SOLVING THE CHALLENGES OF SMALL AND MID-SIZED RETIREMENT PLANS

A GROWTH OPPORTUNITY IN MANAGING FIDUCIARY RESPONSIBILITY

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The market for small and mid-sized 401(k) plans — a vast one encompassing more than 170,000 plans with $1.3 trillion in assets[1] — is on the brink of dramatic change. This market segment, composed of plans between $1 million and $250 million in assets under management, has traditionally been served by bundled solutions offered by brokerage firms and insurance annuity providers. These all-in-one platforms often have high fees, proprietary products and a commission-based compensation system that may not put participants' best interests first. "The largest 401(k) plans are upgraded frequently, but these smaller plans have been slower to upgrade to fee-based, open-architecture systems, and may not meet today's more stringent fiduciary requirements.

Daniel McConologue, the director of corporate retirement plans at NYC-based Ritholtz Wealth Management, says that many sponsors of small and mid-sized defined-contribution plans are just waking up to the fact that they have a fiduciary responsibility. In many cases, their companies maintain legacy plans that may not have been revisited in the decade or more since they were established.

Proprietary funds, single-provider investment menus, and high fees are common. "Often the oversight of plans has been ignored. It's the last thing to get attention from HR directors or treasurers," he explains. "The challenge for advisors is how to get plan sponsors to focus on the fact that they have a responsibility to fulfill the DOL mandate, which is to act solely in the best interests of plan participants and their beneficiaries."

[1]"Retirement Plan Distribution Dynamics: Small- and Mid-Sized Plan Focus," Cerulli Associates, 2012.

Even if small and mid-sized companies wanted to comply with all the rules governing defined contribution plans, they may not have had the resources in the past. Instead, many companies opted for turnkey solutions from recordkeepers or mutual fund providers that often entailed sky-high fees or a less than an optimal menu of investment options. **Now, technology provides a solution in platforms like Vestwell, which combines the reassurance of personal, hands-on investment advice from an experienced advisor with comprehensive open-architecture solutions, the ability to take on fiduciary responsibility on behalf of the client and reasonable expenses.** For forward-thinking advisors, this streamlined capability can unlock a large, underserved market: small and mid-sized retirement plans.

Small and mid-sized plan sponsors are looking for help

There's a growing awareness among plan sponsors of all sizes that they need to be doing more to protect their participants. The 2016 Fidelity Plan Sponsor survey, for instance, found that 38% of plan sponsors are concerned about fiduciary duties, up from just 24% the previous year. That's not an unreasonable fear — most experts say that small and mid-sized plans are increasingly targeted for audit and, if wrongdoing is found, penalties are enforced by the Department of Labor.

To meet these responsibilities, sponsors are overhauling their plans. A Fidelity survey reported that 76% of sponsors were planning to change plan design, the highest percentage ever recorded. An equally impressive 87% had changed an investment option within the last two years, a percentage up 52% since 2012. Companies are looking to their financial advisors for advice on everything from investment selection to performance monitoring to risk assessment, and their search for additional expertise has driven nearly a quarter of them to consider changing their advisor relationship.

McConologue says that plan sponsors — and even, in some cases, plan participants — will contact him for advice on plan structure. "People will ask, 'Hey, are we paying too much for the investment options that we have?'" he says. "Or they may have noticed all of the asset choices move up and down in complete sync. I see plans where they own Fidelity Large Cap. Fidelity Large Cap Growth. Fidelity Contra. You peel away the front page, and they all own the same thing. So that's another one that we tend to see from time to time and counsel people to push back, to try to get a more diverse platform."

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Other hot-button topics include:

- Whether to implement QDIAs (qualified default investment alternatives), a set of prudent retirement planning vehicles such as target date funds that participants are automatically placed into unless they opt out. About 94% of large and mega plans offer QDIAs to their participants, the vast majority (88%) designating target date funds as the default option, according to Callan's 2017 "Defined Contribution Trends,"[2] but far fewer small plans have taken this step.

- Whether to automatically enroll employees: About two-thirds of large and mega plans automatically enroll participants as soon as they become eligible for the plan, according to Callan[3] — a powerful way to increase participation and enhance retirement security. Smaller plans are less likely to auto-enroll, but it's a smart way to

[2] 2017 "Defined Contribution Trends," Callan Associates. 2017. https://www.callan.com/wp-content/uploads/2017/01/Callan-2017-DC-Survey.pdf
[3] Callan, "Defined Contribution Trends."

