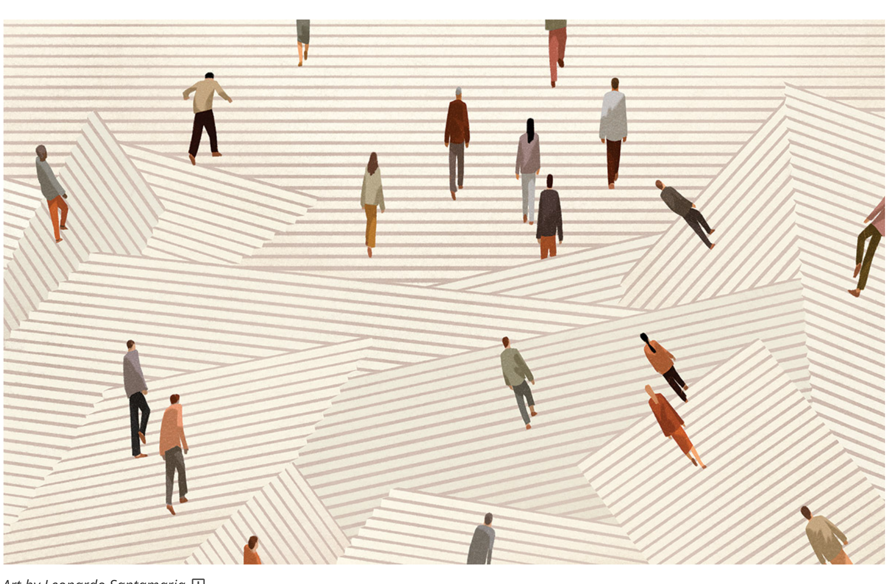
REGULATORY & COMPLIANCE | ADMINISTRATION Published in PLANADVISER January/February 2021

How to Choose a PEP

As pooled employer plans go live, advisers assume a new guiding role.

By Beth Braverman



Art by Leonardo Santamaria

Among the many changes ushered in this year by the Setting Every Community Up for Retirement Enhancement (SECURE) Act is the availability, for the first time, of pooled employer plans (PEPs). These vehicles, a type of multiple employer plan (MEP), allow unrelated organizations to participate in the same retirement scheme.

Although the plans are intended to help small employers access an affordable retirement plan, industry experts expect that midsize companies may also see PEPs as a viable option, due to their lower costs and the ability to offload fiduciary responsibilities, says Karen DiStasio, vice president, retirement consulting services at Commonwealth Financial Network in Boston.

Still, DiStasio says, she does not expect employers to be knocking down the doors of advisers clamoring for PEPs right away.

"I think the demand will be driven by advisers and service providers," she says. "They will bring the potential solution to their client, which will then generate interest from the employers."

With the PEP market still nascent, many advisers are considering their role in the space and the best way to help their clients navigate that space. While some plan sponsors interested in a PEP may put out a request for proposals (RFP) to evaluate potential vendors, others might go through the process more informally, beginning with a conversation with their existing plan provider.

Whether they go the RFP route or not, here are the questions that advisers can help clients answer when evaluating PEPs:

Have they vetted the companies running the plans?

Each PEP must be administered by a pooled plan provider (PPP), which will take on the fiduciary duty of running the plan and register with the Department of Labor (DOL). A plan's PPP could be an adviser, recordkeeper, broker/dealer (B/D) or insurance company.

"Advisers can assist their plan sponsor clients with reviewing the services offered by the various PPPs being considered, as well as the fees that PPPs will charge, and all of the related documentation," says Ari Sonneberg, an ERISA [Employee Retirement Income Security Act] and employee benefits attorney with The Wagner Law Group in Boynton Beach, Florida. "It's also important that the adviser develop a good understanding of what a particular client expects from the PEP and PPP and helps make sure that the PEP, and PPP the client ultimately chooses, meets that expectation."

