KPERS STUDY COMMISSION

Kansas Public Employee Retirement System

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Testimony on the necessity of advice, choice and local control for the success of defined contribution plans; best practices in public sector defined contribution plan design.

Good morning ladies and gentlemen. My name is Doug Wolff and I am President of Security Benefit Life Insurance Company ("Security Benefit"). I'd like to thank the Commission for the opportunity to appear here today to speak to you, about best practices for the design of a defined contribution savings plan option that may be put in place for Kansas Public Employee Retirement System ("KPERS") members. Let me make it clear that Security Benefit supports a fully funded KPERS defined benefit plan. However, I understand the immense funding challenge that sits in front of this Commission. This morning I want to discuss providing retirement savings options that supplement the defined benefit plan currently in place in the State of Kansas. My goal today is to provide information about industry best practices for a KPERS defined contribution component to the state retirement system.

Security Benefit has been doing business in Kansas for over 120 years. Our company is one of the five largest defined contribution providers in the United States specializing in public education retirement plans. Security Benefit is the largest public education defined contribution provider in the United States working with independent financial representatives. With more than 250 plans under administration here in Kansas, Security Benefit is also the largest single provider of retirement plan services for Kansas K-12 public schools providing third party administration and investments for 403(b), 457 and 401(a) retirement plans. Security Benefit provides these types of plans to public schools on a nationwide basis. Our plans are administered through our offices here in Topeka Kansas where we currently employ more than 600 people.

Although we specialize in working with K-12 public schools, we also have a significant defined contribution practice that serves other governmental sectors such as firefighters, city and county employees and rural water district workers. The Ohio Association of Professional Fire Fighters 457 program is one example of the many governmental retirement programs we support.

We believe that our specialization in public education and national experience combined with the insight gained from more than 35 years of working with KPERS members and their spouses on why they need to save for retirement, qualifies Security Benefit to provide this Commission with the insight and guidance on the best defined contribution plan design for KPERS public education members.

As a former KPERS board member, I am very familiar with KPERS funding challenge faced by this Commission. As you well know, there is no easy solution for the KPERS funding issue. Security Benefit supports the work of this Commission to help KPERS meet its ongoing obligations to all active and retired members. Security Benefit is not an *opponent* or a *proponent* of any particular change in the KPERS pension program or the solution for the unfunded liability. The KPERS staff and other pension professionals have addressed the issues and options for this Commission and we leave this issue to those professionals.

On behalf of Security Benefit I wish to reinforce to this Commission, the critical role personal retirement savings plays in the KPERS retirement system and how proper defined contribution plan design is critical to KPERS' mission, a secure retirement for KPERS members, and just as important, all present and future Kansas taxpayers.

Having served the Kansas community for the last 120 years, Security Benefit has learned a few things about retirement readiness planning. First, a multi-faceted savings approach is absolutely necessary for individuals to close the retirement funding gap. Second, our public employees need, and deserve, advice and guidance. Third, KPERS serves a decentralized populace that deserves and requires equity of service. And last, but certainly not least, participant choice and control over sources of investment options and financial advice make a demonstrably significant difference in retirement savings rates.

Background and the "Three-Legged Stool"

Our Kansas public employee retirement system is built upon a three-legged stool philosophy. Kansas, like most states, has provided retirement plan benefits to its public sector workers through a *defined benefit plan*— we refer to this as a mandatory workplace savings plan that can be structured in many forms, this is the first leg of the retirement system stool. The second leg of the retirement system stool is Social Security, the national retirement benefits program many of our nations' senior citizens depend upon to maintain a well-earned, dignified lifestyle during retirement. The third leg of the retirement system stool has always been personal savings. In Kansas, like in many other states and as offered by many private employers, the most important personal retirement savings vehicle is the employer sponsored *defined contribution plan.* In the private sector, everyone is familiar with the 401(k) plan. In fact, 401(k) is the only IRS Code section most Americans know. In Kansas, and across the country, the defined contribution plan for governmental and public education employees is a 457 plan, a 403(b) plan or combination of the two.

