Reasons For and Responses to the Lack of Direct Access to No-Load, Low-Expense 403(b) Plans in Many School Districts

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Editor's Note – by Jason R. Doss

Teachers who want to establish a supplemental retirement savings account through their employer typically must invest their savings in 403(b) plans. These plans were traditionally known as tax sheltered annuities (TSA's) because, historically, teachers were only permitted by the Internal Revenue Code to purchase annuities in these accounts. Even though the tax laws changed many years ago to allow teachers to purchase mutual funds within 403(b) plans, school districts have been slow to change. As a result, many school district continue to only give teachers the option to invest in high cost variable annuities sold by insurance companies.

By publishing this article, I hope to raise awareness of this important issue with the readers of this publication and spawn ideas that could help the thousands of teachers in this country who are being sold overly-expensive and unsuitable insurance products within their supplemental retirement accounts. Thank you.

I. Introduction

In order to assist employees with achieving their dream of retiring at a reasonable age, Congress has provided certain retirement plan tax incentives. Many of these tax incentives allow an employee to invest in a retirement plan pre-tax, allow the earnings on investments within the plan to grow tax-deferred, and create no taxable event until the employee takes distributions from her plan. Furthermore, the specific tax-favored retirement plan created by Congress for employees of school districts is called a 403(b) plan.

This paper will discuss the inner workings of 403(b) plans in school districts and evaluate the investment options available to 403(b) plan participants. Also, this paper will evaluate the impact of high fees and expenses on 403(b) plan investment performance. In addition, this paper will discuss several reasons why many school districts deny employees direct access to no-load, low-expense 403(b) plans. Furthermore, this paper will discuss responses of the NASD, Congress, and 403(b) plan participants to employees' lack of direct access to no-load, low-expense 403(b) plans. Finally, this paper will discuss how some teachers unions have joined forces with 403(b) plan providers to direct members into high-expense 403(b) plans, how the proposed repeal of I.R.S. Revenue Rule 90-24 may eliminate some school district employees access to no-load, low-expense 403(b) plans, and why attorneys who educate themselves on the current 403(b) plan marketplace will likely benefit significantly by representing school district employees.

II. The 403(b) Plan Defined

A 403(b) plan is a retirement plan designed for employees of tax-exempt organizations. The plan confers upon such employees two main benefits. First, employee contributions to a 403(b) plan are excluded from the employee's income in the year the contributions are made. Second, earnings and gains on investments within an employee's 403(b) plan are not taxed until the employee withdraws money from his plan.[1]

A. 403(b) Plan Eligibility Requirements

Only employees of tax-exempt organizations, defined by Section 501(c)(3) of the Internal Revenue Code as qualified employers, may participate in a 403(b) plan.[2] According to the I.R.S., a qualified employer is an organization that is "organized and operated exclusively for religious, charitable, scientific, public-safety testing, literary, or educational purposes."[3] These types of institutions generally include K-12 public schools, colleges, universities, hospitals, libraries, philanthropic organizations, and churches.

B. 403(b) Plan Contribution Limitations

The following types of contributions can be made to 403(b) plans: (1) elective deferrals, (2) nonelective contributions, and (3) after-tax contributions.[4] Elective deferrals are employee contributions made under a salary reduction agreement. This agreement allows the employer to withhold money from the employee's paycheck and contribute the money directly into a 403(b) plan for the employee's benefit. The employee does not pay tax on these contributions until she makes a withdrawal from her 403(b) plan. Most, if not all, of the 403(b) contributions made on behalf of employees of school districts are elective deferrals.

Nonelective contributions are employer contributions made to an employee's 403(b) plan that are not made under a salary reduction agreement.[5] The employee does not pay tax on these contributions until he makes a withdrawal from his plan.[6] Nonelective contributions include matching contributions, discretionary contributions, and mandatory contributions made by the employer.[7]

After-tax contributions are contributions an employee makes with funds that she must include on her tax return.[8] A salary payment on which income tax has been withheld is a

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[1] I.R.S. Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans) For Employees of Public Schools and Certain Tax-Exempt Organizations, March 2006, p. 3.

[2] Id.

[3] I.R.C Section 501(c)(3).

[4] I.R.S. Publication 571, p. 3.

