

## Centralized vs. Decentralized 403(b) Compliance under the Final 403(b) Regulations: *What does it mean?*

One very important function of the written plan, under the final 403(b) regulations, is to describe how plan compliance responsibilities will be allocated among the various parties to the plan, including the plan sponsor, the participants, the investment providers and any additional administrators.

The regulations make it clear that compliance responsibilities may be allocated in any fashion the plan sponsor desires with one critical exception: they may not be allocated to the participant. This translates into limitations on the extent to which the plan (including the plan sponsor, the investment providers and any additional administrators) may rely exclusively on information provided solely by the participant.

Loans provide an important example. Under previous guidance, if a participant maintains accounts with more than one provider, each provider could rely on the participant's representation that he or she did not have loans with other providers that would cause the requested new loan to exceed applicable limitations.

Under the final regulations, such reliance would mean assigning compliance responsibilities to the participant, in much the same way as asking the participant seeking a hardship withdrawal simply to certify, "I have a hardship." As a result, someone on behalf of the plan is now going to have to determine whether the loan, when combined with other loans under the plan, and loans under other plans of the employer, is within applicable limitations. The next logical question is: what are a plan sponsor's options in allocating responsibilities to accomplish this?

There are three primary alternatives, each of which can be structured to be consistent with the final regulations and the IRS model plan language:

- **Fully centralized compliance.** This alternative generally requires that there be a single set of investment options. In this structure, an administrator (which may also be the investment provider) will hold all plan records and make all such loan and distribution determinations. This alternative may be most attractive to larger employers.

However, the final regulations also made it fairly difficult for a 403(b) plan sponsor to use this alternative because the plan will include not only this provider's investment options, but also many pre-existing contracts and accounts maintained with providers that were active in the plan after 2004. Thus, application of distribution and loan rules will have to include coordination across all of these contracts and accounts. This coordination will, in most cases, require something different than fully centralized compliance.

- **Fully decentralized compliance.** This alternative recognizes that frequently there will be multiple providers, and that loans and distributions likely will also be subject to different requirements and limitations under the products of each provider. In this structure, each provider would be required to take into account information about other accounts the participant maintains under the plan, as well as in other plans, in order to confirm the participant's eligibility for a distribution or a loan.

Such confirmation could take one of several forms. The employer or the participant could identify the providers with which the participant maintains additional accounts, and could include information provided by the participant regarding existing loans, etc. However, to avoid allocating compliance responsibility to the participant, the plan provider receiving the loan or distribution request would then confirm with the other provider(s) the specific information relating to the accounts with the other provider(s) as part of the process to determine the participant's eligibility for the loan or distribution. In addition, it is likely that an employer would want to review such requests, either in advance or periodically, to confirm that all relevant providers are being identified. For example, the employer could confirm that the provider currently receiving contributions from the participant is one of the providers to which the provider reaches out. The objective of either the prior review or the periodic review would be to provide a further check and ensure that compliance responsibilities have not been assigned, whether intentionally or not, to the participant, while preserving the decentralized compliance structure.

Of course, all of the providers in the plan are likely to be subject to various federal and state privacy restrictions as well as corporate privacy policies. Whether these decentralized procedures will raise privacy questions may depend on the wording of the contract: if the contract permits sharing such information for compliance purposes, the question may not apply. In any event, one way to address such restrictions is to obtain the participant's consent to share the limited information when the distribution or loan is requested.

*Example:* Employer A's plan has three providers—Provider 1, Provider 2, and Provider 3. Participant X requests a loan from his account with Provider 1. Participant X also has an account with Provider 2. On a plan form, Participant X identifies his account with Provider 2 and an existing loan from that account, and authorizes Provider 1 to confirm this information with Provider 2. Provider 1 confirms the information with Provider 2 and proceeds to process the loan request based on this information.

- **Hybrid approach.** This alternative combines a centralized plan-level determination with respect to distribution or loan requests, with continued decentralized administration of individual accounts with providers. It can involve collecting key data information:
  - in a centralized repository, as with the fully centralized approach, or
  - confirmation of key data for individual transactions, as with the fully decentralized approach.

The centralized function may be performed by the plan sponsor, a third party, or a plan provider (or an affiliate of a plan provider) designated to perform this plan-level service. If a plan provider is designated, it is likely that the plan sponsor will seek contractual assurances that data from this centralized plan compliance function is not permitted to be used by the plan provider (or affiliate), or any other provider, for marketing purposes.

In this hybrid approach, after the initial plan-level determination, the request would then be forwarded to the plan provider where the participant's account is maintained, for processing consistent with the terms of the underlying contract or account.

As employers evaluate the range of alternatives, they may be drawn to different alternatives based upon their individual circumstances. For example, a very large school district with a large number of providers may prefer a fully centralized approach but select the hybrid approach because of the practical realities of the final regulations. On the other hand, a small school district with 100 participants, only five of whom maintain accounts with more than one provider under the plan, may choose a fully decentralized structure because it represents the best use of the district's resources. And of course, the provider's selections may be significantly influenced by applicable state laws and restrictions.

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