



BY JERRY BRAMLETT

# Improving DC Outcomes: A Joint Effort

Responsibility for optimizing outcomes is shifting toward the advisor as coordinator of best practices among providers.

**B**eyond the DC investor, there are three primary providers that affect investor outcomes: the plan sponsor, the record keeper (or TPA) and the investment advisor (or consultant). As it relates to improving outcomes, it is not necessarily the case that all three parties will agree on the best course of action.

Nonetheless, to maximize the impact of dollars being contributed to DC plans, it is critical that plan sponsors and their DC providers work in tandem to enhance outcomes. The investment advisor (due to its potential fiduciary role) is in the best position to affect outcomes; however, the degree to which it can be effective can vary quite widely from plan to plan.

## Plan Sponsor

The assumption often is that plan sponsors have a deep and abiding interest in improving DC outcomes. For many this may be true, but it is certainly not the case with a majority of plan sponsors. Though most plan sponsors will make changes to enhance outcomes, they will do so only if the cost is not considered overly steep.

It is important to consider that the employer has dedicated (within a certain range) a certain dollar amount to fund and manage its DC plan. The plan advisor must work within these parameters when suggesting that the plan sponsor make potentially costly plan design changes. For example, how do the default contribution level, auto escalation and the structure of the company's match affect savings levels and employer costs?

The impact of these plan design features can vary greatly based on plan demographics. It is important to sift through these various factors so as to arrive at a

structure that balances the need to remain under the employer's allocated expense ceiling while managing expenditures and maximizing participants' level of savings. One practical starting point for discussion are the observations and recommendations found in Shlomo Benartzi's book, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans*.

## Record Keeper

Plan advisors have different levels of influence with the various record keeping providers, of both the bundled and unbundled variety. An advisor's influence can often be direct, such as when the record keeper falls under the same corporate umbrella. At other times, the relationship may be entirely new, with both the advisor and the record keeper working together to determine the boundaries of their relationship.

In many, if not most, situations there is significant overlap between record keepers and investment advisors. Plan design and employee communication programs are two areas that often require a great deal of coordination. While the investment advisor is clearly responsible for providing an investment lineup and an asset allocation implementation strategy, how DC investors construct their investment program can be significantly affected by the way the record keeper, through its enrollment systems, presents participants with their investment options.

For example, are the investments presented as a long list of core options in a menu format along with a long list of asset allocation options? Or are the participants presented with two investment options: "do-it-yourself" or "do-it-for-me"? While numerous studies (e.g., Financial Engines, Fidelity, John Hancock) have shown that

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do-it-for-me participants consistently achieve better outcomes than do-it-myself investors, many record keepers persist in presenting decision trees that effectively turn all DC investors into do-it-myself investors.

## Investment Advisor

The investment advisor's explicit role is to create a process and procedural framework for selecting and deselecting funding options in the plan's investment lineup. Unfortunately, best practices do not necessarily follow from simply ensuring that good processes and procedures are in place. In fact, many of the best practices should be viewed with a somewhat critical eye. Here are some to think about.

### It is important that a plan have an investment lineup of all high-performing funds

Most managers hold investment processes and philosophies that fall in and out of favor. Therefore, a recent high-performing fund may have more to do with a manager's style of investing being favored by a recent market cycle rather than expert security selection on the manager's part.

This is not meant to build a case for

passive versus active so much as it is to say that is better to have long-term measures when monitoring fund managers based on multiple market cycles. Studies have shown that maintaining a pristine lineup of top-performing funds can create substantial long-term underperformance. (Towers Watson, 2012, “The Cost of Trigger-Happy Investing”)

Considering what is most important, studies have consistently demonstrated that the most significant impact on portfolio performance is not individual security selection, but the asset allocation policy. (Brinson, 1986; Ibbotson, 2000) If the asset allocation is not appropriate for an individual participant given his or her risk profile, then the high-performing lineup is not of much help.

#### **It is important that DC investors have access to asset allocation vehicles**

It is true enough that having good asset allocation constructs is critical, especially given the great difficulty (or near impossibility) of teaching participants how to allocate their assets. However, it is not of great importance to offer the “best” asset allocation program. A leading managed account provider, in its own study, indicated that the big gap in performance was not so much about asset allocation methods (target-date funds or managed accounts) as it was about whether or not a DC investor actually embraces a do-it-for-me model. (Financial Engines and Aon Hewitt, 2104)

Having an asset allocation program in place is only positive if these programs are adopted by a large numbers of participants. As a general rule of thumb, it is generally accepted that 80% of DC investors ought to be 100% in an asset allocation vehicle or program. While the numbers will vary based on demographics, if the uptake of the asset allocation options is low, something is wrong. Most likely the reason will be that the communication framework is doing a poor job of channeling DC investors into risk appropriate asset allocation vehicles or programs.

#### **Enrollment defaults is an effective means of improving investor outcomes**

There are two challenges when defaulting participants. The demographics (e.g.,

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high turnover) can make dealing with the administrative headaches of defaulting not worth the extra cost and effort. More importantly, if the default is set too low, given that many participants never revise their defaulted numbers, it is often the case that a much higher savings rate could have been achieved by a more active enrollment effort.

The focus ought to be on helping participants determine their replacement ratios and then target savings to meet that future income requirement.

From a mathematical standpoint, this all sounds well and good. However, there are several challenges with this approach to education. For most DC investors, from the time they sign up until they retire, their situations will change in many ways that are unknown at the time of enrollment.

At best, a replacement ratio is a rough guess as to what participants will actually need at retirement. Will they continue to work in retirement? What other assets and sources of income will they have in retirement? Will they be helping out other family members with their financial needs? What will be the condition of their health in retirement?

A replacement ratio is only one way to look at future needs. Most retirees wish


they had saved more — every bit of “extra money” in retirement helps. A more effective message is that the future is filled with uncertainties and that people have a much greater tendency to spend rather than to save.

A stricter means of dealing with what will be required in retirement is to plan for the worst. This means that one should always save up to the match amount and, if at all possible, save up to the maximum amount the plan will allow. “Save until it hurts; and when it hurts more, save more” ought to be the mantra in a world experiencing a “demographic cliff” compounded by a slow growing, low yielding economy and the potential that science may find all sorts of ways to keep people living longer.

This is not to say that “scare tactics” ought to dominate communication campaigns. The truth of what the future looks like for many retirees is scary enough as it is. There is no need for embellishment, only the unvarnished truth of what may lie ahead.

#### **Bringing it All Together**

In order to optimize investor outcomes, the challenge needs to be attacked from all angles, and there should be smooth coordination among the plan sponsor and their various providers and counselors. The adoption of best practices would be best accomplished by designating the primary responsibility to a single provider, thus creating some certainty that enhancing investor outcomes, as the ultimate goal, would receive the focus it deserves.

The current trajectory in the market seems to be moving closer to the investment advisor being that go-to provider. Given that investment advisors are increasingly taking on a named fiduciary role, it would be natural for the advisor to assume the lion’s share of the responsibility for ensuring that DC participants have the best investment outcomes possible. 

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