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Internal Revenue Service
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1111 Constitution Avenue, N.W.
Washington, D.C. 20220

Ladies and Gentlemen:

On behalf of the American Council of Life Insurers (ACLI), we are writing to comment on Announcement 2009-34 (the Draft Revenue Procedure) and the draft section 403(b) prototype plan sample language (the Sample Language) that was released on April 14, 2009. The Draft Revenue Procedure and the Sample Language together are a proposal to establish a program for the pre-approval of prototype plans under section 403(b) of the Internal Revenue Code (Code).

ACLI represents three hundred forty (340) member companies. ACLI member companies account for ninety-four (94) percent of the annuity considerations in the United States. Our members accordingly have a strong interest in the effective implementation of the 403(b) prototype plan program.

ACLI commends the Internal Revenue Service (Service) for its work towards establishing a prototype program for 403(b) plans. This program has the potential to be a great help to plan sponsors in keeping their plans compliant. In our comments below, we suggest a number of specific changes to the Draft Revenue Procedure and the Sample Language that would make the program more effective and usable. We

would welcome the opportunity to speak with the Service and supplement our comments as the Service considers these issues.

I. Plans that Contain a Vesting Schedule Should be Permitted to Participate in the Prototype Program.

Many 403(b) plans, especially ERISA-covered 403(b) plans, include employer contributions and vesting schedules. Vesting schedules are used to reward service and manage costs. ACLI strongly urges the Service to consider adding the ability to include a vesting schedule in the prototype plan. The inability to include a vesting schedule would greatly decrease the usefulness and applicability of this program.[1]

Although ACLI recognizes that Code section 403(b) does not expressly provide for non-vested amounts, the Service has long permitted vesting schedules in 403(b) plans and addressed the treatment of non-vested amounts at Treasury Regulation §1.403(b)-3(d)(2) . Moreover, section 401(a) prototype plans may have vesting schedules and ACLI believes it makes good policy sense to provide equal treatment for 403(b) prototype plans. Certainly, to the extent the 403(b) program is covered by ERISA, the rules under ERISA section 203 would apply to 403(b) vesting schedules. For other 403(b) plans, ACLI believes the prototype program could accommodate vesting schedules that satisfy the minimum vesting standards of Code section 411. ACLI believes that this change would actually encourage the use of 403(b) plans and the prototype program.

II. The Plan Document and Contract Should be Coordinated, Rather than the Plan Document Terms Overriding the Contract in Every Case.

We appreciate the sensitivity reflected in the drafting of the Sample Language to matters that are appropriately governed by the terms of the Sample Language and matters that are appropriately governed by the annuity contract (or custodial account). This is a question of some complexity, given that section 403(b) arrangements as contemplated in the Final Regulations are formed by a series of agreements: between employer and employee, between employee and insurance company, and between insurance company and employer. In certain respects, however, further refinements are necessary for insurance companies prudently to accept involvement in a section 403(b) program that relies on the Sample Language. In the context of a prototype plan document that will have the Service's approval as to form, it is obviously important to ensure that the compliant document may not be altered by external documents in a way that adversely affects the plan document's compliance with the Code and the regulations. However, the broad sweep of the proposed requirement that a prototype plan preempt any conflicting provisions of the contract or custodial account over-compensates, and significantly raises the

[1] One ACLI member company reported that 54 percent of the section 403(b) plan sponsors it works with include a vesting schedule. Another ACLI member company reported that more than 60 percent of all private not-for-profit ERISA 403(b) plans contain a vesting schedule. We believe that many – if not most – of these plans would likely decide to retain their vesting schedule rather than utilize the Service's prototype program.

likelihood of unnecessary operational defects in the event of conflicts between two otherwise compliant documents.

Sections 5.04 and 5.07 of the Draft Revenue Procedure states that the terms of the plan document and adoption agreement must override any inconsistent provisions of any annuity contract or custodial account under the plan. The Sample Language states that the list of vendors maintained by the plan administrator is incorporated as part of the Plan, excluding those terms which are inconsistent with the Plan (read in conjunction with the Draft Revenue Procedure, it appears that the terms of the individual agreements as well as the vendor list are intended to be incorporated as well, only to the extent they are not inconsistent).

The language of the contract is regulated under both state insurance law and state contract law. In addition, many contracts are subject to federal securities law. The annuity contract governs the relationship between the issuer and the contract owner, and conclusively determines the issuer's obligations to the plan's participant. As a matter of contract law, the provisions of the annuity contract generally are not subject to unilateral modification by a non-party. In other words, principles of contract law indicate that the employer should not be permitted to in effect unilaterally change the contract simply by amending the plan document.

