Submitted Electronically

August 13, 2013

Ms. Joyce I. Kahn
Acting Director, Employee Plans Rulings and Agreements
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224-0002

Re: **Revenue Procedure 2013-22 and the Application of the Employee Plans Compliance Resolution System to 403(b) Plans**

Dear Ms. Kahn:

The SPARK Institute, Inc. understands that the Internal Revenue Service ("IRS") has requested comments and recommendations from service providers, practitioners and others who work with 403(b) retirement plans regarding: (1) Revenue Procedure ("Rev. Proc.") 2013-22, the associated sample pre-approved 403(b) plans provisions and information package, and (2) the revised Employee Plans Compliance Resolution System ("EPCRS") under Rev. Proc. 2013-12 as it applies to 403(b) plans. We appreciate this opportunity to provide you with our comments, questions and recommendations regarding such matters. Our member companies include retirement plan record keepers, including the largest 403(b) plan service providers, who have substantial expertise and experience in helping plan sponsors operate their plans and maintain the plan documents.[1]

The following are our comments, questions and suggested recommendations for Rev. Proc. 2013-22 and EPCRS under Rev. Proc. 2013-12.

1. Relationship Between Plan Provisions and Investment Arrangements

a. Pre-approved Plan Program

Background: Rev. Proc. 2013-22 does not impose any special restrictions on the types, number or features of the investment arrangements that may be offered under a

[1] The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms and benefits consultants. Collectively, our members serve approximately 70 million participants in 401(k) plans, and the substantial majority of all participants in 403(b) plans.

pre-approved plan. The terms of the investment arrangements which are consistent with the Internal Revenue Code ("Code") and the plan will be incorporated by reference into the terms of a pre-approved 403(b) plan, and the terms of the plan must override any inconsistent provisions of the investment arrangements. Furthermore, the IRS will not review the terms of investment arrangements under Rev. Proc. 2013-22.

Issue: Because investment arrangements used to fund 403(b) plans generally contain many of the provisions required to be included in 403(b) plans, there are likely to be duplicate provisions in the plan and the investment arrangements. It is unclear to what extent those provisions can be incorporated by reference into the terms of the investment arrangement (or omitted altogether) where the investment arrangement is funding a pre-approved plan. Requiring both the investment arrangement and the plan to contain all of the provisions required for tax compliance increases the complexity of plan administration and increases the likelihood of unintended conflicts between the documents. In addition, an investment arrangement may contain optional provisions not necessary for 403(b) plan compliance that may be inconsistent with plan provisions, and the enforcement of such optional provisions under the terms of the investment arrangement might result in an operational failure for the plan.

Recommendation: In our 2009 comment letter to the IRS in response to Announcement 2009-34, we requested that the IRS identify which provisions necessary for tax compliance should be included in full in the plan document, and to the extent such provisions are in the plan document, it should not be necessary for them to be included in the investment arrangement.[2] The SPARK Institute respectfully requests again that the IRS issue a list of the tax compliance provisions that must be (i) included in all plans and investment arrangements, and (ii) a subset of provisions which can be incorporated by reference from the plan into the investment arrangement (or omitted altogether) if the investment arrangement is used in conjunction with a plan that contains such provision. To the extent that the pre-approved plan provision is necessary for the plan to meet the requirements of the law and regulations, the plan provision must control over a conflicting provision in the investment arrangement. However, where optional provisions in the investment arrangement are inconsistent with the pre-approved plan provisions, the pre-approved plan should be permitted to contain a provision that allows the adopting employer to agree that certain terms of the investment arrangement will override the inconsistent plan document language.

b. EPCRS

Background and Issue: A fundamental principle of Rev. Proc. 2013-22 is that the basic plan document and adoption agreement must supersede any conflicting provision in an investment arrangement. Investment arrangements used in 403(b)

[2] Letter from The SPARK Institute Re: Revenue Procedure for 403(b) Plans; Announcement 2009-34 (June 1, 2009) available at http://www.sparkinstitute.org/content-files/File/SPARK-Inst-403_b_%20Prototype-Comment-6-1-2009-FINAL.pdf.