[5] Id.

[6] Id.

[7] Id.

[8] Id.

source of these contributions.[9] Furthermore, if the plan allows the employee to make after-tax contributions, the contributions are not excluded from the employee's income and the employee cannot deduct the contributions on his tax return.[10]

For year 2006, employees can contribute the lesser of $15,000 (the 2006 elective deferral limit) or 100% of includible compensation for the employee's most recent year of service.[11] Also, for those employees whose employers make nonelective contributions, the 2006 limit is the lesser of $44,000 or 100% of includible compensation.[12] However, it is important to note that the employee is still limited to the $15,000 elective deferral limit. For example, if the employee made elective deferrals totaling $15,000 in 2006, the employer could make nonelective contributions of no more than $29,000 if the employee's includible compensation for 2006 is at least $44,000.

Additionally, a special "catch-up" provision may enable an employee to increase her elective deferrals by $3,000 in 2006.[13] To qualify, the employee must have completed at least 15 years of service with her employer and cannot have made elective deferrals of more than an average of $5,000 in previous years.[14] Contributions made under this catch-up provision cannot exceed $3,000 per year, up to a $15,000 lifetime maximum.[15] Finally, if the employee is age 50 or older during any time in 2006, he may contribute an additional $5,000.[16]

III. Investment Options Available to 403(b) Plan Participants in School Districts

A school district employee may invest her 403(b) account balance only in annuity contracts or mutual funds.[17]

A. Annuity Contracts

The type of annuity available for utilization by 403(b) investors is called a deferred annuity. In a deferred annuity, monetary value accumulates over a number of years through periodic payments (salary reductions). Furthermore, when the investor reaches retirement, he may choose to either have the accumulation paid to him in installments or take withdrawals from the deferred annuity.

There are two types of deferred annuities available to 403(b) investors: fixed annuities and variable annuities. In a fixed annuity, the interest rate on invested dollars has a guaranteed minimum rate and is augmented with additional interest if such interest is

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[9] Id.

[10] Id., pp. 3-4.

[11] Id., p. 8.

[12] Id., p. 4.

[13] Id., p. 8.

[14] Id.

[15] Id.

[16] Id., p. 11.

[17] Id., p. 3.

earned by the insurance company offering the fixed annuity. Alternatively, in a variable annuity, money is invested at the discretion of the 403(b) investor in various separate accounts that usually consist of diversified portfolios of stocks and/or bonds.

B. Mutual Funds

Mutual funds are investments that are, in some ways, similar to variable annuities. Like variable annuities, mutual funds provide individual investors with a simple and diversified way of investing in the stock and/or fixed income markets. Typically, a mutual fund sells shares of the fund to the public and uses the proceeds to invest in a diversified portfolio of securities on behalf of the mutual fund shareholders.

IV. Fees and Expenses Associated With 403(b) Plan Investment Options

There are fees and expenses associated with annuities and mutual funds which must be considered by the 403(b) plan participant before he decides to invest in a 403(b) plan.

A. Fees and Expenses Associated With Annuity Contracts

According to a study by Morningstar, Inc. in the late 1990s, the total yearly expenses of a variable annuity averaged 2.09% of the annuity's accumulation value.[18] However, a few insurance companies provide variable annuities to investors at a much lower cost. For example, TIAA-CREF currently offers variable annuities to 403(b) plan participants with total yearly expenses ranging from 0.42% to 0.63%.[19] Typical fees and expenses that a variable annuity investor incurs include the mortality and expense risk charge, the investment management charge, the contract fee, and the surrender fee.[20]

The mortality and expense risk charge typically guarantees that, if an annuity investor dies before her contract expires, the annuity investor's beneficiaries will receive the greater of the market value of the contract on the annuity investor's date of death or the total amount contributed to the annuity by the annuity investor. This charge also compensates the insurance company for the risk of having to make annuity payments to the annuitant if she lives beyond her life expectancy. Morningstar recently estimated that this charge averaged 1.1% of the annuity's accumulation value per year.[21] However, some low-expense variable annuity companies charge less than 0.10% per year.[22]

The investment management charge is the fee that goes to pay for the services of the money manager and asset management company in charge of selecting and managing the investments within a variable annuity's separate accounts. Morningstar recently estimated that this charge averaged 0.82% of the annuity's accumulation value per year.[23] However, some low-expense annuity companies charge less than 0.20% per year.[24]

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[18] Tam, Pui-Wing, "Buyers Need to Be Aware of Annuity Fees," *The Wall Street Journal*, June 1, 1998.

