Reverse the search

An alternative approach to Defined Contribution recordkeeper and target date fund manager searches

When defined contribution (DC) advisors conduct a search for a new retirement plan, they typically have three goals in mind:

Finding the best recordkeeper at the most efficient price.

Identifying the most appropriate QDIA[1], which is often a target date fund (TDF).

Ensuring the consistency of recordkeeping fees.

ADVISORS CAN TAKE DIFFERENT PATHS TO REACH SEARCH OBJECTIVES—ALTERNATIVE OPTIONS MAY BE WORTH CONSIDERING.

A conventional approach separates the search into two phases: first, choose the record-keeper. Then, choose a QDIA solution. An alternative is to reverse the order of the search. By that we mean selecting the TDF provider first and the most appropriate recordkeeper second. A different order doesn't have to change the essential element of any retirement plan search: DC advisors who act as fiduciaries must follow a prudent process when helping plan sponsors. Their objective is to help clients choose a strong plan that meets their goals.

Reversing the search can offer advisors an opportunity to maintain a prudent plan selection while taking full advantage of potential discounts coming from their plan's target date fund choice.

CASE STUDY: HOW A PLAN SPONSOR COULD HAVE BENEFITED FROM SELECTING A TDF MANAGER FIRST

A DC advisor recently conducted a 401(k) search for a client with $15 million in plan assets and 175 active participants.

PHASE 1 | Recordkeeping only search

The advisor asked four well-known providers of bundled 401(k)s to submit R6 (retirement plan share class)[2] pricing proposals for recordkeeping and administration only—assuming their proprietary funds would not be included. Each made a compelling presentation.

PHASE 2 | Target date fund search

Next the advisor conducted a search for a target date fund manager suited to the plan sponsor's objectives and participant demographics. She also advised the client to conduct a TDF re-enrollment, defaulting participants (unless they chose to opt out) into an age-appropriate TDF vintage for their presumed year of retirement.

Alternative approach | PHASE 2 then PHASE 1

If the TDF manager had been selected first, and the advisor had requested the same four recordkeepers provide R6 TDF re-enrollment pricing second, their proposals would have looked different.

CONVENTIONAL APPROACH 1 → 2

RECORDKEEPER	PRICING*
Provider A	**0.32%**
Provider B	0.28%
Provider C	0.36%
Provider D	0.22%

The committee chose Provider A for its competitive fees and respected brand.

REVERSE THE SEARCH 2 → 1

RECORDKEEPER	PRICING
Provider A	0.32% (chosen in the first round)
Provider B	0.28%
Provider C	**0.00%**
Provider D	0.22%

Provider C is the TDF manager selected by the committee and can apply its investment fees to recordkeeping and administration.

* Pricing was expressed in basis points of required revenue

[1] A plan's qualified default investment alternative (QDIA), which may be a target date fund (TDF) based on participants' date of birth, is the fund to which all participants' assets are automatically moved during a reenrollment, unless the participant makes a new investment election during a specified time period.

[2] R6 shares are offered at net asset value (NAV), with no front-end sales charges (CDSC) or 12b-1 fees.

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WHAT BROUGHT THE PRICING DOWN IN THE REVERSED SCENARIO?

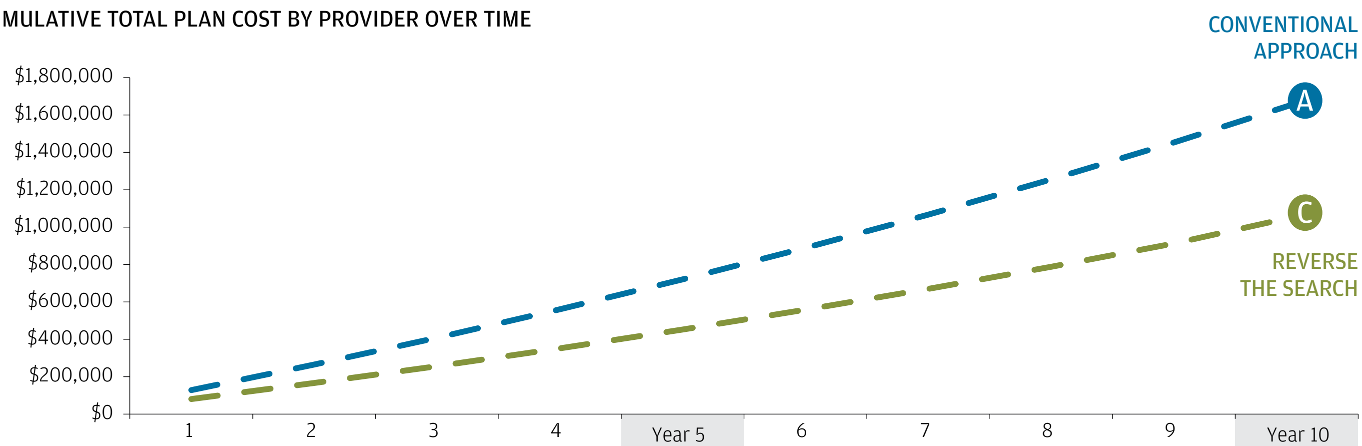
Provider C is also the TDF investment manager that was selected by the advisor for the plan and applies the fees it receives from investments toward plan recordkeeping and administration. Provider C's total plan cost would have been $48,000 per year *less* than Provider A's—provided the plan sponsor uses Provider C's target date fund. Choosing to reverse the search has a significant impact over 10 years as seen below.

ENSURING THE CONSISTENCY OF RECORDKEEPING FEES

If an advisor chooses a TDF and recordkeeper from the same provider, they may want to consider the conditions that would trigger a re-pricing of the plan. For instance, what happens if the advisor switches out the target date fund because it underperforms the investment policy statement?

Advisors should read the fine print in the services agreement and ensure their client is prepared for all contingencies.

CUMULATIVE TOTAL PLAN COST BY PROVIDER OVER TIME



Year 5	Cumulative total plan costs	Year 10
$720,248	Provider A	$1,662,477
$452,249	Provider C	$1,043,881

Source: J.P. Morgan pricing, as of 4/3/17.

CONCLUSION: REVERSED SEARCH AND PRUDENT PLAN SELECTION

When conducting DC recordkeeping and investment searches, advisors are looking to accomplish several goals: to minimize plan costs, ensure recordkeeping fees are consistent, and above all, help plan sponsors meet participants' retirement savings goals through selecting the most appropriate TDF. Reversing the search can offer advisors an opportunity to maintain a prudent plan selection while taking full advantage of potential discounts coming from their plan's target date fund choice.

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