



# Are Managed Accounts More Efficient Than Target Date Funds?

October 2020

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# Executive Summary

Drastic growth in the prevalence, availability, and marketing of professionally managed solutions in defined contribution (DC) plans has accelerated the comparison between target date funds (TDF) and managed accounts (MA).

**We examined a model plan and analyzed the merits of both solutions by focusing on three areas:**

**The asset allocation of a commonly used TDF<sup>1</sup>**

**The asset allocation of a commonly used MA<sup>2</sup>**

**The model plan's participant asset allocations implemented with the MA provider with an assertion of 99% personalization<sup>3</sup>**



**Bill Ryan**  
Head of North America  
DC Multi-Asset Solutions  
Aon Investments USA Inc.

**“It was reasonable for many plan sponsors to install managed accounts in years past when target date funds were more expensive, and there was a greater expectation of meaningful personalization and enhanced portfolio efficiency. With that said, it is critical for plan sponsors to review managed accounts as data is now starting to show they do not have a structural investment advantage over target date funds. We are finding that the majority of differentiation in equity allocations and expected outcomes is attributable to different glide path philosophies between providers, not personalization away from each provider’s base case glide path.”**

<sup>1</sup> Source: Vanguard TRF Quarterly Report December 2019 – Represents the largest TDF provider as of the date of publication.

<sup>2</sup> Source: Individual company financial statements. Cerulli Associates Q2 2018 - Represents the largest MA provider as of the date of publication.

<sup>3</sup> Source: Aon - Participant asset allocation data for this modeling is presented for illustrative purposes only. The participant data is drawn from actual client personalization information as an example of participant decisions within a plan that offers both TDF and MA options. Although your plan’s actual participant personalization may vary from those presented in this analysis, we believe the data establishes the necessary assumptions as a standard to analyze the potential differences between the use of TDFs and MAs within a plan. Population includes 6,556 participants from a plan utilizing 99% personalization as of the date of publication.

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In our examination of the modeled plan, we found that MAs are a less efficient investment solution in this examination, which we believe is representative of the broader universe of plans. More specifically, we conclude three main points:



1. **The degree of portfolio personalization should be examined more thoroughly.** The difference in glide paths between MAs and TDFs accounts for a considerable portion of “personalization,” and personalization statistics may be inflated relative to the effect on participant portfolios.



2. **MA fees are high and erode ultimate performance and account balances.** The additional layer of fees from MAs creates a significant headwind to returns. Recordkeepers as distributors of MAs often retain a significant portion of fees and create an often-overlooked barrier to fee compression.



3. **Claims of value outside portfolio management have issues.** MA providers’ claims of value from improved savings rates are often based on faulty logic, even sometimes claiming credit for services that are available without enrolling in MAs. This is especially problematic for older participants who are the primary users of MAs and often have much higher account balances, causing the fees from their MAs to be sizable relative to their contributions.

It was reasonable for many plan sponsors to install MAs in years past when TDFs were more expensive and there was a greater expectation of meaningful personalization and enhanced portfolio efficiency. Today, we find that the benefits of MAs for portfolio efficiency and personalization are typically small relative to the cost. Though there may be some MA participants who receive sufficient value for the additional fee, these findings advocate for continued use of TDFs for the majority of participants. Based on these findings, we believe plan sponsors should review their MA services and fees to ensure that participants receive value for the cost.

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# Introduction

"Properly measured, the average actively managed dollar must underperform the average passively managed dollar, net of costs. Empirical analyses that appear to refute this principle are guilty of improper measurement."

— William Sharpe "The Arithmetic of Active Management", 1991

The landscape of defined contribution (DC) plans was forever changed due to the consequences of The Pension Protection Act of 2006 (PPA), which made both target date funds (TDF) and managed accounts (MA) eligible qualified default investment alternatives (QDIA). This has led to dramatic growth in the use of TDFs as the preferred default investment over MAs.

Plans Offering		Participants Invested Solely In <sup>4</sup>			Leading Indicators of TDF Growth <sup>1</sup>	
TDF	94% <sup>1</sup>		2005	2019	Participants with TDF Exposure	78%
TDF as QDIA	97% <sup>1</sup>	TDF	0%	54%	Plan Contributions to TDF	59%
MA	37% <sup>5</sup>	MA	0%	5%	New Plan Entrants to TDF	83%

However, due to technological advances, an increased focus on participant financial wellness, and higher fees charged, significant marketing resources have been placed behind distribution of MAs, focusing on the perceived differentiation and advantages over TDFs. As we analyze the participant usage data of real-world plans that have adopted both solutions, it is clear that the primary differences distill to fees and risk level.

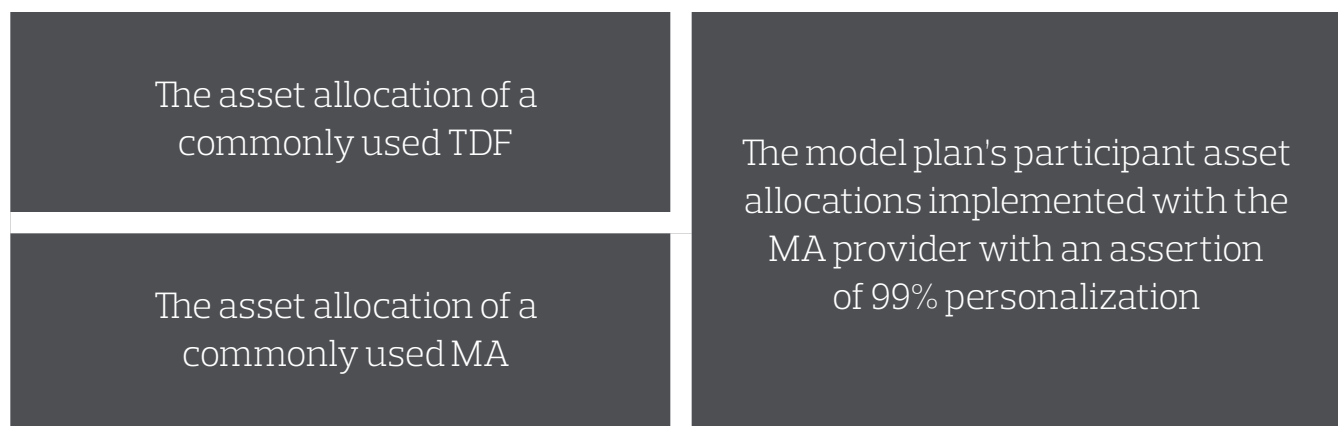
<sup>4</sup> Vanguard, *How America Saves*, 2020