Before his retirement, KPERS Executive Director, Glenn Deck, often referenced the three legs of the KPERS stool and recently testified to the House Committee on Pension and Benefits (February 9, 2011) that personal retirement savings has always been assumed to be at least 10% of the KPERS retirement savings formula. Mr. Deck also acknowledged that for some KPERS participants, the required personal savings percentage could be much greater than 10% because everyone has different circumstances and financial needs.

The reason why I take time to review the fundamentals of the three-legged retirement stool is that we all understand that even fully funded, the KPERS pension benefit does not provide enough retirement income for members. That was never the intent of the program. We also all understand that it is not likely that Social Security benefits will increase significantly over time. Certainly, there is good reason to believe that this second leg of the retirement stool is not as strong as it once was. We also know that healthcare benefits are under more pressure than ever before and the rapidly rising cost of healthcare continues to take a greater percentage of a person's retirement income. This rapid increase in the cost of healthcare alone gives good reason to question the 70% to 80% income replacement ratio most employers assumed is needed for a secure retirement. Just think of the impact upon your lives if you were to take a 20% to 30%

reduction in your household income tomorrow. The reality is that retirees may need 100% or more of their pre-retirement income to cover new expenses and rising costs of healthcare. For KPERS members, who currently have no statutory right to any cost of living increases for general living expenses or healthcare costs, this supplemental savings program is critical.

The point that I wish to emphasize to this Commission is that personal retirement savings is becoming an even more important leg of the retirement income stool. Further, personal retirement savings is the only leg of the stool over which KPERS members have control. We believe that personal advice, participant control and local choice are critical to designing a KPERS defined contribution plan that will maximize personal retirement savings and provide a better retirement solution for our participants. The potential impact of a generation of KPERS members not prepared for retirement has a far reaching impact upon all Kansans.

Creating the Optimal Environment for Personal Savings

We have established that voluntary personal retirement savings are increasingly critical to the success the KPERS retirement system. However, unlike others that have testified to this Commission, we do not believe that it is the role of any employer, consultant or advisor to paternalistically dictate the terms of an employee's retirement saving plan.

We have learned from experience and will demonstrate that personal retirement savings flourish when plan participants are provided personal advice, given appropriate choices and have control over their retirement savings. Simply put, ownership and stewardship necessitate each other.

There are four key factors that contribute to improved personal savings rates and thus optimized outcomes for defined contribution plan participants.

- Participant access to local, personal investment advisors without regard to location, assets or ability to invest;
- Appropriate participant choice of advisors, investment providers and investment options;

- Participant control of retirement plan assets, including the ability of the participant to aggregate all retirement assets with the advisor and investment provider of choice or diversify as desired;
- Clear, uniform and precise disclosure of fees and expenses for services rendered.

These key factors are proven to encourage positive retirement savings behaviors and any modification of the KPERS retirement plan design must support them.

The Case for Advice

When we speak of professional financial advice, we are not just talking about helping people develop investment strategies like how much to invest in stocks or bonds or even picking the "right" mutual fund option. That is certainly an important part of financial services professional advice and an area where many investment advisors specialize after years of study and experience. We are focused on the personal professional advice that encourages people to start and continue to save for retirement. We speak of the professionals that sit across the kitchen table on a weekday evening to create a personal retirement savings plan and then show a KPERS member and her spouse why they should invest an extra $50 or $100 a month to meet their goals.

To illustrate our point, a recent survey by Charles Schwab showed that workers who received personal professional advice on creating a retirement savings plan *increased their average monthly deferral percentage* by 5.42% and their savings rates nearly doubled from 5% to 10% as a result of receiving and implementing the advice. Additionally, the same study showed that 51% of those retirement plan participants preferred one-on-one consultation. This tells us that a majority of workers, including KPERS members, both prefer personal advice and save more, when they have access to personal advice.

