Transcript

Better conversations. Better outcomes.

Episode 46 – Complex situations, personalized approaches: Managed accounts

Lorianne Pannozzo - Long gone are those days where you had a single breadwinner working at a job for 40 years and retiring on a professionally managed pension. Today, the situations are more complex. If you think about just the number of accounts that a household is managing towards retirement, so complexity of life is what's driving managed accounts.

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Emily Larsen - And I'm Emily Larsen. In each episode, we'll explore topics relevant to today's trusted financial advisors, interviewing experts and investigating the world of wealth advising from every angle. We'll also provide you with actionable ideas designed to improve outcomes for advisors and their clients.

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Emily Larsen - Before we get started, one quick request. If you have enjoyed the show and found them a value, please take a moment to leave us a rating or review on iTunes. It would really mean a lot to us.

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Emily Larsen - Managed accounts are a fast growing segment of the financial advice ecosystem, and one of the chief drivers of their popularity is complexity in people's lives. We'll cover this in more detail later, but let's start by introducing our guest. Who better to teach us about this offering than one of the largest retirement providers in the US, Fidelity. Here's our guest.

Lorianne Pannozzo - Lorianne Pannozzo, senior vice president of Fidelity Workplace Solutions.

Ben Jones - How do you describe your role?

Lorianne Pannozzo - I lead product development and management for Fidelity's workplace managed accounts offering, which we call Portfolio Advisory Services at Work or PASW.

Ben Jones - And where do we find ourselves recording today?

Lorianne Pannozzo - We're at a conference room at Fidelity's headquarters in Boston.

Ben Jones - Boston, Massachusetts, one of my favorites. As we sat down in Boston with my dunkin in hand, we started by defining what we mean when we say the term managed accounts. Then we discussed the scale of the managed account marketplace and what needs to happen in order for providers to be successful for participants with these solutions. Managed accounts mean a lot of different things to a lot of people and when I talked to end investors and I say managed accounts, they say well, aren't all accounts managed? And when you talk to advisors at times, they struggle to define what this really means. So, in your opinion, how would you define managed accounts?

Lorianne Pannozzo - So, a managed account, and I'll specifically talk about workplace managed accounts, but they provide ongoing discretionary management and the ongoing monitoring of a specific account, right. So, it is the entire portfolio within that managed account for workplace because it's your 401k plan. And what these accounts do is they personalize the investment strategy based on a participant's unique financial situation, their risk tolerance, their outside holdings, and it adjusts for that, and we do it towards a retirement goal. So, it's really that personalization and then the ongoing investment management with the ongoing monitoring and re-balancing that automatically occur. So, managed accounts tend to be a very scalable solution.

Ben Jones - Now, I want to just -- from the corporate plan sponsor perspective, how does a managed account fit into the overall workplace savings plan?

Lorianne Pannozzo - So, we look at it from a couple of perspectives. First, we say think about your participant base and broad categories -- you have two different types of participants and their investing habits. There are the “I want to do it all myself”, and those participants have the confidence that they can manage this. They may just need point in time advice. They want to get started right or they want to occasionally validate their thinking with someone. But they are off and running. Then there are the ”do it for me” investors and we think about that -- we call it will, skill, and time. So, the will; do they want to manage their investments on their own? There are people who really just have no desire to be engaged in it. Their priorities and interests are someplace else. The skill is are you going to feel confident in your ability to do the managing so that you feel good about where you are. And then the time is -- it's the time prioritization to not only selecting those investments the first time, but you're going to come in and you will be doing the ongoing management. There are people who I really don't want to prioritize my time in that way. So, we think about will, skill, and time first as being are you right for any kind of solution whether it's a target-date fund, or a managed account. That's the “do it for me” solutions. So, together they fit into the overall plan design to meet the needs of those participants.

Ben Jones - When I think about managed accounts inside of a retirement plan, it tends to be if someone selects the managed account option, it's their whole portfolio.

Lorianne Pannozzo - That's right.

Ben Jones - How should an advisor think about it when they have maybe a wealth management client and they've got a portfolio at their wife's work, and a portfolio at their work, and then this managed account. How should an advisor think about what that individual should do or how that fits into the overall portfolio of that individual?

