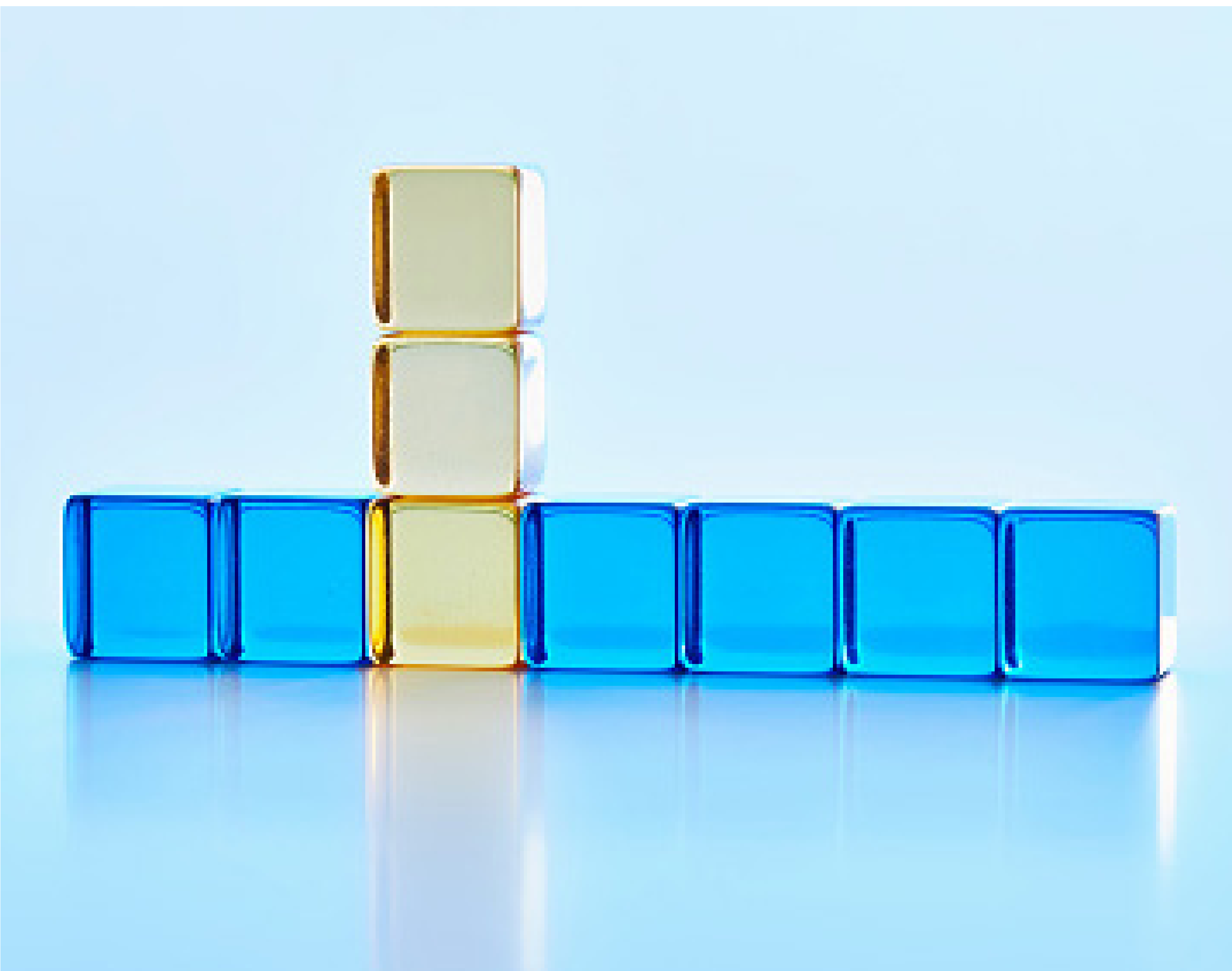
INVESTMENT MANAGER SERVICES

The rise of packaged products in DC plans.



For the advisor or consultant, packaged products present a revenue opportunity while at the same time improving the efficiency of the DC investment selection process.

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Introduction.

