Insights

Managed accounts

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Today's service may not be tomorrow's solution

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In our 2015 paper, *Are Managed Accounts a Better QDIA?*, we credited managed accounts with offering services that were valuable for engaged defined contribution (DC) plan participants with complex financial situations. We also discussed retirement income solutions available through some managed account providers, which continue to gain in importance and attention as DC plans become even more pervasive as workers' primary retirement vehicles.

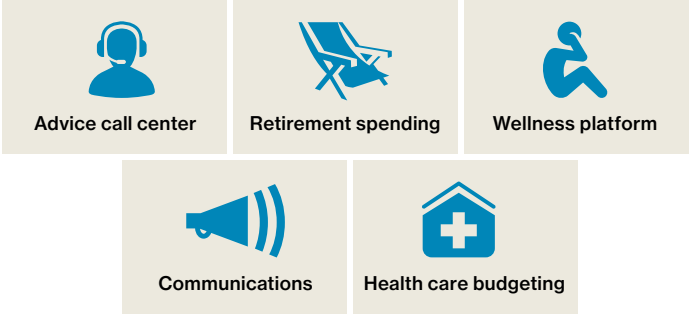
We concluded that, while managed accounts had been moving in the right direction, more progress was needed. We feel this is particularly true for managed accounts to make the leap from opt-in services (their most prominent role in DC structures today) to qualified default investment alternatives (QDIAs), a space now dominated by target date funds.

In this paper, we build on our 2015 groundwork. We examine the managed account value proposition, concerns with the current model, disruptive forces in the industry and the potential for managed accounts to become attractive QDIAs.

The managed account value proposition

When plan participants and sponsors compare managed accounts with target date funds, they often focus on managed accounts' ability to offer customized asset allocations based on participants' goals, objectives and financial situations. While customized allocations are certainly valuable, managed accounts also offer ancillary services that can help participants plan holistically for successful retirement.

These services can include:



While each of these services can add value for participants, they can also pose concerns for plan sponsors.

Concerns about the current model

A primary concern regarding managed accounts, particularly in today's litigious DC marketplace, is **cost.** Many providers' standard fee schedules for opt-in implementations start at 50 basis points or more, in addition to the investment expense from the underlying managers. While there are fee discounts for considering an opt-out (QDIA) implementation, those fees are typically around 10 to 15 basis points less – so there are still material fees for plan sponsors to consider.

For an opt-in implementation, one could assume that participants who would choose to use a professionally managed account service and pay the management fee would make full use of the service. That is, they'd provide information about their goals, objectives, risk tolerance and total wealth; use various planning tools; and speak to representatives as needed. However, in our studies of managed accounts, we've found that in many cases at least half of managed account participants don't personalize.

For this reason, we've become more concerned about **participant engagement.** Participants who use managed accounts fully may realize ample value for the fee, but for participants that don't personalize, it's difficult to justify the added cost. If managed accounts are chosen as the QDIA, the number of participants who don't engage is almost certain to increase.

Finally, **fiduciary concerns** continue to be front of mind, particularly as service offerings expand. Choosing a managed account provider is a fiduciary decision; as such, benchmarking fees and services is crucial. We believe the differences among providers' services make effective benchmarking difficult. That difficulty is increased by the fact that some providers are expanding their tiers of service to include the management of out-of-plan assets. Also, some providers don't offer portability – or offer only limited portability – across recordkeeping platforms, which may create unwanted ties between the managed account and other services.

Disruptive forces in the industry

While the concerns above pertain only to the institutional managed account marketplace, there are also external forces that may shape tomorrow's managed account services.

Some **robo advisors** – online advisory/management services that primarily serve retail investors – have come to market with attractive fees, often by focusing less on ancillary services than do the large, institutional managed account providers. Well-established robo advisors are entering the defined contribution market, though that penetration is still in its early stages. And though these firms must clear some hurdles in order to establish themselves in the institutional retirement market, we believe they could ultimately drive down fees in the industry.

While managed account providers continue to build out their platforms and work with participants to create holistic retirement plans, many **recordkeepers** are moving in a similar direction. The expansion of recordkeeping platform tools to focus on wellness, retirement income and investments has created some overlap with managed account features. This could lead managed account providers to take a fresh look at their offerings to see where they add the most value.

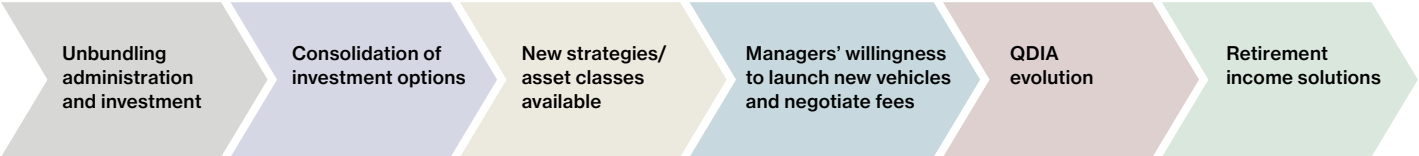
Regulatory and **legal** factors could also affect managed accounts, both directly and indirectly. For example, the Department of Labor's (DOL's) Conflict of Interest Rule seeks to expand the definition of the term fiduciary, which affects plan recordkeepers among others. Sponsors with recordkeepers that plan to provide fiduciary advice to participants will need to accept the possibility of having multiple investment advice providers with varying investment methodologies (assuming a third-party managed account provider is engaged). At the time of this writing, the rule had been delayed until June 2017, at the earliest, for a review of its potential impact on participants.