plans are complex instruments, and many are registered securities that are subject to federal securities laws. In addition, annuity contracts are subject to the various state insurance laws. The terms of the annuity contracts funding the plan control the legal relationship between the issuing insurance company, the employee participant and the institution sponsoring the plan. Once they are issued, the annuity contracts generally cannot be retroactively amended to the extent that the change would alter the rights of the parties under the contract. Because of the complexity of the annuity contract, there is a high probability that a contract provision may not be identified initially as being in conflict with a term in the pre-approved plan. This conflict, once identified, could result in an inadvertent operational failure. That probability increases exponentially when the pre-approved plan uses contracts from multiple annuity issuers (i.e., multi-vendor arrangements) or multiple contracts offered by the same annuity issuer. For example, assume that a plan has an optional provision permitting a lump sum distribution at severance from employment but is funded with an annuity contract that by its terms only permits an annuity payout. Since the plan term cannot be implemented with respect to that contract, the plan has created an operational violation. It is very unlikely that the insurance company will be able to correct this issue by amending the annuity contract.

Recommendation: In such a situation, we respectfully request that the operational error be allowed to be corrected by a retroactive plan amendment that conforms the pre-approved plan document to the terms of the investment arrangement document(s). In this example, the plan would be amended retroactively to limit the payout to annuities when a distribution is requested from that investment arrangement. Such a retroactive amendment should also be allowed to take into account differences in the terms of the various investment arrangements. Again, in this example, the retroactive amendment could provide that the form of payout is subject to the terms of the investment arrangements. As noted above, we understand that to the extent that the conflicting provisions involve mandatory 403(b) plan provisions, the terms of the plan must supersede those in the investment arrangements. However, where the conflict relates to an optional provision that is not required by law, and only relates to a plan feature, the plan should be permitted to be amended retroactively to reflect the provisions of the annuity contracts or investment arrangement document(s), and override the contrary plan document provisions.

2. Vesting Issues

a. Vesting and Separate Account Requirements

Background: Under Section 1.403(b)-3(d)(2)(i) of the Code regulations, if amounts are contributed by an employer to an annuity contract issued by an insurance company before such amounts are non-forfeitable as required in Section 1.403(b)-3(a)(2), then the contract is treated as a contract to which Code Section 403(c) applies. Further, under Section 1.403(b)-8(d)(4) of the Code regulations, if a custodial account that is intended to constitute a 403(b) contract does not satisfy the non-forfeitability requirement of Section 1.403(b)-3(a)(2), the custodial account will nonetheless be treated as a section 401 qualified plan solely for purposes of

Subchapter F of Subtitle A (the rules governing the taxation of exempt organizations, Sections 501 et seq.) and Subtitle F (Procedure and Administration governing the filing of returns and paying of taxes, etc., Sections 6001 - 7874) of the Code with respect to amounts received by it (and income from investment thereof). Under 1.403(b)-3(d)(2)(ii) of the Code regulations, once a participant's interest in a contract that was forfeitable becomes non-forfeitable, the contract may be treated as a Section 403(b) contract provided it meets a number of conditions, including a requirement that "each contribution under a contract that is subject to a different vesting schedule is maintained in a separate account." The preamble to the final regulations under Section 403(b) states that a "separate bookkeeping account" is required for any contract in which only a portion of the employee's interest is vested.

However, Section 8.07 of Rev. Proc. 2013-22 includes provisions that appear to require any 403(b) pre-approved plan with a vesting schedule for non-elective employer contributions to satisfy certain different requirements with respect to non-forfeitable amounts. Specifically, the Rev. Proc. appears to require the plan to maintain the portion of a participant's interest in the plan that is not vested in a "separate account" for the participant that is treated as a separate contract to which Section 403(c) (or, in case of a custodial account, Section 401(a)) applies. As amounts in the participant's separate account become non-forfeitable, they are removed from the separate account and treated as amounts held under a 403(b) plan, to the extent permitted under Section 1.403(b)-3(d)(2)(ii) of the Code regulation. In addition, Item 65 in the IRS Listing of Required Modifications and Sample Plan Provisions and Information Package (the "LRM")[3] for 403(b) plans states that, "All contributions made by the Employer on behalf of a Participant, to the extent not vested, will be credited to a separate account and treated as made to a contract to which section 403(c) (or another applicable provision of the Internal Revenue Code) applies."