Lorianne Pannozzo - Right, so if you think about what the participant cares about and what the advisor is advising towards, it's can I help this person meet their overall goals, right? So they're going to be looking at the goals and assigning these different accounts to the goals. The managed account is one of those accounts that can be assigned towards that goal and part of the personalization is to consider what you have in terms of the outside assets. So, it will adjust the allocation for that specific account to meet what the other asset allocations are in the other accounts and holdings. So, if I have towards a retirement goal an IRA that's all equities, the managed account would make it more conservative, right, so that we have the overall appropriate allocation towards the goal.

Ben Jones - I like that. Now, when it's inside of a corporate retirement plan, who's paying for the managed account?

Lorianne Pannozzo - Typically, the participant pays for the managed account fee. So, the overall wrap fee for the management and ongoing monitoring. There are some instances where a sponsor, they pick up all or some part of that fee.

Ben Jones - And so I've got to imagine this next question is going to be all over the board, but on average, what does a managed account generally cost?

Lorianne Pannozzo - So, I'd say that tends to vary. Often, the managed account fees can be negotiated depending on the size of the overall plan, but typically you target around 50 basis points on a net basis.

Ben Jones - Yeah, we have a very large audience of advisors, a lot of plan advisors as well that listen to this. Why do you think that advisors or consultants should really care about this topic in particular?

Lorianne Pannozzo - Well, I think there are probably three reasons. So, the first one is that is where the market is going. So, your competitors who are also looking for that business will see that's the market growing and we see more and more being aware and starting to consider managed accounts as part of their overall discussion. So, first, that's where the puck's going so lean into it. I think second it actually provides more opportunities to add value. So, there are questions like what's the overall appropriate plan design once we start considering managed accounts as part of that. So, there are additional areas to go ahead and add value. And third, for those advisors who might be focused more on wealth management, it does provide opportunity to better scale and leverage your time. So, it can be really considered as part of that business. So, those few reasons.

Ben Jones - And I'm curious. I hear a lot of folks talk about the growth in managed accounts. It's kind of analogous to you were an early pioneer in target-date and there was a lot of growth in target-date. Why is managed accounts growing? What's the consumer desire or demand? What's creating that growth?

Lorianne Pannozzo - The growth is coming from the participant need. I'll say that absolutely. And if you think about it, it's because the fit for managed accounts are those participants with more complex situations. And complexity in people's lives is just increasing. Long gone are those days where you had a single breadwinner working at a job for 40 years and retiring on a professionally managed pension. Today, the situations are more complex. If you think about just the number of accounts that a household is managing towards retirement, the answer is nine. Nine for just a retirement goal average number of accounts. And according to the Bureau of Labor Statistics -- I was a little shocked by this -- the average pre-retiree will have changed jobs 12 times over the course of their working life, so just the number of workplace benefits that they may have can have increased significantly. So, complexity of life is what's driving managed accounts. You connect the complexity of life to the growth of the “do it for me” solutions, and now managed accounts being added as a more personalized option, that all adds up to the growth of the industry.

Ben Jones - 12 times. Jeeze, I feel like I'm on the distribution curve. I'm in the tail there being halfway through my career, I'm not halfway to that goal.

Lorianne Pannozzo - Well, if you start thinking about the jobs you had as a teenager. I know I worked as a library page for a few weeks, and as a McDonald's fry girl.

Ben Jones - My pre-professional work life was all manual labor. And post it's been almost entirely white-collar labor, so there's definitely a delineation in the type of work that I did over time. So, let's talk a little bit about considerations for managed accounts, and maybe first we talked a little bit about the growth of the market. But, how large is the managed account marketplace. It's a hard thing to get a size on.

Lorianne Pannozzo - Well, managed accounts is a very large market. I'll focus on the workplace market. According to Cerulli at the end of 2016, it was 227B. Now, the market for TDFs according to the same Cerulli data was over $1T. So, combined it's a very large market and it's growing pretty quickly at about 20% annually.[1] Managed accounts we see as being kind of that next wave of personalization.

