NTSA National Tax-Deferred Savings Association
Part of the American Retirement Association
AMERICAN RETIREMENT ASSOCIATION
Working for America's Retirement
4245 North Fairfax Drive | Suite 750 | Arlington, VA 22203 • P. 703.516.9300 • F. 703.516.9308

April 19, 2015

The Honorable Phyllis C. Borzi
Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Room S-2524
Washington, DC 20210

Re: 403(b) Plan Terminations

Dear Assistant Secretary Borzi:

The National Tax-deferred Savings Association (NTSA) appreciates the opportunity to share our concerns and comments on the proper treatment of distributed contracts and custodial accounts in the context of a 403(b) plan termination. This is an issue of great importance to the sponsors of 403(b) plans and the professionals who advise them. Although the Internal Revenue Service (IRS) has opined on this issue, clarifying guidance is badly needed to resolve the issue with respect to plans that are subject to Title I of ERISA. NTSA has previously provided input to the Department of Labor (the "Department" or "DOL") and testified before ERISA Advisory Council whose recommendations are consistent with our own.[1]

NTSA is a national organization of retirement plan professionals who provide consulting and administrative services for 403(b) plans covering thousands of American workers. The members of NTSA and its sister organization, the American Society of Pension Professionals and Actuaries (ASPPA) are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. NTSA and ASPPA are now part of the American Retirement Association whose total membership of more than 17,000 retirement plan professionals is diverse but united by a common dedication to the employer-based retirement plan system.

Summary

In a voluntary private retirement system, as we have here in the United States, the ability to formally terminate a retirement plan, whether a 403(b) plan or otherwise, is inherently a right of plan sponsors. Employers have many valid reasons for both initiating and

[1] See November 9, 2011, ERISA Advisory Council Report, "Current Challenges and Best Practices for ERISA Compliance for 403(b) Plan Sponsors," available at [http://www.dol.gov/ebsa/publications/2011ACreport1.html#ExecutiveSummary].

terminating a plan. The Department should definitively clarify that current regulations[2] allow for this result. Specifically, that a distribution on plan termination of a 403(b)(7) custodial account, 403(b) annuity contract or certificate relating to a 403(b) annuity contract would cause the holder of such a contract, certificate, or custodial account to have received a full distribution of his or her interest in the plan. As such, the individual would no longer be considered a participant in an employee pension plan and upon distribution of all such contracts, certificates or custodial accounts (or, where applicable, cash), the plan would be considered terminated and no longer be subject to ERISA.

Discussion

1. Annuity Contract or Certificate Distribution

ERISA regulation §2510.3-3(d)(2)(ii) provides:

"An individual is not a participant covered under an employee pension plan or a beneficiary receiving benefits under an employee pension plan if—

(A) The entire benefit rights of the individual—

(1) Are fully guaranteed by an insurance company, insurance service or insurance organization licensed to do business in a State, and are legally enforceable by the sole choice of the individual against the insurance company, insurance service or insurance organization; and

(2) A contract, policy or certificate describing the benefits to which the individual is entitled under the plan has been issued to the individual; or

(B) The individual has received from the plan a lump-sum distribution or a series of distributions of cash or other property which represents the balance of his or her credit under the plan."

In the case of a 403(b) plan, when a contract has been distributed from the plan, and as a result the plan sponsor has relinquished any control following such distribution, then both conditions of Sub-section A(1) are met. Specifically, benefits as described in the contract would now be fully and solely guaranteed by the insurer, and solely enforceable against the insurer by the contract or certificate holder. Such treatment would be contingent on delivery of the contract or certificate, as described in Sub-section A(2), although as also acknowledged by the IRS, the contract or certificate may already be in the hands of the participant and the distribution may consist solely of a declaration of its distribution out

[2] 29 CFR 2510.3-3(d)(2)(ii).

of the plan and the absence of any further plan authority over it[3]. Upon distribution, a contract which may have been one of multiple investment program alternatives under the plan, now provides the full guarantee of benefits – as to the precise amount and/or as to the method of valuation (as in the case of a variable annuity) – with respect to the plan value allocated to the contract immediately prior to the distribution.

