# Defined Contribution Insights

## White Labeling: The Next Step in Simplifying DC Plans for Participants

While defined contribution (DC) plans have grown more user friendly over the years thanks to innovations in the industry, investment decisions can still pose a significant challenge to participants, many of whom lack the investment knowledge and experience necessary to allocate their retirement savings effectively. To help address this issue, DC plans are increasingly embracing the concept of "white labeling" — combining multiple managers and strategies into broad groups of investment options. White labeling allows plan sponsors to simplify their suite of investment options while at the same time providing participants access to a robust and diverse lineup of managers and strategies.

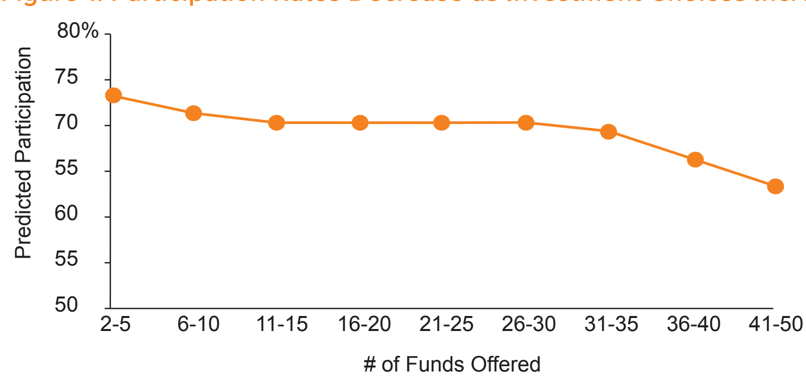
### An Abundance of Choices May Lead to Inaction

Launched in the 1980s as a supplement to defined benefit plans, DC plans today are the predominant pension plan for American workers. In conjunction with this evolution from DB to DC, the responsibility for investment decision making has shifted from plan sponsors to plan participants. To give participants a broad palette of investment choices, many DC plans have come to feature large menus of funds and other investment alternatives. The increase in options has been driven partly by plan participants and partly by a belief that greater choice would encourage increased participation and better participant decision making. Regrettably, in many cases, the opposite occurred; participants were overwhelmed by the number of choices in the investment menu, leading to a lack of confidence, decision making paralysis and even decreased participation.

We have seen this phenomenon of "choice overload" confirmed in various academic and consumer studies in recent years. For example, in the so-called "jam study," shoppers at a gourmet grocery store in California were presented with a tasting booth the featured two displays of exotic jams to taste and buy. One display offered 24 different jams, while another offered only six. Though 60% of passersby approached the 24-jam display, only 3% actually purchased a jar. In contrast, 40% of passersby approached the six-jam display, with 30% making a purchase. The results suggest that although consumers find extensive choice more attractive at first, more limited choices provide a greater motivation to buy.

Another study by the same researchers conducted in 2003 examined whether the number of investment choices in a DC plan would produce a similar response. Here researchers found that participants confronted with an increasing

**Figure 1. Participation Rates Decrease as Investment Choices Increase**




Source: Voya Investment Management, based on results reported in Iyengar, Jiang and Huberman, "How Much Choice is Too Much? Contributions to 401(k) Retirement Plans."

number of investment choices are likely to respond in three ways: they procrastinate, they make worse choices, and they are less satisfied with their choices. These responses are a recipe for participant dissatisfaction at best and non-participation at worst. And dissatisfaction is likely to lead to lower contribution levels compounded over time.

## Making Investment Choices Easier: The Role of White Labeling

To simplify plan participation, engage more participants and even improve diversification, many DC plan sponsors are considering a move to tiered menus with white-label investment options. Such tiered menus generally consist of an asset allocation offering, core offerings and a handful of specialty offerings in an attempt to meet the needs of the different types of participants within the plan. Figure 2 provides an example of such a menu, broken into three tiers:

- Tier one — target date suite for those participants who want decisions made for them
- Tier two — white labeled core and multi-asset funds bucketed by asset class or objective for do-it-yourself investors
- Tier three — brokerage window for participants who want more choices