Ben Jones - Almost like a target-date 2.0 or 3.0.

Lorianne Pannozzo – Yeah absolutely.

Ben Jones - I don't know. Everybody's got a different 0.0. I'm not in technology, so I'm not even sure I know how to allocate points. So, what are the different types of managed accounts that are available for advisors to consider? And, I guess, maybe related to this is when they go to a platform provider or a recordkeeper, do they actually get a choice or do they just take that platform's anointed choice, or is there optionality?

Lorianne Pannozzo - So, first on the types of managed accounts, again, we're talking workplace managed accounts, there's really only the one type. It's the discretionary management. Now, all the flavors depend on the specific providers that you have, and that gets to your conversation about the recordkeeper. That will depend on the recordkeeper’s business model. Some have more proprietary offerings on their platform; others tend to be a little bit more open architecture where there may be choice. So, it really depends on who your specific provider is.

Ben Jones - And so with respect to that, walk me through the decision-making framework that an advisor would go through, the plan sponsor. Obviously, they have really robust procurement processes for finding the right recordkeeper. Does that mean if a recordkeeper only offers one solution, that that needs to be part of the recordkeeper RFP, or would they choose a recordkeeper based upon a managed account RFP?

Lorianne Pannozzo - So, the answer is both and it will depend a bit on the advisor's business model and the capacity at which they're asking. On the recordkeeper side, I think we are seeing it and what we're hearing from advisors is they are seeing much more frequently that it's added as a section of the recordkeeping RFP, whether or not they provide managed accounts as part of their services. However, there are also searches that are specifically around the plan design where the question will come up much more around a managed account provider. The question then is will that managed account provider that selected be accommodated on the recordkeeping platform. So, the answer is both and we are seeing an increasing number of RFPs that are asking for managed accounts and I think that's the key message.

Ben Jones - Correct me if I'm wrong and I certainly don't want to overstate this, but if I look back in time, a lot of the solutions that have been designed to help savers meet their objectives over time, if you go back to the 80s and 90s, it was about a risk-based portfolio you filled out. And it was based on one factor; what's your risk tolerance. And then we evolved into target-date, which was based on a different factor; what's the date that you retire. And then we kind of did custom target-date, which might have been based on a population, maybe two or three factors for a population. It was still based on an average participant, which has its own pitfalls. Managed accounts have the ability to take in a lot of other variables, but are those variables automatic or do you need engagement from the participant to get things like you mentioned about outside assets or other information?

Lorianne Pannozzo - Well, the answer is both because a managed account provider should be able to pull in some data that's automatically record kept on the platform. So, you should have some degree of automatic population. In addition, there can be engagement from the participant that becomes automatic. So, for example, use of an asset aggregation engine to pull in outside accounts. There's a one-time engagement to pull that information in and then that happens on an ongoing basis. And then there's collection of the additional information that needs to happen to create that personalization. And a point on that is it doesn't necessarily happen all at once. So, we'd love to say that everybody -- oh, I'm going to book an hour to go give you all my personal information at a time. Generally, people will provide so much and then there's a little bit of fatigue. It's also just, I'll answer that later. So, you need to have great engagement to make sure you're continually reaching out and providing opportunities for the participant to continue to personalize.

Ben Jones - So, as long as I can recall working now in the retirement plan space for a long time, the struggle has always been with participant engagement. With a managed account, what are some of the ways that you see working to get that ongoing engagement from the participants? Is it peer-led, is it advisor encouraged, is it plan sponsor encouraged, what is it that's working and what are those overall engagement rates?

Lorianne Pannozzo - So, first all of those components need to be leveraged and you want to see programs that are pulled together to make them all sing in terms of really trying to reach out and get that participant engagement. So, things like -- first of all in the enrollment process, you try to capture that information. Some pieces will be provided, not all the pieces. Then you have the onboarding process. The onboarding process should also be looking to capture more information. Great, you're enrolled. Tell us more. And then there's the annual update, right, your portfolio review at the end of the year that you review your information and get an opportunity to add more. Now, when there is live channel engagement, those representatives are great at collecting information, and if you have an advisor who is able to say here are a few participants I see who could really use my help, that's a great opportunity to really interject into that overall service model to add more value and continue to learn about that participant.

