

Selecting a DC plan outsourcer



Turning over significant responsibility for plan management is a big decision. There are a lot of different firms providing outsourcing services. How do you choose among them?

Basic principles

We believe there are three basic principles that should guide the selection of a defined contribution (DC) outsourcing provider:

1. Expertise

As the plan fiduciary, you are responsible for making sure the outsourcing firm you select has the knowledge and experience to take on the duties you delegate. Some outsourcing firms are strong in one area – like investments or administration – and weak in another. Others can do it all. Consider the specific functions you are outsourcing as you evaluate the qualifications of any firm.

2. Alignment

A critical problem for sponsors – and a focus of regulators – is the alignment of fiduciary interests with participants' interests. That's why, under ERISA, a fiduciary's first duty is the duty of loyalty. You will not be able to scrutinize every transaction the outsourcing fiduciary engages in. You must have confidence that when it acts it will be acting for your participants' benefit. Conflicts are inevitable. But, because they are inevitable, transparency – a theme that cuts across all three of these principles – is absolutely essential. The outsourcing provider should be able to explain potential conflicts to you, and there should be an agreed-upon process for their resolution.

3. Accountability

Both the sponsor and the outsourcing provider should have a clear understanding of what is expected and how results will be measured. Explicit performance standards, measurement criteria and reporting procedures should be agreed upon and adhered to. This is not an impossible task, but it does take discipline. Without *transparency* (again) and *follow-through* the entire process is likely to fail.

Types of firms providing outsourcing services

There are, generally, three types of firms that provide outsourcing services.

1. Consultants

Even before ERISA became law, consultants used to provide expert advice on plan design asset allocation strategy and manager recommendations, typically leaving plan sponsors to do the work of implementation. There's a difference between recommending a strategy and actually executing it. As consultants have moved into "full" outsourcing – that is, taking on responsibility for investment decision-making and management – they have had to hire people with experience in portfolio construction and trading – experience not typically found in a traditional consulting organization.

Questions for consultants

Consulting firms that make the foray into outsourcing need to build out the infrastructure and expertise to offer new services and products. Before hiring a consulting firm as an outsourcing provider you will want to consider:

- Their track record. How long have they been in the business? How many clients do they have?
- Do they have outside validation of their success in moving from merely advising to execution (industry awards and client validation)?

2. Investment managers

Investment managers, obviously have experience managing money, making investment decisions and providing investment-related services, such as brokerage and foreign exchange. Some firms have specific areas of expertise (e.g., U.S. small cap or U.S. fixed income). Their focus is not necessarily on an entire portfolio. Other firms offer a greater breadth of services, including funds and recordkeeping, which may present conflicts issues.

Questions for investment managers

- How broad is their asset management experience?
- What is their approach to managing risk across asset classes?
- What procedures do they have in place to deal with conflicts and how do they make conflicts issues transparent to the client?

Questions for multi-managers

- Are they limited to just manager selection oversight?
- Do they have a strong consulting capability -- the necessary problem-solving skills to meet the inevitable challenges and to develop fresh approaches?

2. Multi-managers

The multi-manager model originally evolved out of efforts to provide small-to-medium sized defined benefit (DB) plans with greater diversification and access to money managers typically only available to large plan sponsors. This "manager of managers" model developed, naturally over time, into something that looks very much like investment outsourcing – the selection and oversight of investment managers. Unlike traditional investment managers, multi-managers generally focus on managing overall exposures within the entire portfolio rather than pure security selection within specific asset classes. In an outsourced DC structure, a multi-manager will typically determine fund menu design, asset class strategies, target date fund design and strategy, and will then select investment firms with focused expertise on specific elements within specific assets.

Final thoughts

Different outsourcer models, with different backgrounds and core businesses, provide different strengths and have different weaknesses. Some firms struggle to compensate for gaps in expertise and functionality.

The good firms have been able to develop a robust set of skills, resources and services to comprehensively address the outsourcing challenge.

You're going to be living with your outsourcer for a long time. Your outsourcer will be making decisions that directly affect your plan and the retirement well-being of your plan participants. In selecting an outsourcer, it's critical to understand the issues, understand your outsourcing partner and what it can and cannot do, and rely on a well-designed, thorough selection process.

About Russell Investments

As a leading provider of outsourced investment solutions, Russell Investments understands that as DC plan sponsors explore fiduciary outsourcing, they need to fully understand what can be outsourced and how outsourcing works in practice. Russell Investments has partnered with retirement plan expert Michael Barry, a nationally recognized ERISA expert, to bring you a series of papers on DC plan outsourcing.

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For more information

Call Russell Investments at [800-426-8506](tel:800-426-8506) or visit russellinvestments.com/institutional

Important information

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