For context, given the current economy, job uncertainty, market volatility and low interest rates it is not surprising that we have a national retirement savings problem. The primary job of professional financial advisors working with retirement plan participants is building the trust and confidence for people to create a plan for the future and then forgo a portion of their paycheck now in order to meet that plan. As a CFA and FSA, I can confidently say that the most important factor in maximizing retirement savings is not picking the right investment, overall investment returns or even expenses; the most important factor in building retirement savings is investing as much as you can as early on as you can.

The bottom line is that independent studies prove that people invest more when they have a personal investment advisor to guide them through a personal savings plan.

The Case for Choice

Access to and choice of personal investment advisor and investment provider go hand in hand, and both impact personal savings rates. In fact, in K-12 education, research shows that participation in 403(b) defined contribution plans dramatically *declined* when the number of available investment providers and access to professional investment advice was reduced.

A study by the American Society of Pension Professionals and Actuaries (ASPPA) of school districts in Southern California, discovered over 50% of workers stopped contributing to their 403(b) plans when their existing provider was no longer available for ongoing contributions. Although there was a slight decline in overall participation rates, participants that retained access to their investment advisor and investment provider of choice maintained much higher participation rates over all.

Another example can be found across the border in Colorado. In 2004, Jefferson County School District in Golden, Colorado decided to adopt a single investment provider model for its 403(b), 457 and 401(a) plans. The objectives were to reduce the administrative burden on the district and achieve lower investment expenses for participants. These are appropriate and understandable objectives for any retirement plan sponsor.

The model they implemented was with Great West Retirement Services, one of the largest 457 defined contribution providers in the country. There are a number of large companies that provide similar models in the public sector market. The lower cost, limited choice, no personal investment advice model seemed like a good solution. What the district found was that 403(b) defined contribution participation rates declined steadily each year since the implementation of the new model. The number of contributing 403(b) participants dropped by over 54% from 4,762 participants in 2004 to 2,177 contributing participants at the end of 2009, the latest year for which participation data is publically available. The unfortunate part of this story is that JEFCO could have addressed both the administration issue and the expense issue if it would have adopted an independent third-party administrator to manage the plan and implemented a uniform fee disclosure regimen that would allow the market to work.

JEFCO may have achieved its goal to simply the administrative process, and lower some expenses to participants, but it is hard to argue that less people saving for retirement is a good outcome for anyone.

Another case similar to Jefferson County Public Schools further illustrates this point. When the Indiana Area School District in Indiana County, Pennsylvania switched to a single investment provider, limiting access to investment advice and choice, nearly 40 percent of participants ceased participation in the plan. Generally speaking, a one-size-fits-all approach to for public employees, like KPERS members, will not work.

The Case for Local Control

Given the demonstrated benefit of local advice, and given the geographic dispersion of KPERS' education members, equity of service becomes a critical consideration. By equity of service, we mean that the same level of personal, face-to-face service should be available for our participants in the smallest communities of Kansas to the same degree that they can get in Johnson County or another large population center. Our Kansas employees work in buildings and other worksites scattered throughout the state, in some fairly remote areas. We do not believe it is in their best interest to be left essentially on their own when it comes to retirement planning decisions outside of the mandatory KPERS pension contributions.

Consider Kansas' K-12 employees. Think of the "boots on the ground" required to meet the needs of the 294 Kansas school districts, from Kansas City and Topeka to USD 405 in Lyons to USD 413 in Chanute. Individual public schools simply do not have the resources to develop a "culture of savings" in the same way as the private sector.

If we go to a one-size-fits-all plan, participants who need more one-on-one help to learn about how the plan works, how much to save for retirement, and how to invest their money in the plan are not given the time or professional help they need. Many KPERS members in other governmental sectors work in similar conditions. To make personal planning part of the service we offer to KPERS participants requires hundreds of people to serve every area of Kansas equally.

The best example of the unintended consequences of limiting local control can be found in the Iowa Department of Administrative Services (DAS) Retirement Investors Club. The Iowa DAS plan is a centralized 457, 403(b) and 401(a) plan sponsored by the state that covers all state employees, eligible municipal and county government workers and all of Iowa's K-12 public schools and community colleges.