As a matter of state insurance law, the contract language must be approved by the state department of insurance (or similar body). While (i) employers properly can and will specify requirements that issuers must accept to become approved vendors under the program, and (ii) insurance companies will undertake over time to coordinate certain terms and provisions of their annuity contracts with the employer's plan, particularly with regard to optional benefits, rights, or features (such as plan loans), the terms of the contract, once issued, are binding on the parties. Accordingly, if the terms of the plan document conflict with the annuity contract, the contract as approved by individual state insurance departments must control as the only binding agreement between the contract owner and the issuer.

The Draft Revenue Procedure requires that the terms of the plan document must override any inconsistent terms of annuity contracts that are incorporated by reference. Moreover, the employer (appropriately) has the unilateral authority to amend the model plan. Together, these provisions may functionally supersede the terms of the contract, and mean that issuers cannot be confident that their contracts determine the scope and extent of their obligations. As a matter of contract law, the provisions of the annuity contract are legally enforceable by both parties, and generally are not subject to unilateral modification by either party. It would be no more prudent for an insurance company to submit to such terms than it would for an institutional trustee for a qualified plan to agree that the plan terms either override the carefully negotiated trust agreement at inception or, by unilateral employer amendment, can enlarge or modify the trustee's obligations. Insurers are unlikely to enter into contracts that can be unilaterally changed by the employer through plan amendment.

We recommend clarifying the Sample Language to read as follows:

> The Plan Administrator shall maintain a list of all Vendors under the Plan, including sufficient information to identify corresponding Funding Vehicles. Such a list and the identified Funding Vehicles are hereby incorporated as part of the Plan. In the event of a conflict between the Plan and a Funding Vehicle: (a) the terms of the Plan shall govern to the extent necessary to satisfy requirements of the Code and regulations; (b) the Plan may limit a Participant's rights under the Funding Vehicle to the extent set forth in Treasury Regulation §1.403(b)-3(b)(3) but may not enlarge the duties or diminish the contractual protections of the Vendor without the consent of the Vendor.

III. The Provisions for Verifying Execution of Adoption Agreement and Acknowledging Receipt of Plan Amendments Should be Modified.

The requirements of Section 8.03 and 8.04 of the Draft Revenue Procedure (requiring procedures for verifying that an adopting eligible employer has timely completed and signed new adoption agreements and acknowledging receipt by the adopting eligible employer of plan amendments) place a much greater burden on the prototype sponsor than is required for 401(k) prototype programs. We request that these sections be revised to require prototype sponsors to notify adopting eligible employers of the requirement to timely execute the adoption agreement and that failure to take required amendments into account in the operation of the plan could result in adverse tax consequences.

IV. The Minimum Required Distribution Provisions in the Sample Language Should Be Modified.

Treas. Reg. section 1.403(b)-6(e)(6) states that the Minimum Required Distribution (MRD) rules do not apply to the undistributed portion of the account balance under a 403(b) contract valued as of December 31, 1986, exclusive of subsequent earnings. The Sample Language should make clear that a participant is not required to take distributions from grandfathered amounts maintained in a contract on December 31, 1986, in accordance with Treas. Reg. section 1.403(b)-6(e)(6).

Treas. Reg. section 1.403(b)-6(e) permits 403(b) plans to satisfy the MRD rules in the same manner that the rules are applied to IRAs (i.e., the MRD must be separately determined for each 403(b) contract; however, such amounts may then be totaled and the total distribution taken from any one or more of the individual section 403(b) contracts). The Sample Language should be revised to explicitly permit the application of this rule.

Treas. Reg. section 1.401(a)(9)-6, Q-12(c) states that when applying the MRD rules to an annuity contract under an individual account plan that has not yet been annuitized, the present value of certain additional benefits may be disregarded. The

Sample Language should explicitly state that the value of certain contract features may be excluded from the MRD determination in accordance with Treas. Reg. section 1.401(a)(9)-6.

V. Subsequent Filing Should not be Required for Auto Enrollment Provisions.

The note under item 24 on page 11 of the Sample Language states that auto-enrollment provisions will be added later. We request that when the auto-enrollment provisions are added, re-filing of prototype plans should not be required. In addition, when the auto-enrollment provisions are added, we request that item 47, section 3 explicitly authorize default investments for participants who do not give investment instructions.