[19] For more information, visit TIAA-CREF's website at www.tiaa-cref.org.

[20] Tam.

[21] Id.

[22] For example, TIAA-CREF's annual mortality and risk expense charge currently ranges between .005% and .05% per year. For more information, visit TIAA-CREF's website at www.tiaa-cref.org.

The contract fee, or annual policy fee, is another administrative charge levied by the insurance company. This charge remains fixed from year to year and normally averages between $25 and $75 per year. Also, if the annuity's accumulation value grows large enough, some insurance companies will waive this charge.[25]

Finally, the surrender fee is the charge incurred by some annuity investors who withdraw money from an annuity within several years of the annuity's purchase. This fee is normally around 6% in the first year after purchase, but can be much higher. Furthermore, this charge generally declines by one percentage point a year so that after a certain number of years an annuity investor no longer faces a surrender fee when he takes a withdrawal from his annuity.[26] However, some no-load annuity companies, such as TIAA-CREF, impose no surrender fees on their annuities.[27]

B. Fees and Expenses Associated With Mutual Funds

Mutual fund fees and expenses can be classified as either front-end loads, back-end loads, or expense ratios. All mutual funds have expense ratios. In addition, many, but not all, funds have front-end or back-end loads.

A front-end load is a sales charge levied on the initial investment into some mutual funds. This charge may be incurred when an investor purchases a mutual fund from a commission-based investment salesperson. Although many front-end load funds charge a front-end load of around 5%, some funds impose charges as high as 8.5%.[28]

A back end-load is a sales charge levied on the redemption amount of some mutual funds. Many back-end loads are in the form of declining redemption fees where the percentage sales charge declines each year the fund is held. For example, a fund might charge a six percent declining redemption fee. In such a case, an investor might incur a six percent redemption fee if he liquidates the fund within the first year after purchasing the fund, a five percent redemption fee if he liquidates the fund within the second year after purchasing the fund, and so on. After six years no redemption fee would be charged.

Expense ratios are annual fund expenses stated as a percentage of total assets. Expense ratios may include management fees, fund operating expenses, and 12b-1 fees.

The management fee is generally the single largest expense in the expense ratio. This fee generally is paid to the investment

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[23] Tam.

[24] For example, the investment management charge for all of TIAA-CREF's subaccounts are currently under 0.20%. For more information, visit TIAA-CREF's website at www.tiaa-cref.org.

[25] Tam.

[26] Id.

[27] A no-load annuity company is an annuity company that imposes no upfront sales charges or surrender fees on its annuities.

[28] Many front-end load funds also qualify for breakpoint discounts. A breakpoint discount reduces the front-end sales charge the investor pays and is based on the size of the cumulative investment. The discount increases as the size of the cumulative investment increases.

manager for managing the mutual fund's investments. Additionally, operating expenses go toward running and operating the mutual fund. Combined management fees and operating expenses may range from less than 0.20%[29] of the value of an investor's mutual fund per year to over 1.0%.

12b-1 fees are typically levied only by funds that use commission-based salespeople to distribute their products. The fee is a form of trailing commission and is paid to the salesperson over a number of years. Additionally, 12b-1 fees can increase a mutual fund investor's overall expense ratio by as much as 1.0% per year.[30]

Once its fee structure and expense ratio are determined, a fund is then usually classified either a class A share, class B share, class C share, or no-load mutual fund. Class A share funds usually have front-end loads and little or no 12b-1 fees. Class B shares usually have back-end loads and high 12b-1 fees. However, the 12b-1 fees of class B shares are generally significantly reduced shortly after the fund's redemption fee period expires. Class C shares normally have no front-end loads, a one-percent back-end load, and high 12b-1 charges that do not reduce when the fund's redemption period expires.

Finally, no-load funds have expense ratios, as do all funds, but do not have front-end loads or back-end loads. In addition, no-load funds have little or no 12b-1 fees. Furthermore, no-load funds are typically purchased directly through the fund company itself without the intervention of a commissioned-based salesperson.

