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TESTIMONY TO THE SENATE STANDING COMMITTEE ON KPERS SELECT  
FEBRUARY 7, 2012

**Submitted by Brian H. Graff On Behalf Of The American Society of Pension Professionals and Actuaries (ASPPA) and National Tax Sheltered Accounts Association (NTSAA)**

Thank you for the opportunity to speak with you about Senate Bill 338. I am Brian Graff, Executive Director and CEO of the American Society of Pension Professionals and Actuaries (ASPPA).

ASPPA is a national organization of more than 8,000 members who provide consulting and administrative services for retirement plans covering millions of American workers. ASPPA's membership includes the members of the NTSAA who focus on the governmental plan marketplace. ASPPA and NTSAA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants, and attorneys.

My testimony will focus on the importance of maintaining a 403(b) plan as the defined contribution plan for public school employees, as provided in SB 338. My testimony will also outline critical design elements that must be integrated into the proposed 403(b) plan to ensure public school employees have the ability to plan for a comfortable and secure retirement. Foremost among design considerations, the 403(b) plan must allow public school employees to work with a local advisor of their choice and to have the ability to choose the investment options they want.

**Providing Kansas Employees with the Retirement Savings Options They Need**

The Kansas public employee retirement system is built upon a three-legged stool philosophy. The first leg of the retirement system stool is the mandatory savings program that Kansas provides for its public sector workers as outlined in SB 338. The second leg is Social Security, and the third leg is personal savings.

In Kansas and throughout the country, the most effective personal retirement savings vehicle is the employer-sponsored defined contribution plan. In the private sector, everyone is familiar with the 401(k) plan. The defined contribution plan most often used for public education employees is the 403(b) plan. Although the corporate 401(k) plan is more commonly known to the public, the 403(b) plan has actually been helping public school employees save a lot longer—since the 1960s in fact.

It is commonly understood that personal savings is a critically necessary part of any employees' overall retirement goal, including Kansas employees covered by the current KPERS program. A former KPERS Executive Director publicly acknowledged this, indicating public employees need

to be saving on a supplemental basis to achieve a secure retirement.<sup>1</sup> That is why 50 percent of full-time Kansas public school employees already save on a supplemental basis into a 403(b) plan.<sup>2</sup> The 403(b) plan is the defined contribution plan Kansas public school employees already know and use.

The three-legged approach to retirement will certainly not change under SB 338. Employees will continue to need to save on a supplemental basis to achieve a comfortable retirement. However, employees participating in the new defined contribution program will now be responsible for investing their mandatory employee contributions in addition to any supplemental retirement contributions they are making to their 403(b) plan account. Fortunately, SB 338 makes it easier for public school employees to manage the investment of their mandatory and supplemental retirement contributions by utilizing the 403(b) plan model already operating in Kansas public schools.

If SB 338 did not provide for a consolidated 403(b) plan for public school employees, Federal law would require Kansas public school employees to maintain two separate accounts—one for their mandatory employee contributions and one for their supplemental retirement savings. A Fidelity study showed that workers preferred being able to manage their retirement savings in a single account.<sup>3</sup>

Frankly, maintaining separate accounts is a headache public school employees don't need and SB 338 cures that headache by utilizing the 403(b) plan—the defined contribution plan Kansas public school employees have been using for five decades.

#### **403(b) Plans Work Best When School Districts and Employees Have Choice**

Some will argue today that the best way to design a defined contribution plan is a centralized plan with a limited number of choices. I am here to tell you that's the worst idea.

As a child of two public school employees, I can tell you that public schools are different. My father started as a 5<sup>th</sup> grade teacher and then became a Principal. He worked in the same building for over 40 years. My mother was a Kindergarten teacher for over 30 years. In schools, teachers often view the principal as their boss. Not the school district; and certainly not the state.

Unlike private employers and even other governmental employers, public schools, particularly rural public schools simply do not have the resources to educate employees about the

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<sup>1</sup> Doug Wolff, President, Security Benefit Life Insurance Company, "Testimony on the Necessity of Advice, Choice and Local Control for the Success of Defined Contribution Plans; Best Practices in Public Sector Defined Contribution Plan Design before the KPERs Study Commission" 3 (Nov. 7, 2011) (stating that "Before his retirement, KPERs Executive Director, Glenn Deck, often referenced the three legs of the KPERs stool and recently testified to the House Committee on Pension and Benefits (February 9, 2011) that personal retirement savings has always been assumed to be at least 10% of the KPERs retirement savings formula. Mr. Deck also acknowledged that for some KPERs participants, the required personal savings percentage could be much greater than 10% because everyone has different circumstances and financial needs."), available at [http://skyways.lib.ks.us/ksleg/KLRD/Resources/Documents/KPERs\\_StudyCommission/2011-11-7\\_8\\_MeetingMaterials/SecurityBenefitTestimony.pdf](http://skyways.lib.ks.us/ksleg/KLRD/Resources/Documents/KPERs_StudyCommission/2011-11-7_8_MeetingMaterials/SecurityBenefitTestimony.pdf).

<sup>2</sup> An analysis of participants in 403(b) plans by a large Kansas service provider reflected that 21,777 out of 43,875 full-time employees participated in 403(b) plans sponsored by Kansas public school districts. This sampling represents approximately 65% of the public education employees in Kansas.

<sup>3</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>.

importance of supplemental savings. There is no HR department in every school. Folks are on their own when it comes to retirement savings.