Issue: The SPARK Institute appreciates the fact that Rev. Proc. 2013-22 permits the use of vesting in 403(b) plan design and the sample language includes provisions for plans that provide for vesting. However, we respectfully request that the IRS confirm our understanding regarding the "separate account" requirement. While the language of the final 403(b) regulations and preamble provide that the forfeitable and non-forfeitable portions of the annuity contract will be treated as separate accounts provided the plan maintains a "separate bookkeeping account," we are concerned that the Rev. Proc. and sample 403(b) plan language could be construed to require that forfeitable amounts be maintained in a legally separate 403(c) contract or 401(a) account. Further, we are concerned that the Rev. Proc. and sample 403(b) plan language may require such amounts to be moved from the 403(c) contract or 401(a) account to the 403(b)(1) annuity or 403(b)(7) custodial account, respectively, as such amounts become non-forfeitable.

Recommendation: We respectfully request that the IRS confirm our understanding that the final 403(b) regulations are not intended to require that a separate annuity

[3] LRM, Part II, Section 2, Item 65 at p. 58 (March 2013).

contract or account be used to hold forfeitable amounts. Further, we request that the IRS clarify that unvested amounts can be held in the same contract or account that is used to fund the plan, as long as the unvested amounts can be separately identified and accounted for. While we understand that separate accounting is necessary to determine which annuity contributions are to be treated as held under a 403(b) annuity contract, we see no reason or benefit in requiring anything beyond bookkeeping entries. Requiring vendors to create legally separate contracts or accounts would be operationally challenging and expensive to implement. Record keeping systems of the plan sponsor, vendor, or third party administrator, as appropriate, can track vested and unvested amounts separately in the participants' accounts. Such amounts can be adjusted when the plan sponsor or its designee (such as a third party administrator) notifies the vendor that unvested amounts have become vested.

b. Government Plans

Background and Issue: Generally, the vesting provisions of the Code do not apply to a government plan as long as that plan meets the requirements of 401(a)(4) and 401(a)(7) as in effect on September 1, 1974. In a Memorandum issued by the IRS in April, 2012, the following vesting schedules were deemed to be permitted in a government plan: (i) 15 year cliff vesting schedule; (ii) 20 year graded vesting schedule; (iii) 20 year cliff vesting schedule for public safety employees; and (iv) anything more favorable than these above.[4] LRM item 65 provides that, "the nonelective employer contributions must vest according to a schedule that would satisfy the minimum standards of § 411 if the plan were a qualified plan under § 401(a), regardless of whether the plan is subject to the minimum vesting standards of section 203 of Title I of ERISA." There are government plans that use the grandfathered schedule, and it is unclear whether these vesting schedules, otherwise permitted for government plans, can be used in the pre-approved plans.

Recommendation: We request that the IRS confirm that the grandfathered vesting schedules from pre-1974 can be permitted in these 403(b) plans.

3. Mandatory Pre-tax Employee Contributions

Background and Issue: The SPARK Institute commends the IRS on the thoughtful approach under Rev. Proc. 2013-22 and the related package of recommended 403(b) plan language. While the pre-approved plans will serve many plan sponsors, some will have difficulty utilizing pre-approved plans without the ability to make substantial changes in the documents because of their particular plan designs. One such design which is common among 403(b) plans is the requirement that employees contribute a percentage of their compensation on a pre-tax basis as a condition of employment. This design is similar to the Code Section 414(h) pick-up contributions permitted in qualified plans for governmental employers. While the sample 403(b) plan provisions include mandatory employee contributions, they are only allowed on an after-tax basis.

[4] Memorandum from Acting Director of EP Rulings & Agreements, dated April 30, 2012.

Requiring pre-tax contributions is a popular design among 403(b) plans for a number of reasons. First, such mandatory contributions are generally matched by the employer. However, as the contributions made by the employee are not voluntary, they are not subject to the limit on contributions under Code Section 402(g). Second, as the matching employer contributions, if any, are not made on account of elective or after-tax employee contributions, they are therefore not subject to nondiscrimination testing under Code Section 401(m).

