457 PLAN TRENDS
Five pieces you may be missing in the 457(b) plan puzzle

457 plans, which are defined contribution (DC) plans, are much more than just a brother to the 401(k). These plans have very much their own designs, rules and implementation concerns. Recently, Charlie Ruffel, Founder and Director of PLANSPONSOR, discussed research findings about 457 plans and trends in 457 plan design and administration during a webcast with Eric H. Wietsma, FSA, MAAA, Senior Vice President, and Carl Steinhilber, CFS, National Government Practice Leader, both of MassMutual Retirement Services.

PS: Take us through what’s happening in the 457 space with regard to the multiple vendor scenario.

Wietsma: It’s very common, particularly on the smaller end of government, to have multiple vendors. Compared to the industry as a whole, government plans’ investments tend to be very conservative overall. Counting each vendor as a separate plan historically has been a way to provide choice to participants, which is a common theme in the government market, where sponsors have been very paternalistic and concerned about the diversity of participants that they have in their plans.

We are seeing a trend towards consolidation of vendors as products have improved and vendors have improved their offerings. Sponsors can provide participants with plenty of choice through a single plan offering and through a single vendor, so we expect to see this number of consolidations to continue over time.

In the government market, some trends work their way from the largest plans down the market. In the mega end of the government market, there is a reduction in the number of investment options. You’re also seeing a prevalence for single provider models. The small plan markets still present a great opportunity for advisers and consultants to help sponsors realize efficiencies using plan design.

I think sponsors at one point viewed their role as more hands-off. As long as they were offering choice in vendors, they were doing their job. Today, you see the multi-vendor scenario exist more in that small/mid part of the market, and that’s where we see that consolidation trend. The government market has always had good judgment and discipline around offering a manageable number of providers, so when we talk about multi-vendor in government, we literally mean two or three. It’s very rare to see more than that.

PS: Notwithstanding the general move towards consolidation, the number of investments in these plans is higher than the industry at large.

Wietsma: On average, the government plans have more investment options available for participants than the rest of the industry. A bit of that goes back to the theme of providing choice for a diverse population of participants, where sponsors have adopted new investment asset classes early on.

The other theme here is perhaps sponsors’ unwillingness to replace options. So, as options have grown out of favor, the knee-jerk reaction has been to add new options, which leads to the average number of investments increasing over time.

On the mega end there’s really no appreciable difference
“While the 457 plan is not subject to ERISA, there are a lot of best practices from a process perspective that we see in the government market.”

—Eric Wietsma, FSA, MAAA, Senior Vice President, MassMutual

in the DC industry overall; in the small and mid-market area there is an opportunity for more consultation with sponsors.

Steinhilber: Along the same theme, many governmental plans are either continuing to build customized target-date series or already have one in place. By “customized” we mean that they create custom target-date funds (TDFs) made up of the existing investments in the line-up. Your adviser or consultant has already selected your fund menu, so why not use those funds to create your target-date series?

They get the asset-allocation model from a third party or from the adviser. But you can also take those custom strategies and line them up with lifestyle or investment styles like conservative, moderate or aggressive. So, you can end up with, for example, Series 2050 funds, but within the series a conservative, moderate or aggressive model. With these models, you’re really hitting every type of employee. We call it a custom choice program.

Wietsma: This government market, where DB has been so prevalent, has a strong focus on “set it and forget it,” so the target-date option has been very attractive.

Steinhilber: Mutual funds are obviously the prevalent investment in 457 plans. As plans get larger, they start to use things such as stable value funds and separate account stable value funds. Additionally, there is a higher use of commingled funds than in the industry as a whole, mainly driven by the stable value investment category. The government market has been a leader in finding different ways to help folks diversify their investments.

Wietsma: For the industry, the vast majority (85%) of plans across the market review their investments at least on an annual basis. On the governmental side, close to half do so on a quarterly basis. On the flip side of that, in the micro end of government, 20% responded that they never look at their investment options.

PS: Is there a danger of these reviews becoming rote?

