

403(b) Plan Issues

Addressed by HB 3480

Sponsored by Representative Vicki Truitt, Chair
House Committee on Pensions, Investments & Financial Services

Why HB 3480 Is Needed

1. Abusive Practices by TPAs affiliated with Companies Selling 403(b) Products

- (a) Issue. Certain Third Party Administrators (TPAs) offer to administer 403(b) plans for school districts at no cost or a greatly reduced cost. They do this in order to gain access to employees on a favorable basis to market 403(b) products. Since the charges to the employees in these products must be high enough to cover the “free” or reduced price administration for the district, the employee is paying for the administration. This practice can also be deceptive since employees (a) often do not understand these product charges and (b) may believe that the TPA-affiliated vendor has an “implied endorsement” from the district since the TPA is also administering the 403(b) plan.

Example. Employees of school districts where this practice is in place can often observe the effect of having a TPA affiliated with a vendor. For example, in Fort Worth ISD there are only 14 approved vendors vs. over 42 in Dallas ISD. The TPA in Fort Worth ISD has also stopped most payroll deductions not going to their affiliate or one of the other 14 companies. The TPA in Fort Worth ISD is a subsidiary of the insurance company AIG. AIG also sells 403(b) products in the district. The TPA in Dallas ISD is independent and does not sell 403(b) products. The assumption is that a TPA affiliated with a product vendor can be motivated to allow as few competitors as possible in the plan.

- (b) Legislative Intent. In 2001 the Texas Legislature passed S.B. 273 and this was signed into law. Article 6228a-5, Section 9(a)(6) states that “An educational institution may not accept any benefit from a company or from an agent or affiliate of a company that offers qualified investment products.”
- (1) The intent of this legislation was to prevent these types of marketing practices in public schools. Unfortunately, due to major changes in federal 403(b) rules school districts began to violate this provision and accept “free” services.
 - (2) As a result of these practices by school districts, Rep. Truitt requested an opinion from the Texas Attorney General in 2008 as to whether the practice described above violated the statutes as revised by S.B. 273. The Attorney General ruling did not provide a compelling opinion that this practice is clearly prohibited.
- (c) HB 3480 Solution. HB 3480 would prohibit financial institutions or their affiliates that sell 403(b) products to offer 403(b) administration services to school districts. The companies would have a clear choice: administer 403(b) plans or sell 403(b) products. However, they could not do both because this is a conflict of interest.

2. Vendor Certification by TRS

(a) Issues.

- (1) Limitations on Certification. Although the Legislature gave TRS broad rule-making ability in the statutes authorizing TRS to certify 403(b) vendors, currently TRS certifies only individual mutual fund families as non-annuity qualified investment products. TRS will not certify other non-annuity investment programs that offer mutual funds.
- (2) Multi-Fund Investment Platforms. These non-annuity investment programs are common in the 403(b) market in other states. Companies such as Charles Schwab, Fidelity and many others offer investment platforms that allow plan participants to purchase many different mutual funds from multiple companies at a low cost through a single source. Section 403(b)(7) of the Internal Revenue Code does not preclude this practice.
- (3) Variable Annuity Alternatives. TRS does certify variable annuity products as qualified investment products. These annuity products typically offer mutual fund investments through insurance company “sub-accounts.” However, many of these products have received widespread criticism in major publications. Articles have appeared in the Wall Street Journal, Forbes Magazine, the Los Angeles Times and other publications in recent years alleging that many 403(b) variable annuities have very high fees relative to other types of investments.
- (4) Fewer Choices for Educators. The Internal Revenue Service regulations that became final January 1, 2009. These regulations gave school districts much greater responsibility for the compliance of these plans with federal rules, including establishing and maintaining a 403(b) Written Plan for their plans. As a result, most districts have hired third party administrators (“TPA”s) to administer these plans for them.

Many of the larger TPAs require that 403(b) vendors (1) comply with the terms of each district’s 403(b) Written Plan and (2) furnish data to the TPA electronically in the industry-standard format.

Most annuity vendors have higher charges so they can afford the expense of complying with the TPA requirements. The mutual fund families generally have lower charges and have been reluctant to spend the money to meet these requirements.

Example: Dallas ISD now has over 40 vendors that will meet these requirements, out of 80 vendors on the TRS list of certified companies. However, of the 40+ approved vendors in Dallas ISD, only 6 are mutual fund families. All of the rest are insurance companies.

- (b) HB 3480 Solution. HB 3480 would amend current law to specifically permit companies that offer a multi-mutual fund family 403(b) “platform” to receive TRS certification as long as all of the funds offered are also certified products under TRS rules.