COGENT™ WEALTH REPORTS

Navigating Change in the 401(k) Market

Key Insights for DC Plan Providers and Investment Managers

MARKET STRATEGIES INTERNATIONAL

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MARKETSTRATEGIES
INTERNATIONAL

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401(K) MARKET SEGMENTS DEFINED

Micro: less than $5 million in plan assets

Small: $5 million to less than $20 million in plan assets

Mid-sized: $20 million to less than $100 million in plan assets

Large: $100 million to less than $500 million in plan assets

Mega: $500 million or more in plan assets

Introduction

No longer in cruise control, changes within the 401(k) industry are taking the forms of increased incidence of formal plan reviews and evidence of intention to switch providers and modify investment lineups. With many taking counsel from an external consultant or financial advisor, plan sponsors are clearly articulating what they want from a provider, so it is up to the firms offering 401(k) plans to follow through with a differentiated offering that is competitively priced, provides high-quality choice in investment options and supports strong fiduciary practices.

This research paper examines several behavioral and attitudinal aspects of 401(k) plan sponsors that are likely to impact the defined contribution (DC) industry over the next several years. Data are based on the opinions of a representative sample of 401(k) plan sponsors responsible for plans ranging from less than $1 million to over $1 billion in DC assets.

We begin with as assessment of plan sponsor priorities for the coming year, including their likelihood to reevaluate their current plan provider and investment menu. We then turn our attention to the fee disclosure regulations enacted in 2012 in terms of the impact these regulations are likely to have on plan sponsor behavior going forward. Next, we analyze the potential for provider turnover in the 401(k) market, with special attention paid to the criteria plan sponsors use to evaluate their providers. We conclude with a view of the top reasons stated for switching plan providers and dropping investment managers, highlighting the areas that incumbent providers should be prepared to defend and challenger firms may seek to exploit.

SOURCE: DC INVESTMENT MANAGER BRANDSCAPE™. MARCH 2014.
SOURCE: RETIREMENT PLANSCAPE®. MAY 2015.

Key Findings

Primary Focus of Plan Sponsors

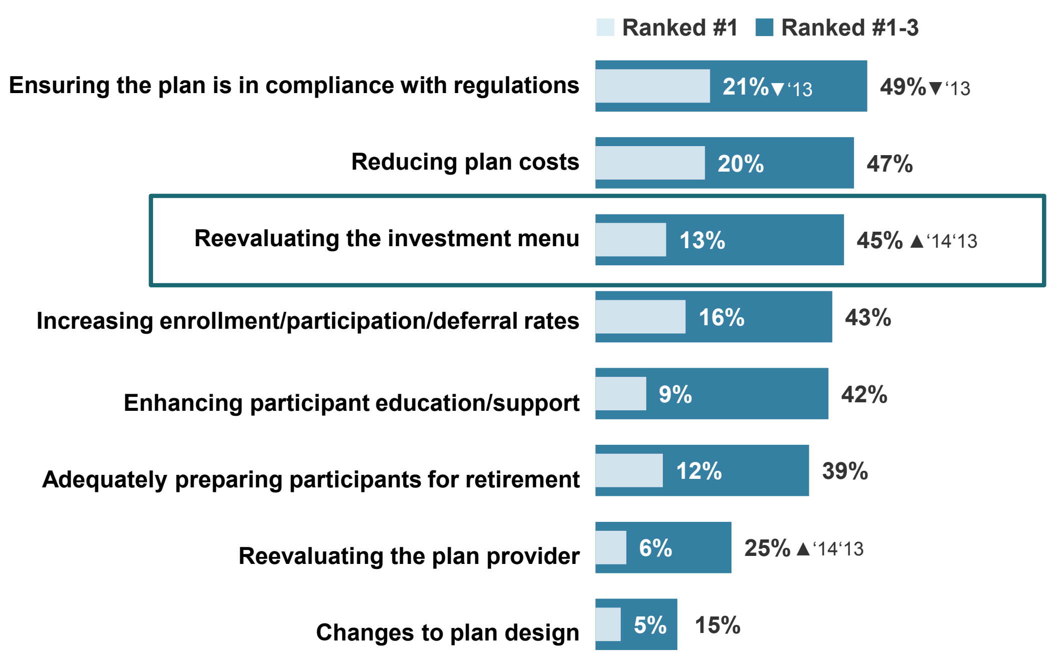
As in previous years, the primary concern of plan sponsors is ensuring the plan complies with regulations, although this aspect is now cited by just under half (49%) of all plan sponsors as a top 3 area of focus, down from 57% in 2013. A very close second in terms of priority is reducing plan costs, with 47% of plan sponsors identifying this area overall and one-fifth (20%) citing this aspect first. Moving up in importance is reevaluating the investment menu, for which 45% of plan sponsors plan to focus in the upcoming year, up from 38% a year ago. In what may be a warning for incumbent providers, one-quarter (25%) of plan sponsors intend to reevaluate their plan provider in the next 12 months, up from 18% in 2014.

