



## STATE LEGISLATION TO CONSOLIDATE RETIREMENT PLANS MAY IMPACT TEACHERS' CHOICES

### Overview

Many teachers currently save their own money on a pre-tax basis through a 403(b) plan. 403(b) plans are similar to 401(k) plans in that employees can make independent decisions as to how much they want withheld from each paycheck and contributed to the plan. In most cases, employees are permitted to change their contribution amount during the year to go higher or lower as their needs dictate. Employers can also make non-elective contributions to 403(b) plans on behalf of their workers.

However, there are some significant differences between 401(k) and 403(b) plans. For example, special additional contributions can be made to school-sponsored 403(b) plans for workers that have 15 years of service. Additionally, participants in 403(b) plans often have individual contracts with the investment provider. Thus, the onus is on the participant to learn about how the plan works, how much to save for retirement, and how to invest their money in the plan. As a result, teachers who participate in 403(b) plans often need to receive more retirement advice than participants in 401(k) plans.

### Schools Are Typically Not Involved in 403(b) Plans

Although some schools have embraced the role of sponsoring a 403(b) plan, the vast majority have adopted a more passive approach. Individual public schools do not have human resource departments and school districts frequently do not have the resources to develop a “culture of savings” in the same way as the private sector. School-sponsored 403(b) plans typically are not subject to the non-discrimination rules that encourage many private employers to foster savings by

### In this Issue:

- Overview
- Schools Are Typically Not Involved in 403(b) Plans
- Workers Want Investment Advice About Retirement and Benefit From the Ability to Receive It
- Workers Participate More When They Have the Ability to Choose Their Investment Providers
- States Are Considering State-Run 403(b) Plans
- Administrative Efficiencies Can be Gained Without Taking Away Teachers' Choices
- Teachers Need the Right Information to Make the Best Choice
- A Reasonable Solution

lower paid workers in 401(k) plans. For the employers who have taken a more passive approach, teachers typically receive information from the service providers to the plan.

Three different business models are typically used to educate employees about their 403(b) plan investment options: (1) independent representatives; (2) a dedicated workforce; and (3) online tools. Independent representatives and members of a dedicated workforce typically provide a hands-on approach to education. They may meet with teachers at their schools, or even at their homes, to discuss the importance of saving for retirement and their options under the plan. An independent representative is affiliated with, but not employed by, a financial services firm. Members of a dedicated workforce are employed by the financial services firm. Under the online method, employees are typically directed to a website where materials about the importance of saving and the plan's investment options are available. Online options tend to be less expensive as a result of the types of services being provided to the individual.

### Workers Want Investment Advice About Retirement and Benefit From the Ability to Receive It

Studies show that many school district employees want help with retirement planning, but have varied preferences about how they want to receive information. Studies additionally suggest that participants in retirement plans perform better when they receive individual one-on-one financial advice. Furthermore, research indicates that these benefits are even more pronounced when the ability to receive financial advice is optional.

Research indicates that workers want the ability to receive help with retirement in a variety of ways. A study by the TIAA-CREF Institute showed that 60% of all near-retirement higher education employees had

consulted with a financial professional within the past two years regarding retirement.<sup>1</sup> The study indicated that 89% of these workers discussed investment allocations with their advisor and 60% of them discussed their savings rate.<sup>2</sup> However, a survey by Charles Schwab showed significant variety in how workers wanted retirement plan information delivered. The survey showed that 51% of retirement plan participants preferred one-on-one consultation, while 23% preferred an online tool that provided personalized investment selection and allocation recommendations.<sup>3</sup> Similarly, a survey from the Profit Sharing/401(k) Council of America (PSCA) showed that the most common education approaches in 403(b) plans included on-site one-on-one meetings, which were used by 63% of respondents for participant education.<sup>4</sup> As a result of these varied preferences, it is important that teachers be given the opportunity to choose the advisors that are right for them.

