Fund Change

Bringing white label investments and CITs to plans of all sizes

Over the past 30 years, defined contribution (DC) plans have become the primary source of retirement income for many American workers. Plan sponsors, accordingly, must acknowledge the importance of a well-designed DC plan, observes Joel Lieb, director of defined contribution at consultants SEI in Oaks, Pennsylvania.

"Sponsors recognize they need to raise the level of investment oversight and put together DC programs that are as institutionally focused as traditional defined benefit [DB] plans, to prepare participants for future events," he says.

Meeting this goal requires understanding work force demographics and income liabilities, designing an optimal selection of investments that takes those into account and presenting it to participants in a way that guides the best choices. Off-the-shelf investment products based in mutual funds may not be a good fit, Lieb notes. "DC plans can bring better outcomes to participants at a lower cost to the plan by employing white label options and collective investment trusts [CITs]."

White label investment options and CITs are two distinct items in the DC sponsor tool kit, although their applications can overlap. Simply put, a white label investment option bears a name of the sponsor's choosing, typically to identify the option with its investment objective rather than the brand name of an investment manager. White labelling also can combine several funds into one option. A collective investment trust is a vehicle that, when compared with conventional '40 Act [Investment Company Act of 1940] mutual funds, provides asset managers and plan sponsors with greater flexibility on fees and operations, and more efficient management of the assets.

For defined contribution plan sponsors, white label funds aid in streamlining fund menus. "Stripping away the fund and manager identification and focusing on the fund objective—'diversified global equity,' for instance—gives the participant a clearer idea of the fund's purpose," says Susan Czochara, head of retirement product strategy for Northern Trust Asset Management in Chicago. Indeed, mutual funds named after old sailing ships, or mountains, or celestial bodies may not reveal much about their investment intentions.

White labelling is becoming increasingly effective, as a result of participants' evolving view of investments. In Northern Trust's recent surveys, Czochara reports, "Performance is top of mind for both retirees and current workers. The next top priority for retirees is who manages the fund, but current workers see the fund objective and fees as more important. As the work force turns over, I think we'll see a focus on what a particular fund is going to provide participants in their portfolios."

> "The employer had a generous ESOP (employee stock ownership plan), so, as a group, the employees had built up an inadvertent concentration in equities. We proposed a white label target-date fund that incorporated a lower equity beta, and customized the glide path to meet their average retirement age of 61," Lieb says. "(The company) also simplified the core menu with about 50% fewer choices of white label options, a mix of mutual funds and collective trusts—wherever we found the most efficiency."

Outcomes can improve as well, she adds. "A plan might have multiple equity core options—U.S. large cap growth, value and core, for instance. Put those three together into one white label option and you have created a better diversified equity investment that will likely reduce volatility over time, and simplified the choices participants have to make."

From the sponsor perspective, once inside the white label structure, there is greater latitude in managing the fund. "Say a plan offers the ABC Growth Fund, but its star portfolio manager leaves and the sponsor decides it's best to hire a new manager," says Brad Smith, a partner in the Atlanta office of consulting firm NEPC. "If ABC Growth is a stated fund in the plan, the recordkeeper has to notify the participants of the change in advance, and the best case scenario is three months—often six months—to communicate that to participants and get it out of the plan. With a white label product, participants are investing in Sponsor XYZ Growth Fund rather than ABC Growth directly, and the sponsor can replace the underlying fund the next day."

Collective investment trusts—also known as collective trust funds, commingled funds, and by several other names—are an alternative to mutual funds. Morningstar reckoned the universe of CITs relevant for defined contribution plans at about $2.4 trillion at mid-year—large indeed but dwarfed by the U.S. mutual fund world of $16 trillion.

More important, however, is their ability to vary the investment management fee rate for a particular investment vehicle based on the client—as opposed to charging the uniform fee rates mutual funds are required to, regardless of investment size. CITs also can accommodate a greater variety of assets than can mutual funds, including illiquid alternatives, and are likely candidates for white labelling.

From a participant perspective, CITs are traded and priced daily and closely resemble mutual funds.

Although once the province of the largest plans, CITs have become available to smaller employers. "In an ideal structure, those who maintain CITs[—typically trust companies—]are sensitive to both large and small sponsors," says Greg Ungerman, defined contribution practice leader at financial consultants Callan LLC in San Francisco.

"The asset manager deals with one pooled investment account, which might, for example, have share classes for investments of zero to $50 million, $50 million to $100 million, and above $100 million—all at different fee rates—and a negotiable fee for accounts larger than that," Ungerman says. A sponsor of the last size plan might engage a CIT's manager for other strategies in its DC or DB plan. "These strategies come in various forms and with managers that are responsive to sponsors' needs; they can be a win for everyone," he says.

"There is a real value to structures that combine white labeling and collective trusts," Lieb observes. One case is multiple plans at one sponsor arising from acquisitions. "Acquired plans likely have different investment menus and assets on different scales. With a white label approach, a sponsor could assign each plan the same investment lineup—and, through a collective trust structure that invests for all of the plans, at the same costs regardless of size. The same investments at the same costs—for a sponsor, that's nirvana.

"When the sponsor does act to consolidate the plans in the future," Lieb adds, "having just one investment lineup makes that far easier. All plans are mapped to one recordkeeper, and the participants continue to see the same investments."

The highest expression of 401(k) design is likely the custom target-date fund (TDF), which incorporates both CITs and white labelling. Lieb recalls a client that had an unusual benefit structure and an employee base that tended to retire earlier than an off-the-shelf target-date fund would anticipate.

"The employer had a generous ESOP [employee stock ownership plan], so, as a group, the employees had built up an inadvertent concentration in equities. We proposed a white label target-date fund that incorporated a lower equity beta, and customized the glide path to meet their average retirement age of 61," Lieb says. "[The company] also simplified the core menu with about 50% fewer choices of white label options, a mix of mutual funds and collective trusts—wherever we found the most efficiency."

In the past, white labelling and CITs have mainly been the province of only very large plans, but the DC industry is always evolving and bringing greater sophistication to smaller plans. Incorporating these options will likely involve substantial work for DC plan committees, but will likely pay off with more tailored investments at lower cost—and a better set of retirement outcomes. —*John Keefe*

KEY TAKEAWAYS

- A white label investment option bears a name of the sponsor's choosing, typically to identify the option with its investment objective rather than the brand name of an investment manager; this creates a more diversified fund, potentially reducing volatility over time.
- CITs are an alternative to mutual funds, providing greater flexibility on fees and operations plus more efficient management of the assets.
- The highest expression of 401(k) design is likely the custom TDF, which incorporates both CITs and white labelling.