

Memorandum

TO: Diocesan Fiscal Managers
FROM: Darrell Lindman
RE: 403(b) Program Issues
DATE: November 10, 2008

I have been asked to send you a memorandum addressing a number of questions related to the 403(b) plan changes and the implementation of the proposed new 403(b) program.

What Employers Will be Eligible to Participate in the new MCC 403(b) Plan?

Eligibility to participate in the new MCC 403(b) Plan for eligible Catholic employers in the Province of Detroit will be limited to employees of the Catholic Church and employees of a “qualified church-controlled organization” (a “QCCO”). A QCCO is defined in Section 3121(w)(3)(B) of the Internal Revenue Code as follows:

“any **church-controlled** tax-exempt organization described in section 501(c)(3), **other than** an organization which—

- (i) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services or facilities; **and**
- (ii) normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities.

The most common examples of Catholic-related entities that will **not** be treated as a QCCO are hospitals, universities (this will typically not include a seminary), childrens homes, nursing homes, retirement housing facilities, and social charities that receive more than 25 percent of their support from sales to the public or from governmental sources. Catholic elementary and secondary schools that are controlled by the Bishop or a Church-appointed Board will be eligible QCCOs. It is important to note that an organization must be “church controlled” to be a QCCO. IRS regulations define “control” for this purpose as requiring that a majority of the organization’s officers or directors are appointed by the church’s governing board or by officials of the church

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(such as the Bishop or Cardinal). Please note that the test concerning what employers can participate in the MCC 403(b) Plan is actually more strict than the test applicable to the MCC Lay Employees' Retirement Plan (the "LERP"). The LERP does not require that a Catholic organization actually be a QCCO to be eligible to participate in the LERP.

A Catholic-related organization that is not a QCCO will not only be excluded from eligibility to participate in the MCC 403(b) Plan, it will have to maintain its own 403(b) plan in compliance with the written plan document requirements of the Final Regulations issued by the IRS under Code Section 403(b), and any employer contributions it makes to the plan will be subject to the nondiscrimination requirements applicable to 403(b) plans that are not sponsored by churches. These organizations will have to adopt (typically this requires Board action) a written plan document that includes certain specific language by the end of 2008. If you are aware of any Catholic organizations in your Diocese that do not meet the definition of a QCCO and who were anticipating being allowed to participate in a 403(b) program sponsored by the Diocese or by MCC, please advise these organizations as soon as possible that they need to establish their own written plans by the end of 2008. The Final Regulations under Code Section 403(b) do appear to subject a 403(b) plan maintained by a church-related 501(c)(3) organization that is not a "qualified church-controlled organization" to all of the specific written plan document requirements set forth in the Final Regulations. It will certainly be advisable for such organizations to also consolidate to a single 403(b) vendor going forward.

How Will the New MCC 403(b) Plan be Structured?

It is anticipated that the new MCC 403(b) Plan will be adopted by the Board of Directors of the Michigan Catholic Conference at its meeting on December 3, 2008 for the benefit of all eligible Catholic organizations in the Province of Detroit. As explained above, these eligible Catholic organizations will be limited to employees of the Catholic Church and all of its "qualified church-controlled organizations." We do not anticipate that it will be necessary for the individual Dioceses to separately adopt the Plan or the Custodial Agreement maintained as a funding vehicle for the Plan, but those details are in the process of being worked out with Prudential representatives.

Prudential has been selected as the sole provider for the new MCC 403(b) Plan, and the MCC will enter into an Administrative Services Agreement with Prudential with respect to the administration of the Plan. Prudential Bank & Trust FSB will serve as the Custodian for all investments of the Plan. The designated "Plan Administrator" of the Plan will be a committee consisting of one representative of each of the Dioceses in the Province of Detroit (the "403(b) Plan Committee"). Each Diocese's representative on the 403(b) Plan Committee will be the Diocese's fiscal manager, unless otherwise designated in writing by the Bishop of the Diocese to the President and CEO of the MCC. The 403(b) Plan Committee will retain CapTrust as its investment consultant to work

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with the Committee in the selection of the mutual funds that will be offered to the participating employees who will self-direct their 403(b) Plan investments. By working with CapTrust and reviewing the investment performance of the mutual funds offered under the Plan on a quarterly basis (at the regularly scheduled meetings of the fiscal managers), the 403(b) Plan Committee will satisfy its fiduciary duties to the employees participating in the MCC 403(b) Plan.

It is anticipated that the authority to make amendments to the MCC 403(b) Plan will be delegated by the Board of Directors of the MCC to the President and CEO of the MCC, provided that any amendments that are not merely technical in nature will be made in consultation with and at the recommendation of the 403(b) Plan Committee.