The recent growth of packaged products in defined contribution plans, including 3(38) programs, advisor managed accounts, Pooled Employer Plans (PEPs), and other products that centralize investment decision-making for large groups of plans, has had a significant impact on the way investment lineups are established and maintained.

Because decisions about what investments are included in these packaged products are largely made at the home office of advisors and consulting firms (rather than by field-level investment professionals), packaged products mean major changes to the way asset managers sell defined contribution investments.

While primarily driven by the retirement "aggregators," every important distribution channel for DC plan investments—most notably wirehouses, independent broker-dealers, and national consultants—have embraced packaged products to some degree. Packaged products are attractive because centralizing DC investment decision-making for DC plans affords both efficiency and revenue opportunities. Not only can advisors and consulting firms reduce the time an investment professional in the field spends making investment decisions, they can also charge the plan for this investment oversight and fiduciary protection. And, in addition to the fiduciary protection they offer plan sponsors, packaged products also reduce fiduciary risk for advisory firms because they allow them to maintain more centralized control over the firm's investment decisions.

In this report, we will explore the rise of packaged products and their implication for the evolution of the DC investment space, including:

- A detailed definition of packaged products and their implications on DC plan investment lineups
- A review of the current state of specific packaged offerings, such as 3(38) programs or advisor managed accounts
- The imperatives for asset managers' sales and national account teams as they pursue success in the packaged product landscape

Packaged products: Definition and implications.

So, what is a packaged product?

While there is no technical definition of what qualifies something as a packaged product, all of them share common characteristics:

- They involve the centralized creation of a group of investments that work together as a "package" within a DC plan.
- The investments included in the package have fiduciary oversight that is provided by the advisor or consultant who creates the packaged product. If required, a third-party fiduciary may also perform the investment oversight.
- The package is utilized across multiple plans within an advisor, consultant, or recordkeeper's book of business.

With these characteristics in mind, there are at least four solutions that fall within the definition of a packaged product **(Exhibit 1).** For advisors and consultants, packaged products are an opportunity to increase both efficiency and revenue. The efficiency gains are a result of employing a more centralized process for evaluating investments for DC plans. For example, creating a standard 3(38) investment lineup for DC plans at the home office, and encouraging advisors to use this list in their plans, removes the need for each advisor in the field to create their own list of approved investments. Instead, advisors can focus on sales, service, and other value-added activities with their plan sponsor clients. The same logic applies to PEP solutions and advisor managed accounts. By leveraging a centralized team to create a standard lineup, the advisory firm is reducing the investment responsibilities of advisors in the field.

Because advisors or consultants can charge a fee to the plan for these services, packaged products also represent a revenue opportunity for advisors and consultants. The fee compensates them not only for their investment expertise, but also for acting as an ERISA fiduciary for the investments in these packaged products.

Recordkeepers have looked to packaged products as another way to generate fee revenue amid significant price pressure on recordkeeping fees. For example, a recordkeeper within an insurance company might partner with a target date provider to create a customized CIT version of the manager's off-the-shelf target date fund (TDF). However, to provide compensation to the recordkeeper, the manager will shift a portion of the typical fixed-income allocation to the insurer's stable value product.

Exhibit 1

Solution	Example
3(38) investment lineup	An advisory firm creates a set lineup of funds for which they take on the role as investment fiduciary. This package of funds is recommended to any plan that wants the advisor to take on fiduciary responsibility for the investments.
MEP, PEP, or group of plans (GoPs)	A consulting firm creates an MEP, PEP, or group of plans (GoPs) with a set lineup of funds. Any DC plan within these structures will utilize these lineups.
Advisor managed account lineup	An advisory firm creates a list of investments to be used within a managed account. Any participant assets invested in the managed account are restricted to one or more of the investments on the list.
Co-manufactured investment solutions	An asset manager and recordkeeper create a co-branded target date CIT to be offered exclusively to the recordkeeper's clients.

For asset managers, packaged products present both an opportunity and a challenge. The opportunity is clear: a single placement in a packaged product can attract significantly more assets than winning a slot in the investment lineup of a single plan. However, the rise of packaged products changes the DC asset management sales process that, for decades, followed a familiar "funnel" pattern **(Exhibit 2)**.

