

## Decentralized 403(b) Administration of Loans and Hardship Withdrawals: *How can (or should) it work? Six commonly asked questions*

As the January 1, 2009, general effective date for the 403(b) regulations draws near, many plan sponsors that have elected a decentralized administrative procedure are working with their providers to ensure that proper procedures are in place. A decentralized process, in very general terms, looks to the individual providers to shoulder many of the administrative responsibilities under the plan, much as those providers may have been doing prior to the final 403(b) regulations, often in conjunction with service provider agreements (also often referred to as "hold harmless" agreements). As plan sponsors go through this review and implementation process, a number of questions naturally arise, and some of them are reflected in the Q&A below.

**Q1: What are the new rules for loans and hardship withdrawals?**

**A1:** Actually, the rules for loans and hardships have not changed significantly. (One official change for hardship withdrawals, applying the 401(k) hardship rules, was actually an existing practice for many plans.) What have changed, though, are the requirements for coordinating across multiple accounts in applying the relevant loan or hardship withdrawal rules and limitations. Plans cannot assign compliance responsibilities to participants. That limitation has led to the conclusion that the plan cannot rely solely upon participant representations regarding other accounts under the plan, when determining whether the participant qualifies for a loan or a hardship withdrawal.

- With regard to hardship withdrawals: this is understood as a prohibition against participant "self-certification," such as relying solely on the participant to determine whether he or she has a qualifying hardship. Arguably, pure self-certification was not permitted even before the final regulations.
- With regard to loans: under prior IRS rules, each provider in a multiple-provider 403(b) program could rely upon the participant's representation that he or she did not have additional loans with other providers that would cause the new loan being requested to exceed applicable limits. Under the final 403(b) regulations, it is clear that such reliance is no longer available.

This does not mean that the plan cannot obtain information from a participant. However, it does mean that a plan should have procedures for confirming certain information if provided by the participant. Thus, for example, if a participant identifies the amount of an outstanding loan from an account with another provider, such information would be confirmed with that provider.

**Q2: I notice that Q&A1 only refers to loans and hardship withdrawals. What about other transactions, such as: exchanges between accounts, distributions upon severance from employment, disability distributions, age 59½ distributions, and QDRO distributions upon divorce? Don't they also require coordination?**

**A2:** Much of the attention in the preamble to the final 403(b) regulations focused upon areas of potential abuse or errors across accounts with multiple providers. Of course, loans and hardship withdrawals are natural candidates for such attention because they require coordination across providers. However, other types of withdrawals, including the ones listed in the question, generally do not present the same types of concerns, and can thus be handled individually by each investment provider. For example:

- Each provider can limit exchanges to approved providers designated by the plan sponsor.
- Each provider can require confirmation from the plan sponsor that a participant has experienced a severance from employment.
- Each provider can also determine whether a participant qualifies for a disability distribution, based upon applicable tax rules and any additional plan limitations.

- Each provider can request whatever documentation they would otherwise require to determine whether the participant has attained age 59½.
- Each provider can determine whether a distribution pursuant to a proposed QDRO can be processed, based upon applicable tax rules and any additional plan limitations.

**Q3: What is the participant's role in a decentralized process for loans and hardship withdrawals?**

A3: The participant's role is to:

- Provide any requested information regarding accounts under the plan;
- Provide relevant information regarding certain accounts outside the plan;
- Authorize providers to obtain information from each other; and
- Authorize the plan sponsor to obtain information from the providers.

Some of these authorizations may already be incorporated into other agreements, such as service provider agreements with the investment providers and salary reduction agreements with the participants. If so, such a redundancy generally would not be a problem unless it creates conflicts with such existing agreements.