<sup>5</sup> PSCA, *62nd Annual Survey for Profit Sharing and 401(k) Plans*

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We examine three primary data sets in relation to a plan's investment option menu:



This population of participants is used since the TDF and MA providers are both offered to the participants, and the MA provider asserts that 99% of those enrolled in MAs have personalized, signaling their view that this is an extremely high level of engagement with the platform. We use these data sets to evaluate the benefits to participants of constructing their own portfolios, using a TDF, or using a MA. We analyze whether a MA is able to create value versus TDFs to justify a layered investment management fee, either by having a structural advantage to create more efficient portfolios or by personalizing the asset allocation risk level.

Our findings indicate that, even with a data set of supposedly highly personalized participants, MAs are currently a less efficient investment solution compared to TDFs because of how defined contribution plans are designed by plan sponsors and used by participants. A significant headwind to investment outcomes for MAs is the additional fee charged for portfolio management (often from 0.40%-0.60%) in addition to the underlying fund expenses, which come at a direct and explicit cost to expected return. We believe this type of analysis modeled can be used as a standard to evaluate the efficiency of MAs for other plan sponsors.



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## How Personalized is the Data?



In our experience working with managed account providers, the statistics they report about the percentage of participants with personalization represents the amount with at least one data item personalized, regardless of the materiality of that data point. For example, they might consider a participant “personalized” if they know only the participant’s salary, even if there is no information about the participant’s outside assets. Additionally, many personalizations may not actually affect the asset allocation. As a result, the “personalization” statistics sometimes seem to inflate how much the managed account provider knows about the participants and the effect on asset allocation. Nevertheless, we point it out in this paper because the managed account provider has specifically asserted that this population has a lot of personalized data – 99% – on the participants, so we believe it is reasonable to evaluate the benefits of personalization from managed accounts.

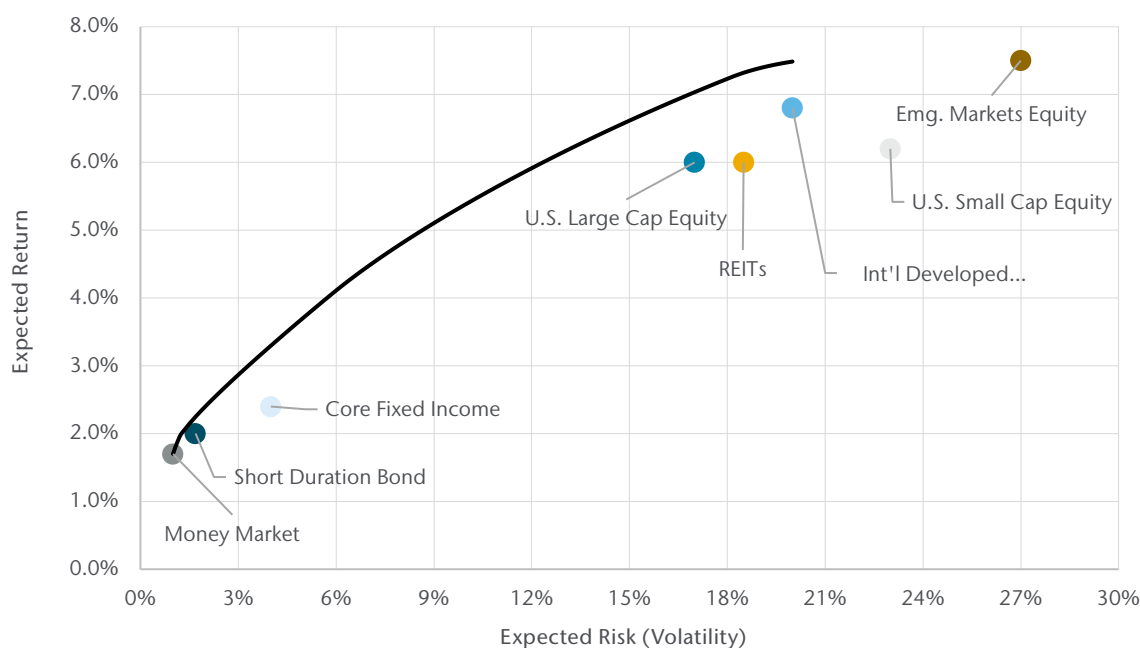
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# Potential Portfolio Efficiency in DC Core Lineups

To begin our evaluation, we've analyzed a common DC core lineup investment design as a control point. A plan's core lineup can be thought of as the full breadth of investment options for the more sophisticated do-it-yourself participant.<sup>6</sup>

Exhibit 1 shows a plan's core investment options, all of which are passively managed. The plan's lineup is also consistent with the most common asset classes DC plans offer according to PSCA.<sup>7</sup>

**Exhibit 1: Core Lineup**



**What Is the Efficiency Potential?**

*\*The expected returns illustrated are calculated using Aon's Q1 2020 Capital Market Assumptions, please see CMA methodology at the end of this document for full disclosures.*

<sup>6</sup> We recognize that some plans offer self-directed brokerage windows, often with an extremely broad opportunity set and esoteric investment options. However, usage of these brokerage windows is generally low and not relevant for the focus of this analysis.

<sup>7</sup> PSCA, 62nd Annual Survey for Profit Sharing and 401(k) Plans

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We use Aon's Capital Market Assumptions<sup>8</sup> to show these options graphically. We use mean-variance optimization to create an unconstrained efficient frontier. We will use this efficient frontier as a way to show the range of risk and return achievable, recognizing that in some ways it overstates the potential improvements (most investment professionals apply constraints to avoid overengineering portfolios based on assumptions that are inherently imperfect) and in other ways it understates potential improvements (our frontier only includes asset classes in the plan's core options, without any active management). We should note that this unconstrained efficient frontier is not reflective of additional fees that would be charged by asset allocation solutions to provide this level of professional portfolio management. In theory, a TDF or MA should be able to recreate this efficient frontier from a plan's core line-up before fees. We will carry this initial unconstrained efficient frontier to other risk and return exhibits throughout our analysis as an anchor point linking each efficient frontier exhibit.



