

## **401(k) Auto-Enroll Paves Path for SMAs: Managed Accounts Get Shot in the Arm from DOL**

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*By Lori Pizzani*

Although mutual funds can surely stake their claim to the lion's share of 401(k) plan assets, and exchange-traded funds have been the popular up-and-comers, separately managed accounts may soon be able to carve out a heftier piece of the 401(k) pie.

This past September, the Department of Labor (DOL) issued rules that clarified a provision of the Pension Protection Act of 2006 that allows 401(k) plan sponsors to automatically enroll new employees into their firm's defined contribution plans (see MME 11/20/06).

Under the new rules, plan sponsors will be allowed to choose from three types of investments for those employees they put on autopilot. That short list includes an investment service such as those funds within a separately managed account program.

By specifically including managed accounts among the acceptable auto-enrollment choices, the DOL has paved the way for managed accounts to elbow their way onto retirement platforms and into investors' wallets.

"I think we'll see more separate accounts within 401(k) plans," predicted Bob Higgins, senior fiduciary consultant with Benefit Plans Plus, a St. Louis firm that provides customized retirement plan services to small- and mid-size companies. While there hasn't yet been a great clamoring for separate accounts, especially at the smaller end of the market, he expects there will be more firms of all sizes considering the use of alternatives to mutual funds.

But it won't necessarily be the DOL's blessing that catapults separate accounts deeper into the 401(k) plan market. Rather, it will be the increased scrutiny of fees, including 12b-1 fees that are charged by a 401(k) plan's underlying mutual funds, that could drive sales into separate accounts, Higgins predicts.

"I think the fee issue is the emerging issue in the industry," he noted, adding that one St. Louis law firm has, on behalf of plan participants, recently instigated a slew of lawsuits against corporate plan sponsors, charging them with failure to disclose plan fees. "Most people think their 401(k) plan is free," he added. "Instead of different retirement classes of shares in funds, there should be funds created especially for 401(k)s," Higgins argued.

Other secular trends could also pave the way for separate accounts to infiltrate deeper into plans.

"We have seen a large paradigm shift to fee-based advisers from traditional brokers," said Ross Brown, vice president, sales and management at ExpertPlan, a retirement plan recordkeeping firm just outside of Princeton, N.J. "They have the tools, such as managed accounts, that they can offer clients." Last month, ExpertPlan launched an enhanced version of its auto-enrollment technology, and has had its separate account platform up and running for four years, Brown noted.

The DOL's letter is a serendipitous event for Harry Clark, CEO of Clark Capital Management of Philadelphia. The release of the DOL's mandates coincided with the planned rollout of his firm's Simplified 401(k) program. American Stock Trust of Phoenix will serve as the custodian to six collective trusts that Clark's firm will manage.

The new investment program lineup includes one ETF portfolio, one portfolio that is 100% invested in corporate bonds and four separately managed accounts, three of which will utilize the

firm's proprietary Navigator Sentry protection feature that employs a put strategy that seeks to protect assets from losses. The managed accounts are all sub-advised by a mix of high-quality external institutional investment managers. "Companies are not just picking a fund but a whole new managed program," Clark said.

The Simplified 401(k) program is modeled after Clark's four-year-old managed account program for clients, and the idea struck when one client told him he loved the SMA program and then asked how he could get it available for his 401(k).

Others believe mutual funds may end up losing 401(k) plan assets to separately managed accounts simply through their own faults, missteps and potential shortcomings.

"It's been a well-known fact for years that 401(k)s [stocked with mutual funds] have been abysmal performers," Clark said.

"Mutual funds got lucky; 401(k)s fell into their lap," said one industry attorney, who spoke on condition of anonymity. But that may change, the lawyer added.

Although target-date and lifecycle mutual funds have been wildly popular and are increasingly being included in 401(k) plans, especially since the DOL explicitly blessed them for default investments as well, they aren't a panacea.

"I think target-date funds are a very good concept, especially for the unengaged or confused investor," said Don Cassidy, executive director of the not-for-profit Retirement Investing Institute of Lakewood, Colo. "Target-date funds make it simple for them, which may also let them feel comfortable being enrolled or, even better, automatically enrolled. But the one issue we cannot yet see the answer on is whether they will prove to have invested aggressively enough, given lengthening life spans and possible further inflation."

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