Fidelity Investments’
Working Guide to the New 403(b) Regulations

A new set of IRS regulations is prompting the first significant changes to 403(b) plans in more than forty years. The regulations apply to all types of 403(b) plans including governmental, higher education, health care, church, tax-exempt institutions, ERISA and non-ERISA plans.

There will be a lot to do to implement the new 403(b) regulations, but the need for short-term action is important to avoid disruption to your institution and your employees. This document addresses some of the major provisions, the things you should know and the steps you need to take.

Exchanges
403(b) plan transactions involving participant-initiated money movement between vendors, particularly between custodial accounts and annuity contracts, have been called transfers, transfers of assets, or sometimes TOAs for short. The new regulations redefine transfers and create a new definition for exchanges. (See FAQs for Exchanges.)

Some vendors in the marketplace have announced that they will not process 403(b) exchanges after September 24, 2007. Fidelity will process participant requests to make exchanges if the request involves an approved or on-plan vendor. If the participant requests an exchange to a vendor that is not approved, the participant will be referred to their employer.

Information Sharing Agreements (ISAs)
One of the new requirements of the regulations is an ISA, which is a formal contract between a plan sponsor and its service providers to ensure that sufficient information (e.g., data necessary to comply with the processing and approving of loans, hardship distributions, and exchanges) is properly shared to enable plan sponsors to comply with the new regulations. ISAs need to be in place by January 1, 2009. The new regulations allow, but don’t require, an ISA to be signed earlier than January 1, 2009 in order for exchanges to continue routinely.

Special rules may apply to “orphan plans” or pre-2005 vendors.
Plan Terminations
The final regulations have confirmed the ability to terminate existing or frozen 403(b) plans. This presents an opportunity for your institution to review and potentially simplify your plan environment. For example, up until now, many non-ERISA plan sponsors have avoided qualified plans because of the additional administrative requirements. Given the new 403(b) regulations, the benefits of a qualified plan might now outweigh any added administrative duties.

If you elect to terminate your 403(b) plan, distribution options for plan assets may include the following:

- Direct rollovers to IRAs, qualified plans, other 403(b) plans or governmental 457(b) plans
- Fully paid-up annuity contracts
- Cash distributions

Even if your 403(b) plan is not frozen, you may have investment providers who no longer receive ongoing contributions or you may decide to reduce the number of providers who receive contributions on an ongoing basis. Although these vendors are frozen, the 403(b) plan still exists. This situation presents an opportunity for you to simplify your plan administration, and Fidelity can help.

Universal Availability
All employees must be able to participate in your 403(b) plan, with some exceptions. When hired, all new employees must be notified of their opportunity to participate in your 403(b) plan. All employees must be notified again at least once each year.

Timing of Contributions
The final 403(b) regulations provide that under a non-ERISA 403(b) plan, a rule similar to the ERISA rule, participant contributions must be sent to vendors as soon as administratively possible to help minimize the amount of time that the participant’s money is out of the market and to improve its potential for growth.

While the IRS regulations do not set an absolute deadline, they present an example in which elective deferral contributions are delivered to vendors within 15 business days after the end of the month in which these amounts would have been paid to the participant. After receipt of good contribution data, Fidelity invests your contribution dollars the very same business day (provided that it is not a New York Stock Exchange holiday).
Written Plan Document
Virtually all 403(b) plans must be documented in a written plan document by January 1, 2009. It must describe all important terms and conditions for eligibility, benefits, limitations, optional features, and distributions and must establish clear guidelines for managing your plan. This includes allocating responsibility for performing 403(b) compliance functions.

Summary
We hope that this document provides clear and helpful information as you and your institution evaluate the impact of these regulations on your plan. The new regulations are prompting many plan sponsors to consider the following questions:

- Do I want the responsibility of coordinating plan activity among the current list of vendors?
- Can the vendors I offer today continue to operate effectively as we move into this new environment?
- Can these vendors meet the new reporting requirements and help me meet my new reporting requirements?
- Do I want to be responsible for overseeing multiple vendors, or would I prefer the vendor or a third party to oversee the new administrative requirements?

Whatever direction your institution needs to take, Fidelity will work with you every step of the way.

In addition, plan sponsors may want to evaluate their 403(b) plan altogether and how that plan fits into their overall retirement benefit offering. Your relationship manager and Fidelity Benefits Consulting can partner with your institution to review and enhance your benefits offering and plan design.
Effective Dates

1. When are the new rules effective?
The IRS released the final 403(b) regulations on July 26, 2007, but has imposed some very aggressive effective dates. Although most of the requirements will not technically be applicable until January 1, 2009 (or a later date for certain governmental, church, and collectively bargained plans or plan features), some of these requirements require action now.

