Streamlining Public Education 403(b) Plans: Eliminating and Consolidating Investment Providers using "Grandfathering" Options

Managing multiple investment providers (providers) in a public education non-ERISA 403(b) plan is cumbersome for employers and far too confusing for employees. The practice of public education 403(b) plans supporting multiple providers (recordkeepers, investment companies and distribution firms) remains in existence today for a host of reasons, few of which offer an adequate rationale for continuance of the legacy system.

Supporting a multiple provider 403(b) plan leads to increased costs, administrative complexity, and an excessively confusing experience for employees. Consolidating investment providers offers significant benefits, including:

- **Increased plan participation:** Simplicity and better communications will result in more employees contributing to, and embracing the benefits of, the plan.
- **Reduced costs:** Simplifying administration and leveraging economies of scale reduces plan and participant costs.
- **Improved efficiency:** Streamlining processes and data management lowers the workload of school district administrators.
- **Enhanced participant experience:** Offering a consolidated platform introduces the opportunity for consolidated and improved participant education.
- **Improved benefits package:** Creating a streamlined 403(b) plan, rather than a chaotic multi-provider plan, allows for an employer to highlight the 403(b) as a core benefit, rather than a supplemental option.

But how does a public K-12 employer navigate a provider reduction while minimizing disruption for participants? Two options of "Grandfathering" existing providers allow for an employer to make the decision to consolidate easier. Here's an exploration of the two primary methods and considerations of grandfathering providers:

Provider Transition Grandfathering Methods

1. No Contribution Grandfathering:

- **Pros:** Simplest approach, potentially significant cost savings.
- **Cons:** Can cause participant disruption, temporary decrease in plan participation, loss of investment options, and the administrative burden of redirecting contributions.

This option requires all existing participant contributions to be either be redirected to one of the new providers or all contributions to stop, and all existing plan participants to be re-enrolled. Both of these options result in significant initial disruption that is often short-lived as the new provider(s) work to better educate, inform and enroll employees in the new, approved offerings.

It is important to note that any plan participant with a balance must be allowed (if they wish) to leave existing account balances at their current (possibly eliminated) provider. These “inactive” accounts must continue to be administered for the plan to remain in compliance with IRS and DOL requirements.

2. Limited Existing Contribution Grandfathering:

- **Allows:** Current participants with legacy providers to continue contributing, but all new enrollments are only allowed to the chosen investment providers.
- **Pros:** Balances cost savings with participant needs, minimizes disruption.
- **Cons:** Ongoing administrative complexity, potential confusion, fairness concerns.

This option is less disruptive, but does introduce the risk of grandfathered investment providers partially or entirely neglecting the servicing of participants contributing to their offering. If providers see no future revenue or growth opportunity, they will invest less time and effort into supporting their customers.

As with the Full Elimination option, it is important to note that any plan participant with a balance must be allowed (if they wish) to leave existing account balances at their current (possibly eliminated) provider. These “inactive” accounts must continue to be administered for the plan to remain in compliance with IRS and DOL requirements.

Plan Document Changes

One of the long-term objectives of the plan should be to encourage all employees to consider contributing only to the new provider(s) and to transfer legacy provider account balances (as appropriate) to the new provider(s).

While increased communication and education will assist in this effort, there are also changes that can be made to the Plan Document to further incentivize legacy provider account balance transfers to the new providers). Perhaps the strongest incentive is to eliminate loans and hardship distributions from legacy providers:

- **Review:** Analyze the existing plan document regarding these features for providers being eliminated.
- **Amend:** Draft and adopt an amendment excluding these features for specific providers.
- **Communicate:** Clearly inform participants about changes and alternative options.

Considerations and Best Practices

- **Communication:** Transparent and consistent communication with participants throughout the process is crucial.
- **Timeline:** Develop a realistic timeline with the plan compliance administrator (aka “TPA”) and all existing and new providers. Include clear requirements, milestones and deadlines.
- **Vendor Selection:** Carefully evaluate potential investment providers based on cost, services, and participant needs. There are third-party firms who can assist with this process.
- **Participant Education:** Offer extensive education and support to help participants understand and adjust to the changes.
- **Professional Guidance:** Consider seeking guidance from qualified legal and financial professionals specializing in non-ERISA 403(b) plans.

Conclusion

Transitioning investment providers is not easy, and it will be met with resistance.

- Existing providers, feeling threatened, may insist that plan participation will decrease due to less financial advisor presence in school hallways and lunchrooms.
- Your plan compliance administrator, whose workload will increase during a provider consolidation, will have trouble seeing the benefits to their role.
- Financial advisors servicing your employees will grow concerned that they will lose clients and business opportunities.
- Employees who currently contribute to the plan may resist disruption, as they may be comfortable with the provider they have.

While the rationale for this resistance may be warranted, public school employers should consider the desired and likely outcome, which is likely to be better for the plan and its participants once the transition is complete.

Furthermore, by understanding the different grandfathering methods and associated considerations, public school employers can navigate provider reduction and consolidation scenarios. The ultimate outcome may be a better plan transition, using these grandfathering options to minimize the disruption.

This article provides general information and does not constitute legal or financial advice. Seek professional guidance for your specific situation.