That is why having the choice to work with a local advisor is so important. Times are tough all over, and that's certainly no different in Kansas. It's hard to convince someone to put money away for retirement, particularly younger workers with tight budgets. Frankly, a bunch of educational materials stuffed in the teachers' school mailboxes doesn't cut it for most. I still remember as a child an advisor coming to our house and sitting down with my parents to talk about the importance of saving for retirement. To be blunt, the role of the advisor in convincing someone to start saving is just as important as the advice on where to invest the savings. And you know what, that advisor needs to get paid and in most cases the advisor is paid from investment fees, which yes will be consequently higher than investment fees on products without a personal advisor.

You will hear from some that the most important thing is to have the lowest cost retirement options. You will hear that lower cost options do have web sites and call centers and that is enough. The facts suggest otherwise. Research from the ASPPA Pension Education and Research Foundation (attached) showed that in a large Colorado school district participation dropped by over 50 percent when they went from multiple 403(b) plan options to a single lower-cost option without personal advisors.<sup>4</sup> Researchers at RAND Corporation found that 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>5</sup>

I am certainly not saying that the issue of fees is unimportant. I am only saying that teachers and other public school employees need a variety of choices with different levels of services and fees—some lower cost and some not. You wouldn't want to go to a mall that only had a dollar store. Similarly, public school employees need different kinds of retirement savings options that best suit their needs.

Of course, Kansas public school employees have the right to know what services they are paying and how much they are paying for those services. That is why we partnered with the National Education Association to create a model disclosure form for 403(b) plan services and fees so that public school employees can easily make apples to apples comparisons of their retirement savings options. A copy of the USA Today article describing this new tool as well as the form itself is attached to my written testimony.<sup>6</sup> A large number of school districts have already committed to requiring investment providers to comply with the disclosures. We strongly encourage you to require Kansas 403(b) plan providers to comply with these national disclosure standards as well so that Kansas public school employees have the best information to make the best choice for them.

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<sup>4</sup> 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), available at <http://savemy403b.org/wp-content/uploads/2011/10/ASPPAWhitePaper-ProtectingParticipation.pdf>.

<sup>5</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>6</sup> Christine Dugas, *New tool to clearly disclose 403(b) fees*, USA Today (Feb. 1, 2012), available at <http://www.usatoday.com/money/perfi/retirement/story/2012-02-01/teachers-403b-retirement-plans/52908370/1>. The 403(b) Model Disclosure Form is available at <http://savemy403b.org/wp-content/uploads/2012/02/403b-Model-Disclosure-Form.pdf>.

## **Local Kansas School Districts Should Have a Role in Selecting Retirement Options for Their Employees**

In designing the ideal defined contribution program for Kansas public school employees it is critical that local Kansas school districts play a role. Practically speaking, local Kansas school district officials and teachers are in a much better position to know which advisors provide better services. With all due respect to the people in Topeka, the people in the Stafford School District, for example, know which advisors do a better job in Stafford.

That is why we strongly recommend that SB 338 be amended to incorporate 403(b) plan options selected by local Kansas school districts. In other words, in addition to the 403(b) plan providers selected by KPERS, each Kansas school district would select some additional 403(b) plan providers specifically for its employees. These will most likely be from the providers already operating in the school district, including local Kansas advisors. From the perspective of a Kansas public school employee they will now have an excellent array of retirement savings options that will include low-cost state selected options and options selected by their school district that provide access to effective local advisors. All of it coordinated by KPERS. It's the best of both worlds.

The model I am describing is not something new and is not complicated to do. It is exactly the model being successfully used today in states like Florida and Michigan. In those states, an independent TPA, who doesn't sell 403(b) plan products and does not have a conflict of interest, was hired. The cost of the TPA is paid for by the 403(b) plan vendors, not by the state consortium. You will be hearing today from an independent TPA who will talk about how easy this is to do and how effective it is.

### **Conclusion**

Personal advice, participant control and local choice are the key factors to designing the most effective defined contribution plan that will maximize personal retirement savings and provide a better retirement solution for participants. In the case of public school employees, there is no need to reinvent the wheel. Kansas public school employees already have a defined contribution plan, the 403(b) plan, that they have been using for 40 years and includes these elements.

The good news is that SB 338 already incorporates the 403(b) plan for Kansas public school employees. All that is needed is an amendment to give local school districts a role in selecting the retirement savings choices for their employees. Then Kansas public school employees can have the state of the art retirement savings program that they want and deserve.

Thank you. I would be pleased to take any questions.

# PROTECTING PARTICIPATION

The Impact of Reduced Choice on Participation  
by School District Employees in 403(b) Plans

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# EXECUTIVE SUMMARY

403(b) plans provide an important method to save for retirement for many school district employees. These plans allow workers to make independent decisions as to how much they want withheld from each paycheck and contributed to the plan. Employees are typically permitted to adjust their contribution amounts during the year as necessary. School districts can also make contributions to 403(b) plans on behalf of their workers.

403(b) plans differ from 401(k) plans in that school districts are frequently less involved than private employers are in their 401(k) plans. 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 lower paid workers. Additionally, participants in 403(b) plans often have their own individual contracts with the investment provider. Often, a school may only collect contributions and make its auditorium or gymnasium available for advisors to meet with interested employees. Thus, participants bear more responsibility, and often need more help to learn about how the plan works, how much to save for retirement, and how to invest their money in the plan.

This paper examines the impact of participant choice in 403(b) plans. It looks at the extent to which school district employees want choices

in their 403(b) plans and whether providing those choices is beneficial to them.

It finds that many participants want the ability to receive assistance with their retirement plans. For example, a study by the TIAA-CREF Institute showed that 60% of near-retirement higher education employees had consulted with a financial professional about retirement during the previous two years. A study by Merrill Lynch also revealed that 34% of retirees would recommend working with a financial advisor early in life.

