

**WRITTEN STATEMENT  
FOR THE RECORD**

**TO THE  
UNITED STATES HOUSE OF REPRESENTATIVES  
WAYS AND MEANS COMMITTEE**

**IN THE HEARING ON  
APPROPRIATENESS OF RETIREMENT PLAN FEES**

**TUESDAY, OCTOBER 30, 2007**

**SUBMITTED ON BEHALF OF  
BERTRAM L. SCOTT  
EXECUTIVE VICE PRESIDENT, TIAA-CREF**

Chairman Rangel, Ranking Member McCreery, Members of the Committee, I am Bert Scott, Executive Vice President for TIAA-CREF. I appreciate the invitation to appear here today to discuss how the 403(b) market place currently functions, as well as how we think it will evolve in the coming years.

TIAA-CREF has focused on the financial security of individual investors since Andrew Carnegie formed the non-profit Teachers Insurance and Annuity Association of America (TIAA) in 1918 as a fully funded retirement system to help colleges attract talented teachers. Our mission is to ensure the financial security of, and strengthen the institutions and individuals we serve by providing financial products that best meet the unique needs of those in the not-for-profit academic, medical, research and cultural fields. In 1952, TIAA created the College Retirement Equities Fund (CREF), a stock-based fund and the world's first variable annuity.

With over \$420 billion in assets under management, TIAA-CREF is a leading financial services organization, a major institutional investor, and one of the world's largest private retirement systems with more than 3.2 million individual investors at more than 15,000 institutions. We are an industry leader in the 403(b) market place, with over 50% of the market share by assets. Currently, TIAA pays out more than \$10 billion per year in retirement income to half a million of our participants and first began paying out benefits in 1919.

TIAA is one of only three insurance companies in America to hold the highest ratings from all major rating agencies<sup>1</sup>. Our customer reach extends to every state in the nation. Each of our clients relies on us to help them meet their financial needs to and through retirement. We also administer the 529 college savings plans for 10 states, as well as the Independent 529 Program (I-529). Additionally, TIAA-CREF is one of the largest institutional real estate investors in the nation, with a global portfolio of direct and indirect investments in excess of \$67 billion.

### **How Does the 403(b) Market Place Work?**

403(b) plans were created as the primary means of providing employer-based retirement income to employees of not-for-profit institutions including higher education, research and cultural institutions. They were designed to be a defined contribution pension plan that accumulates and pays out lifetime retirement income.

The 403(b) market can, generally, be segmented into two types of plans, the employer sponsored, defined contribution, money purchase plans and the employee funded tax-sheltered annuity (TSA). These two types of plans exist at the same institution as complements to one another, or can stand alone as exclusive offerings.

In our core market of higher education, we see these two types of plans paired together providing aggregate retirement benefits for plan participants. TIAA-CREF's experience focuses primarily on the model that is core to our business, the combined money purchase/TSA 403(b) plan.

The 403(b) market is quite different from its 401(k) corporate counterpart, although there are surface similarities. 403(b) plans were originally conceived and continue to be operated as the primary means of providing employer-based retirement income for those in the not-for-profit community. As a result, while it is a defined contribution program rather than a defined benefit program, its goal is to provide lifetime retirement income. The 403(b) market was not designed as a supplemental savings or profit sharing program, which is how the corporate 401(k) market was originally conceived.

The primary savings vehicle used in the 403(b) market are annuities, which are specifically designed to provide lifetime retirement income. Annuities provide guarantees to the individuals who purchase them. Mutual funds, which exist in the 403(b) world but are more prevalent in the 401(k) world, do not provide for lifetime retirement income and are structured very differently from annuities.

Plan sponsors typically provide diverse investment options for employees in a 403(b) plan via multiple full-service plan providers. It is not unusual for a typical 403(b) plan to have three or four full-service pension providers at the institution that compete for individual plan participants to select them. In contrast, a typical 401(k) plan has a single record keeping and service provider with multiple investment managers on the platform.

Recent events, including regulations released by the Internal Revenue Service in July, and proposed regulations from the Department of Labor have the potential to move 403(b) plans toward a 401(k) model, establishing “401(k) type” reporting requirements for 403(b) plans.

TIAA-CREF is a full service provider, with products that encompass investment choice, participant services and education provided at cost to our institutional and individual clients. It is important to note the differentiation between full service and unbundled providers. In the 403(b) market place, full service providers provide investment services, record keeping services, client education services, and income benefits on behalf of plan sponsors at one “all in” price. Full service providers have menus of services that are offered to plans for one price, regardless of whether you use only one or all of the services provided. Full service providers can offer these suites of products and services because they have built out the infrastructure and have achieved economies of scale to allow them to offer the services at an efficient price.

The alternate plan structure that is much more prevalent in the corporate 401(k) world is that of an unbundled provider, where various plan services are coordinated by a centralized record keeper, but farmed out to various “subcontractors.” These various subcontractors then provide investment management, educational services, plan compliance services, and other plan support functions. The costs of these services are paid by revenue sharing from companies offering their investments on the platform and/or participant account charges.

