

THE FOWLER LAW FIRM PC



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THE FOWLER LAW FIRM NEWSLETTER

403(b) Plans: Vultures in Your Schools!

April 14, 2008



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Dear Readers:

If you are a school or college administrator, or an elected official of a public school or junior college district, you have probably heard a lot about 403(b) plans. Until recently, 403(b) plans have required some college or school district staff time to administer, but if configured correctly they did not create much exposure.

Friends, this is all about to change, and generally not for the better. The costs and risks to offer these benefits to your staff are going to dramatically increase, particularly the invisible costs. So before you leap headfirst into yet another set of completely thankless and unfunded responsibilities, consider with care the following advice. There is still plenty of time to make changes to your 403(b) plan, but you need to start talking about this issue with senior administrators and governing boards **right now!**

Above and beyond anything else, remember that a Texas public school or junior college district is **not** required to offer a 403(b) plan. Consider for a moment the real reasons you as employer decided to do so, and ask yourself if any of your reasons really make sense. Let us discuss the most commonly stated reasons for offering a 403(b) plan, and analyze their persuasiveness.

I. Every other education institution is offering one, and I will miss out on prime opportunities to recruit the best teachers and staff if I don't offer a 403(b) plan!

Welcome to the stock argument of your local 403(b) vendor. While this line of reasoning is both reasonable and plausible, it is also completely untrue. Your authors would encourage you to take a moment and talk to the HR recruiters and other staff members who are scouring the United States (and often other countries) to find you top talent. Young people, both of the single variety and those with a family, are almost certainly the basis of your prospective work force, so you need to consider their perspective. And the young people considering working with a school district are interested in the substance of their check at the end of the month, as well as insurance or other benefits that benefit them and their families **right now**. Most young families can ill afford to defer the taxes on a few thousand dollars through a financial process that also ties up ready access to that money, and they almost certainly won't make it their primary concern when choosing a prospective job.

2. Your TRS annuity will never pay you enough to survive. You need to have a 403(b) plan to live!

Again we turn our attention to the 403(b) vendors camped out in the Faculty Lounge, as they hawk an endless array of cheap, attention-seeking trinkets, while we consider this, their second stock argument. Vendors have scared countless young and low income earners with misinformation like this, and for that they ought to be ashamed. Statements like this grossly mischaracterize the value of the TRS and the fact that TRS could, for many, well be a far more reliable source of income than social security, particularly in light of the current financial condition of each fund.

The truth is, in comparison to most other plans, including those offered by many city and county governments, TRS is very generous. Most wage earners in both the private and public sector cannot ever expect to participate in something like the TRS system. This is not to say that a person should rely entirely on TRS to provide for their retirement, and we certainly encourage young people to begin saving for retirement as soon as they can afford to do so. Nonetheless, while many investments do not afford the deferred tax advantage of a 403(b), many investments are simply **better**, outperforming 403(b)'s by far **and** charging less in fees, both for advisory and management services.

Submerged within this vast ocean of financial complexity is an irrefutable truth. Any program that is so lucrative that it can afford to dedicate a sales force to faculty lounges and every major exhibit hall and booth where educators mix and mingle, is a program whose vendors are benefiting mightily. This is in part because the commissions and management fees for these plans are in many instances much higher than other similar investments. Unless a young employee spends the time and effort to truly evaluate issues such as this, as well as comparing other similar investments, analyzing their risk, assessing the penalties for borrowing or using the funds too early, and accepting the possibility that the funds may fail or decline in value, that employee has **no** idea whether a 403(b) is worth their investment. And while your authors have made countless presentations through the years and given exhibit hall talks throughout the state of Texas, they have never personally witnessed 403(b) vendors sparing even a moment to discuss the true financial complexities of their product. And even if they did, does your typical young employee really have both the ability and willingness to understand these complex products, as well as their risks and drawbacks?

While our portrayal of 403(b) vendors appears cynical, it is based not merely upon experience but also upon some simple facts. At the end of the day, the benefits of a 403(b) plan that can realistically be enjoyed by wage earners in the \$30,000.00 to \$45,000.00 income category (which includes most young public school and junior college district employees) are almost negligible once the fees and the income tax savings are calculated. The maximum amount which may be contributed to a 403(b) is \$15,500.00 in one year. How many of your employees have that much to contribute?