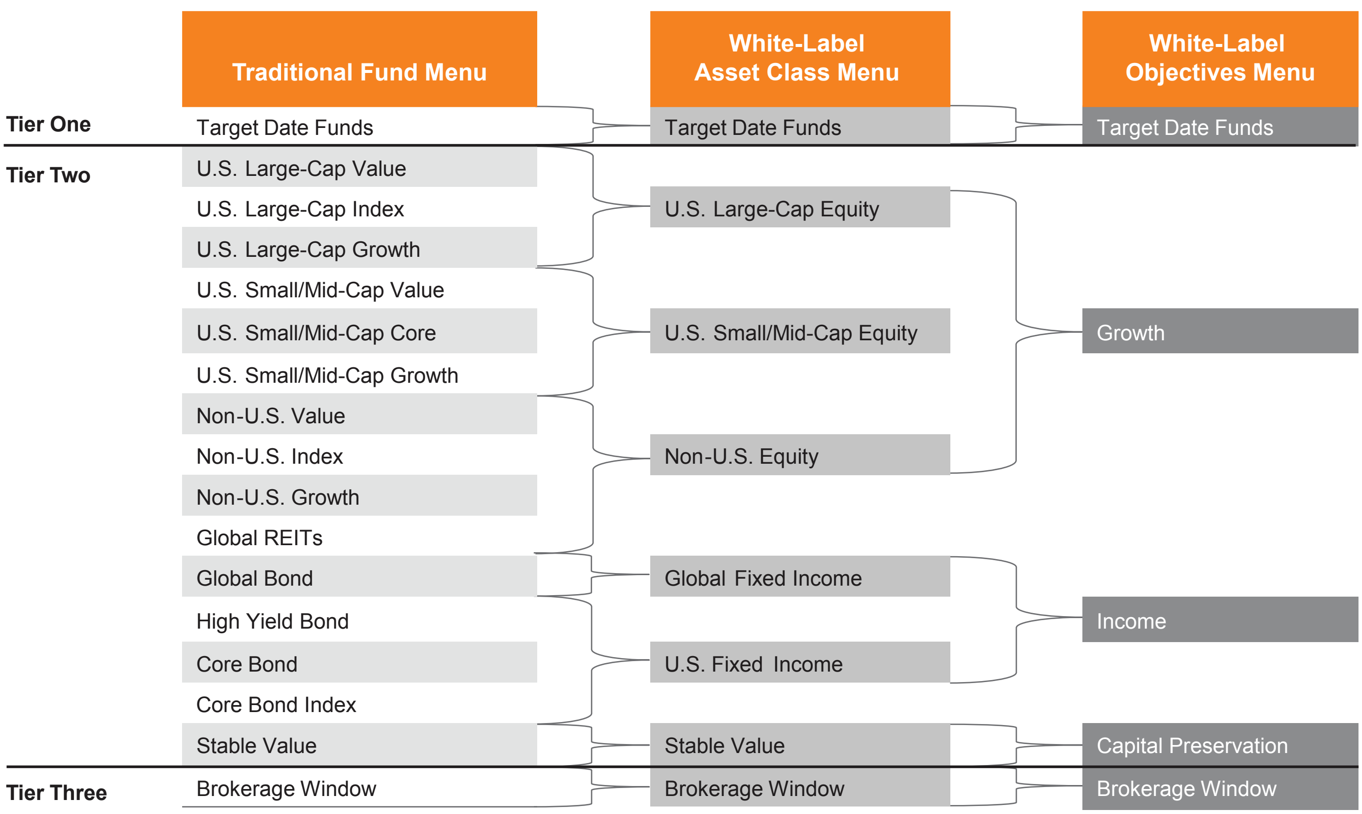
The bulk of plan participants will likely use tier one, with some choosing target date funds for their ease of use and robust asset allocation and others being defaulted into them.

Tier two is where so-called white labeling fits into the structure. Essentially, white labeling combines multiple managers, investment styles or asset sub-classes into groups and gives them broad, descriptive labels, thereby reducing the number of investment choices confronting participants while continuing to provide them with access to a robust and diverse lineup of investments. With white labeling, plans can move from a vast array of core products — in Figure 2, four bond options and nine equity options — to an abridged menu of white-label options grouped either by asset class or objective. Likewise, a plan can move from having distinct core bond and high yield bond options to a single "U.S. Fixed Income" white label, for example, or create a white labeled "U.S. Large-Cap Equity" option that includes multiple underlying managers, each potentially offering a different investment approach. It is also common for white labelling to include a mix of value, growth and core investing styles.

Employing highly descriptive names for the white-label portfolios helps participants more easily determine the nature of the investments. For example, instead of branding three or four large-cap equity funds with names such as "Capital Fund" or "Horizon Fund" that don't relate to the underlying investment objective, plan sponsors could give their white-label options descriptive names such as "Growth" or "U.S. Large-Cap Equity."

