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403(B) VERSUS 401(K)

Presented by:

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February 5, 2010

*Qualified Pension Administrator
Qualified 401(k) Administrator*



403(B) BASICS AND NEW REGULATIONS



WHAT IS A 403(B) PLAN?

A 403(b) plan is a special type of retirement plan for certain tax-exempt organizations and public educational organizations (K-12 and colleges). 403(b) plans permit elective deferrals like a 401(k) plan, but must limit investments to annuity contracts and mutual funds.



WHAT IS THE DIFFERENCE BETWEEN A 403(B) PLAN AND A TSA?

Originally, 403(b) plan investments were limited to annuities known as tax-sheltered annuities. Although Congress now allows 403(b) plans to invest in mutual funds, many people still refer to these plans as TSAs.



WHAT TYPES OF CONTRIBUTIONS MAY BE MADE TO A 403(B) PLAN?

- **Elective deferrals through payroll withholding**
- **Employer matching contributions**
- **Employer non-elective contributions**

ARE 403(B) PLANS SUBJECT TO DEPARTMENT OF LABOR REQUIREMENTS (ERISA)?

A 403(b) plan sponsored by a government or church is not subject to ERISA. 403(b) plans sponsored by other tax-exempt organizations which are deferral-only plans may be exempt from ERISA requirements if the employer's involvement in the plan is limited. 403(b) plans with any employer contributions are subject to ERISA.



WHAT REQUIREMENTS MUST BE MET FOR A DEFERRAL-ONLY PLAN TO BE EXEMPT FROM ERISA REQUIREMENTS?

- Participation must be voluntary
- Each participant must be able to enforce his or her rights under the contract directly
- Employer's involvement must be limited to:
 - Permitting investment vendor access to employees
 - Requesting and compiling investment information



WHAT REQUIREMENTS MUST BE MET FOR A DEFERRAL-ONLY PLAN TO BE EXEMPT FROM ERISA REQUIREMENTS (Continued)?

- **Employer's involvement must be limited to (continued):**
 - **Collecting deferrals**
 - **Holding group annuities in the employer's name**
 - **Limiting investment providers**
 - **No receipt of compensation except reasonable expenses**



WHAT ARE THE REQUIREMENTS FOR A 403(B) PLAN SUBJECT TO ERISA?

- Annual report filing requirement (Form 5500)
- Provide participants with Summary Plan Description
- Subject to vesting rules
- Subject to joint and survivor annuity distribution requirements
- Deferral deposit requirements (timing)



WHAT IS INVOLVED WITH THE FORM 5500 FILING?

Only certain questions were required to be answered by ERISA 403(b) plans and no additional schedules were required. Beginning with the 2009 year, Form 5500 must be completed in its entirety, including all schedules.



WHAT ARE THE DEFERRAL DEPOSIT REQUIREMENTS?

ERISA 403(b) plans must deposit deferrals as soon as they can be reasonably segregated from the employer's assets, but in no event later than the 15th business day of the following month. Small employers (with less than 100 participants) are expected to deposit deferrals within 7 days. Larger employers are expected to deposit deferrals sooner. Recently issued regulations have declared the 7 day limit as a safe harbor for small employers.



WHAT IS THE WRITTEN PLAN DOCUMENT REQUIREMENT?

- **Commencing in 2009, all 403(b) plans must have a written plan that includes all material terms:**
 - **Eligibility**
 - **Benefits and limits**
 - **Optional features (loans, hardship withdrawals, etc.)**



WHAT IS THE WRITTEN PLAN DOCUMENT REQUIREMENT (Continued)?

- **Annuity contracts or custodial accounts must be identified**
- **Any responsibilities that are allocated to investment vendors or a third party administrator must be explained**

DOES THE IRS OFFER A PRE-APPROVED PROTOTYPE PROGRAM?

The IRS does not currently offer a 403(b) document program nor does it have a determination letter program. Private letter rulings may be obtained but are costly and uncommon.