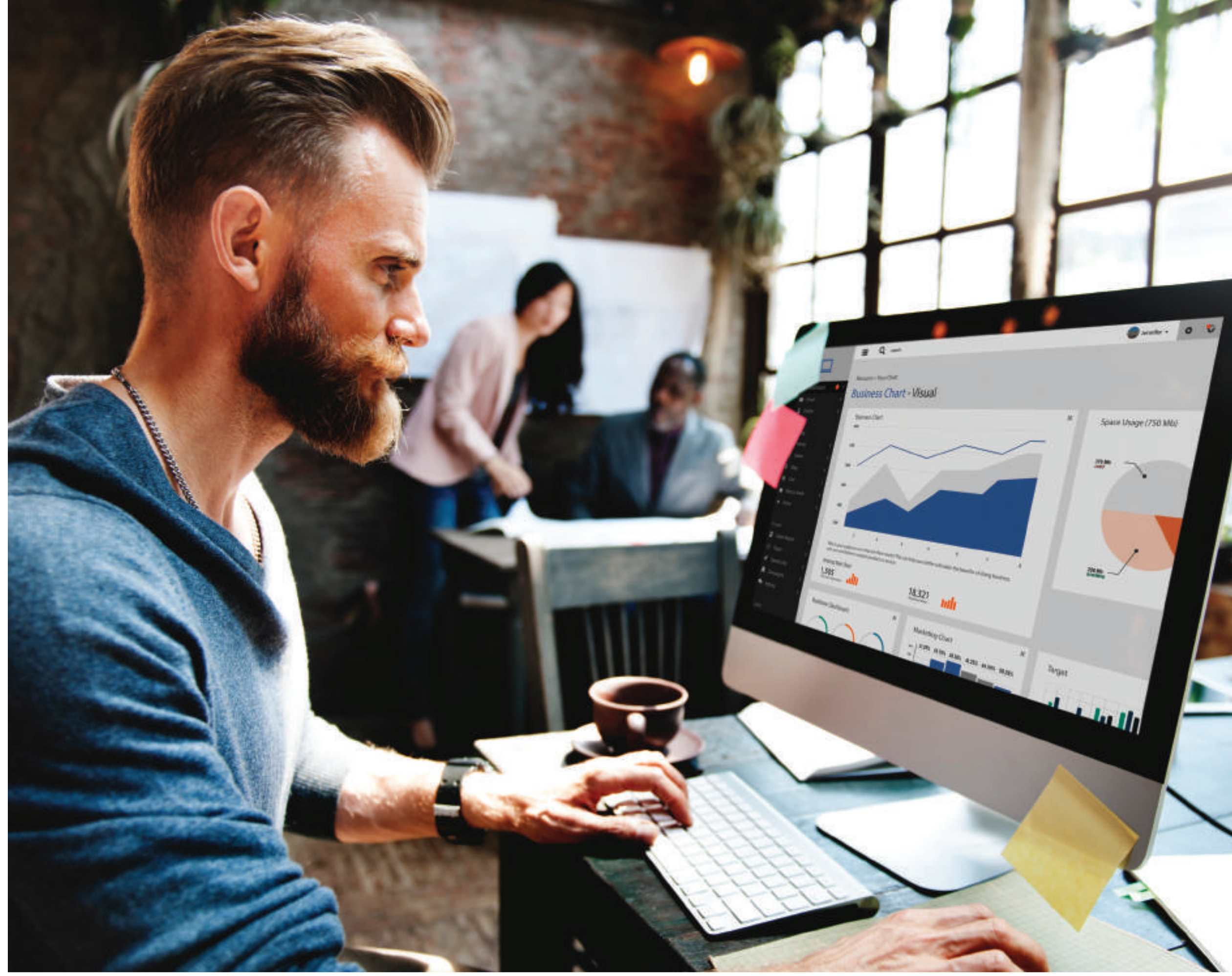
ensure the broad participation that enables highly paid employees to max out their contributions.