C. The Effect of High Fees and Expenses on Investment Performance

High fees and expenses may dramatically affect the investment performance of an annuity or mutual fund over time. This fact has prompted several recent warnings to investors from the Securities and Exchange Commission (SEC) on the SEC's web site (www.sec.gov). For example, the SEC warns that when considering purchasing a mutual fund, "scrutinize the fund's fees and expenses. . . . A fund with high costs must perform better than a low-cost fund to generate the same returns to you. Even small differences in fees translate into large differences over time."[31]

Furthermore, in an effort to assist investors with better understanding the effect of fees and expenses on their investments, the SEC recently created an online tool called the Cost Calculator. According to former SEC Chairman Arthur Levitt, "the Cost Calculator takes some of the mystery out of mutual funds by enabling investors to evaluate and compare costs."[32] In order to use the calculator, which is available on the SEC's web site, investors must plug in actual fees and expenses of their annuity or mutual fund, estimate how long they plan on holding the investment, and estimate the investment's average annual rate of return.

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[29] For example, the current expense ratio for the Vanguard 500 Index Fund Investor Shares is 0.18%.

[30] Dalton, Michael A., et al., *Personal Financial Planning Theory and Practice*, Kaplan Financial, St. Rose, Louisiana (2005), p. 563.

[31] U.S. Securities and Exchange Commission, "Mutual fund Investing: Look at More Than a Fund's Past Performance," p.1 <http://www.sec.gov/investor/pubs/mfperform.htm>.

[32] Burns, Judith, "SEC Tool to Calculate Costs of Funds," *The Wall Street Journal*, April 7, 1999.

For example, suppose five investors recently inherited $100,000 a piece and each decides to invest his or her money into a diversified investment portfolio. Investor 1 places her money in a variable annuity with total yearly operating expenses of 2% and a six-year declining surrender charge. Investor 2 invests his money in a class A mutual fund with a 3.25% up-front sales charge and a yearly expense ratio of 1.0%. Investor 3 invests her money in a class B mutual fund with a yearly expense ratio of 1.8% and a six-year declining surrender charge. The expense ratio, however, reduces to 1.0% in year seven. Investor 4 invests his money in a class C mutual fund with a 1.8% yearly expense ratio. Finally, Investor 5 invests her money in a no-load mutual fund with an annual expense ratio of 0.2%.

According to the SEC Cost Calculator, if all investors earn a gross average rate of return of 11%[33] and hold their investments for 20 years, at the end of 20 years Investor 5 will have fared substantially better than her counterparts. As Table 1 shows, she will have accumulated approximately $136,596 more than Investor 2, $146,498 more than Investor 3, $213,940 more than Investor 4, and $236,341 more than Investor 1.

Table 1 – Effect of Fees on Investment Performance Over Time

INVESTOR	INVESTMENT	TOTAL COST OF INVESTMENT[34]	END OF HOLDING PERIOD TOTAL
1	Variable Annuity	$267,985	$538,246
2	Class A Fund	$168,240	$637,991
3	Class B Fund	$178,142	$628,089
4	Class C Fund	$245,584	$560,647
5	No-load Fund	$ 31,644	$774,587

V. Reasons for the Lack of Direct Access to No-Load, Low-Expense 403(b) Plans in Many School Districts

In spite of the SEC's recommendation that fees and expenses should be scrutinized carefully and the wealth of information indicating that high fees and expenses may significantly hamper long-term investment performance, many school districts do not allow their employees direct access to no-load, low-expense 403(b) plans. Instead, according to noted financial columnist Jane Bryant Quinn, a school district typically "arranges for [the employee] to invest through payroll deduction but pretty much ignores

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[33] The SEC estimates that the average return for the S&P 500 stock index over the past 30 years has been approximately 11%. *See http://www.sec.gov/investor/tools/mfcc/get-started.htm.*

[34] The Total Cost of Investment is the sum of the total fees paid plus the foregone earnings.

[35] Quinn, Jane Bryant, "403(b) Gets a Little More Like It's Cousin," *washingtonpost.com*, July 8, 2001, p. 2.

what's going on."[35] The reasons for such apathy by many school districts regarding ensuring low-expense investment options for employees include the lack of ERISA regulation of 403(b) plans and concern about the school district's liability for withholding excess taxes from 403(b) plan participants.