WHERE CAN A 403(b) WRITTEN PLAN BE OBTAINED?

- **Most investment vendors will offer a sample written plan**
- **Most 401(k) document providers can provide 403(b) plan documents**
- **Attorneys who prepare ERISA plan documents can prepare 403(b) plan documents**



MAY A 403(B) PLAN IMPOSE A VESTING SCHEDULE?

Employer contributions may be subject to a vesting schedule and the plan is responsible to track non-vested contribution balances.



MAY A 403(B) PLAN HAVE A ROTH FEATURE?

**Yes, a 403(b) plan may include a Roth
elective deferral feature in addition to a
pre-tax elective deferral feature.**



MAY A 403(B) PLAN IMPOSE ELIGIBILITY CONDITIONS?

A 403(b) plan may impose eligibility conditions on employer contributions but must make elective deferrals available to all employees immediately upon employment except for employees who do not customarily work 20 hours per week, are eligible to defer under a 401(k) or other 403(b) plan, are nonresident aliens or student employees.



WHAT ELIGIBILITY CONDITIONS MAY BE IMPOSED ON EMPLOYER CONTRIBUTIONS?

**A 403(b) plan may impose minimum age
(no less than age 21) and minimum service
(no greater than 2 years of service)
conditions to receive employer matching
or non-elective contributions.**



WHAT ARE 403(B) PLAN CONTRIBUTION LIMITS?

- **The maximum a participant may defer for 2010 is \$16,500**
- **Certain types of tax-exempt organizations permit participants to make additional deferrals called “15 years of service catch-ups” of up to \$3,000. The rules are complex and require detailed plan accounting records and increase the maximum to \$19,500**



WHAT ARE 403(B) PLAN CONTRIBUTION LIMITS (Continued)?

- If age 50 or older as of 12/31/2010, a participant may defer an additional catch up amount of \$5,500 for a total \$22,000 or \$25,000 if the 15 years of service catch-up also applies
- The maximum annual addition that can be made on behalf of any participant in 2010 is \$49,000 or \$54,500 for a participant eligible for the age 50 catch-up



WHAT ARE THE 403(B) PLAN DISTRIBUTION RULES?

- **Distribution of elective deferrals may only be permitted upon termination of employment, attainment of age 59 ½, death, disability, financial hardship or plan termination**
- **Distribution of employer contributions held in a custodial account (mutual funds) may only be permitted upon termination of employment, attainment of age 59 ½, death, disability or plan termination**



WHAT ARE THE 403(B) PLAN DISTRIBUTION RULES (Continued)?

- **Distribution of employer contributions held in an annuity may only be permitted upon termination of employment, attainment of a specific age, passage of a specific amount of time, death, disability, financial hardship or plan termination**

WHAT EVENTS CONSTITUTE A FINANCIAL HARDSHIP?

- **Medical expenses**
- **Purchase of a principal residence**
- **Payments to prevent eviction from or foreclosure on a participant's residence**
- **College tuition, room and board**
- **Funeral expenses**
- **Casualty loss to primary residence**



WHAT ARE OTHER 403(B) PLAN RULES?

- **403(b) plans are subject to required minimum distribution requirements (age 70 1/2)**
- **A court may issue a domestic relations order that divides a 403(b) plan account on account of divorce**
- **403(b) plans may permit participants to obtain participant loans from their accounts**



WHAT ARE OTHER 403(B) PLAN RULES (Continued)?