Ben Jones - So, tell me a little bit about -- obviously, it's a growing marketplace. It's growing fast. We talked a little bit about the participant desire for advice driving that, but what are some of the other trends that are driving the managed account marketplace today?

Lorianne Pannozzo - We discussed the participant need certainly being one of them. Then there's the overall growth in the industry, so there are more providers, I think, getting into the game to start providing managed accounts and certainly as the need for personalization has increased, so have the different methods that providers are using to do that. One interesting trend that we have seen is around the QDIA. So, managed accounts is an option as a QDIA and some smarter plan design around that saying who are the appropriate individuals that we might want to default into a target-date fund for example versus a managed account for those participants who have more complex needs. So, trying to move the QDIA beyond a one size fits all solution.

Ben Jones - That's really interesting. Have you seen anyone actually split their QDIA choice between managed accounts and target-date?

Lorianne Pannozzo - Not yet. We have recently introduced the capability, so it's still a pretty new offering in the industry and I know there are a couple of other providers who are doing that. There's not been the selection, but there's certainly been a lot of interest, particularly in the consultant community and for some, I'd say, of the bright leader sponsors that we work with.

Emily Larsen - If you're considering managed accounts as an option for your plan sponsors, it's important to look at the demographics from a will, skill, and time perspective as Lorianne pointed out. Then, look at providers, capabilities, and approach to identify fit as well as consider how it will be positioned on the investment menu. Ben and Lorianne discussed what advisors should consider when thinking about a managed account provider.

Ben Jones - How do they think about the differentiators and the way the different providers -- you mentioned there's a lot of new providers, and I've noticed a lot of the robos that weren't successful in the retail market are now trying to attack the workplace market, so tell me a little bit about the things that an advisor should consider or think about when they're assessing a managed account provider.

Lorianne Pannozzo - So, a few factors. First, fiduciary, so is the provider stating that they're the 338 fiduciary for the participant investment decisions. So, that's one factor you absolutely want to keep in mind. Second, personalization - what is the degree of personalization that they're actually providing? Is it more like this custom target-date solution or are we fully personalizing for the participant including many different factors, outside assets, spousal assets, their own profile, as part of that. The ongoing portfolio monitoring, so frequency of monitoring for drift, re-balancing, looking at that. Really the customer experience too, so both the digital customer experience, how integrated is it with the overall flow that your recordkeeper is providing. Is it easy, is it simple, is it intuitive around that customer experience, the service models, so are there people they can talk to, you mentioned robos. They don't want to add the personal, though, many of them are finding that in order to get the engagement and the results, you need to provide that and a cost, so the managed account fee, does that fee include access to a human being? Are there integration costs and because of this engagement factor, are there additional costs for participant communications and programs, all things that you would want to go ahead and consider.

Ben Jones - That makes a lot of sense, and I think that two things that really stick out in my head when I think about what you just explained. First the customer experience. In the way that we manage employees in retirement using good behavior management, the experience is everything for engagement. But advisors tend to like to focus on the investment problem, so is there wide differences in the optimization engines or the philosophies that these managed account providers are using or is it, or are they all using a somewhat similar method to get to these custom allocations?

Lorianne Pannozzo - I think that's one of the things that you want to look at, the degree of difference again, so it all starts with personalization, because that's the factor that's going to determine what's the portfolio allocation for you that's going to help you reach that goal. Different providers have different degrees of personalization that’s involved. I can't speak to everybody's -- the engines that they're specifically using, but that's certainly something that you would look at. I think the different providers would say they have a secret sauce in that, so it's really you understanding which -- what is the philosophy of each provider and what's their methodology.

Ben Jones – Target-date when it came out, it's evolved, it's grown into a very large segment of the marketplace, and we've seen a lot of fee compression in that marketplace. Do you anticipate that as managed accounts grow that there will be fee compression in that or is it because the advice part is so valuable that it's priced appropriately today?