2. There is some question as to whether the changes to 90-24 transfers and exchanges will really go into effect on September 25, 2007. Does it look like there are more announcements to come?
The IRS remains publicly committed to ending 90-24 transfers on September 24, 2007, a date which is 60 days after the final regulations were issued. However, in the event that the IRS does issue guidance that changes our expectations (as described below), we will promptly notify you.

Exchanges

3. Will our 403(b) plan (and exchanges between providers) basically be frozen in time until January 1, 2009?
No. The IRS is allowing vendors to accept exchanges if the receiving vendor reasonably expects to remain as an active or approved vendor on the plan on January 1, 2009 when the final plan document is required. Employers who have already determined the available vendors under their 403(b) plan, and have shared this information with the vendors, should not be affected by the elimination of 90-24 transfers.

4. What replaces 90-24 transfers? What is an approved vendor?
In lieu of making 90-24 transfers between vendors, after September 24, 2007 participants will request an exchange. Generally, an exchange is any money movement among investment options in the same plan, including among mutual funds and annuity contracts.
After September 24, 2007, vendors receiving the funds (an approved vendor) must either:

- have a current relationship with the employer such as being on-plan or currently receiving salary reduction and/or employer contributions, and intend to have an ISA in place by January 1, 2009, or
- have an ISA already in place with the employer.

The vendor releasing the funds is likely to require confirmation of the receiving vendor’s status as an approved vendor under the plan to insure that the distribution is not taxable. Generally, the employer provides this information if the releasing vendor does not already have it. Fidelity will require this confirmation prior to making an exchange out.

5. Are transfers (similar to transfers that occur between 401(k) plans) still possible in a 403(b) plan after September 24, 2007?

Yes. Transfers between two different 403(b) plans are permitted (such as transfers to 403(b) plans of other employers), or to governmental defined benefit plans to purchase permissive service credit. The participant needs to be a current or former employee of the employer (or the business of the employer) for the receiving 403(b) plan. Also, both plans need to allow transfers. Finally, there cannot be a reduction in the benefit. This means that there can be no transaction fee applied, although contingent deferred sales charges (CDSCs) may be charged per the terms of the contract. Operationally, the plan sponsor, and not the participant, must direct Fidelity to make transfers under the plan.

6. As a plan sponsor, how will this impact my plan?

In order to enable your participants to continue to make exchanges, the plan sponsor is required to determine the vendors under its plan. ISAs with vendors are required by January 1, 2009.

7. Can a participant exchange assets from a frozen plan vendor to an active provider on our plan?

Yes. A participant can still move money from a frozen vendor to an approved vendor. However, that same participant will no longer be able to move money in the opposite direction. Only approved vendors can accept exchanges and new money.
8. What happens after September 24, 2007 if a vendor makes an exchange for a participant to a vendor that does not have (and will not have) an ISA in place with the employer by January 1, 2009? Does the participant face a penalty?

If ISAs are not in place by January 1, 2009, as long as the assets are moving from one approved vendor to another approved vendor (see #4 above), there will be no tax impact to the participant. However, any assets being moved to a vendor that is not approved could be treated as a taxable distribution.

9. Why did the IRS shut down 90-24 transfers?

One of the primary purposes of the regulations as a whole is to diminish the extent to which 403(b)s differ from 401(k) retirement plans. With respect to 90-24 transfers, the IRS believed that employers did not have sufficient knowledge as to where the monies were being transferred and that there was not sufficient compliance oversight on these accounts. Additionally, participants could take excessive loans, not pay them back, and take hardship distributions without a real financial hardship, etc. – all in violation of the tax code.

After September 24, 2007, all exchanges between vendors must be associated with an employer and a 403(b) plan so that there is fuller transparency for the employer. The employer will have continuing responsibility for compliance with respect to these assets.

Information Sharing Agreements (ISAs)

10. What needs to be included in an ISA?

The ISA is an agreement to share information sufficient to ensure compliance with respect to four elements of the tax laws:

- Loans
- Hardship distributions
- Distribution events
- Recovery of basis in the contract

11. Let’s assume that there is no ISA in place or the plan sponsor isn’t sure whether one is. Can participants continue to make exchanges from other vendors to Fidelity after September 24, 2007?

