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SEC Launches Investigation of Practices in Retirement Plans for Teachers, Government Employees

Regulator looks to determine 'if violations of the federal securities laws have occurred'

By Anne Tergesen and Gretchen Morgenson
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The Securities and Exchange Commission has sent letters to companies that administer retirement plans for teachers and other government workers, opening a probe of practices in a market that consumer advocates contend is subject to abuse.

The regulator "is conducting an investigation" to determine "if violations of the federal securities laws have occurred," said an SEC document The Wall Street Journal reviewed.

Earlier this year, Jay Clayton, the chairman of the SEC, expressed concern about the prevalence of high-cost investment products in schoolteachers' retirement accounts, said Michael Pieciak, commissioner of financial regulation for Vermont.

The agency is seeking details on how administrators—which often serve crucial roles in selecting investments for 403(b) and 457 retirement plans for employees including teachers and government workers—choose investment options and police themselves when conflicts of interest arise.

The agency also is requesting documents pertaining to any compensation the administrators have received since Jan. 1, 2017 for referring investors to specific investment options or companies.

It is unclear what triggered the investigation or how many 403(b) and 457 plan administrators have received similar letters. The SEC didn't immediately provide a comment. The agency, which characterized the investigation as "a non-public, fact-finding inquiry," has the authority to issue fines or even revoke licenses to sell the products it regulates, including mutual funds and variable annuities which are staples of these plans.

Sponsored by state and local governments, 403(b) and 457 plans are a variation of the better-known 401(k) programs in the private sector. As with 401(k) plans, 403(b)s allow workers to contribute up to $19,000 a year, or $25,000 for those 50 or older, to tax-advantaged investment accounts.

While state laws generally require government entities to manage their 403(b) and 457 retirement plans in employees' best interests, they aren't governed by the federal pension laws that privately sponsored 401(k) and 403(b) plans must adhere to. The enforcement and penalties for violations aren't as stringent as with these federally regulated plans, said Bob Toth, an attorney in Fort Wayne, Ind., specializing in employee-benefits law.

Mr. Toth said that while “the SEC typically reviews broker dealers to make sure they are doing their job right and in accordance with regulations,” it is unusual for the agency to focus on 403(b) and 457 plans.

He added that many administrators of 403(b) and 457 plans fall under the SEC’s purview if they are also registered as broker-dealers or registered investment advisers, which the agency regulates. The SEC also oversees individual registered representatives of such companies, some of whom also work for 403(b) and 457 plan administrators which aren’t otherwise under the SEC’s purview.

The 403(b) plans held about $1 trillion in assets in 2017, the most recent year for which figures are available, according to sources including the Investment Company Institute, the mutual-fund industry trade group.

In its probe, the SEC also requests “information and documents” pertaining to how administrators provide investment counseling to investors. It asks for explanations of any gifts administrators have received from companies that sell investments. The agency also is seeking organizational charts that show companies that own or have ties or partnership with 403(b) or 457 plan administrators.

News of the SEC investigation comes after New York state’s financial-services watchdog last week opened a probe of insurance-industry practices in the 403(b) market. The New York Department of Financial Services has demanded that a dozen major life insurers detail how they market retirement-income products to teachers, in a bid to assess whether insurers or their agents are taking advantage of teachers in selling potentially high-cost and inappropriate retirement-savings investments.

Mr. Pieciak said the SEC’s San Francisco office has been scrutinizing accounts and the investment options available to teachers. He said 403(b) plans are on the radar for other state securities regulators as well.

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