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THE FINANCE ISSUE

THE CHANGING FINANCIAL LANDSCAPE

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Watching Your *B*'s and *Q*'s

The federal government is applying **increased scrutiny to 403(b) retirement plans** and schools have new oversight responsibilities.

by Donna Davis

The Internal Revenue Service and the Department of Labor have a new focus – 403(b) retirement plans. These plans attracted little attention during the past 50 years, but now independent school business officers, human resources directors, heads of school, and trustees need to prepare for increased scrutiny into their programs' compliance procedures and fiduciary oversight.

"403(b)s have definitely moved into the fast lane," says Gary Mauger, Managing Partner of New Pinnacle Consulting Group, an NBOA Affinity Partner. "Schools are no longer able to plead ignorance."

403(b) retirement plans have existed since the 1960s, governed for decades by "temporary" rules. In 2009, however, the IRS and DOL – both of which share oversight of retirement plans –implemented permanent rules similar to those governing 401(k) plans.

Along with the rules, regulators from both the IRS and DOL are checking up on 403(b) plans with audits. The IRS audit looks at filings and tax issues such as tax deferrals, while the DOL is more interested in how the provider is protecting participants' investments. It's not unusual to receive scrutiny from both parties.

"If the IRS finds something wrong, then often the DOL will want to get in on the party," Mauger cautions.

THE TWO-PART PICTURE

The rules fall into two broad categories: operational compliance and plan investment due diligence, monitoring, and compliance. Both areas require that school administrators and trustees invest time, money, and expertise to satisfy the government's demands.

The consequences of inaction include audits, fines, or sanctions – and even legal action against a school and trustees from plan participants who believe their retirement funds were mishandled. For example, fines for failing to file IRS Form 5500 can total $100 a day for every day the form is late, up to a maximum of $15,000 a year.

The operational compliance piece requires schools that provide 403(b) plans to have an up-to-date, accurate plan document that reflects how the school administers the plan. For some schools, the requirement is a surprise, since before 2009, the government did not mandate plan documents for 403(b)s.

Annual disclosures are also part of the regulatory package. As of 2009, sponsors of 403(b) plans, with few exceptions (such as faith-affiliated institutions), must file an annual IRS Form 5500, which is essentially their plan's tax return. Large plans must attach an auditor's opinion with the form. Sponsors also may have to submit other IRS forms, such as the Form 8955-SSA, which reports information about separated participants with deferred vested benefits. In addition, 403(b)s must meet stringent anti-discrimination requirements ensuring that highly compensated employees do not receive better benefits than their lower-salaried colleagues.

During a recent NBOA webinar on 403(b) due diligence, Dick Shafer, Executive Director of Well and Good LLC, a registered investment advisor, said most of the independent schools he contacted had met the mandate to have an updated, written plan document by the December 31, 2009 IRS deadlines and had begun completing their Form 5500s.

Schools not subject to the Employee Retirement Security Act of 1974 (ERISA) may not have to complete the Form 5500, but they still must provide fiduciary oversight. Many school administrators and trustees bristle at accepting that responsibility. The new reality, however, puts those duties in the hands of the people who are already the school's prime fiduciaries – members of boards of trustees – along with the business officer and any other school administrators involved in the retirement plan decision-making.

That second category is causing many business officers to lose sleep. As part of its written plan document, every school must designate a fiduciary. A fiduciary is responsible for selecting a plan investment funding vehicle, monitoring performance on a regular basis, and deciding whether to keep, add, or change investments based on the best interest of plan participants. The requirement isn't new – fiduciary standards arise from English common law. Plan investment fiduciary best practices solidified after ERISA.

WHERE TO BEGIN

A good way to start addressing your school's 403(b) requirements is to form a plan oversight committee that engages the business office, head of school, human resources, and the board. Take heart in the fact that your school probably already has a robust fiduciary process in place through your board finance and investment committees. Your school's retirement plan can become a component of that process. – an important one since plan assets may compare in significance to your endowment or physical plant.

