MEMORANDUM TO CLIENTS

July 22, 2009

RE: DOL Provides Some Form 5500 Relief for 403(b) Plans

In response to concerns expressed by many in the 403(b) community, including a June 16, 2008 letter from the Groom Law Group, that the new Form 5500 requirements for the 2009 plan year, including the audit requirement for large plans with 100 or more participants, would be difficult or impossible for many tax-exempt employers to meet, the Department of Labor ("DOL") has issued Field Assistance Bulletin 2009-2, providing transition relief for plan administrators of 403(b) plans who are otherwise required to first comply with expanded annual reporting requirements for the 2009 plan year. The FAB generally allows 403(b) plans making good faith efforts to comply to avoid the administrative burden and expense of having to collect and include in their 2009 Form 5500 financial report information on certain individual annuity contracts and mutual fund custodial accounts of current and former employees which were entered into before 2009 and for which the employer has no ongoing contribution obligation after 2008.

Generally, the FAB parallels IRS transition guidance in Rev. Proc. 2007-71, as recommended by Groom's comment letter, and allows some older contracts to not be treated as part of the plan, at least for 5500 reporting purposes and the related audit requirement for large ERISA-covered 403(b) plans. The relief contains four general provisions, summarized below, along with a few questions it raises.

1. Pre-2009 Contract Relief

The principal relief provided by the FAB is that the administrator of a 403(b) plan does not need to treat annuity contracts and custodial accounts as part of the employer's ERISA plan or as plan assets for purposes of ERISA's annual reporting requirements provided that:

- the contract or account was issued to a current or former employee before January 1, 2009;
- the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009;
- all of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer; and

- the individual owner of the contract is fully vested in the contract or account.

2. Participants With Only Excludable Accounts/Contracts Not Counted as Participants For 5500 Purposes

Current or former employees with only contracts or accounts that are excludable from the plan's Form 5500 or Form 5500-SF under the above transition relief do not need to be counted as participants covered under the plan for Form 5500 annual reporting purposes. This may be helpful in allowing some plans to be "small plans" (generally, those with fewer than 100 participants) eligible for simplified reporting.

3. DOL Will Not Reject 5500s With Qualified Opinions Due to Pre-2009 Contracts

The Department also will not reject (as it would otherwise do automatically) a Form 5500 on the basis of a "qualified," "adverse" or disclaimed audit opinion if the accountant expressly states that the sole reason for such an opinion was because such pre-2009 contracts were not covered by the audit or included in the plan's financial statements. Except for this relief, accountants engaged pursuant to ERISA section 103(a)(3)(A) to perform audits of employee benefit plan must perform audit procedures and report in accordance with generally accepted auditing standards as required by ERISA and the Department's implementing regulations.

4. Guiding Principles For Accountants Performing the Audits and Treatment of Expenses

Perhaps to remind plan sponsors that, if a plan is subject to ERISA, 403(b) plan fiduciaries have responsibilities that may not have been adequately followed in the past, the Department points out in the FAB that the guiding principle must be to ensure that appropriate efforts are made to act reasonably, prudently, and in the interest of the plan's participants and beneficiaries, and that, although ERISA's annual reporting requirements may result in added costs to a plan, they believe that an administrator of a 403(b) plan should be able to prepare an acceptable Form 5500 without undue expense or burden.

The Department goes on to remind fiduciaries that ERISA's recordkeeping requirements require that whether lost or destroyed records can, or should be, reconstructed – and whether the persons responsible for retention of the plan's records are, or should be, personally liable for costs incurred in connection with the reconstruction of records or other consequences of their loss or destruction – depends on the facts and circumstances of each case. The Department states that it expects that accountants engaged to conduct employee benefit plan audits will notify plan administrators of questions, issues, and irregularities discovered as part of the audit engagement that could materially affect the plan's audit expenses or other costs associated with making the transition to ERISA's generally applicable annual reporting regime. This may be taken as a warning, too, that the cost of bringing the plan into shape for contracts and accounts to be audited in accordance with the FAB, if due to some less-than-optimal fiduciary practices in the past, should not be borne by the plan.

5. Some Questions about the FAB

Overall, we think the relief in the FAB is going to be very helpful to ERISA-covered 403(b) plans, but some practical questions or legal points for clarification remain.

First, it is our understanding that, though the FAB and the related press release refer to the 2009 plan year 5500, it is not intended by the Department that the guidance be just for the 2009 5500. We understand that it is intended to apply for 2010 and all future year 5500s, unless and until the Department issues more guidance, such as on the question of when a 403(b) contract may be considered distributed (such that the recipient is no longer a participant for ERISA disclosure purposes). The latter is important for future 5500s, as well as the application of ERISA duties generally. Groom Law Group wrote a comment letter to the Department on May 13, 2009 providing its analysis of that question. (The letter can be found online at www.groom.com.) The Department of Labor seems to still be considering that issue.

Other important questions raised by the guidance include whether final contributions to a contract that were attributable to late 2008 but were actually contributed in early 2009 may still be treated as 2008 contributions for purposes of the FAB, and whether there is any distinction in applying the FAB in the case of group annuity contracts versus individual contracts. On the latter point, for example, the requirement that a certificate under a group contract be directly enforceable by the participant against the insurer may be unclear in some cases.

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Please call one of the following, or the Groom attorney you regularly contact, if you have any questions about this or any other matter.

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