In many ways, the white-label option works much like a target date or custom target date solution. Like a target date option, a white-label approach limits the number of choices facing participants while at

### Figure 2. Tiered Investment Structures Simplifies Allocation Choices for Plan Participants




Source: Voya Investment Management

the same time giving them seamless access to a breadth and depth of investment management expertise. Participants simply choose the investment option that meets their investment objectives; behind the scenes, a service provider (either the plan's record keeper or trustee) pools the underlying products to create the white-label portfolio that appears online and on statements.

Plan sponsors can employ both active and passive strategies within each white-label option as appropriate. Lower-cost passive strategies combined with actively managed portfolios focused on alpha generation may reduce the blended average fees for a white-label option. While plan sponsors could offer distinct active and passive options and let participants choose between them, we believe an active-passive mix affords participants the potential to experience the benefits of both active and passive management.

Finally, as plan sponsors will retain fiduciary responsibility for the choice of investment offerings, including white-labeled alternatives, they must be sure to document all decisions around manager selection and allocation, benchmarking for white labels and provide appropriate disclosures. Alternatively, the plan's investment consultant can assist with these decisions and help with the implementation process. All in all, responsibilities are in line with basic fiduciary responsibilities with regard to oversight of the investment menu, including the responsibility to prudently select and monitor investment options.

## Advantages and Challenges of White Labeling for Plan Sponsors

For the plan sponsor, white labeling offers a number of advantages that ultimately benefit participants. There are also several challenges, though for the most part these can be easily overcome.

**Advantages**

- **Simplicity.** By providing an easier way to participate in their DC plan via white labeling, sponsors can improve employee satisfaction and engagement.
- **Improved investment diversification.** White labeling allows plan sponsors to offer participants a robust, diversified menu without overwhelming them with choice, which should encourage effective investment decisions. Further, certain asset classes that may not be as attractive on a stand-alone basis, such as diversifying fixed income components, can be incorporated into a white label.
- **Enhanced portfolio construction.** Single-manager risk can be reduced while increasing the potential for higher alpha by combining high-conviction or "best-of-breed" managers.
- **Greater vehicle flexibility.** Because the white-label portfolio and not the underlying investment vehicle is the option being offered to participants, an appropriately structured portfolio could include mutual funds, collective trusts, private funds or a combination, expanding the investable universe.
- **Simplified Investment changes and communication.** Plan sponsors can add or replace fund managers within a white-label sleeve without the participant-notice period normally required of changes to a plan's investment lineup; since the participant is investing in the white label and not the individual products that underlie it, fiduciaries only need provide an update to participants alerting them of the change. From a fiduciary perspective, this flexibility is particularly important in those infrequent instances when an underlying fund has unusual problems or if an underlying investment adviser shows worrisome instability or manager turnover.
- **Potentially lower fees.** Sponsors can lower their costs when relationship pricing is available, by leveraging DB managers, or through a combination of active and passive investment strategies.

**Challenges**

- **Implementation.** White labeling presents operational complexities at setup and requires coordination among multiple parties — record keeper, trustees, investment managers and investment consultants — as well as resources to manage the execution. However, leveraging partners with strong expertise in implementing white-label strategies can smooth the process.
- **Reporting.** As with custom target date funds, fund fact sheets for white labeled options are a compilation of data from the underlying managers through the record keeper or trustee; tickers and fund data are not publicly available. This presents less of a challenge in recent times, as participants have grown accustomed to accessing their account information and product fact sheets via web-based applications or their mobile devices. In addition, the lack of historical performance likely can be overcome through historical composite performance, provided that appropriate disclosure is furnished.
- **Participant acceptance.** Sponsors may be concerned about giving up the "name brands" associated with popular retail mutual funds, while participants may be reluctant to embrace the more generic white-label options. There may also be pushback from a minority of participants who like a large menu. This latter challenge can be met by instituting a brokerage window that offers seemingly unlimited choices for the few who want it.

## Conclusion

Voya believes that, in most cases, the benefits of white labeling outweigh the challenges and present a unique value proposition for plans sponsors and their participants. Through simplification, investment optimization and fee reductions, white labeling aims to improve investment outcomes for participants. Working with service providers that are highly experienced in white-label implementation can make the transition as seamless as possible for plan participants. Likewise, strong communication out of the gate can ensure that participants see the vast benefits offered by the white-label structure.

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