The oversight committee's early tasks may involve examining the existing plan document and making it conform with how the school administers the plan. The panel can also adopt an investment policy statement that establishes plan objectives, such as desired levels of risk and return, range of investment opportunities, and fee and other cost parameters. Take advantage of investment-savvy board members, school counsel, or a fiduciary service provider to help with this work.

The due diligence portion of the work usually continues with a review of all investment funding vehicles your plan offers and their current performance. The goal is to match the funding vehicle with your plan and its participants' needs. If you identify plan services or investments with subpar results, take action and either eliminate them or place them on watch status until they earn your confidence. Due diligence also includes examining fees and expenses and determining whether they are reasonable in light of the services provided. "Benchmarking" compares your plan to similar plans' fees. Fiduciaries also must make certain disclosures to participants, such as informing them about fees, fund changes, and enrollment deadlines.

403(b) Plan Compliance Resources

It's not easy complying with new 403(b) plan requirements. But you don't have to go it alone. Here are a few resources:

- The IRS and DOL explain the requirements for both operational compliance and investment due diligence in these two sections of their websites:
Tax Information for Retirement Plans: http://www.irs.gov/Retirement-Plans
Current Challenges and Best Practices for ERISA Compliance for 403(b) Plan Sponsors: http://www.dol.gov/ebsa/publications/2011ACreport1.html

- NBOA members can view the webinar, "Solving the Retirement Plan Fiduciary Responsibility Puzzle: Case Studies" at http://www.nboa.net/MemberPages/webinar_archive.aspx

- Schools that want more information can contact TIAA-CREF's administrative telephone center at 888-842-7782 or contact their school's relationship manager. They can also check the website at www.tiaa-cref.org for resources and events, such as regional workshops and seminars on 403(b) issues.

TAKING THE PLUNGE

For compliance, due diligence, or both, schools can choose to go it alone or hire a consultant. Business officers accustomed to assuming a multitude of tasks might be tempted to take on 403(b) duties themselves. Regulators, however, assume that whoever is overseeing your school's plan investment is an expert in 403(b) arrangements, Shafer notes. Most business officers, human resources directors, heads, and trustees are not.

Schools can call on investment-savvy board members to accomplish the compliance piece. Frank V. Aloise Jr., Chief Financial Officer for 1,102-student Springside Chestnut Hill Academy in Philadelphia, PA, followed that path. He took advantage of board members, one an attorney familiar with retirement plans and another trustee who had served on the 401(k) committee for a large corporation, to review the current state of the school's 403(b) plan and the changes needed. The committee conducted the initial review and wrote a plan document based on that review, then hired a consultant to help complete its work.

Other schools also opt for outside help. Maryann McGowan, Business Manager for the 176-student National Child Research Center in Washington, DC, first hired an attorney to bring the plan document in compliance by the December 31, 2008 deadline. "I was elated when this project was completed, but quickly became disappointed when our attorney told us there was more to come" and she could not help with that additional work, McGowan told the webinar audience.

Working through NBOA, the school hired a consultant to provide the additional compliance guidance it needed. The services include initial plan review and revision, non-discrimination testing, form preparation, and continuing updates on IRS and DOL rule changes as well as additional review of the plan as needed.

Many business officers, heads, and trustees who reach the next step – investment due diligence – find themselves quickly overwhelmed.

the position that "if I don't do anything, I might be better protected." The better approach is to "get in and take action, because you can be held accountable whether you take action or not," Lewis says.

Again, schools can find outside help with investment oversight and participant education – but it needs to be the right kind. "People in the 401(k) world assumed they could do 403(b)s," says Palmer Ball, Business Manager for Spartanburg Day School in Spartanburg, South Carolina. "It quickly became obvious they had no clue. You absolutely need to search out the people who have experience with nonprofits and TIAA and the TIAA investment lineup."