Advisers can help clients evaluate the various possible service providers—which, besides the administrator, may also include a third-party administrator (TPA) and an investment adviser—involved with a given PEP to determine whether the fit is appropriate. That includes confirming whether the providers have experience with multiple employer plans, have the right cybersecurity controls in place, and have appropriate customer service experience.

Are the investment options correct for the plan's participants?

One way that PEPs may be able to keep costs down is by ensuring the available investment options stay limited, so it is important for the sponsor to evaluate the offerings of each plan to determine whether the investment menu makes sense for its plan participants. Plan sponsors will have no control over which investments are in their plan, at least in its initial iterations, so the sponsor needs to be comfortable with the selections that the PPP has chosen—and with its approach to investment selection and changes going forward.

Those serving as 3(38) investment advisers will need to monitor the investments in the PEP and provide the sponsor with a regular, documented process for reviewing funds' performance and the rationale for making fund changes when that becomes possible or keeping watch-list funds in the lineup despite their failing to meet standards, says Dallas-based Courtney Stroope, a vice president at Lockton Retirement Services, which is launching a series of PEPs.

Does the plan design meet your client's needs?

Especially in these early days of the PEP market, the design for PEPs may be relatively barebones and less open to customization by member plan sponsors. Creating PEPs with fewer bells and whistles allows the plan administrator to keep its costs down and enables it to create more favorable pricing for plan sponsors; this also reduces the potential for errors.

But as PEPs will likely be more rigid in design than would a 401(k) plan of even lesser size, advisers should discuss with their clients which plan design elements, such as the vesting schedule or company match level, are most important and look for plans with those offerings. That is particularly important for plan sponsors that like the design elements of their existing 401(k) but are considering a PEP to reduce expenses and administrative time.

"The best advice that advisers can give clients when it comes to shopping for a PEP is they should understand the provisions of the PEPs they're looking at and what the differences are among the various ones they're considering," Sonneberg says.

How much does the plan cost, and what is the client paying for?

Because PEPs have just launched, their costs may vary widely, so advisers will need to work with their clients to carefully examine the fees associated with each plan as well as evaluate the value of the plan's benefits. Prices may come down over time as new plans are able to gain the scale necessary for more favorable pricing.

Stroope says advisers should help plan sponsors to understand how proprietary products are being used and to know—and document—what revenue is being collected and how that affects fees.

"If proprietary products are included and revenue from them is being used to lower the administration cost of the plan, make sure those choices meet the prudency test," she says. "If they did not lower fees, would these still be funds you'd offer participants?"

Besides looking at bottom-line expenses, plan sponsors will need to consider the value they receive from other advantages of joining a PEP, such as reduced liability and the opportunity to refocus staff on the company's core business rather than plan administration. Companies that have never previously offered a retirement plan might also factor in the value of having an additional tool to attract and retain employees.

Is there a non-PEP plan that might be more suitable?

PEPs will serve as a welcome alternative for some employers, but even with the plans' lower costs, many employers will find a traditional 401(k) plan the better option. It is important for advisers to discuss both routes with interested clients.

"Helping clients decide whether or not a PEP makes sense for them really comes down to understanding their own business strategy," Stroope says.

Clients that want more control over their retirement plan, or that use it for specific outcomes such as employee attraction or incentive, may want a more flexible vehicle, she adds. Clients that are focused elsewhere and that prioritize risk, workload and cost reduction may be better served by a PEP.

"It will be interesting to see how competitive PEPs are, up against the small-market solutions that already exist," DiStasio says. "There are some small-market solutions that actually look a lot like PEPs already."

Tagged: PEPs, pooled employer plan, pooled plan provider, PPPs, SECURE Act

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The New '60/40' Portfolio?

Adjusting the composition of investments to meet new market realities.

By Rebecca Moore

The traditional 60/40 portfolio allocation may no longer be effective for meeting retirement plan and plan participant needs, investment professionals have been suggesting. The balanced portfolio is intended to provide returns to help participants accumulate savings for retirement, while at the same time mitigating equity risk and preserving wealth, says Susan Czochara, head of retirement solutions, at Northern Trust Asset Management (NTAM).

