FEATURE STORY

How Do I Move My Money?

Navigating the Minefield of Contract Exchanges, Plan-to-Plan Transfers and Rollovers

BY MICHAEL WEBB

Though the 403(b) final regulations became effective nearly three years ago, rampant confusion remains with respect to moving one's money into and out of plans and between vendors within a 403(b) plan. In fact, to this day, I have seen plan sponsors and participants consistently attempt one type of transaction (rollover, exchange, or plan-to-plan transfer) when another transaction type would have been far more appropriate.

This article will attempt to demystify the regulations that govern participants' movement of 403(b) (and 457(b)) assets, and will address some common misconceptions about the differences between these three very distinct types of transactions.

Plan-to-plan transfers can be used to move assets between similar plan types, but beware of the significant restrictions that apply to such transactions — especially with respect to ERISA plans.

Rollovers Out of Plans

The good news: Rollovers were unaffected by the final regulations.


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The bad news: Many participants did not understand the rollover rules in the first place!

Understanding a rollover is grounded in the two principles:

- One may only roll over an eligible rollover distribution, which means that an individual must be eligible for a distribution under a retirement plan.
- A rollover is the only one of the three transaction types (ignoring the limited exception for transfers to purchase service credits under a governmental defined benefit plan) whereby assets can move between different types of plans (such as 403(b) to IRA, or a 403(b) to 401(k), etc.)

The first principle is the most misunderstood aspect of rollovers. If there is no distributable event (*e.g.,* with respect to elective deferrals, an in-service employee who is not at least 59½ years of age wishes to move assets), there can be no rollover.

As a reminder, in-service distributions of elective deferrals prior to age 59½ are generally only available in the event of financial hardship, and hardship distributions are not eligible for rollover. If the plan is even more restrictive — for example, if all in-service distributions are prohibited — then rollovers for current employees out of the 403(b) plans of their current employer would not be possible.

Distributions on certain types of employer contributions (as opposed to elective deferrals) may be less restrictive; but these are often more restrictive than the restrictions on elective deferrals. Thus, most active employees are not in a position to use rollovers out of the 403(b) plan of their current employers.

The rules are similar for governmental 457(b) plans. However, for 457(b) plans of private tax-exempt entities, rollovers are not permitted.

The second principle involves an important distinction, within the context of the first one. Let's take the example of an individual who wishes to move assets from a 403(b) plan to an IRA. Since different plan types are involved, it is clear that the only allowable transaction is a rollover. Thus, we would ascertain whether the employee is active or has had a severance from employment. If the employee has experienced a severance, and is no longer an employee of the plan sponsor, a rollover may be completed, with a rare exception when distribution of certain plan assets cannot be withdrawn until actual retirement. If the employee is active, chances are he/she cannot complete a rollover, unless another distribution eligible event (*e.g.,* attainment of age 59½, if the plan permits), has occurred. No distribution means no rollover.

> ***Rampant confusion remains with respect to moving one's money into and out of plans and between vendors within a 403(b) plan.***

Any rules that would apply to ordinary distributions, such as spousal consent to waive a QJSA for ERISA plans, would apply to rollovers as well. Lastly, 403(b) information sharing agreements (ISAs) are not required for rollovers out of a 403(b) plan.

Contract Exchanges

Two types of transactions arose from the ashes of Revenue Ruling 90-24 transfers, which were eliminated under the final 403(b) regulations. They are contract exchanges and plan-to-plan transfers.

Unique to 403(b) plans, and unlike rollovers, contract exchanges may be made prior to a distributable event, such as severance from employment. Thus, for in-service employees, contract exchanges are much more viable. The disadvantage is that contract exchanges are only permitted within a plan that permits exchanges, so assets cannot be moved outside the plan in this fashion. Thus, contract exchanges are only utilized in plans with multiple approved providers. Such providers must be specifically listed in the plan as being approved in order to receive a contract exchange of assets.

Approved providers are generally providers to which current contributions are being made, although it is possible to list "exchange-only" providers in the current plan document. Such providers would not be eligible to receive current contributions, but could receive exchanges. That actually occurs relatively rarely in non-ERISA plans. ERISA plans often, however, contain "inactive" plan vendors that are required to remain part of the plan under ERISA.

In addition to the requirement that the plan must permit exchanges, there are two other requirements for contract exchanges:

- The accumulated benefit after the exchange must equal the accumulated benefit prior to the exchange. (Note that the application of surrender charges would not violate this requirement.)
- The distribution restrictions in the new contract must be as stringent as those in the prior contract, and the new contract issuer must agree to provide the employer with information necessary for compliance with the final 403(b) and other tax regulations for transactions like loans and hardship distributions.

It should be noted that the second requirement does not necessarily call for the execution of a separate information sharing agreement, since all providers receiving ongoing contributions would be required in their written plans to share information. An information sharing agreement would only be necessary for the "exchange-only" recipient providers described above.

