Setting the Record Straight:
Retirement Security for Educators

Across the country, new 403(b) plan best practices are emerging as the long-term financial security of educators and retirees is considered.

By Bruce Corcoran

The landscape of public education retirement plans is in an upheaval. A variety of economic, demographic, and political factors make it increasingly difficult for defined-benefit pension plans alone to provide educators with an adequate retirement. As a result, for the nearly seven million educators in America’s public primary and secondary schools, supplemental options such as 403(b) plans are becoming ever more important.

But with all the benefits of 403(b) plans, some administrative practices common in this now-crowded marketplace can harm participants. Most troubling is the fact that, under the banner of offering educators freedom of choice in their retirement plan investments, these practices may actually reduce the amount participants can accumulate and may have a negative effect on their retirement security.

Although there is much debate about how 403(b) plans should be managed, one point is above debate: the long-term financial security of educators and retirees should be of primary importance to everyone involved in this significant issue.

School districts today have two distinctly different models for administering their 403(b) plans: open access and select access management.

The open access model follows an “any willing provider” structure that requires districts to permit any interested financial provider to sell products to employees—without considering investment quality, fee structure, or potential for redundant record-keeping costs.

The select access model (sometimes called controlled access) curbs the proliferation of providers, usually through a competitive bidding process. The 403(b) plan sponsor evaluates and preselects preferred investment partners, which centralizes and streamlines administration. At the same time, the bidding process allows the school system to negotiate how fees are structured.

Non-ERISA Plans and Fiduciary Responsibility

Public K–12 403(b) plans are not governed by ERISA, the Employee Retirement Income Security Act of 1974, which protects the retirement assets of millions of Americans. However, many such non-ERISA plans do operate under a fiduciary best-practices model because they have a fiduciary status that derives from state statute, common law, trust law, or other sources.

In this context, “any willing provider” becomes most troubling. Not only can it lead to the aggressive marketing of higher-cost products in the education environment, but it can also trigger direct and real liability for a non-ERISA plan that does not operate under a fiduciary best-practices model.

For this reason, we’re seeing such plans move away from the “any willing provider” provision that, as we shall see, can inhibit the ability of a state or district to administer plans, control costs, and manage risk in a
prudent way. A recent study of four state plans from the TIAA-CREF Institute provides some compelling examples.

The study found that, using the open access model, California and Texas generally have plans with a large number of providers and investment options, and a broad range of relatively high fees. Using a select access model, Arizona and Iowa generally have a relatively small number of providers and products, and relatively low overall fees. Specifically, the average annual investment fee is 2.11% in California and 1.71% in Texas, whereas the fees are 0.87% in Iowa and 0.8% in Arizona.

California is interesting for another reason. Some groups in the state have sought to amend a law requiring school districts to actively manage each insurance company selling products in their district.

According to the Los Angeles Unified School District (LAUSD), the presence of “any willing provider” makes it nearly impossible to comply with both the law and Internal Revenue Service guidelines in a prudent way. The district also points out how difficult it is, from a risk management and oversight perspective, to effectively manage 27 providers that offer more than 1,000 investment choices to employees.

The LAUSD presents a textbook case of what can happen when a group of “trusted” high-cost providers are “willing” to aggressively market their investment products to public employees—with no contractual duty to protect the best interests of those employees. The district’s current and former employees have a total of $1.8 billion in 403(b) retirement accounts with 27 approved vendors. Table 1 shows how that money is distributed.

<table>
<thead>
<tr>
<th>403(b) Accounts (approved vendors only)</th>
<th>Percentage of Accounts</th>
<th>Percentage of Funds</th>
<th>Average Account Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-cost vendors</td>
<td>95.5</td>
<td>92.0</td>
<td>$30,362</td>
</tr>
<tr>
<td>Low-cost vendors</td>
<td>4.5</td>
<td>8.0</td>
<td>$57,999</td>
</tr>
</tbody>
</table>

Table 1. Distribution of Retirement Account Funds for Los Angeles Unified School District Employees

In contrast to this commission-based model widely seen in K–12 today, in a fee-based model the adviser has a written duty to disclose conflicts and put the interests of the educator first. Clearly, in the LAUSD and other districts, “any willing provider” is not providing the results people deserve.

**A Change in the Air**

Like the LAUSD, other districts are seeking a new way. Across the country, new 403(b) plan best practices are emerging. School districts are joining together to create consortia, pooling their assets and their influence to achieve economies of scale and to push for competitive bidding from providers in select access programs.

More districts are also enhancing the 403(b) experience for participants, providing access to more objective advice and delivering services through a broader variety of channels, including the web, call centers, and the critically important element of local advisers. It all adds up to better service at a lower cost for participants and improved efficiency for districts that are finding that simplified, streamlined programs are easier to manage than open access programs.

