



NTSA

National Tax-Deferred Savings Association

Part of the American Retirement Association

403(b) Plan Enhancement Guide

Automatic Enrollment

Match Programs

Retirement Education Programs

Special Pay Plans

Building On NTSA's 2018 403(b) Survey

In 2018, the National Tax-Deferred Savings Association (NTSA) in partnership with the Plan Sponsor Council of America (PSCA) examined the savings rates of public education employees in more than 4,400 school districts across the country. The research provided a benchmark for national 403(b) savings rates and revealed that the number one factor driving participation and savings rates in school districts is participant choice. The report was made available to school districts nationally to assist them in understanding how to improve 403(b) participation and savings rates to help employees achieve a comfortable and timely retirement.

This paper extends the work of NTSA's 2018 survey of public education 403(b) retirement plans to offer suggestions on how to further improve the 403(b) benefit and encourage greater employee participation and savings.

The Importance of 403(b) Savings

Increases in longevity coupled with the increasing cost of health care in retirement are making retirement substantially more expensive today than for prior generations. State retirement system plans are reducing benefits and eliminating cost of living adjustments. Individuals who save in 403(b) plans are better prepared to leave service at normal retirement ages and have more flexibility to meet their future financial needs.

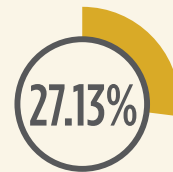
Additionally, in 15 states, teachers do not participate in the Social Security system. In those states, 403(b) savings plans help enable employees to bridge the retirement income gap created by reduced pensions and the lack of Social Security benefits.

Opportunities to Enhance 403(b) Plans

The 2018 research done by the NTSA and the PSCA identified multiple solutions that can be offered within a 403(b) to help increase participation and savings. These include:

SUMMARY STATISTICS

Average Participation



Contribution Rate
as a % of Salary



- (1) Maintaining a Multi-Vendor Environment
- (2) Increasing Participant Access to an Advisor
- (3) Auto Enrollment
- (4) Match Programs
- (5) Retirement Education Programs
- (6) Special Pay Plans

The 2018 research, entitled “Improving Retirement Savings For America’s Public Educators,” details the importance of the first two solutions from above (Maintaining a Multi-Vendor Environment, and Increasing Participant Access to an Advisor). This paper will focus on the next four topics to help increase participation and savings for America’s public educators.

The implementation of auto enrollment, match programs, retirement education programs and special pay plans (coupled with maintaining a multi-vendor environment and increasing participant access to an advisor), will result in the following benefits for the employer:

- Increased participation and savings rates, which will increase the number and percentage of employees that are more financially secure and better prepared for retirement.
- More financially secure employees who stay longer and are happier and more productive.
- Higher employee retention as 403(b) benefit become more valued.
- More skilled employees to the employer.
- Immediate increase in overall enrollment, thus avoiding the IRS audit pitfall of low participation levels.
- Fiscal budget flexibility and tools in managing outlays for employees near retirement, particularly when utilizing the special pay plan.

Along with the benefits to the employer, participants in the 403(b) plan will see complementary benefits:

- Increased contributions and account balances.
- Ability to more fully participate in the value of the 403(b) benefit (e.g., emergency savings if needed, service credit buybacks, match programs).
- Improvements in financial well-being, which leads to happier employees and greater career longevity.
- Employee understanding, earlier in one’s career, of the value of accumulating

retirement savings that supplement their defined benefit plans and Social Security.

- Flexibility, allowing employees to retire earlier, regardless of changes in the defined benefit plan.
- Employees will not be required to pay payroll taxes on the employer contributions.
- Access to financial professionals to address complex retirement issues.

Auto Enrollment

How Automatic Enrollment Works in a 403(b) Plan

Most 403(b) plans require employees to affirmatively choose to put money into a plan. Traditional retirement plan enrollment involves choosing a provider with whom to invest. If your plan is supported by dedicated financial advisors that facilitate the enrollment process, this will offer more robust service to your employees. Enrollment in the retirement plan can seem confusing and complicated to employees, especially new employees, which can lead to an employee deciding to not enroll at all. This is why the auto enrollment feature, combined with financial education for all employees – especially new hires when onboarding – is imperative. Once the auto enrollment feature is selected in your district, the next steps are as easy as 1-2-3.