According to ERISA Section 3(21)(A), an employer is a fiduciary with respect to a retirement plan and, thus, is subject to ERISA fiduciary duties "to the extent" that the employer "exercises any discretionary authority or discretionary control respecting management" of the plan or "has any discretionary authority or discretionary responsibility in the administration" of the plan. Correspondingly, one of these ERISA fiduciary duties should be to ensure that the retirement plan includes quality, low-expense investment options. However, since most 403(b) plans are individual plans in which the employer merely arranges for the employee to invest through payroll deductions into a plan chosen by the employee, such plans are not subject to ERISA regulation.

In addition, the complex set of rules which govern how much an employee can contribute to a 403(b) plan each year have prevented some school districts from granting their employees direct access to no-load, low-expense 403(b) plans. Moreover, these complex rules have caused great concern to school districts ever since the I.R.S. began auditing 403(b) programs in the 1990s. According to the I.R.S., an employer "could be the subject of penalties for federal income tax withholding and FICA (if applicable) tax that should have been withheld on the excess contribution."[36]

Furthermore, in order to reduce potential liability for excess employee 403(b) contributions, many employers have turned to the use of hold harmless agreements. These agreements purport to transfer liability that might result from improper 403(b) withholdings to investment providers. However, many no-load annuity and mutual fund providers have refused to sign such agreements since the I.R.S. has stated that the employee, not the investment provider, is the individual or entity responsible for monitoring contributions to the employee's 403(b) plan.[37] Also, many of these agreements do not even allow a 403(b) participant, who invests in a no-load annuity or mutual fund, to have his or her CPA or tax attorney complete a maximum allowable 403(b) contribution calculation on a yearly basis and submit the calculation to the employee's school district.[38] Therefore, in some school districts, the only 403(b) plan investment options from which employees have to choose are high-expense variable annuities or mutual funds offered by commission-based salespeople who, acting as an agent for their investment provider employer, have agreed to do a yearly maximum allowable 403(b) plan contribution calculation for their school district employee customers.

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[36] Internal Revenue Service, "Retirement Plans FAQ regarding Tax Sheltered Annuities," p. 1 <*http://www.irs.gov/retirement/article/0,,id=96975,00.html*>.

[37] For example, IRS Publication 571 states that "this publication can help you better understand the tax rules that apply to your 403(b) (tax-sheltered annuity) plan." In addition, the publication states that "you," in other words the employee, "should figure your MAC (maximum amount contributable to your 403(b) plan) for the current year" See IRS Publication 571, p. 2 and p. 4.

[38] For example, several hold harmless agreements, which were drafted by 403(b) service providers and placed in force between Western New York public school districts and 403(b) service providers, allowed only the "service provider" to perform the calculation and submit the calculation to the school district.

VI. The NASD's Response to the Lack of Direct Access to No-Load, Low Expense 403(b) Plans in Many School Districts

Partially in response to the previously mentioned monopolistic power exercised by insurance companies in selling high-expense annuities to 403(b) plan investors, the National Association of Securities Dealers, in 1999, issued Notice 99-35 in order to remind NASD members of their responsibilities pertaining to variable annuity sales in tax-deferred accounts. The notice states:

> When a registered representative recommends the purchase of a variable annuity for any tax-qualified retirement account . . . the registered representative should disclose to the customer that the tax-deferral accrual feature is provided by the tax-qualified retirement plan and that the tax-deferred accrual feature of the variable annuity is unnecessary. The registered representative should recommend a variable annuity only when its other benefits, such as lifetime income payments, family protection through the death benefit and guaranteed fees, support the recommendation[39]

The Notice further states that an NASD member "should conduct an especially comprehensive suitability analysis prior to approving the sale of variable annuities with surrender charges to a customer in a tax-qualified plan subject to minimum distribution requirements."[40] In 403(b) plans, minimum distributions are required to begin by April 1 of the year after the account owner turns age 70 ½.[41]

