



# New Fiduciary Responsibilities Fall to Hospitals, Other 403(b) Sponsors

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BY GINNY BOGGS AND DOUG CONKEL

**With the IRS imposing sweeping changes for the first time in more than 40 years, here are a few things plan sponsors should know. Like 401(k)s, 403(b)s have come under increased scrutiny. The overriding question for sponsors: Does your plan work to the exclusive benefit of participants?**

Decades ago, 403(b)s were designed to serve employees of tax-exempt organizations. But while the market has changed dramatically over the years, the structure of 403(b)s has essentially remained the same. Many currently operate without a written plan document. Some have become so loaded with a multitude of investment products (frequently high-cost annuity products) from numerous vendors that they are nearly impossible to manage.

On Jan. 1, 2009, new IRS regulations will go into effect. The rules are far-reaching and likely will ring in a new level of competitiveness for the market and a much better product for plan participants. But for hospitals, which often offer 403(b) plans to their employees, it means greater fiduciary responsibilities and potential liabilities.

## **WHAT ARE PLAN SPONSORS' NEW RESPONSIBILITIES?**

The new regulations will impose due diligence and compliance criteria that require plan sponsors to demonstrate that their plan is acting in the best interest of participants.

For plan sponsors that don't already have one, the new regulations require them to create a written plan document. It may also be in their and their employees' best interest to develop an investment policy statement with guidelines for selecting, monitoring, and evaluating plan investment options, as well as form an investment committee that meets regularly to review investment performance, plan expenses, and employee education.

In addition, plan sponsors will be required to coordinate compliance with all IRS plan limitations, including loan and distribution rules, among all providers. In the past, sponsors simply had to ensure compliance with contribution limits.

## **START WITH A PLAN**

Foremost among the new rules is that 403(b)s must have a written plan document and must be operated according to the plan's written terms, similar to 401(k) plans. This means sponsors will be required to review and describe all the investment options available under their 403(b) plan, which could be a daunting task.

The best course of action may be to bring in a single organization to handle recordkeeping and administrative services. Plan sponsors will need to take stock of not only what they currently offer, but also the fees charged and returns gained on all products. All plans benefit from a good audit. This should put sponsors in a better position to determine what they want to include in their 403(b) plan and why, likely opening the door to more best-in-class investments.

In addition to outlining investment options, written plans must clarify eligibility, benefits, contribution limits, loans, hardship withdrawals, distributions, fund transfers, and rollovers. They must also identify who is responsible for the coordination of compliance with all IRS plan limitations, including the loan, distribution, and hardship withdrawal rules, on an aggregate basis, across all providers and investment options.

## HIDDEN FEES IN 403(b)s

Just as mutual fund investments in 401(k) plans have been under scrutiny for hidden fees that erode plan participants' retirement savings, the fees charged for annuity products in many 403(b) plans are becoming a hot issue.

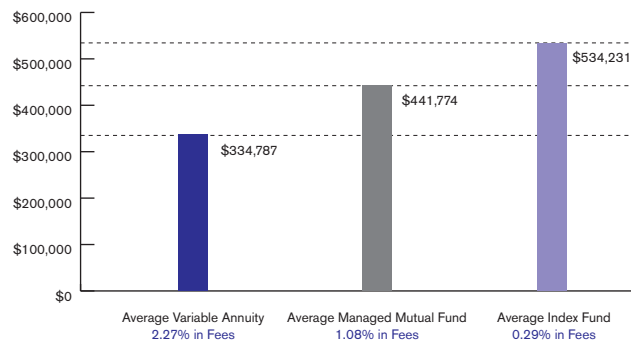
But in the case of 403(b)s, the hidden fees have tended to be even higher because of outdated rules, the confusing fee structures of many annuity investments, and a legacy system of investment options that has not kept up with the market.

The result of the higher overall costs of annuity-type investments compared with mutual funds is lower investment returns, translating to fewer retirement dollars.

As shown here, assuming contributions of \$250 a month over 35 years with an annualized rate of return of 8%, the average variable annuity would grow to only \$334,787 after 35 years, while the managed mutual fund would grow to \$441,774 and the average index fund would grow to \$534,231—differences of \$106,987 and \$199,444, respectively.

### How Fees Affect Returns

Value after 35 years,  
assuming \$250 contributed monthly with an 8% average annual return.



Source: Average annual fees for variable annuity—Variable Annuity Research and Data Service (VARDS), a unit of Morningstar, Inc.; average annual fees for mutual funds—categories analyzed in Morningstar.

## STRICTER TRANSFER RULES

Under the new regulations, only two types of transfers will be allowed: (1) transfers/exchanges within the same 403(b) plan, among sponsor-approved investments, as spelled out in the plan document, and (2) transfers to another 403(b) plan, but only under certain circumstances.

## BRIGHT-LINE TEST FOR UNIVERSAL AVAILABILITY RULE

Under what is known as the universal availability rule, plan sponsors are required to offer their organization's 403(b) plan to all employees, with limited exceptions. The new regulations will establish a bright-line universal availability test of 1,000 hours of service.

Taken as a whole, the new regulations add up to more hands-on involvement. But the call for more transparency and closer attention to investments provides the opportunity to build a better 403(b).

For more information about the new 403(b) rules, contact your local Milliman consultant or go to [www.milliman.com](http://www.milliman.com) and search on "403(b) regulations."

*Doug Conkel is a principal with the Dallas office of Milliman. Ginny Boggs is a senior compliance consultant with the Dallas office of Milliman. They can be reached at 214.863.5500 or at [doug.conkel@milliman.com](mailto:doug.conkel@milliman.com) and [ginny.boggs@milliman.com](mailto:ginny.boggs@milliman.com).*

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