CURCIO ✦ WEBB

MANAGED ACCOUNT CHECKLIST

A Guide for In-House Fiduciaries

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Summary

Our goal at Curcio Webb is to provide independent, objective advice and guidance so companies can make the most appropriate decision about their employees' retirement and health and welfare benefits options. We work with companies in the areas of financial due diligence, increasing employee engagement and risk mitigation.

There have been several class action lawsuits filed on behalf of participants in 401(k) plans sponsored by major employers. The commonality: Fidelity served as the recordkeeper and Financial Engines, Inc. (FE) provided participant-level investment advice and managed accounts services. It was alleged that FE had a relationship with Fidelity to gain access to Fidelity clients and facilitate FE's service delivery. For this, FE allegedly paid Fidelity asset-based fees that plaintiffs claimed were unreasonable relative to the services Fidelity provided to FE.

Courts have ruled against the plaintiffs and dismissed these complaints because, the courts found, Fidelity was not involved in the fiduciary decision to offer managed accounts or the selection of FE as the managed account provider. As the court in the lawsuit relating to a Delta Air Lines 401(k) plan stated:

> "If Delta believed, as the Complaint alleges, that the fee-sharing arrangement between [Fidelity] and FE wrongfully inflate[d] the price of investment advice services, Delta was free to decline to hire FE or terminate its relationship with [Fidelity] and FE to avoid an unfavorable fee-sharing arrangement."

This recent litigation has significant implications for in-house fiduciaries in relation to participant-level investment advisors (also referred to as managed account providers). Our in-depth evaluations of these firms show significant differences among providers that in-house fiduciaries should consider. Additionally, this litigation reinforces the importance for an in-house fiduciary to document its diligence related to the selection and monitoring of a managed account provider. The checklist included herein reflects the factors we recommend be considered during the evaluation.

Considerations for in-house fiduciaries

Arrangement Between Managed Account Provider and Recordkeeper

As with the selection and monitoring of any service provider, it is well understood that in-house fiduciaries need to consider the services provided and fees charged to participants by managed account providers. The court decisions re-enforce the need for in-house fiduciaries to consider the arrangement between the recordkeeper and the managed account provider and, more specifically, the services rendered by each and the amount and basis of fees paid and revenues shared. From our evaluations, two of the most common models are:

- ***Direct Access.*** In this model, the plan contracts directly with the managed account provider and the recordkeeper provides a technology bridge to the managed account provider's website (and potentially access to clients). In exchange, the managed account provider pays the recordkeeper a fee (historically asset based).
- ***Indirect/subcontracted.*** In this model, the plan contracts with the recordkeeper (or an affiliate) for managed account services. The recordkeeper then subcontracts with or licenses modelling technology from the managed account provider. In this model, the recordkeeper provides some direct participant services, for instance, staffing the call center with advisory representatives, and buys other services from the managed account provider – for which it pays a fee.

Both models raise difficult questions in relation to the fees paid for the services rendered, namely, how to assess whether they are reasonable. There are no clear-cut answers however, in our experience, plans with more than $50 million in managed account assets whose providers share revenues through asset-based formulas need to take special care in the assessment of the revenue allocation.

IMPORTANT: This does not mean fiduciaries must choose the least expensive provider. Managed account providers differ in important ways, for instance, as to investment philosophy and service delivery, and divergent fees may be justified. Thus, an in-house fiduciary may need to dig deeper into a managed account provider's business model, financial arrangements, and partner relationships than is typical when evaluating potential service providers.

Engagement in Dynamic Evaluation & Monitoring Process

With the popularity of managed accounts, the growing number of providers, increasing variety of managed account products, and the opportunity for multiple providers to be offered on a single recordkeeping platform, Curcio Webb clients have increasingly requested managed account provider evaluations. Our experience indicates that managed account providers differ considerably across many parameters. This makes comparisons difficult and requires a dynamic evaluation process, investigating available providers, thinking about what might work best for participants given their unique circumstances, and circling back to providers for further in-depth review. In cases where in-house fiduciaries may not have multiple options documenting the diligence efforts remains important.

Making a prudent selection of a managed account provider is not the end of the story. Like all appointed fiduciaries, the managed account provider must be monitored by the in-house fiduciary to ensure the appointment remains prudent over time. Because they provide participant-customized investment management, managed account providers and the accounts they manage represent a unique investment option and it is not obvious how to evaluate prudence over time. Typical approaches to monitoring investment managers do not easily carry over to managed accounts. For example, well established benchmarks to compare managed account performance are not available.

Finally, adding to the confusion and complexity is the fact that this is an evolving landscape with providers introducing new products and services, creating an expanding array of alternatives.

Notwithstanding the complexities, developing a prudent evaluation and monitoring process is possible. We have developed this guide to provide following high-level checklist that may be useful to in-house fiduciaries.

1. Investment Philosophy

Managed account provider investment philosophies differ widely, with some advocating a totally passive approach and others incorporating varying degrees of active management. Projections of returns and risk (important in determining basic portfolio allocations) vary as well, with some adjusting them more frequently and others taking a longer-term approach.

