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Teachers' 403(b) Plans See Big Changes

These programs are becoming more like corporate 401(k) plans as school districts respond to revised rules

BY LESLIE SCISM

For years, teachers in Albany, Ga., invested in tax-advantaged savings programs known as 403(b)s just as many educators elsewhere do: Instead of getting a menu of stock funds or other investment choices from their employer, like those offered in corporate 401(k) plans, the teachers listened to pitches from insurance agents pushing their various companies' programs.

Now, the district, Dougherty County School System, has done something that counts as revolutionary in this corner of the investing world: Over resistance from many commission-paid agents, administrators have created a single district 403(b) that is similar to a 401(k).

In 2010, they used competitive bidding to select an exclusive provider, a unit of American International Group Inc. Then, advisory firm Invest-N-U put together a menu of low-cost stock and bond funds, along with a retirement-income annuity.

"What we had was a multitude of vendors, maybe 13, and everyone was coming in saying, 'Mine is the best,' " says Robert Lloyd, the district's executive director of finance and operations. "My concern is to give our staff the best possible tools" to maximize retirement income, and narrowing investment options and cutting out agents was deemed the way to go, he says.

The move puts Dougherty County in the vanguard of what consultants say is a massive wave of change for 403(b)s.

STIRRING THE POT

When 403(b) plans were introduced in the 1950s, federal law restricted participants to insurance products. Congress later authorized mutual funds, but annuities remained popular because insurance agents make sales calls at schools much more frequently than mutual-fund providers, a 2009 Government Accountability Office report found. Annuities typically include minimum-income guarantees or other downside protections, plus a death benefit. While these features are valued by many teachers, they make the products pricier than low-cost mutual funds and reduce upside potential.

Most districts, meanwhile, have taken a hands-off approach; in essence, the 403(b)s in many places are akin to individual retirement accounts.

Much of the current change is being driven by Internal Revenue Service rules that began taking effect in 2009 and that give plan sponsors administrative and compliance responsibilities for employees' 403(b) investments.

Change also is coming as growing numbers of teachers face cuts to their traditional pensions, giving them more incentive to sock away money in 403(b)s, consultants and school officials say.

With pension cutbacks, 403(b) plans are becoming a greater part of assets necessary to fund retirement and thus "need to be far more robust than, 'Let's have a bunch of insurance agents show up in the cafeteria' " to sell annuity contracts after school, says Kent Novell, principal at consulting firm Retirement Research Inc.

Some three million elementary- and secondary-school employees across the U.S. had about $109 billion in 403(b)s as of 2010, according to estimates from consulting firms. The 403(b) category also includes some nonprofit, governmental and religious organizations, as well as colleges, though many of these other employers already are running their plans like 401(k)s, consultants say.

Low-cost insurer and fund firm TIAA-CREF, which has long dominated the higher-education sector, sought to stir the pot of change in elementary and secondary schools with a report in late 2010 that concluded an educator in a 403(b) that screens providers to hold down fees can potentially accumulate tens of thousands of dollars more in retirement wealth over a career than a colleague in a plan that doesn't screen and has high fees.

Insurance agents noted that TIAA-CREF has a vested interest in the matter: It would like to expand in the K-12 market.

To which Bruce Corcoran, a TIAA-CREF executive, responds: "TIAA-CREF's interest in increasing access to lower-cost retirement-plan options is well-aligned with teachers and can help provide them with thousands and thousands of dollars of additional retirement savings."

AGENTS PUSH BACK

With thousands of school districts across the U.S. taking different approaches, it remains far from certain what kind of 403(b) will evolve as the standard, consultants say.

An average school district now has five to 10 providers seeking the business of its employees, down from 40 before the IRS rules took effect, according to Boston-based consulting firm Cerulli Associates.

Some of that reduction has taken place as districts band together and use their combined buying power to get lower prices in request-for-proposal processes that shrink the number of providers eligible to offer products to educators. In Michigan, for example, more than 200 districts formed a consortium that operates with a half-dozen "core" providers, each with its own menu of investment options.

Some statewide 403(b)s also are similarly stressing low costs, including one being set up in North Carolina.

But change isn't always easy. Dougherty County's conversion effort dragged out over three years, Mr. Lloyd says. Agents sent letters criticizing the concept to teachers and school-board members, and one agency hired a lawyer who questioned the process on multiple grounds, prompting the district to retrace some steps, according to Mr. Lloyd and public documents.

"You've got teachers trying to retire with a reasonable standard of living, and people, probably making a lot more money than they are, trying to push them into inferior products" to earn high commissions, Mr. Lloyd says.

Ken Love, an agent in Georgia for Life Insurance Co. of the Southwest, defends his role, saying "participation will drop without representatives educating employees on the need and importance of a 403(b) plan. Our mission is educating the educators on 403(b)s."

In some states, longstanding laws are holding up change. In May, a senior official with the Los Angeles Unified School District asked California's insurance commissioner to support revision of a law that essentially allows "any willing provider" to sell 403(b) investments there, according to The Wall Street Journal's review of the official's letter. The letter said that the plan's oversight committee wanted to reduce the list of 27 vendors to "a more manageable number," but that insurers had warned litigation "would likely ensue."

A spokesman for the commissioner says the matter is among issues under consideration for the 2012 legislative calendar.

To be sure, not all school officials are in favor of limiting choice, saying teachers like the financial advice that commissions make possible. Some support an effort under way by the American Society for Pension Professionals and Actuaries and the National Education Association, among others, to create a model disclosure form to allow apples-to-apples comparisons of products' costs and benefits.

In some cases, teachers say the changes are raising their costs instead of lowering them because the firms their districts hired to oversee the 403(b)s charge fees.

"I'm a big advocate of low fees, and the new regulations have caused an extra layer of fees," says Richard Nichols, a high-school teacher in suburban Chicago. But he says he understands the need for strengthened monitoring of 403(b)s because "I do not think a lot of the other teachers search out the low-cost providers."

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