Targeting the Defined Contribution Investment Only Market

The defined contribution market has experienced rapid growth during this decade. The market has significant potential for investment managers because the plan assets tend to be sticky as participants typically invest for long periods of time and often do not change their investment allocation. The growth of this market can be attributed partially to the decline in the defined benefit plan market. Future growth will be greatly enhanced by auto-enrollment and improved asset allocation among participants through increased use of target-date and target-risk funds and managed account solutions.

While the defined contribution market offers great opportunity, it is also a difficult market for investment managers to penetrate. One of the fastest growing defined contribution segments, but most challenging, is the defined contribution investment only (DCIO) market. The DCIO market is comprised of assets managed by investment managers that are not affiliated with record keepers.

SEI's Knowledge Partnership joined with Sway Research to analyze the opportunities and trends in the DCIO market. The findings were captured in four Strategy Briefs delivered to SEI's investment manager clients to help them make informed decisions regarding their strategic distribution efforts.

KEY INSIGHTS FROM THE DCIO RESEARCH:

The DCIO market offers tremendous opportunity for investment managers. A recent survey led by Sway Research revealed that many investment managers recognize this opportunity and have made expanding their DCIO distribution efforts a strategic priority.

- DCIO assets are projected to grow at a rate of 9% over the next five years, and there will be over $1 trillion of new DCIO assets up for grabs over the same period.
- The primary driver of DCIO growth is the shift towards open-architecture platforms away from proprietary fund lineups.

The DCIO market offers a wealth of opportunity for smaller 'boutique" managers. As DC plan providers look for new investment managers to include in their plans, many of these assets are going to boutique firms that specialize in a specific asset class.

The SEI Knowledge Partnership is an ongoing source of action-oriented business intelligence and guidance for SEI's investment manager clients. It helps clients understand the issues that will shape future business conditions, keep abreast of changing best practices, and develop more competitive business strategies.

The Partnership is an initiative of SEI's Investment Manager Services unit, which delivers operating solutions including fund accounting and administration, hedge fund services, and separate account services.

- In order to participate in this market, investment managers do not need a widely recognized brand name. Rather, they must have a proven investment process and be a pure player.
- A rise in the use of multi-manager strategies is also increasing opportunities for boutique managers to earn mandates for the management of a specific sleeve within a larger portfolio.

A DCIO distribution effort does not require a massive, dedicated sales staff. Instead, an investment manager should focus on understanding the specific roles and knowledge requirements unique in this channel.

- Many investment managers are using their existing retail sales force to actively target retirement-focused advisors, although it is preferable to also support a DCIO sales effort with sales personnel that possess experience selling DC plans.
- Sales professionals should be prepared for an analytics-based, institutional-like sales process in order to successfully influence the gatekeeper and third party administrators.

A growing portion of DCIO assets are migrating from traditional domestic large and mid-cap portfolios to small cap, international and target date products. Most specifically, plans are looking for products that meet the changing demands of the retirement market as well as the various share class requirements.

- The investment strategy attributes necessary to secure retail intermediary platform placements apply to the DCIO market as well. The most important attributes evaluated include performance, manager tenure and expense ratios.
- The share class structures that offer the most value in the DCIO market often depend on the preference of the gatekeeper. However, according to Sway Research, the most preferred share classes in order of preference are:
  - 25 bps with a 12b-1 service fee
  - 50 bps with a 12b-1 service fee
  - Institutional fund share with no 12b-1 service fee

For several managers, the DCIO market has proven to have the highest margins when compared to mutual fund wrap, sub-advisory, 529 plans and insurance programs. Most managers in the DCIO market typically experience margins between 20-30%.

- Recently, managers in this space have experienced margin pressure from a push for lower management fees and the growing importance of meeting gatekeeper screens around median fees and expenses.

The DCIO market offers opportunity for investment managers to expand their distribution, but it is not without some key challenges. Understanding the marketplace and establishing the necessary infrastructure are the foundations for building and maintaining a successful DCIO effort.

For more information on the DCIO industry trends, please contact Chris Brown at Sway Research.
Phone: 603-382-5300
chris@swayresearch.com
www.swayresearch.com

For more information on services to support your firm's distribution effort, please contact SEI.
610-676-1270
ManagerServices@seic.com
www.seic.com/ims

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