Studies showed participants have varied preferences regarding how they want to receive assistance. For example, a survey by Charles Schwab indicated that 51% of participants preferred one-on-one consultation, while 23% preferred an online tool. A study by ING reflected that 59% of government workers wanted seminars or meetings, while 66% preferred printed materials. Multiple methods for receiving assistance, such as those described in the surveys, are currently available to 403(b) participants through the marketplace.

The paper finds that participant choice is valuable both in terms of helping workers prepare for retirement and maintaining participation levels in 403(b) plans. Studies indicate that workers save more for retirement and have greater diversification when they have the ability to consult with a financial professional. Additionally, researchers at the RAND Corporation found that individuals who

voluntarily elect to receive advice have greater positive performance results than both persons who do not receive advice as well as individuals who automatically receive advice.

Data also reflects that participation in 403(b) plans declines when the number of investment providers is reduced. In Southern California, around 50% of workers stopped contributing to their 403(b) plans when their existing investment provider was no longer available. Similarly, the number of participants dropped by over 54% when a school district in Colorado went from 55 investment providers to a single investment provider model for its 403(b) plan. Nearly 40 percent of participants

ceased participating in a 403(b) plan at a school district in Pennsylvania when the plan went from nineteen investment providers to a single investment provider.

Thus, the paper suggests that school districts should avoid reducing the number of investment providers in order to protect the levels of participation in 403(b) plans. School districts that are interested in reducing costs may want to consider options that include using an independent third party administrator (TPA) to administer the plan and providing transparent disclosure of investment fees and other expenses to workers.

# INTRODUCTION

For many school district employees, 403(b) plans provide an important means to save for retirement. Participants in these plans can make independent decisions with regard to how much they want withheld from each paycheck and contributed to the plan. Unlike 401(k) plans, there is typically less employer involvement in school-sponsored 403(b) plans. Thus, the onus is on the worker 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, school district employees often need to receive more retirement advice for 403(b) plans than participants in 401(k) plans.

This paper evaluates the impact of participant choice in 403(b) plans. It examines the extent to which workers prefer choice in their 403(b) plans and the impact of having choices.

The paper finds that school district employees benefit from the option to receive advice, both in terms of their preparation for retirement and participation levels. It further finds that data reflects a decrease in the participation rates for 403(b) plans when the number of investment providers is reduced. As a result, this paper suggests that school districts consider alternatives to reducing the number of investment providers in order to reduce costs. These include using an independent third party administrator (TPA) to administer the plan and providing transparent disclosure of investment fees and other expenses to workers.



## 403(b) PLANS PROVIDE SCHOOL DISTRICT EMPLOYEES WITH AN IMPORTANT METHOD OF SAVING FOR RETIREMENT

<sup>1</sup> See, e.g., Kristi Cook & Ellie Lowder, *The Source* 1-21 (3rd ed. 2011); 2011 *Investment Company Fact Book*, Investment Company Institute, available at [http://www.icifactbook.org/ib\\_ch7.html](http://www.icifactbook.org/ib_ch7.html).  
<sup>2</sup> 26 U.S.C. § 403(b).

<sup>3</sup> *Id.*  
<sup>4</sup> 401(k) plans must satisfy nondiscrimination requirements, which generally provide that the average deferral percentage rate for highly compensated employees is limited by the average deferral percentage rate for non-highly compensated employees. 26 U.S.C. § 401(k). Section 403(b) plans are not subject to this nondiscrimination requirement. Instead, if an employer permits one employee to defer salary into a 403(b) plan, they must generally extend this offer to all employees of the organization (known as the "universal availability rule"). 26 U.S.C. § 403(b)(12).

Many employees of school districts save for retirement through a 403(b) plan. Public education employers primarily use 403(b) plans as their only defined contribution plan.<sup>1</sup>

### Saving Through 403(b) Plans

Participants in 403(b) plans can make independent decisions with regard to how much they want withheld from each paycheck and contributed to the plan.<sup>2</sup> In most cases, employees are permitted the flexibility to change their contribution amount during the year to accommodate changes in their personal needs. Employers can also make non-elective contributions to 403(b) plans on behalf of their workers.<sup>3</sup>

### Role of School Districts

School-sponsored 403(b) plans are unlike 401(k) plans in that there is typically less employer involvement. Individual public schools do not have human resource departments and school districts typically lack the resources to develop a "culture of savings" in the same way as the private sector. Additionally, school-sponsored 403(b) plans frequently are not subject to the non-discrimination rules that motivate many private employers to encourage savings by lower paid workers.<sup>4</sup> Furthermore, participants in 403(b) plans often have individual contracts with the investment provider. As a result, schools often simply make their auditoriums and gymnasiums available for advisors to meet with interested employees.

Thus, the onus is on the worker 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, school district employees often need to receive more retirement advice for 403(b) plans than participants in 401(k) plans.

### Multiple Options are Currently Available for Helping School District Employees to Save

Three different business models are typically used to educate school district employees about their 403(b) plan and its invest 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. In contrast, members of a dedicated workforce are employed by the financial services firm.

Under the online method, school district employees are typically directed to a website where materials about the importance of saving and the plan's investment options are available. The fees associated with online options tend to be less expensive as a result of the types of services being provided to the individual.

## WORKERS BENEFIT FROM THE ABILITY TO RECEIVE INVESTMENT ADVICE ABOUT RETIREMENT

<sup>5</sup> See, e.g., *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) (hereinafter "New Rules"); 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>6</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>7</sup> Yakoboski, *supra* at 3.

<sup>8</sup> *Id.*

<sup>9</sup> New Rules, *supra* at 14.

