



403(b) Retirement Savings Plans

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OVERVIEW

Q: What is a 403(b) plan?

A: A 403(b) plan is a tax-deferred retirement savings program sponsored by a public school system or a tax-exempt organization. A 403(b) plan is similar to a private-sector 401(k) plan or a public-sector 457 plan. All three are *defined contribution* plans.¹

Both 403(b) and 457 plans are tax deferral plans that may be sponsored by a public school district. A number of differences exist between the two types of plans, including differences in contribution limits, catch-up contribution amounts, and timing of distributions.

Q: What are the two basic types of 403(b) plans for Texas school districts?

A: The two basic types of 403(b) plans available in Texas school districts are *elective* and *nonelective*. The primary difference between the two lies in whether the employee or district chooses to establish and contribute to an account on behalf of the employee. With an *elective* plan, the employee chooses—“elects”—to establish and contribute to the account through salary deferrals. With a *nonelective* plan, the district chooses to establish and contribute to the account, although the plan may permit the employee to also make contributions.

In reading articles and guidance regarding 403(b) plans, Texas districts should be mindful of the distinction between elective and nonelective 403(b) plans. Because a district establishes and contributes to a nonelective plan, the district has more decision-making authority and greater responsibility for the plan’s operation. Much of this authority and responsibility does not apply to elective plans.

¹ The Department of Labor’s Web Site has a helpful explanation of the different types of retirement plans. www.dol.gov/dol/topic/retirement/typesofplans.htm.

Texas is unusual in that our state law gives employees the right to establish elective plans. Because of this, and also because of the absence of organized labor in Texas, nonelective plans are the exception and not the rule. Most of the resources on 403(b) come from outside of Texas and relate exclusively to nonelective plans. **For these reasons, it is very important that Texas districts work with benefits attorneys and investment advisors who are familiar with Texas law.**

Q: Are Texas districts required to sponsor elective 403(b) plans?

A: Yes. These plans are elective for employees, not for districts. A district may not refuse to enter into a salary reduction agreement with an employee for the purpose of making contributions to an *eligible qualified investment*, or to certain ineligible investments described below. Tex. Rev. Civ. Stat. 6228-5, sec. 9(1). As a practical matter, then, a district must sponsor a 403(b) plan if even one employee elects to establish a 403(b) account.

Q: Are districts required to sponsor nonelective 403(b) plans?

A: No. Some Texas districts maintain nonelective 403(b) plans as an additional retirement program, attendance incentive, or other employee benefit, but Texas law does not require districts to establish or maintain these plans.

Q: Can a district terminate its 403(b) plan?

A: The answer depends on whether the 403(b) plan is elective or nonelective. A district *must* sponsor an elective plan if even one employee wants to contribute to an eligible qualified investment. Texas districts are not, however, required to sponsor nonelective 403(b) plans. Thus, a district may terminate a nonelective 403(b) plan if it complies with the procedures and requirements in the IRS rules.

Whether termination of a nonelective plan is advisable is another matter. The personal savings rate has declined significantly in the past few years.² Tax-sheltered savings plans are one means by which districts can help their employees save for retirement. A district may decide that the burdens imposed by the new 403(b) rules outweigh the benefits of nonelective plans. A district may also decide that another type of retirement plan, such as a 457 plan, would be a better choice for its employees. A district that is considering termination of a nonelective plan should work with its benefits counsel to determine the feasibility of termination.

² www.bea.gov/briefm/saving.htm.

Q: Is our district required to have a written 403(b) plan?

A: Yes. **Any Texas school district that has even one employee who contributes to an elective 403(b) plan must have a written plan document.** The IRS adopted rules regarding 403(b) plans in 2007. One of the biggest changes from the 2007 rules is a requirement that a district have a written plan document for all 403(b) plans it sponsors. The plan document(s) must address the “material terms and conditions” of the plan(s), including:

- Terms and conditions for eligibility;
- Form and timing of distributions;
- Contracts available under the plan; and
- Any optional provisions, such as hardship withdrawals, distributions, loans, transfers, and rollovers.

The plan document may also allocate responsibility for administrative functions to parties other than the district (e.g., third party administrators), but the plan may not impose any compliance responsibility on the employee.

