**State-Sponsored 403(b) Plan is a Win-Win for Employers and Employees ---
Saves Scarce Dollars for Educating Students**

Summary

In 2007 the Iowa Association of School Business Officials (IASBO) identified a major problem for hundreds of public employers in the state. The issue: a pending change in the IRS regulations that would require 403(b) accounts [tax sheltered annuity plans for educational institutions and non-profit organizations] to be managed as employer-sponsored plans rather than as plans for each participant. This problem was particularly significant in Iowa as an "any willing provider" state, because under state law a school district could not turn down a 403(b) provider. One school district in Iowa had 158 providers that it remitted funds to each month, and even small school districts had 10-20 providers.

Effecting change required significant collaboration and coordination with teacher and support staff unions, the school administrator association, IASBO, the school board association, community colleges, area education agencies, attorneys, and the Departments of Education and Administrative Services. Bringing about change would also require many meetings and discussions with state legislators and legislative lobbyists. By collaborating with these partners, a state-sponsored 403(b) plan ("the state plan") was created with six providers effective January 1, 2009. More than 15,000 active participants joined the state plan in its first year, contributing more than $5 million monthly. In 2012 there are still over 15,000 active contributors and over $6,000,000/month in contributions.

Employers were not required to join the state plan, but the new state law required employers and bargaining units to reach consensus on a local plan or to join the state plan. Participating employers in the first year (2009) included:

- 332 school districts (92%), including the largest 65 districts in the state
- 15 community colleges (100%)
- 10 area education agencies (100%)
- the state's department of education

There have been school district and AEA consolidations since 2009, but even in 2012 there are 318 of 351 school district participating in the state plan, 100% of the community colleges and AEA's, the Department of Education and the Board of Regents board office.

Under the new (2009) state law and effective January 1, 2010, employers who chose to establish a local 403(b) plan must select providers and investments through a competitive bid process. Administration and Boards must collaborate with bargaining units when making vendor and product selections.

Vendors and investments in the state's plan have been selected pursuant to a competitive bid process (conducted at least every six years). This competitive bid process was coupled with the state of Iowa's 457 (deferred compensation) plan. The state's Department of Administrative Services sponsored this effort with the assistance of professional consultants and in collaboration with the IASBO officials and key partners in the state.

Was a state-sponsored plan really needed?

At a national level, the new 403(b) regulations radically changed an employer's responsibilities for retirement accounts. More than 50% of the school districts in our state have fewer than 700 students, and these districts generally have 100 or fewer employees. A business office staffed with one employee would not be able (or feel qualified) to administer a local 403(b) plan. Taking on this responsibility was daunting to most school business officials.

This issue was first brought to a legislative committee in late October 2007, less than three months before the 2008 state legislature convened. It was evident from committee members and lobbyists at the meeting that any proposed legislation would require collaboration with various employee organizations. The thought of gaining consensus among these groups was seemingly out of reach. In addition, there had never been any formal "partnership" between school districts and state government, let alone a partnership that also included the AEA's and community colleges. In addition, the employee organizations and school district administrative teams had little or no experience collaborating on legislation.

In late 2007, IASBO developed a survey for school districts in the state. More than 75% of districts responded with information about their current 403(b) providers and participation within the employee groups. It was clear that the number of 403(b) providers was itself a potential obstacle in implementing the new regulations. Even very small districts worked with 10-20 providers, and many districts worked with more than 50 providers. As noted earlier, the new state plan has six providers.

Was the "Iowa solution" logical?

All states were impacted by the new regulations, but few were facing IRS compliance in an "any willing provider" environment. It was obvious that school districts and other employers were facing significant implementation costs before the January 1, 2009, effective date, and these entities lacked the expertise and the funding to meet the anticipated ongoing costs. In addition, each district that sponsored a 403(b) plan would have ongoing costs that could be mostly mitigated through a state-sponsored arrangement.

The groundwork laid with legislators in October 2007 fostered legislative awareness of the IRS regulations and the urgency for action in the 2008 legislative session. Immediately after the presentation, a lobbyist for the state teachers' association made it clear that the teachers' union expected to have significant input into the process. Reaching "common ground" with the union was yet another significant concern.

IASBO worked to develop a rapport with representatives and lobbyists with various professional and employee organizations. Many meetings were required to provide a common understanding of the new regulations, to discuss implications affecting employees and employers, and to consider possible options.

