Fisher Investments Institutional Group®

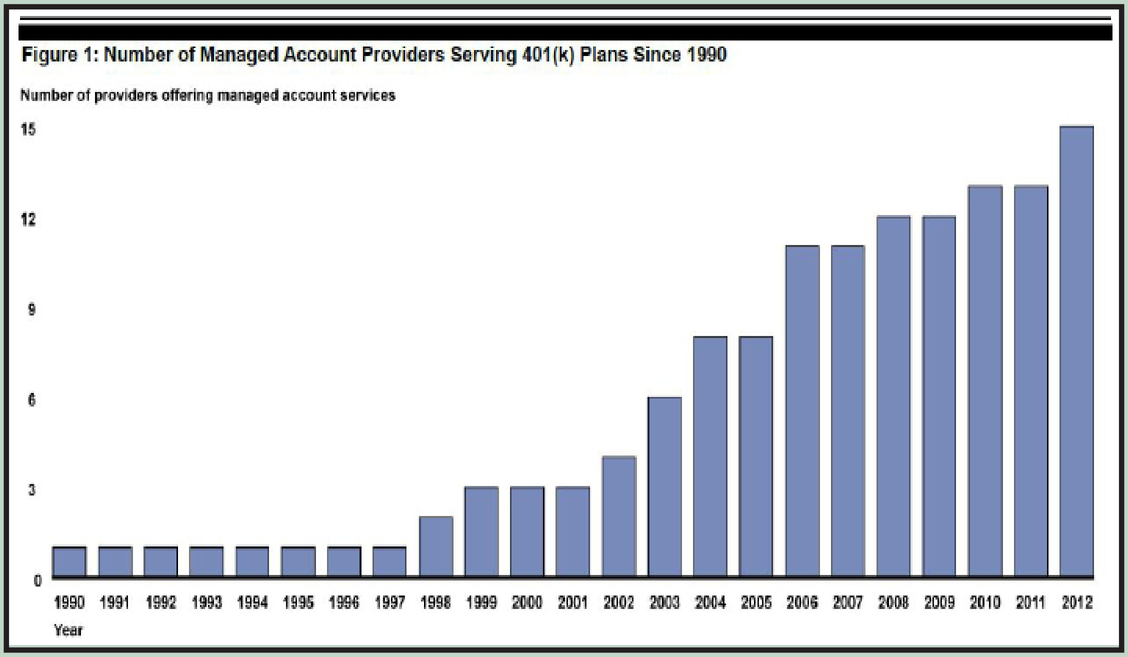
Personalized Retirement Outcomes (PRO)

Myths of Managed Accounts

INTRODUCTION

Retirement managed accounts (RMAs) have the potential to greatly improve retirement outcomes for hard-working defined contribution plan participants. Although adoption of RMAs has begun to steadily grow, many plan sponsors and retirement plan advisors have overlooked RMAs as a result of outdated misconceptions about the feasibility and a lack of awareness of the benefits they deliver. What are RMAs? According to the United States Government Accountability Office, they are "investment services under which providers make investment decisions for specific participants to allocate their retirement savings among a mix of assets they have determined to be appropriate for the participant based on their personal information."[1] In other words, RMAs leverage personalization for each individual participant, taking into account their total financial picture and tailoring asset allocations to meet their specific retirement needs.

RMAs are not a new concept as they have been available to 401(k) plans since the 1990's.[2] It wasn't until the Pension Protection Act of 2006 - when the Department of Labor included managed accounts as one of three Qualified Default Investment Alternatives (QDIA) eligible for safe harbor protection – when the number of retirement managed account providers began to grow steadily in the defined contribution space.[3]



Source: GAO Analysis of information from managed account providers. GAO-14-310

While plan sponsors and advisors saw the great potential of personalized solutions, the service providers within the defined contribution industry originally didn't have the technology nor product structure necessary to allow RMAs to effectively provide individually-tailored solutions as a default. The industry instead settled for Target Date funds, which offered at least some degree of personalization, albeit just based on age. While Target Date funds have dominated QDIA selection over the past decade, advancements in financial technologies (FinTech) have occurred that have positioned retirement managed accounts to finally deliver on the massive benefits a personalized solution can provide as a default investment for hard-working retirement plan participants. Progressive retirement plan advisors and plan sponsors have recognized these advancements and have begun to embrace retirement managed accounts. In this paper, we introduce the first myth in our series of "myth busters" discussing the common misconception that in order for a managed account solution to be effective it requires action on behalf of the participant. We will explore this and four additional myths relating to retirement managed accounts over the course of the next few months that include:

1. Managed accounts do not benefit younger participants
2. Managed accounts are too expensive
3. A managed account service diminishes the role of the plan's advisor
4. Managed accounts are hard to benchmark.

