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JOB MARKET

Tips to Help Nonprofit Employers Get Ready for New IRS Rules on Retirement Savings Plans

By Lynn O'Shaughnessy

Prodding workers into realizing the importance of saving for retirement used to be one of the most frustrating tasks for Marcia Brown, director of programs at the Nonprofit Coordinating Committee of New York, which represents close to 1,500 nonprofit groups in New York City.

"When I started 12 years ago, we did lots of retirement workshops, but we struggled to get the message across," says Ms. Brown. "People didn't accept it."

But the apathy has vanished, she says: "People are now convinced they have to save, which is a big change."

Workers may be more motivated, but are nonprofit employers able to steer them to the best choices? This question is even more relevant today because of looming changes in the 403(b) retirement plan, in which many nonprofit employees participate. A 403(b), just like the corporate 401(k) plan, allows workers to shelter their earnings from taxes until the cash is withdrawn for retirement.

The 403(b) is undergoing its most significant changes in decades. It is critical that employers understand what these changes are and modify their retirement plans to comply with new federal rules.

"What I think is important for any philanthropic organization is to know these regulations are coming, understand there will be requirements of fiduciary responsibility, and get ahead of it now," advises Dan Otter, the co-creator of [403bwise](#), a Web site that provides a wide range of 403(b) educational information.

The aim of the changes by the Internal Revenue Service is to bring more accountability and professionalism to the 403(b) world. The retirement funds have traditionally received less oversight from employers than have 401(k) programs.

The IRS proposed the new regulations in 2004 and expected to have them in place by January 2006. But the agency received a flood of comments, which delayed the creation of a final version. The IRS has announced that the regulations won't take effect earlier than January 1, 2008, to give employers, workers, and investment companies time to adjust.

Here's what nonprofit employers need to do to get ready for the coming changes:

Choose providers carefully.

Because of the more detailed paperwork that the new IRS rules will require, employers are expected to limit the providers of retirement plans.

"Pruning the number of vendors you have will make life easier," says Bruce Delbecq, an accountant who heads the nonprofit benefits group at the Auburn Hills, Mich., office of Plante & Moran, a consulting firm. "By having one vendor, the investment expenses may be less and you may be able to get the vendor to provide more education and investment advice. It's more difficult when money is dispersed among vendors."

Sixty-five percent of 403(b) plans that serve nonprofit workers already rely on just a single provider, according to the Spectrem Group, in Chicago, a strategic consultant to financial-service firms. In situations where nonprofit employers offer multiple options, Mr. Delbecq says, many use two or three providers that have attracted the bulk of the accounts, with the rest holding just a scattering of the cash. Eliminating these stragglers, he says, can make sense.

The Girl Scout Council of Greater St. Louis is one charity that decided to shed its many 403(b) providers and instead

settle on one family of funds offered by a company that it considers reliable. The move came after the group dropped its pension plan and decided to make contributions through a 403(b) instead. After hearing presentations from several providers, the council selected one that offers 18 investment choices, so at least one option should appeal to every type of investor, says Kathy Dabrowski, the council's director of program services. "Too much choice can be hard sometimes for people to know what to choose."

With diminished choices, however, it is critically important for a nonprofit employer to offer top-notch retirement-savings options, so charities need to scrutinize each provider's investment choices, expenses, and services, say pension experts and nonprofit employers.

Understand the costs.

When selecting any 403(b) provider, an employer should be able to get a cost breakdown for each expense. Annuities, which provide tax-deferred returns with an insurance component, typically carry the highest costs. A 403(b) annuity may include investment expenses, insurance and administrative fees, charges for special features, and penalty charges that may be triggered if money is withdrawn within a certain number of years. According to Morningstar, the investment research firm in Chicago, the average annual cost for a variable annuity is 2.39 percent. In comparison, the average annual cost for a typical mutual fund is 1.4 percent. Low-cost 403(b) mutual-fund providers include Fidelity Investments, T. Rowe Price, TIAA-CREF, and the Vanguard Group.

The San Diego Foundation is one nonprofit employer that has intentionally stayed away from annuities in its 403(b) plan, citing their overall cost and their prohibitive penalties for early withdrawal, says Duane Drake, the foundation's chief financial officer.

"We see people every year unwind these accounts, and it's really awful to have to pay taxes and the penalties," says Mr. Drake.

The organization chose an investment lineup with a local bank that offers no-load mutual funds, which don't charge a sales commission, from several mutual-fund families. The San Diego Foundation won't sign off on any investment choice that charges more than the median fund (meaning the one whose costs are greater than that of half of all available funds, and less than the other half), says Mr. Drake, who regularly monitors the costs and performance of the organization's 403(b) lineup.