<sup>10</sup> Merrill Lynch *Affluent Insights Quarterly: National Fact Sheet*, Merrill Lynch Wealth Management (Jan. 2011), available at <http://www.benefitplans.baml.com/Publish/Content/application/pdf/GWMOL/MLAIQ-Q1-2011-National-Fact-Sheet.pdf>.

<sup>11</sup> *Id.* at 1.

<sup>12</sup> This is consistent with the vast body of learning preferences theory in the realm of education, particularly with regard to adult learning. Examples of these types of models can be found in Cross, K.P. (1981). *Adults as Learners*. San Francisco: Jossey-Bass; and, Gardner, H. (1993a). *Multiple Intelligences: The Theory in Practice*. NY: Basic Books.

<sup>13</sup> New Rules, *supra* at 18 (surveying over 1,000 participants in 401(k) plans).

<sup>14</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>15</sup> *Public Employees in Focus: ING studies the economic outlook of today's government workforce*, ING Retirement Research Institute 24, available at [http://ing.us/ri/file\\_repository/44/Public-Employees-in-Focus-White-Paper.pdf](http://ing.us/ri/file_repository/44/Public-Employees-in-Focus-White-Paper.pdf).

Participants often receive guidance about their 403(b) plans with respect to a variety of critical issues, including the importance of participating in the plan, the appropriate savings rate for their financial situation, what types of investment alternatives are available in the plan, and which investment(s) may be appropriate for them.<sup>5</sup>

As discussed below, studies show that many teachers want help with retirement planning, but have varied preferences about how they receive information about their retirement plans. 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.<sup>6</sup>

### Workers Want Retirement Plan Advice

Numerous studies have indicated that employees want assistance with their retirement plans. A study by the TIAA-CREF Institute showed that 60% of near-retirement higher education employees had consulted with a financial professional within the past two years regarding retirement.<sup>7</sup> The study indicated that 89% of these workers discussed investment allocations with their advisor and 60% of them discussed their savings rate.<sup>8</sup> A study by Charles Schwab showed that 70% of retirement plan participants either actually received professional financial advice in the previous two years or had wanted to receive advice.<sup>9</sup>

Similarly, a survey by Merrill Lynch found that retirees significantly valued working with a financial advisor.<sup>10</sup> The survey asked retirees about the number one piece of long-term saving and investing advice they would give their 30-year old self. Thirty-four percent of them recommended working with a financial advisor earlier in life.<sup>11</sup>

### Participants Have Varied Preferences for Delivery of Advice

Research reveals that workers have significantly varied preferences with respect to the delivery of retirement plan information.<sup>12</sup> A survey by Charles Schwab 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>13</sup>

Similar results were shown in other surveys. The Profit Sharing/401(k) Council of America (PSCA) found 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>14</sup> A study by ING reflected that 59% of government employees who wanted their employer to make more financial education available to them preferred to receive this information through seminars or meetings, while 66% wanted printed materials and 53% preferred online education.<sup>15</sup>

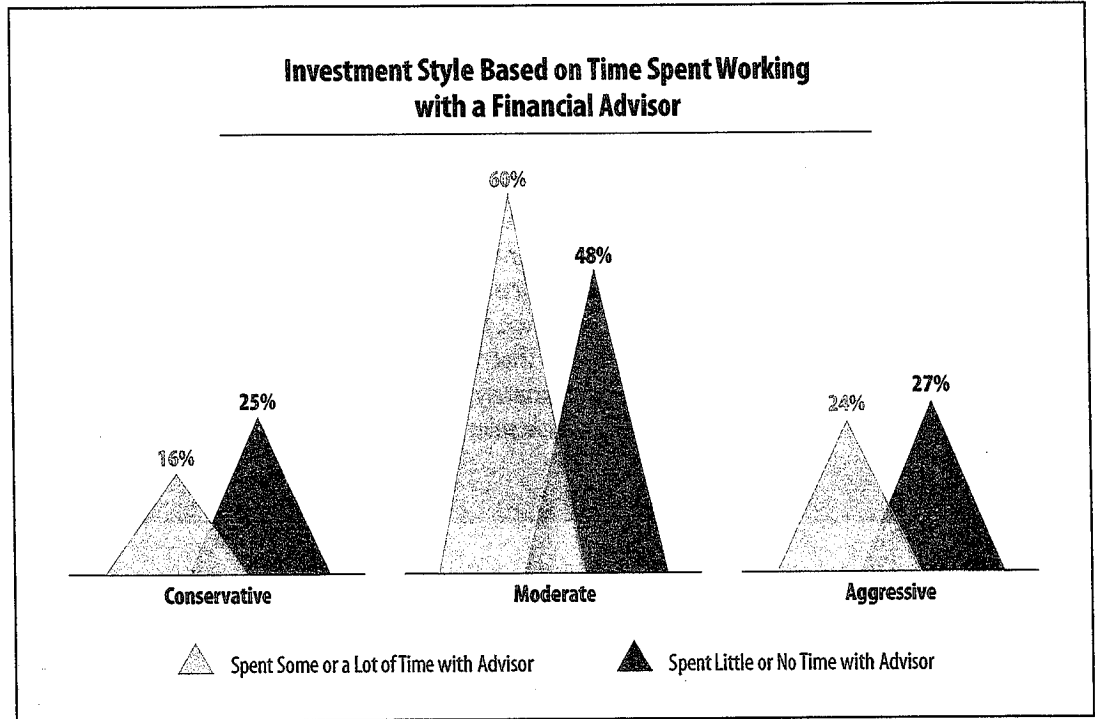
## Workers Frequently Perform Better with Financial Assistance

Studies indicate that workers tend to perform better when assisted by financial professionals.<sup>16</sup> A study by ING showed that people who spent time with a financial advisor saved significantly more for retirement. The survey noted that:

"Individuals who spent at least some time working [one-on-one] with a financial advisor

have saved, on average, more than twice the amount for retirement than those who report no time. That gap jumps to more than triple for those who report spending a lot of time with an advisor as compared to those who did not."<sup>17</sup>

As reflected in the following chart, 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>18</sup>



<sup>16</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>17</sup> "Help Wanted" White Paper, ING Retirement Research Institute 6, available at [http://ing.us/rri/file\\_repository/78/Help-Wanted-White-Paper.pdf](http://ing.us/rri/file_repository/78/Help-Wanted-White-Paper.pdf).