### **Fiduciary Oversight of 403(b) Plans**

If a 403(b) plan is subject to the Employee Retirement Income Security Act of 1974 (“ERISA”) it will also be subject to ERISA’s fiduciary rules. ERISA covered 403(b) plans include private-sector plans sponsored by Code section 501(c)(3) organizations, under which the employer takes an active role making employer plan contributions and/or managing the plan, such as choosing the plan investment options.

Non-ERISA 403(b) plans include private employee elective deferral only 403(b) plans in which the employer does not take an active role (as described in Department of Labor (DOL) Regulation section 2510.3-2(f)), non-electing church plans, and governmental plans. Non-ERISA covered 403(b) plans will not be subject to ERISA fiduciary rules but will be subject to those fiduciary rules existing at common law or applicable state statutes.

State fiduciary requirements for governmental 403(b) plans often mimic ERISA fiduciary requirements and ERISA is often followed as a best practice.

403(b) plans are almost always run as participant directed individual account plans, and many of them choose to comply with ERISA section 404(c). That section provides that plan fiduciaries will not be liable for the participant’s exercise of investment control over his or her account. However, as in the case of 401(k) plans, plan fiduciaries will remain liable for the prudent selection and monitoring of plan funding and investment alternatives offered under the terms of the plan. In most instances (church plans being the exception), 403(b) plans may only invest in annuity contracts and mutual funds.

### **403(b) Vendor Selection Process**

Plan sponsors in the 403(b) market place often select vendors through a competitive bid process, initiated through a Request for Proposal (RFP). In our experience, large, mid and small plans have different needs and different options that are readily available in the current market place.

Larger plans that enjoy scale can pick from a greater assortment of investment options and plan services offered by larger providers servicing the 403(b) market. Full service providers service the majority of the higher education market place, with sole record keeping arrangements (the 401(k) model) being utilized or contemplated by a number of the largest institutions in the market.

Small plans, similar to small businesses in the private sector, typically do not have the resources in-house to administer complex plans. Based on their lower participant and asset volume they also cannot generate the scale required to attract some of the larger providers. As a result, small plans usually choose among plans offering standard plan administration and pre-set investment options.

When selecting a vendor(s) to offer the retirement plan services, employers weigh a number of factors in the process including investment options, plan administration, education, investment advice and price.

### **Investment Options**

Plan providers must offer a full complement of high quality investment products covering various asset classes to help their employees reach their retirement objectives.

We believe that successful providers in the 403(b) marketplace must offer a full complement of high quality investment products covering various asset classes including cash equivalents, equities, fixed income, guaranteed returns and investment styles such as actively and passively managed funds. Diverse investments options such as these allow participants within a plan to design a portfolio, usually with the advice from the vendor, which best meets their investment goals, risk tolerance, and time horizon.

In recent years, lifecycle or target retirement date funds have proliferated in defined contribution plans. The simplicity of “one stop shopping” inherent in these types of funds appeals to both plan administrators and individual plan participants who may not feel confident making an investment allocation decision on their own.

Finally, in order to compete, more and more vendors are offering an open architecture investment platform, where investments from other companies can be offered as a complement to the firm’s proprietary investment options. When evaluating investment proposals, larger plan sponsors sometimes employ an internal investment committee or third party benefit consultants, who perform due diligence reviews of each of the proposed investment options and suggest alternatives when necessary.

### **Retirement Income**

TIAA-CREF’s mission is to help individuals meet their financial and savings needs to and through retirement. We work with plan participants to evaluate if they are saving enough for retirement, that they are invested properly to meet their goals and that they will not outlive their retirement income.

Plan administrators face a critical challenge in helping their employees address these issues as they transition into retirement. It is important that employers act to provide appropriate retirement plans and policies that promote adequate and secure retirement income for employees. Plans should be designed to manage the various risks that threaten retirement income adequacy and security, including investment volatility, longevity and inflation.

Some portion of an individual’s retirement accumulation should be guaranteed for a lifetime and a portion should be allocated to address the negative effects of inflation. Secondary purposes such as wealth accumulation, providing survivor income and other death and disability benefits also are appropriate components of a comprehensive retirement benefit policy.

The recent rollouts of new retirement income mutual funds continue a trend of asset management providers and insurance companies looking for ways to tout their company's ability to help provide income for life.

However, unlike the annuity products TIAA-CREF has offered for nearly 90 years, these new funds, while they seek to distribute monthly income, do not come with any guarantees, as to either the amount paid to the retiree or to the duration of those payments. This means investors must evaluate how much money they have accumulated, the pace at which income can be withdrawn, how long they will live, as well as market contingencies.

### **Plan Services**

An important variable in the selection of a plan sponsor is the breadth of assistance a provider delivers in retirement plan administration. Successful vendors offer comprehensive services that include record keeping, enrollment, reporting, client education and advice, as well as payment services.

The most successful vendors offer comprehensive services for plan sponsors which include plan design, implementation of new plan features, enrollment of participants, help in keeping the plan compliant and open exchanges of data with an institution's human resource and payroll area as well as plan fiduciaries. Reports are generated at both the individual and plan level on a regularly scheduled basis (quarterly for individuals), or on an ad hoc basis as needed. Plan services also extend to the participants within the plan.