The MCC 403(b) Plan will permit participating employers to elect to make employer contributions (matching or otherwise) on behalf of their employees, and these employers and their contribution formulas will be listed on an attachment to the MCC 403(b) Plan document. Except as described on this attachment, no participating employer will be required or permitted to make any employer contributions to the MCC 403(b) Plan. It is very important that you advise Laura Stearns and me as soon as possible if any of the units in your Diocese will be making any type of employer contributions to the MCC 403(b) Plan, other than simply forwarding employees' salary deferral contributions to the Plan. For any unit which will make such employer contributions, we need to know: (1) which employees are eligible to receive such contributions—this includes any eligibility criteria such as age, length of service, or position; (2) must an eligible employee complete any specified number of hours of service during the calendar year or be employed on the last day of the calendar year to receive such contributions, and are there any conditions (such as death, disability or retirement) that excuse any such conditions; and (3) details concerning the contribution formula, such as "5% of compensation," or "50% of the employee's salary reduction contributions, provided that only salary reduction contributions up to 8% of compensation or up to \$4000 will be taken into account." Again, for those few employers who make employer contributions with respect to some or all of their employees, we need complete information describing all criteria that relate to those contributions.

Employers who participate in the MCC 403(b) Plan will have to provide certain information to Prudential concerning changes in their employees' employment status, but loans and hardship withdrawals will be handled directly between Prudential and the employees. It is anticipated that all administrative and investment costs of the MCC 403(b) Plan will be passed through to the participating employees and charged against their accounts. A significant administrative cost that the Plan will incur initially (until Plan assets reach a certain size) will relate to the number of payroll feeds that Prudential is required to receive. This cost and the payroll processing structure are still being negotiated with Prudential, and anything the fiscal managers can do to reduce the number

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of payroll feeds that Prudential or a third party agent will have to receive will reduce this administrative cost.

We will be working with Prudential to do everything possible to have the new MCC 403(b) Plan up and running as of January 1, 2009, or as soon as possible after that date. Amounts withheld from employees paychecks in January of 2009 must be deposited in the new custodial account with Prudential by the 15th business day of February, 2009. While it will not be possible to complete all the enrollment meetings with employees by the end of December 2008, it is hoped that Prudential will be able to make available to your employers a new enrollment form that the employers can provide to employees currently making 403(b) contributions, so as to allow them to have their 403(b) deferrals start as early as possible in 2009. Employers should not use prior salary reduction agreements applicable to discontinued vendors as authorization to withhold 403(b) deferrals after 2008. Enrollment and educational sessions with all employees will continue in early 2009.

What Should Your Units Do with Respect to Withholding 403(b) Deferrals in 2008?

A number of inquiries have been made concerning whether your units should continue to withhold 403(b) deferrals from employees' paychecks through the end of 2008, even if that means these deferrals will not be received by the discontinued vendors until some time in 2009. We recently learned that a top IRS official has stated verbally that he thought that, as a matter of administrative interpretation, a 403(b) plan could treat amounts withheld in December of 2008 and paid to the 403(b) provider in 2009 as 2008 contributions. The real problem here, however, is that most discontinued vendors will refuse to accept any 403(b) deposits after 2008, unless they have the required agreements in place with the depositing employer. A unit that withholds 403(b) deferrals from its employees' paychecks in December of 2008 runs the risk that it will not be able to deposit all those deferrals with all the relevant vendors in 2008. Many discontinued vendors who receive 403(b) deposits in 2009 will return those amounts to the employers who sent them. If an employer receives these 2008 deferrals back from a discontinued vendor in 2009, the employer runs the risk that it will have to amend previously issued 2008 W-2 forms. I think the best advice you can give your units is to not withhold any more 403(b) deferrals in 2008 after the date on which they are totally confident that they will be able to do so and get that money to the discontinued vendor in 2008. A little leg work on the employer's part in finding out when the 2008 deferrals must be mailed to be accepted by the vendor as a 2008 contribution will go a long way toward eliminating problems in 2009. Some vendors may be willing to accept amounts withheld in 2008 as 2008 deferrals, even though they are not received until January of 2009. Where that happens, I am not worried about it causing the employer's 403(b) plan any compliance problems. However, you should advise your units to not withhold any 403(b) deferrals in 2008 that they are not confident they can get to the discontinued vendor in 2008. Some employers may want to take the conservative position that no 403(b) deferrals can be

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made in December of 2008. I urge you to communicate this information to your units as soon as possible so that affected employees can be given the opportunity to perhaps increase November, 2008 deferrals to make up for the amounts they will be unable to defer in December.

What Else Do the Fiscal Managers Need to Do in 2008 on These Matters?

It is important that the fiscal managers obtain the necessary information from their units to complete a list of vendors who have received 403(b) contributions from Diocesan employers after 2004 and who will be discontinued on or before December 31, 2008. Please continue to assemble this information, and for each discontinued vendor, record those units you are aware of who sent post-2004 contributions to that vendor. If you have not already done so, please do **not** send out to any discontinued vendors the notices we previously provided. We will be working with our Prudential representatives on any additional language they want added to the orphan contract notice, and we will get any revisions made to the orphan contract notice out to you as soon as possible so that you will be able to send these notice out in 2008. Thanks for your assistance in these important matters.