Myth #1

MANAGED ACCOUNTS REQUIRE PARTICIPANT ACTION IN ORDER TO BE EFFECTIVE

There are two reasons this myth exists. There are some (although rare) retirement management accounts that base their "personalization" purely on age and a participant-completed subjective risk tolerance survey. We'll set aside some obvious issues with basing participant allocations strictly on subjective risk tolerance for now, but needless to say, unless the participant completed the survey, these solutions add little value over strategies that rely solely on participant age. Additionally, some advisors still believe all RMAs require participant input to add value because...that used to be true. The more common RMA approach, including the approach used by Fisher Investments Personalized Retirement Outcomes (PRO), is to use known information about a participant to deliver a personalized investment path toward building a sufficient level of retirement income for that individual. However, when RMAs were approved as a QDIA in the Pension Protection Act of 2006, very few recordkeepers and RMA providers had the data quality nor technology to automatically provide important participant-level information. Delivering true personalization via a default solution wasn't within reach for most of the industry for much of the first decade following the PPA.

Fast forward to today and you'll see many recordkeepers and RMA providers now have the technology and data in place to allow RMAs to deliver on the promise of personalized portfolios for each participant, even 'defaulted' participants. Retirement Managed Accounts using a financial situation-based approach leverage data points provided by the recordkeeper, such as age, salary, savings rate, account balance, state income tax rate, gender and even pension income in some cases to create value for the participants even without any action on the participants' part. Using this automatically-provided information, RMAs such as Fisher Investments Personalized Retirement Outcomes can create a personalized asset allocation tailored to each plan participant and update the allocation as the participant's circumstances change. As such, a managed account leveraging default information is a far better solution than a target date fund creating asset allocations solely on age.

2%	87 bps	20%
HIGHER DEFAULT RATE	ADDED VALUE	ENGAGEMENT
The median defined contribution plan participant defaulted into a managed account saves 2% of salary more, on average, than the median participant defaulted into a target date fund.[4]	An unengaged participant at age 50 can experience an 87 basis point increase in value by receiving a more optimally personalized allocation, savings rate advice and by mitigating negative behavioral tendencies.[5]	Morningstar analysis shows approximately 10% of participants engage with the managed account program at or shortly after enrollment, and that the level of engagement increases to over 20% after being defaulted in the solution after 2 years.[6]

To back up this assumption further, Empower's article titled "Made to Measure" provides an excellent analysis identifying the additional value a retirement managed account (RMA) service provides to participants. When evaluating the impact of a financial situation-based approach, Empower calculates an unengaged participant at age 50 can experience a 27 basis point increase in value by receiving a more optimally personalized allocation. While allocations can be tailored even more for a participant who chooses to provide additional details (e.g. spousal age, health, etc.), the information provided for defaulted participants captures 90% of the allocation benefit.[7]

Beyond improving allocation fits, RMAs have shown to generate value for unengaged participants by improving behaviors that can help lead to more successful outcomes. Most notably, RMAs have proven to drive increased participant saving rates, and as Empower notes, the "increased retirement contribution aren't limited to engaged participants."[8] Numerous studies have concluded this same surprising result. Morningstar reports the median defined contribution plan participant defaulted into a managed account saves 2% of salary more, on average, than the median participant defaulted into a Target Date Fund.[9] According to Empower, this increase in savings rates generates an additional 30 basis points of value to unengaged participants.[10]

Additionally, RMAs have shown to be the "stickiest" QDIA, meaning more participants choose to stay invested in professionally-managed RMAs at a higher rate than Target Date funds or Balanced funds.[11] Having the confidence to stay within the plan's professionally-managed QDIA further helps the participants avoid their own harmful investment behaviors, generating additional 20-40 basis points of value for unengaged participants.[12] While we feel the case is clear that RMAs generate value for "defaulted" participants, RMAs deliver one last benefit: they improve engagement from otherwise unengaged participants. When managed accounts are used as a qualified default investment alternative, Morningstar analysis shows "approximately 10% of participants engage with the managed account program at or shortly after enrollment, and that the level of engagement increases to over 20% after being defaulted in the solution after 2 years."[13] Not bad for a group of typically unengaged individuals.