Wietsma: Certainly that’s a “watch out” for all sponsors and those that help, whether it’s providers, consultants or advisers. One of the things we all need to check ourselves on is that these are retirement plans, and frequent investment changes probably are not in the best interests of the plans.

While the 457 plan is not subject to the Employee Retirement Income Security Act (ERISA), there are a lot of best practices from a process perspective that we see in the government market. For example, the existence of documented investment policy statements (IPS), the formal review of investments on a regular basis, continually looking at plan design. On the 457 plan, it’s fairly simple because it’s employee voluntary money, so there isn’t a whole lot of plan design there. But in some of the other DC options that are made available in the government space there certainly is.

PS: To what extent was innovation in this space almost accidental, or do you think it really demonstrates a lot of intelligent thinking about what these plans should look like?

Wietsma: I think it’s a little bit of both. There is a general feeling that more choice is better, so sponsors in the government market have been willing to offer more investment options in their plans. But sponsors have generally taken a paternalistic approach and tried to make the plan attractive for the diverse participant base of the clients they serve.

On the governmental side, participation rates are lower than the rest of the industry. That’s not a surprise, given the existence of defined benefit (DB) plans and the lack of employer matching dollars in these 457 plans, but clearly it’s on the way up. And I think that’s a great sign for the industry.

Account balance only tells part of the story here; take this benefit in conjunction with defined benefits that exist in the vast majority of these entities. It’s not surprising that account balances are slightly lower in the government market; it’s really the lack of an employer match. And despite the fact that there isn’t an employer match, average balances are still fairly substantial here.

PS: Talking about different retirement savings, a lot of these 457 plans have a pension plan alongside them. Could you take us through how that plays out?

Steinhilber: On the governmental side, overall about 90% of the employers will provide either a defined benefit or a cash balance or DB/DC hybrid pension plan. Of the 90% of plans that offer a defined benefit or hybrid plan, over 91% of them are still active and open to eligible employees.

Most of the DB plans are self-administered, but in the mid and small end many of the DB plans are outsourced to firms.
that can handle the 457 plan as well as the 401(a) or the DB plan. As these DB plans and governmental employers continue to face funding challenges, we're seeing a trend moving forward with defined contribution plans or DB/DC hybrid plans.

PS: To what extent are advisers involved in all of these different plan offerings, or have they just been 457-focused?

Steinhilber: There are consulting firms that focus just on the government space, and those firms will do both the defined benefit and the employee contribution plan, as well as other employee benefits. There are many consultants at the large end that will do more than one type of plan, but in the smaller markets there is definitely segmentation between defined contribution and defined benefit.

PS: Like every other segment of the marketplace, 457s saw a real uptick in what we call “unforeseeable emergency” withdrawals during these last years.

Wietsma: During the financial crisis and what followed, there was a large uptick, but the good news is that we've seen that number come back down. There's usually a retirement education specialist or a participant adviser on the ground, and when there is someone assisting participants in making decisions about whether or not to take an unforeseeable emergency loan, those numbers tend to be lower.

We've been working with our education specialists to make sure that the local person not only knows about the core 457 plan, but can also discuss the defined benefit or defined contribution plan and the interplay between the two. It does take some work and training.

In the government side, the inclusion of a loan provision is much lower than in the rest of the market, and as we meet with government sponsors, we're seeing a trend towards people rethinking these provisions. Typically, it's added a lot of complexity to the day-to-day administration of the plan and concern, quite frankly, from participants around the leakage of their retirement savings through this feature.

PS: How did Roth plans impact this marketplace?

Wietsma: Fifty percent of government plans offer a Roth option, and it's much higher as the plan size gets bigger. So, as you move into the mega end of the market, you start to see upwards of 70% that have this option.

PS: What is and isn't happening in the catch-up contributions space?

Steinhilber: I assumed that we would see 100% across all lines because this is an option that the Internal Revenue Code (IRC) made available and that every plan should make available to their participants—the ability to save more for retirement once they reach age 50, but this is not the case, especially in the small and mid-market.

