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Protecting retirement for our country's educators

Does a greater number of investment providers result in better outcomes for 403(b) plan participants?

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The aim of every plan sponsor should be to build and maintain a best-in-class retirement plan for its participants. Maximizing participation, providing valuable financial education, creating an excellent menu of investment strategies, and minimizing expenses are the goals of most sponsors. While these objectives are straightforward, many school district plan sponsors struggle with how to implement them. Adding to that struggle is the confusion about how many retirement plan providers to include in a 403(b) plan. Does a greater number of investment providers result in better outcomes for 403(b) plan participants?

There has been an ongoing debate about the “right” number of provider choices to provide in a 403(b) plan to achieve an appropriate balance between participant choice and plan effectiveness. The American Society of Pension Professionals & Actuaries published a white paper in 2011 titled “Protecting Participation: The Impact of Reduced Choice on Participation by School District Employees in 403(b) Plans.” The paper claims that reducing retirement plan providers within a 403(b) plan ultimately will result in lower plan participation. In addition, the article asserts that more retirement plan provider choices equates to greater participation, and therefore a better outcome for plan sponsors and for retirees.

These arguments might at first sound convincing. However, the research of our firm and our experience in helping school districts create the right plan for participants demonstrates that more choices do not lead

to greater participation. In fact, more choices negatively affect a plan by significantly increasing fees and plan expenses, which ultimately result in lower investment returns for the participants.

The feedback is clear from our plan participant surveys for numerous school districts and public employers: participants and plan sponsors alike want to reduce plan fees. Of all participant surveys collected, more than 60% noted reducing plan fees as the leading goal for the plan. These results are repeatedly validated. In an article titled: "Who's Watching The Door: How Improving 403(b) Administrative Oversight Can Improve Educators' Retirement Outcomes," authors Robert Clark of North Carolina State University and David Richardson of the TIAA-CREF Institute note "open access" systems result in higher fees and adverse effects on participant outcomes. "Controlled access" systems are those 403(b) plans that have had their investment provider choices reduced. In their paper, Messrs. Clark and Richardson state "transitioning from an open access to a controlled access model can enhance the efficiency of the 403(b) plan, resulting in lower fees, and thus increasing wealth accumulation for public school educators."

Research continues to prove that excessive choice, rather than being a benefit to participants, is actually a detriment. This phenomenon is referred to as "paralysis from analysis." Psychologist Barry Schwartz published a book in 2004 titled: "The Paradox of Choice — Why More is Less." Mr. Schwartz concluded that excessive choice leads to worse outcomes for consumers, across virtually all consumer decision-making forums.

The following excerpt is from an article by the American Psychological Association in 2004:

"Social psychologists Sheena Iyengar, Ph.D., a management professor at Columbia University Business School, and Mark Lepper, Ph.D., a psychology professor at Stanford University, were the first to empirically demonstrate the downside of excessive choice. In a 2000 paper in the Journal of Personality and Social Psychology (JPSP, Vol. 79, No. 6), the team showed that when shoppers are given the option of choosing among smaller and larger assortments of jam, they show more interest in the larger assortment. But when it comes time to pick just one, they're 10 times more likely to make a purchase if they choose among six rather than among 24 flavors of jam."

Instead of leading to more thoughtful choosing, more options in a 401(k) plan led people to act like the jam buyers: When given two choices, 75% participated, but when given 59 choices, only 60% did, according to Iyengar in the article "How Much Choice is Too Much?: Contributions to 401(k) Retirement

Plans." In addition, Iyengar and her co-writers found that the greater the number of options, the more cautious people were with their investment strategies.

Similar examples are reviewed in the book "Nudge: Improving Decisions About Health, Wealth, and Happiness," by Richard Thaler and Cass Sunstein. The authors state that many people favor freedom of choice over any kind of paternalism. This way of thinking offers a simple solution to many complex problems: just maximize choices. However, the authors go on to contend that this theory is based on a false assumption and misconceptions. The false assumption is that almost all people, almost all the time, make choices that are in their best interest, or at the very least are better than the choices that would be made by someone else. Observing human behavior leads to the clear conclusion that people often make poor choices in those areas in which they have little experience and little information.

In the experience of our firm, there is no correlation between a reduction in the number of investment providers and a decrease in workers' participation in 403(b) plans. The case study of the Jefferson County School District, the largest school district in the State of Colorado, illustrates the successes of a controlled-access model.

For years, the Jefferson County Public School District in Colorado had an "open-door" policy for 403(b) plan providers, resulting in the district having more than 50 investment provider/retirement plan vendors. In 2005, district officials examined the plan structure and decided to improve fees, services and investment offerings for participants. Originally, they set out to just reduce the number of providers to three or five and asked for two separate pricing and service scenarios for a single-provider, a three-provider and a five-provider model. After careful evaluation, the officials decided that participants would greatly benefit by switching to a single retirement plan provider.

Seven years later, the number of participants in the 403(b) plan and a new 457 plan rolled out in 2006 increased 31% and 312%, respectively. Not only did the plan sponsor increase retirement plan participation, but it also managed to dramatically reduce fees.

All-in fees (investment, record keeping, and administration) are now estimated at 0.79%, vs. more than 2% in 2005. The plans' participants, who pay all of the fees, now have access to low-cost institutional funds. Over the course of decades, the teachers are estimated to save many thousands of dollars as a result of these lower fees. In addition, participants have access to better education with branded materials and a website landing page that compares the district's specific plan to a generic vendor-based page. They have on-site education provided by two dedicated representatives who are assigned to their plan.

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While the debate continues between “open-access” systems and “controlled-access” systems, multiple studies, participant survey results and a specific demonstrated situation support the findings that participation is not adversely affected with a reduction in choice, and that ultimately participants in 403(b) plans greatly benefit from reduced fees and better service. A reduction in the number of investment options creates a more efficient plan with improved participant outcomes.

In the end, it is this model that ultimately protects the retirement of our country's educators.

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