When we examine these priorities by plan size, we find that the proportion of Micro plans intending to reevaluate their investment menu and their plan provider has increased over the past two years, from 33% in 2013 to 45% today. All told, nearly half (46%) of Small plan sponsors intend to reevaluate their investment menus in the coming year, up from 37% in 2014, and one-quarter (24%) of Mid-sized plans intend to reevaluate their plan provider in the next 12 months. Yet both Large and Mega plans prioritize reducing plan costs, balancing this with the need to enhance participant education (Large, 47%) and to adequately prepare participants for retirement (Mega, 48%). EXHIBIT 1

Changes in the Number of Investment Options

DC plan sponsors continue to refine their investment lineups, with half (50%) of all plans intending to make some sort of change to their investment offering in the coming year. One-third (35%) expect to change the mix of plan investments, averaging 16 to 20 options in total, while keeping the total number of investments the same. Of particular note, 55% of Small and 51% of Mid-sized plan sponsors are likely to modify their investment lineups in this fashion. In contrast, 31% of Mega plan sponsors intend to increase the total number of offerings, while more than half (52%) of Micro plan sponsors are not planning any change. EXHIBIT 2

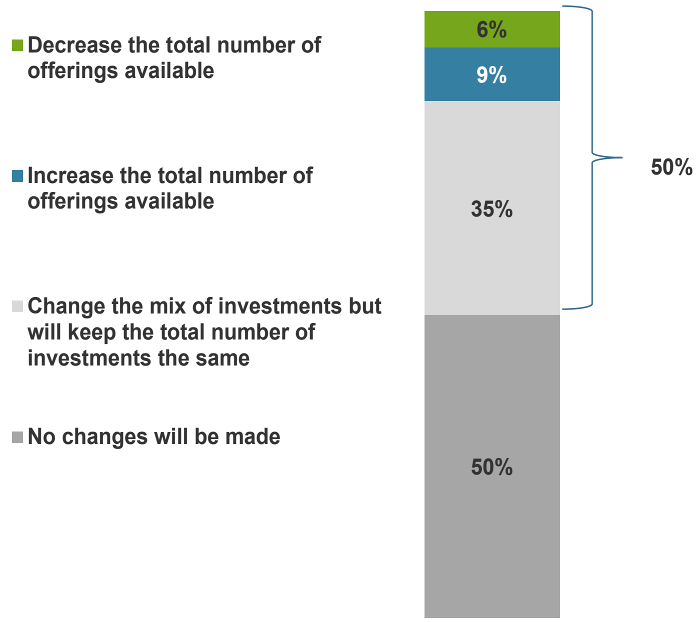
EXHIBIT 1
PRIMARY FOCUS OF PLAN SPONSORS



Base: All plan sponsors
▲/▼ = Significant change from stated year
△/▽ = Significant change observed in 2014 sustained in 2015
Source: Market Strategies International. Cogent Reports™. Retirement Planscape®. May 2015.

EXHIBIT 2

CHANGES IN NUMBER OF INVESTMENT OPTIONS: NEXT 12 MONTHS



Base: All plan sponsors

▲/▼ = Significant change from stated year

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Source: Market Strategies International. Cogent Reports™. DC Investment Manager Brandscape™. March 2014.

Likely Steps After Receipt of Fee Disclosures

Cogent has been monitoring the impact of the fee disclosure requirements on both plan provider and investment manager relationships since the regulations were enacted in 2012. While many in the industry speculated that the regulations would spur a wave of turnover activity in the marketplace, we consistently find that plan sponsors are most often utilizing the fee disclosure information they receive for benchmarking purposes.