A major concern was that just fifteen months and one state legislative session stood between the beginning of this initiative and the effective date of the IRS regulations. The state legislature convened in mid-January 2008 and adjourned in late April. The Governor then took a few weeks to review legislation and to decide which bills he would sign into law, leaving fewer than eight months to create and implement a solution.

How did other states address this change in IRS regulations?

Some states have adopted a similar model to centrally administer, monitor, and evaluate 403(b) plans. Iowa already had a 457 plan for its employees, and the 457 platform was leveraged to establish the state-sponsored 403(b) plan. ***State legislators commented that the state plan provides a clear example of the way public entities can collaborate to create efficiencies.*** The state plan also built a bridge for future collaborative efforts among governmental agencies and related professional associations. In some states each district was left to create its own plan, and therefore some districts signed exclusive arrangements with one provider.

What efficiencies were created by the Iowa 403(b) plan?

The new state plan created much efficiency by:

- eliminating redundancy in start up time and cost by working with the appropriate state personnel to standardize plan documents and board resolutions
- centralizing communications to plan participants through webinars and a state-hosted website that featured the state's 403(b) plan providers, their ratings from rating agencies, investments, fees and expenses, historical investment performance, salary reduction forms, etc.
- centralizing review and approval (or denial) of hardship withdrawals, loans, and rollovers
- centralizing the RFP process at the state level and recognizing that individual employers would not have market "buying power" to access low cost group investment products
- achieving vendor appreciation of a statewide plan and related processes, which eliminated contracts with hundreds of local plans
- reducing investment and advisor fees/expenses and eliminating deferred or other sales charges and restrictions, thereby providing greater flexibility and liquidity for an employee's investments. The state plan leveraged a competitive quote process for 2009 (transition year), followed by a formal competitive bidding process effective as of January 1, 2010. Administrative fees (excluding fund management expenses) for group investment products are now 0 % to .95% compared with 1.2% to 1.5% for individual annuities. The group products also waive the annual contract fees. (see also attachments 1 and 2)
- providing an annual review of investment performance by an outside consultant. If a given investment is not performing well against similar investments, the investment is substituted with a better performing option in its asset class.

Does the state plan have any connection to student achievement?

Significant cost savings were attained by participating employers, saving already scarce resources for classroom instruction. To achieve these savings, the state 403(b) plan eliminated:

- legal fees for each district by leveraging the attorney relationship already in place with the IASBO Board
- consultant fees by leveraging a consultant contract from the state's 457 plan
- third party administrator (TPA) fees, including service fee minimums that would have been significant to the smaller participating employers. Some insurance companies were willing to provide TPA services for "free," but those companies would have required that their products be offered to district employees. Example: The competitive TPA quotes received by the West Des Moines Community School District (WDMCSD) identified potential costs as exceeding $2,000/**month.** That compares to "full service" costs of < $500/**year** for employers in the state plan. In addition, employers avoided several thousand dollars in legal and consulting fees. In total, the annual cost savings to the WDMCSD approximated the cost of one certified FTE.

- By comparison, as the new regulations were being implemented, a 10,000 student suburban district in Illinois spent approximately $60,000 per year to retain a consultant for 403(b) advisory and administration services for its stand-alone 403(b) plan.

Conservative estimates (in 2009) put the annual cost savings for the state's participating employers at $600,000 - $800,000, inclusive of TPA fees, consultancy and legal costs. Statewide this savings is enough to fund 12 -16 certified staff members.