<sup>8</sup> Details regarding capital market assumptions can be found in the appendix

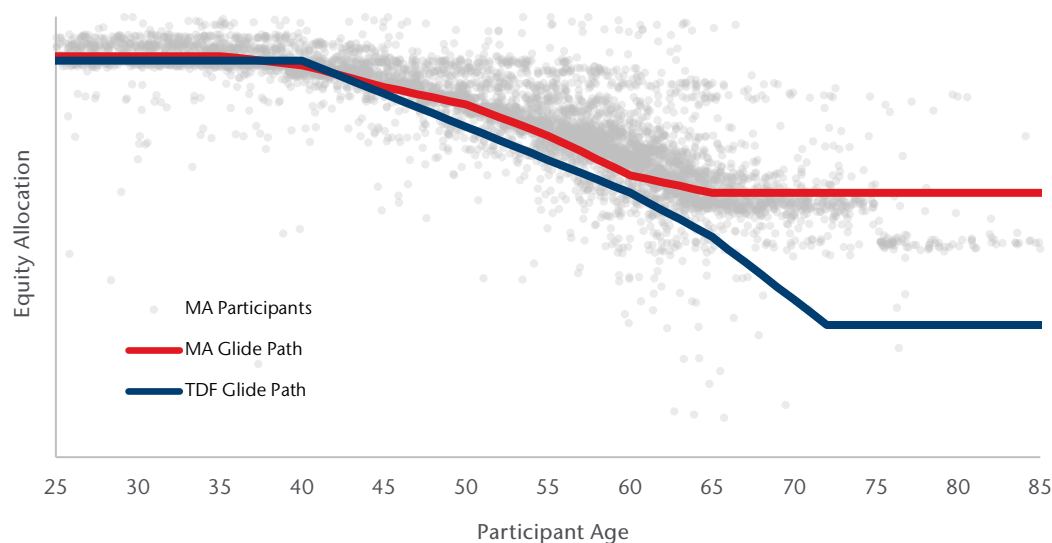
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# The Overlooked Philosophical Differences

Frequently overlooked when comparing MAs to TDFs is the baseline philosophy or starting point of MA providers. Therefore, before we evaluate personalization and the host of unique issues that can arise, it is important to understand where MAs place a participant without personalization.

To do so, we've compared the base asset allocations of the aforementioned common TDF and MA. In Exhibit 2, we illustrate the traditional view of comparing each product's level of equity allocations based on a participant's age, commonly expressed as a glide path.

**Exhibit 2: Equity Allocations by Age for a Plan's TDF, MA, and MA participants**



How different  
is the starting  
point?

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A key consideration illustrated by the differences in base asset allocations is that, even if both solutions are implemented with passively managed underlying portfolios, these products are not truly “passive” due to the active decisions of selecting asset classes, building portfolios, and assigning a target risk level to each participant.

The two glide path lines in Exhibit 2 show that, without accounting for differences in investment efficiency or personalization methodologies, these solutions appear to be similar until approximately age 65 (considered default retirement age), when the majority of participants tend to leave their plans around retirement.<sup>9</sup> This begins to show the need for a plan sponsor to evaluate what the true differences are to justify the differences in cost. For this, we suggest using a robust framework<sup>10</sup> to decompose and evaluate portfolio construction of both TDFs and MAs to determine suitability for a plan based on its risk tolerance. This becomes particularly important as we show that many MA participants ultimately receive a risk level materially similar to that glide path.



**Even if both solutions are implemented with passively managed underlying portfolios, these products are not truly “passive”**



<sup>9</sup> Vanguard, *How America Saves*, 2020

<sup>10</sup> Chastain, Aaron, Bill Ryan, and Eric Friedman. “Set It and Forgot It? Plan Sponsors Need Hands-On Engagement for Review of Solutions that Allow Participants to be Hands-Off.” Aon Insights (30 January 2019). <https://retirement-investment-insights.aon.com/defined-contribution/set-it-and-forgot-it-plan-sponsors-need-hands-on-engagement-for-review-of-solutions-that-allow-participants-to-be-hands-off>

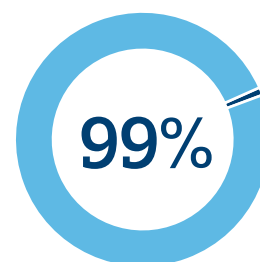
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# Do Managed Accounts Produce Differentiated Portfolios?

In addition to the glide paths shown in Exhibit 2, we have plotted the individual asset allocations of an actual population of participants invested in MAs.

This population of participants is used since the MA provider claimed that 99% of those enrolled in MA have personalized, signaling an extremely high level of engagement with the platform. This exhibit is one often shown in marketing presentations by MA providers or recordkeepers showing the degree of personalization provided by the MA, arguing that the range of unique allocations is sufficient value to justify the extra cost. Based on the dispersion of the dots, it might appear that the MA is resulting in asset allocations for participants that differ from the glide path of the TDF offered in the plan. However, simply gauging value based on this visual is not sufficient evidence to assess the efficacy of MA portfolio personalization.

The next step is to quantify the difference in the glide paths and the equity allocations of the MA participants' portfolios shown in Exhibit 2, which will identify large clusters of participants not easily identified by the visual chart. This also allows us to control for differences in the glide paths of the TDF and MA, showing the degree of portfolio change due to personalization versus the difference in provider philosophy. We show this in Exhibit 3, by comparing each individual portfolio's equity allocation to the in-plan TDF glide path and the MA provider's glide path to equity at the same ages.