The result of the NASD's filing of Notice 99-35 has been a flood of class action lawsuits filed by investors, who were sold variable annuities within their tax-deferred accounts, against the insurance companies whose agents recommended the purchase of the annuities. Most of the claims allege that the insurance companies did not honor the guidelines set forth in the notice, and some of the claims have resulted in substantial settlements.[42] For example, American Express recently agreed to pay more than $215 million in benefits to more than two-million class participants.[43]

Furthermore, the lawsuits appear to by aimed only at insurance companies who sell high-expense, agent sold annuities in tax-deferred accounts to investors and are not aimed at insurers, like TIAA-CREF, who offer no-load, no surrender charge, low-expense variable annuities directly to investors in tax-deferred accounts. Also, most of the suits ask for insurers to repay "superfluous" insurance fees and refund surrender charges on inappropriately sold policies.[44] The suits also seek to stop "deceptive" sales practices by the insurance companies.[45]

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[39] NASD Notice to Members 99-35, p. 3 <*http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_004395.pdf*>.

[40] Id.

[41] I.R.S. Publication 571, p. 13.

[42] Panko, Ron. "Can Annuities Pass Muster?" *Best's Review*, July 2000, p. 106

[43] Id.

[44] "What a Deal: A Lawyer is Suing to Prove the Obvious; that Variable Annuities in Qualified Plans are Not a Bargain," *Dow Jones Investment Advisor*, December 1999, p. 20.

[45] Id.

VII. Employee Responses to the Lack of Direct Access to No-Load, Low-Expense 403(b) Plans in Many School Districts

Even if an employee's only 403(b) plan options are high-expense annuities or mutual funds, there are several courses of action that the employee can take to gain eventual access to no-load, low-expense 403(b) plans. For example, the employee can form a committee within his school district and ask the school district to include, in its 403(b) plan options, at least one no-load annuity or mutual fund company. In addition, when petitioning the school district, the committee should provide the district with research illustrating the long-term detrimental effect of high-fees and expenses on investments. Also, the committee should point out the potential benefits to the district for allowing direct access to no-load, low-expense 403(b) plans.

One such benefit to the school district the committee should mention is that, if a no-load, low-expense 403(b) option is provided, each employee's future 403(b) account balance may be substantially greater than if the employees were forced to invest in high-cost investments. The committee should further explain that a higher account balance would be beneficial to the school district because many employees may be able to retire sooner. For example, assume that because a teacher periodically invests in a no-load, low-expense variable annuity or mutual fund her 403(b) account balance at age 60 is $200,000 more than it would have been if she was forced to invest in high-cost investments. Also, assume that because her 403(b) account is $200,000 larger, the teacher decides to retire at age 60 as opposed to age 63. This would result in over $100,000 of cost savings to the district if the retired teacher was making $70,000 a year at age 60 and the district replaced the retired teacher with a new teacher to whom they paid only $35,000 a year.

Also, the employees should explain to the school district that providing direct employee access to no-load, low-expense 403(b) plans may better help the school district to attract and retain employees. Many school districts in the country that are facing teacher shortages may find this argument particularly persuasive.

If, however, after pointing out the benefits of providing *direct* access to no-load, low-expense 403(b) plans, the school district still refuses to facilitate a payroll remittance to such plans, the employees should consider taking advantage of I.R.S. Revenue Rule 90-24 in order to gain *indirect* access to no-load, low-expense 403(b) plans. Under this rule, if an employee transfers funds from one 403(b) account to another, and the transferred funds continue to be subject to the early distribution restrictions as set forth in the Internal Revenue Code, the transfer is not an actual distribution and, consequently, is not a taxable transfer.[46] Also, the rule states that "it is irrelevant whether a complete interest or a partial interest is transferred, and whether the transferring individual is a current employee, a former employee or a beneficiary of a former employee."[47]

To effectively facilitate a 90-24 asset transfer and avoid sales and surrender charges, the employee should consider taking the following steps. First, from the school district's list of approved 403(b) plan vendors, the employee should find a vendor who offers a no-load money market mutual fund within its 403(b) plan. (Many money market mutual funds, even if offered by high-expense mutual fund or insurance companies, do not impose

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[46] Internal Revenue Service Revenue Rule 90-24, p. 3 <*http://taxlinks.com/rulings/1990/revrul90-24.htm*>.

