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IN FOCUS

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403(b) Pension Plans: Overview and Legislative Developments

Introduction

A pension is a benefit employers may offer to assist employees in preparing for retirement. Pension plans may be sponsored by private sector (nonprofit and for-profit) employers or public (governmental) employers and may be classified according to whether they are (1) defined benefit (DB) or defined contribution (DC) plans and (2) sponsored by one employer or more than one employer. In DB plans, participants (or their beneficiaries) typically receive regular, monthly benefit payments in retirement (which some refer to as a "traditional" pension). In DC plans, participants have individual accounts that can provide a source of income in retirement.

Two common types of DC plans are 401(k) plans and 403(b) plans (named for the corresponding sections of the Internal Revenue Code [IRC; Title 26 of the *U.S. Code*]). A 401(k) plan is a type of DC plan available to private sector employers. A 403(b) plan (which may be called a *tax-sheltered annuity plan*) is a type of DC plan sponsored by public educational organizations (including public primary and secondary schools, state colleges and universities, and public junior colleges), 501(c)(3) tax-exempt entities, and employers that provide retirement income accounts for ministers (e.g., churches). While many 403(b) plans are sponsored by single employers, recent legislative changes may increase the number of those sponsored by more than one employer.

Despite distinct legislative histories, there has been a move toward harmonizing rules for 401(k) and 403(b) plans. This In Focus provides background on 403(b) plans, highlights areas in which they differ from 401(k) plans, and discusses current legislative developments surrounding 403(b) plans.

403(b) Plans and Federal Pension Law

Pension plans are generally tax qualified, which means that plan sponsors and participants receive certain tax advantages provided they meet IRC requirements. Some provisions of the IRC apply to both private and public sector plans, while some apply to one or the other. Nearly all private sector pension plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), which is enforced by the Department of the Treasury, the Department of Labor (DOL), and the Pension Benefit Guaranty Corporation (PBGC). ERISA was enacted to protect the interests of pension plan participants and beneficiaries. ERISA sets standards that private sector pension plans must follow, including with regard to participation, funding, and fiduciary responsibility (standards that govern how individuals with authority over pension plans must behave).

Whether a 403(b) plan is subject to ERISA depends on its sponsoring employer and/or the degree of employer involvement in the plan. Plans sponsored by private sector, tax-exempt 501(c)(3) entities are subject to ERISA except for those that meet a safe harbor exemption in which the employer's role is limited (see 29 C.F.R. §2510.3-2(f) and DOL's Field Assistance Bulletin 2007-02). Among other provisions, the safe harbor specifies that employers may not contribute to the plan and employee participation must be voluntary (i.e., no automatic enrollment features).

Plans sponsored by public educational organizations and churches are exempt from ERISA. However, church plans may elect ERISA coverage.

ERISA 403(b) plans submit annual Form 5500 filings with DOL, PBGC, and the Internal Revenue Service (IRS). Form 5500 includes data on the number of plan participants, financial information about the plan, and details of companies providing services to the plan. In plan year 2022 (the most recent Form 5500 data available), DOL indicated that there were 19,398 private sector 403(b) plans with 10.2 million participants. The U.S. Government Accountability Office estimated that in 2019, ERISA 403(b) plan assets comprised 57% of all 403(b) plan assets.

Structure of 403(b) Plans

Section 403(b) of the IRC permits three categories of funding arrangements: (1) annuity contracts provided by an insurance company, (2) custodial accounts invested only in Securities and Exchange Commission–registered mutual funds, or (3) retirement income accounts for church employees described in Section 403(b)(9) of the IRC (which are treated as annuity contracts). Retirement income accounts do not have investment restrictions.

Employers have varying degrees of involvement in their 403(b) plans—ranging from minimal involvement, such as providing a list of insurance carriers to eligible employees (common in 403(b) plans sponsored by K-12 school districts), to greater involvement, such as choosing investment options and providing an employer match. Starting in 2009, IRS regulations required that 403(b) plans—both ERISA and non-ERISA—be maintained pursuant to written plan documents (with some exceptions for certain church plans).

Features of 403(b) Plans

The following summarizes information on 403(b) plans, noting comparisons with 401(k) plans where relevant.

Enrollment. ERISA 403(b) plans may include automatic ("auto") enrollment features, in which employees are, by default, enrolled in the plan but can opt out. As a condition of the safe harbor exemption, private sector 403(b) plans that are not subject to ERISA are not permitted to auto enroll participants. In addition, some states (via state law) do not permit non-ERISA 403(b) plans to auto enroll. A provision in the SECURE 2.0 Act of 2022 ("SECURE 2.0," enacted as Division T of P.L. 117-328) required that new

401(k) and 403(b) plans (with some exceptions) auto enroll newly eligible employees effective for plan years beginning after 2024. It is unclear how this provision affects safe harbor 403(b) plans.