- (1) Explain to employees that your district will auto enroll them in the 403(b) plan unless they opt out.
- (2) Tell employees what default percentage of their pay will go into the investment account.
- (3) Refer employees to financial advisor(s) who will assess their goals and risk tolerance before selecting their investment provider or a default investment option.



Most employees move forward with the default investment option and default contribution rate. However, one size does not fit all. Employees' needs vary by age, financial profile and goals over time. The ability to meet and work with a financial advisor to evaluate all investment options assists participants in attaining future and present financial goals.

It is important to note, when setting up a default investment option, that the type of product should be liquid, easy to transfer and provide flexibility for employees to make investment changes as their savings requirements evolve. Having a guaranteed interest fund should be considered. That means that the account is guaranteed to earn interest and at the least, should not go down in value. In addition, the default option should not favor any specific investment provider.

Should an employee choose not to participate in the 403(b) plan, there is the option to opt out of the auto enrollment process. However, in most cases, employees participating are better off saving for retirement in the end.

Once enrolled, employees can choose to stop their contributions or increase or decrease the amount they are contributing at any point in their plan participation.

Plans offering auto enrollment see a significant increase in participation. In 2010, only 12% of plans had an auto enrollment feature; that doubled to 24% by 2017 (PSCA's 2018 403(b) Plan Survey).

The Power of Auto Enrollment

One way to look at the positive impact of auto enrollment is to consider the value of starting contributions to the 403(b) earlier in an employee's career, thus facilitating a greater accumulation and/or earlier retirement.

Illustrating the Benefits to Plan Retirement Readiness:

Here is an illustration comparing the retirement readiness of an employee who starts contributing at the start of employment versus waiting five years to start investing in the 403(b) plan.

Here we see that an employee who starts contributing at hire through an auto enrollment feature with a 5% default contribution would generate over \$68,000 in incremental retirement savings, compared to an employee who opts out of auto enrollment and delays contributions for five years. This illustration highlights the power of auto enrollment in multiple ways.

| | |
|--|----------|
| Starting Salary | \$39,440 |
| Annual Salary Increase (%) | 2% |
| % of Salary Contributed | 5% |
| Average Contribution Per Paycheck (2x mo.) | \$86 |
| Total Contributions over 1st 5 years | \$10,262 |
| Value of those Contributions upon Retirement in 35 years (6% return) | \$68,494 |

The \$68,000 in extra savings is significant when compared to the median amount of retirement savings for all workers in their 60s, which is about \$172,000 (Transamerica survey).

Finally, the positive impact across the entire employee base is likely much more significant as many, without the auto enrollment prompt, will wait much longer than five years to start contributing.

Additional Considerations When Implementing Auto Enrollment in a 403(b) Plan

A best practice is to offer employees the opportunity to choose to enroll with one of the qualified investment providers in your plan. If an employee is not prepared to choose an investment provider, the employer will select the default provider and the default investment already selected by the employer during implementation.

The U.S. Department of Labor (DOL) provides guidance for 401(k) plans and other retirement plans that are subject to ERISA on how to select a default investment option under its qualified default investment alternative (QDIA) safe harbor. Following the QDIA approach is recommended for non-ERISA school district 403(b) plans as well.

The employee should be encouraged to review regularly any investments in the default account to ensure those savings are matched to their individual retirement goals. A financial professional is very valuable in this review.

The employer can adjust the *amount* of the default automatic deduction to facilitate savings.

Employers should decide the best percentage. We recommend at least a *minimum* of 3% of salary for all employees (although you can choose a different percentage by class of employee). Note: The higher the default rate, the greater the impact on retirement savings.