Even as these trends become more widespread, misconceptions about the select access model continue to circulate. Such misconceptions are at least partly due to an organized and well-funded lobbying effort by a special-interest group of high-cost providers that has mobilized to maintain the “any willing provider” status quo.

**Misconception 1: Select access makes participation rates go down.** Participation in a plan is driven by a variety of factors, including (1) the ability of a sponsor to offer a prudent plan to employees, (2) the presence of a flexible range of high-quality investment choices, (3) the amount of and transparency surrounding the fees for those investments, and (4) the quality of the education and advice provided to employees.

None of these factors is negatively affected by a reduction in the number of providers. In fact, several school districts—including two in Illinois and one in Arizona—reported increased participation after consolidating their plans with a single provider.

Even more dramatic, when Jefferson County Public Schools in Colorado switched to a single retirement plan provider, participants gained access to low-cost institutional funds and all-in fees dropped from more than 2%
to 0.79%. This result was directly attributable to curbing the number of retirement plan providers. Over the course of a 30-year career, the savings on annual contributions to the plan could be significant—which could go a long way toward increasing employee engagement.

**Misconception 2: Select access reduces choice.** Select access reduces the redundant administrative systems that a district needs to manage, not the variety of investment choices. With today’s open architecture, technology-based solutions, and brokerage window options, even a single-vendor approach still offers employees access to thousands of investment options, including low-cost mutual funds, annuities, fixed-income accounts, and exchange-traded funds—all offered on a more efficient record-keeping and service platform.

For those employees who need guidance, the reduced complexity makes it easier to make better choices. For those who want to make decisions on their own, the broad range of investment choices lets them follow a self-directed path.

It’s also worth noting that the select access model makes it easier for participants to move their money around—even daily—usually without a front load, back load, or the cumbersome paperwork and delays common when dealing with dozens of different companies. Again, saving a participant’s money and time is a primary objective for a provider with a documented fiduciary responsibility.

**Misconception 3: Select access eliminates access to advisers.** In fact, school districts can maintain access to all types of advisers. The difference is that they can be true advisers, offering objective advice, and the district can hold them to a fiduciary standard in dealing with employees. For example, TIAA-CREF works with 15,000 advisors managing $11 billion on behalf of their participants in assets across the country, in a fee-based fiduciary model that formalizes the best interests of the plan and participants in its agreement structure.

There’s another important fact about advice. When a large number of providers each offer a large number of investment options, a participant’s ability to assess the options and make an educated choice can be clouded. (And, as we saw with California and Texas earlier, too many options can also increase participant costs.)

It’s obvious that good advice is crucial to good participant decisions. And it’s just as obvious that a provider who has a fiduciary responsibility to participants is likely to provide objective advice that focuses on positive outcomes—untainted by competing and undisclosed conflicts of interest.

**All About Outcomes**

Let’s conclude where we began: by seeking the best way to provide employees with a safe and secure retirement. The data in the TIAA-CREF Institute study mentioned earlier suggest that teachers in open access plans actually face a lower likelihood of a secure retirement simply because they are subjected to a more complex fee structure and higher overall investment expenses. Clearly, increased choice and competition—in the form of an unlimited number of financial providers—do not yield higher-quality or lower-cost investment offerings for teachers.

The select access model, with a limited number of providers, allows districts to apply more strict oversight of a provider’s products. Capping the number of providers also provides economies of scale for minimizing fees and gives states bargaining power to select lower-cost options for their teachers. Importantly, participants in a select access plan face easier choices, from prescreened vendors, offering a variety of investment choices—which may include those with no fees at all.

Many districts are adopting the “best practices of a fiduciary” approach to improve investment quality.

The decision about how to manage today’s vitally important 403(b) plans is up to states, municipalities, and school districts. Leaders making financial decisions in these organizations should ask themselves some questions: If you were to build a retirement program today, how would you design it? Would you allow virtually any company to market any product with any cost structure to your employees? Are you comfortable with 15% front loads? With 17% surrender fees? Or a 12% internal asset-based expense ratio?

The final questions are, should you have a role in deciding which providers, investments, and fee structures your employees are presented with? And should you be able to manage and monitor your program in the best interests of your employees?

Although the debate is just beginning, change is happening. Many districts are adopting the “best practices of a fiduciary” approach to improve investment quality, to improve decision making, and to lower costs for participants. They are turning away from high costs, difficult choices, and diminished outcomes. And their objective is clear: to ensure that the people who benefit from their retirement programs are their employees, and not those providers who are selling the status quo.

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