<sup>18</sup> *Id.* at 5.

<sup>19</sup> New Rules, *supra* at 4.

<sup>20</sup> *Id.* at 27.

<sup>21</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>22</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>23</sup> They also examined self-reported patterns of advice usage by a sample of 401(k) participants. Although previous studies had found positive correlations between the use of advisors and the quality of the individuals' portfolios, they did not find any correlation between financial literacy and having used an advisor from this approach. *Id.* (citing Bluetgen et al (2008); Hacketh et al (2009)).

<sup>24</sup> The paper notes that approximately 65 percent of individuals in the third group elected to receive advice and that the individuals who chose advice were significantly less financially literate.

Similarly, a study by Charles Schwab found that professional guidance had a positive impact on retirement plan participants.<sup>19</sup> The study indicated that workers who received advice increased their average monthly deferral percentage by 5.42%.<sup>20</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>21</sup>

## Participants' Behavior Improves When They Have the Option to Receive Assistance

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 examined the circumstances in which individuals improve their financial behavior as a result of receiving advice.<sup>22</sup> They randomly assigned individuals to one of three groups and asked them to perform a portfolio allocation task.<sup>23</sup> Participants in the first group did not receive any advice. Those in the second group all received the same financial advice. Individuals in the third group only received advice if they asked for it.<sup>24</sup>

Their research indicated 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. As indicated below, participants in the third group who elected to receive advice made

significantly fewer mistakes in terms of the amount of equity and with respect to the diversification of their portfolios.<sup>25</sup>

| Mistakes                | 1 <sup>st</sup> Group:<br>No Advice | 2 <sup>nd</sup> Group:<br>Unsolicited Advice | 3 <sup>rd</sup> Group:<br>Elected No Advice | 3 <sup>rd</sup> Group:<br>Elected Advice |
|-------------------------|-------------------------------------|--|---|--|
| <b>Zero Equity</b>      | 37.6%                               | 37.1%  | 46.1%                                       | 27.6%                                    |
| <b>Underdiversified</b> | 13.2%                               | 10.4%  | 19.3%                                       | 4.4%                                     |
| <b>Too Aggressive</b>   | 1.4%                                | 1.5%   | 2.7%  | 1.1%                                     |
| <b>Too Conservative</b> | 65.5%                               | 65.3%  | 65.8%                                       | 56.2%                                    |

<sup>25</sup> Hung & Yoong, *supra* at Tables 22 and 27.  
<sup>26</sup> *Id.* at 2.

Thus, the ability of participants to choose whether they received financial advice had a significant impact on their performance. Researchers at RAND Corporation found that “individuals who actively solicit advice ultimately improve performance, in spite of negative selection on financial

ability. One interesting implication for policymakers is that expanding access to advice can have positive effects (particularly for the less financially literate)...<sup>26</sup> Thus, they found that it is important that participants have the ability to decide and elect whether to receive financial advice.

## IMPACT OF OPTIONS ON PARTICIPATION IN 403(b) PLANS

<sup>27</sup> Robert Clark & David P. Richardson, *Who's Watching the Door? How Controlling Provider Access Can Improve K-12 Teacher Retirement Outcomes*, TIAA-CREF Institute Research Dialogue 4 (Nov. 2010), available at [http://www.tiaa-crefinstitute.org/pdf/research/research\\_dialogue/98a.pdf](http://www.tiaa-crefinstitute.org/pdf/research/research_dialogue/98a.pdf).

<sup>28</sup> Internal Revenue Service, Revenue Procedure 2007-71.

<sup>29</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.

Many school districts recognize the importance of increasing participation in their 403(b) plans. As noted by the TIAA-CREF Institute, "Given the current pressures on other components of public teacher retirement benefits, it is important for school systems to increase participation in and contributions to [403(b)] plans."<sup>27</sup>

Although further research would help validate the results, data indicates a correlation between a reduction in the number of investment providers and a decrease in the level of participation by workers in 403(b) plans, which does not appear to be caused by alternate factors. Thus, the data suggests that fewer workers participate in 403(b) plans when the number of available investment providers is reduced.

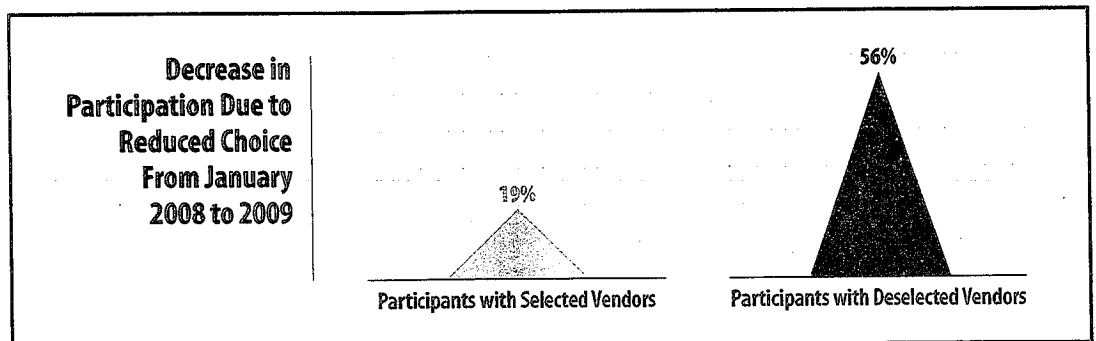
### Participation Declined When Number of Investment Providers Was Reduced in California

