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MANAGED ACCOUNT PROVIDERS
10 FIDUCIARY CONSIDERATIONS

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Managed accounts within defined contribution (DC) plans are receiving heightened regulatory scrutiny. This paper discusses 10 crucial fiduciary issues that plan sponsors should analyze when reviewing and monitoring managed account services and providers.

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The prevalence of managed accounts within DC plans continues to grow, leading to increased scrutiny by regulatory bodies. In July 2014, the Government Accountability Office (GAO) recommended that the Department of Labor (DOL) conduct an in-depth review of managed account services due to the potential fiduciary responsibilities facing plan sponsors, who sometimes implement these programs without the requisite due diligence. In response to the GAO recommendation, the DOL agreed that the issues raised warrant further investigation and committed to conducting such a review.

Most plan litigation hinges on procedure rather than outcome. Given the heightened regulatory scrutiny of managed account services and the complexity of the issues raised, it is essential that plan fiduciaries explicitly address their responsibilities pertaining to the selection and review of managed account providers. Fiduciary liability can be mitigated by conducting a comprehensive review and selection process, documenting the results of this process through committee minutes or other official records and by utilizing service providers as needed to understand the complexity of the issues at hand. Based on the GAO's recommendations and Mercer's experience with, and evaluation of, managed account providers, we have identified 10 crucial fiduciary issues plan sponsors should analyze when reviewing and monitoring managed account services and providers.

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1. IMPLEMENTATION APPROACH

Managed accounts, like target date funds, are permissible Qualified Default Investment Alternatives (QDIA) per DOL regulations. Accordingly, the fiduciary decision to select managed accounts as the QDIA must be documented and supported by a comprehensive analysis of the managed account provider's fees, services and investment methodology.

2. DEFAULT VS. CHOICE

A majority of participants "defaulted" into a managed account program do not utilize the features of the service that may have the largest impact on their retirement outcome — entering data on non-plan assets and answering a risk-profile questionnaire. Lack of engagement with the managed account provider by defaulted participants is often due to a lack of time, interest, and/or knowledge needed to actively manage their personal retirement goals. Accordingly, it is important that plan sponsors understand how additional participant information impacts the asset allocation and glide-path methodology of the managed account provider. As part of this review, it is necessary to understand how the managed account provider defines "personalization." For example, some managed account providers consider selecting a date of retirement as personalization, whereas other providers require participants to change the risk level or add additional account data for their account to be considered personalized. These differences will lead to significantly different results for participants.

3. CONTRIBUTION RECOMMENDATIONS

Plan sponsors need to understand and evaluate the contribution advice methodology utilized by the managed account provider, since philosophies on contribution recommendations vary significantly among providers. For example, some providers believe in a "nudge" methodology, in which participants are advised to increase their contribution rates by 1%–2% per year, even if their individual retirement outcomes goals require a contribution level that may be 4%–5% higher than their current contribution level. Other providers tell participants the actual amount they should contribute to maximize retirement readiness as soon as they are enrolled in the program. Some managed account providers advise participants to contribute less to the plan if they are "on track" to meet their stated retirement goals, while others never advise a participant to save less. Additionally, some managed account providers advise participants to save outside the DC plan before maximizing contributions to the plan. All of these distinct methodologies lead to different participant outcomes and therefore must be analyzed as part of the managed account provider evaluation.

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4. ASSET ALLOCATION MODELING APPROACH

The asset allocation modeling approach also differs meaningfully among providers. The investment assumptions (return, risk, correlation, etc.) used by the managed account provider, the methodology underlying those assumptions, and the resources dedicated to developing these assumptions differ by provider. The frequency with which the assumptions are reviewed and updated also varies. The asset allocation assumptions have a considerable impact on the retirement readiness of participants, as the allocation to equity versus fixed income can vary significantly for the same participant depending on the managed account provider.

5. PORTFOLIO CONSTRUCTION APPROACH

From a portfolio construction perspective, it is important that the plan sponsor understands and evaluates how the plan's investment options will be utilized within the managed account service model. Key considerations include the use of active versus passive funds; the minimum number of asset classes required for an optimal portfolio; the provider's ability to utilize non-plan investments (and the corresponding impact to the participant utilizing these options should service termination occur); the ability to utilize multi-manager, white-labeled investment options in the portfolio construction process; the allowable "limits" (if applicable) of company stock in the portfolio; and the use of balanced funds and target-date funds within the managed account portfolio. Differences in approach start with the initial investment direction from the managed account provider to the participant. For example, in order to reach the recommended portfolio allocation, some providers gradually liquidate a participant's current portfolio and purchase the recommended portfolio over a three-to-nine-month period while other providers liquidate a participant's portfolio and purchase the recommended portfolio immediately.