Studies indicate that workers tend to perform better when assisted by financial professionals.<sup>5</sup> A study by ING showed that people who spent one-on-one time with a financial advisor saved an average of more than twice the amount for retirement than those who report no time. People who spend a lot of time with an advisor saved an average of three times as much as those who did not.<sup>6</sup> The study also indicated that people who spent more time with a financial advisor tended to invest more moderately than those who did not.<sup>7</sup> Similarly, a study by Charles Schwab found that professional guidance had a positive impact on retirement plan participants.<sup>8</sup> The study indicated that workers who received advice increased their average monthly deferral percentage by 5.42%.<sup>9</sup> They found that their savings rates nearly doubled from 5% to 10% as a result of receiving and implementing advice. The study also

found that 92% of investors remained invested from July 2008 to February 2009 and their accounts had greater diversification.<sup>10</sup>

Researchers found that individuals who voluntarily elect to receive advice have greater positive results than both persons who do not receive advice as well as individuals who automatically receive advice. Researchers at RAND Corporation found that individuals who voluntarily choose to receive advice performed better than all other participants, even though the individuals in this group were significantly less financially literate.<sup>11</sup> Participants who had the option to elect to receive advice and did so, made significantly fewer mistakes in terms of the amount of equity and with respect to the diversification of their portfolios.<sup>12</sup>

### Workers Participate More When They Have the Ability to Choose Their Investment Providers

Recently issued research suggests that fewer workers participate in 403(b) plans when the number of available investment providers is reduced.<sup>13</sup>

At school districts in Southern California, over 50% of workers stopped contributing to their 403(b) plans when their existing provider was no longer available. Nearly three times as many workers in these school districts stopped making contributions to their 403(b) plans when their preferred investment provider was no longer available.<sup>14</sup> From January 31, 2008 to January 31, 2009, 19 percent of workers ceased making contributions when there was no change in the investment provider that they were using for their 403(b) investments.<sup>15</sup> However, 56 percent of workers ceased making contributions during this same time period when the investment provider they had been using for their 403(b) investments was no longer available.<sup>16</sup>

Data reveals that the number of participants substantially dropped when a single investment provider model was adopted by the Jefferson County School District in Colorado.<sup>17</sup> The school district had previously utilized up to fifty-five

<sup>1</sup> Paul J. Yakoboski, *The Use and Impact of Advice Among Near-Retirees*, TIAA-CREF Institute Trends and Issues 3 (Feb. 2010), available at [http://www.tiaa-crefinstitute.org/articles/ti\\_nearretirees0210.html](http://www.tiaa-crefinstitute.org/articles/ti_nearretirees0210.html).

<sup>2</sup> *Id.*

<sup>3</sup> *The New Rules of Engagement for 401(k) Success*, Charles Schwab 18 (Sep. 2010), available at [http://aboutschwab.com/images/uploads/schwab\\_engagement\\_study\\_slides.pdf](http://aboutschwab.com/images/uploads/schwab_engagement_study_slides.pdf) (surveying over 1,000 participants in 401(k) plans).

<sup>4</sup> Rebecca Moore, *403(b) Plans Increase Use of Advisers and Online Communications*, PlanSponsor.com, available at [http://www.plansponsor.com/403b\\_Plans\\_Increase\\_Use\\_of\\_Advisers\\_and\\_Online\\_Communications.aspx](http://www.plansponsor.com/403b_Plans_Increase_Use_of_Advisers_and_Online_Communications.aspx).

<sup>5</sup> See, e.g., Brian Bell, et al., *Assessing Investment Advice Provided to Participants in Defined Contribution Retirement Plans*, La Follette School Workshop Reports (2010), available at <http://minds.wisconsin.edu/bitstream/handle/1793/43882/retirement.pdf?sequence=1> (indicating that some studies suggest a large, positive effect given higher levels of advice while others find a more negligible effect).

<sup>6</sup> ING Retirement Research Institute, *Public Employees in Focus: ING studies the economic outlook of today's government workforce*, available at [http://ing.us/rrr/file\\_repository/44/Public-Employees-in-Focus-White-Paper.pdf](http://ing.us/rrr/file_repository/44/Public-Employees-in-Focus-White-Paper.pdf).

<sup>7</sup> *Id.*

<sup>8</sup> New Rules, *supra* at 4.

<sup>9</sup> *Id.* at 27.

<sup>10</sup> *Id.* (reflecting that participants who did not receive advice were invested in an average of 3.7 asset classes, compared to a minimum of 8 asset classes for participants who received advice).