Questions to consider include:

- What is the foundation of their investment philosophy?
- How are the projections of returns and risk developed?
- What are their projects for returns and risk by asset class?
- What asset classes are considered?
- Do they accommodate active, passive or both styles of management?

2. Distribution Solutions

Some providers offer distribution solutions (also referred to as "decumulation" services), that is, services, tools or products intended to help manage the spend-down of the account.

Questions to consider include:

- What, if any, distribution solution is offered?
- What is the philosophy and process for managing and distributing assets during the draw-down phase?
- How are participants migrated from the accumulation to distribution phase?

- How are outside assets and other benefits, such as Social Security, pension, etc., considered?
- Are insurance products incorporated?

3. Proposed Glide Path

Each managed account program has a "baseline" glide path (shifting the investment strategy from return seeking to capital preservation as retirement approaches) around which participant portfolios can be customized. The shape of this glide path and its terminal point (point at which there is no more movement of assets) differ among providers, based on their varying assumptions and models relating to retirement savings.

Questions to consider include:

- What is the baseline glide path?
- What is the terminal point of the glide path?
- How often are assumptions revisited and how does that process occur?
- How much can participant customization impact the shape of the glide path and the participant portfolios?

4. Portfolio Customization

Most managed account providers allow participants to shape a retirement portfolio based on assets in the plan account plus assets held outside of the plan, target retirement age, and/or risk tolerance. An important difference among providers is the set of parameters a participant can use to customize their portfolio and the potential impact that may have. Some providers offer a handful, while others offer more than twenty.

Questions to consider include:

- Besides current age, risk tolerance and retirement age, what factors are or can, if the participant wants, be used to create a customized portfolio?
- What customization options are most popular?
- What customization options have the largest impact the participant portfolio and how large is the impact? Smallest?
- What percentage of participants use each of the customization options?

5. Approach to Company Stock

Fiduciaries of plans that offer company stock as an investment option face a binary choice – providers either embrace company stock or virtually exclude it from the scope of services. Some providers are willing to take on the fiduciary responsibility of company stock oversight (which generally results in much smaller individual positions) while others prefer to minimize responsibility for this aspect and exclude it from consideration. Given the variety of views expressed toward company stock, this difference in approach can be important to plan sponsors.

Questions to consider include:

- What is their approach to company stock allocations – does their model consider or exclude?
- If the model considers company stock allocations:
    - Is there a maximum allowable exposure?
    - If the allocation exceeds the maximum, how quickly is it reduced?
- Can the participant control the allocation to company stock?

6. Pace of Transition

The speed at which managed account providers will transition a new participant account from its current to its managed optimal state varies. Some implement the change immediately while others move more gradually, considering entry points and market impact.

Questions to consider include:

- How quickly is a new participant account transitioned to a more optimal portfolio?
- Does the participant have any discretion over the transition?
- What factors are taken into consideration in the portfolio transition?

7. Frontline Advisors?

Some providers use their own advisors to consult with participants. In other cases, the recordkeeper offer advisors (distinct from the call center). In a few cases, no specialized advisors are available. Either way, it's important to understand advisors' qualifications, training and experience.

Questions to consider include:

- What is the educational background of the advisors?
- What type of initial and ongoing training do they receive?
- How are the advisors monitored?
- What type of certifications do they have?
- What is the turnover of the advisory staff?

8. Fees

It's important to not only understand the fees charged to participants, but, as noted above, the sharing of revenues between the recordkeeper and the managed account provider. Where managed account assets are over $50 million, and the transfer payment is asset based, this can raise questions about the reasonableness of these charges.

Questions to consider include:

- What fees are charged to the participants and the plan sponsor?
- What services does the recordkeeper provide?
- What services does the managed account provider offer?
- How are roles and responsibilities allocated between the recordkeeper and managed account provider?
- How are the fees shared between the recordkeeper to the managed account provider? Is the fee structured as an asset-based or fixed fee?
- Are the fees reasonable for the services delivered?
- Are each of the recordkeeper and managed account provider's revenues reasonable?

9. Results

At the end of the day, the managed account program needs to demonstrate positive results. There are many ways of assessing results, such as higher contribution rates, more efficient portfolios, or net of fee performance relative to a benchmark. Whatever the metrics, documenting the value for the fees paid is critical.

Questions to consider include:

- What is the participation rate and average length of participation?
- What are the net of fee performance results (risk and return) of the managed accounts? How do the results compare to a relevant benchmark?

- Are participant portfolios reasonable, given the circumstances?
- Are portfolios more risk appropriate (relative to a participant's age)?
- What has been the impact on contribution rates?

Do you need help?

Curcio Webb opened its doors in 1997 with the sole purpose of creating a business that is independent, objective, and provides deep employee benefit and investment technical expertise. This allows us to solve what is most important to you without bias or a preconceived agenda.

Curcio Webb's consultants bring a breadth of experience and the mindset of service to each project. The underlying principles of our business are demonstrated daily by the way we interact with each other, our clients, and service providers.

We have a thriving and successful business with people that are leaders in their industries. We've had the privilege of partnering with businesses over two decades who have given us a wide array of references relevant to our culture, service, and technical prowess. Nevertheless, we never take our success for granted. We always ask how we can get better.

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