In this traditional sales model, DCIO firms worked with recordkeepers to ensure their funds were available on as many platforms as possible. This was the most straightforward step in the process as recordkeepers were generally open to adding almost any new fund. In fact, a typical recordkeeper supports as many as 6,500 individual mutual fund products on their platform, a number that represents 65% of the approximately 10,000 mutual funds available in the U.S.[1]

From there, an asset manager's mission is to drive asset flows into their funds. This requires the fund to first make it onto an advisor or consultant's approved list. (They typically maintain a "shortlist" of about 27 funds for the plans they sell).[2] Then, the fund must find its way into the lineup for a specific plan (a DC plan, on average, has 17 funds in its lineup).[3] It's not until their fund is selected and contributed to by a plan participant (the average participant has 2.4 funds in their account)[4] that the asset manager finally begins to see assets flow into the fund.

Each step in this process requires significant effort from the asset manager's sales and national accounts teams. It could take years for a new fund to make its way through this sales funnel.

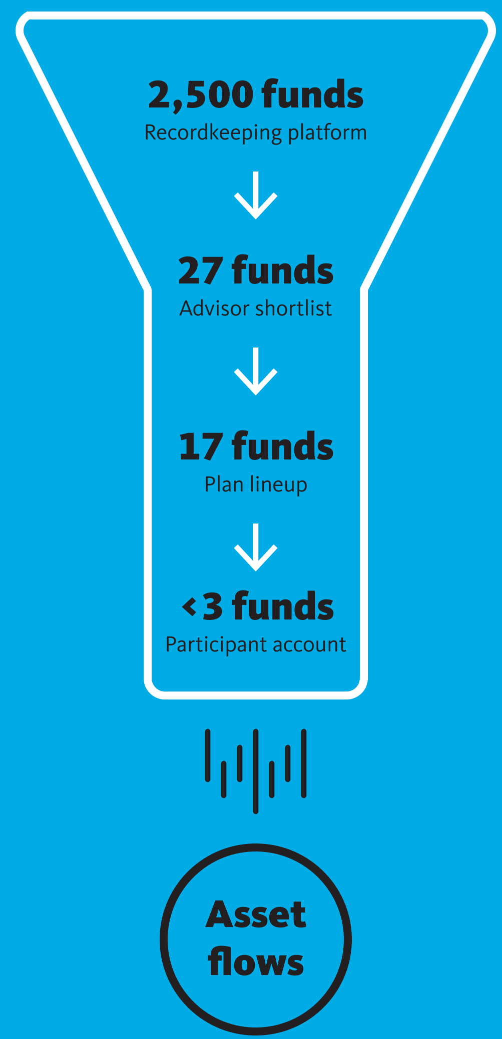
However, other than the need to be included on the recordkeeper's platform, the distribution process for packaged products is dramatically different. Instead of focusing on getting onto the approved list of individual advisors, sales teams must identify packaged product opportunities at the advisor's home office. Once the opportunity is identified, there may be negotiation around vehicle (CIT, SMA, 40 Act fund) and pricing (given the size of the opportunity, the advisor may demand relationship pricing from firms that want to participate in their packaged solutions). However, once accepted as part of a packaged product, asset managers can avoid the process of wholesaling funds to individual advisors.

The next section takes a much deeper look at the growth and outlook for a number of the most common packaged products.

[1] ICI, 2022 Fact Book, 2022
[2] RLF interviews with DC-focused plan advisors, 2020-2022
[3] Vanguard, "How America Saves," 2022
[4] Ibid.

Exhibit 2

The traditional DCIO sales funnel



Packaged product growth and outlook.

Asset flows into packaged products are expected to increase significantly during the next five years.

A 2021 RLF survey of 12 asset managers found that they expect packaged product flows from aggregator firms to increase from the current level of 10% of total retirement flows to 30% by 2025. Similarly, they expect packaged product flows from broker-dealer firms to quadruple from 5% to 20% by 2025 **(Exhibit 3)**.

In this section, we address outlooks for four specific types of packaged product offerings.

3(38) programs

3(38) fiduciary programs have become more popular in recent years as plan sponsors look to not only reduce their potential liability for plan investments, but also decrease the amount of time spent monitoring them. In a 3(38) arrangement, the plan sponsor's responsibility is limited to monitoring the 3(38) investment manager rather than each of the investments in the plan's lineup.