- How soon employes should be eligible: Should the plan cover just full-time or some part-timers as well? How long before employees become eligible? Peer group analysis shows what other companies in a given industry do — and helps tailor plan design to the sponsor's unique needs for attracting and retaining talent.

- Whether to offer an employer match and how large it should be: An employer match is one of the best ways to encourage employees to participate — and to put away enough for retirement. Peer group comparisons will show whether a plan is competitive with others in its industry.

- How the plan's investment lineup compares with those offered by peer companies: Is there a decent range of investment options, including diversified all-in-one options as well as funds that represent the major asset classes? Are there too many options, or too many of the same type of investment? Has performance been in line with benchmarks and competitive peer groups? A plan's investment lineup should include enough options to allow participants to allocate assets effectively, but not so many that they become confused or unable to choose. Peer group comparisons show companies how they stack up next to the firms that are competing for the same types of employees.

- Whether fees and expenses are in line with industry averages: Investment fees have fallen steadily over the last decade, with retirement plans paying about 48 basis points on average in 2016, versus 83 basis points in 2003, according to the Investment Company Institute. If a plan sponsor hasn't benchmarked fees within the last five years, there's a good chance that they're paying too much.



Building a practice around small and mid-sized plans

Most advisors have one or two retirement plan clients, but few specialize in this market niche. A recent survey by the Retirement Advisor University found that out of the 300,000 active advisors in the U.S. who are licensed by the SEC or FINRA, around 250,000 work on or get paid by at least one 401(k) plan. Yet a much smaller segment – roughly 25,000 — have a significant presence in this market, overseeing at least five plans and $25 million in assets. An even smaller elite group of advisors, numbering about 2,500, service at least ten plans and more than $250 million in assets.

The market, then, is fragmented, with most plans serviced by advisors who have only a cursory familiarity with the complexities of retirement plans. That leaves an opening for advisors who can bring expertise to the table, whether on their own or through a partnership with a company like Vestwell, which provides full-service retirement services.

Daniel McConologue got started with 401(k) plans 20 years ago, as a favor to a friend who was trying to create a 401(k) plan for his start-up company. A former CFO of a public company, he had been involved in benefits management before, from the buy-side, and he enjoyed navigating the regulatory and investment complexities that these plans involved. He opened a consulting business to assist in 401(k) plan design and implementation, and then in 2015 merged his company with Ritholtz Wealth Advisors. He currently maintains relationships with about half a dozen retirement plans — and he is working closely with Ritholtz's team of financial advisors to bring his peers up to speed about how to sell and service these plans.

"We tend to deal with smaller plans — professional partnerships like doctors and dentists and architects — often where the principals of those firms have the majority of the assets in the plan," says McConologue. "So my goal is to always start at the beginning and say, 'What's the plan design? Is it meeting your objectives?' From there we progress into: 'Are you doing the things that we believe are necessary to maintain command and control over the stewardship of the plan?' "

To answer these types of questions, often he runs analysis from FI 360 to create peer-to-peer comparisons of investment lineups and other vendors to benchmark fees against competing plans. He also spends time with sponsors explaining how Vestwell's platform takes over the plan's fiduciary responsibilities, via section 3(16), 3(21) or 3(38) fiduciary investment management services (see "Taking over three types of fiduciary responsibility" for more).

For McConologue, Vestwell's ability to take on fiduciary responsibility is a big part of their appeal. "The more things you leave to a plan sponsor to do, the more things they'll get wrong, so I like Vestwell's fiduciary service very much," he explains. He also values the customer service that Vestwell provides. "Their turnaround time for proposals and reviews is very fast. I wait for days with some of the other platforms, but I've never waited a day on Vestwell to give me feedback. They dive in." He adds that they have provided highly personalized service, even to some of his smaller clients. "That I never had to nudge them to be proactive with the client has just been terrific."

Daniel Hannoush, co-founder of the Atlanta-based RIA firm One and Done, has only been offering a retirement plan for about a year. Because his partner, Jim Rasmussen, worked for 20 years in the corporate headquarters of fast-food

TAKING OVER THREE TYPES OF FIDUCIARY RESPONSIBILITY

Most small and mid-sized companies don't want or have the capacity to take on fiduciary responsibility for the 401(k) plan they offer, but under the law, they're on the hook for making sure that investment options, fees, plan structure and administration are all performed in the best interest of plan participants. Vestwell's retirement platform allows plan sponsors to offload their fiduciary responsibility onto an experienced partner — offering three levels of fiduciary oversight.

