The Hidden Gold in Mid-Size Rollovers

By Kerry Pechter *Thu, Dec 4, 2014*

Inspira, a $20 million IRA recordkeeper, and GuidedChoice, say they can turn small, unprofitable rollover IRAs into revenue generators for a wide range of big recordkeepers and others. "This industry is begging for reinvention," says Inspira's Pete Littlejohn.

When 401(k) participants change jobs, they're not the only ones thinking about where their accounts might go next. Recordkeepers, asset managers, registered investment advisors, automatic rollover specialists, and rollover magnets like Fidelity and E*Trade, to name a few, all take an interest.

The intensity of their interest, of course, depends on the size of the account. The largest accounts are the most sought-after. The smaller ones get cashed out or gobbled up by automatic rollover specialists. The mid-sized pots—worth $5,000 to $50,000— are like odd-sized fish: too small to keep, too big to ignore.

Too often, says Pete Littlejohn, the director of strategic partnerships at **Insp*ira***, a $20 million closely held IRA recordkeeper based in Pittsburgh, the owners of those accounts wind up in steerage on titanic asset management platforms, generating minimal or even negative revenue and receiving barebones yet over-priced service in return.

Littlejohn (right) thinks those investors deserve better. In fact, he thinks the whole IRA food chain would be more efficient if recordkeepers and others farmed out their $5,000-to-$50,000 accounts to white-label IRAs at Insp*ira*—at least until the accounts got bigger. Meanwhile, the account owners would get first-class advice from **GuidedChoice** and everybody—investor, recordkeeper, asset manager, Insp*ira* and GuidedChoice—would see upside.

"We're building a mechanism for any firm that wants to outsource its most expensive clients," Littlejohn, who gets excited when he describes the potential for Insp*ira*'s idea, explained to *RIJ* recently. "We can give them first-class treatment for a quarter to a third of what Wall Street charges. We tell the recordkeeper, 'You can quit saying either yes or no to a rollover and instead say yes to all of them. If the account balance is below the bar, take it off your expensive legacy based technology chassis and kick it out to us.'"

Insp*ira* can't go down this road alone; it needs a managed account provider. So it has teamed up with GuidedChoice, the advice firm powered by CEO Sherrie Grabot and Nobelist Harry Markowitz, to provide the same type of managed account to IRA customers that the firm provides to 401(k) participants.

For GuidedChoice, whose direct customers are plan sponsors, the partnership represents a chance to participate, if indirectly, in the rollover business. IRA custodians had apparently been proposing such partnerships to GuidedChoice for some time, and Inspira had a business plan that matched GuidedChoice's low-cost culture.

"The business kept coming to our doors, from existing clients who wanted to broaden their relationship with us and others," Ashley Avaregan, a senior vice president at GuidedChoice, told *RIJ* this week. Its relationship with Insp*ira* is non-exclusive; Insp*ira* is also talking to Georgia-based **Financial Soundings** about a partnership.

Perceiving an opportunity

Insp*ira*'s opportunity is predicated on the idea that large, established financial firms that handle rollover IRAs and the 401(k) accounts of separated workers are in a bind over mid-sized accounts. They don't want to lose the assets but the accounts barely generate enough revenue to cover their maintenance costs. Most of them don't ideally want to handle accounts below a certain bar, usually about $50,000.

Insp*ira*, a backoffice IRA recordkeeping firm founded in 2002 by Lowell Smith Jr., decided to reach out to those firms—plan recordkeepers, third-party administrators (TPAs), insurance companies and banks—with an offer to take on the management of their below-the-bar accounts.

A 401(k) recordkeeper, for instance, could offer departing employees with smaller accounts the option of rolling over to a white-label IRA at Insp*ira*, under the original company's logo, or through Insp*ira*'s own Pinnacle IRA brand. The recordkeeper would incur no further costs, and could even reabsorb the account if and when its value exceeded their bar. In the meantime, Insp*ira* would pay the recordkeeper a modest asset-based income.

The incoming assets would go into a managed account run by GuidedChoice or another low-cost provider. GuidedChoice would put the money into its own menu of low-cost institutional index funds or ETFs. If the recordkeeper had its own proprietary funds, assuming they were no-load and institutionally priced, GuidedChoice could build a managed account out of those.

Shifting the administration of mid-sized rollovers from large companies to Insp*ira* would end up as savings and/or profits for everyone in the chain, including the investor, Littlejohn claims. "It's 50 to 80 basis points, all in, if we use an institutional investment lineup," he told *RIJ*. That would include about 20 basis points for index funds, plus GuidedChoice's managed account fee, plus Insp*ira*'s fee, plus perhaps 20 basis points for the outsourcer of the account.

If the outsourcer wanted GuidedChoice to build managed accounts out of its proprietary funds, the all-in cost might range from 75 to 110 basis points, he said. Whatever the price, he added, it will cost the underlying client only 25% to 33% of what he or she would have been charged on a large recordkeeper or wirehouse platform.

How can Insp*ira* do that? With low overhead and the zero marginal costs per customer, Littlejohn says. Insp*ira* doesn't have the legacy IT systems, the investments bricks-and-mortar, or the army of employees. In short, Insp*ira* brings to the rollover business the kinds of advantages that robo-advisors are bringing to the advice business.

"We don't have skyscrapers or corporate jets. We don't build our own IT systems, so they're never outdated. Software in the 401(k) space is more and more customized. We're reinventing the IRA delivery system. We'll give people the same experience that large account owners get at a much lower price."

'Begging for reinvention'

Not so coincidentally, all this is taking place at a time when regulators are scrutinizing the rollover process. Phyllis Borzi, director of the Employee Benefit Security Administration, wants to raise the standard for advice-giving on IRA rollovers to the fiduciary level, and to protect qualified account owners from the higher fees they'll encounter when they roll over to a retail IRA.

"That's why price was the biggest factor for us out of the gate," Littlejohn said. "We wanted to beat the DoL to the punch in terms of making management of IRAs a fiduciary act. We're already where Phyllis wants to go."

Given the trillions of dollars in the rollover IRA space, and the fact that a large percentage of the account values are in the $5,000 to $50,000 range, Littlejohn sees a huge opportunity. He expects mid-market IRA business not just from recordkeepers and TPAs, but also from DCIO (defined contribution investment-only) asset managers who want to get an oar in the rollover business, from "affinity" groups like AARP who want to establish white-label rollover IRA programs for their members and perhaps from future state-sponsored DC plans in Illinois, California and Connecticut. "This industry is begging for reinvention," he said.