**99% of those enrolled**  
in managed accounts  
have personalized

### Exhibit 3: MA Participant Equity Allocations Comparison

Difference in Equity	TDF Glide Path	MA Glide Path
0%-5%	39%	72%
5%-10%	34%	16%
<b>Total 0%-10%</b>	<b>73%</b>	<b>88%</b>
10%-15%	12%	7%
15%-20%	7%	2%
20%-25%	4%	2%
25%-30%	3%	1%
30%-35%	1%	0%
35%-40%	0%	0%
>40%	1%	0%
<b>Total &gt; 10%</b>	<b>27%</b>	<b>12%</b>

**This analysis of the spread of portfolio allocations illustrates why a higher level of scrutiny needs to be applied to how much of the difference in asset allocations is due to true personalization rather than simply a difference in the base glide path.**

Only 27% of the MA participants receive an equity allocation that is more than 10% different than the in-plan TDF glide path. When we compare those same portfolios to the MA provider's glide path (the starting default position), we see that even fewer—12% of participants have an equity allocation personalized by more than 10%. We highlight two key takeaways based on this data:

- The base glide path is an important input and may be different from the in-plan TDF. A significant portion of asset allocation differences between the individual portfolios and in-plan TDF are simply due to differences in the glide paths between the TDF and MA. This supports our suggestion that evaluation of baseline investment philosophies and fit for the plan is needed. Most MA participants are on or very close to the baseline glide path.
- Managed accounts may not provide significant personalization of equity allocation relative to their base glide path. Though 99% of these participants have personalized portfolios, only 12% of participants receive equity allocations with meaningful personalization. This likely results from a combination of three factors:
  1. investor time horizon (as proxied by age) is the dominant consideration in determining asset allocation,
  2. participants commonly do not provide significant data to support meaningful personalization, and/or
  3. MA providers do not adjust asset allocation to the degree assumed or advertised.

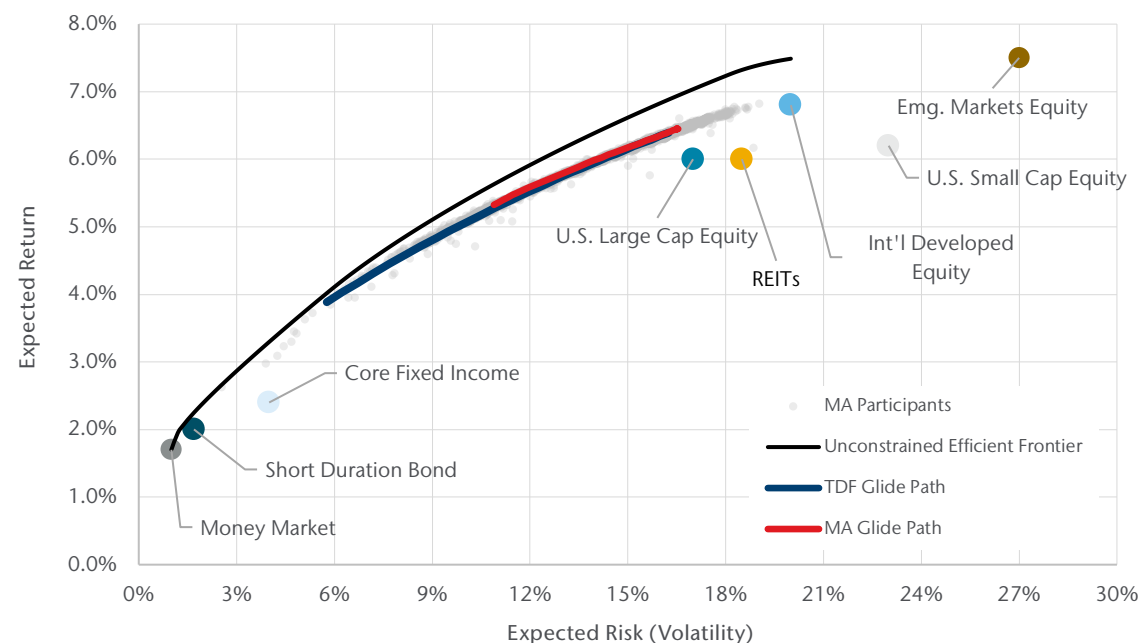
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# Do Managed Accounts Produce More Efficient Asset Allocations?

To apply an additional level of scrutiny, we now apply mean/variance analysis to the portfolios for this group of MA participants.

It is important to note that at this point, the MA participants are being modeled based only on their asset allocations before applying the MA provider's portfolio management fees.

## Exhibit 4: Efficiency of the TDF Glide Path, MA Glide Path, and MA Participants Do Both Solutions Have the Ability to Create Efficient Portfolios?



**Managed accounts don't have a structural advantage over TDFs in providing a more efficient base glide path.**

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Both the TDF and MA glide paths are less efficient than the unconstrained efficient frontier. This observation is expected and can be explained by the various constraints or preferences applied during the TDF and MA providers' portfolio construction process. The primary drivers are common practical portfolio considerations such as maintaining a portfolio diversified across a certain number of asset classes or constraints on minimum or maximum asset class exposures. Other differences may include differences in capital market assumptions, preferences for certain asset classes, or other implementation considerations used during the portfolio construction process. For these reasons, we believe it appropriate to use the professionally managed solutions' glide paths as a proxy for a reasonable constrained efficient frontier accepted by the industry at large.

The primary observation from Exhibit 4 is that managed accounts don't have a structural advantage over TDFs in providing a more efficient base glide path. We also observe in Exhibit 4 that the MA participants are in very tight cloud around the MA provider's base glide path, with the main difference being that some of the portfolios are extended further than the base glide path. This wider extension is a function of the MA participants being allocated along the frontier at higher and lower risk levels, as we showed in Exhibit 2. However, we also showed in Exhibit 3 that those portfolios are the small minority.