In State Street Global Advisors insights report "Portfolio Construction In and Out of the Core for the Next Decade," Matthew Bartolini, head of SPDR [S&P Depository Receipt] Americas Research, says scrutinizing the portfolio is warranted, "as recent returns have not been as strong as they were in prior decades."

He says the new reality includes expectations of lower returns going forward. A lower return from the 60/40 portfolio means bonds would be expected to provide a greater return to make up for the loss, he says, something he calls "unlikely."

The Mix for DC Plans

The 60/40, or balanced, portfolio is achieved differently by participants in defined contribution (DC) retirement plans than by institutional investors such as defined benefit (DB) plans, Czochara notes. While some participants like to choose their own investment mix, arguably the majority of plan participants get a balanced portfolio through target-date funds (TDFs) and white label funds.
With lower expected returns and increased volatility, participants have two options for achieving their retirement goals: saving more or taking on more risk in equities to try to get higher returns, Czochara says. "It's been a challenge to get them to save more, so we believe they'll take on more risk," she says.

According to an NTAM report, "Equity Designed With Retirement in Mind," by NTAM Retirement Solutions retirement strategist Paul Kubasiak, taking on more risk in equities is unattractive to retirement savers, especially those nearing retirement. It suggests that one way to mitigate risk and market volatility is through the use of a quality low-volatility (QLV) portfolio. Low-volatility stocks are shares of companies that tend to experience a narrower range of returns versus the market as a whole, such as the Russell 1000 Index, a large-cap stock index, the report explains.

For DC plans, investment choices available to participants who prefer building their own portfolio should be expanded to include private credit and real assets, to permit greater yield and protection from inflation; globally diversified equity choices should also be increased, says Jamie Lewin, head of BNY Mellon Investor Solutions.

For plan sponsors using a balanced fund as their DC plan's qualified default investment alternative (QDIA), Lewin says, it is important to preserve the cost effectiveness of balanced funds, meaning passive strategies are still important, but "a bit more dynamism" can be considered. "In the next decade, those managing balanced portfolios will take an active view of selection for both equity and fixed income," he says. "Active selection and choice, not necessarily active investing, will separate the winners from the losers and will help savers continue to accumulate."

Lewin says, as participants grow older, particularly when there is an increasing role of fixed income to hedge against risk and protect wealth, another variable is needed in addition to age. "We think there should be one more input: How has the investor done? That is, has the participant accumulated above or below what is expected to adequately meet his needs in retirement? If the participant has under-accumulated and is just adding fixed income because he's getting closer to retirement age, that may compound the problem," Lewin says. "We're projecting 0% to 2% returns for fixed income at best, so now may not be the best time to increase the fixed-income allocation.

"The underlying market conditions that have prevailed in the past 30 years have made the traditional 60/40 portfolio an effective strategy, but we don't think it will continue in the next decade," Lewin says.

4 Methods to Consider

According to the State Street Global Advisors' report "Portfolio Construction In and Out of the Core for the Next Decade," there are four key strategies for building a more effective 60/40 portfolio. These methods also will likely affect fees and taxes.

- Target active management in areas where there is a strong track record of above-benchmark performance;
- Expand market coverage within the MSCI All Country World Index (ACWI) and Bloomberg Barclays Aggregate Bond Index (Agg) to seek out under-represented areas or create a different risk/return profile;
- Structure portfolios based on factors that have historically earned a premium, while having patience and trusting the process; and
- Increase exposure to noncorrelated strategies to help navigate market uncertainty and provide a more differentiated return path than the one just stocks and bonds would provide.

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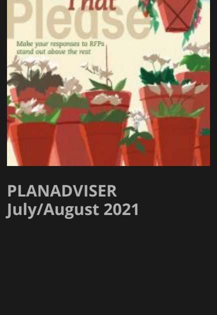

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