PLAN SPONSOR BEST PRACTICES FOR MANAGED ACCOUNTS

FRANCIS INVESTMENT COUNSEL LLC

866-232-6457 | WWW.FRANCISINVCO.COM | WWW.MONEYADVICEATWORK.COM

How employees invest their retirement savings within their employer-sponsored retirement plans is arguable one of the most important workplace decisions they will make. Despite this decision's importance, employees often lack the knowledge to confidently make these investment decisions on their own.

Employers have responded to this need. According to a recent Plan Sponsor Council of America survey, most employers now offer some form of asset allocation assistance to their employees.

Personalized Investment Advice Solutions

The most popular tool for providing asset allocation assistance to employees is a target retirement date suite of funds. According to the 2018 PLANSPONSOR Defined Contribution (DC) Survey, nearly three out of four (73%) plan sponsors use a target-date fund for their plan participants' default investment option. This means participants have easy access to a professionally managed, diversified investment product. The product is tailored to the participants' needs based upon their age and expected time to retirement.

Some plan sponsors, however, elect to go further by offering personalized investment advice to employees, and one of the fastest growing ways of doing this is managed account services. A managed account service gives individual investors access to personalized, professional asset allocation advice. Such a service is typically available through a retirement plan recordkeeper.

Before jumping on the managed accounts bandwagon, plan sponsors need to fully understand this offering and what it means for their plan participants.

The Advantages of a Managed Account Service

The pitch for managed accounts is straightforward enough: Target date funds are professionally managed but are not as customized to a participant's situation as is a managed account. Besides age, a managed account service can consider a participant's other assets and risk tolerance. In theory, this more personalized approach should yield a better result.

The Disadvantages of a Managed Account Service

What recordkeepers generally leave out of their pitch is the fact that as their margins continue to shrink, a managed account service can be a strong driver of additional revenue for them.

In response to shrinking margins, some recordkeepers have changed their business models to focus on "capturing" participant retirement assets in various investment products – managed accounts, for instance.

Plan sponsors need to be aware of this profit motive when providing participants access to these services. Because recordkeeper advisers are most often not fiduciaries, they're free to make recommendations that increase the fees they earn. Many service representatives receive an annual bonus which is partially determined by how much additional revenue they are able to generate for their firm.

Considerations for Managed Accounts

In our opinion, managed account services are not inherently better or worse than target date funds. Our primary concern is that plan sponsors don't blindly follow the recommendation of a service representative with a strong profit motive. Instead, they should carry out proper due diligence before making the important fiduciary decision whether to add a managed account service.

Here are some of the most important items we recommend plan fiduciaries address when making the fiduciary decision whether to add a managed account service:

Implementation Approach: Review the data needed by the managed account provider when providing advice. At a minimum, the provider should review the participant's age, income, risk tolerance, current plan savings, contribution rates, spousal data, and outside plan savings.

Asset Allocation: Review the methodologies utilized in creating portfolios to match each individual participant's unique circumstances to the portfolio recommended. For instance, a plan sponsor should review assumptions used by the provider if the stated goal is to achieve a defined retirement income replacement ratio. Compare this information to the plan's target date provider assumptions.

Historical Performance: Review the historical performance of the managed account service provider. When contemplating hiring a professional asset management service, the investigation of proof of skill (i.e. track record) is a key element in a prudent process.

Participant Experience: Determine how often the portfolio will be reviewed with each participant, the circumstances that would prompt a change in the account's allocation, and whether interactions between the participant and service provider are recorded to assist the plan sponsor in auditing the advice provided.

Fees: Review fees and the procedures followed by the provider to ensure participants understand what they are paying for the service. Compare these fees to those incurred when utilizing the plan's target date funds.

Data Privacy: Understand how the provider manages participant information. Participant information should not be used for the purpose of solicitation if the provider offers other products or services.

Some of the managed account providers we've reviewed are not able to provide all of the above information making it difficult, if not impossible, to satisfy an expert's definition of a prudent selection process.

Further Fiduciary Concerns

Recent lawsuits, alleging "kick-backs" from managed account providers to recordkeepers, raise the concern of undisclosed conflicts regarding how and why managed account services are offered. If a plan sponsor makes these types of services available, the first question that should be asked is, "Is your firm acting as an ERISA fiduciary when it recommends a managed account to a participant?"

If their answer is yes, they should be able to provide confirmation in writing that they are an ERISA fiduciary. It is illegal for an ERISA fiduciary to make a recommendation that increases its own compensation or is not in the participant's best interest.

If the answer is no, understand the fiduciary "recommending" the participant incur the extra costs of a managed account service is the plan sponsor.

Due Diligence is Key

We recommend plan sponsors consider the due diligence completed to confirm the appropriateness of adding a managed account service to the Plan. Proper execution of a clearly defined due diligence process is key in demonstrating the prudent selection of a managed account service.