VI. The 401(a)(17) Compensation Limit Should Address Certain "Grandfathered" Arrangements.

Paragraph 2.2(a) of item 31 of the Sample Language should be revised to address the Code section 401(a)(17) limit applicable to certain governmental employers.

VII. The Definition of Plan Administrator and Allocation of Responsibilities Should Be Modified.

Although the Draft Revenue Procedure only refers to allocations of administrative responsibilities in the Adoption Agreement, the sample adoption agreement language in item 21 of the Sample Language clarifies that the plan may incorporate a separate document which reflects the allocation. Such incorporation is expected to be a preferred method for many employers, eliminating the need to execute a new adoption agreement with any change in administrative procedures. With respect to the sample adoption agreement language, use of the term "Memorandum of Understanding", although not defined in either the Draft Revenue Procedure or the Sample Language, implies a pre-existing concept with particular legal significance, though it has no prior existence in the regulations, and it also implies the existence of a single document where there may be multiple documents, including separate agreements with individual service providers. We propose revising paragraph (2b) of item 21 to read as follows:

> Allocation of Duties: Administrative duties are allocated among two or more parties according to one or more service provider agreements. All such agreements are incorporated herein by reference into the Plan. Any administrative duties not allocated under such agreements are reserved to the Employer.

VIII. The Sample Language on Timing of Contribution Remittances Should be Clarified.

The example in the final regulations, regarding the timing of contribution remittance, provides for such remittance within fifteen business days following the end of the respective month. Item 27 of the Sample Language designates the period merely as fifteen days, which could either be considered ambiguous or imposing a fifteen calendar day requirement. We request that this section be clarified to reflect a period of fifteen business days following the end of the respective month.

IX. The Provision for Loan Repayment Should be Made More Flexible

With the exception of new loans to participants with outstanding defaulted loans, no provision in the Code or regulations imposes a particular method of loan repayment (billing, coupon, salary deduction, etc…), nor is there any requirement that the repayment method be the same for all investment arrangements under the plan. The proposed sample adoption agreement language includes a selection of a single repayment method for the entire plan. The Sample Language itself (in item 42) defaults to payroll deduction repayment unless an alternate method is elected in the adoption agreement. While a plan sponsor may decide to impose a repayment method requirement, there is no requirement that they do so.

We propose that the Sample Language be revised to include, as an option, "any legally permitted method prescribed in the Funding Vehicle."

X. The Sample Language Should Clarify that a Participant May Communicate his Salary Deferral Election, Investment Elections, and Beneficiary Designation on Separate Forms.

Item 23 (on page 10) of the Sample Language can be read to require that a participant communicate his or her salary deferral election, investment elections, and beneficiary designation on a single form. Providing such elections on a single form is not currently standard industry practice due to the dissimilar nature of these elections. A section 403(b) participant's salary deferral election serves as an agreement between the participant and the employer that allows the employer to reduce the participant's compensation and to have that amount contributed to the plan on his or her behalf. Such agreement fundamentally differs from a participant's investment election or his beneficiary designation, each of which serve the administrative function of communicating a participant's preferences regarding asset allocation and the distribution of funds upon his or her death. Accordingly, the language of the model plan should clarify that issuers still retain the flexibility to require that participants make salary deferral elections, investment elections, and beneficiary designations separately.

Furthermore, any attempt to mandate a singular "one size fits all" approach to participant communication belies the diversity within the section 403(b) provider

market. Section 403(b) contracts are issued by a range of financial services providers. Individual flexibility in the design of administrative processes is integral to the efficacy of the section 403(b) market. Contract issuers have invested significant resources into designing and implementing administrative platforms that maximize efficiency and minimize costs for the participants, employers, and providers. Accordingly, issuers must have the flexibility to structure processes, including the investment election and beneficiary designation processes, in the manner that best meets each issuer's individual administrative needs.

While it is clearly not the intent of the Service to implement a comprehensive administrative mandate to provide for elections and designations on a single form, the language of item 23 requires clarification regarding this point. Requiring a single form in fact will raise administrative costs for many section 403(b) plans, and will not advance any relevant objectives under the Final Regulations. Accordingly, ACLI proposes that item 23 of the Sample Language be amended to clarify that participant salary deferral elections, investment selections, and funding designations may be provided to the employer and/or issuer on separate forms.

In addition, item 23 of the Sample Language suggests that the participant must designate only one beneficiary, as opposed to allowing multiple beneficiaries. The language should be clarified to permit designation of more than one beneficiary.