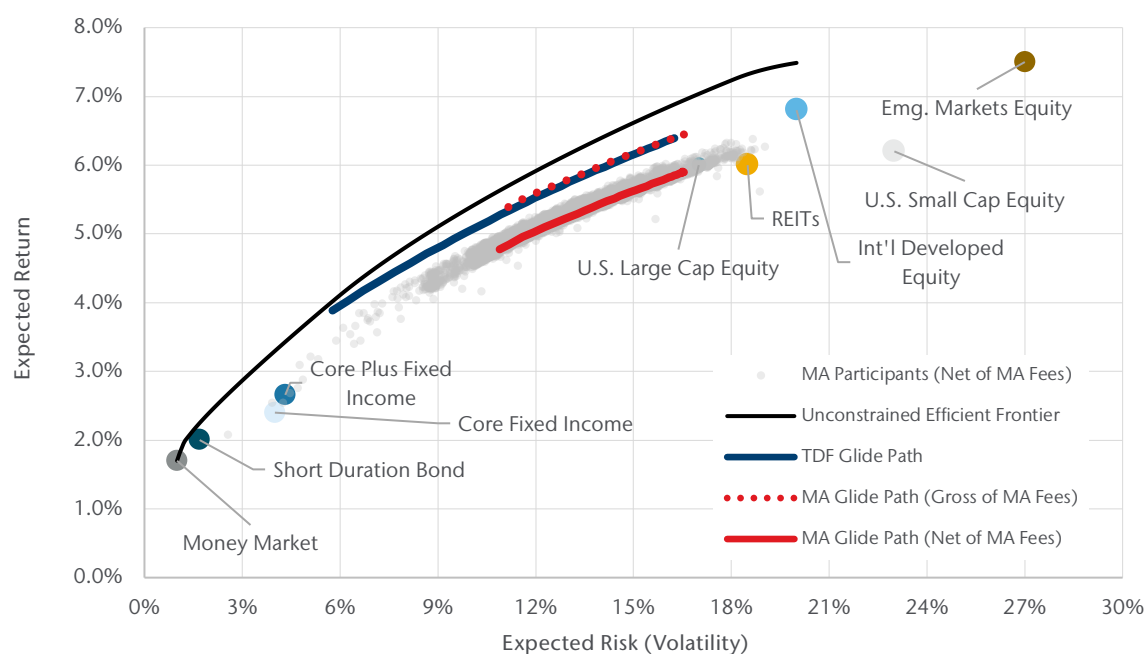


# Impact of Fees on Efficiency

Given that there is no structural advantage to portfolio efficiency for MAs, we now evaluate the impact of the cost structure.

This plan's situation allows us to make an apples-to-apples comparison of each of our efficient frontier analyses since each fund is passively managed. This minimizes differences in the underlying investment manager fees among of the funds in the core lineup, the unconstrained efficient frontier, the TDF, the MA provider, and the MA participants. Until now we did NOT consider the additional management fee charged by the MA provider. In Exhibit 5, we apply the MA provider's fee schedule to the MA participants shown in Exhibit 4. The fee structure is applied to each of the individual participant portfolios based on balance size and associated MA fee schedule for the plan. The highest fee breakpoint is applied to the base glide path to illustrate the upper bound of the fee effect since many participants in MAs may be in the highest fee tier.

**Exhibit 5: Efficiency of the TDF Glide Path, MA Glide Path, and MA Participants, Net of MA Fee**



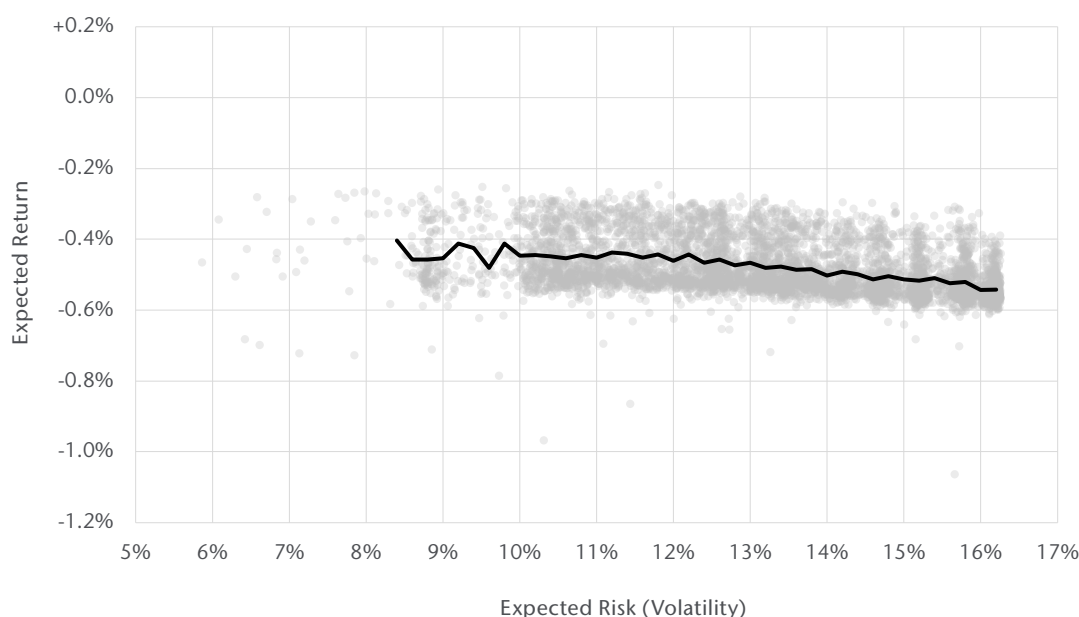
**How High  
is the Fee  
Hurdle?**

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In Exhibit 5, both the MA glide path and participant population expected returns experience a parallel shift down from the efficient frontier. This is unsurprising since the only change between the exhibits was to apply the portfolio management fee charged by the MA provider, which comes directly at the expense of expected return. Another unsurprising, yet illuminating, outcome is that the MA participant population cloud meaningfully expands from Exhibit 4 to Exhibit 5. This is not due to the ability to create more efficient portfolios but is due to the differences in size of each participant's balance, which influences the fee charged by the MA provider. The MA provider fees ranged from 0.40% for the lower risk portfolios to 0.54% for the higher risk portfolios. The difference in fees based on risk level is primarily due to application of a tiered fee schedule and younger participants generally having lower balances than older investors.

**Exhibit 6: MA Participants Expected Return versus TDF Equal Risk Portfolio, Net of MA Fees**



**Additional  
Fees Lead  
to a Drag on  
Expected  
Returns**

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In Exhibit 6, we show the drag on expected return for each of the MA portfolios versus the expected return of the TDF portfolio of equivalent risk. This illustrates even a passive implementation of a MA portfolio comes at a significant cost after including the extra layer of management fees. Pensions & Investments<sup>11</sup> reported that MA assets in DC plans have grown to \$348 billion as of the end of 2019. Though the industry is significantly concentrated with three providers, the universe includes eight of the largest MA providers who have different portfolio construction principles and different fee schedules. For simplicity, we assume that most participants using MAs pay similar fees. Conservatively applying the lowest fee and expected return loss of 0.40% leads to an estimated \$1.4 billion headwind to returns industry wide.

