MILLIGAN&COMPANY, LLC

Client Briefing

Regulations Affecting 403(b) Plans

Spring 2008

During the past few years, the Internal Revenue Service and the Department of Labor identified problems with 403(b) plans and determined that changes were needed. The result is that 403(b) plans subject to ERISA – typically those with 100 or more participants – will now be treated more like other pension plans for reporting requirements.

The new regulations affect most tax-exempt organizations such as nonprofits, public schools, universities and hospitals. They introduce important due diligence and compliance expectations that will reshape the way tax-exempt employers oversee and manage their 403(b) plans.

The new regulations are comparable to those that apply to 401(k)s and are expected to emulate their results – transparency, fee disclosure and the growing need for fiduciary scrutiny. Employers will have to meet increased fiduciary responsibility, including: accountability for fees paid to service providers; compliance and oversight of plan providers and plan provisions; better communication; and delivery of a prudent investment platform to plan participants.

Major changes will transform Plan Sponsor's responsibilities and reshape plan management and oversight

Start planning now – compliance with these changes is crucial. If your 403(b) plan has 100 or more participants new regulations impose due diligence, compliance and reporting requirements.

While these regulations add a layer of complexity for plan sponsors, failure to comply may result in substantial penalties for the organization. Non-compliance could also result in adverse tax consequences to employees who participate in the 403 (b) plan.

What's changing?

Increased Plan Sponsor fiduciary responsibility – new regulations impose due diligence and compliance requiring employers to assume increased fiduciary responsibility and the liability that goes along with it. Among their new responsibilities, the Plan Sponsor (typically the employer) must: develop policy statements with guidelines for selecting, monitoring and evaluating investment options; form an investment committee that meets regularly to review investment performance and plan expenses; provide employee education; and coordinate compliance with IRS plan limitations, such as loan and distribution rules, with all providers.

Written plan documents – 403(b) plans must now have a written plan document and must be operated according to these written terms. The plan document must include all material provisions on eligibility, benefits, contribution limits, investment options, loans, hardship withdrawals, distributions, fund transfers and rollovers.

Written description of all available investment options – all investment options available through the 403(b) plan must be described in the plan document. Employers must designate approved investment providers and products in the written plan document.

Stricter transfer rules – once the new regulations take effect, transfers may be limited to transfers/exchanges within the same 403(b) plan, among employer-approved investments, and, with some limitations, transfers to another 403(b) plan.

Universal availability rule – employers sponsoring a 403(b) plan are required, with limited exceptions, to offer the plan to all employees. The new regulations will establish a bright-line test that complies with the universal availability rule of 1,000 hours of service.

Annual meaningful notice to plan participants – new regulations require an employer to provide an annual meaningful notice to all eligible employees of their rights to participate along with an effective method for making and changing their deferral elections.

Changes regarding deposits, catch-up contributions – employers must transmit employees' salary reduction contributions as soon as is reasonable for proper plan administration. Regulations cite an example of no later than 15 business days after the month in which the amounts would have been paid to the employee.

The rules also require coordination of the special catch-up contribution under Code Section 402(g)(7) (generally requiring 15 years of service with a qualified employer) that allows an additional $3,000 to $15,000 in contributions.

Expanded IRS/DOL Form 5500 reporting – new 5500 reporting rules will require the same extensive reporting and independent audit requirements that apply to 401(k) and other qualified retirement plans.

403(b) Plan — New Audit Requirements

Generally, organizations subject to ERISA (plans with 100 or more participants) are required to have their 403(b) plans' financial statements audited. The first audit must be completed with the 2009 plan year. However, Form 5500 requires the Statement of Net Assets be fully comparative, meaning the 2008 financial information must be included in the plan's 2009 audited financial statements. In practice, employers have only until the end of 2008 to prepare for the new rules.

Financial Information – plan financial information needs to be available for 2008 to meet ERISA requirements and for 2009 to complete the plan audit. Employers should contact their investment custodian to ensure that investment statements are available for 2008 and each year following.

Participant Records – auditing standards require certain procedures be performed at the participant level. 403(b) recordkeepers should provide employers with records by participant along with plan totals showing the activity for the year. This could be a significant request, particularly if plan participants are provided individual account numbers that are not linked to the Plan Sponsor.

Plan Administration – virtually all plan recordkeeping is outsourced and, up to now, most Plan Sponsors had minimal involvement in the plan. With a plan audit, there is an expectation that Plan Sponsors have controls over their plans – even if certain functions are outsourced. Auditing standards require an understanding of these controls in order to communicate observations and inform clients about any "significant deficiencies" in accounting procedures or internal controls, including any weakness that creates a risk of errors in financial statements.

Without proper accounting procedures and internal controls in place, organizations could have significant deficiency letters issued and management would be charged with developing action plans to address and resolve the deficiencies so they do not recur.

When is the effective date?

While these new regulations are generally effective January 1, 2009, now is the time to start planning to meet all new regulations. In addition, plans with annual audit requirements must have comparative statements (2007 and 2008) of net assets available to plan beneficiaries by the effective date.

Why choose Milligan?

Employee benefit plan audits require in depth expertise of the industry and current regulations. Milligan's employee benefit teams provide these services for plans at small, private companies to those with assets over $2+ billion and participants exceeding 60,000. Our clients include large plans with substantial internal support and in-house technical expertise as well as smaller plans that rely on Milligan's employee benefit teams to provide this support and expertise.

Our auditors are familiar with all plan types including Pension, Profit Sharing, 401(k)s, Employee Stock Ownership Plans, Cash Balance Pension Plans, Health and Welfare Plans, 403(b)s, SEPs and other hybrid retirement plans. Milligan also has an in-depth knowledge of government plans that are subject to state regulatory requirements rather than ERISA.

We address the individual needs of each client. We assess the key risks and issues of each plan before commencing work to ensure our efforts focus on significant areas.

The firm is a member of the Employee Benefit Plan Audit Quality Center and our staff has the expert knowledge required to perform plan audits. We invest in the development of methodologies, approaches, tools and practices suited to employee benefit plans and keep current on the latest regulatory developments, practice guidance and technical updates.

The key aspects of our employee benefit plan services are:

Understanding your operations — we tailor our approach to your needs

Planning — we coordinate with you, your administrator, payroll and personnel functions as appropriate. We draw up realistic timetables and budgets, sharing information and documentation wherever possible to save time and minimize costs.

Coordinating with service providers — we meet with trustees, actuaries, recordkeepers and investment managers to discuss plan status, report on matters from the audit and discuss technical developments in the pension sector.

Assessing risk and materiality — we focus and prioritize our audit approach.

Assigning team responsibilities — we ensure work is carried our efficiently and effectively, by the most appropriate members of each team.

How do we get started?

Faced with so many regulatory and accounting rules and the increased fiduciary liability these changes bring, many employers will look to firms with extensive benefits expertise to perform audits of their investment plans. The IRS has signaled that it will be ramping up its audits of 403(b) plans to insure compliance with the new regulations.

Milligan & Company is ready to assist you in complying with these new regulations and preparing for your initial audit.

If you have any questions on this Client Briefing or would like more information, please contact Jovan Goldstein at 215.496.9100 ext 104 or by email — jgoldstein@milligancpa.com.

This guidance is not intended to be a comprehensive summary of final regulations associated with 403(b) plans. However, it is intended to summarize significant aspects of the regulations for your consideration.

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