to maintain a 403(c) account, especially if there are other options available. We also would like language in the definition of Includible Compensation to reflect the grandfather rule for certain participants in governmental plans in effect on July 1, 1993 (see Treas. Reg. §1.401(a)(17)-1(d)(4)(ii)). Section 6.32 – Distribution Limitations for Elective Deferrals. We recommend that distributions pursuant to qualified Disaster Recovery Assistance or any other permissible distribution under the Internal Revenue Code or applicable law be included on the list of exceptions to the general distribution limitations, as new or temporary exceptions are added periodically (for example, Qualified Hurricane Distributions). In addition, the language should also reflect the special rules for pre-1989 elective deferrals. Finally, we suggest replacing the language “becomes disabled (within the meaning of section 72(m)(7) of the Internal Revenue Code,” with the language “incurs a Disability” – consistent CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 7 of 11 with our recommendation in Section 1.7 above to conform the definition of Disability to that of section 72(m)(7). Section 6.33 – Small Account Balances. Distribution of small account balances should be subject to the terms of Individual Agreements. Some provider agreements do not permit account balances to be distributed without written consent of the participant. We recommend adding “to the extent permitted under the Individual Agreements” to both the sample plan language and Adoption Agreement language. Sections 6.34-6.38 – Minimum Distribution Requirements. We propose a number of changes to the series of sections addressing required minimum distributions. First, the provisions should allow for waiver of required distributions when the law permits, such as for 2009 under the Worker, Retiree, and Employer Recovery Act of 2008 (“WRERA”). Second, the sample language does not reflect the rule that the minimum distribution requirements can be satisfied through distribution from another 403(b) account, i.e., when a participant has multiple 403(b) accounts. Third, in subsection 35.3, it appears that some words are missing from the first sentence between the words “can be made as” and “the required beginning date.” Fourth, in subsection 38.2.3, we request addition of the phrase “to the extent required by regulations” before “the entire interest.” Fifth, we suggest the addition of language recognizing that benefits accrued before December 31, 1986 are grandfathered from the section 401(a)(9) requirements. Sixth, we suggest deletion of the references to the special rules for 5 percent owners, which are not applicable to the types of entities that may maintain a 403(b) plan. As a more general comment on the required distribution sections, we believe the sample plan language could be simplified by combining the provisions for custodial accounts (subsections 35 and 36) with the provisions for annuity contracts (subsections 37 and 38). We do not see a reason for separate sections, as the

same rules will apply to both types of contracts, unless the annuity contract is actually annuitized. The distinct rules for annuitized benefits can be addressed within the single section for pre-death distributions and the single section for post-death distributions. We believe combining these sections will eliminate potential confusion over which sections should govern a particular contract. Section 6.39 – Distribution of Amounts Held in a Rollover Account. We recommend adding related language to the Adoption Agreement, as follows: [ ] The Plan permits distribution of all or part of any amounts held in the rollover account at any time. Section 6.40 – Direct Rollovers. We note that plans must allow a nonspouse beneficiary to roll over an eligible rollover distribution to an IRA for plan years beginning after 2009. The language in subsection 40.2.3 (Distributee) should be revised accordingly. We also note that that this provision should allow for the rollover of amounts that would have been required minimum distributions but for a statutory waiver of the requirements, for example, in connection with WRERA. CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 8 of 11 Section 7.41 – Hardship Distributions. We strongly recommend amending the first sentence to read as follows: “If elected in the Adoption Agreement and to the extent permitted under the Individual Agreements....” Not all Vendors offer hardship distributions or agree to process hardship distributions without certain assurances from employers. Therefore, hardship distributions may not be available in all cases. Section 8.42 – Loans to Participants. As mentioned earlier, the availability of loans is subject to the terms of Individual Agreements. It is important that subsection 42.1 be amended to read as follows: “If elected in the Adoption Agreement and to the extent permitted under the Individual Agreements. . . .” Secondly, many Vendors that offer loans restrict the loan amount to no more than one-half the nonforfeitable accrued benefit invested with that particular custodian or insurer, and some do not offer loans in excess of the one-half limit even if that amount would be less than \$10,000. We recommend revising subsection 42.2(b) to allow for these more restrictive policies contained in the custodial account or annuity contract. Finally, we believe the Adoption Agreement either should not specify the loan repayment method or should state that repayments will be made in accordance with the Individual Agreements. Some Vendors may accept payments through payroll reductions while others may use coupon books or some variation thereof. Section 9.43 – Rollover Contributions to the Plan. Subsection 43.1 should be amended to read as follows: “If elected in the Adoption Agreement and to the extent permitted under the Individual Agreements. . . .” Not all Vendors accept rollover contributions due to the requirement of separate accounting. In addition, subsection 43.2 provides that the Plan Administrator may require documentation from the distributing plan – we request that the receiving Vendor also be permitted to require any documentation it deems necessary. Section 9.45 – Exchanges Within the Plan. We suggest revising this section to speak in terms of “contract exchanges” instead of “exchanges within the plan,” as we believe the meaning of “within the plan” is unclear. For example, we understand that a grandfathered contract, which is not considered to be part of a plan, can be exchanged into a contract with a Vendor eligible to receive contributions under a plan or a Vendor authorized to receive exchanges pursuant to an information sharing agreement. This type of exchange would not appear to be entirely “within the plan.” Section 10.47 – Investment. We recommend revising subsection 47.4 to read as follows: 4. The Plan Administrator shall maintain a list of all investments available under the plan for future and past contributions, and the custodians/insurers through which such investments are available Vendors under the Plan. Such list is hereby incorporated as part of the Plan, excluding those terms which are inconsistent with the Plan. CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 9 of 11 Section 11.48 – Termination. We request that subsection 48.1 be revised to enable currently frozen plans to use the document and to avoid misunderstandings about partial termination, as follows: 1. Termination of Contributions. The Employer has no obligation or