2. With respect to the distribution of a custodial account (and conceptually, to the distribution of an annuity contract or certificate)

In this case of a custodial account, the provisions of Sub-section (B) would be applicable. 403(b)(7) custodial accounts are held under agreements which are subject to state laws including contract laws, where there is often privity of contract directly between the plan participant and the custodian of the 403(b) assets. The participant in such cases is actually a party to such contracts with the custodian, and the plan sponsor is not. Where there is such privity, often the 403(b) plan sponsor has no legal authority to distribute the assets in these accounts on plan termination, and some custodians have not retained any right to unilaterally amend the agreement to provide for such authority under the terms of the custodial agreement. These contracts are only associated with a 403(b) plan typically for IRS compliance purposes, even though the plan sponsor has no contractual rights under the arrangements.

The "distribution" of these contracts upon the termination of the 403(b) plan does not entail the transfer of rights from the plan to the participant, as such rights are already held by the participant. Rather, it involves the transfer of plan administrative responsibility from the employer to the custodian. This transfer of responsibility effectively results in an in-kind "distribution" of the custodial account. Such a distribution would be merely preserving the participant's rights under the contract, and would cause no interference with ownership rights existing under the agreement prior to termination. After distribution, as suggested below, the participant would still be the owner and could exercise those rights under the custodial account. The custodian would continue to hold assets in a custodial account, subject to the underlying contract's terms and applicable IRS requirements for tax deferral of the assets held in the custodial account, until such time as an actual distribution is requested by the participant, as the distribution would be an in-kind distribution of the account itself representing the "balance of his or her credit under the plan." As noted in our prior correspondence, from a contractual standpoint it is clear that a custodial agreement could be considered "distributed" from the plan, absent contrary provisions in either the plan or the custodial account agreement. Upon such a "distribution", a custodial account should stand in no less favorable a position than in-kind distributions of other property, such as in-kind distributions of employer stock (which may be subject to favorable tax rules), where applicable, or the mutual fund shares themselves (which would not only be a distribution but also taxable unless rolled over to an IRA).

[3] See Revenue Ruling 2011-7, 2011-10 I.R.B. (March 7, 2011).

In the case of a group custodial agreement, the result would be the same. As an in-kind asset, the employer has the legal ability to "distribute the custodial account" upon termination of the plan, even where a participant does not separately consent or cooperate with such distribution. Such a participant is effectively a "non-responsive participant," for whom public policy supports making termination distributions in a manner which preserves the retirement plan characteristics of the funds.

Although ERISA does not apply to every 403(b) plan, it does establish a recognized public policy supporting preservation of retirement assets, where practicable. Generally, the distribution of assets on plan termination is governed by the fiduciary requirements of ERISA to encourage plan fiduciaries to properly wind up the affairs of a terminating plan. The Department created a safe harbor that permits the transfer of nonresponsive participants' assets to an IRA custodial account. This safe harbor preserves the continued tax deferred status of the participant's retirement assets and is a "preferred' method of distribution.[4]

If a 403(b) plan with 403(b)(7) accounts terminates, a participant would be given the option of taking a liquidating rollover distribution. If a participant with an individual 403(b)(7) custodial account doesn't respond to the distribution notice, he or she would be considered a non-responsive participant. The 403(b) custodial account is functionally and structurally similar to an IRA custodial account. There is no effective difference between, on the one hand, liquidating the assets in a non-responsive participant's 403(b) custodial account and establishing a tax deferred IRA custodial account in the participant's name and, on the other hand, merely transferring a non-responsive participant's 403(b) custodial account to that participant's control. However, employers generally have no ability to unilaterally terminate 403(b)(7) custodial accounts in order to effectuate a distribution to an IRA custodial

Examples

Example 1:

Employer A has previously entered into a group custodial account agreement and also applied for and received an annuity contract for Employer A's 403(b) plan. Both the custodial account and the annuity contract maintain individual participant accounts under the plan and under the respective investment arrangement or product, and in the case of the annuity contract participants receive a participant certificate. Both the custodial account and the annuity contract include terms providing that exercise of any account or contract rights by the participant may be limited by the terms of the plan. The custodial agreement provides that in the event of plan termination, the plan may accomplish that

[4] See, DOL Field assistance Bulletin 2004-02 and DOL Reg. § 2550.404a-3, safe harbor for distributions from terminated individual account plans (published 4/21/2006).

termination by distributing either cash or individual custodial accounts to participants, subject to applicable requirements of the Code and ERISA. The annuity contract provides that in the event of plan termination, the plan and the employer cease to have any authority over the contract except as holder, and the underlying participant certificates are otherwise administered solely pursuant to the directions of the participant and the terms of the Code and ERISA, and that spousal consent requirements, if applicable, shall continue to be applied by the insurance company.

At the time of plan termination, the plan sponsor/fiduciary elects to make in-kind distributions of custodial accounts and annuity certificates to the participants. The individual custodial account distributed to a participant reflects the entire balance of his or her credit under the plan, represented by the value of the mutual fund shares held in the individual custodial account following the distribution.

The participants already hold the annuity certificates. Upon termination, the benefit rights under the annuity contract (which may be a fixed annuity, a variable annuity, or a combination fixed and variable annuity) are guaranteed by, and solely enforceable by the participant against, the insurer under the certificates they already hold. Under any of these annuity contract variations (fixed, variable, or combination), the benefit rights of the participant are defined both before and after the termination under the terms of the contract, including the valuation of the participant's interest on any particular date. Although not required, the insurer might issue an endorsement to the individual annuity certificates to further memorialize the distribution of the contract out of the plan.

In these circumstances, the custodial accounts and annuity certificates should be treated as having been distributed from the plan in the plan termination process, for purposes of ERISA.

Example 2:

Same general facts as Example 1, except that the original plan purchase involved individual custodial accounts and individual annuities, all owned by the participants but subject, by their terms, to the terms of the plan and the requirements of the Code and ERISA. The employer relinquishes any further control over them and declares them distributed as part of the plan termination. Although not required, the insurer might issue an endorsement to the individual annuity contracts to further memorialize the distribution of the contract out of the plan.

In a circumstance such as this, the individual custodial accounts and annuity contracts should also be treated as distributed out of the plan in the plan termination process, for purposes of ERISA.

NTSA recommends that the DOL definitively clarify that a distribution on plan termination of a 403(b)(7) custodial account or annuity contract (or certificate relating to

a an annuity contract) would cause the participant to have received a full distribution of his or her interest in the plan and upon distribution of all such contracts, certificates or custodial accounts (or, where applicable, cash), the plan would be considered terminated and no longer be subject to ERISA.

* * *

These comments were prepared by NTSA's Government Affairs Committee, Susan Diehl, Chair, with primary drafting by Richard A. Turner. Please contact Craig P. Hoffman, Esq., APM, General Counsel and Directory of Regulatory Affairs, at (703) 516-9300 if you have any comments or questions on the matters discussed above. Thank you for your time and consideration.

Sincerely,

/s/
Craig P. Hoffman, Esq., APM
General Counsel
American Retirement Association

/s/
Susan D. Diehl, CPC, QPA, ERPA, Chair
NTSA Government Affairs Committee

/s/
Richard A. Turner
NTSA Government Affairs Committee

CC:

Mr. John J. Canary, Director
Office of Regulations and Interpretations
US Department of Labor

Mr. Jeffery J. Turner
Deputy Director of Regulations and Interpretations
US Department of Labor

Mr. Seth Tievsky
Senior Technical Advisor
Employee Plans Rulings & Agreements
Tax Exempt and Government Entities Division
Internal Revenue Service

Mr. Eric Slack
Employee Plans
Tax Exempt and Government Entities Division
Internal Revenue Service