From the standpoint of the plan sponsor-provider relationship, a majority (55%) intend to maintain their current fee arrangements, up from 46% in 2013. However, there appears to be a growing minority of plan sponsors that are likely to take action. More than 4 in 10 Mid-sized and Large plan sponsors say they intend to request fee reductions from their current providers, and one-third (34%) of Large plans are likely to issue a formal RFP for recordkeeping services, up from just 21% a year ago.

When we assess the potential impact to the investment menu or investment manager relationships, we find that one third (33%) of all plan sponsors continue to use the fee disclosure information as a benchmarking tool, while one-quarter (25%) plan to leverage this new knowledge to negotiate for lower fees. Importantly, the proportion that intend to request lower fees doubles in the Large (51%) and Mega (48%) plan segments. In addition, nearly half (46%) of Large plans and more than one-third (35%) of Mega plans are also aiming to change some or all funds to lower-fee share classes. EXHIBIT 3

Likelihood of Switching Plan Provider: Next 12 Months

Three-quarters (75%) of plan sponsors are at least somewhat likely to initiate a formal review of their current 401(k) plan over the next 12 months. Among this subgroup, 15% say that a switch in providers is highly likely, while another 50% feel the potential for plan turnover is somewhat likely. Correspondingly, just one-third (36%) of plans sponsors are certain that they will not initiate a change in providers in the coming year. Notably, this potential for likely turnover increases to 26% among Large plans and 21% among Mega plans. Moreover, the percentage of Mid-sized and Large plan sponsors that are certain they will not move the plan is significantly lower than 2014 levels, suggesting that the potential for changes in plan provider relationships is growing. EXHIBIT 4

Criteria Used to Evaluate Plan Providers

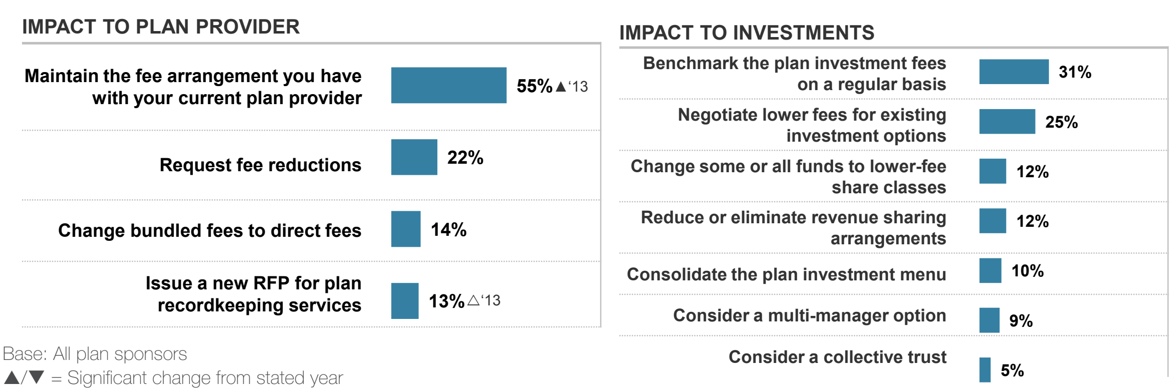
All plan sponsors are regularly evaluating their current providers—most often annually. Consistent with last year, we find that the criterion plan sponsors report to use most often in this evaluation process is quality of investment options (55%), which arguably has nothing to do with plan administration but illustrates the influence that the investment options made available on the recordkeeping platform have on the overall relationship. Plan administration fees and range of investment options are each named by 48% of plan sponsors, and overall service quality for participants ranks closely behind at 46%. Notably the criterion of plan design features is identified by 37% of plan sponsors this year, up from 30% in 2014, suggesting that plan sponsors may be looking for a greater level of support from their providers in optimizing the design of their plans.