<sup>11</sup> Angela A. Hung & Joanne K. Yoong, *Asking for Help: Survey and Experimental Evidence on Financial Advice and Behavior Change*, RAND Working Paper Series WR-714-1 (2010), available at [http://www.rand.org/pubs/working\\_papers/WR714-1.html](http://www.rand.org/pubs/working_papers/WR714-1.html).

<sup>12</sup> *Id.* at Tables 22 and 27.

<sup>13</sup> See, Debra Davis, GERALYN MILLER, and JUDY MILLER, *Protecting Participation: The Impact of Reduced Choice on Participation by School District Employees in 403(b) Plans*, ASPPA Pension Education and Research Foundation (2011).

<sup>14</sup> As of January 31, 2008, participants were making contributions to 194 investment providers for the plan. Seventy-eight of these investment providers were deselected.

<sup>15</sup> As of January 31, 2008, there were 10,613 participants were making contributions with investment providers who were not later deselected. As of January 31, 2009, there remained 8,608 participants of this group.

<sup>16</sup> During the process, 201 investment providers would not agree to coordinate information with the employer and were therefore deselected. Participants were contributing amounts to 78 of these investment providers as of January 31, 2008. As of January 31, 2009, there were 846 participants who were making contributions to investment providers who were later deselected. As of January 31, 2009, there remained 376 participants of this group.

<sup>17</sup> Jefferson County School District R-1, *Record Keeping Services for Tax Sheltered Annuity 403(b) Request for Proposal (RFP) #22649* (Issued June 21, 2010).

investment providers for its 403(b) plan.<sup>18</sup> As of January 1, 2006, they selected a sole investment provider for the district's 403(b) plan and redirected all contributions to the new investment provider.<sup>19</sup> The number of contributing participants dropped by over 54% from 2004, when multiple investment providers were available to 2009 when a single investment provider approach was used.<sup>20</sup>

Similarly, data reflects that the number of workers at a school district in Pennsylvania who participated in the 403(b) plan was significantly reduced when the school district switched to a single investment provider approach. The Indiana Area School District in Indiana County, Pennsylvania had nineteen investment providers in September 2008. By September 2010, after it switched to a single investment provider, nearly 40 percent of participants ceased participation in the plan.<sup>21</sup>

Thus, the data suggests that participation is adversely impacted when the number of investment providers is reduced.

## States Are Considering State-Run 403(b) Plans

Many states recently created or introduced bills to create state-run 403(b) plans for public schools (known as "consolidation").<sup>22</sup> These plans frequently authorize the State Treasurer to establish a 403(b) plan for local boards of education to offer to their employees. The State Treasurer either administers the plan or hires a third party administrator (TPA) to administer the plan. They also usually select a small number of investments as options for participants. Frequently, the same vendor is permitted to serve as the TPA and provide investment options to participants. Although local boards of education can frequently continue to offer their own 403(b) plans, there is a considerable disincentive to do so given the convenience of using the state's plan.

For example, North Carolina recently passed a law that authorizes the Department of State Treasurer to establish a 403(b) plan known as the "North Carolina Public School Teachers' and Professional Educators' Investment Plan".<sup>23</sup> Employees of local boards of education can participate in this new plan. Local boards of education could continue to offer 403(b) plans. The Department of State Treasurer will select a third-party vendor of retirement options with the goal of obtaining lower administrative fees and enhanced services. The plan would be administered by a TPA who could also be the vendor providing the retirement options.

The Department of State Treasurer and Board of Trustees for the North Carolina Supplemental Retirement Plans will select the investment options for the State 403(b) plan.

## Administrative Efficiencies Can be Gained Without Taking Away Teachers' Choices

403(b) plans should be structured as efficiently as possible, while providing teachers with the ability to select the right advisor for them. Advocates of these consolidation efforts argue that it would result in lower investment fees and administrative expenses. They posit that the use of a single TPA will reduce costs. They also argue that the state's selection of investment providers for teachers will result in lower fees charged to participants.

The advocates of consolidation efforts are right that the use of a single TPA may reduce fees. There are many instances where hiring a single TPA may be the right solution to provide efficiencies and reduce administrative costs to the school district. In order to allow teachers to have the choice to select the right provider for them, it is important that the TPA be independent.