There are some positive aspects of the Iowa DAS plan for this Commission to consider. First, the DAS recognized the value of maintaining a multiple Code sections defined compensation plan, that includes 457, 403(b) and 401(a) plans to provide the maximum benefits for the various employee groups. Second, the Iowa DAS maintained a multiple provider system (there are five approved investment providers) which allows all plans to minimize concentration risk, encourage competition and allow participants to simplify their investments by aggregating all plan assets with their provider of choice. Multiple Code and multiple provider models are actually quite common in many public schools and municipalities across the country and there are many very good independent third party administrators that administer these plans very efficiently. ING is the third party administrator of the Iowa DAS plan.

The problem with the Iowa DAS plan is that the state focused on investment expenses as the primary tool for evaluating investment providers. This led to the unfortunate result of pricing local personal financial advisors out of the plan. The practical result is that personal, face-to-face help is essentially not available for rural Iowa. It is only available in the large population centers of Iowa such as Des Moines. Most participants are asked to turn to on-line tools or call centers for advice, which does work for some participants. Without local advisors working with participants and encouraging them to start and continue a retirement savings plan, many employees, especially in rural areas, were not enrolling in the program and the state had to assume the role of educator and advisor for the defined contribution plans. Remember, only 5.4% of people save additional dollars when they're on their own.

Today, if a school or other government worksite in Iowa wants to schedule time for someone to speak to the local employees about the importance of personal retirement savings through the defined contribution plan, a worksite representative has to go online and request a meeting that will be run by the DAS. The local worksite is responsible to pay for any printed materials the DAS provides for the meeting and if the employees actually would like to meet with someone face-to-face instead of watching a web based presentation, the local has to pay a set meeting fee and a fuels surcharge based upon distance traveled from Des Moines.

What the state government created was a plan design that has an understaffed government agency with few people in Des Moines charging affiliated employers for the same services that local financial advisors had previously provided as part of their personal advisory services. The new plan has been in place for about three years and we have yet to see a participation rate study, we are especially interested on how the rural areas have been impacted. Unlike what has been created in Iowa, we believe maintaining a private sector solution is the optimal solution for defined contribution plan design.

While not perfect, the path toward a better model may lie in the Florida Model Plan. Again, this is a multi-Code multiple provider defined contribution plan that offers 403(b), 457 and 401(a) plans. This plan offers five providers and does include both direct and full service advice models. This plan uses an independent third party administrator that manages all of the plan and provider details very effectively. Other than the varied service models offered under this plan, the primary differentiator between the Florida Model Plan and the Iowa DAS plan is that the Florida Model allows each local employer, in this case a school district, to select additional investment providers in addition to the five core providers offered by the plan. Our experience and the data shows a multiple provider and local employer option plan is beneficial to business competition in this market and thus, also to providing the employees better savings options.

This plan design feature recognizes that local control and choice is important to maintaining healthy plan participation rate and maximizing savings. As a reference point, remember the 50% drop in participation rate experienced in California when plan participants no longer have access to their choice of investment provider and advisor. The qualification is that any investment provider selected by the local employer must meet the administrative requirements of the third party administrator and share in the plan administration expenses. This model is a very good example of a centralized offering combined with an appropriate level of local control.

One area where we think this model should be improved is with regard to disclosure. We have demonstrated that choice and advice are good and promote healthy savings practices. We believe that these principles of a well-regulated open market work even better when the plan participants, the KPERS members, are fully informed, and can easily make comparisons among options and have all of the information they deserve when making such an important decision.

The Case for Disclosure

The Paradox of Choice is something that this Commission will likely hear reference to in testimony when considering the KPERS defined contribution plan design. Simply put, the paradox of choice suggests that too many options are bad because people become paralyzed when they must choose between too many options. The argument as it relates to defined contribution plan design is that given too many options, plan participants will simply choose not act. Therefore the number of choices, investment provider, investment options, etc. should be limited.