Lorianne Pannozzo - We believe it's priced appropriately today for all the services that are being provided. There's certainly a lot of innovation going on in the space, so I would say as a future trend, you'd likely see some degree of that, but it really depends on is the provider creating all of that value in the account through both management of the portfolio and the ongoing planning and other services that are being provided.

Ben Jones - And it might be over time that the innovation leads to more services, which might increase the delivery.

Lorianne Pannozzo - Absolutely that could happen. So on that point you just raised about more services being provided, the example you had raised earlier about robo advisors coming in, what they've seen is that that low price point didn't provide enough value, so they have been adding more human support, which has increased the overall price points.

Ben Jones - I'm really interested in the robo evolution, in particular because they haven't been tested through a scary market yet and it'll be interesting to see if they can manage the behavior of all of the clients that they have over time, but that's just my two cents on it. I think one of the things advisors do best when they're at their best is really keep clients from making really poor rash decisions immediately and so we'll see if they pull it off. Maybe they've got it all figured out.

Lorianne Pannozzo - Absolutely. One of the success factors of the managed account should be that those participants are staying the course and they're staying invested.

Ben Jones - Now, one question I do have about the service model of an advisor, many advisors charge you their consulting fee to a plan sponsor for their ongoing services, or maybe they charge an asset-based fee in some cases as well. Does the service model of the advisor change if managed accounts are the majority of a plan sponsor's asset base?

Lorianne Pannozzo - Well, an advisor would be doing everything they're doing today, and in fact probably be adding some more value over the course of their relationship with the sponsor and the participants, but they will also be able to perhaps leverage their time better in some ways, since a lot of that ongoing work that we talked about is being provided by the managed account provider. So, the advisor will still be all involved in recommending the plan design and in fact this is another element to be able to bring into that. They'll be looking at who are the right participants into this account looking at the demographic evaluation and they're certainly be fiduciary for everything around the 321 on that. And in addition, you can think about what are those additional services we want to provide for participants with more complex needs. So, those potentially enrolled in the managed account. There are the annual participant meetings to really have those discussions and maybe additional wealth planning meetings as we've uncovered some more of these complex needs and you realize that they may have other needs that are not being addressed through the workplace plan itself. And then with the managed account there's more of reviewing the plan insights and trends and offering ongoing suggestions to the sponsors.

Emily Larsen - Now we switch gears a bit. From what an advisor needs to consider in the managed account provider to what they need to consider for the end participant. First we'll identify who managed account participants are, then we'll explore what a well-designed experience can do for them.

Ben Jones - And so then if we shift to the participant side as advisors think about the participant demographics, who are the participants that are selecting these managed accounts? Do they tend to be any demographic commonalities or is it all over the board as well?

Lorianne Pannozzo - First of all, it's definitely a mental split around -- or behavioral around who are those who want to "do it myself" versus "do it for me". We also see the chief need being complexity of situations. In terms of demographic, I would say we see versus target-date funds for example, we see age being one factor; they tend to be a bit older in a managed account. Not a huge gap, but definitely that's a differential we've seen. Certainly in terms of overall assets, I'd say that's one of the biggest areas that we see the difference. Income, so some of those factors we see being higher levels in a managed account versus a target-date fund and I think that's very intuitive when we talk about complexity of needs correlating to some of those factors.

Ben Jones - When a plan sponsor or an advisor goes out to educate the participant population about the option of a managed account, how do they explain the attributes or why a participant might consider selecting a managed account provider? How do they frame this for the participant?

Lorianne Pannozzo - For the participant? We try to do it pretty simply. Again, it goes back to this how do you feel about investments? The will, skill, and time conversation - so to introduce it really that way. Again, around the need. And then if there's a target-date fund in the lineup as well, it's then a matter of the complexity of your need and your situation. So do you have a different risk tolerance that may not be accommodated in the current roll down of the TDF? Do you have outside assets, spousal assets, how much are you managing towards a single goal right here for retirement? It's really if you have other sources of income. There's a lot of questions that you then ask, so it's really not positioning an investment solution or another, but it's that really underlying understanding of the needs and then being able to say for a more personalized solution to meet your complex needs, a managed account is likely the best choice.