Q: Is there a required form for the 403(b) plan document?

A: No. The plan document need not be in any special form, so long as it addresses all of the material terms and conditions of the plan. The plan “document” may incorporate other documents by reference.

Several resources are available for development of the plan document. The IRS has issued model language for public school districts at Revenue Procedure 2007-71: www.irs.gov/pub/irs-irbs/irb07-51.pdf. A district is not required to use the IRS’s model, but if it does it may rely on the model to the extent it adopts the exact language or language that is “substantially similar in all material respects.” The Association of School Business Officials International (ASBO) has included a sample plan in its 403(b) Resource Center: www.asbointl.org/index.asp?bid=9709. Finally, some districts may choose to rely on third party administrators or benefits attorneys to develop the 403(b) plan document.

IRS RULES

Q: What do the IRS’s 403(b) rules mean for our district?

A: The rules increase districts’ compliance responsibilities and require that districts have written 403(b) plans.³ Two basic duties or responsibilities exist with respect to tax-sheltered plans: *compliance* and *fiduciary*. *Compliance duty* is the responsibility to ensure compliance with the rules for the type of plan, including limits on enrollment, contributions, transfers between

³ The IRS issued final regulations on July 26, 2007. The regulations are published at 26 C.F.R. parts 1 and 31.

plans, distributions, and rollovers. *Fiduciary duty* is, in the most basic terms, the responsibility to prudently exercise any discretionary authority relating to the plan. This includes the duty to exercise prudence in selecting vendors.

While much attention has been paid to fiduciary duties under 403(b) plans, the rules arguably do not increase or decrease a district's fiduciary duties. Districts have always had fiduciary duties with respect to these plans. The rules do, however, require districts to take a more active role in compliance. Previously, districts had little accountability for 403(b) plans. Many districts relied on annuity vendors to enforce requirements. Compliance responsibility now falls more squarely on districts.

Q: Does my district owe a fiduciary duty with respect to our 403(b) plans?

A: Probably. Fiduciary duties relate to the exercise of discretionary authority. If a district exercises any discretion with respect to a plan, the district may owe its employees a duty to exercise its discretion in a prudent manner. For further information, ASBO had prepared a Q & A document regarding fiduciary duties:
[www.asbointl.org/ASBO/files/ccLibraryFiles/Filename/000000002650/ASBOFiduciaryERISA
APiece.pdf](http://www.asbointl.org/ASBO/files/ccLibraryFiles/Filename/000000002650/ASBOFiduciaryERISA%20Piece.pdf).

Q: What is the deadline for complying with the 2007 rules?

A: The general compliance date was December 31, 2008. The IRS subsequently extended the deadline for a district to adopt a 403(b) written plan to December 31, 2009, provided that:

- On or before December 31, 2009, the district had adopted a written plan that was intended to satisfy the requirements of section 403(b), effective as of January 1, 2009;
- During 2009, the district operated the plan in accordance with a reasonable interpretation of section 403(b), taking into account the final regulations; and
- Before the end of 2009, the district made its best efforts to retroactively correct any operational failure during the 2009 calendar year to conform to the terms of the written plan.

Notice 2009-3, www.irs.gov/pub/irs-drop/n-09-03.pdf.

INVESTMENTS AND VENDORS

Q: What is an “eligible qualified investment”?

A: An eligible qualified investment is a qualified investment product offered by a company that either has certified to the Texas Teacher Retirement System (TRS) or is eligible to certify to TRS that it meets applicable laws and rules.⁴ Tex. Rev. Civ. Stat. 6228-5, sec. 4(3).

⁴ An exception exists for contracts entered into before June 1, 2002. Additional information regarding 403(b) plan vendors, including a list of vendors, is available on the TRS Web Site:
www.trs.state.tx.us/global.jsp?submenu=403b&page_id=/403b/403b_welcome.

Q: Do we have to accept any vendor who certifies its eligibility to TRS?

A: Yes, unless the vendor refuses to comply with administrative procedures in the district's written plan. Again, a Texas district may not refuse to enter into a salary reduction agreement with an employee with respect to an eligible qualified investment. The district may, however, require that the vendor follow any administrative procedures the district has adopted to comply with the IRS's 403(b) rules.