<sup>11</sup> Pensions & Investments: Managed accounts slow to gather steam, April 20, 2020.

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# What About the Value of Personalization?

Many argue that the participant has chosen to pay the layered cost for emotional comfort, access to personalized asset allocation management, and other benefits such as savings advice.

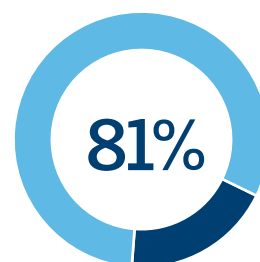
However, participants often have access to the other advice components for no extra cost, so the cost of MAs is for the potential benefits of professional portfolio management. Of course, we must not lose sight that a key value proposition claimed by MA providers is providing a more appropriate asset allocation for an individual than a TDF. As established in Exhibit 3 and again in Exhibit 7, special attention should be paid to the attribution of simple differences in baseline assumptions versus the actual personalized asset allocation given to an individual participant.

Of participants paying for this portfolio management service:

**Only 28% are allocated more than 5%**  
in equity allocation different than the glide path

**Only 12% are allocated more than 10%**  
in equity allocation different than the glide path

Even the 16% who have a 5-10% difference in equity allocation are expected to have materially similar outcomes to the glide path allocation. Building on Exhibit 3 showing how much personalization impacts asset allocations, Exhibit 7 shows how this translates into portfolio expected return and volatility (before applying the 0.40% - 0.60% fee for MAs).



**81% are expected**  
to have materially  
similar outcomes  
to the base glide  
path allocation

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## Exhibit 7: MA Participant Equity Allocations Comparison

Difference	TDF Glide Path	MA Glide Path
0%-5%	39%	72%
5%-10%	34%	16%
Total 0%-10%	73%	88%
10%-15%	12%	7%
15%-20%	7%	2%
20%-25%	4%	2%
25%-30%	3%	1%
30%-35%	1%	0%
35%-40%	0%	0%
>40%	1%	0%
Total > 10%	27%	12%

**The majority of differentiation in equity allocations and expected outcomes is attributable to different glide path philosophies between providers, not personalization away from the glide path**

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### Expected Return Comparison (before MA fees)

Difference	TDF Glide Path	MA Glide Path
0.00%-0.25%	50%	81%
0.25%-0.50%	29%	12%
0.50%-0.75%	10%	5%
0.75%-1.00%	6%	1%
1.00%-1.25%	3%	0%
1.25%-1.50%	2%	0%
1.50%-1.75%	0%	0%
1.75%-2.00%	0%	0%
>2.00%	0%	0%

### Expected Volatility Comparison

Difference	TDF Glide Path	MA Glide Path
0%-1%	44%	75%
1%-2%	32%	15%
2%-3%	12%	6%
3%-4%	6%	3%
4%-5%	4%	1%
5%-6%	1%	0%
6%-7%	1%	0%
7%-8%	0%	0%
>8%	0%	0%

81% of MA participants are within 0.25% of expected return and 75% are within 1% of expected volatility of the MA glide path (before applying MA provider fees). For comparison, a 5-10% change in equity allocation to a 60% global equity and 40% core bond portfolio would change the expected return by a range of 0.20% to 0.40%, less than the additional fees charged.

Our analysis surfaces answers to two key questions:

1. Is a MA provider's **base glide path** worth the average additional fee of 0.40% for professional portfolio management?

Our answer is “No” based on Exhibit 5, which compared the TDF versus MA provider’s base glide path net of fees.

2. Is the **personalized asset allocation** worth the average additional fee of 0.40% layered by the MA provider?

Our answer is “No” again, based on the observations in Exhibit 7 as 80%+ of participants receive similar outcomes to the base glide path in terms of both asset allocation and expected risk/return.

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# What is the Value of Savings Advice?

Adjustment of participant savings rates is ultimately a settlor decision, not a fiduciary decision, so care must be taken when assigning value for fees paid to fiduciary matters such as discretionary portfolio management.

An Empower study claims that MAs could improve a participant's savings rate as a percentage of pay by a range of 0.30% for the unengaged participant to 0.80% for the engaged participant<sup>12</sup> and claims that the value generated is equal to the savings rate increase. MAs typically charge 0.40% to 0.60% of assets. This apples-to-oranges comparison of percentage of pay versus value on account balance makes it difficult to assess the net impact on account balances.



For participants with account **balances similar to their pay**, the impact to the average participant's balance is approximately **break-even**.



For participants with **smaller account balances**—typically lower service and younger participants—there might be a **net increase** in account balance.



For participants with **larger account balances**—typically higher service and older, there would be a **net drag** on the account balance.

This is a key point since MA enrollment tends to be much more prevalent among older participants, and MAs are largely considered to be more appropriate for older participants due to potentially differentiated financial situation.

<sup>12</sup> Empower 2018: Made to measure: evaluating the impact of a retirement managed account

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An increase in savings rate is positive for retirement planning as savings rates are a significant driver of retirement readiness. However, the additional dollars in a participant account from increased savings are contributed by the participant by reducing current consumption, so it seems disingenuous for the MA provider to claim that the solution created windfall improvements from higher savings rates. While there may be incremental benefits to savings, participants generally have access to savings rates advice at zero marginal cost, without enrolling in MAs.

A more frictionless and proven solution for plans wanting to impact savings rates would be to leverage the SECURE Act, which allows the auto-escalation cap to increase from 10% to 15%. A 5% adjustment to auto-escalation could be 2x to 10x more impactful than the MA impact and would impact all plan participants, regardless of MA enrollment or engagement level. Additionally, these services typically are costless to participants.



# Why are Managed Accounts Expensive?

Investment products are no different than other products where the price is impacted by both fixed and variable costs, as well as by the ability to capture profit.

**The core components of an investment solution cost include three primary components:**



The variable costs tend to be the investment management and the distribution expenses which grow with the assets, but usually at a diminishing rate. The fixed costs tend to be the administration and operation expenses, which we would expect to diminish as a percent of assets with each incremental dollar invested into the product. This price structure is true for both TDFs and MAs, but the question can be asked why a MA is significantly more expensive than most TDFs when looking at the all-in fee. The primary drivers of the higher fee can be viewed through the lenses of scale, competition, and incentive structure.