**Q4: What is a provider's role in handling requests for new loans and for hardship withdrawals, in the decentralized process?**

A4: The provider's role includes:

- Reaching out to the listed providers and confirming the data provided.
- Determining whether the participant is eligible for the requested distribution, based upon the information and documentation provided, including:
  - In the case of a hardship, supporting documentation of the claimed need.
  - In the case of a principal residence loan, supporting documentation that the loan is for the purchase of a principal residence.
- Processing and tax reporting the approved distribution.
- Maintaining records of the distributions, including supporting documentation.
- Periodic plan reporting as agreed with the plan sponsor.

**Q5: If the provider only contacts other providers if they are identified by the participant, to confirm the data the participant provided with respect to those providers, it would seem that the plan is relying solely on the participant to identify the providers. In that situation, is the task of listing the providers an assignment of compliance responsibilities to the participant? What if a participant forgets to list, or intentionally omits, a provider or account?**

A5: Decisions about plan administrative procedures routinely involve important balancing concerns: ensuring that the procedures comply with applicable requirements, while seeking the most effective and efficient use of limited plan sponsor resources. For many plan sponsors, perhaps one out of ten participants will request a hardship withdrawal or a loan in a given year, and perhaps one out of ten of those may have accounts with multiple providers. Plan sponsors seeking to maintain tight compliance procedures while avoiding what may truly be "managing to the exception" have identified multiple alternatives, including:

- Requiring plan sponsor signoff on the participant loan and hardship forms, limited to a determination whether the plan sponsor knows of other providers with which the participant maintains accounts (such as from monthly reports provided by each of the investment providers, or from easily referenced payroll remittance records).

- Requiring periodic plan sponsor review of processed loan and hardship forms, to look for similar omissions.
- Automatically listing all available plan providers on the form and requiring that a provider contact each of those providers before processing a loan or hardship withdrawal request.

**Q6:** Is the provider's role different if the plan is subject to Title I of the Employee Retirement Income Security Act of 1974 ("ERISA")? If so, to which plans does ERISA apply?

**A6:** Yes. As a general matter investment providers that make discretionary determinations under an ERISA plan can become fiduciaries under the plan, and for that reason in many cases those investment providers do not undertake discretionary responsibilities in ERISA plans. It is important in those cases for the plan's fiduciary, whether the employer or another party, to review and approve all of the loan and hardship withdrawal requests or to clearly specify how a provider should process such requests without exercising discretion (such as through very specific pre-approved procedures). Another requirement that is generally unique to ERISA plans is a requirement for spousal consent to be provided for many loans and distributions that are requested by married participants. If this consent requirement applies, it often includes a requirement that the consent be notarized or witnessed by the plan administrator. This step may be most likely to be addressed on the individual provider's separate distribution form.

As for which plans are subject to ERISA: as a general matter plans of governmental employers, and plans of church employers that have not made a contrary election, are exempt from Title I of ERISA. Plans of private tax-exempt employers are generally subject to Title I of ERISA, except in certain limited cases involving plans which, generally:

- include only voluntary employee contributions;
- provide employees with a reasonable number of investment providers and options; and
- exclude any discretionary control by the employer.

As a final note, it is important for plan sponsors to keep things in perspective, as they prepare for the January 1, 2009, general effective date for the final 403(b) regulations. It is of course important for a plan sponsor to be ready on January 1. It is also important to remember that few if any of the decisions plan sponsors are making in preparation for January 1 are necessarily permanent. Just as a plan sponsor can change its plan from time to time, they can also change their compliance procedures, in response to new rules or new information. A plan sponsor that starts 2009 with a decentralized approach may decide to centralize a portion of the plan's administrative procedures, or vice versa. A plan sponsor that starts the year reviewing each form to ensure that a participant has listed all accounts they have under the plan may later decide that an alternative process may provide equivalent compliance assurance with lesser resource commitments. And a plan sponsor that finds, notwithstanding solid compliance procedures, that a distribution or loan violated applicable rules may take advantage of available IRS self-correction guidance to correct the error.

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Houston, Texas

AR 22272 (11/2008) J71259 ER