The typical advisor will maintain only one or two 3(38) lineups and will require that any plan sponsor that wants them to serve as 3(38) fiduciary use one of these standard lineups. For asset managers, securing a spot in a 3(38) lineup ensures that they will be included in any plans for which the advisor is taking on discretion for the plan's assets.

The aggregators, in particular, have been a catalyst behind the rise of 3(38) programs. A 2022 RLF survey of 13 aggregators found that they serve as 3(38) fiduciary on 26% of their DC plans **(Exhibit 4)**. We expect this number to increase in the coming years as aggregators put more emphasis on developing white-labeled, small-plan solutions with select recordkeeping partners. These turnkey plan offerings are designed to be simple and low cost for smaller companies and as such include 3(38) investment oversight as standard. Notable recent product launches include OneDigital's Complete Retirement Solution and HUB's Retirement Select.

Brokerage firms and banks have also entered the small market 401(k) business by partnering with recordkeepers to offer a white-labeled solution. And, again, these solutions include 3(38) as a standard part of the offering. Notable recent product launches have come from firms like Goldman Sachs, UBS, and Huntington Bank. For a more comprehensive list of small market products that have come to market since 2020 and include 3(38) investment lineups, see **Exhibit 5**.

The launch of these new white-labeled products puts a significant amount of additional momentum behind 3(38) programs, and as a result, will increase the amount of assets flowing into packaged products.

Advisor managed accounts

Advisor managed accounts (AMAs) are another packaged product that, because of their rapid growth, will lead to more DC assets circumventing the traditional sales funnel as discussed earlier in this report. Unlike traditional managed accounts in which the technology provider such as Morningstar oversees the investments, in AMAs, the plan's advisor provides (and is paid for) investment oversight of the managed account.

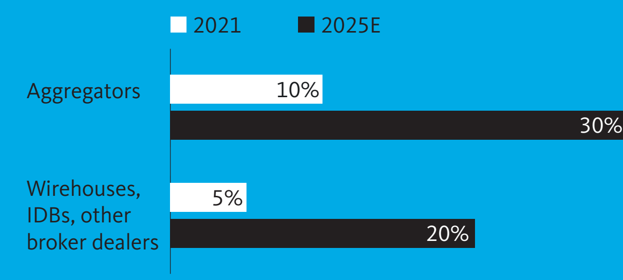
As with 3(38) programs, aggregator firms have been the catalyst behind the growth of AMAs. As of October 2022, the average aggregator firm offers their AMA solution through eight different recordkeepers.[5] Aggregators report that 8% of their DC plans offer AMA, and 6% offer it as the qualified default investment alternative (QDIA).[6] The aggregators that have reported the most success with generating asset flows into AMAs are Sageview, OneDigital, and Pensionmark.[7]

Looking at 2023, an RLF survey of DC recordkeepers found that they expect significant growth in plan sponsor's adoption of AMAs. This is especially true in the large end of the market where they predict that the percentage of plans offering AMAs will increase from 18% to 25%, and the percentage of plans offering it as a QDIA will increase from 18% to 22%. The expected growth in the small market is positive but more modest **(Exhibit 6)**.

[5] Retirement Leadership Forum 2022 Aggregator Survey
[6] Ibid.
[7] Ibid.

Exhibit 3

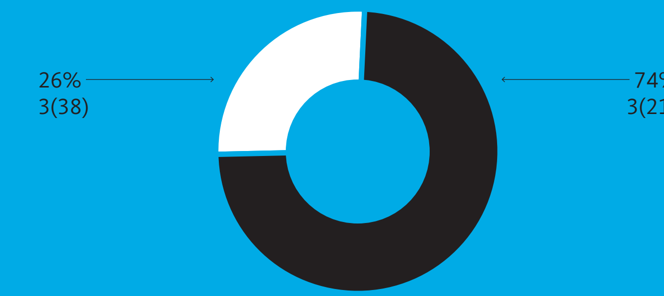
Packaged product flows as percentage of total flows expected to increase