We do not know what the right number of choices is for retirement plans. However, simply reducing choices may not be sufficient. Remember plan participation in California public schools dropped when choices were eliminated. The real problem we may need to solve is not the number of choices for participants but providing the right information and professional help for participants to make choices. Full disclosure may be a better solution than fewer choices.

Plan participants should know exactly what they are paying for, the services they receive and who is being paid for those services. Security Benefit fully supports the joint retirement plan disclosure initiative endorsed by the Association of School Business Officials, the National Education Association, the National Tax-Sheltered Accounts Association and the American Society of Pension Professionals and Actuaries and we strongly recommend that this Commission make the uniform disclosure required for any KPERS defined contribution plan providers.

Retirement plan and investment fees are a significant issue facing many retirement plan sponsors, investment companies and financial advisors. In some cases, this concern is with good reason. One possible response to the issue is a race to the bottom to find the lowest possible fee. It is not in KPERS best interest to follow this path and experience the same unintended consequences as Jefferson County or the Iowa DAS. Pricing vital services out of the plan design in pursuit of the lowest fee possible arguably creates larger issues and liabilities of a workforce not prepared for retirement.

Full fee disclosure and participant education are a much better option for dealing with the question of plan expenses. Participants can make informed choices when all fees and services are clearly documented for the plan sponsor, investment provider and financial advisor. No hidden fees and participant choice or options make for a defined contribution plan best practice. A draft model of the fee disclosure document is included in our exhibit to this testimony.

Best Practices in Governmental Retirement Plan Design

Experiences in other public retirement systems demonstrate that the optimal public defined contribution plan must:

1. Integrate local professional advice for all worksites irrespective of location or investable assets in order to maximize personal retirement savings behaviors which includes a 403(b);
2. Use a flexible plan design that includes multiple IRS Code sections (403(b), 457, 401(a)) administered by an independent third party administrator to maximize flexibility and savings options for participants;

3. Allow participant choice and control of investment options with the ability to consolidate all plan assets with a single provider for increased savings rates;
4. Allow each public education employer to add investment providers for all plan types;
5. Require all providers meet established administrative requirements;
6. Utilize disclosure of fees, services and payments as the best practice for the plan sponsor and investment providers rather than market restrictions.

Our task today is to create an environment that leads to greater retirement readiness for Kansas public employees. What I have spoken about today is how we can create the best environment using these six standards for a supplemental public sector defined contribution plan that will encourage state workers to save for the retirement they have earned and the retirement they deserve.

Thank you for the opportunity to testify.

Additional Resources for Commission Members

PROTECTING PARTICIPATION
The Impact of Reduced Choice on Participation by School District Employees in 403(b) Plans
http://savemy403b.org/wp-content/uploads/2011/10/ASPPAWhitePaper-ProtectingParticipation.pdf

403(B) TASKFORCE ON FEE DISCLOSURE
http://savemy403b.org/news-releases/asbo-nea-ntsaa-form-joint-403b-taskforce-to-offer-fee-disclosure-solution

STATE LEGISLATION TO CONSOLIDATE RETIREMENT PLANS MAY IMPACT TEACHERS' CHOICES
http://savemy403b.org/wp-content/uploads/2011/09/StateLegislationConsolidation.pdf

IRS PLAN FEATURE COMPARISON CHART
http://wpconversiondemo.com/demo1/wp-content/uploads/2011/09/IRS-Plan-Feature-Comparison-Chart.pdf

THE VALUE OF THE 401(K) SYSTEM
http://www.asppa.org/document-vault/pdfs/mediaroom/ASPPAIssueBrief401kSystemValue.aspx

TEACHERS WANT CHOICE

Impact of Teacher Participation in 403(b) Plans

403(b) plans provide school district employees with an important means to save for retirement. However, state legislation is threatening to eliminate workers' retirement options, which would likely result in lower participation in 403(b) plans.

