RETIREMENT ADVISOR COUNCIL

VIEWPOINT

TIME TO TAKE A CLOSER LOOK AT MANAGED ACCOUNTS

Why You Would Benefit From a Committee Discussion of In-Plan Managed Accounts

Managed accounts offer a variety of potential benefits, including greater personalization of retirement accounts, the ability to address individual needs, create more appropriate asset allocation, increase overall diversification, and boost plan participation and contribution rates. On the other hand, concerns and drawbacks must be addressed, including higher costs, a lack of relevant benchmarks, and questions as to how best to present managed accounts.

SO, WHAT SHOULD YOU WATCH FOR IN CONSIDERING MANAGED ACCOUNTS?

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The PPA set the stage in 2006

Passage of the Pension Protection Act of 2006 (PPA) was a pivotal moment in the history of defined contribution (DC) plans. Among other things, the PPA provided fiduciary protection for plan sponsors and advisors through the creation of qualified default investment alternatives (QDIAs).

Further to that, the Department of Labor defined QDIAs as one of three types of investments: target-date funds, balanced funds, and managed accounts. Of these three, target-date funds have taken off in popularity, and are being used as a QDIA by almost four in five defined contribution (DC) plans, with less than one-tenth managed accounts and balanced.

Although managed accounts haven't really achieved widespread usage, we believe that it's now time to take a closer look at them. In brief, managed accounts are accessible, powerful tools that can personalize and customize retirement solutions for many plan participants, possibly leading to measurably better long-term financial outcomes. However, questions remain regarding how managed accounts are implemented and how they can be optimized for the greatest employee benefit.

Source: PSCA's 2020 63rd Annual Survey of Profit Sharing and 401(k) Plans

What Are Managed Accounts?

Managed accounts are professionally managed and personalized portfolios that address the needs, preferences, risk tolerance, and situation of an individual DC plan participant. Managed accounts can also be monitored daily and rebalanced regularly with the goal of ensuring the individual participant enrolled in the account achieves retirement readiness.

They qualify as a QDIA under the Employee Retirement Income Security Act (ERISA) but can also be used within a DC plan as one of a number of investment choices, without being the default investment. They can also be used in conjunction with target-date funds as a combined QDIA.

What Has Hindered Wider Usage?

HIGHER COSTS

Managed accounts generally charge a fee separate from the investment management fees charged by underlying investment funds. That alone might make some plan sponsors reluctant to use them as an investment option or as a QDIA. There might be uncertainty or unease over fiduciary liabilities if a plan places participants into a higher-cost investment. Ultimately, however, the questions of value and net returns are more important than cost alone.

UNCERTAINTY OVER COST/VALUE

A more thorough fiduciary analysis of cost versus value is necessary before dismissing managed accounts as too costly. The key question from a fiduciary perspective is: Is it in the participants' best interest to be given the option of using a managed account in their 401(k)? While costing more, it could have the net overall benefit of higher returns and/or more appropriate asset allocation and ultimately improved retirement outcomes.

NOT WELL UNDERSTOOD OR APPRECIATED

Managed accounts are a relatively new offering for retirement plans, mostly adopted within the past decade. Further, managed accounts have continually evolved over time. That lack of a track record has until now been a hurdle blocking the wider usage and appreciation of managed accounts. However, significant changes to managed accounts in recent years mean the topic warrants review. A managed account is the most personalized account a participant can choose through the recordkeeping system.

What Has Changed?

In recent years, several developments have led retirement plan advisors and sponsors to reconsider and look more closely at managed accounts. These include:

- Costs trending lower.
- Improvements in technology and data collection leading to better access to participant information.
- Greater emphasis on more holistic financial well-being.
- Deeper appreciation for actions that plan fiduciaries can take at the plan level in support of plan participant outcomes.
- *Managed accounts can be customized* even without the participant's input. Several platforms now automatically extract a variety of participant-level data from recordkeeping systems. However, that customization is more complete and effective with active input from participants, leading to improved outcomes.
- *For optimal results,* participants use interactive online tools to help estimate retirement income and consider their entire financial picture. For example, they may enter information from external investment accounts and other assets outside of their work-sponsored retirement plan, their estimated Social Security benefits, their level of risk tolerance, planned retirement age, estimated life expectancy, health information, number of dependents, their spouse's retirement and saving information, and other relevant data.
- *Costs of managed accounts are lower now,* in part because of the use of technology. The ability to access and apply data through automation makes the managed account process more streamlined and more time-efficient on the part of an advisor as well as the managed account provider, resulting in lower and more reasonable costs. A scan of the market by Council members found fees varying between 0.05% and 0.80%. Morningstar Research has found average fees at about 0.40% with a common range of 0.35% to 0.50%.[1] The same managed account model could be available at various price points. Therefore, plan sponsors should consult with their plan advisor to understand the trade-off between service and cost that could influence their fiduciary decision.
- *A clearer understanding of fiduciary protection and obligation* by plan fiduciaries, including sponsors and their advisors. In recent years, various ERISA litigations have clarified fiduciary responsibilities, obligations, and standards. That applies broadly but also specifically to managed accounts and their usage and role in supporting improved retirement readiness.
- *Greater availability of managed accounts* by numerous providers, leading to greater competition, and improved affordability and acceptance.