Yes. In various speeches and presentations to the 403(b) community, the IRS has made it very clear that it is reasonable for a vendor to assume for operational purposes that, if it
currently is on-plan (meaning that it has a payroll slot and receives regular employee or employer contributions) that it already has an ISA incorporated into its existing agreements or that it will execute an agreement by the deadline.

12. **What happens after September 24, 2007 if a vendor makes an exchange for a participant to a vendor without an ISA in place with the employer? Does the participant face a penalty?**

If ISAs are not in place before January 1, 2009, as long as the assets are moving from one approved vendor to another approved vendor (see #4 above), there will be no tax impact to the participant. However, any assets being moved to a vendor that is not approved could be treated as a taxable distribution. It is our understanding that the IRS may be providing additional guidance in this area, especially because many innocent participants may be affected.

13. **I have heard that noncompliant 403(b) accounts will turn into 403(c) accounts in 2009 (e.g., if ISAs are not in place in time). What is a 403(c) account? Is this a service that Fidelity offers?**

403(c) accounts are taxable accounts that require different tax reporting, documentation, etc. The amounts contributed to a 403(c) account are taxable to the employee; they are not tax-deferred, like contributions to a 403(b). Therefore, the employer must report those amounts to the employee as taxable wages. Unfortunately for the participant, these amounts are not distributable to him or her until a distribution event occurs under the plan – although the participant has already been taxed on them. At this time, we are not planning on offering 403(c) accounts or supporting these accounts.

**Loans**

14. **What are the rules for loans?**

Generally, loans:

- must be available under the 403(b) plan, if included in the plan by the employer.
- must comply with the limits of IRS Code Section 72(p), when aggregated with current and previous loans from other vendors.
- must be certified by the employer or plan administrator – self-certification is not allowed after December 31, 2008.
• must have a reasonable rate of interest, a fixed repayment schedule (with repayments being made at least quarterly); in addition, repayment safeguards must be in place.

15. **What is the dollar limit on loans under IRS Code Section 72(p)?**
   In general, all outstanding plan loans for a person cannot exceed the lesser of:
   • $50,000 (minus the difference between the highest outstanding loan amount within the previous 12 month period and the current loan balance), or
   • The greater of 50% of the vested account balance or $10,000.
   In other words, $50,000 is the maximum possible loan. Special rules may exist for loans under $10,000.

16. **When does a loan (or a portion of a loan) become a deemed distribution?**
   In general, a loan becomes a deemed distribution for tax purposes if:
   • it exceeds the IRS Code Section 72(p) dollar limit (only the excess is a deemed distribution).
   • it has a payment schedule that exceeds the five-year limit (for non-residence loans), or that does not comply with the substantially level (at least quarterly) repayment requirement.
   • the participant has failed to make required loan repayments and the loan is in default.
   In the case of a deemed distribution, the participant is taxed as if he or she received a distribution, but the participant still has an obligation to repay the loan.

17. **If the plan provides for loans, do all approved vendors need to offer loans?**
   It depends upon the plan document’s wording, but it is our understanding that plan documents can say that “Loans are available under the Plan, to the extent that a vendor offers loans,” or, “If a participant wants a loan, he or she has to obtain one through Vendor X.” The plan may require that assets be consolidated at one vendor prior to enabling a participant to request a loan.

18. **What errors has the IRS found in the area of loans?**
   Based on the results of its audits, the IRS found that participants were getting loans in excess of the allowable limits, or which were not repaid. Bad loans are deemed distributions, which are taxable to the participant and need to be reported to the IRS.

**Hardship Distributions**

19. **What are the new rules for hardship distributions?**
   Hardship distributions:
   • must be available under the 403(b) plan, if the plan sponsor has added the feature.
• must comply with the 401(k) rules, including the requirement to suspend contributions for six months.
• must be certified by the employer or plan administrator – self-certification is not allowed after December 31, 2008.

20. What does the 401(k) safe harbor for hardship distributions require?
The participant must have an immediate and heavy financial need for a distribution. The IRS has deemed the following needs to be immediate and heavy under the 401(k) safe harbor:
• Expenses for (or necessary to obtain) medical care that would be deductible under section 213(d) (determined without regard to whether the expenses exceed 7.5% of adjusted gross income).
• Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments).
• Payment of tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education for the employee, or the employee’s spouse, children, or dependents.
• Payments necessary to prevent the eviction of the employee from the employee’s principal residence or foreclosure on the mortgage on that residence.
• Payments for burial or funeral expenses for the employee’s deceased parent, spouse, children, or dependents.
• Expenses for the repair of damage to the employee’s principal residence that would qualify for the casualty deduction under section 165.