EMPLOYEES PERFORM BETTER WITH FINANCIAL ASSISTANCE

Investment style based on time working with a financial advisor

Spent some or a lot of time with advisor

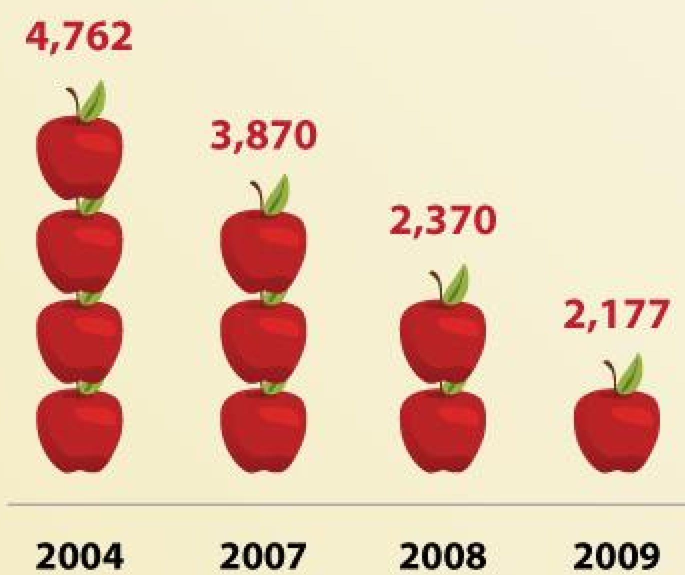
Spent little or no time with advisor

A study by Charles Schwab found that professional guidance had a positive impact on retirement plan participants.

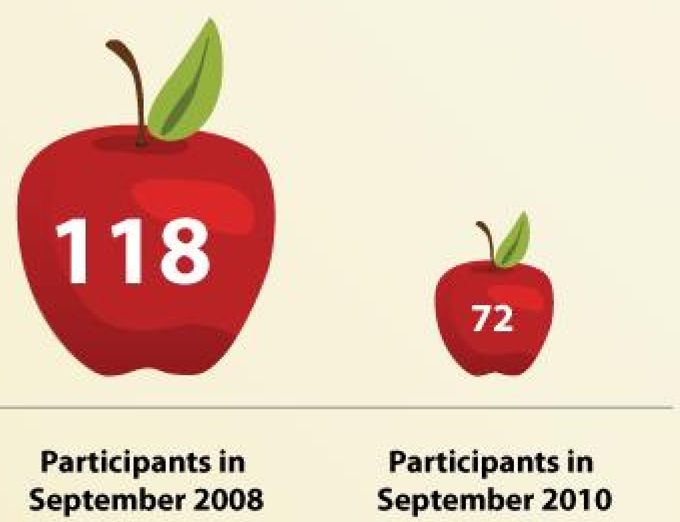
5-10 percent They found that their savings rates nearly doubled from 5% to 10% as a result of receiving and implementing advice

SCHOOL DISTRICT EMPLOYEES PARTICIPATE LESS WHEN THE NUMBER OF PROVIDERS IS REDUCED

Participation in Colorado school district's 403(b) plan dropped by 54% when they switched to a single investment provider