**MAs have a structure in which recordkeepers are often the entity distributing the product and taking a significant portion of the fees<sup>13</sup>**

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TDF assets under management are significantly larger than MAs, allowing for a level of price differential due to economies of scale. Further, MAs bear additional cost components through the plan recordkeeper to facilitate an integrated experience for participants with the rest of the plan's investment options. Costs associated with the need to be part of the recordkeeper's ecosystem should be analogous to fixed costs: recordkeeper infrastructure, technology setup and connectivity, and running phone lines for participants (though call centers are typically provided regardless of MA availability). While it is true that the large technology component and initial setup at a recordkeeper are time intensive and may require skilled labor, the ongoing maintenance to support that technology can be amortized as MA assets grow, resulting in a lower percentage of AUM cost component.

Recordkeepers can control the competition and price on their own platforms, so there has not been an incentive to meaningfully decrease fees. There are generally only one or two MA options on a platform, often with a preferred or proprietary provider. This closed architecture structure creates an environment where to truly have competition for MAs, a plan sponsor must be willing to change recordkeepers. This environment is similar to the early stages of TDF growth, when recordkeepers controlled TDF platform availability with proprietary solutions. Only recently have we observed a MA solution with a significantly decreased cost, with a new entrant priced from 0.15% to 0.30% instead of the typical 0.40%-0.60%.



**MAs have a structure in which recordkeepers are often the entity distributing the product and taking a significant portion of the fees<sup>13</sup>**

This creates a financial incentive for recordkeepers to promote inclusion of MAs in every plan regardless of fit or success and to communicate frequently to participants to solicit enrollment. There also may be an incentive to promote a specific provider, rather than providing access for plan sponsors to choose the product that has the best value. This is also seen by increasingly coordinated and aggressive efforts between MA providers and recordkeepers to advance MAs as the QDIA for plans.

<sup>13</sup> Chastain, Aaron, Bill Ryan, Bridget Steinhart, Rhonda Jinks, Elizabeth Groenewegen, "Unfolding the Managed Accounts Fee Enigma," Aon Insights (7 March 2019). <https://retirement-investment-insights.aon.com/defined-contribution/unfolding-the-managed-accounts-fee-enigma>

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# Conclusion

It was reasonable for many plan sponsors to install MAs in years past when TDFs were more expensive and there was a greater expectation of meaningful personalization and enhanced portfolio efficiency.

Today, we find that the benefits of MAs for portfolio efficiency and personalization are typically small relative to the cost. Though there may be some MA participants who receive sufficient value for the additional fee, these findings advocate for continued use of TDFs for the majority of participants.

While ultimately selecting between two professionally managed investment solutions is a fiduciary decision, further work should be conducted on the potential value of other settlor related benefits to MAs. One example may be further contextualizing savings rates impacts relative to broader opportunities such as auto-escalation.

As technology improves, we may truly see MA providers move the DC industry forward as we eventually expect the invisible hand of economics to drive significant fee reductions for MAs. Until then, participants in MAs risk sacrificing retirement outcomes.

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# Call to Action



1. Determine your plan's risk tolerance and apply that risk tolerance to the selection of your professionally managed solutions to ensure they are aligned. Evaluate your plan and committee's risk capacity from both an ability and willingness to take investment risk.  
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2. If you offer MAs within your plan, further negotiate the cost of that service, including evaluating offerings at other recordkeepers to encourage competition.  
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3. After further negotiation, if fees are still not reasonable for the services being provided, then turn off managed accounts.  
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4. Reassess your recordkeeper's engagement strategy, recognizing their incentive to increase MA enrollment, and determine how to define true effectiveness of the MA program.  
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5. Analyze your plan's experience with the participants enrolled in MA to understand the drivers of asset allocation and the expected outcomes.  
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6. Advocate for standalone advice services without requirements to be accompanied by an offering of professional management services. This can produce similar advice for a participant at much lower total costs, which may be more appropriate for some populations.

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# Appendix

## 10-year Capital Market Assumptions

Index	Asset Class	Expected Return	Expected Volatility	Correlations														
				1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	Large Cap U.S. Equity	6.0%	17.0%	1.0000	0.9191	0.7854	0.7237	0.0899	0.0896	-0.0489	-0.0489	0.0144	-0.1366	-0.0181	0.6102	0.3346	0.6591	0.3696
2	Small Cap U.S. Equity	6.2%	23.0%	0.9191	1.0000	0.7234	0.6698	0.0739	0.0742	-0.0486	-0.0486	0.0088	-0.1302	-0.0247	0.5640	0.2890	0.6073	0.3443
3	Int'l Developed Equity	6.8%	20.0%	0.7854	0.7234	1.0000	0.7476	0.0491	0.0495	-0.0376	-0.0376	0.0172	-0.1131	-0.0495	0.5847	0.4601	0.5342	0.3467
4	Emerging Markets Equity	7.5%	27.0%	0.7237	0.6698	0.7476	1.0000	0.0688	0.0694	-0.0374	-0.0374	0.0246	-0.1163	-0.0170	0.6608	0.3292	0.4901	0.3159
5	Cash (Gov't)	1.7%	1.0%	0.0899	0.0739	0.0491	0.0688	1.0000	0.9860	0.4404	0.4404	0.4573	0.2355	0.6006	0.1553	0.1955	0.0875	0.1490
6	Cash (LIBOR)	2.0%	1.0%	0.0896	0.0742	0.0495	0.0694	0.9860	1.0000	0.4340	0.4340	0.4569	0.2329	0.5929	0.1618	0.1923	0.0876	0.1472
7	TIPS (1-3 Yr)	2.1%	2.0%	-0.0489	-0.0486	-0.0376	-0.0374	0.4404	0.4340	1.0000	1.0000	0.5222	0.3703	0.2064	0.0981	0.1650	-0.0263	0.0226
8	TIPS (1-10 Yr)	2.4%	4.5%	-0.0489	-0.0486	-0.0376	-0.0374	0.4404	0.4340	1.0000	1.0000	0.5222	0.3703	0.2064	0.0981	0.1650	-0.0263	0.0226
9	Core Fixed Income	2.4%	4.0%	0.0144	0.0088	0.0172	0.0246	0.4573	0.4569	0.5222	0.5222	1.0000	0.7756	0.5872	0.3143	0.0657	0.0169	0.0494
10	Long Gov't Bonds	2.5%	9.0%	-0.1366	-0.1302	-0.1131	-0.1163	0.2355	0.2329	0.3703	0.3703	0.7756	1.0000	0.4943	-0.1094	-0.0321	-0.0928	-0.0448
11	Non-US Developed Bonds	1.9%	3.0%	-0.0181	-0.0247	-0.0495	-0.0170	0.6006	0.5929	0.2064	0.2064	0.5872	0.4943	1.0000	0.1086	0.0670	-0.0003	0.0472
12	High Yield Bonds	3.6%	12.0%	0.6102	0.5640	0.5847	0.6608	0.1553	0.1618	0.0981	0.0981	0.3143	-0.1094	0.1086	1.0000	0.3696	0.4112	0.2613
13	Commodities	4.2%	17.0%	0.3346	0.2890	0.4601	0.3292	0.1955	0.1923	0.1650	0.1650	0.0657	-0.0321	0.0670	0.3696	1.0000	0.2066	0.0906
14	U.S. REITs	6.0%	18.5%	0.6591	0.6073	0.5342	0.4901	0.0875	0.0876	-0.0263	-0.0263	0.0169	-0.0928	-0.0003	0.4112	0.2066	1.0000	0.4501
15	Core Real Estate	6.1%	15.0%	0.3696	0.3443	0.3467	0.3159	0.1490	0.1472	0.0226	0.0226	0.0494	-0.0448	0.0472	0.2613	0.0906	0.4501	1.0000

