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Learning from Institutional 401(k) Plans

The practices employed by institutional plans can help guide retail plan sponsors.

In our view, many of the best practices developed in the retail and under-$250 million 401(k) and 403(b) markets come from their institutional peers. Understanding these trends not only allows retirement plan advisers (RPAs) to be forward-thinking, but gives their retail plan sponsor clients confidence to make improvements.

The Callan Institute 2020 Defined Contribution Trends Survey offers interesting insights on the institutional DC market (114 plan sponsors, of which 87% have more than $200 million in assets and 65% have more than $1 billion) and a peek into the future for retail plans. Here are some key highlights:

Target Date Funds

- 93% of institutional plans offer a target date fund (TDF) compared to just 40% of plans surveyed by Society for Human Resource Management (SHRM) – *70% of plans have fewer than 500 employees*
- 77% of TDFs are fully or partially indexed
- 17% of plans use a custom TDF with another 20% planning to offer one in 2020 due to:
  - Best-in-class investments
  - Costs
  - Control over glidepath
- 87% use their TDF as the default option
- Just 21% use their recordkeeper's TDF

We believe there's a huge opportunity for RPAs to move DC clients into TDFs, especially as the default option, with only 40% offering them in the retail market, partly because just 42% deploy auto enrollment. The move away from the recordkeeper's proprietary TDFs is obvious, as is the use of indexing. Custom TDFs offer larger RPA groups or practices the opportunity to generate additional revenue as the 3(38) adviser, although there are fiduciary concerns.

Investments

- 80% of plans use institutional vehicles, such as the institutional share class, SMAs and CITs
- Just 12% use a bundled model where only the recordkeeper's funds are offered
- 86% use mutual funds, up from 83% in 2018; 70% use CITs, down from the previous year
- 94% have an investment policy statement

There's a move to CITs in the institutional market happening as plans try to get lower fees and more transparency between investment fees and recordkeeping fees. Similarly, the move away from recordkeeper's proprietary funds is occurring in the retail market, which may require the RPAs to work with the plan sponsor on how to move to a per-participant recordkeeping fee model.

Fees

- Fees are a top priority for institutional plans, driven in part by increased litigation risk
- 67% plan to switch to a lower-cost fee share class
- 50% plan to renegotiate manager fees and 45% recordkeeper fees
- Only 12% rely exclusively on revenue-sharing, compared with 65% that deploy a per-participant fee
- Just 15% plan to issue an RFP as a way to benchmark fees, with most relying on databases from the consultant or recordkeeper

The increased focus on fees is causing institutional plan sponsors to move to more transparent solutions. We believe RPAs of retail plans will follow that model, so expect to see more per-participant fee structures and fee-based advisor solutions.

Plan Design and Participant Services

- Auto features by larger plans
  - Enrollment
    - New employees: 71% for institutional plans compared with just 42% for retail plans
    - Current: both at 20%+
  - Escalation: 76% compared with 19% for retail
  - Investment re-enrollment: 18%
- Plan to retain assets of retiring or terminated employees: 72%
- 95% offer advice or guidance, although mostly through online, managed accounts and group seminars
- 87% offer a Roth option
- 50% expect to add financial wellness services

Obviously, there's a huge opportunity for RPAs to move retail plan sponsors into the auto plan design, which should increase use of TDFs and overall participation rates. Larger plans see the value of keeping participants in the plan post-retirement and retaining assets, so they have more leverage to negotiate provider fees. Though still a buzzword with little impact, "financial wellness" is in demand, as is providing participant advice solutions.

Larger plans are still reluctant to offer annuities or retirement income products that use them because they have fiduciary concerns, see little demand from participants, and are concerned about insurer risk and costs. This is also true for smaller plans.

Overcoming the Hurdles

While HR professionals are eager to make changes to assist employees in their DC plan, they sometimes hit a brick wall with senior management concerned about costs, work and liability. RPAs need to help clients overcome these hurdles and show the benefits whether because of increased productivity, better retention and recruiting, as well as transitioning older more costly workers into retirement. Using statistics from the institutional market can help, but even more effective would be to compare the plan with progressive peers that are of similar size, industry and location.

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