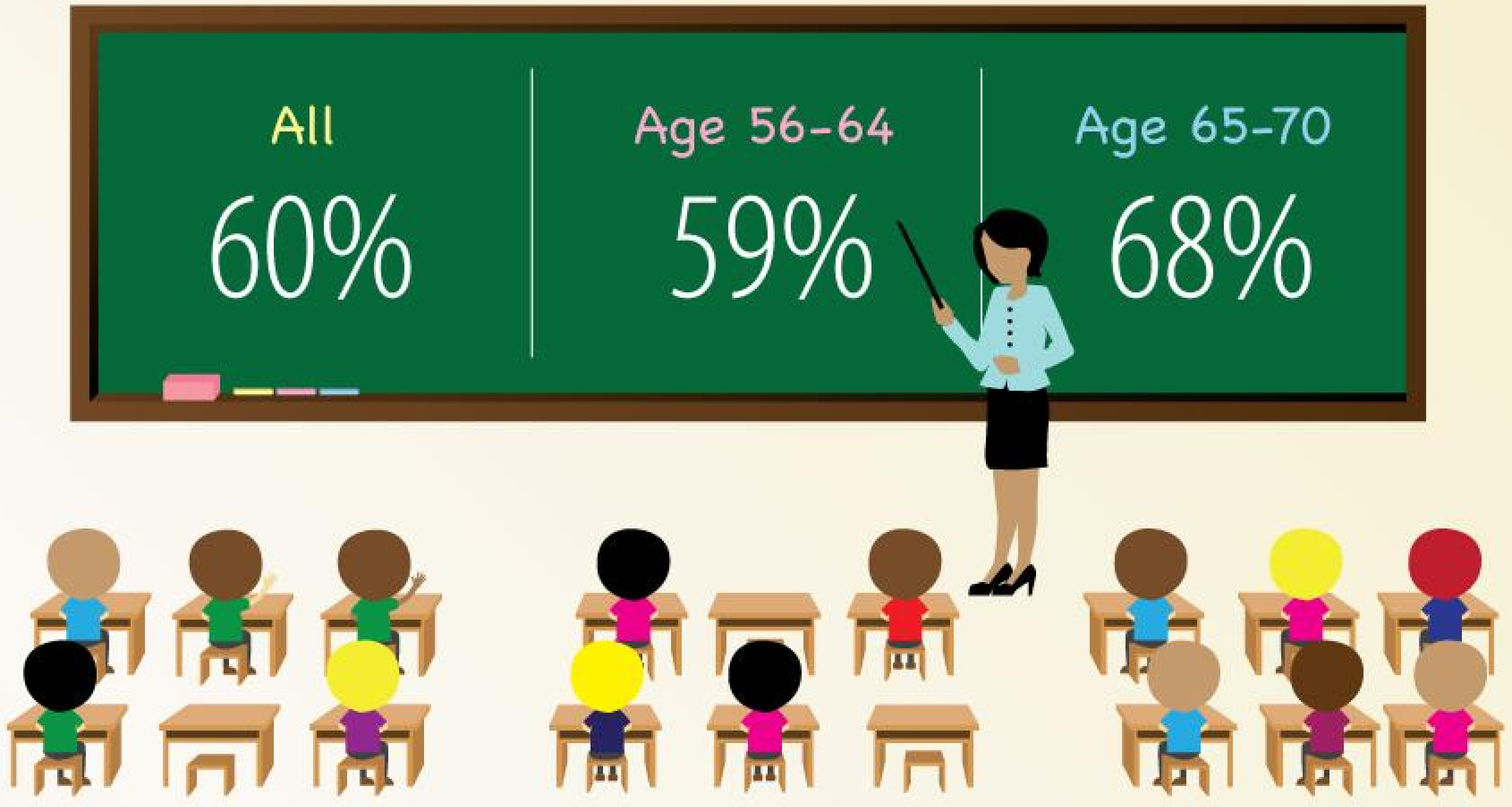


The number of participants in a Pennsylvania school district's 403(b) plan declined by nearly 40% when they went to a single provider