Examples of these services would include:

- 24-hour access to account balances with the ability to change allocations and make transfers via a secure web connection.
- Access to a registered representative for account information and guidance via a toll free number for extended hours into the evening and weekend.
- Access to individual counseling session at the employees' workplace.
- Group education meetings and webinars on the pertinent financial topics of the day.

### **Individual Education and Objective Investment Advice**

For a 403(b) plan to be successful, the participants in that plan need to be educated about the importance of saving for retirement and investing wisely, along with balancing the appropriate amount of risk and return needed to meet their specific retirement goal. TIAA-CREF has a long history of providing education and guidance to plan participants to help them evaluate investment alternatives before they make decisions.

This year our individual consultants will hold more than 110,000 one-on-one counseling appointments with clients throughout the country. We provide our clients with personalized, objective advice within the framework of a "high-touch" experience delivered by non-commissioned consultants working for a not-for-profit entity. This is

critical, as plan participants today are faced with a much broader range of investment options and choices in their retirement plans. This is particularly important for employees as they approach retirement, when so many variables need to be assessed and risks mitigated: investment risk, longevity risk, inflation risk, health risk and unexpected expense risk.

The bundling of these components provides an advice offering unique in the industry. We provide objective, third party advice on all the funds that we record keep on our platform, including not only TIAA-CREF's investment funds but also non-proprietary investment products. The service is available to all participants, and is provided at no additional cost, ensuring that those participants most in need of investment and income management advice can obtain it.

### **Price**

One of the most important variables considered by plan sponsors is the cost and expense of providing a 403(b) retirement plan. The range of cost in the marketplace can vary significantly from vendor to vendor. At TIAA-CREF we provide meaningful disclosures to help plan participants and their beneficiaries make informed decisions about building their retirement future. As a matter of course, we disclose all of the expenses associated with investing in our registered investment products in our annual prospectuses for the CREF Variable Annuities and TIAA-CREF Mutual Funds. Expenses are broken out into the categories of Investment Advisory Expenses, Administrative Expenses, Distribution Expenses (12b-1), Mortality and Expense Risk Charges and Acquired Fund Fees and Expenses<sup>2</sup>.

In the same document, we also provide individual investors with the impact of expenses on a hypothetical investment of \$10,000 over a 1, 3, 5, and 10 year period, for each of our investment options. All of our funds' performance and prices are posted on our website.

### **Opportunities for Congress to Help 403(b) Plan Providers**

We commend Congress for acting to make investing in retirement plans easier for all Americans. Related to the challenges of increasing savings, our clients have expressed concern about the escalating cost of providing health care to retirees.

According to a recent TIAA-CREF study, individuals retiring now will need to have saved about \$210,000 in order to pay for health care expenses during retirement from age 65 to age 90. This is the amount not covered by Medicare and does not include the potential costs for long-term health care. It is also increasingly difficult for employers in our markets to continue to finance the costs of retiree health coverage. The likely outcome is that employers in the 403(b) market will be reducing these retiree health commitments going forward, and employees and retirees will be left to shoulder an increasing share of these costs.

Saving for healthcare expenses can certainly be accomplished through retirement savings vehicles such as 403(b) and 401(k) plans. However, contribution limits to these plans and the tax treatment of distributions limit their ability to fully meet the savings needs. Further, under accounting standards employer and employee contributions to these plans are not considered as assets when calculating the liabilities for providing retiree healthcare coverage to former employees. Employers offering retiree healthcare coverage and employees saving for retirement expenses will both be better served if incentives and/or enhancements are made to specialized defined contribution savings vehicles.

Plans sponsors and plan providers have a responsibility to help individuals become more aware of healthcare costs and to encourage preparedness. Employees must understand the importance of saving for retirement, including the daunting cost of healthcare, and with clear incentives to utilize specialized savings vehicles, both plan sponsors and plan providers will be in a better position to ensure financial security of retirees.

We are fortunate in the United States that life expectancy has been steadily increasing, but we must face the public policy challenges that come with that. Another proposal we would encourage Congress to consider is to provide tax incentives for individuals who select to annuitize a portion of their retirement contributions. By encouraging individual investors to elect a stream of payments that they cannot outlive, we will have effectively addressed the longevity risks of our seniors outliving their retirement assets.

We would like to thank the Committee for inviting TIAA-CREF to share our views on this important topic. I look forward to answering any questions you may have.

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<sup>1</sup> A++, A.M. Best Company (as of 6/07); AAA, Fitch (as of 5/07); Aaa, Moody's Investors Service (as of 5/07); AAA, Standard & Poor's (as of 7/07) – the highest possible ratings from these independent analysts. These ratings of TIAA as an insurance company do not apply to the TIAA Real Estate Account, to CREF or to the mutual funds.

<sup>2</sup> Acquired Fund Fees and Expenses are the accounts proportionate amount of the expenses of other investment vehicles in which they invest. These expenses are not paid directly by participants. Instead, participants bear these expenses indirectly because they reduce the performance of the investment vehicle in which the Accounts invest.