[47] Id.

any sales or surrender charges.) Second, the employee should open up a new 403(b) plan account with the approved 403(b) plan vendor offering the no-load money market mutual fund as an investment option. Third, the employee should open up a 403(b) plan account with a no-load, low-expense annuity or mutual fund company.

Fourth, the employee should instruct the employer to remit the employee's 403(b) plan contributions to the approved vendor. Fifth, the employee should periodically (every three to six months) facilitate a 90-24 transfer from the money market fund in the approved vendor's 403(b) plan to the 403(b) plan which offers no-load variable annuities or mutual funds.

It is important to note that, although the I.R.S. allows employees to facilitate a 90-24 transfer, the employer and the approved vendor must permit such transfers in order for the 90-24 transfer to be facilitated. Fortunately, many employers and approved vendors currently allow 90-24 transfers.

VIII. The Lack of Union Support for Direct Access to No-Load, Low-Expense 403(b) Plans in Many School Districts

In their quest to gain direct access to no-load, low-expense 403(b) plans, one would think that school district employees can count on their union for help. However, some of the nation's largest teachers unions have joined forces with financial services companies to steer members into high-expense 403(b) plans.[48] Teachers unions currently endorse financial services firms, 403(b) plans, and financial products. In return, the financial services firms reciprocate with financial support for the unions.[49] For example, the National Education Association collected nearly $50 million in royalties in 2004 on the sale of annuities, life insurance and other financial products.[50] In addition, the New York State United Teachers (NYSUT) has received as much as $3 million a year from ING Group for encouraging its 525,000 members to invest in an annuity sold by the insurance company.[51]

The relationship between NYSUT and ING recently prompted an investigation by New York State Attorney General Eliot Spitzer. The investigation revealed that a 403(b) plan, offered by ING and endorsed by NYSUT's Members Benefits unit, charged investors fees and expenses as high as 2.85% per year while delivering only limited benefits.[52] The investigation also revealed that NYSUT's Member Benefits unit endorsed ING's 403(b) plan even though less expensive alternatives were available, received undisclosed payments of as much as $3 million per year for endorsing ING's 403(b) plan, and took steps to conceal its financial arrangement with ING from its members.[53] In June 2006, NYSUT's Members Benefits unit entered into

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[48] Kristoff, Kathy M. "Unions' Advice is Failing Teachers." *latimes.com*, April 25, 2006, p. 1 *<http://www.latimes.com/business/la-fi-retire25apr25,0,6936648,print.story?coll=la-home-bu…>.*

[49] Id.

[50] Id., p. 2.

[51] Id., p. 2.

[52] New York State Attorney General. "NYSUT's Members Benefit Unit Settles Probe: Settlement is Part of Ongoing Investigation of Retirement Products," p. 1 *<http://www.oag.state.ny.us/press/2006/jun/jun13b_06.html>.*

[53] Id.

an agreement with Spitzer to resolve the investigation.[54] Under the agreement, the unit promised to adopt a series of reforms and pay $100,000 to cover the costs of the investigation.[55]

IX. The Potential Repeal of Revenue Rule 90-24

Since some teachers unions have turned out to be poor allies in school district employees' quest for direct access to no-load, low-expense 403(b) plans, many employees are thankful that they may be allowed indirect access to such 403(b) plans via 90-24 transfers. However, in November 2004 the Treasury and I.R.S. proposed revised regulations concerning 403(b) plans.[56] The proposed regulations seek to eliminate all 403(b) transfers to a 403(b) plan that is not offered by an employer approved 403(b) vendor.

In their written comments to the Treasury and I.R.S. on the proposed regulations, National Tax Sheltered Accounts Association advisors Kristi Cook and Ellie Lowder explained effect of the potential restrictions on 90-24 transfers in the following way:

> The proposed regulations provide for the repeal of Rev. Ruling 90-24 and the imposition of a limitation on transfers and exchanges *only* to vendors that are authorized under the current employer's "plan," or to the venders of a new employer if the participant leaves the employment of one employer and begins work for a new 403(b)-eligible employer. The new limitation completely eliminates the ability of 403(b) participants to transfer one 403(b) account to another 403(b) account of a provider that is not part of the employer's 403(b) arrangement, and eliminates the ability of 403(b) participants to transfer the account values after they are no longer working (either retired, or working for an employer that is not eligible to sponsor a 403(b) arrangement).[57]