- 403(b) plans may permit participants to exchange one plan investment for another
- A 403(b) plan participant may roll his/her account to an IRA, a Roth IRA, a qualified plan, a governmental plan or another 403(b) plan

DIFFERENCES BETWEEN 403(B) AND 401(K) PLANS



403(B) VERSUS 401(K)

Investment Options

403(b)

Annuity contracts

Custodial accounts-mutual funds

Information sharing agreements

Expenses

-Individual annuities have mortality and expense charges and back-end loads or surrender charges

-Mutual funds often have front-end or back-end loads

-Group annuities same as for 401(k)

401(k)

Full range of options

Held in trust

Expenses

-Group annuities or plan level mutual fund platforms provide 'purchasing power' advantages



403(B) VERSUS 401(K)

Documentation

403(b)

Required by 12/31/2009

-must identify product vendors

IRS prototype program coming
in 2010

401(k)

Required since 1974

Prototype and volume submitter
documents available



403(B) VERSUS 401(K)

Eligibility

403(b)

Universal Availability

- employee deferrals
- annual notice

Can impose minimum age/service

- employer contribution sources

401(k)

Can impose minimum age/service

- all contribution sources
- flexibility in defining entry dates



403(B) VERSUS 401(K)

Employee Contribution Testing and Limits

403(b)

\$16,500 in 2010

Pre-tax, Roth or both

15 YOS Catch-Up

Age 50 Catch-up

No ADP nondiscrimination testing

401(k)

\$16,500 in 2010

Pre-tax, Roth or both

Age 50 Catch-up

ADP nondiscrimination testing



403(B) VERSUS 401(K)

Employer Contribution Testing and Limits

403(b)

410(b) minimum coverage
401(a) (4) general nondiscrimination
ADP testing
No top heavy testing

100% of compensation up to \$49,000
\$5,500 age 50 catch up

401(k)

410(b) minimum coverage
401(a) (4) general nondiscrimination
ADP testing
Top heavy testing – minimum
contribution required if top heavy
100% of compensation up to \$49,000
\$5,500 age 50 catch up



403(B) VERSUS 401(K)

Plan Terminations

403(b)

All assets to be distributed

No new 403(b) plan for 12 months

401(k)

All assets to be distributed

No new DC plan for 12 months



CHANGING FROM 403(B) TO 401(K)



ADVANTAGES

- **Lower expenses**
 - Assets are usually pooled with decreasing expenses
 - Usually no loads or surrender fees
- **Broader investment selection**
 - Multi fund company platforms operate like single vendors
 - Brokerage accounts (individual stocks and bonds)
 - Limited partnerships, real estate, collectibles, etc.



ADVANTAGES (Continued)

- **Third party administrator oversight**
 - **Compliance with government regulations**
 - **Calculation of employer match or nonelective contributions**
 - **Withdrawal coordination, including hardships and loans**
 - **Vesting tracking**
 - **Creative plan design**
 - **Pro-active consultation**
- **Plan sponsor control**
 - **May impose eligibility requirements**
 - **Plan Administrator/Trustee authorize all transactions**



DISADVANTAGES

- **ADP testing**
- **Top heavy requirements**
- **Third Party Administration fees**
- **No 15 YOS catch-up provision**
- **More liberal distribution rules**

CHALLENGES OF MAKING A CHANGE

- **Distribution of 403(b) accounts**
 - Encouraging participants to act
 - Surrender fees
 - List of current account holders/vendors
- **Uncertainty of value of transferred assets**
- **Lack of government guidance**



QUESTIONS AND ANSWERS



KB Pension Services, Inc.

KB Pension Services, Inc. provides quality, full-service qualified retirement plan consulting. We design benefit programs that balance the financial objectives of your business with the needs of your employees. We are a third party administrator providing administrative services for your retirement program. You can expect accurate, timely information to both employer and employees from KB Pension Services.

Because our firm is active in the local business community, we are aware of the needs of local businesses and can provide a plan to meet those needs. We provide services to over 400 companies and would welcome the opportunity to add you to our client family.

- **401(k) Plan Administration**
- **Not-for-profit 403(b) and TSA Plan Consulting**
- **Pension and Profit Sharing Plan Consulting**
- **Plan Design**
- **Third Party Administration Services**



Thank you!

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