1) All expected returns are based on CMAs which contain projections about future returns on asset classes. These do not assume additional alpha for active management strategies within these asset classes, and are modeled to represent a low nominal fee passive index, with the exception of hedge funds and private equity, where traditional passive investments are not available. Therefore, the model assumptions for hedge funds and private equity strategies include a higher model fee impact for these asset classes. You cannot invest in an asset class directly, or within the model asset classes assumed within the CMAs. CMAs do not include asset class fees or any underlying expense ratios. Expected returns are geometric (long-term compounded; rounded to the nearest decimal). Expected returns presented are models and do not represent the returns of an actual client account. Not a guarantee of future results.

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# Capital Market Assumptions Methodology

The following capital market assumptions were developed by Aon's Global Asset Allocation Team and represent the long-term capital market outlook (i.e., 10 years) based on data at the end of the fourth quarter of 2019. The assumptions were developed using a building block approach, reflecting observable inflation and interest rate information available in the fixed income markets as well as Consensus Economics forecasts. Our long-term assumptions for other asset classes are based on historical results, current market characteristics, and our professional judgment. Expected returns are using Aon's Q1 2020 10 Year Capital Market Assumptions as of 12/31/2019. CMAs contain projections about future returns on asset classes. These do not assume additional alpha for active management strategies within these asset classes, and are modeled to represent a low nominal fee passive index, with the exception of hedge funds and private equity, where traditional passive investments are not available. Therefore, the model assumptions for hedge funds and private equity strategies include a higher model fee impact for these asset classes. You cannot invest in an asset class directly, or within the model asset classes assumed within the CMAs. CMAs do not include asset class fees or any underlying expense ratios. Expected returns are geometric (long-term compounded; rounded to the nearest decimal). Expected returns presented are models and do not represent the returns of an actual client account. Your actual returns will be reduced by your advisory fees and other expenses you may incur as a client. Aon's advisory fees are described in Part 2A of Aon's Form ADV. Not a guarantee of future results.

**Please contact your Aon representative for more information on our Capital Market Assumptions.**

## Material uncertainty

Given that the future is uncertain, there is material uncertainty in all aspects of the Capital Market Assumptions and the use of judgment is required at all stages in both their formulation and application.

## Allowance for active management

The asset class assumptions are assumptions for market returns, that is we make no allowance for managers outperforming the market. The exceptions to this are the private equity and hedge fund assumptions where, due to the nature of the asset classes, manager performance needs to be incorporated in our Capital Market Assumptions. In the case of hedge funds we assume average manager performance and for private equity we assume a high performing manager.

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## **Inflation**

When formulating assumptions for inflation, we consider consensus forecasts as well as the inflation risk premium implied by market break-even inflation rates. Fixed income government bonds

The government bond assumptions are for portfolios of bonds which are annually rebalanced (to maintain constant duration). This is formulated by stochastic modeling of future yield curves.

## **Inflation-linked government bonds**

We follow a similar process to that for nominal government bonds, but with projected real (after inflation) yields. We incorporate our inflation profiles to construct nominal returns for inflation -linked government bonds.

## **Corporate bonds**

Corporate bonds are modeled in a similar manner to government bonds but with additional modeling of credit spreads and projected losses from defaults and downgrades.

## **Other fixed income**

Emerging market debt and high yield debt are modeled in a similar fashion to corporate bonds by considering expected returns after allowing for losses from defaults and downgrades.

## **Equities**

Equity return assumptions are built using a discounted cash flow analysis. Forecast real (after inflation) cash flows payable to investors are discounted and their aggregated value is equated to the current level of each equity market to give forecast real (after inflation) returns. These returns are then converted to nominal returns using our 10 year inflation assumptions.

## **Private Equity**

We model a diversified private equity portfolio with allocations to leveraged buyouts, venture capital, and mezzanine and distressed investments. Return assumptions are formulated for each strategy based on an analysis of the exposure of each strategy to various market factors with associated risk premia.

## **Real Estate/Property**

Real estate/property Real estate returns are constructed using a discounted cash flow analysis similar to that used for equities, but allowing for the specific features of these investments such as rental growth.

## **Hedge funds**

We construct assumptions for a range of hedge fund strategies (e.g. equity long/short, equity market neutral, fixed income arbitrage, event driven, distressed debt, global macro, managed futures) based on an analysis of the underlying building blocks of these strategies. We use these individual strategies to formulate a multi-strategy assumption which is quoted in the Capital Market Assumptions.

## **Currency movements**

Assumptions regarding currency movements are related to inflation differentials.

## **Volatility & Correlations**

Volatilities and correlations are based on historical data. Both volatilities and correlations can change significantly at times of market stress. This is captured by the model.

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