Costs for third-party consultants don't have to strap your school's operating budget. After learning that some schools were paying $40,000 each for outside services, Ball started looking for a less costly option. She convinced a consortium of 15 private colleges in South Carolina to allow 10 independent schools in North and South Carolina (representing the Palmetto Association of Independent Schools) to join and share the cost of due diligence services. The consortium hired a vendor for $75,000, and by dividing the cost, each school – depending on size – pays between $2,000-$4,000 annually. The schools work from a uniform policy statement and receive investment performance analysis, fee comparisons, and ongoing education for employees.

Schools can also look to NBOA (which offered the recent webinar on 403(b) plans) or their regional business officers association for advice on compliance, due diligence, and consultants. The Philadelphia Area Independent Schools Business Officers Association (PAISBOA), for example, offers education programs on 403(b)s to its members.

They can also seek help from TIAA-CREF, which serves most independent schools. TIAA-CREF Managing Director Ben Lewis, who works with NBOA member schools, has seen schools adopt the position that "if I don't do anything, I might be better protected." The better approach is to "get in and take action, because you can be held accountable whether you take action or not," Lewis says.

TIAA-CREF has developed three models for tackling fiduciary responsibility. In all of them, schools share in that duty:

1. The school decides on a do-it-yourself approach and takes advantage of TIAA-CREF's 403(b) Tool Kit, supported by guidance on how to select and monitor investments, investment analytics, and sample documents such as an investment policy statement. This model is part of TIAA-CREF's service.
2. This option allows client schools to engage a "low-touch model" with an independent third party through TIAA-CREF to analyze both proprietary and non-proprietary investment products. The third party, Ibbotson Associates, part of Morningstar's investment management division, selects and monitors investments based on the school's needs, generates reports, and provides ongoing education on sound fiduciary practice.
3. The school hires a local advisor for investment advice and monitoring. TIAA-CREF can provide schools with names of fund advisors in their areas. They typically meet quarterly with client school officials. Lewis says this option is the most costly.

"Some have aggressively jumped in and taken the path of one of these three models," he notes. Others remain hesitant as they try to understand their choices.

"No matter what solution they go with, the critical piece is the prudent process," Lewis explains. "You want to show that you have put a good process in place and thoughtfully decided these are the funds we want to offer and these are the reasons why based on cost and performance, and that we have a monitoring process and have documented it."

If your school does face an audit, having a "fiduciary folder" – whether it's online or in your desk drawer – shows officials that your school has put a prudent process in place, Lewis says.

403(B) IN THE FUTURE

Mina Fader, Chief Financial Officer for 861-student Germantown Friends School in Philadelphia and chair of PAISBOA's Retirement and Pension Committee, says her goal is to help business officers understand not just the regulatory and due diligence aspects surrounding 403(b)s, but also their fiduciary responsibilities.

Response has been slow, especially among smaller schools, she says. "It is a change in culture, and some business officers may think, 'Why is this our responsibility?' It's one additional job and they don't have the resources."

A survey from the recent webinar reflects the relative lack of action. When asked if their schools had established a plan oversight committee, 37 percent of the respondents said yes, but 58 percent said no, and 5 percent were uncertain.

The job, however, is one that independent schools cannot ignore any longer. In March 2013, the IRS sent out a 401(k) Compliance Check Questionnaire to 1,200 randomly selected plan sponsors. Ninety-eight percent of the sponsors responded; the 2 percent that did not answer the questionnaire were audited. Aloise sees this move as a warning sign. "I'm concerned that the IRS and DOL will be watching and will punish people – they are poised to come after us."

Mauger recommends that business officers take an "inquisitive approach" to 403(b) compliance and due diligence. Ask questions about your school's plan document, administration, and investments, and bring trustees and the head into the discussion. "The old approach of ignoring it and hoping it will go away is the worst thing you can do," he says. "It's not a fun task to deal with, but once it's under control and in shape, keeping your 403(b) in shape is a lot less tough." ■

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