One method for employers to consider when selecting a meaningful default contribution rate would be to set the rate based upon a calculation of the average, potential income gap in retirement for employees in the plan. Using an average salary and retirement age, the default contribution rate could be set based on the rate necessary to fill this income gap. Your advisor can be helpful in calculating this default contribution rate.

The amount can also be a set dollar amount in lieu of a percentage, if your payroll system does not allow for a percentage of pay.

A useful feature to consider is an annual automatic increase in the contribution percentage up to a maximum cap. For example, consider the initial default percentage at 3%, which

would then increase by 1% each year until it reaches 7%. Note: The average deferral rate in school district plans is 6.9% (see the next page for an illustration of the impact of an automatic increase feature).

The *type* of automatic deduction can be adjusted to facilitate savings. You can choose either a regular pre-tax deferral and/or a designated Roth contribution, which is an after-tax deduction.

In many states, providers are working together to provide seamless “participant engaging” vendor-neutral education programs that are easy for the employer to coordinate. Ask your TPA or other plan representative for more information and to assist in coordinating this effort.

Value of Starting Contribution 5 Years Early at Different Default Rates

| DEFAULT PERCENTAGE | 2% | 3% | 4% | 5% | 6% |
|--------------------------------------|----------|----------|----------|----------|----------|
| Value of Contributions at Retirement | \$27,398 | \$41,096 | \$54,795 | \$68,494 | \$82,193 |



The Magnified Power of Auto Enrollment With an Automatic Deferral Increase

An automatic increase feature combined with auto enrollment assists employees to save sooner and helps overcome the inertia of making contribution changes once in the plan. By extending the first illustration to simply add a 1% automatic annual increase in the contribution percentage to a total of 10%, we see a tremendous impact for the employee.

| | |
|--|-----------|
| Starting Salary | \$39,440 |
| Annual Salary Increase | 2% |
| % of Salary Contributed – Year 1 | 5% |
| % of Salary Contributed – Year 6 on | 10% |
| Average Contribution Per Paycheck Yr 1–5 (2xmth) | \$120 |
| Total Contributions over 35 Years (compared to Starting Yr 6 and fixed at 5%) | \$102,775 |
| Value of those Contributions upon Retirement in 35 years (6% return) | \$315,954 |