Individuals who invest in a Qualified Default Investment Alternative (QDIA) are generally unengaged to begin with; they are taking zero action to direct their retirement plan investments and rely on the plan's decision to provide a helpful default investment option.[14] With the level of financial illiteracy present in today's U.S. workforce[15] it is no surprise the "default" option is what approximately 85% of plan participants tend to go with, many of who are in drastic need of help in order to have enough money for retirement.[16] With roughly 75% of Defined Contribution plans using Target Date Funds as the default option of choice,[17] we have to ask ourselves, "What can we be doing to ensure better outcomes for our plan participants?" Clearly, studies show additional value can be realized for the unengaged participant when enrolled in a retirement managed account service.

So, to recap, it used to be true that RMAs needed participant action in order to provide value, but that's no longer the case. Thanks to advances in technology and data quality, RMAs can be used as a default solution and deliver 152-257 basis points of annual value to participants by individually-tailored investment allocations, driving increased savings rates, and giving participants the confidence to stay within the professionally managed default option selected by the plan.[18] After all the effort advisors and plan sponsors have put into encouraging participants to increase saving rates and improve their retirement outlook, who would have thought, choosing a Retirement Managed Account, like Fisher PRO, as the default option could be a major boost to finally achieving successful results.

ABOUT FISHER INVESTMENTS PERSONALIZED RETIREMENT OUTCOMES SOLUTION

Fisher Investments Personalized Retirement Outcomes (PRO) is a next-generation managed account created to help improve retirement outcomes for participants and their plan sponsors. Available to a retirement plan as either an affordable Qualified Default Investment Alternative (QDIA) or as an additional positive election option, PRO utilizes information automatically provided by the recordkeeper to implement and monitor personalized asset allocations for each individual participant without requiring engagement. For no additional cost, PRO offers an easy-to-use online portal for participants who would like the option to better understand their retirement outlook and provide additional information (such as spousal age and outside income) that could further refine their personal asset allocations.

Unique amongst all managed account options, PRO participants receive the benefit of actively managed investment funds advised by Fisher Investments tenured Investment Policy Committee (IPC) allowing for cohesive and effectively communicated management in addition to providing risk controls should market conditions change. PRO's consistent and streamlined approach to portfolio construction provides participants diversification without complexity and allows for plan sponsors and their retirement advisors easy benchmarking capabilities. As a service oriented organization with a strong background in delivering personalization to both high net worth individuals and institutions across the world, the Fisher Investments PRO team will work alongside retirement advisors and the plan sponsor to offer a customized service plan tailored to their needs. We encourage all plan sponsors and advisors to embrace their fiduciary responsibilities and consider whether PRO could improve the retirement readiness of the participants more so than the plan's existing investment options. While the benefits of managed accounts have been documented in numerous studies not all plans are alike.

To see if your plan could benefit, please contact Fisher Investments Personalized Retirement Outcomes (PRO) for a free analysis of your plan at:

(888) 803-1621 or FisherPRO@fi.com
www.fi-inst.com/pro

Disclosures

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Endnotes

1. United States Government Accountability Office (GAO) – Report to the Ranking Member, Committee on Education and the Workforce, House of Representatives "401(k) Plans: Improvements Can Be Made to Better Protect Participants in Managed Accounts"
2. Ibid.
3. Ibid.
4. Morningstar "The Impact of the Default Investment Decision on Participant Deferral Rates: Managed Accounts vs Target-Date Funds."
5. Empower Institute "Made to Measure; Evaluating the Impact of a Retirement Managed Account."
6. Morningstar "The Default Investment Decision: Weighing Cost and Personalization."
7. Empower Institute "Made to Measure; Evaluating the Impact of a Retirement Managed Account"
8. Ibid.
9. Morningstar "The Impact of the Default Investment Decision on Participant Deferral Rates: Managed Accounts vs Target-Date Funds."
10. Empower Institute "Made to Measure; Evaluating the Impact of a Retirement Managed Account"
11. Morningstar "Which Default Investment is the Stickiest"
12. Ibid.
13. Morningstar "The Default Investment Decision: Weighing Cost and Personalization."
14. Manning & Napier "Managed Accounts in Defined Contribution Plans" (November 2, 2016) https://www.manning-napier.com/insights/blogs/research-library/managed-accounts-in-defined-contribution-plans
15. University of Pennsylvania Law School – Institute for Law and Economics "Defined Contribution Plans and the Challenge of Financial Illiteracy."
16. Morningstar "The Default Investment Decision: Weighing Cost and Personalization."
17. Ibid.
18. Empower Institute "Made to Measure; Evaluating the Impact of a Retirement Managed Account"
19. Morningstar "The Default Investment Decision: Weighing Cost and Personalization."