Q: Do we have to accept an annuity that is not an "eligible qualified investment"?

A: Yes, but the district must first provide written notice of ineligibility. Under former law, a district was prohibited from entering into a salary reduction agreement with an employee unless the employee designated an investment that was an eligible qualified investment. In 2009, the Legislature changed this provision. A district may now enter into or continue a salary reduction agreement relating to an annuity that is not an eligible qualified investment, including an investment product of a company whose certification has been denied, suspended, or revoked by TRS, if the district first provides written notice to the employee that:

- Indicates the reason the annuity is no longer an eligible qualified investment or why certification has been denied, suspended, or revoked; and
- Clearly states that, by signing the notice, the employee is agreeing to enter into or continue the salary reduction agreement.

Tex. Rev. Civ. Stat. 6228-5, § 9(a)(8).

TRS maintains a list of changes to the 403(b) vendor roster on its Web site: www.trs.state.tx.us/403b/documents/history_companies.pdf. Districts may wish to consult this list when complying with the first bullet point.

Q: What restrictions exist on access to employees by vendors of annuities?

A: Basically, no vendor may have exclusive access to employees. A district may not:

- Require or coerce an employee's attendance at any meeting at which qualified investments are marketed
- Limit the ability of an employee to initiate, change, or terminate a qualified investment at any time the employee chooses
- Grant exclusive access to an employee by discriminating against or imposing barriers to any agent, broker, or company that provides qualified investments
- Grant exclusive access to an employee's financial information, without the employee's written consent, to a company offering qualified investment products or to the company's agent or affiliate

- Accept any benefit from a company that offers qualified investment products, or from an agent or affiliate of the company

Tex. Rev. Civ. Stat. 6228-5, sec. 9(a)(8).

The Legislature expanded these restrictions in 2009 by adding “affiliates” to the existing prohibitions.

The Legislature has also restricted the ability of third party administrators (TPAs) to hold meetings to market qualified investment products to employees. A TPA that has a contract with a district may not hold a marketing meeting unless the TPA has provided representatives of other companies on TRS’ certified list an opportunity to attend and market their qualified investment products at the meeting. Tex. Rev. Civ. Stat. 6228-5, § 9B. In other words, a TPA may have a meeting with employees to market annuities only if the TPA invites all other vendors to the meeting.

Q: Does our district have to hire a third party administrator for its 403(b) plan?

A: The law does not require a district to hire a TPA to manage its 403(b) plan(s). As a practical matter, however, many districts will find that a TPA is advantageous. TPAs typically manage 403(b) elections, screen for compliance, approve payroll deductions and receive the funds, and forward funds to the vendors selected by employees.

TPAs have special expertise and can shoulder most of the administrative responsibilities. Also, because TPAs represent large groups of employers, they have more bargaining power with vendors. A district that does not use a TPA may find vendors unwilling to comply with its plan requirements.

Region X ESC is providing TPA services to Texas school districts, as is TASB-affiliate First Public. Many other companies also provide these services.

Q: Can a district use a 403(b) vendor as its third party administrator?

A: It depends. This question was posed to the Texas Attorney General because of the potential conflict of interest if a vendor provides TPA services. Specifically, a concern was raised that the vendor/TPA might get preferential access to school district employees in violation of the statutory restrictions discussed above.

The attorney general concluded that use of a vendor/TPA may violate the law if the TPA provides its services to the district for free or at a reduced fee and the district—rather than the employees—benefits from the arrangement. Tex. Att’y Gen. Op. GA-633 (2008). Other aspects of the arrangement may violate the statute, depending on the facts and circumstances. If, for example, a vendor does not charge a district to provide TPA services, but then charges a higher administrative fee to employees, such an arrangement could conflict with the district’s fiduciary duty to the employees. Because this is a complicated issue, a district should consult its attorney before entering into a TPA agreement with a company that is also a 403(b) vendor.

UNIVERSAL AVAILABILITY

Q: What is universal availability?