Things to Consider Before Adopting Auto Enrollment

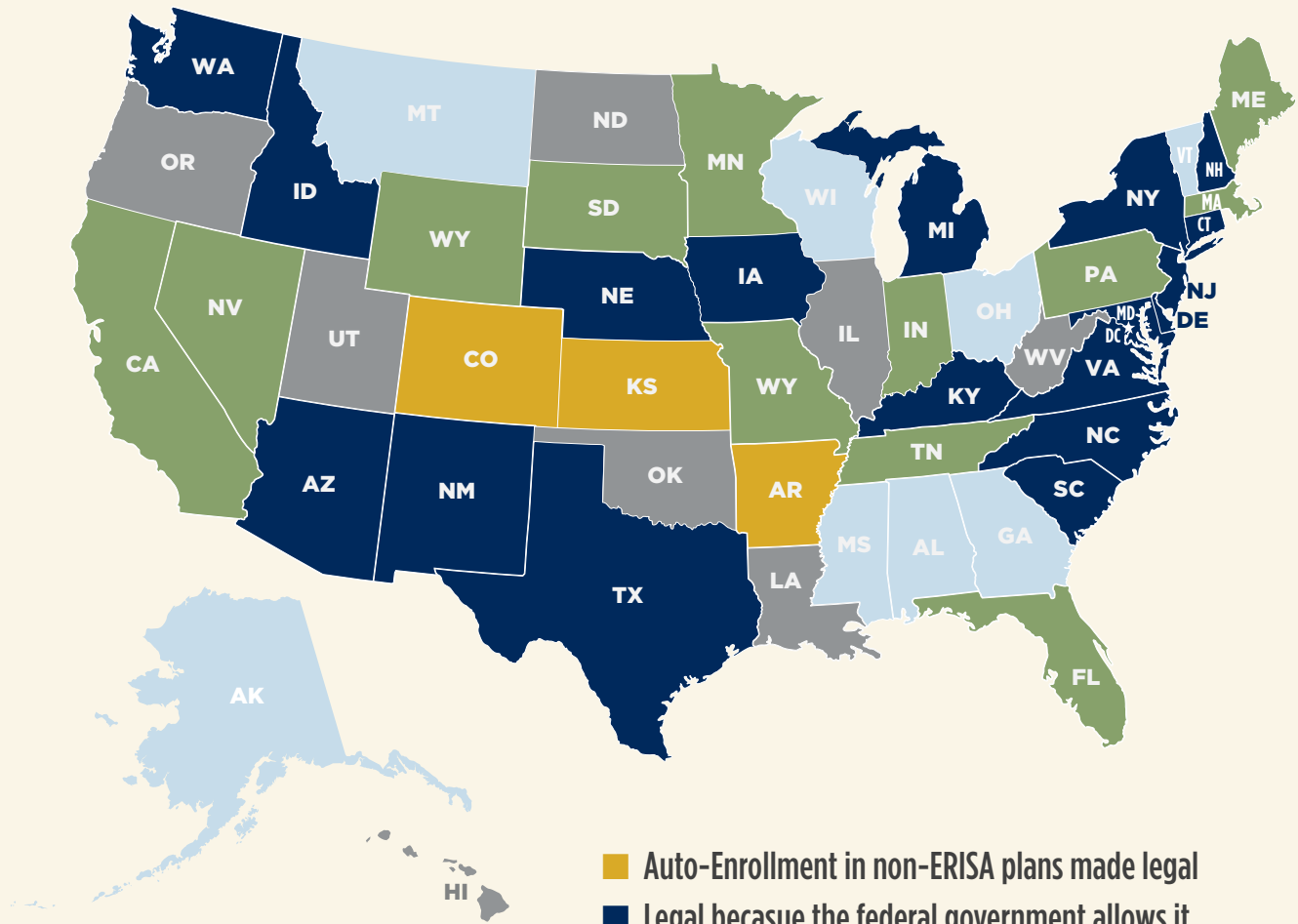
State Laws

State laws vary, but as of 2019, there are generally only a few scenarios of concern:

- Three states have explicitly made automatic enrollment in non-ERISA plans legal: Arkansas, Colorado and Kansas.
- 18 states make automatic enrollment legal through permissive statutes that allow it if the federal government allows it (which it does): Arizona, Connecticut, Delaware, Idaho, Iowa, Kentucky, Maryland, Michigan, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, South Carolina, Texas, Virginia and Washington.
- Eight states prohibit automatic enrollment, unless it is required by law: Hawaii, Illinois, Louisiana, North Dakota, Oklahoma, Oregon, Utah and West Virginia.
- 13 states prohibit automatic enrollment because they require written permission from the employee to make payroll deductions: California, Florida, Indiana, Maine, Massachusetts, Minnesota, Missouri, Nevada, Pennsylvania, Rhode Island, South Dakota, Tennessee and Wyoming.
- Eight states and the District of Columbia have yet to address the issue clearly or at all: Alabama, Alaska, Georgia, Mississippi, Montana, Ohio, Vermont and Wisconsin.

Employers should remember that laws are subject to change, and this could necessitate alterations to existing automatic enrollment arrangements at a future date. Therefore, employers should check with their qualified tax advisor before implementing an automatic enrollment feature.

AUTO-ENROLLMENT IN NON-ERISA PLANS ACROSS THE NATION



- Auto-Enrollment in non-ERISA plans made legal
- Legal because the federal government allows it
- Prohibit auto-enrollment unless required by law
- Prohibit auto-enrollment because written permission is required from employee to make payroll deductions
- State law unclear, further guidance needed

Collective Bargaining Agreements and Union Requirements

Related to the topic of employee consent noted before are collective bargaining agreements and union requirements. While state laws may allow for automatic enrollment arrangements, existing agreements between employers and their employees through collective bargaining could restrict or prohibit automatic deductions, even though they are for the benefit of employees. Plan sponsors should become aware of whether agreements like these might affect their ability to adopt automatic arrangements.

