# Unitized model portfolios

## A framework for evaluating the next generation of retirement plan investment solutions

Change is constant in the retirement industry. Are you keeping up and capitalizing on innovative investment solutions that are becoming available? Of growing interest to advisors who specialize in retirement plan services are the enhanced solutions for managing unitized model portfolios. Unitized model portfolios, sometimes referred to as unitized managed accounts, provide advisors the flexibility to customize investment solutions based on a broad range of investment objectives, while also simplifying investment decisions for participants. Emerging solutions retain these core benefits but are designed to integrate more seamlessly with recordkeeping platforms to facilitate daily trading and provide greater transparency and more features to help advisors manage their portfolios.

### First generation solutions

In most retirement plans today, participants are in control of their savings outcomes and bear responsibility for deciding how much to contribute as well as how to invest their savings. Their financial security in retirement depends on how well they manage these responsibilities — a burden many savers find too heavy to manage effectively. The first generation of solutions designed to simplify the investment management process for employees participating in retirement plans were primarily single-manager (proprietary) target date funds (TDFs).

The rapid growth of TDFs was driven in part by their inclusion in the list of "qualified default investment alternatives" (QDIAs), which provide fiduciary protections when used as a plan's default investment option. According to one study, 75.6% of participant-directed plans that used a QDIA had designated a TDF as the plan's default fund in 2015.[5] The simplicity of a TDF also makes them a popular choice among participants who make investment elections but seek a simpler option than sifting through the plan's investment menu to create their portfolio. Armed with one piece of information — their anticipated retirement date - participants are able to choose an investment portfolio. The simplicity of TDFs, however, also revealed some weaknesses in these first generation solutions.

**Single manager (propriety) funds** — Most of the early TDFs were designed as a fund of funds solution restricted to proprietary products offered by a recordkeeper or investment provider.

**Age as sole variable** — The simplicity of using age as the only variable necessary proved overly simplistic since not all investors of the same age have the same risk tolerance or savings objectives.

**Glide path variations and control** — The glide path was controlled solely by the TDF manager, with no ability on the part of the plan sponsor or advisor to adapt it to a plan's demographics or philosophy.

One theme that runs consistently through the list of TDF challenges is that skilled advisors were prevented from adapting the TDF investment mix or glidepath to create a solution that would better suit the needs of their retirement plan clients. Equipping advisors with the flexibility to customize solutions to a set of variables broader than just age, while still preserving the simplicity of choice from the perspective of participants, is the foundation on which the next generation of investment solutions is built.

## Next generation solutions

Recognizing the limitations of the early TDF products, the market evolved to introduce solutions that allowed a higher level of customization by skilled investment advisors. Unitized model portfolios have emerged as a leading solution in this new environment.

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| **Simplicity for participants** | For participants, this alternative retains the simplicity gained by the early TDF products – choosing a single investment product that contains a diversified mix of assets and is automatically rebalanced. For many participants, this provides a much higher probability of building a portfolio appropriate for long-term retirement savings than would occur if they selected investments from the broad menu offered in their employers' plan. The unit value for the portfolio is typically calculated daily allowing participants to view the current value of their account, just as they would if they had selected mutual funds or other investment options in the plan. |
| **Sophistication for advisors** | Managed portfolio solutions enable advisors to capitalize on their investment expertise and deliver deep value to retirement plan clients. Instead of being constrained to offering a solution based solely on participants' anticipated retirement dates, advisors are free to build models that serve a broad range of investment objectives. Many advisors build a series of models based on risk tolerance. Others create models that factor in both risk tolerance and age, adjusting the asset allocation over time based on a glide path designed by the advisor. Additionally, models may be created to represent specific asset categories or classes, commonly known as "white-label" investments. |
| **Diverse investment options** | Another limitation that is absent in these solutions is a single-manager (proprietary) focus. Most model portfolio platforms allow advisors to choose from a broad and diverse lineup of the top-performing funds across multiple managers, with the freedom to eliminate any underperforming investments based on the criteria and timeline set by the advisor. |
| **Scalability** | Most advisors who design model portfolios for investment clients, build a mix of portfolios that can be deployed across their base of retirement plans. |
| **Fiduciary status** | As more diverse and sophisticated investment products are introduced in the marketplace, plan sponsors and committees who serve as the plan's investment fiduciaries are increasingly dependent upon the expertise of investment professionals to assist with the selection and monitoring of plan investment alternatives. Building and managing model portfolios for retirement plans is an ERISA fiduciary function. ERISA fiduciary status provides assurance to retirement plan fiduciaries and participants that advisors will be held to high standards of loyalty and prudence and must avoid conflicts of interest in providing model portfolios. |

For advisors considering adding model portfolio services to their menu of retirement plan services, there are a number of solutions available in today's marketplace to help build and manage the portfolios they will offer to clients. As with any important business decision, it is important to compare options and costs as well as how seamlessly the portfolios can be integrated into the plan. For example, some recordkeepers may not be capable of efficiently administering unitized model portfolios. Advisors may find they need to develop additional education materials to help plan sponsors and participants understand model portfolios as compared to more traditional options such as mutual funds. Determining the appropriate benchmarks for the model portfolios' performance and fees can also be more challenging. In addition to the fees associated with each underlying investment, most advisors assess a fee for managing the portfolios. There may also be a fee for the portfolio management product or platform that an advisor chooses.