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Fees and Expenses Count

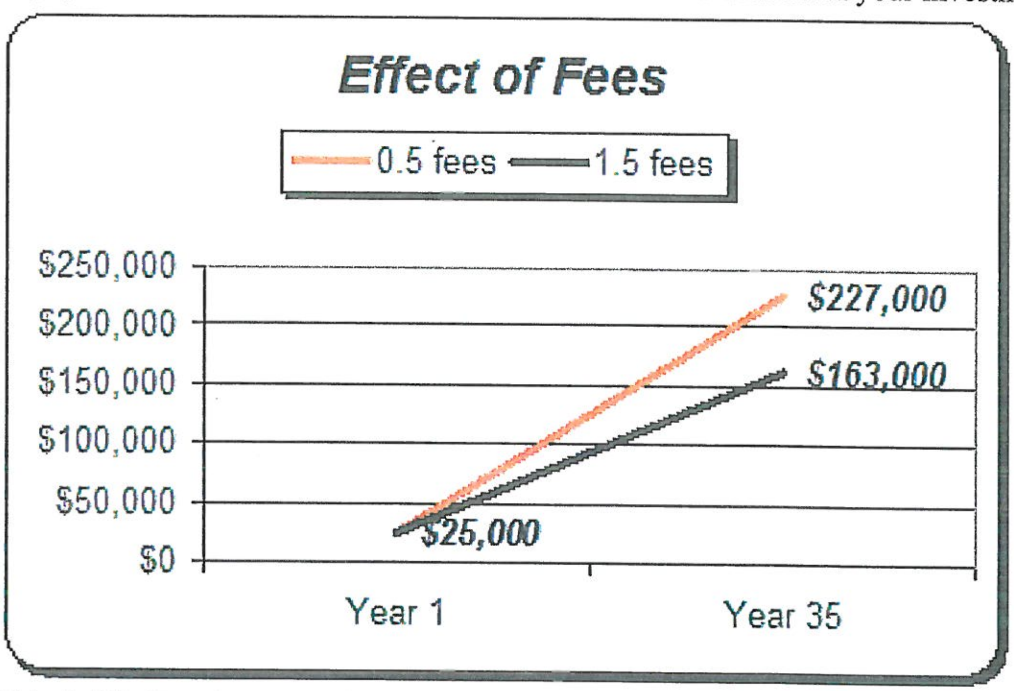
New evidence from Morningstar Inc. indicates the impact of fees on performance: Lower-fee funds outperform high-fee funds. "If there is anything in the whole world of mutual funds that you can take to the bank, it's that expense ratios help you make a better decision," wrote Russel Kinnel, director of Morningstar fund research, in the report. "In every single time period and data point tested (for the report), low-cost funds beat high-cost funds."

While the Morningstar report covers thousands of mutual funds, Ohio DC offers a select group of investment options. We use an expert investment consulting firm that considers fees as part of a comprehensive evaluation process in selecting and monitoring investment options.

This same conclusion regarding fees was reached in a Department of Labor article on the effect of fees on a retirement account. While the article talks about fees in a 401(k) plan, the lessons apply equally well to Ohio Deferred Compensation and other 457(b) plans. The article presents the following example, which demonstrates how fees and expenses can impact your account.

"Assume that you are an employee with 35 years until retirement and a current (retirement) account balance of $25,000. If returns on investments in your account over the next 35 years average 7 percent, and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to $227,000 at retirement, even if there are no further contributions to your account. If fees and expenses are 1.5 percent, however, your account balance will grow to only $163,000. The 1 percent difference in fees and expenses would reduce your account balance at retirement by 28 percent."

Go to www.dol.gov/ebsa/publications/401k_employee.html and read the entire article. As always, we encourage you to ask about and understand all fees associated with all of your investments.



Source: Ohio Public Employees Deferred Compensation Program
https://www.ohio457.org/iApp/tcm/ohio457/guide/basics/fees/count/index.jsp

Attachment 2

Why Consider Fees?

In a 401(k) plan, your account balance will determine the amount of retirement income you will receive from the plan. While contributions to your account and the earnings on your investments will increase your retirement income, fees and expenses paid by your plan may substantially reduce the growth in your account which will reduce your retirement income. The following example demonstrates how fees and expenses can impact your account.

Assume that you are an employee with 35 years until retirement and a current 401(k) account balance of $25,000. If returns on investments in your account over the next 35 years average 7 percent and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to $227,000 at retirement, even if there are no further contributions to your account. If fees and expenses are 1.5 percent, however, your account balance will grow to only $163,000. The 1 percent difference in fees and expenses would reduce your account balance at retirement by 28 percent.

In recent years, there has been a dramatic increase in the number of investment options typically offered under 401(k) plans as well as the level and types of services provided to participants. These changes give today's employees who direct their 401(k) investments greater opportunity than ever before to affect their retirement savings. As a participant you may welcome the variety of investment options and the additional services, but you may not be aware of their cost. As shown above, the cumulative effect of the fees and expenses on your retirement savings can be substantial.

You should be aware that your employer also has a specific obligation to consider the fees and expenses paid by your plan. ERISA requires employers to follow certain rules in managing 401(k) plans. Employers are held to a high standard of care and diligence and must discharge their duties solely in the interest of the plan participants and their beneficiaries. Among other things, this means that employers must:

- Establish a prudent process for selecting investment options and service providers;
- Ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided;
- Select investment options that are prudent and adequately diversified;
- Disclose plan, investment and fee information to participants to make informed decisions regarding their investment options under the plan; and
- Monitor investment options and service providers once selected to see that they continue to be appropriate choices.

Source: United States Department of Labor
http://www.dol.gov/ebsa/publications/401k_employee.html