Match Programs

How Match Programs in a 403(b) Plan Work

Match programs provide for the employer to match employee contributions in order to increase participation, as well as attract and retain quality employees.

The employer must make a determination regarding how much to match employee contributions (e.g., a 100% match up to 5% of salary). The plan's TPA and financial advisors are good resources to the employer in determining the match amount and any impact on plan operations. The match is done with pre-tax employer funds placed into the participant's account. Generally, the funds are deposited into the same account that the participant has chosen for their elective deferrals.

Similar to an auto enrollment program, it is important for the employer to provide education materials to explain the match benefit to all employees. As a best practice, this would include onsite education seminars to both raise awareness of the match program and to facilitate financial literacy.

The Power of a Match Program

By expanding on the illustration of the power of auto enrollment from the previous section, we see how a match magnifies the benefit to employees while providing potential economic advantages to employers.

While each school district has a unique employee compensation structure, a match program may offer the ability to provide a benefit to employees that is more affordable than the equivalent in salary compensation. Following is an example of the savings that a district might see if the match reduces FICA payments and employer contributions to the state retirement plan.

| | |
|--|------------------|
| Auto Enroll Illustration: Value at Retirement of Starting Contributions 5 years early | \$68,494 |
| Value at Retirement to Employee of 100% Match up to 5% | \$68,494 |
| Total Benefit of Auto Enroll + Match | \$136,988 |
| Total Savings at Retirement in 35 years for an Employee with 5% contribution + 100% Match | \$579,219 |

Retirement Education Programs

Employees Need the Right Information to Make the Best Choice

Your school district employees need the right information to make the best choice regarding their retirement security. This information should include the services associated with the various 403(b) offerings, so participants can choose the option(s) that best suit their needs.

| Employer's Equivalent Cost For Salary Compensation vs. Match | |
|---|--------------|
| Cost of Match | \$86 |
| Salary | \$86 |
| FICA & Medicare (7.65%) | \$7 |
| State Retirement Plan Contribution | \$9 |
| Cost of Salary + FICA + Pension | \$102 |

In an effort to improve the understanding of retirement planning options and improve participation rates in 403(b) plans, the NTSA created a comprehensive retirement educational program that is available to school districts and their employees across America. The NTSA educational program is vendor-neutral and does not include any specific investment product recommendations. Attendees of the program gain a greater awareness of what they will need to save to supplement their pension plan and Social Security and how to take action.

Certified Retirement Education Specialist

The NTSA Certified Retirement Education Specialist (CRES) Advisor is qualified and available to teach employees of your school district about the retirement education program. The Certified Retirement Education Specialist has completed a certificate program through the American Retirement Association (ARA) Retirement Planning Academy addressing the important retirement planning considerations of public employees. The NTSA CRES Advisor has agreed to abide by the highest standards of professional conduct and to coordinate all educational activity in accordance with school district solicitation policies and guidelines.

More information regarding the CRES Retirement Education Program and a registry of CRES Advisors is available at [NTSA-CRES.org](https://www.ntsa-cres.org).

Special Pay Plans

How a Special Pay Program in a 403(b) Plan Works

While auto enrollment and match programs facilitate early participation in the 403(b) plan and offer incentives to increase contributions during the employee's careers, special pay plans are tools within a 403(b) plan to help employees as they approach retirement.

A 403(b) plan which includes employer contributions in lieu of paying compensation (most commonly to replace unused sick leave and vacation pay) or to encourage an action (most commonly to encourage long-term employees to retire) is often referred to as a special pay plan.

Internal Revenue Code Section 403(b)(3) specifically defines includible compensation as the amount earned in the most recent period that counts as one year of service, and permits includible compensation to be counted for up to five tax years following the tax year in which employment is severed. Publication 571 specifically states that employer contributions can be made for severed employees for up to five tax years following the tax year of severance.

