Why DC fiduciary outsourcing?

Today 69% of U.S. private sector workers with access to a workplace retirement plan will be entirely dependent on their defined contribution plan (DC) - plus Social Security - to meet their retirement income needs.[1] As a DC plan sponsor you may be faced with the demands of running a company and your DC plan. Many defined benefit sponsors outsource their plan duties when faced with the same dilemma. Is it time for DC plan sponsors to do the same?

Mike Barry, President, Plan Advisory Services Group

The job of a DC plan sponsor has become more complicated.

As originally conceived, the "modern" 401(k) retirement account was to be managed mainly by the plan participant. The sponsor picked a provider, selected a fund menu, and that sponsor's job was done. Participants decided whether to join the plan, how much to contribute, which funds to invest in. This was supposed to be a participant-driven system. For the plan sponsor, compliance with ERISA Section 404(c) was thought to be enough. In some companies, the entire plan was run from the human resources department.

While there may be some plans that still operate like that, for the most part, those days are gone.

As the defined benefit (DB) system has – for most corporate plan sponsors – become at best a legacy system for a limited group of older employees, the DC/401(k) system has become the primary retirement savings vehicle for most private-sector U.S. workers. The transition from DB to DC/401(k) has drawn concern from policymakers, regulators and many sponsors who have begun to realize that the participant-driven model has serious shortcomings. To help improve results for participants – i.e., increase participation and savings rates, improve asset allocation, reduce fees and help employees achieve better retirement income outcomes – the sponsor must be significantly involved.

Now, a DC/401(k) sponsor is expected to consider automatic enrollment; to pick (or design) a set of funds (typically a target date fund series) deemed appropriate for the participant population, into which most participants will be defaulted; evaluate the target date fund glide path; and provide a core menu for participants. To support the plan, the sponsor must arrange for and interface with a record keeper, monitor the performance of the plan's other providers and, of course, monitor the investment performance of the plan's funds.

Additionally, the sponsor must continually review the plan's various fee arrangements, and an increasing body of data concerning those arrangements, to make sure fees are competitive. Finally, all of this – how the plan works, what the fund choices are, how the target date funds work, what all of the different fees are, and what are distribution options – must be communicated to the participants extensively and in detail, and in "plain language."

In this new context, the sponsor has become a target.

As a leading provider of outsourced investment solutions, Russell Investments understands that before DC plan sponsors answer "why DC 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.

This first paper in the series will explore why a DC fiduciary should consider outsourcing.

[1] Source: U.S. Department of Labor, Form 5500 Summary Reports through 1998; EBRI Databook 1999-2011

The DC plan sponsor is the target of litigators, regulators and policymakers

For several years, plaintiffs' lawyers have been targeting DC sponsors. Going forward sponsors can expect more lawsuits alleging that they have not understood or properly discharged their 401(k) plan duties.

Regulators will also continue to target DC sponsors. In 2012, the U.S. Department of Labor finally completed its fee disclosure project. In addition to new participant disclosure requirements, providers are now required to provide sponsors detailed information about a variety of fees and expenses. This new information comes with a kicker: sponsors are going to be held accountable for reviewing and understanding it. And if there is (or someone can claim there is) a problem – such as a service provider charging above-market fees – the sponsor will be expected to do something about it.

Why is there so much pressure on DC sponsors? DC plans have become the main retirement savings vehicles for U.S. workers, and policymakers and regulators are realizing that the only person capable of driving improvements in the system is the sponsor.

Another big factor: the fiduciary decisions sponsors make in DC plans affect participant accounts. If a DB sponsor, say, picks a bad fund, the losses affect the sponsor, not the participant – the sponsor will have to contribute more to make up the loss. But in a DC plan, a bad fund results in losses to *participants'* accounts. High fees reduce *participant* balances. So, in DC plans, participants are natural plaintiffs.

Why sponsors are now thinking about outsourcing

In a simpler financial world, the new demands and pressures on DC sponsor-fiduciaries might be manageable. Sponsors used to think that just hiring a bundled provider constituted "outsourcing." Not anymore.

Sponsors now live in a world that requires their significant oversight of record keepers, trustees and custodians, where emerging markets and small cap are standard components of an investment strategy, and where the complexity of every transaction raises questions about whether they really understand who is paying what fees.

Moreover, there is intense pressure – from policymakers and litigators – to institutionalize DC investments. This involves the use of separate accounts, collective trusts and multi-manager white-label funds, and understanding the associated structural, administrative and participant communications issues. Strategies previously used only in large DB plans.

In this new world, being a fiduciary requires a high level of specialized knowledge. And a good deal of time and resources.

A good manager knows what to delegate and what not to delegate. The argument for outsourcing is clear: tasks requiring special expertise that is not part of the sponsoring firm's core competency should be outsourced to the experts.

What's the difference between outsourcing and just hiring an expert?

While the sponsor will always retain a residual fiduciary responsibility, ERISA clearly contemplates, and provides rules for, the delegation of fiduciary responsibilities. The problem for a plan sponsor is understanding what level of fiduciary responsibility a provider is accepting on their behalf. Many service providers – consultants, financial advisors, trustees, mutual funds – have tried to limit the extent to which they take on fiduciary responsibility. Often the outcome was: "I [the service provider] will take on this very narrow fiduciary task and you [the sponsor] are left with everything else."

That is changing. There are now firms – Russell Investments is one of them – that will take on a robust set of fiduciary responsibilities. This is the difference between real fiduciary outsourcing and the simple bundling of services without fiduciary responsibility: the intention in fiduciary outsourcing is to broadly transfer to the outsourcing firm not only the management of plan services, but also the fiduciary responsibility for those services. The sponsor retains only those responsibilities it intends to – generally, decision-making about overall strategy and design.

For most firms, outsourcing DC fiduciary responsibilities makes a lot of sense. Which responsibilities? Our next article will discuss "What to outsource."

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Call Russell Investments at **800-426-8506** or visit **russellinvestments.com/institutional**

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