

Choosing a Retirement Saving Plan when 401(k), 403(b) and 457 Plans Are Offered

Executive Summary

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Compared to the adoption and management of 401(k) plans in the private sector, the retirement saving landscape is much different and more complex in the public sector. Public employers have the option of offering alternative types of saving plans regulated under special tax codes. State governments can offer their employees the ability to enroll in either a 401(k) or a 457 plan. Local government employees may have the option of participating in a state-managed 457 plan, the state-managed 401(k) plan, and these agencies may also offer their own locally managed 457 plan. In addition to these plans, school districts may offer employees locally managed or, in some cases, state-managed 403(b) plans. Thus, the saving decision for many public employees consists of first deciding whether to contribute to a retirement saving plan offered by their employer. Having made this saving decision, employees then must select the most appropriate saving plan from the two, three or even four plans that are offered. In some cases (especially in 403(b) plans), even after selecting the plan of choice, employees will then find themselves having to choose from a number of vendors in one or more of these plans (Clark and Richardson, 2010; Clark and Hanson, 2013; Clark et al, 2016).

To examine retirement saving plans in this multi-plan, public sector environment, we first review the plan offerings by school districts in North Carolina. All 115 districts in the state offer their employees the option of enrolling in the state-managed 401(k) plan and a district-managed 403(b) plan. In addition, many of the districts allow school personnel to contribute to the state-managed 457 plan and/or a locally managed 457 plan. Second, payroll data from school districts are examined to observe decisions by school personnel to contribute to one or more of the saving plans offered through their employer. Key findings are (1) about one third of the 71,156 employees included in the study were contributing to at least one

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plan and (2) 10 percent of all contributors were contributing to two or more plans. Third, we examine individuals contributing to multiple plans to see if those contributing to either 401(k) or 403(b) plus contributing to a 457 plan are primarily highly compensated employees. We begin by comparing and contrasting the rules and regulations governing these plans and how they are managed.

1. Characteristics of retirement saving plans

In general, 401(k), 403(b) and 457 plans are very similar; however, some important tax and regulatory differences exist. A first distinction is which government agencies and public employers have the option of offering each of these retirement saving plans. State and local government employers have the option of offering 457 plans to their employees as well as being able to continue to offer legacy 401(k). In 1986, federal legislation removed the option for public employers to establish new 401(k) plans; however, existing plans were allowed to continue operating. Local governments covered by state pension plans can still decide to offer the legacy state 401(k) plan. Public schools, hospitals and charitable organizations are also allowed to offer 403(b) plans to their employees. In some states, public school employees are considered state workers and are thus able to contribute to any available plans offered by their school district or the state government.

All of these plans allow employees to make pretax contributions. Government employers can also offer Roth options in the various plans that allow employees to contribute after-tax dollars to the plan. The annual dollar limit on employee contributions is the same in all of the plans (\$18,000 in 2016) and this maximum is increased periodically. All of the plans have the same age-50-and-over catch-up provisions that allow older workers to contribute an additional \$6,000 per year. Contributions to 401(k) and 403(b) plans count toward the same maximum contribution limit; however, contributions to 457 plans are viewed independently from the other two plans. Thus, highly compensated school management personnel seeking to maximize their own contributions to tax-preferred saving plans have an incentive to allow 457 plans alongside of 403(b) and 401(k) plans so that they can make contributions above the limit of the individual saving plans.

Distributions without tax penalties are allowed at retirement after age 55 in both 401(k) and 403(b) plans while the 457 plans allow such distributions at termination of employment at any age. This may be an important distinction as many public employees retire from their career state or local jobs in their early 50s. In-service distributions are allowed prior to age 59 and a half in both the 401(k) and 403(b) plans with a 10 percent tax penalty. In-service distributions are not allowed in 457 plans. Thus, workers who wish to maintain the ability to access their funds prior to retirement may be more likely to contribute to 401(k) or 403(b) plans.

All of the plans have a required minimum distribution at age 70 and a half. All distributions in each of the traditional or non-Roth plans are treated as ordinary income for federal income tax purposes. In comparison, distributions from Roth plans are not considered taxable income. All of the plans allow rollovers to other retirement saving plans or IRAs. These differences in distribution rules may also provide incentives for public employees to prefer one type of plan over the others and give managers a reason for providing employees the option of selecting from several retirement saving plans.

Prior to the passage of the Economic Growth and Tax Relief Reconciliation Act in 2001, 401(k), 403(b) and 457 plans were subject to different regulations related to elective deferrals, employer contributions and other areas. After the passage of new legislation, 403(b) plans were subject to greater oversight. Now, despite similar treatment by the IRS, remaining differences in plan characteristics may appeal to public employers and employees with different saving objectives. Therefore, district administrators may try to accommodate these preferences by offering alternative retirement saving plans.

