Pennsylvania House State Government Committee

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Statement by John D. Schu

Practices for Consideration by Pennsylvania as Compared to other States

INTRODUCTION

Good morning Chairmen Metcalfe and Cohen and Members of the House Standing Committee on State Government. Thank you for this opportunity to provide testimony with regard to this important issue.

My name is John Schu and I am SVP of Branch Development for Lincoln Investment Planning. Lincoln Investment Planning is a Broker/Dealer and Investment Advisory firm headquartered in Wyncote, Pennsylvania just outside of Philadelphia. Lincoln is a family-owned business started almost 50 years ago with the mission of serving our local community's financial planning needs, focusing on the unique retirement planning needs of public school employees. Over the year's Lincoln Investment Planning has remained dedicated to helping educators prepare for retirement. We started with one office outside of Philadelphia and now serve 375 Pennsylvania public school district defined contribution plans and have helped 31,000 employees managing $1.2 billion in Pennsylvania public education employee assets.

Today, Lincoln Investment Planning is one of the largest independent national firms serving public education defined contribution plans. We have 300 employees and 800 independent financial advisors. Our 230 Pennsylvania based corporate employees are located in our branch offices throughout the state, including the Philadelphia area, Pittsburgh, Bethlehem, Erie, Lansdale, Bloomsburg, and 9 other Pennsylvania cities.

Lincoln investment planning is a member of the National Tax-deferred Savings Association (NTSA) is the nation's only independent, non-profit association dedicated to the 403(b) and 457(b) marketplace. NTSA was formed in 1989 as the National Tax Sheltered Annuities Association (NTSAA) and joined the American Retirement Association in 2009. Today, its 3,300+ members include practitioners, agencies, corporate and employer members. NTSA's mission is to provide high-quality education, technical support, information resources and networking forums for professionals in the 403(b) and 457(b) marketplace.

EVERY PENNSYLVANIA PUBLIC SCHOOL HAS A RETIREMENT PLAN THAT WORKS

This committee has the important task of shaping policy and legislation that will impact every citizen of the Commonwealth for decades to come. And I'm certain that the fact that any decision is likely to displease some, if not all, constituents only makes this task more difficult.

What I would like to offer to this committee is that there are many businesses like Lincoln Investment Planning throughout the Commonwealth of Pennsylvania that have been quietly building successful defined contribution programs for Pennsylvania public schools. Many of these firms have been helping public school employees prepare for retirement for decades. That's a lot of experience working successfully in the very unique public school environment, experience that can be helpful for all involved in the pension reform process.

Every Pennsylvania public school offers a defined contribution plan outside of the PSERS system. The plans are usually specific types of defined contribution plans known by their internal revenue code sections 403b or 457. The type of plan offered isn't as important though as the fact that every public school employee already has access to a 401k type defined contribution plan and approximately one-third of public school employees are already actively saving in these retirement plans today.

LOCAL PLANS WORK BEST

Despite the success of local plans, previous proposals to replace the existing public pension system with either a hybrid or straight defined contribution plan included provisions that would all but wipe out these local plans. Prior proposals sought to replace the existing structure with a new state-run defined contribution plan. It's sort of a "destroy the good in want of the perfect" mentality. The problem is that what's perfect on paper doesn't always translate to reality. And here's why that is certainly true in this case.

In 2007 the Iowa Legislature passed legislation that led to the elimination of local school district defined contribution plans. Local plans were replaced by a state sponsored program run out of Des Moines. The theory was that the department that supported the defined contribution plan for state employees in Des Moines should be able to do offer the same service to public schools throughout the state. The state would negotiate lower fees and streamline administration, etc.

In 2009, the state launched its new retirement program for public school employees and all but a few districts signed on. The plan was perfect in the eyes of the department running the program. The fees were indeed low and everything, including investment education was run through a central office in the capitol. The program was heralded for all the investment expenses it would save employees.

As it turned out the state was right in that many employees saved even more money in investment expenses than projected, but just not for the expected reasons. What happened is that more than half of the participants that had been contributing to their retirement plan, stopped making contributions to the retirement plan. You see, they saved in fees because they stopped saving. Iowa is now issuing a RFP to reintroduce local retirement plan providers back into the public school defined contribution plan system in hopes of getting savings rates back to where they were prior to 2009.

LOCAL INVESTMENT PROFESSIONALS MATTER

This example illustrates what Lincoln Investment Planning knows from 50 years of experience; people need help to understand why it is so important to save pre-tax and where and how much to invest for retirement. And when given no choice, people choose not to invest. And the Iowa state plan is just one example.

In Southern California, around 50% of workers stopped contributing to their 403(b) plans when their existing investment provider was no longer available. Similarly, the number of participants dropped by over 54% when a school district in Colorado went from 55 investment providers to a single investment provider model for its 403(b) plan. Nearly 40 percent of participants ceased participating in a 403(b) plan at a school district in Pennsylvania when the plan went from nineteen investment providers to a single investment provider.

The data shows that disrupting or trying to replace the defined contribution plans that are already in place at every Pennsylvania public school could likely cause half of the current savers to drop out of the system. A reform measure that results in less people saving for retirement is simply a big step in the wrong direction.

And don't forget, many of the firms and advisors that are successful in helping public school employees are Pennsylvania business like Lincoln Investment Planning. It's the efforts to replace the local support with bungee jumping enrollers from Charlotte or Texas that just don't work. It's not likely that many of the people here today started their retirement savings plan by going online or dialing an 800 number.

DEFINED CONTRIBUTION PARTICIPANTS NEED PROFESSIONAL ASSISTANCE

One of the policy issues discussed when it comes to pension reform is how much of the risk should be shifted from the state to the employee. A hybrid plan that includes a defined benefit and defined contribution plan has some level of risk sharing and a straight defined contribution plan shifts all of the investment risk to the employee.

Lincoln Investment Planning does not have a position on what if any plan design changes should be made. What we do know though is that it isn't right to shift any portion of the investment risk to employees without making sure that employees have access to an investment professional they choose and trust.

You see local investment professionals are not only key to getting people to save more money, investment professionals also help plan participants manage their investments. A study by CIRANO found an increase of 58% more in assets when people get to work with the advisor of their choice over four to six years. Working with an advisor for seven to fourteen years shows an increase of 99% over those not using a financial advisor. [1]

One example for consideration is the Federal Thrift Savings Plan ("TSP"). The TSP is considered a model in low cost retirement plan, although part of the reason costs are low is that the plan is subsidized by tax dollars. Local advisors are not incorporated into the plan support. The result is that the investment with the most plan assets, nearly 50% of plan assets, is the guaranteed account. That means that half of the retirement savings in the plan has missed out on

one of the most significant growth periods in the equity market and is instead likely growing only slightly faster than inflation.

A similar result would not deign well for the retirement preparedness of Pennsylvania public employees under a hybrid or defined contribution plan scheme.

LOCAL PLANS AND INVESTMENT PROFESSIONALS ARE A VALUEABLE RESOURCE

Local school district control of 403(b) and 457(b) plans work because employees are able to work with their advisor of choice. That is why I am testifying today in support of retaining local school district control over these plans and not sweeping 403(b) and 457(b) plans out of the mix when considering other pension reform.

[1] Econometric Models on the Value of Advice of a Financial Advisor, 2012 Claude Montmarquette, CIRANO

SIGNOR TO THIS TESTIMONY

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