XI. The Definition of Account Balance (Item 2 of Sample Language) Should Be Modified.

Section 403(b) variable annuity contracts are not subject to, generally, the "investor control" principles applicable to "nonqualified" annuity contracts or, as "pension plan contracts" within the meaning of Code section 818(a), the diversification requirements of section 817(h). This means that these section 403(b) contracts can, unlike nonqualified annuities, be invested in publicly available mutual funds. To avoid any ambiguity as to whether such investments are permissible during periods when non-vested contributions to such contracts are treated as separate section 403(c) contracts pursuant to Treas. Reg. §1.403(b)-3(d)(2), "account balance" should be defined to include that section 403(c) balance.

In addition, the current Sample Language creates an ambiguity, as to whether the plan is required to create a separate aggregate record reflecting the sum of the individual accounts. A plan sponsor may always choose to create such additional account records. However, because many of the contracts and accounts in these plans consist of either individual accounts or group allocated accounts, many plan sponsors will prefer to recognize this term as a mathematical sum of the participant's contracts and accounts under the plan. We propose that the definition of account balance be clarified to allow for the balance to be maintained as the sum of separate records, rather than requiring a separate plan-level record.

XII. The Definition of Beneficiary (Item 5 of Sample Language) Should Be Modified.

This provision should explicitly contemplate that each annuity contract may supply a default beneficiary designation, when the participant does not have on file with the issuer an effective beneficiary designation in good order. In addition, item 5 suggests that the participant must designate only one beneficiary under the plan, as opposed to allowing multiple beneficiaries under multiple contracts. The Sample Language should be clarified to permit more than one beneficiary.

XIII. The Provisions Regarding Benefit Distributions at Severance From Employment or Other Distribution Events (Items 32 and 70 of Sample Language) Should be Modified.

These sections should expressly reflect that that the available forms of distribution will be governed by the annuity contract.

XIV. The Provisions Regarding Eligible Rollover Contributions (Item 43, Paragraphs 2 and 7 of Sample Language) Should Be Modified.

The Sample Language should not limit rollover contributions to cash only, but rather should permit each individual contract to specify the form or forms of rollover contributions that will be accepted by that issuer. In addition, a separate account for rollover distributions is of practical import only if the contract permits in-service withdrawals of such amounts, and should not be required when such distributions are not allowed.

XV. The Provisions Regarding Information Sharing Agreements (Item 45, section 5.2(ii) of Sample Language) Should Be Modified.

The sharing of information concerning after-tax contributions, and the implicit expectation that an issuer will take that information from other issuers into account in tax reporting distributions, was neither required in the Final Regulations nor anticipated by employers and issuers in redesigning their procedures and systems in response to the Final Regulations. This particular aspect of the information sharing regime has significant, and costly, operational ramifications for issuers, which will inevitably be borne indirectly by participants. This should not be the case: issuers are properly responsible for information reporting based on their individual products, and participants are properly responsible for reporting the proper amount of taxable income on their individual returns. Nor is it appropriate or (under extant systems) possible for an issuer to withhold tax other than in respect of its own contract. Moreover, given the low incidence of after-tax contributions to section 403(b) programs, systemic modifications to accommodate reporting or withholding on any broader basis cannot be justified under any reasonable tax compliance cost/benefit analysis.

This is also a point on which perfect information will regularly not be available; experience shows changes in approved issuers or recordkeepers for an employer's plan, for example, can degrade the availability of such information. If this section is retained – and for the foregoing reasons we urge that it be deleted – at a minimum the practical limits on the exchange of this information should be explicitly reflected in the model plan.

XVI. The Provision Regarding Mistaken Contributions (Item 53 of Sample Language) Should Not Be Limited to the "Mistake in Fact" Standard.

To our knowledge, the "mistake in fact" standard is not applicable to section 403(b) plans of public schools, and we see no tax policy basis to limit the return of erroneous contributions in such plans to that standard.

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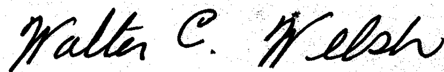
On behalf of the ACLI member companies, thank you for consideration of these comments. As stated above, we welcome the opportunity to discuss these comments and engage in a productive dialogue with the Service and Treasury on these important issues.

Sincerely yours,



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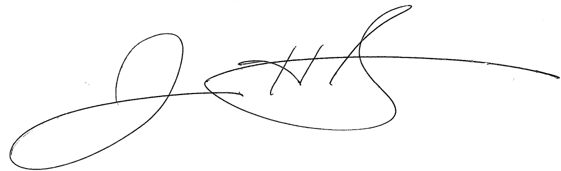

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