Differences in costs might seem insignificant, but over time the larger expenses can sharply erode employees' account balances. Suppose, for instance, that a worker contributes \$6,000 a year to a 403(b) that generates a yearly 8 percent return, before expenses, in an average-priced annuity. After 25 years, the account would be worth \$329,147. In contrast, an employee who favored average-priced mutual funds would walk away with significantly more — \$382,046. An employee, who used even cheaper index funds, which track major benchmarks, such as the Standard & Poor's 500 Index, could pocket more than \$450,000.

Despite the price disadvantage, insurance companies that offer annuities dominate the 403(b) universe. The Spectrem Group estimates that only 19 percent of 403(b) money is invested in mutual funds.

Create plan documents.

One of the big changes that a nonprofit group will need to grapple with when the new rules take effect is an IRS requirement to produce a formal document that outlines the policies that govern its retirement offerings. The employer must identify its providers and the eligible investments in this document. It must also outline information on eligibility of employees to participate in the 403(b) plan, contribution limits, hardship withdrawals, loan requirements, and withdrawal procedures.

Drafting one document that multiple providers will accept, rather than writing an individual one for each company, could be the easiest route, Mr. Delbecq says. But all the participating providers would have to agree on the terms of one comprehensive document. It is not necessary to start from scratch when writing this document. The IRS, for instance, has announced that it will provide model language for the documents, and samples may also be available from a charity's lawyer or its potential 403(b) providers.

Creating this document can be an invaluable exercise, says Mark Kleene, gift-planning officer at the Vitae Caring Foundation, in Jefferson City, Mo. When Mr. Kleene arrived at the anti-abortion group in 2005, there was no formal

structure to the plan and employees had access to just one local 403(b) provider. By creating a written document that he could share with employees, Mr. Kleene recalls, "it was so much easier to communicate to the employees."

At the same time, Mr. Kleene worked on providing enough variety to please employees who were deciding where to invest their retirement money. Vitae Caring now offers two no-load mutual-fund providers and two firms that offer "socially responsible" investments, , along with funds through a national brokerage house and a local firm. With all the changes in place, the number of Vitae Caring employees who participate in the retirement plan has jumped from 16 percent to 35 percent. While Mr. Kleene's goal is to get all of the charity's employees to start a 403(b) account, he is pleased that every new worker is participating.

Revisit the organization's 403(b) regularly.

Once in place, employers need to monitor their 403(b) programs and their costs. Neglect "will almost always lead to excessive costs," observes Ronald E. Hagan, chief executive at Roland/Criss Fiduciary Services, in Arlington, Tex., which advises employers on their fiduciary responsibilities.

A nonprofit organization should consider creating an in-house advisory board to set up procedures to oversee the providers, suggests Rania V. Sedhom, senior manager and regional director at BDO Seidman, in New York, which offers employers consulting on tax and financial issues. Every three years or so, check to see if other providers offer better services at cheaper costs.

With fewer 403(b) providers, flexibility is key. When choosing an annuity provider, examine what kind of penalty charges are involved, since they could hurt employees if workers ultimately switch to a different provider. Many employers don't realize they can negotiate on the size of any penalty charges.

Notify workers about escape routes.

Nonprofit employees need to know that, when the new IRS regulations take effect, their freedom to invest their pretax contributions beyond their own 403(b) investment menu will disappear. Currently, workers who don't like their employer's choices can typically move some or all of the cash in their accounts to outside 403(b) providers, thanks to something called a 90-24 transfer. Most often, people who take advantage of this escape route are investors who want to flee from expensive annuities and deposit their money into cheaper mutual funds. Employees who contribute to 401(k)'s don't enjoy this flexibility, but neither will nonprofit workers when the regulations take effect.

Learn about the new rules.

In a survey conducted by Fidelity Investments and released last May, 85 percent of employers who offered 403(b) plans were worried to some degree about the forthcoming regulations, says John Begley, executive vice president of the Fidelity Investments Tax-Exempt Services Company, in Boston. However, he notes, "we believe these concerns are to be expected given the magnitude of these changes and how long it has been since 403(b) regulations have seen any material modifications."

To ease the anxiety, check out both the [IRS Web site](#) cited above and [403bCompare](#). Developed by the California State Teachers' Retirement System, the Web site provides information on the 403(b) providers used by school districts in the state, including a breakdown on fees, information which may also prove useful for nonprofit employers.

Encourage participation.

When overhauling a nonprofit employer's 403(b) offerings, don't forget to encourage workers sitting on the sidelines to enroll. Tell employees who already have 403(b) accounts that they can stuff even more money into them beginning this year, because as of January 1 the annual contribution ceiling was raised to \$15,500. Meanwhile, workers who are at least 50 years old can contribute another \$5,000.

Despite the challenges that nonprofit employers face with their 403(b) programs, Ms. Brown of the Nonprofit Coordinating Committee of New York is encouraged that so many workers are enrolling.

"People understand the importance of participating now," she says. "Even the 26-year-old in our office signed up immediately. Protecting their financial future is the most important part of all."