An analysis of employees in fifty-five school districts in Southern California shows that over 50% of workers stopped contributing to their 403(b) plans when their existing provider was no longer available. Guidance issued by the Internal Revenue Service generally permitted

employers to cease permitting 403(b) plan contributions to any investment providers that did not agree to coordinate information (known as "deselected investment providers") if certain requirements were satisfied.<sup>28</sup>

As a result of this guidance, many 403(b) plans reduced their number of investment providers during 2008. Workers were no longer permitted to make contributions to deselected investment providers and therefore needed to choose a different investment provider to continue making 403(b) contributions. It is important to note that although the school districts did not want to reduce choice, we understand that they felt obligated to deselect vendors who would not agree to coordinate information with them in order to maintain the integrity of the plan.

As indicated in the following chart, 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>29</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>30</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>31</sup>

Thus, the reduction in available investment providers correlated to a reduction in participation by workers in these 403(b) plans.

### Participation Significantly Declined When a Single Investment Provider Model Was Adopted in Colorado

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 (known as "Jeffco Public Schools").<sup>32</sup>

Jeffco Public Schools had previously utilized up to fifty-five investment providers for its 403(b) plan.<sup>33</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>34</sup> As indicated in the chart below, data provided from 2004 through 2009 reflects a significant decline in participation.<sup>35</sup> The number of contributing participants dropped by approximately 54% from 2004, when multiple investment providers were available to 2009 when a single investment provider approach was used.<sup>36</sup>

<sup>30</sup> As of January 31, 2008, there were 10,613 participants making contributions with investment providers who not later deselected. As of January 31, 2009, there remained 8,608 participants of this group.

<sup>31</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, 2008, there 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>32</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); Jefferson County School District R-1, *Tax Sheltered Annuity 403(b), 403(b)7, and 457 Plan Request for Proposal No. 21282* (Issued Sept. 16, 2005).

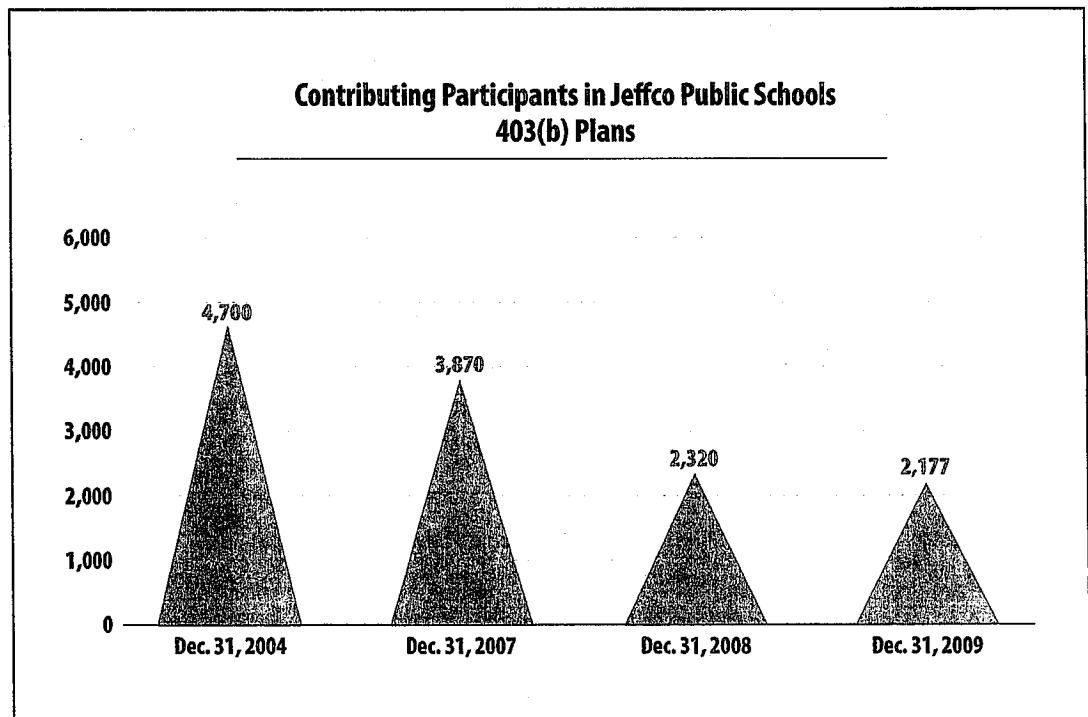
<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

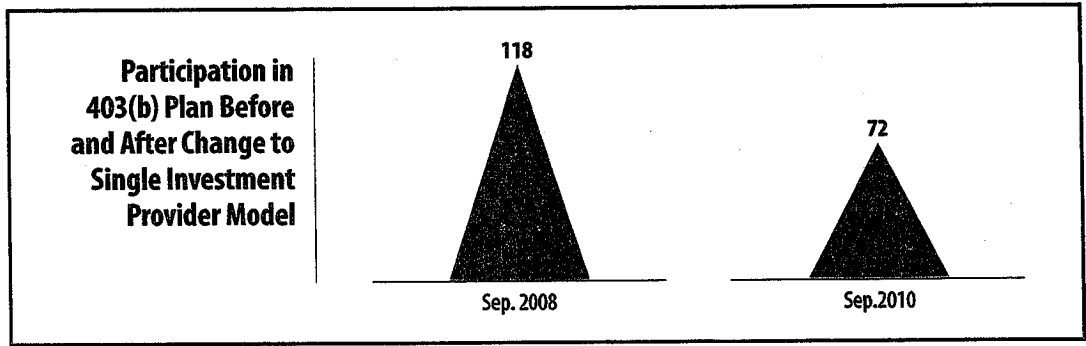
<sup>37</sup> Participation dropped from 118 employees participating at approximately \$37,347 per month in September 2008 to 72 employees participating at approximately \$25,680 per month in September 2010, reflecting a decline in participation of 38.98 percent.



