National Tax-Deferred Savings Association

Apples and Oranges: **Why K-12 403(b)s Work**

Comparisons between public and private sector benefits are understandable – indeed, such comparisons are often a large factor in employment decisions. But the variety and types of employers - and workers – covered by programs that operate under the auspices of 403(b) plans – are extraordinarily diverse. So much so that viewing 403(b) plans as a monolithic entity generally produces misleading results, despite the commonality of the Internal Revenue Code that supports their foundation. Like apples, 403(b) plans come in many varieties. However, to compare a 403(b) plan to a 401(k) plan is comparing apples and oranges.

For example, programs sponsored by non-profit associations and hospitals are, in fact, often quite comparable to 401(k) plans in design, operation and focus. They share similarities in terms of the typicality of matching employer contributions, investment menu size and construction. Programs sponsored by the nation's universities share many of those attributes as well, though they tend to make available investment menus that are considerably more complex, and sometimes make available multiple recordkeeping platforms to support access to that wider variety of options – alongside coverage by traditional defined benefit pension plans – an option rare among private sector employers these days, and one that both simplifies and complicates retirement planning. Education workers – those in the K-12 market – also typically are covered by a traditional defined benefit pension plan, and frequently rely on multiple providers to extend choice access – but also have attributes unique to that market that will be addressed below. These are all examples of the different types of employers and workers that may have access to 403(b) plans

According to the U.S. Bureau of Labor Statistics' (BLS) most recent Annual National Compensation Survey (released March 2021), public sector educators are well-served by employer-sponsored retirement plans. At least 94% of teachers have access to a retirement plan at work, and 99% of primary, secondary, and special education teachers have access to such a plan. This compares quite favorably to private industry, where just 68% of workers have access to a retirement plan. Likewise, in the BLS' most recent Employer Costs for Employee Compensation survey (December 2021), retirement and savings costs represent 13.5% of public school teachers' compensation, which again compares quite favorably to private industry where 3.5% of compensation is related to retirement and savings.

Comparisons With 401(k)

Due in no small part to their prevalence, it has long been standard practice by some to look to the design, operation and oversight of 401(k) plans as an appropriate model for that of the 403(b) programs available to workers in the governmental and non-profit sectors. However, and specifically regarding the programs available to workers in the K-12 education sector, those comparisons are ill-informed.

First, and in sharp contrast to those in the private sector, the 403(b) plan provided to education sector workers is nearly always a supplemental arrangement – one offered in addition to a traditional defined benefit pension plan. Said another way, education sector workers still have available to them the traditional three-legged stool of retirement funding, whereas most in the private sector now must rely significantly, if not solely, on their 401(k) and Social Security alone.

This disparity has two foreseeable outcomes. First, individuals covered by those 403(b) plans are much more likely to assume that their pension alone will provide sufficient resources in retirement, though aspects such as tenure and vesting may well undermine that assumption. In fact, research shows that state DB plans generally only covers 50% to 75% of a teacher's salary at retirement. While that is significantly better than that available to the vast majority of private sector workers, it still leaves a retirement funding gap.

Secondly, they may well assume that they will obtain Social Security benefits, though some programs preclude that access as a trade-off with their pension contributions. For example, in the state of Texas, teachers do not pay into Social Security and thus do not have access to Social Security benefits. Even if a teacher earns credits from another job, the offset provisions of the state plan may effectively eliminate the social security benefits.

Finally, and most significantly, their awareness of, and enrollment in, their 403(b) account often requires the assistance of a trained financial advisor, as they must navigate the complexities of defined benefit plan structure and benefits alongside their decision to participate in the supplemental 403(b) plan at appropriate levels and choose and monitor investments commensurate with that goal.

For a summary of typical key differences between 403(b) and 401(k) plans please see the below chart.

FEATURES OF...	PUBLIC SCHOOL 403(B) PLAN	401(K) PLAN
Primary Plan	No, supplemental to State Plan	Yes
Subject to ERISA	No	Yes
TPA provides administrative and compliance support*	Yes, often	Yes, often
Employer has Fiduciary Responsibility for Investments*	Not typically, unless imposed by State Law	Yes
IRS Filing Requirements	No	Yes, Form 5500
# of Investments	Often multiple investment options for multiple investment providers (“vendors”)	One set of plan investments
Investment Selection Process	Employee Driven	Selected By Employer
Information Sharing Agreements	Typically required	Not required. Plan investments selected by Employer.
Match Contributions**	Limited (typically found in state DB plan)	Very frequent
Non-Elective Contributions**	Limited	Frequent
Post-Employment Contributions	Yes, for year of separation plus the next 5 years	Yes but only for the year of separation
Focus of Advisor Support	Supports Employees	Supports Employer
Account Structure	Often Individual Custodial Accounts or Annuity Contracts	Group Investment Accounts

PRODUCT TYPES

Annuities	Yes	Typically, no
Mutual Funds	Yes	Yes
Individual Stocks & Bond	Not permitted	Permitted

* Most school districts hire a third-party administrator to help with plan compliance and administration including maintenance of up-to-date plan documents, plan procedures and controls. However, since 403(b) plan participation is voluntary and investment selection is the responsibility of participants, most school districts do not hire plan level advisors to assist with these elements.