6. PARTICIPANT EXPERIENCE

While the methodology of a managed account provider is identical regardless of the plan's recordkeeper, the participant experience may vary significantly. Some areas that a plan sponsor should review include call center support (is it provided by the recordkeeper or the managed account provider?); the online experience (how is it for participants to enroll and utilize the managed account provider's tools?); and the consistency of the managed account provider's recommendations with the recordkeeper's investment guidance tools (for example, some plan sponsors opt to "turn off" certain web-based guidance tools if they are in conflict with the managed account provider's recommendations). Accordingly, it is critical to evaluate a recordkeeper's investment guidance tools and deliverables against the managed account provider's offering and to conduct a web demonstration of the managed account provider's participant experience from a usability perspective. Finally, the communication strategy and reporting provided to participants and plan sponsors will depend on the relationship of the managed account provider with the recordkeeper and the plan sponsor.

7. ADVICE TO RETIREES

Once a participant reaches the retirement phase, the advice varies by managed account provider. Most providers offer advice on drawdown strategies incorporating social security strategies as part of that advice. However, the providers differ in their capabilities to include participant health data, including savings for health care expenses. Furthermore, the drawdown strategy for participants can have meaningful variations, as some providers do not offer spend-down advice. Finally, the fees associated with continuing the managed account services during the drawdown phase vary from one provider to the next.

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8. REPORTING

Plan sponsors should require managed account providers to deliver customized reporting to both the plan sponsor and participants. It is important that the reporting include quantitative data showing the results of the managed account services relative to other asset allocation alternatives. For example, the net of fees results for the managed account participants can be compared to the results of nonmanaged account options (such as the managed account participant average contribution rate versus average plan contribution rate; the percentage of online advice participants who enter outside account data or customize two or more key criteria used for modeling versus the percentage of managed account users entering the same information; the rate of return for participants in each age cohort, often compared to the plan's target-date funds or a broad market target-date fund universe; and so on). These data will allow plan sponsors and participants to better measure the success of the services for the fees they are paying.

9. CONTRACT TERMS

Contract terms also vary among managed account providers, as plan sponsors will be negotiating directly with either their recordkeeper (who utilize the managed account provider as a sub-advisor) or their managed account provider. It is imperative to review and negotiate managed account provider contracts to ensure that the fiduciary outsourced services represent the agreed-upon participant and plan sponsor services. Key areas of negotiation include indemnification, choice of law, termination, data privacy, limits of liability, and insurance coverage. Finally, there will be a variance in the willingness of the managed account provider to implement service-level agreements or performance guarantees based on the effectiveness of the solutions.

10. FEES

Fees for managed account services differ depending on the contracting relationship with the managed account provider and the recordkeeper. Plan sponsors have a fiduciary responsibility to ensure that the fees for the managed account services are reasonable in relation to the services provided to the participant and the plan sponsor. For example, the provider may have different fee schedules for its investment advice and managed account services, depending on its relationship with the plan's recordkeeper. When a recordkeeper partners with a provider in a "subadvised relationship," the recordkeeper may have the ability to waive annual investment advice participant fees. Conversely, when the provider contracts directly with the plan sponsor, the annual investment advice fees will likely not be waived. There are similar differences in the actual managed account "basis point fees," depending on the plan's recordkeeper. Finally, since the recordkeeper collects additional revenue from offering managed account services, the plan sponsor should evaluate this additional compensation in the context of "reasonableness" of overall plan fees.

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CONCLUSION

The increased focus on managed accounts by regulatory authorities, combined with the complexities associated with the services provided, ultimately calls for greater attention to the process used to select and monitor these providers. A comprehensive, documented process can lead to better retirement outcomes for plan participants while ensuring that plan sponsors mitigate fiduciary risk.

ABOUT THE MANAGED ACCOUNT STRATEGIC RESEARCH TEAM (SRT)

Mercer's Managed Account SRT is composed primarily of field consultants who specialize in advising DC clients with managed account exposure. The SRT strives to provide a client-facing perspective on research, new ideas, and intellectual capital, and to serve as a resource for questions regarding investment issues and related consulting processes
as they pertain to managed account questions.

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