BILL NUMBER: AB 1949 (Cedillo) as introduced February 23, 2012

SUMMARY

AB 1949 authorizes a charter school, school district or county office of education, through a competitive bidding process, to limit to four or more the number of vendors authorized to provide 403(b) products to school employees. This bill is designed to allow CalSTRS members to make more informed and cost-effective decisions regarding their retirement savings by authorizing employers to provide high-quality products at a lower cost. Employers who choose may still continue to allow all approved vendors to be accessible to their employees.

BOARD POSITION

Support in concept, recommend amendments. Permitting school districts to reduce the number of 403(b) vendors offered to employees will allow CalSTRS members more streamlined access to vendors offering high quality, lower cost products, which is consistent with the Teachers' Retirement Board's commitment to improve the opportunity for members to save using pre-tax vehicles. Amendments are recommended to clarify that vendors should not be mandated to offer specific 403(b) products so as not to constrain employer and employee ability to determine what best fits their needs.

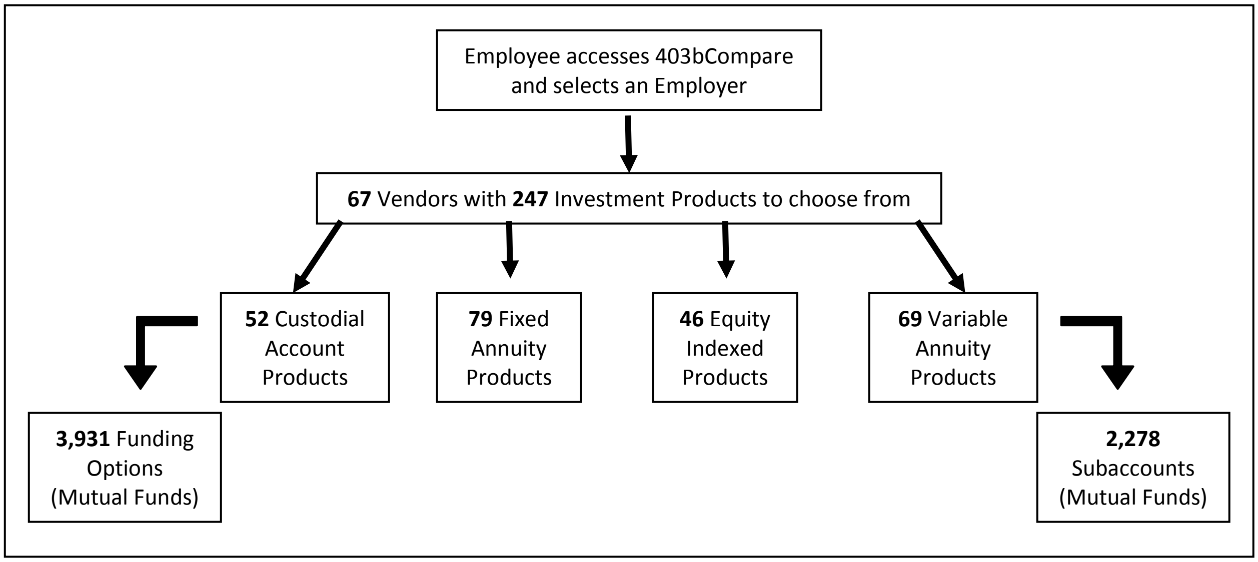
REASON FOR THE BILL

Current law allows for an open playing field for 403(b) vendors, which means any 403(b) product from a qualifying vendor must be made available to educators for investment, regardless of cost or quality.

ANALYSIS:

Existing Law:

California Insurance Code section 770.3 was enacted in 1954 to prevent managers at state agencies from channeling employees' retirement contributions to their friends in the financial services industry. Current law creates an open playing field for 403(b) vendors, which means any 403(b) product from a qualifying vendor must be made available for investment by employees of school districts, county offices of education or charter schools. What started out as a goal of providing a level playing field for vendors, and a range of investment choices for employees, has expanded into an unwieldy disarray of multiple products and fee structures. Chapter 1095, Statutes of 2002 (AB 2506–Steinberg), required CalSTRS to maintain an impartial investment information bank of 403(b) vendors and investment products via an Internet website (403bCompare.com). Vendors who sell 403(b) products to school districts also must be registered on 403bCompare.com, and all products sold by the vendor must be listed with full fee disclosure. Currently, there are 67 approved vendors on the website with 247 registered products, which break down further into thousands of custodial account, fixed annuity, equity indexed and variable annuity products, as shown in the following chart.



This Bill:

AB 1949 modernizes California's 403(b) market, bringing it in line with the best in class approach already being used by the UC and CSU systems, more than 40 other states and the private sector. This bill promotes CalSTRS members' increased participation in planning their retirement savings by allowing employers to cut through the overwhelming field of complicated products with high fee structures and vendors with a lack of fiduciary oversight. Members will be able to make more informed decisions while considering less costly products.

AB 1949 allows the role of gatekeeper for selecting 403(b) vendors to be taken on by a school district, county office of education or charter school, fulfilling IRS requirements. Even if an employer chooses to have a Third-Party Administrator (TPA) oversee compliance of the plan, by allowing a competitive bidding process to select a limited number of vendors, this bill would provide employers with more control and the ability to offer their employees a manageable field of the highest quality products at the lowest cost.

Amendments are needed to clarify the sponsors' intent and provide more flexibility to school employers. The bill appears to restrict the vendor pool to only those vendors that offer all three types of 403(b) products and a range of bundled service models. It is our understanding that it was not the author's intent to require each vendor to offer all three types of products, but to ensure that the employer's bidding process results in all three types of products being available to the employee. In addition, amendments are recommended to delete the requirement for vendors to provide a range of bundled service models in order to allow employers and employees to choose, through the competitive bidding process, how services should best be provided.