Let us assume we are dealing with the median income of your school district or college employee, say \$40,000.00. Let us also assume this person does not have other income or savings on which to rely (which is increasingly the norm, according to the statistics of the U.S. Department of Labor). Let us also look at how much is actually saved in taxes from a realistic contribution of approximately \$2,000 a year. First, we will subtract the fees assessed by the plan, fees that are paid by the employee, and that range upward of 3% in many plans. Then, we will consider the potential for the investment to decline in value as there are annuity and mutual fund options that charge additional fees for management. Additionally, we will recall that the entire amount in the 403(b) is restricted from use by the employee other than at steep interest rates and penalties. Finally, after taking all of these factors into consideration, ask yourself

the following question: **HOW MUCH GOOD AM I DOING THESE YOUNG PEOPLE WHO ARE EARNING \$40,000 A YEAR BY OFFERING A 403(b)?**

United States Department of Wage Statistics for Texas: http://www.bls.gov/oes/current/oes_tx.htm#b25-0000

Let's also look at one final common vendor argument in favor in 403(b)'s.

3. This plan costs you nothing and does not exposure a political subdivision to liability!

It doesn't cost much for an employer to process a single check. But when you multiply the cost of several checks per employee for every participating employee and all the products they may choose, plus the new reporting and information document the IRS will require the sponsoring plan employer to prepare beginning in 2009, the price skyrockets, both in your time and money. With that in mind, you must determine your true cost and if you can actually prepare all of this without hiring outside consultants.

Then there is the issue of liability. For the remainder of 2008, liability for the mishandling of these payments, as well as the fiduciary responsibilities that accompany the sponsoring of a plan, are open issues not yet well resolved by the courts, since governmental entity-sponsored 403(b)'s are not covered by ERISA. But thanks to new regulations promulgated by the IRS, starting on January 1st, 2009, employers will have significantly broader responsibilities with regards to the plans that they offer.

New IRS Regulations: <http://www.irs.gov/pub/irs-tege/td9340.pdf>

And in either case, know this: The real exposure is the huge amount of time an employer spends if the IRS elects to audit your programs. Your external auditors likely will not provide assistance without additional charge. Many external auditors will not know enough about this area to feel comfortable, and will refer you to a consultant who will demand substantial compensation. And your administrative staff will also be tied up for days through the terror and the tedium of producing documents for IRS. Plan documents, employee payroll documents, bank records, and more will have to be produced. That is the reality of even the most superficial audit by the IRS. They don't come to you; you, your records, and perhaps a part of your soul go to them!

Have you been scared away from 403(b)'s yet? If not, here is something else to think about: as an employer you have assumed these duties by contract, and virtually all school and college liability insurance policies *exclude* coverage for employee benefit mistakes. So if you are sued for mismanaging one of these plans (which will most likely occur when one of the products the employees selected failed), not only will there will be a large group of employees after you (namely every employee who selected that plan), but also your school or college policies simply will likely not afford you a defense or cover a settlement offer!

Dear Readers, nothing that we have discussed above has anything to do with the actual operation of the plan. These are all things that you should think long and hard about *before* you begin or renew a 403(b).

As stated before, the implementation date for the new IRS reporting you as an employer must do is January 1, 2009, so if you are dead set on offering 403(b)'s you should familiarize yourself with the new rules and make sure that your plans comply.

But in lieu of hiring even more staff members to do new, complex and thankless tasks, and if you really want to give your employees something they might appreciate a lot more than a risky investment plan, you might want to think about just offering them a pay raise!

In your every 403(b) adventure, we wish you the very best.

Ms. Fowler and/or Mr. Pearce will be presenting on this topic in a number of venues throughout Texas from now through September 2008 including:

Texas Association of Community College Business Officials Annual Conference in Waco, Texas on *June 12, 2008*. For more information, please visit <http://taccbo.org/content.php?p=2008Conference>.

Texas Association of School Business Officials Summer Conference in Kerrville, Texas on *June 13, 2008*. For more information, please visit <http://www.tasbo.org/>.

National Association of Purchasing Directors/City and County Purchasing Officials Timeline 2009 in South Padre Island, Texas on *June 27-28, 2008*. For more information, please visit <http://www.napmrgv.org/timeline/timeline.htm>.

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This information is provided by Laura S. Fowler JD and John G. Pearce JD/CPA, Attorneys at Law with The Fowler Law Firm PC. It is not intended as a substitute for careful review by legal counsel of your choosing. We would be most honored to assist you in your every real legal need.

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As with any legal issues, please consult your attorney with questions.