A view of the top evaluation criteria by plan size reveals the importance of the quality of the investment options across all but the Mega plan segment and the increase in emphasis on the range of options available on the platform to the largest plans. Meanwhile, service quality for participants is the top criterion cited by Large plan sponsors, and a very close second among Small and Mega plans. Micro plans are driving the increased attention to plan design features, while Mid-sized plan sponsors express more interest this year in ease of fulfilling fiduciary responsibilities. EXHIBIT 5

EXHIBIT 3

LIKELY STEPS AFTER RECEIPT OF FEE DISCLOSURES

% LIKELY: TOP 3-BOX



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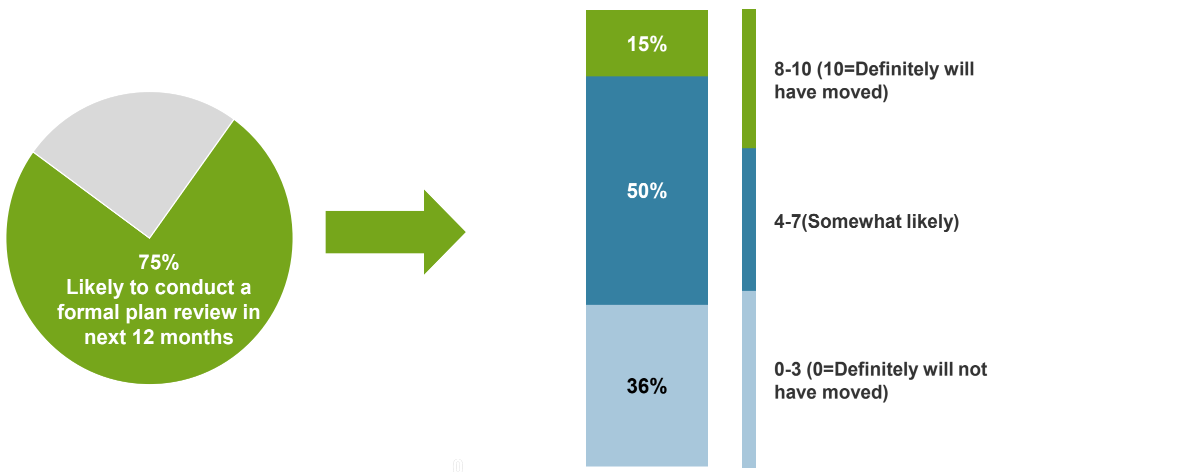
Source: Market Strategies International. Cogent Reports™. Retirement Planscape®. May 2015.
Source: Market Strategies International. Cogent Reports™. DC Investment Manager Brandscape™. March 2014.

EXHIBIT 4
LIKELIHOOD OF SWITCHING PLAN PROVIDER: NEXT 12 MONTHS

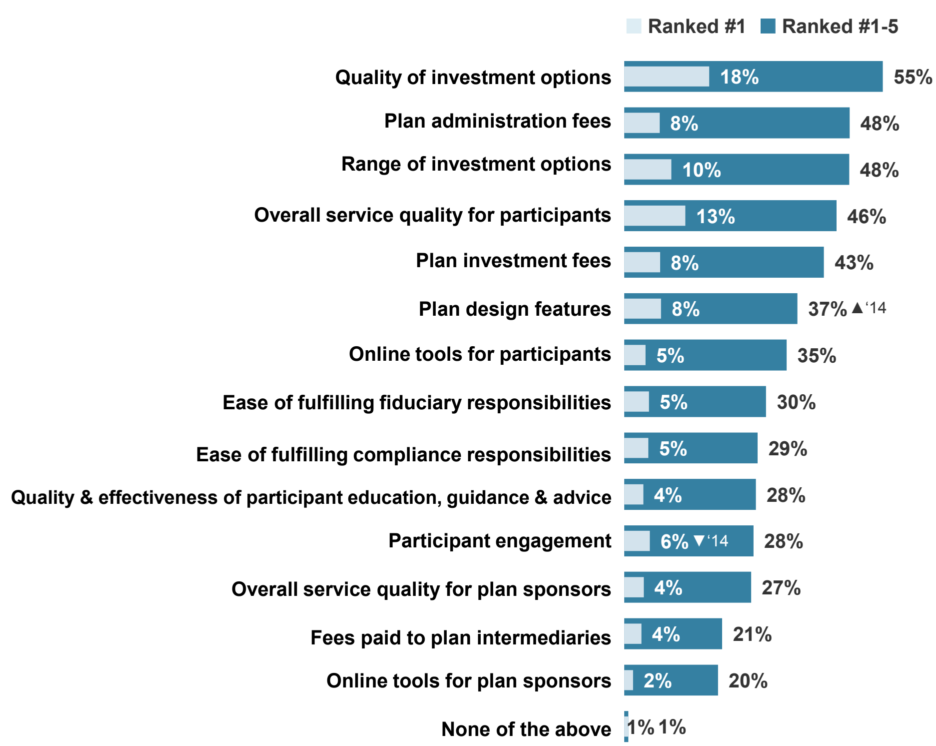


Base: All plan sponsors
▲/▼ = Significant change from 2014

Base: Plan Sponsors Likely to Conduct a Formal Plan Review in Next 12 Months
▲/▼ = Significant change from 2014

Source: Market Strategies International. Cogent Reports™. Retirement Planscape®. May 2015.