Source: RLF 2021 DCIO Survey

Exhibit 4

Percentage of aggregators' plans utilizing fiduciary services



Source: RLF 2022 Aggregator Survey

Exhibit 5

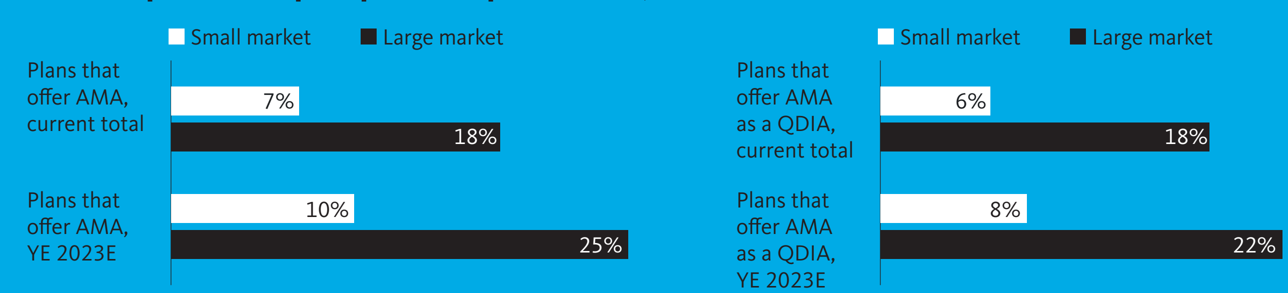
Small market product launches with imbedded 3(38) launched since 2021

Product name	Plan advisor	Recordkeeping partners(s)
Direct Fiduciary	CAPTRUST	T. Rowe Price
Goldman Sachs Workplace Retirement Solution	Goldman Sachs	Ascensus
HUB Retirement Select	HUB International	ADP, PAi (now part of Ascensus), others
Huntington 401(k) Center for Business	Huntington Bank	PAi (now part of Ascensus)
intelli(k)	intellicents	OneAmerica
OneDigital Complete Retirement Solution	OneDigital	Ascensus
Retirement Plan Exchange with Retirement Plan Manager	UBS	Transamerica

Source: Company press releases as of January 2023

Exhibit 6

Recordkeeper's view of plan sponsor adoption of AMA, 2022-2023E



n=9 small market and 8 large market recordkeepers
Source: RLF Second Half 2022 Sales Survey

Like in 3(38) programs, the underlying funds for an aggregator's AMA are selected by the home office and used across all their plans with AMAs. For asset managers, then, securing a spot in an AMA lineup represents a significant asset opportunity without the need to sell their products to each individual advisor at the firm.

Pooled employer plans (PEPs)

Because pooled employer plans (PEPs) allow multiple businesses to participate together in one large 401(k) plan, and because all of the participating employers use the same investment lineup, asset managers view PEPs as yet another attractive packaged opportunity. Securing a placement in one PEP gives the asset manager access to the retirement assets of dozens or even hundreds of employers.

As of the end of 2021, the average recordkeeper had three PEPs on their platform, although one recordkeeper reported having 15.[8] And, according to recordkeepers, demand for PEPs has increased significantly across 2022, especially among advisors, where 71% of recordkeepers report seeing increased demand **(Exhibit 7)**. Plan sponsor demand has been more muted (only 29% of recordkeepers said demand from them has increased), but to the extent advisors are generally making the PEP recommendation to a plan sponsor, recordkeepers view advisor demand, rather than plan sponsor, as most indicative of future growth.

Co-manufactured products

Increasingly, asset managers are being asked by recordkeepers and advisors to "co-manufacture" investment products for inclusion in 401(k) lineups. These firms then expect a share of the asset manager's revenue in exchange for putting the power of their large sales force behind the product. For that reason, asset managers view co-manufactured products as an opportunity to attract significant assets through a single "sale," which is the definition of a packaged product.

Forty-five percent of DCIO firms have built at least one co-manufactured product with a recordkeeper **(Exhibit 8)**, but one DCIO firm reported having built products with five recordkeepers. All but one DCIO firm reported that the products created were customized target date funds. The most common arrangement is that the product uses the asset manager's off-the-shelf TDF but substitutes the recordkeeper's stable value fund for some of the fixed income allocation. For this reason, the co-manufactured products are typically CITs.