LEGISLATIVE HISTORY

AB 1480 (Mendoza, Chapter 432, Statutes of 2008) allowed CalSTRS to offer a Roth Individual Retirement Account for the purpose of rolling over assets held in an annuity contract or custodial account offered by CalSTRS.

AB 2191 (Mullin, Chapter 230, Statutes of 2008) eliminated the authority of the State Controller's Office to purchase annuity contracts pursuant to section 403(b) of the Internal Revenue Code for specified state employees and allowed these employees to participate in the CalSTRS annuity program.

AB 2462 (Mullin, Chapter 780, Statutes of 2006) authorized the Teachers' Retirement Board to supply, or contract to supply, fiduciary, recordkeeping and administrative services for employer-sponsored deferred compensation plans to school districts, community college districts and county offices of education that elect to contract with CalSTRS to provide those services.

SB 1872 (Denham, Chapter 123, Statutes of 2004) allowed the University of California (UC) to restrict employees to UC-selected annuities when investing through UC's 403(b) retirement plan, thus permitting UC to designate a limited number of annuity products that may be appropriate for their employees.

AB 2506 (Steinberg, Chapter 1095, Statutes of 2002) required CalSTRS to establish a registration process for vendors wishing to offer 403(b) retirement plan investment products to employees of school districts, community college districts and county offices of education. Required CalSTRS to establish an impartial investment information bank via an Internet website containing information about the retirement investment products offered by the registered vendors containing objective comparisons of participant cost and education, as well as vendor experience and services.

PROGRAM BACKGROUND

California's open arrangement for 403(b) products has created a chaotic amalgamation of expensive and confusing choices. This hinders the ability of members to make the most informed and cost-effective choices possible regarding their retirement savings.

According to data provided in a white paper issued by TIAA-CREF in 2011 titled “Who's Minding the Door,” California educators pay some of the highest fees over their counterparts in other states where employers may limit the number of vendors. When CalSTRS compared data with states that competitively bid their 403(b) programs, cost disparities were found. A vendor that charges 1.51 percent for an index fund with an 11-year surrender period in California charges 1.07 percent and no surrender fees for the same product at a district with a competitively bid multi-vendor program. This same company is a single vendor in another state and may charge only 0.67 percent for the same index fund with no surrender charge. This experience suggests that a competitive bidding process creates an incentive for vendors to reduce costs.

In addition, a 2003 study of 401(k) participation by the Pension Research Council at the University of Pennsylvania concluded that the more choices offered to an employee, the lower the probability that the person would participate in the retirement plan at all. This is a common response when consumers are offered too much choice, and they have no personal basis to decide which is best. In fact, an excessive number of investment choices could lead employees to seek out the assistance of a commission-driven salesperson to “assist” the employee in deciding which plan is “best” for the employee.

Until 2009, when the IRS issued the most sweeping changes to the 403(b) regulations in over 50 years, 403(b) contracts historically had been an agreement between the employee and the 403(b) vendor. Now, the employer is responsible for tracking each of the numerous investment options available to employees. Most school districts do not have 403(b) compliance expertise or available staff to properly administer their 403(b) plans. Therefore, employers often hire a TPA to handle compliance and to regulate the vendors authorized to do business with that employer.

OTHER STATES’ INFORMATION

Less than 10 states nationally still have the “any willing vendor” model. Many states that have made the switch to a reduced number of vendors cite a need for higher quality services at lower costs and a desire to assist employees who are overwhelmed by the number of investment options. Some states allow bidding at the individual district level, while other states have created statewide programs to leverage economies of scale across all the employers.

FISCAL IMPACT

<u>Program Cost</u> – By potentially reducing the number of vendors whose products are offered to employees of an individual school district, there could be an increase or decrease in the number of participants for an individual vendor, such as Pension2. There could also be a potential reduction in the need for the 403bCompare product.

<u>Administrative Costs/Savings</u> – With potentially fewer vendors registering their 403(b) products on 403(b)Compare.com, there may be a reduction in the funds available to administer the website. In 2011-12, vendors participating on 403bCompare.com pay $7,136.79 to register their company or organization and $97.56 for each 403(b) product offered. (The number of products offered ranges between one and 20; however, most vendors average three to four products.)

In addition, there is potential for an increase in Pension2 activity if more of the program’s products are selected by educators. Additional procurement costs may be associated with these potential increases.

SUPPORT

Small School Districts’ Association
The Hartford
TIAA-CREF
Variable Annuity Life Insurance Company (VALIC)

OPPOSITION

American Fidelity Assurance Company
American Society of Pension Professionals and Actuaries (ASPPA)
Financial Services Institute
National Tax Sheltered Accounts Association (NTSAA)

ARGUMENTS

Pro: Encourages increased member participation and better investment decision-making by providing for a more streamlined slate of 403(b) product choices.

Authorizes employers, which are now more responsible for 403(b) products being offered on their campuses, to be involved in the selection process.

Allows for a competitive bidding process that will likely lower costs and increase quality of the 403(b) products offered.

Con: Potentially reduces vendor choices for school employees.

Allows an employer to use the bidding process of another employer without determining whether the fee structure is appropriate for both employers and their employees.

LEGISLATIVE STAFF CONTACT

Joycelyn Martinez-Wade
Legislative Advocate,
CalSTRS Legislative Affairs,
(916) 414-1980
jmwade@calstrs.com

Mary Anne Ashley
Acting Director,
CalSTRS Governmental Affairs and Program Analysis,
(916) 414-1981
mashley@calstrs.com

Richard Woonacott
Deputy Secretary, Legislation
State & Consumer Service Agency
(916) 468-8478
richard.woonacott@scsa.ca.gov