Finally, rules that would apply to rollovers, such as spousal consent to waive QJSA for ERISA plans, would not apply to contract exchanges. In that case, a distribution is not involved, and, moreover, assets remain within the plan.

Plan-to-Plan Transfers

The third method of moving assets is via a plan-to-plan transfer, which is permitted in both 457(b) and 403(b) plans, but with differing restrictions.

As the name of this type of transaction indicates, it is used to transfer assets between plans, as opposed to within a plan, where the contract exchange would be the appropriate transaction.

Unlike a rollover, a plan-to-plan transfer is permitted only between plans of the same type (*e.g.,* 403(b) to 403(b), 457(b) to 457(b), etc.). However there is a limited exception to this same-plan-type rule for transfers to purchase service credits under a governmental defined benefit plan (see below).

Unfortunately, 457(b) plans involve a further complication: plan-to-plan transfers are not permitted between 457(b) plans of governmental and tax-exempt entities. In addition, plan-to-plan transfers are further restricted by plan type. For governmental plans, an active employee may transfer his/her current 457(b) plan assets to another 457(b) plan maintained by his/her current employer; transfers are not permitted to plans of prior employers.

The final 457(b) regulations limit transfers between plans of tax-exempt entities to those employees who have incurred a severance of employment from one plan sponsor and subsequently wish to transfer assets to the 457(b) plan of their current tax-exempt employer; active employees of tax-exempt entities may not transfer plan assets. Such 457(b) plan-to-plan transfers, while permissible, are relatively rare, and thankfully so, since the rules are so convoluted.

Plan-to-plan transfers are likely to be only slightly more commonplace for 403(b) plans, since rollovers will be available for many employees who are eligible for plan-to-plan transfers. However plan-to-plan transfers will be permitted in two situations where rollovers would not be permitted, assuming the employee was not eligible for a distribution.

Specifically, the final 403(b) regulations permit transfers by an active employee from his/her current 403(b) plan to that of a prior employer or to another 403(b) plan of his or her current employer.

Several caveats do apply. One major issue is the requirement that both the receiving plan and the current plan permit such transfers. In other words, the current plan must permit transfers out, and the receiving plan must allow transfers in.

Having seen completed plan documents of various plan sponsors, I can state that it may be difficult to find both a plan that permits transfers out, and a receiving plan that permits transfers in. Many plans restrict transfers out, due to vendor contract restrictions, while a number of plans also limit transfers into the plan, out of concern that any defects associated with transferred assets under the prior plan could carry over to the current 403(b) plan.

The IRS's model plan language emphasizes this concern, requesting confirmation that the transferor plan is a plan that "satisfies section 403(b) of the Code."

In addition, for ERISA plans, certain sections of the Code and ERISA essentially conflict with the plan-to-plan transfer provisions. Though those fiduciary and other provisions are beyond the scope of this article, consider the following example of one such conflict.

Suppose a plan contains a QJSA provision whereby spousal consent is required for loans and any distributions that are not in the form of a QJSA. Imagine a participant whose assets are currently in an ERISA 403(b). If there is a non-ERISA 403(b) plan, which is also maintained by her current or prior employer, she could circumvent the spousal consent provisions by simply completing a plan-to-plan transfer of assets to a non-ERISA plan, where spousal consent would not be required for future loans/distributions. This example explains only one of many reasons that ERISA plans would not permit individual plan-to-plan transfers out of their plans.

Information sharing agreements are not required for plan-to-plan transfers. As with contract exchanges, rules that would apply to rollovers would not apply to plan-to-plan transfers, since a distribution is not involved.

Finally it should be noted that there is a special subsection of the plan-to-plan transfer provisions that permits 403(b) plan assets to be transferred to a qualified governmental defined benefit plan for the purpose of purchasing permissible service credit in the defined benefit plan. This is the sole example of where a plan-to-plan transfer can be made between different plan types (a 403(b) plan and a 401(a) defined benefit plan, in this case).

Conclusion

If one is attempting to move assets between different plan types (*e.g.,* 403(b) to IRA), one will need to be eligible for a distribution from the plan one wishes to move assets from, since only rollovers are permitted in such a scenario. Plan-to-plan transfers can be used to move assets between similar plan types, but beware of the significant restrictions that apply to such transactions, especially with respect to ERISA plans.

In summary, when transferring assets between plan providers within a 403(b) plan, contract exchanges are the transaction of choice.

Please note that this article is for general informational purposes only, and is not intended to be taken as legal advice or a recommended course of action in any given situation. Readers should consult their own legal advisor before taking any actions suggested in this article.

Michael Webb, TGPC, CEBS, AIF™, is the chair of NTSAA's Education Committee. He is Vice President, Retirement Services, at Cammack LaRhette Consulting, an independent HR benefits consulting firm specializing in non-profit industries.