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Design Revolution

Fund Menu Design Tips for 403(b) Plan Sponsors

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For many years prior to the passage of the 403(b) regulations and ensuing fee disclosure regulations, there was little oversight required of plan sponsors with respect to the fund menu they offered to participants. Over the last four years, this practice has changed dramatically.

Today, 403(b) plan sponsors are faced with a number of new challenges and obligations, one of which is to design a fund menu that is broad enough to meet the needs of its diverse participant population while at the same time not overwhelming less sophisticated investors.

The first step is to evaluate what is currently in place. This is the point at which many plan sponsors will seek out the assistance of an independent advisor with experience in the 403(b) market. As a committee, several factors should be evaluated early on in the process:

1. How many vendors are being made available to participants? Is one particular vendor used more than another?
2. Are there vendors that are currently frozen to new participant contributions, but accepted contributions anytime after January 1, 2009?
3. What types of contracts exist in the plan today (i.e., group or individual)? This will have an impact on a plan sponsor's ability to make plan enhancements.
4. Within the vendors that are currently available, how many investment options do participants have to select from? How many options are being utilized today?
5. Among the available investment options, is performance competitive when compared to appropriate benchmarks?
6. Among the vendors and investments available to participants, what are the fees being charged to participants and are they reasonable?
7. How is information about the plan and investments being communicated to participants today?

Once they are armed with answers to the questions posed above, plan sponsors should start thinking about what their ideal fund menu design may look like. In this step of the process, it is important to remember that there is no "one-size-fits-all" solution. Each institution is unique and, as such, may have specific ideas that shape their offerings. For example, is there a large population that has invested in low cost index funds? Do participants have a loyal following to a specific fund family or fund type (e.g., socially responsible funds). These are all clues that a committee should consider in constructing their new fund menu.

Beyond what the clues from the aforementioned questions may describe about a plan, new and different ideas should be tested as part of the decision making process as well. For example, a new fund menu design trend of "less is more" is beginning to gain the attention of some plan sponsors. Imagine that a plan offers one or more emerging markets funds today with only modest participant interest. As a committee, the two obvious options when redesigning the fund menu would be:

1. Narrow the focus to a single emerging markets fund and continue to offer participants "dedicated" emerging market exposure, or;

2. In lieu of a "dedicated" emerging markets fund in the plan, offer a well-diversified international equity fund which has underlying exposure to emerging markets. This strategy can help to reduce the overall number of funds in a plan and may also help to improve the investment selection process for participants. This type of strategy can be applied to other asset classes within the plan.

Of course, the redesign is only one piece of the puzzle. Once a committee has arrived at a new or redesigned fund menu, the challenge then becomes getting participants from point A (the current menu) to B (the new menu). As a committee, there are some important factors to consider:

1. Are there contracts in place that may limit or restrict a plan sponsor's ability to transfer existing assets and future contributions to the new investment options? Oftentimes, this occurs when individual contracts are being used. Because the funding contract is between the individual participant and the investment company, the plan sponsor does not have the ability to move, or "map," current assets. Under this scenario the plan sponsor would typically have the ability to "freeze" the current investment option and redirect all future contributions to the new investment option. It would be up to the participant to decide what to do with the assets that will remain in the "frozen" fund.

2. Develop a mapping strategy to limit participant disruption. This can be a challenge when plan sponsors are implementing a new menu that offers participants fewer vendors and considerably fewer investment options, which is oftentimes the case. Plan sponsors should consider a mapping strategy that directs funds into the same or similar asset classes. This will also help to preserve allocation decisions that participants may have elected on their own. In the absence of a "like" investment option on the new or redesigned menu, plan sponsors should consider mapping participant assets to the plan's designated Qualified Default Investment Alternative (QDIA). Mapping to a like investment or to the plan's QDIA option may provide certain DOL safe harbor protections to the plan fiduciaries.

3. Communicate with participants often and early. This is of particular importance when making significant changes to the investment menu. It is not uncommon for a plan to consolidate from 150 fund options or more down to 20 or less. In certain segments of the non-profit marketplace, participants demand information well before changes occur and on a more frequent basis relative to their for-profit counterparts. In addition to written communications, plan sponsors should consider conducting "live" participant sessions prior to implementing changes. These live sessions may come in the form of "community forums," where members

of the human resources staff, the investment committee, and the advisor present information on the process that was conducted and the ultimate decisions that have been made. These types of events provide opportunities for participants to ask questions and receive greater clarity on the changes that are being made to their plan. In many cases, this type of early and frequent communication plan can help to reduce the number of participant calls to the benefits staff after changes have been implemented.

As discussed earlier, while the process that a plan sponsor carries out may be similar to other institutions, there is no "one-size-fits-all" solution. The ideas and designs that are ultimately implemented should be a reflection of a plan's demographics. This is a process that is considered a daunting task for many, when in fact it should be viewed and embraced as an opportunity to make a positive impact on how participants approach and plan for retirement.

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