Ben Jones - And when they do that, do they then frame, but there is some work that you have to do to really make this super robust for you. You mentioned there's some automation that pulls in, but the real value is I think of managed accounts is understanding the entire situation, which some of those things are only going to be known by the participant saying here's the rest of my complex situation.

Lorianne Pannozzo - Absolutely. And that's honestly one of the areas where you can do so much online, but in turn you say listen, the value prop here is about personalization, we want to learn everything about you. I think that's really where often that personal touch comes in, because it's not around okay, here's the information I need to collect about you so that we can make this account work. It's a much more natural discussion over listen, I want to understand you, tell me about yourself and in that conversation, you're going to elicit a lot of these kind of responses, right? So, it's really a part of that natural conversation about understanding who somebody is.

Ben Jones - Do most plans today have a managed account and some other type of target-date or QDIA or are you seeing plans just select just managed accounts?

Lorianne Pannozzo - In our experience in the business that Fidelity record keeps, we are seeing a majority of those being in some sort of dual design. On Fidelity's record kept platform, we see that 98% of clients offer a target-date fund and 47% offer a managed account.[2] And Fidelity believes that the two are complimentary solutions where a target-date fund can meet the simpler needs of investors and the more complex needs of investors can be best met by the managed account.

Emily Larsen - Here's a recap of some of the key ideas from Ben's conversation with Lorianne.

1. Consider the population by will, skill, time, and complexity.

2. Evaluate the provider's fit with six attributes in mind. Here they are listed in no particular order: fiduciary status, personalization, ongoing monitoring, customer experience, cost, and methodology.

After considering the plan sponsors, participants and providers, advisors should have the knowledge and information they need to create a successful plan for all the stake holders. Ben asked Lorianne what it feels like when an advisor and their plan sponsor gets the managed account choice right.

Lorianne Pannozzo - So, for the plan, I would say it's the sum of the individual participants, and what we want to see from a participant is a couple of things. So first that they're engaged. That means they've provided that personalized information and it means that when they have a change of a life event, that they know I need to update my information or the next time we reach out, they say, yes, this happened to me, I'm going to let you know about it, so they're an engaged participant. The second they feel confident, so they have confidence that they are in the right portfolio and that they know where they stand towards their goal and that's this periodic here's what we're doing for you, here's how you stand, I think is part of creating that confidence. And finally, we touched on this earlier, is staying invested, that they have -- they're in it for the long haul, they're not panicking when there's a sudden market change, that they believe that there's somebody who's got my back on this, and I'm just going to stay involved and stay invested.

Ben Jones - And so if you were to summarize our entire conversation today in two sentences or less, what would you say?

Lorianne Pannozzo - Managed accounts are a growth industry and you should really be considering it for those participants who have more complex needs.

Ben Jones - To learn more about the thoughts of the Fidelity Workplace Solutions Team, visit our show notes page at bmogam.com/betterconversations. There you'll find additional resources, papers, and links to more content on this topic.

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Emily Larsen - We value listener feedback and would love to hear what you thought about today's episode, or if you're willing to share your own experiences or insights related to today's topic, please e-mail us at betterconversations@bmo.com. And of course, the greatest compliment of all is if you tell your friends and co-workers to subscribe to the show. You can subscribe to our show on iTunes, Google Play, the Stitcher app, or your favorite podcast platform. Until next time, I'm Emily Larson.

Ben Jones - And I'm Ben Jones. From all of us at BMO Global Asset Management, hoping you have a productive and wonderful week.

Emily Larsen - This show and resources are supported by a talented team of dedicated professionals at BMO, including Pat Bordak, Gayle Gibson, Matt Perry, and Derek Devereaux. This show is edited and produced by Jonah Geil-Neufeld and Annie Fassler of Puddle Creative.

[1] Lorianne mentioned Cerulli. This references Cerulli Edge, Retirement Edition, Q1 2017 reflecting Q4 2016 data. [2] She also mentioned record kept data. This references data as of 9/30/2017. This data includes both proprietary and non-proprietary managed account clients and participants across Fidelity's recordkeeping platform, including both Defined Contribution (DC) and Tax-Exempt (TEM).

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