EXHIBIT 5
CRITERIA USED TO EVALUATE PLAN PROVIDERS



Base: All plan sponsors
▲/▼ = Significant change from 2014
Source: Market Strategies International. Cogent Reports™. Retirement Planscape®. May 2015.

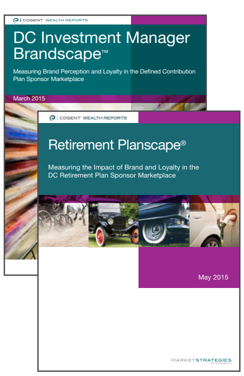
Reasons for Switching Plan Providers

Regardless of their likelihood to initiate a formal review or change providers in the coming year, plan sponsors ranked the top 3 reasons that would cause them to switch 401(k) plan providers, using a similar set of criteria as was referenced for the plan provider evaluation. At the top of the list for a second year in a row is the aspect of plan administration fees, cited by 41% of all plan sponsors. Quality of investment options and plan investment fees tie for second at 33%, and range of investment options moves up in importance as a reason for switching, identified by 30% of plan sponsors this year, up from 21% in 2014.

Plan sponsors in all plan size segments agree on the importance of plan administration fees, identified as the top reason for switching providers across the board. Mega plans rate service quality for participants equally with plan administration fees, and in general, appear less fee-sensitive than their smaller-plan counterparts. Plan investment fees rank second as a reason for switching among Micro, Small and Large plans, while Mid-sized plans are more likely to switch due to the quality of the investment options. EXHIBIT 6

Reasons for Dropping/ Reducing Investment Managers

While relatively few plan sponsors say they are likely to drop or reduce their investment offerings from a particular investment manager in the next 12 months, nearly 6 in 10 plans (59%) are willing to part ways if there is underperformance relative to benchmarks. Investment team turnover, an issue that has plagued a handful of high-profile investment firms over the past year, is cited by 27%, while the desire to reduce fees and expenses is noted by 26%. That said, 41% of Mega plans along with 62% of Small plans point to fees as a primary reason for dropping a manager, while one-quarter (23%) of Large plans cite concerns over organizational instability. EXHIBIT 7



Insights shared in this white paper are derived from our DC Investment Manager Brandscape™ and Retirement Planscape® reports. The DC Investment Manager Brandscape report helps defined contribution investment only (DCIO) providers assess their competitive position in the marketplace and improve their marketing and distribution efforts to maximize future growth. Retirement Planscape allows plan providers to pinpoint competitive strengths and weaknesses in brand, loyalty and key plan sponsor experience metrics to maximize acquisition opportunities and minimize attrition.