Contributions. Like employees in 401(k) plans, employees in 403(b) plans may make pre-tax contributions, designated Roth contributions, or after-tax (non-Roth) contributions (if permitted by the plan). *Pre-tax contributions* lower an individual's taxable income, but withdrawals of savings (i.e., contributions and any investment earnings) attributable to them are included in taxable income. *Designated Roth account contributions* do not lower taxable income, but qualified withdrawals are not included in taxable income. *After-tax (non-Roth) contributions* do not lower taxable income. Withdrawals attributable to these contributions are not included in taxable income, but investment earnings attributable to them are included in taxable income. Employers may match a fixed percentage of employee contributions (such as matching contributions up to, for example, 5% of a worker's compensation). Employers may also make nonelective contributions (those not based on an employee's contributions).

Some 403(b) plans permit employees to make additional contributions upon (1) reaching age 50 and/or (2) having at least 15 years of service with the same eligible 403(b) employer (an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches). The latter is known as the *15-year rule* and is not available to 401(k) plan participants. The amount permitted to be contributed under the 15-year rule depends on an employee's contribution history and years of service. All contribution types are subject to annual limits.

The *universal availability* rule states that if any employee is eligible to make 403(b) elective deferrals (i.e., employee contributions), all employees must be eligible to make them. Certain employees (e.g., certain part-time employees and those making contributions to a different plan sponsored by the same employer) may be excluded.

Hardship distributions and loans. Like 401(k) plans, 403(b) plans may offer hardship distributions and loans, though specific details may vary. Hardship distributions are pre-retirement distributions for employees who face financial need. Hardship distributions are included in taxable income and subject to a 10% penalty unless an exception in Title 26, Section 72(t), of the *U.S. Code* applies. Loans (which can be made from the plan, known as a plan loan, or between the annuity contract issuer and the participant, known as a policy loan) permit participants to borrow from their account balances, though the mechanics differ between 403(b) plan and policy loans.

Investments. Under current law, 403(b) plans are generally limited to investing in annuities or mutual funds through custodial accounts (except for retirement income accounts for church employees). In contrast, 401(k) plans have few investment restrictions. Many 401(k) plans invest through collective investment trusts (CITs), which are pooled investment funds maintained by banks or trust companies that are available only to certain retirement plans (not including individual retirement accounts [IRAs], for example). CITs are regulated by the Office of the Comptroller of the Currency, an independent bureau of Treasury. CIT trustees must comply with ERISA fiduciary duty if plan assets are invested in the CIT.

Recent Legislative Developments

SECURE 2.0 (P.L. 117-328) included provisions affecting 403(b) plans:

- Section 106 amended the IRC to formalize 403(b) multiple employer plans (MEPs) and authorize 403(b) pooled employer plans (PEPs). PEPs are a type of MEP in which unrelated employers join to offer a common retirement plan. Prior to the authorization of PEPs, each employer participating in a 403(b) MEP (or "aggregation arrangement") had to demonstrate a business or organizational connection and was treated as sponsoring its own 403(b) plan under the IRC. Under Section 106, 403(b) MEPs and PEPs may file a single Form 5500 and both gain relief from the "one bad apple" rule, in which one participating employer that fails to satisfy plan qualification requirements could result in the entire plan failing them.
- Section 602 expanded the types of 403(b) contributions permitted to be withdrawn as hardship distributions to include all types (making the rules consistent with those for 401(k) plans). Prior to this provision, only employee contributions without earnings were permitted to be withdrawn.
- Section 128 amended the IRC to permit 403(b) custodial accounts to invest in group trusts (as described in Revenue Ruling 81-100 and subsequent rulings) with other retirement plans and IRAs. A CIT is an example of a group trust. Previously, assets of a 403(b) custodial account could not be commingled in a group trust with assets other than those of regulated investment companies (i.e., mutual funds). However, without amending relevant securities laws (e.g., the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940), 403(b) plans are unable to invest in CITs.

In the 119th Congress, S. 424 and H.R. 1013, as reported out of the House Financial Services Committee on May 20, 2025, would amend securities laws to permit 403(b) plan assets to be invested with certain other retirement plan assets in CITs and in non-registered variable annuities through *insurance separate accounts*. Insurance separate accounts are accounts within annuity contracts typically used to hold variable annuities. Unlike *general accounts*, assets in separate accounts are segregated from all other assets of the insurance company.

Proponents contend that CITs and insurance separate accounts have lower fees and would assist in diversifying 403(b) participants' investment portfolios. However, some caution that CITs are less regulated than mutual funds and do not publicly disclose fee and expense information and that assets in them are not able to be rolled over to IRAs or, in many cases, to other qualified plans.

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