A: *Universal availability* is the requirement that a district permit all eligible employees to participate in a 403(b) plan. This may sound obvious, but the IRS has identified inconsistent application of eligibility rules as one of the most frequent mistakes made in the administration of 403(b) plans. A mistake in universal availability may result in the entire plan's losing its tax exempt status.

The IRS considers universal availability to be so important that it has initiated a compliance effort directed at this one issue. The IRS is contacting school districts throughout the nation to determine whether all eligible employees are provided an opportunity to participate in the districts' 403(b) plans. More details on the project are available on the IRS Web Site: www.irs.gov/retirement/article/0,,id=171019,00.html. A district that receives a compliance contact letter and questionnaire from the IRS should contact its attorney for assistance.

Q: How can we be sure that we are complying with the universal availability requirement?

A: The best way to achieve compliance is to understand the eligibility rules and the most common mistakes. The basic rule is that if one employee is eligible, every employee is eligible, except that the district may exclude certain groups of employees. Specifically, a district may exclude⁵:

- employees who will annually contribute \$200 or less to the plan
- employees who participate in a 401(k) or 457 plan, or another 403(b) plan
- non-resident aliens
- students performing certain types of services
- employees who normally work fewer than 20 hours per week

www.irs.gov/retirement/article/0,,id=171020,00.html.

If a district allows one individual who could be excluded to participate, then the district must allow all excludible individuals to participate.

Q: What are the most common mistakes relating to universal availability?

A: According to the IRS, the two most common mistakes are: (1) improperly excluding eligible part-time employees; and (2) failing to offer all eligible employees an *effective opportunity* to participate in the 403(b) plan. The IRS states that the groups most likely to be mistakenly

⁵ Under previous rules, a district could also exclude employees who made a one-time election to participate in a governmental plan instead of a 403(b) plan, employees covered by a collective bargaining agreement, and visiting professors. A district that excluded any of these groups before the new rules may continue the exclusion for the period of time specified in the rules.

excluded are nurses, substitute teachers, maintenance workers, bus drivers, and other employees who are not full-time, not permanent, or not under contract.

A district may exclude employees who do not normally work at least 20 hours per week. In the past, it was difficult to determine eligibility for employees whose schedules fluctuated from week to week, such as substitutes. The new rules set forth a simplified test for determining whether an employee normally works fewer than 20 hours per week. A district may exclude a part-time employee only if: (1) for the 12-month period after the employee's employment started, the district reasonably expects the employee to work fewer than 1,000 hours; and (2) for that year and each subsequent year, the employee in fact works less than 1,000 hours.

The *effective opportunity* test requires that all eligible employees have a chance to participate in the 403(b) plan. Whether a district gives employees an effective opportunity depends on all of the facts and circumstances, including whether employees were given notice of the availability of the plan and sufficient time to elect to participate. The IRS will consider a district to be in compliance if it provides employees with an opportunity, at least once each year, to make or change their elections to contribute to the plan.

RESOURCES

Q: What TASB policies apply?

A: Check out TASB Policy CRG(LEGAL): Deferred Compensation and Annuities.

Q: Where can I get more information?

A: More information about 403(b) plans is available on the IRS's Web Site:
www.irs.gov/retirement/article/0,,id=172430,00.html.

The Association of School Business Officials International (ASBO) has created a 403(b) Resource Center, including timelines and sample documents:⁶
www.asbointl.org/index.asp?bid=9709.

TRS has provided the following FAQs on 403(b) certification:
www.trs.state.tx.us/info.jsp?submenu=403b&page_id=/403b/faq_403b_certification.

A district with specific application concerns should consult its own counsel. The district can also contact TASB Legal Services at 800-580-5345 for general assistance.

This document is provided for educational purposes only and contains information to facilitate a general understanding of the law. It is not an exhaustive treatment of the law on this subject nor is it intended to substitute for the advice of an attorney. Consult with your own attorneys to apply these legal principles to specific fact situations.

Updated by Holly Claghorn, Senior Attorney, January 2010

⁶ ASBO has provided a timeline for compliance in its 403(b) Resource Center. In working with this timeline, Texas districts that sponsor only elective 403(b) plans should disregard any references to vendor selection and collective bargaining agreements.