PERCENTAGE OF PLANS OFFERING A PROFESSIONAL MANAGED ALTERNATIVE

Plan Size by Number of Participants	Percentage of Plans
1 - 49	22.8%
50 - 199	39.2%
200 - 999	54.2%
1,000 - 4,999	50.0%
5,000+	50.5%
All Plans	43.6%

As a result, managed accounts have increased in popularity over the past decade or so. In 2009, roughly one in four DC plans provided a managed account option. However, by 2020, more than half of DC plans with at least 200 participants offered a professionally managed option within their plan, according to findings in the Plan Sponsor Council of America 64th annual survey

This rising popularity is reflected by a stated receptiveness on the part of employees, as revealed in the findings of Franklin Templeton's "Voice of the American Worker Survey."[2]

THE SURVEY FOUND THAT:

68%

of American workers say, "I wish my employer recommended financial strategies to me based on my income and financial goals."

87%

American workers would be comfortable sharing some kind of information with employers in exchange for more personalized benefits.

55%

of American workers say, "I would prefer my employer use all available information to personalize my benefits as much as possible."

Improve well being

As employees seek opportunities to improve well being, most are interested in benefits such as access to a financial professional (56%), financial planning tools (62%) and financial education (54%).

1 https://www.investmentnews.com/whitepapers/the-impact-of-managed-accounts-on-participant-savings-and-investment-decisions-2

2 https://www.franklintempleton.com/insights/research-findings/voice-of-the-american-worker-survey

How Can Managed Accounts Be Made Even Better?

As good as managed accounts are – and they have come a long way in a fairly brief period – they can be improved further so as to take best advantage of today's technology and be used more extensively and effectively.

THESE FIVE STEPS CAN HELP MAKE BETTER USE OF MANAGED ACCOUNTS:

1 . Develop a more comprehensive view of participant assets, incorporating external data: The most effective financial planning is done with a holistic view of the client's entire portfolio and other pertinent personal information, which can include spousal data.

2. Increase personalization by making it easier for participants to engage and input their information: Although streamlined access to comprehensive participant data could reduce the need for participants to input more pertinent information, the more personal and financial data that users provide, the more complete, accurate, and effective the managed account platform can be, offering better guidance for individual users.

3. Reduce the need for participant input: Keeping in mind the above point, inertia will prevent participants from taking the time to provide all their relevant financial information. Collecting more detailed participant information from the plan sponsor or the retirement plan service provider will encourage a better end-result for disengaged or less involved users. One option is to collect some information from payroll feeds.

4. Promote better understanding and use of managed accounts by participants: To get participants to make better use of managed accounts, promote, communicate, encourage, and raise awareness and understanding of this valuable tool.

5 - Help advisors to understand and apply managed account technology better: It's not just participants and plan sponsors who need to understand and appreciate the value and benefit of managed accounts. Plan advisors should be as familiar as possible with the platform and its technology to maximize the use and benefit derived from managed accounts.

How do Managed Accounts Mesh With Fiduciary Responsibilities?

Plan sponsors have "fiduciary protections for the investment services of investment managers, so long as (they) prudently select and monitor the investment managers," according to Fred Reish, JD, a well-known and prominent ERISA attorney, who specializes in fiduciary responsibility. "This is sometimes referred to as a 3(38) "safe harbor."[3]

To qualify for fiduciary protection, therefore, the onus is on plan sponsors to prudently select and monitor providers and to document the results through committee minutes or other official records.

In selecting managed account providers, critical questions include:

- How are participant allocations determined?
- Does that comply with fiduciary principles?
- Does this reasonably reflect the needs and circumstances of each participant?
- What is the cost of the service?
- How are costs and performance benchmarked?
- Are investment expenses and account management fees reasonable?
- Are the services easy for participants to access and use?

In addressing these questions, the fiduciary process involves evaluating cost, but it's fundamentally important to consider cost in light of value received. The notion of fiduciary risk is too often mistakenly associated with selecting a low-cost option. That is not at the heart of ERISA concerns. Following a prudent and thoughtful process is, in which, as Fred Reish points out, "the analysis turns to value."[4]

"In that case," he notes, "the managed account services should be designed to provide value to participants that equals or exceeds the cost differential."