### Participation Declined When the Number of Investment Providers Was Reduced in Pennsylvania

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>37</sup>



### Impact of Complexity on Participation

At least one research paper has suggested that increased choice may result in lower participation by workers in 403(b) plans due to "plan complexity."<sup>38</sup> Although this research was primarily focused on plan fees, it suggests that having numerous investment choices for teachers creates a process that is too complex and therefore may be responsible for fewer workers participating in 403(b) plans.<sup>39</sup>

However, this hypothesis is inconsistent with the above data that showed declines in participation in 403(b) plans when the number of investment providers is reduced. As a result, the data does not support the suggestion that the availability of numerous investment alternatives has negatively impacted participation in 403(b) plans.

<sup>38</sup> Clark & Richardson, *supra* at 14.  
<sup>39</sup> *Id.* at 7.

# PROTECTING CHOICE

<sup>40</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.  
<sup>41</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>.

Given workers' significant interest in having the ability to receive financial advice and the positive outcomes related to choice, policymakers should protect the ability of school district employees to choose the investment providers that suit their needs. 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. In order to accomplish this, workers need to be given adequate information to make informed decisions about their 403(b) plans.

Some states are considering options with the objective of reducing the cost of 403(b) plans.<sup>40</sup> The data reflects that 403(b) plans should be structured as efficiently as possible, but without eliminating choice.

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

403(b) plans can and should be structured to lower investment fees and administrative expenses, while providing school district employees with the ability to select the advisor and level of service that best suits their needs. Fees and expenses can be reduced without forcing workers to give up the ability to choose the right providers for them.

For example, school districts may want to use a single third party administrator (TPA) to reduce fees and administrative complexity. 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 to avoid conflicts of interest. For example, utilization of an independent TPA will ensure that educational materials provided to public school employees are product neutral.

States could also implement a state-wide 403(b) program with certain "core" investment providers that must be offered, and allow each school district to select additional investment providers they think are appropriate for their workforce. 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 would promote competition between investment providers to the benefit of school district employees while reducing the administrative burden for the districts.

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>41</sup> If states prohibit or discourage school districts from using their current investment providers, school district employees will often have to maintain multiple 403(b) accounts.



To protect choice, any state-wide 403(b) program should also 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.

A structure similar to the one proposed here is already being used in Florida by the IBC Model Plan.<sup>42</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>43</sup>

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

School district employees need to be given adequate information to make informed decisions about their 403(b) plans. This information should include the services that will be provided under the various offerings

so participants can choose the option that best suits their needs. For example, some participants want a very low-cost option with limited personal service, while others want to work closely with an advisor on a one-on-one basis and are willing to pay for that level of service. The right advisor can be of great assistance in helping an employee to plan and save for retirement, to be an informed consumer, and to select the investment product that is best suited to that participant's unique needs.

In order to accomplish this, workers should be able to easily compare the services being offered to them and the costs associated with those services.<sup>44</sup> 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.

<sup>42</sup> Information about the IBC Model Plan is available at <http://www.themodelplan.com>.

<sup>43</sup> The Model Plan FAQ, available at <http://www.themodelplan.com/faq1.html#faq1>.

<sup>44</sup> These types of disclosures will be required for 401(k) plans under the regulations to Employee Retirement Income Security Act of 1974 ("ERISA") sections 404(a) and 408(b) (2), which are designed to provide plan fiduciaries and participants with relevant information about the services provided to the plan and the fees paid for those services.

## CONCLUSION

Many school district employees want the option to receive assistance and benefit from multiple options, both in terms of their preparation for retirement and participation levels. Researchers have found that performance improves when individuals have the ability to elect to receive advice. Additionally, data reflects that there is often a decrease in the participation rates for 403(b) plans when the number of investment providers is reduced.

As a result, school districts should consider alternatives to reducing the number of investment providers in order to minimize costs. These include using an independent third party administrator (TPA) to administer the plan and providing transparent disclosure of investment fees and other expenses to workers. Policymakers can allow school district employees to continue to have the options they prefer, while accomplishing their objective of reducing cost and administrative complexity.

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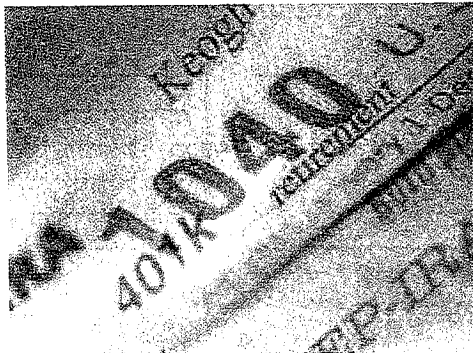
## New tool to clearly disclose 403(b) fees.

By Christine Dugas

Published: February 1, 2012

Just as many teachers are seeing pensions shrink, they're relying more on costly 403(b) retirement plans that are not covered by the new federal fee disclosure rules.

Public school employees have no help from their school systems in making informed investment choices, so an industry task force, including the National Education Association, today will unveil a tool that will clearly disclose 403(b) plan fees.