Fortunately, there is still time for employees to facilitate a 90-24 transfer to a no-load, low-expense 403(b) plan that is not an employer approved 403(b) vendor since the final regulations will not be effective earlier than January 1, 2008.[58]

X. Attorney Responses to the Lack of Direct Access to No-Load, Low Expense 403(b) Plans in Many School Districts

The fact that employees in many school districts lack direct access to no-load, low expense 403(b) plans is certainly bad news to such employees. However, the aforementioned lack of access is potentially good news to attorneys representing school district employees in disputes with the financial services industry. Attorneys, who educate themselves on the current 403(b)

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[54] Id.

[55] Id.

[56] Department of the Treasury, Internal Revenue Service. "Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts". REG-155608-02. November 16, 2004 <*http://www.irs.gov/pub/irs-regs/15560802.pdf*>.

[57] Cook, Kristi and Ellie Lowder. "Written Comments from the National Tax Sheltered Accounts Association on the 403(b) Proposed Regulations," p. 13.

[58] Internal Revenue Service. "Delay in Effective Date for Regulations Under Section 403(b)." IR-2006-136. August 29, 2006 <*http://www.irs.gov/newsroom/article/0,,id=161446,00.html*>.

marketplace, will likely benefit significantly by representing school district employees in at least two ways.

First, attorneys will likely benefit from continuing to bring class action lawsuits against insurance companies whose agents improperly sold annuities to school district employees within their tax-deferred 403(b) accounts. According to the Spectrem Group, a Chicago-based research firm, of the approximately $600 million invested in 403(b) plans at the end of year 2005, almost 500 million was invested in annuities.[59] The class action suits will likely continue to allege that such annuities were unsuitable for the employees and that the annuity salespeople violated provisions within NASD Notice 99-35. In addition, some creative class-action attorneys may assist school district employees in filing lawsuits against teachers unions for steering members into high-expense, union-endorsed 403(b) plans. Credible online tools, such as the SEC Cost Calculator, may be of assistance in computing and establishing damages.

Second, attorneys will likely benefit by representing employees in their quest to have a no-load, low expense mutual fund company added to their employer's list of approved 403(b) vendors. Such legal representation may prove invaluable to school district employees during a time when the potential repeal of Revenue Rule 90-24 is looming and brokerage and insurance companies are fighting hard to prevent employees from gaining direct access to no-load, low expense 403(b) plans. For example, a New Jersey math teacher recently convinced his school district to add no-load, low expense mutual fund company Vanguard to the school district's list of approved 403(b) vendors.[60] In addition, the teacher organized seminars for his fellow teachers and convinced 50 of them to sign up with Vanguard as their new 403(b) plan provider. Furthermore, even though the teacher was not compensated in any way from his campaign and the information presented in his seminars was thorough and balanced, a sales agent for AXA-Equitable Life Insurance Co., one of the school district's other 403(b) approved vendors, threatened the teacher with legal action.[61]

XI. Conclusion

In conclusion, 403(b) plans offer significant tax advantages to employees of school districts who desire to accumulate wealth and retire at a reasonable age. However, the tax advantages gained by 403(b) plan investors are currently being eradicated by high investment costs in school districts that deny their employees direct access to no-load, low-expense 403(b) plans. Furthermore, the proposed regulations may also deny many school district employees indirect access to no-load, low-expense 403(b) plans by repealing Revenue Rule 90-24. One can only hope that school districts and teachers unions will take a more proactive stance in ensuring that employees have direct access to no-load, low-expense 403(b) plans. Such a result would surely be of great benefit to ***both*** school district employees and school districts. However, until such a stance is taken, many attorneys will remain busy representing school district employees in their quest to gain direct access to no-load, low expense 403(b) plans and in class action lawsuits against high-expense 403(b) plan providers and, perhaps, teachers unions.

[59] Wasik, John F., "New Jersey Teacher Wins Fight on Retirement Fees." *Bloomberg.com*, October 2, 2006, p. 1 <*http://www.bloomberg.com/apps/news?pid=20601039&sid=aQm8SUAzWPHk &refer=home*>.

[60] Id.

[61] Id.