Section 1.402(g)(3)-1(b) of the Code regulations specifically authorizes such contributions. It provides that an elective deferral does not include a contribution that is made pursuant to an employee's one-time irrevocable election made on or before the employee's first becoming eligible to participate under the employer's plans, or a contribution made as a condition of employment that reduces the employee's compensation. These contributions are treated as employer contributions for contribution limits and nondiscrimination testing purposes. IRS Notice 89-23 (the special nondiscrimination guidance issued for 403(b) plans in 1989) also provided that such contributions are considered employer contributions and, thus, are subject to the nondiscrimination rules of section 403(b)(12)(i).

Recommendation: The SPARK Institute urges the IRS to expand the pre-approved plan program to make clear that sponsors can include and will receive approval of plans that allow mandatory pre-tax employer contributions. This flexibility will better serve the 403(b) plan community by making the pre-approved plans available to more plan sponsors.

4. Required Minimum Distributions

Background: It is common in the educational and other tax-exempt communities for participants to work for a number of different employers that offer 403(b) plans. Consequently, individuals can have multiple investment arrangements issued by different vendors under different plans. For purposes of applying the Code Section 401(a)(9) required minimum distribution ("RMD") requirements, 403(b) contracts are treated as individual retirement accounts ("IRAs"). As with IRAs, 403(b) investment arrangements in one or more 403(b) plans may be aggregated for purposes of determining the annual required distribution amount, and participants can satisfy their RMD requirements from any one or more of the annuity contracts or custodial accounts holding mutual funds issued under any of the plans. Further, as stated in the IRS' Retirement Plans Frequently Asked Questions Regarding Required Minimum Distributions, it is the 403(b) contract owner who must calculate the RMD separately for each 403(b) contract that he or she owns, and who can choose to take the total amount from one or more of the 403(b) contracts.[5]

[5] IRS Retirement Plans FAQs regarding Required Minimum Distributions, Questions 6 & 7, available at http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions#5 (last updated February 6, 2013).

Issue: Neither vendors nor plan sponsors will know definitively if terminated participants have satisfied their RMD requirements from a particular plan because the participant's full RMD amount may be distributed from any investment arrangement under any plan. Plan sponsors may have no contact with participants who terminated years (and possibly decades) earlier. Further, they may not be aware of or have any contact with other 403(b) plan sponsors in which participants may have participated. Vendors are also not likely to have knowledge relevant to determining RMDs about any of the other investment arrangements that their policyholders have with other vendors. Only the participant will have information about such other investment arrangements, plans and vendors in order to determine whether or not the individual satisfied his or her RMD requirements. It is not clear what responsibility a plan sponsor (or the plan's vendors) will have with respect to satisfying RMD requirements from the investment arrangements issued under a specific plan.

Recommendation: For the reasons summarized above, it is uncommon for administrators of 403(b) plans to force any RMDs from their plans. Rather, vendors typically inform participants who are approaching age 70-1/2 about the RMD requirements and the possible penalties that can be imposed if the requirements are not satisfied. The SPARK Institute respectfully requests that the IRS acknowledge the plan sponsors' and vendors' limited ability to ensure participants are complying with the RMD rules, and provide that compliance is the participant's responsibility. Since neither the plan sponsors nor the vendors have knowledge of what other plans or investment arrangements the participants may have available to satisfy the RMD rules, neither plan sponsors nor the vendors should be required to process RMDs without being directed by the participant to do so. Plan sponsors should not be required under the terms of the plan, and vendors under the terms of the investment arrangements, to distribute participants' holdings to meet unknown, and unknowable, RMD obligations. Further, we urge the IRS not to require plan sponsors or vendors to request that participants provide affirmative proof or represent that he or she is satisfying the RMD rules. Doing so will be administratively burdensome and plan sponsors and vendors have little, if any, means of ensuring that participants are responsive to such requests for proof. Just as with IRAs, the IRS will be able to enforce the RMD requirements by means of the significant 50 percent penalty against a participant who fails to comply.

5. Use of EPCRS by Employers Sponsoring both 403(b) and 401(a) Plans

Background: 403(b) plan sponsors may also sponsor 401(a) plans or multiple 403(b) plans. Operational failures in one plan may result in operational failures in the other plan. For example, failure to implement an automatic annual increase to a participant's rate of elective deferrals to a 403(b) plan may result in correspondingly insufficient matching contributions in the sponsor's 401(a) plan (where the 401(a) plan is used to accept the matching contributions) or in a second 403(b) plan. Or, a hardship distribution taken from one plan may not result in the suspension of employee contributions to all plans of the employer.