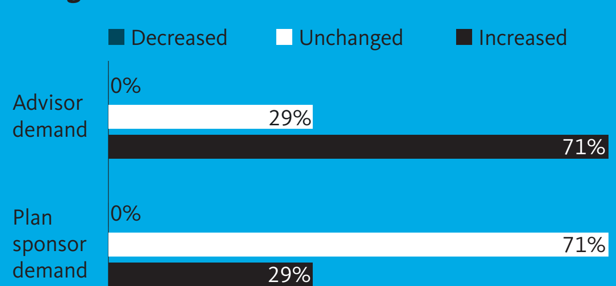
RLF research interviews with DCIO firms found that these co-manufactured products have experienced substantial asset flows to date and firms commented that they are an integral part of their individual growth strategies going forward.[9]

While less common, some advisor firms have co-manufactured products with asset managers as well. The most notable example is RPAG's flexPATH products that, since their inception in 2015, have gathered over $36 billion in DC assets.[10] Through negotiated relationship pricing with the asset managers, RPAG is able to offer low-cost versions of dozens of well-known target date and single-sleeve strategies. The strategies are offered only to retirement plans and only in CIT form. While currently flexPATH is available solely to RPAG-affiliated advisors, asset managers involved in the program have reported that RPAG is considering opening distribution to a much broader set of advisors.

[8] RLF Q4 2021 Recordkeeper Sales Executive Survey
[9] RLF Research interviews with DCIO Sales Leaders, August 2021
[10] flexPATH Strategies LLC Form ADV, November 2022

Exhibit 7

Recordkeepers' reported YOY change in demand for PEPs



Source: RLF 2022 Recordkeeper Sales Executive Survey

Exhibit 8

DCIO firms reporting they have built co-manufactured products with recordkeepers

n=11
Source: RLF 2021 DCIO Packaged Product Survey

Imperatives for asset managers.

The growth in the use of packaged products in defined contribution plans has significant implications for both the product and sales development teams at asset manager firms.

To remain competitive amid the changing environment, we recommend three specific steps.

1. Strengthen the CIT lineup

CITs are the vehicle of choice for packaged products because of their low cost and flexibility. In terms of cost, because packaged products typically have additional fees associated with them (e.g., a 3(38) fee, a managed account fee, etc.), it's critical that asset managers make available the least expensive, most efficient share classes. In the retirement world, this means CITs. In fact, asset managers interviewed for this report indicated that winning a mandate in a packaged product often requires discounts off the already-low CIT pricing. According to these asset managers, requests for this "relationship pricing" are becoming more common, and as a result, managers are reexamining their CIT pricing strategies with an eye toward reining in the number of pricing tiers. A typical example from one asset manager interviewed for this research is as follow:

- **Share class 1.** Low-cost CIT share class for general distribution and positioned to most of their distribution partners as the lowest cost available. As part of this re-pricing, they are eliminating tiered or breakpoint prices.
- **Share class 2.** A share class with additional discounts over share class 1 for the best opportunities with the best partners. This share class would be used in packaged product solutions.
- **Share class 3.** An even lower cost share class aimed at mega plan sponsors where there is an opportunity for significant, immediate asset flows (i.e., because the CIT might be replacing a competitor's fund that has significant assets under management).

In addition to pricing, the other advantage CITs offer packaged products is flexibility. Compared to mutual funds, CITs are more easily customized and can include annuities, stable value, private equity, or other nonstandard investments. This is an advantage for situations where the creator of the packaged product wants the asset manager to modify their standard CIT to better align with the needs of the offering.

For these reasons, most of the more well-known packaged solutions exclusively use CITs, including:

- **OneDigital's Personalized Portfolios.** The AMA product keeps costs low by exclusively using CITs for the underlying investments in the managed account.[11]
- **Raymond James 3(38) Solution.** The 3(38) program at Raymond James includes an all CIT option.[12]
- **MercerWise PEP.** All the investments in Mercer's pooled plan are CITs.[13]
- **RPAG FlexPATH.** All investments in these co-manufactured vehicles are housed within a CIT vehicle.