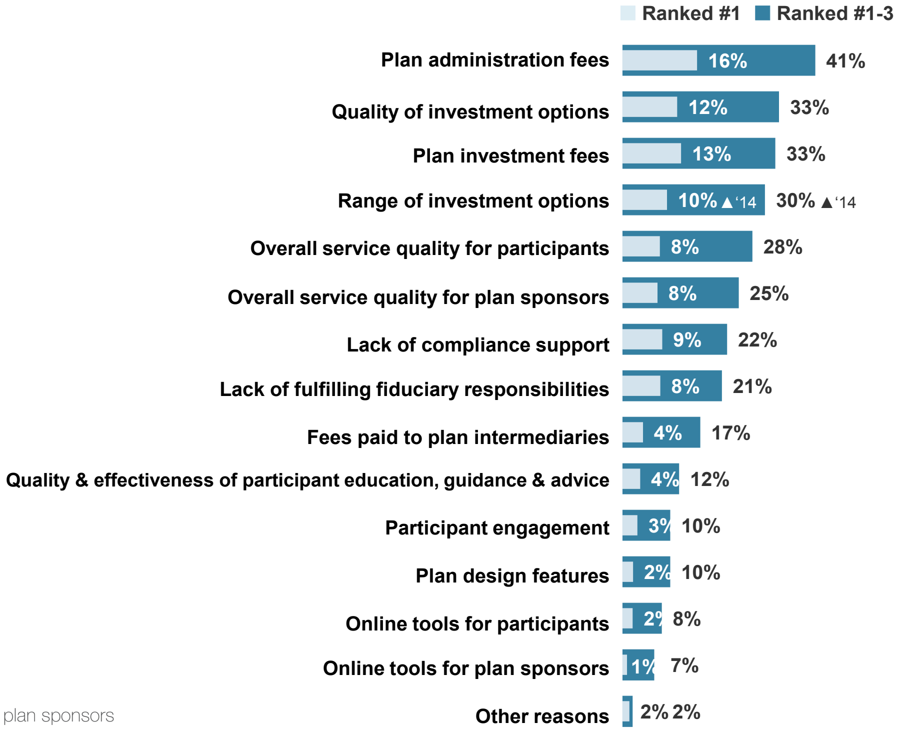
Contact us at **cogent-reports@marketstrategies.com** or 617.441.9944 for more information on the full reports.

Strategic Implications

Amid this time of change in the 401(k) market, plan providers cannot afford complacency. To ready themselves for review, providers will need to be prepared to defend the quality and range of investment options, plan administration fees and overall service quality for participants, as these areas top the list of criteria used by plan sponsors during the evaluation process. From a competitive standpoint, the stalwart leaders in the industry are being increasingly challenged. The gap is narrowing between the historically dominant providers and the rest of the pack on key measures such as awareness and impression. And, in fact, we see instances of challenger brands leapfrogging over the industry leaders in terms of future consideration potential.

It's also important for providers to be aware of the shift in the top consideration drivers going back to the essentials—ease of doing business and delivering value for the money, as these are critical qualities to convey to prospective clients. Interestingly, the aspect of strong brand recognition among participants, which has historically been the most important consideration driver, has diminished in importance this year. This is certainly welcome news for challenger firms that have been struggling to compete with the big-name brands in the industry, and ties back to the top criterion plan sponsors use to evaluate their providers, as well as our finding that "having a well-respected brand" is the top consideration driver for investment firms. Essentially, this means that the brand name of the record-keeper is less important for participants than having well-respected and recognizable firms providing the investment options.

EXHIBIT 6
REASONS FOR SWITCHING PLAN PROVIDERS



Base: All plan sponsors
▲/▼ = Significant change from 2014
Source: Market Strategies International. Cogent Reports™. Retirement Planscape®. May 2015.

EXHIBIT 7
REASONS FOR DROPPING/REDUCING INVESTMENT MANAGERS

Base: Plan sponsor users likely to drop/reduce brand
▲/▼ = Significant change from stated year
Source: Market Strategies International. Cogent Reports™. DC Investment Manager Brandscape™. March 2014.

SOURCE: DC INVESTMENT MANAGER BRANDSCAPE™. MARCH 2014.
SOURCE: RETIREMENT PLANSCAPE®. MAY 2015.

Methodology

This research paper is derived from two separate online surveys of 401(k) plan sponsors; the first conducted in February and March 2015 and the second conducted in March and April 2015 by Cogent Reports. For the first survey, respondents were required to have shared or sole responsibility for evaluating and/or selecting investment managers or investment options for their organization's 401(k) plan. For the second survey, respondents were required to have shared or sole responsibility for plan design, administration or selection and evaluation of plan providers.

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About Market Strategies International

Market Strategies International is a market research consultancy with deep expertise in consumer/retail, energy, financial services, healthcare, technology and telecommunications. The firm is ISO 20252 certified, reflecting its commitment to providing intelligent research, designed to the highest levels of accuracy, with meaningful results that help companies make confident business decisions.

Market Strategies conducts qualitative and quantitative research in 75 countries, and its specialties include brand, communications, customer experience, product development, segmentation and syndicated. Its syndicated products, known as Cogent Reports, help clients understand the market environment, explore industry trends and evaluate and monitor their brand and products within the competitive landscape. Founded in 1989, Market Strategies is one of the largest market research firms in the world, with offices in the US, Canada and China.

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