This overview of retirement saving plans has shown that in contrast to the rather simple choice facing firms in the private sector, public employers, especially local governments and school districts, face a range of retirement saving options. City and county governments may have the ability to be part of state-managed 401(k) and 457 plans. Alternatively, they may decide to offer their own 457 plan. School districts may also be able to piggy-back on state plans and/or offer their own 403(b) plans. Joining state plans seems like an easy option with low administrative costs, yet many public employers have chosen to offer their

own plans while also allowing their employees to enroll in the state plans. Historically, 403(b) plans were the primary option selected by school districts. In part, this is because these plans were available to schools prior to the advent of 401(k) plans and, perhaps, because they were not subject to ERISA regulations and thus involved less administrative work on local personnel.

An important difference in the management of these plans is choice of vendors. In most cases, state-managed plans select a single vendor through some type of competitive bidding process. In contrast, locally managed 403(b) plans tend to allow any vendor that is able to meet certain criteria to be part of the plan. The result is that participants in 403(b) plans have a considerable choice of vendors; however, this choice may come at the expense of having less oversight by the employer and higher fees.

2. Savings options offered by North Carolina school districts

To determine the plan offerings by each of the school districts in North Carolina, a survey was sent to each school district’s Chief Finance Officer, Director of Business

Operations, or Director of Human Resources.¹ The survey data were merged with individual-level payroll records from March 2013 collected from about half of the school districts in North Carolina.

Table 1 shows the incidence of various retirement plans in the 90 districts that responded to our survey and for the 53 districts with payroll records that were successfully merged with survey responses. The analysis below is based on payroll records for 71,156 full-time employees in the 53 school districts and information from our district survey. Table 1 illustrates a wide variety of plan offerings, plan oversight and management decisions.² As shown in the first portion of Table 1, all school districts in the two samples offer a locally managed 403(b) plan and the NC 401(k) plan, North Carolina’s state-managed 401(k) retirement saving plan. Thus, all districts in the sample offer at least two plans and 75 out of 90 (over 80 percent) districts allow their employees to select from all three types of retirement saving plans. Among the districts that provided payroll data, the patterns in plan offerings are similar.

Table 1. Plan offerings across North Carolina school districts

	(1)	(2)
School Districts	Survey	Payroll Data
Number of Plans:		
2	<i>15 districts</i>	<i>5 districts</i>
3	<i>75 districts</i>	<i>48 districts</i>
Offers 401(k) managed by state	<i>90 districts</i>	<i>53 districts</i>
Offers 403(b) managed by district	<i>90 districts</i>	<i>53 districts</i>
Offers 457 managed either by state or district	<i>75 districts</i>	<i>48 districts</i>

Numbers in italics are the count of districts that fall into each category.

Source: Information on number of plans in each district were gathered from a survey of school district administrators.

1. See, Clark et al (2016) for a description of the survey and the 403(b) landscape in North Carolina.
2. In the following analysis, we have merged locally managed 457 plans and the state-managed 457 into a single category 457 plan. While there may be some differences in the specific options between these two plan types, they are both subject to the regulations governing 457 plans. While both plan types are governed by the same IRS rules and regulations, the state plan is managed by the Retirement System Division of the State Treasurer’s office and has a single vendor. In comparison, the locally managed plans are established by the local school board and often have multiple vendors.

3. School personnel and their saving decisions

The payroll data include individual records with information on age, gender, marital status, race, occupation, years of tenure and monthly earnings. In addition, these data indicated the amount employees contributed to each retirement saving plan offered by the district in March 2013. In total, we examine the records of 71,156 employees of school districts across North Carolina. Using these records, we are able to determine whether workers were participating in the various plans. Because we have data for only a single month, we are unable to calculate annual contributions to

the various plans. The means for the entire sample are presented in Table 2, Column 1. As expected, this public school labor force is more than three quarters female. The average age of employees is 40 years with over 11 years of tenure. Educational professionals including teachers, TAs, mentors, coaches, speech therapists, audiologists, tutors and instructors represent 78.6 percent of the sample. The racial composition of the personnel is 72.9 percent white and 20.6 percent black. Almost 60 percent of the employees are married; however, single women represent one third of the total sample of employees.

Table 2. Means of sample population by participation status: in percent

Characteristics	Total (1)	Participating in at least one plan (2)
Age	40.06	46.62
Male	21.61%	19.26%
Female	78.39%	80.74%
Single	41.99%	40.92%
Married	58.01%	59.08%
Single Male	9.27%	7.90%
Married Male	12.34%	11.36%
Single Female	32.72%	33.02%
Married Female	45.67%	47.72%
White	72.90%	73.74%
Black	20.61%	19.63%
Hispanic	1.41%	1.03%
Other	5.08%	5.61%
Managers	3.09%	4.95%
Education Professionals	78.60%	82.36%
Support	18.30%	12.69%
Tenure (years)	11.28	13.66
N	71,156	22,791

Source: Payroll data from 53 school districts in North Carolina.

Column 2, Table 2 reports the means of individuals who are contributing to one or more plans in the payroll data. The average age of individuals contributing to a saving plan is about 6.5 years greater than the sample at large. It is interesting to note that women, both married and single, are slightly more likely to be participating in a plan, as are managers and educational professionals while a much smaller proportion of the support staff are contributing to a saving plan. Participants have about 2.4 more years of tenure than the general labor force.