3(16): In this scenario, Vestwell is named plan administrator and takes on responsibility for all daily plan operations. This is the most comprehensive form of fiduciary oversight.

3(21): Here, the service provider takes on responsibility for managing the plan and its assets, giving investment advice for a fee and administering the plan.

3(38): The service provider is responsible for the investments in the plan, and can manage, acquire or dispose of any assets of the plan.

retailer Chick-fil-A,their practice is largely focused on offering financial planning services, including retirement plans, to Chick-fil-A franchise owners. Most of his clients have never had a 401(k) plan before, so part of the sale is explaining the benefits of tax-deferred savings that these plans entail. And since the franchises typically have only a few salaried, full-time employees (alongside a large number of hourly part-timers), the pitch usually focuses on what a retirement plan can do for the owner.

"Some business owners improve their net worth in any given year they offer a 401(k)," says Hannoush. "Consider that business owners (and their spouse if working in the business) can defer up to $60,000 per year (or $54,000 if they are less than 50 years old). Couple this with the fact that 401k plan administration fees and contributions made by the business on behalf of the employees are also tax-deductible. The tax savings can offset the cost of administering the plan and sometimes even net positive cash flow for the business owner."

CONSIDER THE FACT THAT BUSINESS OWNERS (AND THEIR SPOUSE IF WORKING IN THE BUSINESS) CAN DEFER UP TO $60,000 PER YEAR

Hannoush and his partner have grown their business by offering simple, streamlined plans based on the Vestwell platform — and allowing business owners to outsource their fiduciary responsibilities to Vestwell, a key concern. "The various fiduciary roles Vestwell (and supporting partners) take on makes administering the plan for advisor and plan sponsor much easier," he says. "Vestwell takes on much of the responsibility including communicating with participants, tracking eligibility, monitoring and adjusting investment lineup and filing necessary tax documents. This allows the plan sponsor to focus on improving their business, not worrying about the nuts and bolts of offering a 401(k). This also allows advisors to focus on educating the participants and growing their practice."

Also, he adds, just having one point of contact through Vestwell makes it much easier to sell and service retirement plans. "There is one company to deal with. 401(k)s are complicated and have a lot of moving parts. This includes many service providers working together to ensure a smooth and compliant experience. Having one person to call and one website to log in to simplifies the otherwise complex experience."

Hannoush says that offering 401(k) plans has given his firm a competitive edge in a crowded market. "There are a lot of financial advisors out there, but not a lot of them that do this and do it well," he says. "We're really in depth and a lot of times we push back on a recommended plan design because we get the nitty-gritty. We know the tax benefits. We do a pretty in-depth cash flow and tax analysis to really help them design plans. I don't think there are a lot of people doing that."

That specialization has fueled rapid growth for One and Done. This year, Hannoush says, their firm's assets under management have been growing by about 10% to 15% per month, and right now, as a relatively new firm, they are generating growth coming almost entirely from signing up new plans. "When the assets in the plans begin growing and compounding, that growth is going to be exponential," says Hannoush.

Vestwell gives you the tools to meet small-business needs

The small and mid-sized retirement market offers exciting opportunities, but it's not easy developing the expertise and capabilities to navigate the plan design and compliance. The good news is that you don't have to do it yourself. Vestwell provides a streamlined, white-labeled retirement platform that acts as an extension of your advisory firm.

Vestwell has automated many of the most time-consuming parts of overseeing 401(k) plans — like onboarding participants and providing investment education and risk assessment. We also operate as 3(16) and 3(38) fiduciaries, making sure that advisory firms and the plans they manage comply with changing laws.

Through our platform, you can offer the powerful automated capabilities of robo advice with the high-touch, personal service your clients expect from you.

Are you ready to take part in the explosive growth potential in the small and mid-sized retirement market? Get in touch with Vestwell to find out how we can support you with the industry's leading advisor platform for 401(k) plans. Visit our website at www.vestwell.com for more information.

ABOUT VESTWELL

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