Alternatively, the employer may make its own determination, based on facts and circumstances, that the participant has an immediate and heavy financial need.

Also, the participant must have no other resources available. The IRS has established a safe harbor for employers to rely on; if met, the distribution will be deemed necessary to satisfy the immediate and heavy financial need if:
• the employee has obtained all other currently available distributions and nontaxable (at the time of the loan) loans under the plan and all other plans maintained by the employer.
• the employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least six months after receipt of the hardship distribution.

Hardship distributions are not exempt from the IRS 10% early withdrawal penalty if the participant is under age 59½. Furthermore, hardship distributions are subject to ordinary income taxation in the year distributed.
21. How might the new regulations change my organization’s hardship distribution processes?
Self-certification for the immediate and heavy financial need, or whether any other resources are available, will not be possible after December 31, 2008. The employer (or plan administrator, TPA or recordkeeper) will have to approve the participant’s hardship distribution request and monitor contribution suspensions.

Plan Documents

22. Is there a remedial amendment period, if the employer does not have a written plan by January 1, 2009?
No. This is a hard and fast date.

23. Do frozen plans need plan documents?
Yes. Even if no further contributions are being made to the plan, it must still be documented in order to reflect the significant elements, such as distribution features. Special rules apply to pre-2009 “orphan plans” and discontinued vendors.

24. If a plan sponsor is going to terminate its 403(b) plan before January 1, 2009, does it need to be documented now, prior to termination?
Plan sponsors can rely on the plan termination provision of the final 403(b) regulations starting July 26, 2007, if all the contracts issued under the 403(b) plan at the time of plan termination are in compliance with the requirements of the final 403(b) regulations (except the written plan document requirement).

If a plan sponsor currently has a written plan document, it should be updated to comply with the final 403(b) regulations, and include termination provisions, before it is terminated.

Employers should consult with their benefits advisor or legal counsel on this issue.

25. There’s some confusion between the IRS’s and DOL’s rules on whether or not providers must be named in plan documents. Can you explain that?
The proposed regulations would have required that vendors be listed in the plan document. However, the final regulations do not require this level of specificity with respect to investment options; it is generally sufficient if a plan document simply states that annuities and mutual funds are available investment options under the plan. In addition, the DOL specifically
said that listing vendors in the plan is possible, but employer selection might mean that the employer would not be eligible for the non-ERISA safe harbor for their 403(b) plan.

The plan can incorporate an external list of vendors. There needs to be some legal document that tells participants what the available vendors are for future contributions and exchanges, as well as something that lists the vendors which the employer recognizes as holding its 403(b) plan assets.

**Miscellaneous Questions**

26. **Will there be any impact on Qualified Domestic Relations Orders (QDROs)?**
   No. The 403(b) regulations have not changed the rules for QDROs and the process for qualifying them.

27. **What happens to the 90-24 transfer accounts that were established by participants without any employer control, approval, or involvement prior to September 25, 2007?**
   Our understanding is that those accounts are grandfathered, but only to an extent. In other words, plan sponsors are not required to go out and find or identify these old 90-24 accounts. However, their grandfathering is limited. A participant cannot continue to use the 90-24 rules to make another transfer of a grandfathered account. If the participant who is the owner of the grandfathered account wants to make a transaction in that Fidelity account after September 24, 2007, the transaction will be subject to the new rules that apply under the new regulations. For example, if the participant has terminated employment with the sponsor of the plan that is the source of the account’s assets, the participant cannot make another transfer. The participant may roll over the account to an IRA or to the plan of the participant’s current employer.

28. **Will Registered Investment Advisers (RIAs) and other intermediaries be affected by the new 403(b) regulations?**
   Yes. These regulations limit the flexibility of participants to choose how to invest their 403(b) assets. For example, after September 24, 2007, exchanges can be made only to approved vendors. So, the RIA or other intermediary must ensure that the intended exchange will be made to an approved vendor under the 403(b) plan.
29. Can Fidelity help with forms and/or contract issues that I, as a plan sponsor, need to take care of?

Yes, Fidelity Investments offers a straightforward ISA if your organization requires it, but it is not necessary to have it in place before January 1, 2009.

If you have any questions regarding the information in this document or the 403(b) regulations in general, please contact your Fidelity representative or call 1-800-354-9738.