The data there I think equates to plans not having advisers to help make sure the plan is up to date, giving all the latest and greatest benefits to employees. The proof point of that is when you look at the large and mega end, where there are these active consultants, 100% of the mega plans that responded to the survey had this feature available.

PS: Can the economics of these small 457 plans be attractive to advisers?

Steinhilber: Absolutely. I would consider it similar to the small and mid-sized markets of the corporate market or the not-for-profit market. For years it was considered to be a closed market with only certain folks with expertise to work in it. There also were some barriers to entry having to do with being able to pay for an adviser. But we've seen a trend in requests for proposals (RFPs) in plans that are looking to start to consolidate. They're also involving an adviser, and the RFP includes the request to compensate the adviser for their services.

For the most part, these plans are self-funding. They run themselves and pay for themselves. That can be handled from an adviser standpoint. The model we've seen is through an expense reimbursement arrangement or account, where a portion of the revenue generated by the investments in the plan is used to offset the cost of the adviser.

Mechanically, you can handle it different ways. Providers will set up a reimbursement account, the excess revenue will go to that account, and then the plan sponsor has access to that money to pay for the expense.
PS: To what extent does the capability for advisers in the corporate space translate into the 457 space?

Steinhilber: From an investment review standpoint, it runs pretty much the same. The only thing you need to keep in mind, other than to help the sponsor select good investments, is the more conservative nature of the government market, so you need to think about that when you’re thinking about stable value.

Also, when you run an RFP, you have to run through a procurement process that is usually very structured, and the larger the plan, the more structured it is. There are certain rules and regulations or local ordinances that have to be followed when an RFP is done.

The good news is, from a consultant standpoint, there is usually someone from the procurement area that will help the consultant through that part of it. As part of the RFP review process, the procurement department will also help with the initial review of your RFPs, making sure everything’s been answered.

The RFPs, because of those governmental requirements or local requirements, can be a little bit more complex. But again, providers that have been in that space for a while understand that and they’ll work with the advisers on that. Other than that, it does run a lot like a corporate plan, where a committee will be involved to review.

The committee will be made up of some of the key decisionmakers, the chief financial officer (CFO) or the business officer of the local governmental entity, representatives of human resources (HR), and employee base representatives, for example. Sometimes there will be unions involved. Where I’ve seen it be most successful is where the unions and management are on the committee together, working together through the RFP process.

One piece of advice I’d give to advisers thinking about this: Speak with a provider who is in the 457 space today to get a taste of the space.

PS: Are you seeing advisers migrate into this world, or does it still tend to remain a world of specialists?

Steinhilber: In the larger space, it still seems to be the government specialists or the consultants. I’ve seen some advisers move into that, but in the smaller space we have seen advisers look to broaden their practice and expand into that area.

PS: To what extent does this landscape look like the corporate world?

Steinhilber: The plan design tends to be a little simpler. There aren’t many third-party administrators (TPAs) that are involved. It tends to be more of a bundled administrative setting, and oftentimes it’s a fairly narrow group of providers that operate in the space.

PS: When formally evaluating your DC provider, you’re looking at a slightly higher bar than you would be on the corporate side.

Steinhilber: There are certain states where regular procurement is actually the law, so you see all entities in those jurisdictions following a very regular review process. These best practices are very strong in the government market.

Again, at the micro end of the government market, we see that multi-vendor, hands-off approach by sponsors where a third of them say they don’t review their providers very often or ever. That certainly presents an opportunity for counsel.

PS: From the plan sponsor standpoint, how have they gone about trying to find the right advisers for their plans?

Wietsma: It’s a different story as you look at plan size. At the upper end of the market, they’ve done a great job, and consultants that have specialized at that end have made the plans modern, taking advantage of the best practices that exist. As you move down-market, there has been more reluctance on the sponsor side to take a hands-on approach.

You see pockets of the market where choice rules: “As long as I’m providing choice, I’m doing a good job.” I think there’s an opportunity in the industry to continue to push through that and help these sponsors get to a better place.