## Questionnaire for evaluating model portfolio platforms

As you evaluate the role unitized management portfolios will play in your retirement plan business model and explore the different solutions available in the marketplace, you may find the following checklist helpful.

**Investment fiduciary responsibilities**

☐ **Are your advisor firm's policies and procedures compatible with unitized model portfolios?**
Building and managing model portfolios is a fiduciary function. Review your firm's policies and procedures regarding investment advice and investment management services, including service agreements, and documentation and tracking requirements.

☐ **Does the service provide the flexibility you need to build model portfolios for your retirement clients?**
Will you have the option to build and manage model portfolios that can be deployed across multiple plans? Will you have the option to customize your models at the plan level to accommodate a plan's investment policy statement (e.g., eliminating certain investments for social or religious reasons)?

☐ **Will you have access to pre-built model portfolios from third party fiduciaries?**
Some solutions provide access to a menu of model portfolios designed by institutional fiduciaries that you may introduce to your retirement plan clients. What are the fees associated with the pre-built portfolios?

☐ **What are the fees and fee disclosure capabilities?**
How do the fees for the services compare among the solutions? How are the fees disclosed to plan sponsors (fiduciaries) and plan participants? Are you able to incorporate a portfolio management fee that will be factored into unitized value?

**Investment options**

☐ **Do you have access to all the types of investment alternatives you need for your model portfolios?**
Will you be able to fulfill your fiduciary duty of prudence based on the available investment options? Do you have access to only mutual funds or mutual funds and ETFs? Keep in mind that an investment may be appropriate for a model portfolio even if it would not be considered prudent as a stand-alone option in a retirement plan menu. Are there a sufficient number of options within each category of investments?

☐ **What performance and benchmarking features are offered?**
Can the system track and report portfolio performance over time? Can it create a projection of historical performance for periods before your model portfolio was created (based on the performance of the underlying investments)? What benchmarks are available for the model portfolios? Can you benchmark each underlying investment? Do you have authority to designate the benchmark?

**Systems capabilities for portfolio management**

- ☐ **Is this a well-established product?**
  When was the managed portfolio service launched? Does it have a proven track record of performance – trading functionality, system availability, reporting accuracy? How often does the product release enhancements? How competitive are the functionality and fees relative to other options?

- ☐ **How complex is the system for you to maneuver?**
  Model portfolio technology continues to evolve. Assess the level of efficiency and ease of use to make certain you do not waste time managing data input and manual oversight. Your time is precious and better spent on applying your investment expertise as opposed to cumbersome data entry functions.

- ☐ **Do the portfolios integrate seamlessly with the recordkeeping systems used by your clients?**
  Can the recordkeeper accept and display the portfolios as an investment option, like other alternatives in the plan? Can the recordkeeper post fact sheets describing the portfolios? Can the system accept and post a daily value for the model portfolio? Can it trade these investments efficiently? The early iterations of unitized managed portfolios often meant delayed trades (T+3). Newer solutions that have built appropriate links to recordkeepers are able to trade T+1.

- ☐ **What rebalance functions are available to you?**
  Does the system have automatic rebalancing features? If so, can you set the timing for the rebalancing (e.g., specific date, weekly, monthly, semi-annually, annually)? Do you have the option to manually rebalance if that is your preference? Does the system enable you to apply an asset allocation glidepath if you elect to create custom TDFs?

- ☐ **What reporting and monitoring features are available to you?**
  What types of alerts are provided if a model portfolio is out of tolerance based on the parameters you set for the portfolio? Assuming you create portfolios that are deployed across multiple retirement plan clients, what types of plan-level reports are available to you? Can you customize your views and reports? Can you brand reports with your firm's logos and colors?

[1] Investment Company Institute, The US Retirement Market, Third Quarter 2017, December 2017, https://www.ici.org/research/stats/retirement/ret_17_q3

[2] "How Much Choice is Too Much? Determinations of Individuals Contributions in 401(k) Retirement Plans," Iyengar, Huberman, and Jiang; In: Pension Design and Structure: New Lessons from Behavioral Finance, edited by O.S. Mitchell and S. Utkus, Oxford University Press, Oxford, 2004; "Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans," Shlomo Benartzi; Portfolio/Penguin, 2012

[3] H.R. 4, Pensions Protection Act of 2006, August 2006, https://www.govtrack.us/congress/bills/109/hr4/text

[4] Department of Labor, Qualified Default Investment Alternative, 29 CFR 2550.404c-5, October 2007

[5] Profit Sharing Council of America, 59th Annual Survey, Reflecting 2015 Plan Experience



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