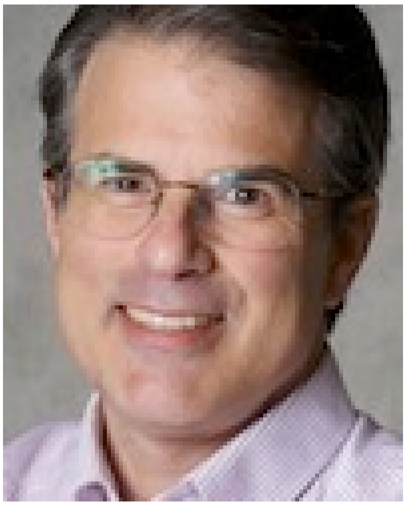
The 'Institutionalization' of the 401(k)

By Kerry Pechter *Thu, Jul 19, 2018*

The defined contribution retirement system may be about to become less employer-driven and more industry-driven. RIJ talks about it with DCIIA president and CEO Lew Minsky.



The defined contribution retirement savings system in the US may be only one or two Congressional roll call votes away from a subtle but far-reaching shift in direction, philosophy and leadership.

A new paradigm called "institutionalization" may be about to glide like an Amtrak Acela into Washington, D.C.'s white marble Union Station.

Lew Minsky, the president and CEO of the Defined Contribution Institutional Investors Association (**DCIIA**), which advocates for the asset managers, recordkeepers and other providers of services to retirement plans and participants, used that term in a recent email with *RIJ*.

Institutionalization, as Minsky later described it in an interview, means a transfer of direct sponsorship of private 401(k) plans fro employers to industry players. Traditionally, each employer has required more or less its own unique Department of Labor-regulated plan from 401(k) service providers; in the future, industry players could offer one plan design to hundreds of small, mid-size or even large employers.

This shift, which current law prevents from fully flourishing, would check several boxes:

¶ Many employers say they don't want the legal liability, cost, or administrative of offering a federally regulated retirement plan.

¶ Service providers say the shift would allow them to apply their economies of scale to every plan, no matter how small, making the whole system cheaper and more efficient. As one asset manager's whitepaper said, it would change the retirement industry the way the mass-produced Model T changed the American auto industry.

¶ In Washington, policymakers and legislators want to boost retirement savings among the have-nots of the current system—tens of millions of low-income and minority workers whose employers don't currently offer a plan.

Here's an edited version of *RIJ*'s interview with Minsky:

RIJ: Lew, when you say 'institutionalizing' the retirement industry, what exactly does that mean?

Lew Minsky

Minsky: It means shifting the defined contribution model to a more institutional model. It means pooling assets, broadening the set of solutions, and closing the performance gap that exists between DC and [professionally managed] defined benefit pension funds, endowments and foundations. In the broadest sense, it means driving better outcomes for participants.

RIJ: We're talking about institutionalizing the 401(k) for smaller companies specifically, right?

Minsky: Institutionalization involves a recognition that, at least at the small end of the employer spectrum, there's a disconnect between the work required to set up a plan and the risk required to be a plan sponsor, on the one hand, and the capabilities and capacities of small and 'micro' employers.

RIJ: Can you give me an example?

Minsky: For instance, DCIIA itself is a small business. And we're already in the retirement business. So we should be well positioned to run a small plan. But it's a lot of work for a small employer like us. So we participate in a multiple employer plan, or MEP. We're in the American Bar Association's plan. We feel like that's the best solution for us. But the requirements—the nexus [or 'commonality'] required to be in a MEP like ours requirements—are very limiting, however. We support opening that up.

RIJ: So, today an association and employer like the American Bar Association or the National Association of Auto Dealers can sponsor a MEP. But, under some of the legislation pending in Congress, a retirement plan service provider would be able sponsor a MEP… is that right?

Minsky: It’s an open question as to who would be the sponsoring employer of these plans. I expect we’ll see a solution evolve that looks more like Australia’s system. In Australia, they have **superannuation plans** or supers. They have disintermediated the employer through the sponsorship of trusts. The employer would make mandatory contributions for employees. Clearly, it will be an uphill climb to require mandatory employer contributions in the US. But it’s a discussion that we’ll eventually have to have. I haven’t found an economist yet who thinks that we can close the coverage gap without at least a ‘soft nudge’ in that direction.

RIJ: Who would be most likely to sponsor a multiple employer plan here in the US?

Minsky: Companies with built-in distribution models, particularly those with strong retail brands, will find it attractive to sponsor these programs. Others that are less well-positioned to sell directly to employers will look to be solution providers.

RIJ: You mentioned disintermediation. What will all this mean for the financial advisors, like members of the National Association of Insurance and Financial Advisors, who currently put together 401(k) plans for small employers?

Minsky: I don’t think the members of NAIFA should be concerned. We’re looking to make the pie bigger. It can work to the benefit of everyone—especially for the individual worker. I’m sure we’ll see a multi-faceted system develop, along the lines of 529 plans. There will be institutional distribution options as well as options for brokers to sell plans to their clients and earn commissions.

RIJ: Some say that institutionalization will help close the so-called coverage gap by encouraging and enabling more small employers to offer 401(k) plans for the first time. But others tell me that institutions will likely sell multiple employer plans to companies that currently offer plans. They’re an easier sell, but aggregating existing plans won’t narrow the coverage gap.

Minsky: Some of this will evolve organically. I expect to see a combination of approaches. Leading providers and others will have opportunities to recruit new employers that have been left out of the system because the challenge was too daunting before. We’ll also see a model where existing plans get an option to upgrade. If, as an employer, I already have a plan through ‘recordkeeper X,’ and that recordkeeper develops its own MEP, I might be able to get the same services I had before at a lower cost. For other companies, institutionalization will be an opportunity to refine their model—i.e., step up their game in the face of competition.

RIJ: What’s the likelihood that institutionalization will actually happen?

Minsky: Whether it’s through RESA [the Retirement Enhancement and Savings Act of 2018], or through industry ingenuity, we are ultimately going to see an expansion of pooling arrangements. As a system, we have to provide a model that’s easier for small employers to offer plans. The mix of providers who are serving plans will change a bit. It will become more institutionally-focused on the investment side and more retail-focused in terms of outreach to individuals. But, in the long run, to make meaningful societal changes with respect to retirement savings, we’ll have to think about policy and decide if we’re willing to introduce a soft mandate.

RIJ: Thank you, Lew.