Although schools will not be required to adopt the industry standard, called the 403(b) Model Disclosure Form, the NEA hopes they will use it to better educate their employees about the retirement fund options. "It is a big deal," says Lisa Sotir, general counsel for NEA Member Benefits.

The form is designed to give school employees — from teachers and guidance counselors to janitors and bus drivers — an apples-to-apples comparison of their investment options and the fees that brokers and providers receive.

Much attention has been focused on new federal requirements that will improve fee disclosures on 401(k) plans.

But governmental retirement plans, which mostly include public school 403(b) plans, are exempt.

"Public school employees are let out in the cold unless we do something," says Brian Graff, CEO of the American Society of Pension Professionals & Actuaries, which helped create the retirement tool.

With 401(k) plans, employers are responsible for selecting and monitoring investment options. But school districts do not have control of 403(b) plans, and that puts more pressure on workers to make the best retirement decisions, says Alessandra Hobler, analyst at Cerulli Associates.

The 403(b) plans originally were just a supplement to traditional pensions, and employees had to comb through complicated options that used to be mostly highcost annuities. Now, more of them also include mutual funds. But of the \$109 billion in public K-12 school 403(b) plans last year, Cerulli says the assets were still predominately invested in annuities.

Ed Brand, superintendent of Sweetwater Union High School District in Chula Vista, Calif., says a tool such as the new disclosure form is much needed.

Joe Coppola, president of Bergen County Education Association in New Jersey, agrees: "There is more good information given to a consumer on buying a refrigerator than there is (to teachers) on retirement planning.

**403(b) Model Disclosure Form  
for the Plan Year Beginning January 1, 20\_\_**

Company's Name: \_\_\_\_\_ (the "Company")

Plan or School District's Name: \_\_\_\_\_ (the "Plan")

Product Name: \_\_\_\_\_

The following types of services will be provided and the following expenses may be charged to your account/annuity. You should also receive documents titled "Comparative Chart" and "How to Read the 403(b) Model Disclosure Form" with this document.

**I. Services**

| Type of Service                                       | Face-to-Face<br>One-on-One | Face-to-Face<br>In a Group | By Phone | By Mail | Online | By a Licensed<br>Advisor / Agent |
|---|----------------------------|----------------------------|----------|---------|--------|----------------------------------|
| <b>Advisory Services</b>                              |                            |                            |          |         |        |                                  |
| Educational materials about financial decisions       |                            |                            |          |         |        |                                  |
| Educational materials about retirement plan           |                            |                            |          |         |        |                                  |
| Educational seminars                                  |                            |                            |          |         |        |                                  |
| Enrollment  |                            |                            |          |         |        |                                  |
| Investment guidance                                   |                            |                            |          |         |        |                                  |
| Investment planning tools                             |                            |                            |          |         |        |                                  |
| Professionally-managed asset allocation<br>portfolios |                            |                            |          |         |        |                                  |
| Retirement calculator                                 |                            |                            |          |         |        |                                  |
| Retirement planning                                   |                            |                            |          |         |        |                                  |
| SEC regulated investment advice                       |                            |                            |          |         |        |                                  |
| Suitability review                                    |                            |                            |          |         |        |                                  |
| Other:  |                            |                            |          |         |        |                                  |

| Type of Service                | By Phone | By Mail | Online |
|--------------------------------|----------|---------|--------|
| <b>Administrative Services</b> |          |         |        |
| Account access                 |          |         |        |
| Account transactions           |          |         |        |
| Automatic rebalancing          |          |         |        |
| Loan processing                |          |         |        |
| Monthly statements             |          |         |        |
| Quarterly statements           |          |         |        |
| Other:                         |          |         |        |

For additional information, see [insert Company's web site].

**II. Administration and Operational Fees** - These are additional fees that may be charged to your account/annuity.

| Type                  | Charge |
|-----------------------|--------|
| TPA Fees              |        |
| Distribution Fees     |        |
| Loan Origination Fees |        |
| Loan Maintenance Fees |        |
| Other:                |        |

| III. Annuity Product Charges |   |
|------------------------------|---|
| Type                         | Charge  |
| Front End Charge             |   |
| Surrender Charge / CDSC      | <input type="checkbox"/> Schedule applies separately to each deposit made to the contract<br><input type="checkbox"/> Schedule applies to all balances under the contract based on the initial effective date of the contract<br>Description: |
| Contract Fee                 |   |
| Mortality & Expense Fee      |   |
| Other:                       |   |

| IV. Custodial Account Charges |        |
|-------------------------------|--------|
| Type                          | Charge |
| Front End Charge              |        |
| Surrender Charge / CDSC       |        |
| Administrative Fee            |        |
| Custodial Fee                 |        |
| Wrap Fee                      |        |
| Other:                        |        |

V. Investment Information - See enclosed Comparative Chart. Note that some of the fees on the Comparative Chart have also been disclosed on this form.

VI. Payments to Third Parties - These are NOT additional amounts charged to your account/annuity.

| A. Annuity Products   |  |
|---|--|
| 1. Commissions and/or Other Marketing or Service Payments Directly Related to the Purchase of or Deposit(s) in This Product |  |
| 2. Description of Payments to Other Third Parties Related to Endorsements, Marketing or Promoting This Product              |  |

| B. Custodial Accounts   |  |
|---|--|
| 1. Commissions and/or Other Marketing or Service Payments Directly Related to the Purchase of or Deposit(s) in This Product |  |
| Fund Class or Family  | Brief Summary of Recipient(s) and Their Payments |
|   |  |
|   |  |
| 2. Description of Payments to Other Third Parties Related to Endorsements, Marketing or Promoting This Product              |  |