Benefits to the Employer

- The ability to stretch the contributions for as long as five years helps relieve the employer's current year's budget and tax burden.

- The district will save payroll taxes, since no such taxes are due on employer contributions to 403(b) retirement plans. In states where public education employees contribute to Social Security, the savings is 6.20%, plus 1.45% for Medicare taxes plus any other applicable payroll taxes. The plan also contributes to the affordability of retirement for long-term employees who wish to retire with dignity, making way for budget savings when new hires earn substantially less in salary.

Benefits to Each Employee

- The employee will not be required to pay payroll taxes on the employer contributions, thus holding on to more of their valuable retirement dollars.
- The employee will not pay income taxes on the lump sum compensation payment, and can control the income tax consequence by managing withdrawals from the 403(b) account to mitigate ultimate tax liability.

The Power of a Special Pay Plan

Following is an illustration of how a special pay plan benefits both the employer and the employee.

John Jones will retire, at which time he will be due \$76,000 in unused leave pay.

The public school district does not wish to pay \$76,000 in a lump sum at retirement; thus, it adopts an administrative policy providing that the district will contribute \$38,000 per year until the full \$76,000 has been paid.

John's earnings for his last full 12 months of service is \$77,000; thus, the employer could contribute up to \$56,000 in each of five post-employment tax year under the Internal Revenue Code Section 415(c) limit (the 2019 limit as indexed).

Note: *if there are other employees retiring or severing employment with unused leave pay in that same year, the district should take care to include those employees in the plan.*

The Employer Generates Significant Benefits as Well:

The ability to replace unused leave payouts in the final year of service with employer contributions is stretched for up to five years following the year of severance of employment.

The employer realizes payroll tax savings (7.65% when employers must contribute to Social Security) because, unlike compensation, employer contributions are not subject to those taxes. For example, assume there are nine retiring employees with situations

similar to John's. The grand total of payment of their unused leave pay is \$630,000. If paid as compensation, the district's current-year budget is negatively affected by that large payment of unbudgeted dollars. Additionally, assume payroll taxes of 7.65%, or just over \$48,000, which must be paid on compensation versus \$0 if made as employer contributions.

The enhancement of a secure retirement for employees with the additional contributions to their 403(b) plan.

Steps to Implement a Special Pay Plan in a 403(b) Plan

The plan document should be amended to include employer contributions.

The district will prepare and adopt administrative language describing the special pay plan (for whom the amounts are to be contributed in general terms, and the timing of those contributions). Included in that language should be the statement that no individual employee has been given a cash option.

The district will require financial advisors to meet with affected employees to establish a 403(b) account to receive the employer contributions (done before employment ceases), and to explain the benefits of the plan.



Conclusion

Employers Should Pay Attention to Plan Design Decisions

Increased employee financial health equates to increased employer financial health and operational efficiency. By focusing on available plan design options, an employer can save money while providing for additional savings for their employees towards retirement. Specifically, an employer should review four key plan design opportunities:

- (1) Consider the addition of a carefully constructed auto enrollment and auto escalation feature for an employer's current voluntary savings 403(b) program. By adding this plan design feature, the employer will turn the power of inertia in favor of, not against, the employees' decision-making process.
- (2) Consider the introduction of an employer matching component to the 403(b) plan. This can be a cost-effective way to enhance employees' financial benefit, while still prudently managing the employers' financials when compared to a straight increase to salaries and wages.
- (3) Consider adopting the NTSA Retirement Education Program, facilitated by a Certified Retirement Education Specialist.
- (4) Consider the addition of "other post-employment benefit" obligations (in particular special pay plans) through a retirement plan contribution. This allows the employer an opportunity to reduce tax liabilities and increase budget flexibility, all while increasing employees' retirement funding.

While not all of these plan design decisions will suit all employers' situations, they should be carefully reviewed and considered when determining an organization's long-term strategic goals.