** Although not common, Employer contributions are starting to be made to certain Public School 403(b) plans.

More Like an IRA

To unpack that just a bit, by design, from the participant's perspective, the typical K-12 403(b) plan operates more like a payroll-deduction individual retirement account (IRA) than a typical 401(k). While the employer is responsible for oversight and compliance with IRS regulations on a plan level, the employee / participant experience for a 403(b) account is similar to that of an individual investment. For the 403(b) plan, and unlike a 401(k) plan, there are typically no group education meetings, no enrollment campaigns, and – because of the supplemental nature of these programs, no automatic enrollment – at least not beyond the mandatory participation in the defined benefit plan, which is quite common. The decision to participate is voluntary and where to invest is much more open-ended than a 401(k) – in fact default investments are rarely needed and rarely stipulated in a 403(b).

For participants, 403(b) accounts operate similarly to an individual retirement account (IRA) established with a local personal banker. The advice 403(b) participants receive is similar to that found with a typical bank IRA, although the fees paid for that advice are typically well below those found in an IRA. In fact, the education and advice received from a typical 403(b) plan advisor is likely the only such education these individuals are likely to receive about their retirement needs, options and alternatives. Without that relationship with a 403(b) plan advisor, most participants would assume that those needs are 100% met by the provisions, vesting and funding of their traditional defined benefit plan – though these days that is almost certainly not the case.

More and Better Choices

Another comparison drawn with 401(k)s – one often promoted by 401(k) vendors – is the supposed advantage in restricting choice in access to funds and fund providers. While too much choice can indeed be intimidating for those making investment decisions unaided, the K-12 403(b) market typically offers not only investment advice - but access to investment advisors - in rough proportion to the number of those platform investment options.

In fact, based on 2020 data collected by NTSA, the average number of vendors that provide a custodial agreement or annuity contract in a typical 403(b) plan is six. This means teachers participating in a supplemental 403(b) plan have access to a variety of different options as to where and how to build additional retirement savings – and points to the value of working with a financial advisor in helping them make choices best suited to serve their wants and needs in developing a supplemental savings plan beyond the foundation of the state DB plan. This choice of vendors coupled with the ability to work one on one with a financial advisor, is essential to making informed choices that instill confidence – and, in addition to the distinctions noted above, represents a real difference in how K-12 403(b) plans operate, compared with their disarmingly similar 401(k) cousins.

Advisor Impact

Indeed, data also suggests that fewer teachers participate in 403(b) plans when the number of available investment providers and commensurate access to trusted advisor resources is limited. Said another way, when public teachers and staff no longer have access to the option(s) in which they choose to save and the professional assistance of their trusted advisor, they stop saving, and/or save less. For example, in 2009, Iowa transitioned from the traditional competitive, open 403(b) marketplace model to a narrow set of five options – only to subsequently see participation rates in the program plummet dramatically. In fact, some counties in that system suffered enrollment reductions of up to 50%.

The number of investment choices was subsequently expanded to 30 approved companies and the participation rate increased dramatically. Highlighting these challenges, a 2017 study done by the Public School Employee's Retirement System Board (PSERB) under PSERB Resolution 2017-43 in Pennsylvania, demonstrated that the range of 403(b) plan and 457(b) participation rates in America's public school districts is dramatic, suggesting that the investment and provider choices that each school district makes available, as well as the resources they provide to help teachers understand the benefits of participation, are key differences in driving participation rates. That survey further revealed that participation rates for the 636 public schools surveyed ranged from approximately 56% to more than 75.69%. In situations where the 403(b) is not a supplemental plan (for example where the teachers may be exempt from the state teachers' pension) there is 100% participation, since the teacher and the employer provide mandatory contributions to the 403(b) plan.

The Right Combination(s)

Continuing education for teachers, coupled with access to a trusted advisor, not only helps increase participation rates, it also serves to help build teacher retirement account balances. The education and assistance from an advisor supports teachers from early in their career through retirement. As noted earlier, there is evidence that working directly with an advisor increases participation. Coupled with their state sponsored retirement plan, a supplemental plan with a choice of options and access to a financial advisor can help teachers overcome the many factors that often impede saving for retirement, such as low salaries, significant student loan debt and lack of financial education – and unrealistic assumptions about the benefit that will ultimately be provided by their state DB plan.

Those intricacies – and the development of a workable plan to provide a secure financial footing for retirement – are the essence of the support provided by the type of 403(b) advisors that obtain the Certified Retirement Education Specialist (CRES) certificate sponsored by the National Tax-Deferred Savings Association (NTSA), and the firms that comprise the organization's Strategic Partners.

Objective data supports the conclusion that teachers in the K-12 market are saving more for retirement today than their counterparts in corporate America. Moreover, through access to a robust set of options, the freedom to exercise choice, guided by personalized and individualized connections with advisors, today's teachers are supplementing retirement assets which otherwise might fall short of needs and expectations. Financial education as well as access to trained, professional advisors provides the right mix to support informed choice and expanded plan participation. The ability for each teacher to choose from a variety of vendors and advisors to best fulfill their retirement savings needs positions these supplemental retirement programs in the right place – and at the right time – to enhance retirement security for one of our nation's most valuable resources – the public school teacher and staff.