Issue One: The SPARK Institute member companies provide record keeping services to employers with complex plan designs and across plan types. It is unclear whether 403(b) and 401(a) plans can be covered in one Voluntary Correction Program ("VCP") submission under EPCRS, if necessary to resolve the error. Requiring separate VCP submissions based on plan type would result in duplicative legal effort for plan sponsors and the IRS. Additionally, it will also require plan sponsors to pay duplicate filing fees.

Recommendation: The SPARK Institute respectfully requests that the IRS clarify that single VCP submissions may include a single submission to correct errors in both 401(a) and 403(b) plans.

Issue Two: The compliance fee under Section 12.02 of Rev. Proc. 2012-13 is generally based on the number of participants in the affected plan(s). If an error with the same root cause affects multiple plans, but employees participate in more than one plan, the number of participants will be double-counted and the compliance fee will be higher than reasonably intended by the IRS. There are a number of reasons why the likelihood of errors affecting individuals who participate in more than one plan of an employer is high, and may be unavoidable, when one or more plans involved is a 403(b) plan. First, plan sponsors often cannot terminate 403(b) plans as a practical matter, and the Code does not currently permit mergers between "unlike" plans. Therefore, sponsors may be obligated to maintain multiple plans and an individual may be a participant in the frozen 403(b) plan as well as the active 403(b) plan. Second, as noted above, retirement plan designs of tax-exempt employers may intentionally integrate 403(b) plans with 401(a) plans, and an individual may make salary deferral contributions to the 403(b) plan and receive matching contributions in the 401(a) plan. The SPARK Institute believes that sponsors should not be punished for maintaining multiple plans, and requests that the IRS calibrate EPCRS fees accordingly.

Recommendation: The SPARK Institute respectfully requests that when a tax-exempt or governmental employer maintaining multiple plans submits a filing under EPCRS for an error that affects more than one of its plans, the compliance fee be determined by aggregating the total number of individuals in all of the affected plans and counting each individual only once even if in more than one plan.

6. Application of Rev. Proc. 2007-71 to Rev. Proc. 2013-22 and Rev. Proc. 2013-12

Background: Rev. Proc. 2007-71 described certain "grandfathered" contracts as not being part of a post-2008 403(b) plan.[6] The Rev. Proc. addressed the reality of the 403(b) environment that existed prior to 2009; since there had been no requirement to keep track of investment arrangements from discontinued issuers or those that were issued as a result of 90-24 exchanges, or even to keep track of the discontinued issuers themselves, it could be difficult or impossible to identify all of the investment arrangements that had previously been issued to fund the 403(b) arrangement. Moreover, many issuers were similarly unable to connect the investment arrangements that they had issued with the employers who maintained the plans. The Rev. Proc. struck an appropriate balance by

[6] The different categories of investment arrangements discussed in Rev. Proc. 2007-71 have been given different names, but for this discussion they are all referred to as "grandfathered contracts."

creating a continuum of sponsor responsibility that reflected the difficulty in identifying these historical investment arrangements.

Issue: The same difficulties in identifying older investment arrangements are also a concern with the 403(b) pre-approved program and the revised EPCRS. One of the themes of Rev. Proc. 2013-22 is that in the event of a conflict between the terms of the plan and the terms of the investment arrangements, the terms of the plan will govern. If the employer is unaware of the existence of an investment arrangement, much less the terms of that arrangement, it is impossible to manage a possible conflict. For example, consider an employer that adopts a pre-approved plan and elects to choose a design that does not permit hardship withdrawals. If a grandfathered contract issued in a 90-24 exchange from before September 25, 2007 allows participants to receive hardship withdrawals, the plan would inadvertently fail to be operated in accordance with its terms. While it seems that the plain language of Rev. Proc. 2007-71 would cause the grandfathered contracts to be treated as outside of the plan for purposes of adopting a pre-approved plan, Rev. Proc. 2013-22 did not explicitly address this issue.