[11] OneDigital Press Release, September 2020
[12] Raymond James 3(38) Retirement Solution Overview, 2020
[13] Mercer, MercerWise Plan Description, 2022

Exhibit 9

Asset managers' change in sales resources focused on aggregator home offices

Source: RLF 2022 DCIO Sales Survey

The imperative for asset managers as they look for success with packaged products, then, is to ensure that all their most popular retirement investment options have a CIT version.

2. Increase home office coverage

To succeed in the changing sales environment, asset managers must first and foremost increase coverage of the home offices of key distribution partners. Unlike the traditional retirement sale where decisions about which investments to use are made by advisors in the field, packaged product decisions are made centrally, and asset managers must be more closely aligned with these home office teams.

In fact, a 2022 RLF survey found that retirement-focused asset managers are already making changes: 100% have increased focus on home office relationships at aggregators because of the increased packaged product activity at these firms **(Exhibit 9)**.

In follow-up interviews with asset managers for this report, they specifically mentioned that the reason behind the increased focus was to get placements in packaged products: 3(38) programs, AMAs, PEPs, and co-manufactured investments.

To enable this increased home office focus, 25% of asset managers said they are adding additional headcount to the national accounts teams. The remainder of firms are enabling increased coverage by either reducing the amount of time national accounts teams spend with recordkeepers, wirehouses, and IBDs, or assigning home office coverage to wholesalers within the aggregator's territory.[14]

3. Invest in building partnerships

The legacy DC sales model for asset managers is a very transactional process between a wholesaler and an advisor or consultant; one where the wholesaler is selling an off-the-shelf product and looking to repeat a standardized sales process with as many clients as possible.

Packaged products, by contrast, are more akin to whale hunting: it's a lot of work, but one win has a huge payoff. This difference in sales process requires a mindset change among asset managers from selling widgets to investing in partnerships. It's a shift that, frankly, many asset managers struggle to make because the packaged product sales process goes against the traditional sales culture at asset managers. The three areas that define partnership on packaged products include:

- **The flexibility to customize products and pricing to meet the needs of the packaged product.** Many firms fear "cannibalizing" 40 Act fund business with cheaper, customized versions of the same product. Others fear that continually rolling out customized products for specific partners becomes an administrative nightmare. Either way, packaged products are growing quickly, so breaking this legacy mindset is a critical first step.
- **The willingness to invest with partners.** The success of asset managers' packaged product sales efforts is very much tied to the success of the packaged product. Asset managers must be willing to invest alongside partners as they look to promote their solutions to plan sponsors. This could mean direct investment (e.g., sponsoring sales meetings) or indirect (e.g., asking wholesalers to pitch the packaged solution to advisors and plan sponsors on behalf of the firm that created the packaged product).
- **The restraint to focus on best-fit partners.** Traditional wholesaling is a volume game, one predicated on scheduling enough sales visits with enough clients to get the sales needed to meet an annual goal. Packaged products sales, on the other hand, are a more involved sales process with negotiation over product features and pricing. As such, sales of packaged products require careful attention to which relationship an asset manager wants to focus on.

[14] RLF 2022 DCIO Sales Survey

Summary and conclusions.

The expanded use of packaged products has altered the way investments in DC plans are managed because they shift the discretion over investment selection from an individual advisor or consultant—working with a plan committee—to investment teams at the home office.

By taking the decisions out of the hands of the plan sponsor, packaged products allow them to shift much of the fiduciary liability to the advisor or consultant. For the advisor or consultant, packaged products present a revenue opportunity while at the same time improving the efficiency of the DC investment selection process.

Because packaged products fundamentally change the investment decision process, asset managers must align their resources to these new decision-makers. They must allocate additional resources to the home office where the investment decisions for packaged products are made. Equally important for asset managers, however, is the need for a full suite of CIT products for their most popular retirement investments. Because of their low cost and flexibility, CITs are a natural fit with packaged products and, indeed, most packaged solutions have adopted CITs as the vehicle of choice. CITs, therefore, are critical to competing for shelf space in packaged products.

Most importantly, packaged products involve a change in mindset for asset managers, from one focused on "wholesaling" to one where success is predicated on forging partnerships with the creators of the packaged products. For asset manager firms who have built their businesses around volume and scale, this mindset shift may be the most difficult change to make, but also the most important.

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