liability whatsoever to maintain the Plan for any length of time and may discontinue contributions under the Plan at any time without any liability hereunder for any such discontinuance, either prior to or effective as of the adoption date of this Plan document. Termination of contributions to one or more custodians or insurers under the Plan (but not all) shall not be deemed to be a partial termination of the Plan. Consistent Adoption Agreement language should be added, as follows: [ ] Contributions to the Plan were discontinued by the Employer as of [date]. In addition, with respect to subsection 48.2, we note that in a letter to W. Thomas Reeder dated March 17, 2009, the Institute requested guidance on how to accomplish termination of a 403(b) plan funded through individual custodial accounts where the employer does not have authority to direct a distribution without the participant's consent. We explained that there may be situations where the participant does not consent to a distribution and the custodial agreement does not provide for forced distributions or rollovers. In that case, the custodian should be able to treat the account as taxable and issue a Form 1099-R after allowing the participant a period of time to request a distribution. The sample plan language should be revised to reflect this option.

Section 12.51 – Domestic Relations Orders and Qualified Domestic Relations Orders. We suggest revising the language meant for plans other than governmental or nonelecting church plans, to read as follows: If a judgment, decree, or order (including approval of a property settlement agreement) that relates to the provision of child support, alimony payments, or the marital property rights of a spouse or former spouse, child, or other dependent of a Participant is made pursuant to the domestic relations law of any State (“domestic relations order”), then the amount of the Participant's Account Balance awarded to an Alternate Payee shall be paid only if such domestic relations order is determined by the Plan Administrator or its agent to be a qualified domestic relations order as defined in section 414(p) of the Internal Revenue Code, or any domestic relations order entered before January 1, 1985.

Section 12.52 – IRS Levy. This section provides that the Plan Administrator may pay amounts demanded under a levy issued by the IRS. We note that the Vendor may be the recipient of a levy, rather than the Plan Administrator, and will be required to make payment. CC:PA:LPD:PR (Announcement 2009-34) June 1, 2009 Page 10 of 11

Section 12.53 – Mistaken Contributions. It would be helpful if the sample language was revised to include ministerial or clerical mistakes that do not meet the definition of “a mistake of fact.”

Part II Section 4.61 – Nonforfeitable Contributions. We strongly urge the Service to allow prototype 403(b) plans to have vesting schedules. Many employers sponsoring 403(b) plans and making employer contributions utilize vesting schedules. These employers should not be prevented from participating in the prototype program. If the Service believes, however, that it is impermissible for 403(b) plans to have vesting provisions, we urge the Service to provide separate guidance indicating this position and the reasons behind it. Until such time, we believe vesting schedules can be accommodated in the prototype program without raising issues such as how to classify non-vested amounts. 403(b) plans covered by ERISA are subject to minimum vesting standards under section 203 of ERISA, and these standards appropriately could be imported into the prototype program for all employers wanting to adopt a prototype plan.

Section 4.62 – Contribution Formula. Neither of the two options in the Adoption Agreement language would permit an employer to allocate contributions to employees who do not complete more than 500 Hours of Service and are not employed on the last day of the plan year. We therefore suggest an additional option for employers with more generous contribution policies. In addition, the Adoption Agreement language should include a choice for a formula mandated by outside agreements such as collective bargaining agreements or severance of employment contracts.

Section 4.64 – Matching Contributions. We request that the sample language be revised to permit discretionary matching contributions as well as matching contribution formulas providing a match greater than 100 percent of the

Participant's contributions. Section 4.65 – After-Tax Employee Contributions. Not all Vendors accept after-tax contributions due to the requirement of separate accounting. Therefore, the first sentence should be amended to read as follows: "If elected in the Adoption Agreement and to the extent permitted under the Individual Agreements. . . ."

Section 6.70 – Requirement: Distribution Limitations for Employer Contributions. It appears that the distribution exceptions for QDROs and IRS levies set forth in sections 12.51 and 12.52 (applicable to Part I of the document) would not apply to employer contributions (Part II of the document). We request that section 6.70 be revised to reflect distributions of employer contributions permitted pursuant to a QDRO or levy. In addition, Adoption Agreement language appears to be missing for subsection 70.2. CC:PA:LPD:PR

(Announcement 2009-34) June 1, 2009 Page 11 of 11 General Comment We fully recognize the challenges associated with drafting model plan provisions. With that in mind, we have some modest editorial suggestions. There are multiple instances throughout the sample language where terms are capitalized but not defined anywhere in the document, as well as terms that are defined but occasionally appear without capitalization. Examples include the terms "Adoption Agreement" and "Memorandum of Understanding," which are not defined; and "Participant" and "Disability" which are defined, but sometimes not capitalized. We encourage greater consistency in this regard. \* \* \* We appreciate the opportunity to comment on the proposal and draft language and look forward to working with the Service on the issues described above. Please do not hesitate to contact the undersigned if there are questions or if further discussion would be helpful. Sincerely, /s/ Elena Barone Elena Barone Associate Counsel – Pension Regulation

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