This issue is also a concern in the revised EPCRS program under Rev. Proc. 2013-12. While it is clear that there can be no 403(b) plan document failures or operational violations of the plan terms in years prior to 2009, there can be an operational failure as defined under Rev. Proc. 2008-50 that is eligible to be corrected under the rules of that version of EPCRS. However, if the pre-2009 operational failure includes grandfathered contracts, it can be difficult or impossible to fully correct it. For example, assume that an employer discovers that contributions for certain employees were in excess of the 401(a)(17) limits for years that include years before 2009. To the extent that some of those contributions were made to grandfathered contracts that cannot be identified, the employer cannot effect a full correction by reducing the balance in those contracts. The alternative method of correcting a 401(a)(17) violation by retroactively amending the plan to increase contributions to other employees can also be frustrated by the existence of grandfathered contracts. To the extent other employees during the years of the over contribution hold grandfathered contracts that now cannot be identified, the sponsor could not contribute the additional amounts required by the correction method.

Even if the employer could identify the grandfathered contracts, for a variety of reasons it may be problematic for the de-selected issuer, who has long since severed its relationship, to assist in implementing a correction. Rev. Proc. 2013-12 exacerbates this problem by requiring an employer filing under VCP to represent that the plan sponsor has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary. Some employers will not be able to make that representation because they may not be able to identify and contact all entities, and ensure cooperation. It is unclear if the inability to make this representation, for what is likely a small subset of investment arrangements, means that no correction can be made at all for any investment arrangements. This could result in fewer 403(b) sponsors being able to take advantage of EPCRS.

Recommendation: The SPARK Institute believes that the principles of Rev. Proc. 2007-71 should be explicitly applied to the pre-approval program. We respectfully request that the IRS make clear that any investment arrangement that would not be considered part of the plan under Rev. Proc. 2007-71 should not be part of a pre-approved plan and should not be considered in determining whether the plan and the investment arrangements are in conflict. With respect to grandfathered contracts and EPCRS, we also request that any grandfathered contract that cannot be identified or where the issuer is not cooperative should not be required to be considered under the corrections process. Such grandfathered contracts should not be treated as part of the plan in applying EPCRS correction principles, nor should the employer be required to include them as part of the documentation under the plan. Alternatively, the IRS should explicitly permit employers to proceed with the correction of other investment arrangements and obtain reliance under EPCRS if the employer is unable to identify the contracts or obtain an issuer's cooperation after a reasonable, good faith effort. We urge the IRS to modify the representation required to be submitted by 403(b) sponsors in a VCP filing to reflect this reasonable, good faith standard with respect to grandfathered contracts.

7. Correction of Failure to Adopt a Written 403(b) on a Timely Basis

Background: Under Rev. Proc. 2013-12, if a written 403(b) plan is adopted after the December 31, 2009 deadline, it must be corrected for its untimely adoption by a VCP filing. In some cases, sponsors of written plans adopted after the December 31, 2009 deadline have subsequently discovered operational errors in their plans. These operational errors may themselves need to be corrected by a VCP filing in addition to the VCP filing required for the untimely adoption of the written plan.

Issue: Submitting two separate VCP filings, one to correct an untimely adoption and another to correct an operational error, in order to bring into compliance a plan that had been untimely adopted, is cumbersome and administratively burdensome. It would be more efficient if a plan sponsor could retroactively adopt a corrected plan that both cured the untimely adoption and the operational error of the originally adopted plan.

Recommendation: The SPARK Institute respectfully requests that the plan document being filed under the VCP to correct the untimely adoption be allowed to supersede the document that was originally adopted after the 2009 deadline. In other words, if the operation of the plan did not conform to the untimely adopted document, we request that the correcting document that is submitted under the VCP be permitted to conform to the plan operation as of January 1, 2009. The plan sponsor should not be required to submit a separate VCP for <u>operational</u> errors stemming from the untimely plan adoption, and there should be no requirement to correct operational violations for failing to operate the plan in accordance with the terms of that untimely adopted document, where a correcting document is part of the VCP submission.

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Thank you for considering our views and recommendations on these very important topics. The SPARK Institute is available to provide additional information and clarification regarding these matters. Please do not hesitate to contact us at (704) 987-0533.

Respectfully,

Larry H. Goldbrum
General Counsel