Individuals are not restricted to contribute to only one plan. In fact, they have the option of contributing to any or all of the plans offered by their district. Table 3 indicates the

proportion of employees who contribute to the various plans. First, we note that 32.0 percent of all employees or 22,791 individuals are contributing to at least one retirement saving plan. Of these, 20,388 or 18.8 percent of all employees contribute to exactly one plan. The district-managed 403(b) plan is the most popular plan with 14.7 percent contributing only to this plan while 10.0 percent contribute solely to the state-managed 401(k) plan. Only 4.0 percent of all workers contribute only to a 457 plan. In total, 89.5 percent of all individuals who are contributing to any plan are participating in a single plan.

Table 3. Distribution of employees by retirement saving plans and participation rates

Characteristics	Number of Individuals	Participation Rate Percent of Sample
Total Sample	71,156	100.0%
No Plan	48,365	68.0%
Any Plan	22,791	32.0%
Type of Coverage		
Only 401(k)	7,095	10.0%
Only 403(b)	10,464	14.7%
Only 457	2,829	4.0%
401(k) and 403(b)	964	1.4%
401(k) and 457	971	1.4%
403(b) and 457	292	0.4%
401(k), 403(b) and 457	176	0.2%

Source: Payroll data from 53 school districts in North Carolina.

Earlier, we discussed how combining either a 401(k) or a 403(b) plan with a 457 could have some financial advantages due to differences in tax regulations. In this sample of North Carolina school personnel, 971 individuals contributed to both 401(k) and the 457 plans, another 292 employees participated in both 403(b) and 457 plans while another 176 workers contributed to all three plans. Thus, 6.3 percent of individuals who contributed to a retirement saving plan chose a strategy that would allow them to exceed the contribution limit of \$18,000 per year. Perhaps the oddest combination is the 964 employees who contributed to the 401(k) and the 403(b) plans. These plans were subject, in general, to the same government rules on the maximum annual contribution.

4. Do highly compensated employees participate in multiple plans?

One policy concern is whether highly compensated individuals exploit the tax rules that provide separate contribution caps for 457 plans as compared to 403(b)

and 401(k) plans. To address this possibility, we examine the sample of only individuals who contributed to a retirement saving plan. Column 1, Table 4 presents the means for district personnel that contribute to a 457 plan and at least one other plan. These are individuals who potentially could make the maximum annual contribution to both the 457 plan and the maximum to either the 401(k) or the 403(b) plan offered by their district. Column 2 reports the means for those who contribute to only one plan or to a 401(k) plan plus a 403(b); these are individuals who could only contribute up to a total of the contribution limit in either plan. Comparing the means of these two groups provides no support that managers and highly compensated workers are more likely to take advantage of the separate IRS rules allowing for the separate contribution caps in 457 plans. In fact, those that contribute to a 457 plan plus another retirement saving plan actually have lower annual earnings. Clark, Pathak, and Pelletier (2017 forthcoming) provide additional statistical evidence that indicates that highly compensated individuals are not more likely to be contributing to multiple plans in an effort to exceed the annual contribution limits.

Table 4. Means for participants in 401(k) and/or 403(b) and 457 plans compared to participants in only one plan (403(b), 401(k) or 457 Plan) or those contributing to 401(k) and 403(b) plans

	Participants in 401(k) and/or 403(b) plus 457 plans (1)	Participants in only one plan or contributing to both 401(k) and 403(b) plans (2)
Annual Salary (in \$10,000s)	3.15	3.42
Salary^2		
Tenure (years)	12.70	13.67
Tenure^2		
Managers	4.94%	4.95%
Support	14.83%	11.69%
Black	26.25%	19.64%
Hispanic	1.25%	1.06%
Other Ethnic Group	5.57%	4.25%
Single Male	7.90%	7.78%
Married Male	9.33%	11.31%
Single Female	32.31%	33.39%
Observations	1,436	19,714
Mean of Dependent Variable		

This table is based on payroll data for only the 48 districts in which employees can contribute to all three plan types.

Concluding observations

Public employees face an expanded choice of retirement saving plans relative to similar workers in the private sector. Federal tax policies allow state and local governments the opportunity to offer 401(k) plans that dominate the private sector, along with 457 plans. Public schools and certain other organizations also can offer 403(b) plans to their employees. Our analysis of public school employees in North Carolina illustrates a range of economic and demographic factors that influence the decision to enroll in one of these plans in a similar fashion as private sector employees.

The three alternative plans have similar characteristics and IRS guidelines; however, several differences in the plans imply that certain workers may prefer one plan type over the others. We observe that North Carolina school personnel are most likely to select 403(b) plans as 14.7 percent of employees were contributing only to this plan type; however, 10.0 percent chose to contribute only to the state-managed 401(k) plan. While 3.4 percent of employees were contributing to multiple plans, we find no indication that managers and highly compensated employees are more likely to be contributing to multiple plans in order to exceed the annual contribution limit on retirement saving.

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