However, fees and expenses can be reduced without causing workers to lose the ability to choose the right providers for themselves. Although a state-wide 403(b) program could select certain "core" investment providers that must be offered, each school district should be allowed to select additional investment providers they think are appropriate for their workforce. This will promote competition between investment providers to the benefit of teachers. These additional options would be administered by the state program's independent TPA, and any administrative fee or disclosure requirements would be the same as for the state-selected investment providers.

This approach would also allow workers to keep their retirement savings in one place. A study by Fidelity reflected on the importance to investors that retirement savings be held in a single account.<sup>24</sup> If states prohibit or discourage school districts from using their current investment providers, teachers will have to maintain multiple 403(b) accounts.

<sup>18</sup> *Id.* at 1.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> Participation dropped from 118 employees participating at approximately \$37,347 per month in September 2008 to 72 employees participating at approximately \$25,680 per month in September 2010, reflecting a decline in participation of 38.98 percent.

<sup>22</sup> See, e.g., Illinois Senate Bill 1826, Maryland House Bill 843, Maryland House Bill 1155, Maryland Senate Bill 735, North Carolina S.L. 2011-310, Ohio House Bill 153, and Texas House Bill 1974. Iowa also offers a state-wide 403(b) plan to teachers.

<sup>23</sup> North Carolina S.L. 2011-310 (previously known as House Bill 730, which was approved by the Governor on June 27, 2011).

<sup>24</sup> Fidelity® Study Finds Many Investors Lack Understanding of Options for Assets in Old Workplace Savings Plans, Fidelity.com (May 17, 2011), available at <http://www.fidelity.com/inside-fidelity/individual-investing/lack-of-understanding-of-options-for-assets>.

When states select the lowest cost options, they may not be making available the types of services that participants need to help them understand the importance of saving for retirement and the amount that they need to save for retirement.

To protect teacher choice, any state-wide 403(b) program should not restrict the ability of a school district to negotiate the terms and conditions of their arrangements with investment advisors or favor investment providers selected by the state. Workers in different school districts are unique. This will provide teachers and other public employees with a wide array of retirement savings options to suit their needs.

This approach is already being used in Florida by the IBC Model Plan.<sup>25</sup> Florida's four major education associations formed the IBC to help Florida K-12 employers reduce costs and satisfy the tax code's requirements for 403(b) accounts.<sup>26</sup>

## Teachers Need the Right Information to Make the Best Choice

Workers need to be given adequate information to make informed decisions about their 403(b) plans. Teachers should be able to choose the investment option that best suits their needs and the freedom to work with the advisor that they trust. For example, some participants want a very low-cost option with limited service, while others want to work closely with an advisor on a one-to-one basis and are willing to pay for that level of service. The right advisor can be of great assistance in helping a teacher to be an informed consumer and to select the investment product that is best suited to that teacher's unique needs.

In order to accomplish this, teachers should be able to easily compare the services being offered to them and the costs associated with those services. There should be transparent disclosure of investment fees and all other expenses so that workers clearly understand what they are paying and what they are getting in return. The National Tax Sheltered Accounts Association (NTSAA) is working with other organizations, including the National Education Association (NEA), on creating a 403(b) Model Disclosure Form.

## A Reasonable Solution

Improvements can and should be made by the 403(b) industry in order to help teachers make the choices that are right for them and reduce costs. Both of these objectives can be accomplished without limiting the number of 403(b) providers and curtailing teacher choice. School districts can hire a single TPA to administer their plans. States can also offer state-wide 403(b) program which include "core" investments and also allow school districts to select additional investment providers. Additionally, a model disclosure form will enable teachers to make educated decisions about their advisors and investment options.

Teachers and other public employees deserve the ability to make informed decisions about their investment providers and select the options that are right for them. States should not attempt to rein in administrative costs in a way that will deny participants' the ability to choose the provider that best meets their needs,

<sup>25</sup> Information about the IBC Model Plan is available at <http://www.themodelplan.com>.

<sup>26</sup> The Model Plan FAQ, available at <http://www.themodelplan.com/faq1.html#faq1>.