"The managed account services should be designed to provide value to participants that equals or exceeds the cost differential."

- FRED REISH, JD

Performance benchmarks are an inherent challenge with managed accounts, which are highly individual and customized. It is not the purpose of a managed account to outperform an index but rather to address individual needs and concerns and to help participants achieve a state of retirement readiness. Aside from concerns over the risks of including managed accounts in a DC plan, there are risks to plan participants if they don't have such an option.

Plan sponsor concern for the protection and privacy of, and access to participant data is on the rise as cybercrime becomes commonplace. Increases with the scope and amount of data collected to support managed accounts. Implementing managed accounts necessarily entails manager access to personal information about individual participants– advisor or service provider. Plan fiduciaries would do well to document rules of engagement regarding uses of this rich data for purposes other than delivering managed account service.

3 https://www.hartfordfunds.com/practice-management/defined-contribution-insights/fiduciary-considerations-managed-accounts-participants.html

4 https://www.hartfordfunds.com/practice-management/defined-contribution-insights/dynamic-qdias-a-transition-from-target-date-funds.html

How do Managed Accounts Compare With Balanced Funds and Target-Date Funds?

	ERISA QDIA	Adapts to age/time horizon)	Customized to individual needs, situation
Balanced Funds	Yes	No	No
Target-date Funds	Yes	Yes	No
Managed Accounts	Yes	Yes	Yes
Dynamic QDIAs: TDFs and Managed Accounts	Yes	Yes	Yes

1

Balanced funds are an improvement over low-yielding money market/stable value default funds but they don't work with a set-it-and-forget-it mentality, which is typical of many plan participants who might not de-risk as they approach retirement. For example, an allocation that works for a 25 year old typically doesn't suit a 65 year old.

2

Target-date funds (TDF) are better than balanced funds in that they are designed to be age-appropriate and to gradually de-risk along a glide path en route to the participant's retirement age. However, they fall short of the individualization and customization that is required to reflect our different preferences, levels of risk tolerance, and other situational differences.

A noteworthy finding in research for this paper, which corroborates much anecdotal evidence, is that some TDF users often invest in other funds as well as the TDFs, thereby reducing their effectiveness as a focused, one-fund approach geared towards broad age-related diversification and automatic de-risking as retirement age approaches. Only 11% of surveyed workers knew that TDFs are designed as a single-fund solution. More than six in 10 workers admitted that they didn't know anything about TDFs.[5]

3

Managed accounts are an important step beyond TDFs, providing the potential for more efficient risk-adjusted returns as well as more customization, leading to more appropriate asset allocation for many individuals. Studies, such as the one mentioned below,[5] show improved overall returns and a wider dispersion of returns and asset allocation, which underscores that one size doesn't fit all.

4

Dynamic QDIAs are another possibility. A DC plan could have multiple QDIAs, in which they use TDFs for younger participants and a managed account for older participants, suggests Fred Reish, an ERISA attorney and industry authority. Plan sponsors should consider their default options across their entire workforce, with younger participants starting off in target-date funds. Then, as they approach retirement age, when individual differences become more significant, they could be defaulted into managed accounts that would address those differences as well as the greater complexity of financial decisions as retirement approaches.

5 https://www.planadviser.com/managed-accounts-better-participants-tdfs/

Considerations

As promising as managed accounts are, there remain numerous considerations to evaluate. First, a variety of managed accounts exist, with varying levels of advice and degrees of personalization provided. These include accounts managed by an advisor, the plan recordkeeper, or a third party. Some managed accounts provide one-on-one in-person service while others rely on a less expensive and more basic digital tool.

Personalization comes in different degrees. Passive personalization relies on the automatic capture of data regarding the participant while active personalization involves the participant actively providing personal information, including outside (non-plan) assets, for a more complete picture.

As noted earlier, managed accounts could be implemented as the DC plan's QDIA, as part of a dynamic QDIA, or as an entirely optional choice, in which the individual participant takes the initiative to opt in.

Performance benchmarks are an inherent challenge as the nature of managed accounts is highly individual and customized. Imperfect substitutes can be provided as a benchmark, such as using the performance of a target-date fund family offered as a default investment in the plan, with index performance weighted. However, the main focus of managed accounts isn't to outperform an index but rather to address individual needs and concerns and to aide in plan participant retirement readiness.

Managed accounts remain a relatively new and increasingly popular and accepted option for plan sponsors to consider. They can be particularly appropriate and helpful for participants who seek more individualized attention. They can be highly useful as employees near the transition into retirement and seek more flexible, dynamic, and customized solutions.

Discussing managed accounts in a committee meeting could help plan sponsors with a heterogeneous workforce exercise their fiduciary responsibilities. We encourage sponsors to explore this option and to determine whether providing it will serve the needs of their plan participants.

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