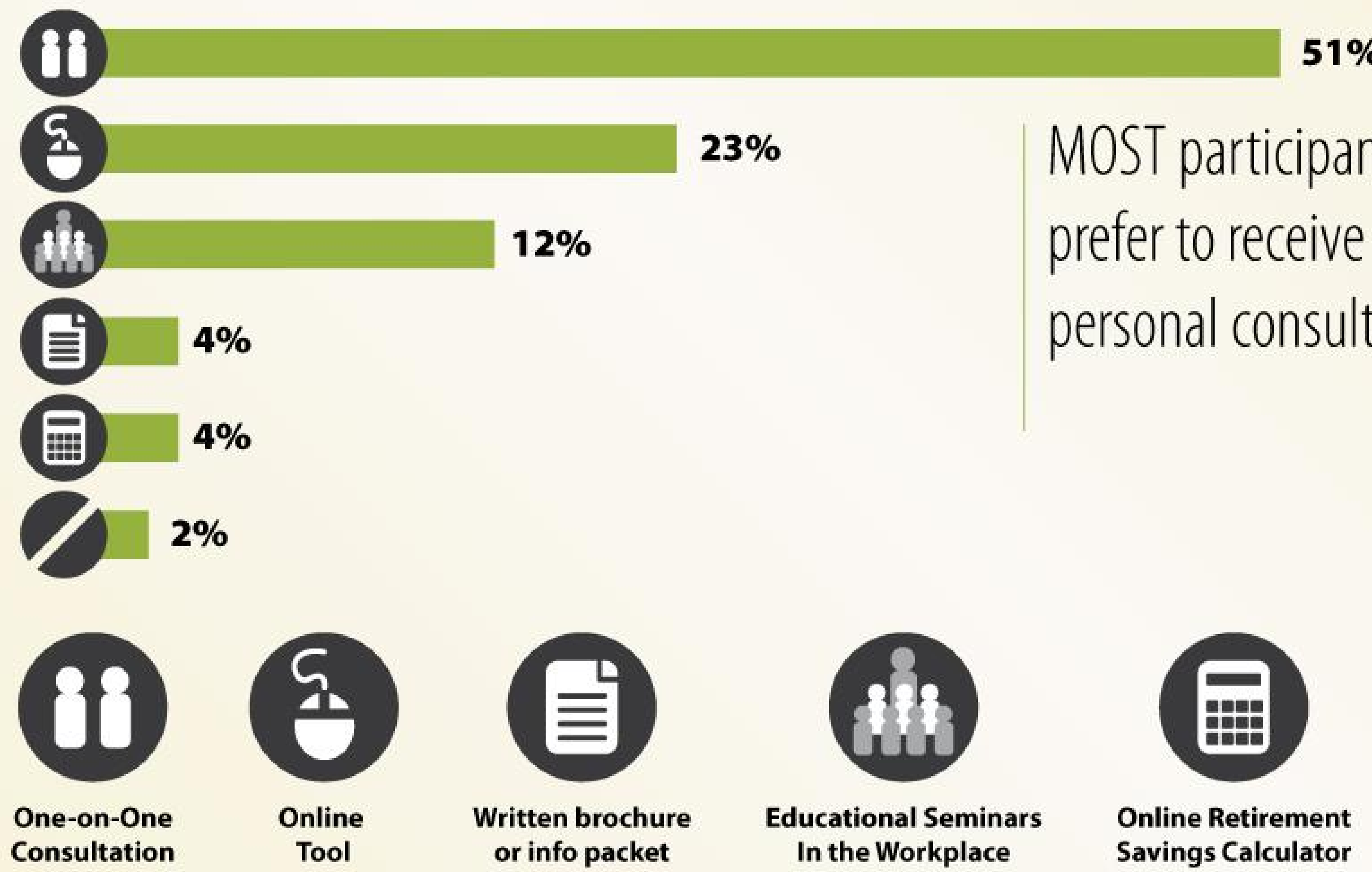
TEACHERS WANT ADVICE

Study by TIAA-CREF showed that 60% of near-retirement higher education employees had consulted with a financial professional within the past two years regarding retirement.



PARTICIPANTS HAVE VARIED PREFERENCES FOR HOW THEY RECEIVE HELP

Preferred Method of Receiving Retirement Planning and Investment Help



MOST participants would prefer to receive help via personal consultation

NO CHOICE VS CHOICE

An analysis of employees in **55** school districts shows that **over 50%** of workers stopped contributing to their 403(b) plans when their existing provider was no longer available

Source: Debra Davis, Esq., LL.M., Dr. Geralyn Miller, Ph.D., and Judy Miller, FSA, MSPA, *Protecting Participation: The Impact of Reduced Choice on Participation by School District Employees in 403(b) Plans*, ASPPA Pension Education and Research Foundation, available at http://SaveMy403b.org.