Another relevant example is the Government Accountability Office's (GAO's) 2014 Managed Account report. The report recommended a number of factors for the DOL to consider – including consistent fiduciary roles, improved performance and benchmarking disclosures, and oversight guidance – to help sponsors select providers. Finally, a number of lawsuits have recently been brought against administrators for their fee arrangement set-ups with managed account providers, in both a data connectivity and a sub-advisory context. While these suits' outcomes are uncertain, they could prompt further scrutiny of managed account fee components.

Evolution of managed accounts: becoming an attractive QDIA

It's clear that the evolving DC landscape continues to affect managed accounts. Some developing trends, shown in *Figure 1* below, suggest that managed accounts may be well-positioned to help shape DC plans as primary retirement vehicles. The trends of recent years have been cost-focused, including the unbundling of administration and investment, the consolidation of investment choices to improve both scale and participant decision making, the addition of new strategies to ensure participant needs are met, and the increased availability of low-fee institutional investment vehicles such as collective investment trusts.

Figure 1.



While DC plan sponsors see cost-cutting opportunities as low-hanging fruit, we believe they also recognize that to help participants retire successfully, they must customize plans to some extent. To that end, we believe sponsors should engage in discussions around key areas in accumulation and retirement spending – evolving the QDIA and retirement income solutions. Given that participants' financial situations may become more complex through their careers, managed accounts may have a role to play in both of those areas.

This raises a question: What must managed account providers do in order to become more attractive as a QDIA? In *Figure 2,* we summarize some actions, all of which we believe can help move services in the right direction.

First and foremost, **costs** must come down, particularly as today's large sponsors can access off-the-shelf, passive target date funds at all-in costs of 10 basis points or less. As we explain above, the cost concern is exacerbated by the fact that many participants who default won't fully engage with the service.

One way we propose to mitigate this concern is to give managed accounts providers access to **non-core menu options.** This would enable defaulters to access more diversified portfolios than they could by solely using the core lineup. It's reasonable for sponsors to consider clarity of choice and participant behavior when designing a structure; however, a professional manager – such as a managed account provider – may benefit from a broader investment opportunity set. Today, there are recordkeeper constraints and fiduciary considerations for using non-core options, but many managed account providers could handle a construct with non-core options.

In addition to its managed account report, the GAO more recently reported on the findings of a 2016 study. Based on those findings*, the agency recommended, among other things, that limited liability relief be provided to plan sponsors that offer an appropriate mix of **lifetime income options.** While fiduciary relief could increase adoption, a service like managed accounts could help participants determine the most appropriate allocations to lifetime income options.

We feel sponsors should also be aware of, and discuss with participants, the new offerings in the marketplace, including **hybrid models** that seek to balance the low cost of target date funds with the customization provided by managed accounts. In our 2015 paper, we explained one example of a hybrid implementation. This approach strives to create a blended default: Participants are initially defaulted into a target date fund. If they don't take action, then at some trigger point (e.g., reaching a certain age) they're transitioned into a managed account at a time when they might be more engaged in retirement planning. This design may allow participants to avoid paying higher, layered management fees throughout their careers, while allowing for customization at a time when it's potentially most valuable and participant engagement levels may be the highest.

Figure 2.

Cost

Costs need to come down – especially in the current DC environment

Non-core assets

Combat the argument that unengaged participants get "an expensive TDF"

Retirement income

We believe MAs are in a position to lead the charge here and provide needed custom income solutions

Hybrids

Evolve QDIAs to balance cost and customization

Technology

Pull in more data by default for unengaged participants

Portability

Unbundle MA decision from recordkeeping decision

Flexibility

Sponsors should be able to choose services they most value

* GAO: Government Accountability Office, *401(K) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants,* GAO-16-433: Published: Aug 9, 2016.

Technology continues to improve managed account offerings. A decade ago, managed account providers typically received very little information from participants automatically – sometimes only information about balance and age. Today, it's common for providers to receive data on such things as a participant's salary, balance, age, contribution rate, retirement age, gender, state of residence, match formula, pension amount, loan amount, brokerage window allocation and outside assets. This automated personalization allows for customization at some level, even for minimally engaged participants.

Portability should continue to improve given that explicit ties between a recordkeeping platform and managed account are typically unwanted. Finally, we feel sponsors should have the **flexibility** to choose the ancillary services they value most. Certain managed account services add significant cost, which may be appropriate when the sponsor and participants value those services. For others, a lower-cost asset allocation service may be more amenable. Flexibility in implementation could help managed accounts strengthen their value-for-fee proposition and gain ground in the QDIA market.

Conclusion

Managed accounts offer a compelling service, albeit with considerations for sponsors that are driven by both today's offerings and the changing DC industry. As the market changes and participant needs and demands evolve, managed accounts will need to adapt to remain competitive, particularly to make headway in the QDIA space.

At Willis Towers Watson, we work with our clients to evaluate managed account services. Selecting a managed account provider is a fiduciary decision that should be supported by a qualitative review – to understand factors such as assumption setting, portfolio construction, glide paths, retirement income portfolios and consideration of personal circumstances – and a quantitative evaluation.

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