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White Label Funds in Defined Contribution Plans: An Introduction

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According to a recent survey,[1] over 30% of plans with over $1 billion in participant assets had adopted white label structures. Another survey estimates that $750 billion to $1 trillion of participant assets are invested in white label funds.[2] Many recordkeepers have developed infrastructure to accommodate white label funds, which has benefited plan sponsors looking to adopt this structure. The scale necessary to manage white label funds has come down significantly, making it feasible for plans above $250 million to consider the approach.

Why are plan sponsors increasingly implementing white label solutions in their defined contribution plans? What are the challenges associated with white label options? In the following pages, we provide an overview of white label funds and address the advantages and disadvantages, as well as utilization and governance, of these structures. While white label funds have many nuances and complexities, here, we focus on the basics to provide a foundation on which to begin building knowledge of white label solutions.

What are white label funds?

White label funds are a unitized investment structure that consists of a single manager or multiple managers (e.g., "fund of funds") with a generic name based on the fund objective or asset class exposure being provided. For example, a plan sponsor might create an International Equity white label fund that includes an international equity index fund, along with actively managed strategies, both in developed and emerging markets. Generally, white label funds are a way for plan sponsors to simplify investment decisions, improve strategy descriptions, and potentially enhance diversification for participants.

White label structures can provide exposure to a single sub-asset class such as domestic equity or span multiple asset classes such as within a custom target date fund. Plan sponsors can define the objective and collaborate with their consultant on the best combination and construction of strategies to include in the white label fund. White label funds can also combine active and passive strategies, and they have the flexibility to include strategies that might not be appropriate for participants on a stand-alone basis. White label structures allow plan sponsors to construct custom white label funds that may include underlying managers or strategies in a risk-controlled framework with allocations determined by the fiduciaries for the plan.

[1] Source: PIMCO 2020 Annual Consultant's Survey.

[2] Source: ICI 4Q 2020 Survey. The survey estimates that total market value of 401(k) and other private-sector DC plans was $7.3 trillion.

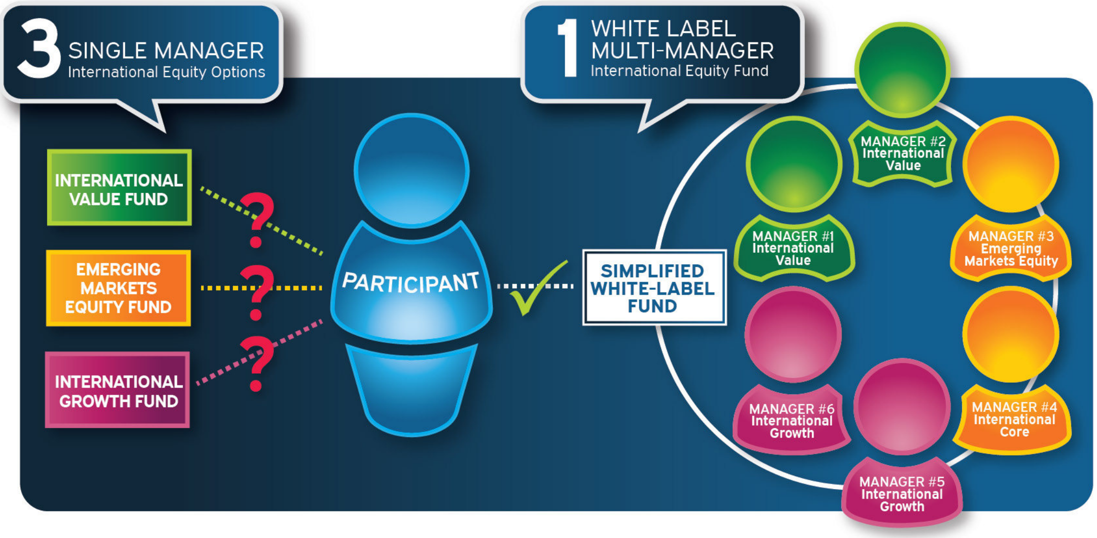

FIGURE 1

Single Managers versus Simplified White-Label Fund

Source: Meketa.

What are the advantages?

Simplification of the investment menu is one reason for increased adoption of white label funds. Having too many fund choices can overwhelm participants and promote poor investment behavior such as return chasing or inadequate diversification. Creating straightforward white label building blocks (e.g., asset classes such as US equity, fixed income, international equity) simplifies the choices for participants and allows the plan sponsor to work with their consultant to determine the optimal structure for each asset class.

Another benefit is enhanced diversification. As stated earlier, certain asset classes or strategies may not be appropriate for the plan participants on a stand-alone basis, but that does not necessarily mean they should be excluded altogether. Through a white label structure, plan sponsors can add niche strategies in a controlled and diversified fashion. Investment offerings in emerging market equity, high yield bonds, and core private real estate can provide significant benefits to participants. However, some plan sponsors may not consider them to be an appropriate stand-alone investment option for participants due to their volatility, focus, or potentially limited liquidity. The improved diversification achieved by including these assets in a white label structure should prove beneficial to performance over time. A white label structure can also offer manager diversification, allowing plans to combine multiple investment managers and strategies in a single option.

Using white label structures may also result in investment fee savings for participants by allocating assets to a niche strategy in a structured fashion and/or including a dedicated allocation to passive management. A plan sponsor is less likely to add a stand-alone strategy that may not be well utilized or may be poorly understood. However, if they instead include what might otherwise be a niche strategy inside a white label fund, these barriers can be overcome. With a set allocation within the white label structure, plan sponsors can estimate the size of the allocation and the potential for future asset growth, which can enable better fee negotiations with the niche investment manager.

Plan sponsors can include a combination of active and passive strategies within the white label structure. Typically, the higher the allocation to passive, the lower the overall fee of the white label option. For example, a core plus fixed income white label option could be constructed with a passive core bond fund as the 'core' and complemented with active high yield, bank loan and emerging markets debt strategies as the 'satellite' components within the fund. The passive core bond index provides broad exposure to an efficient asset class of core bonds and drives down overall fees, while the active strategies provide additional return potential for the white label fund.

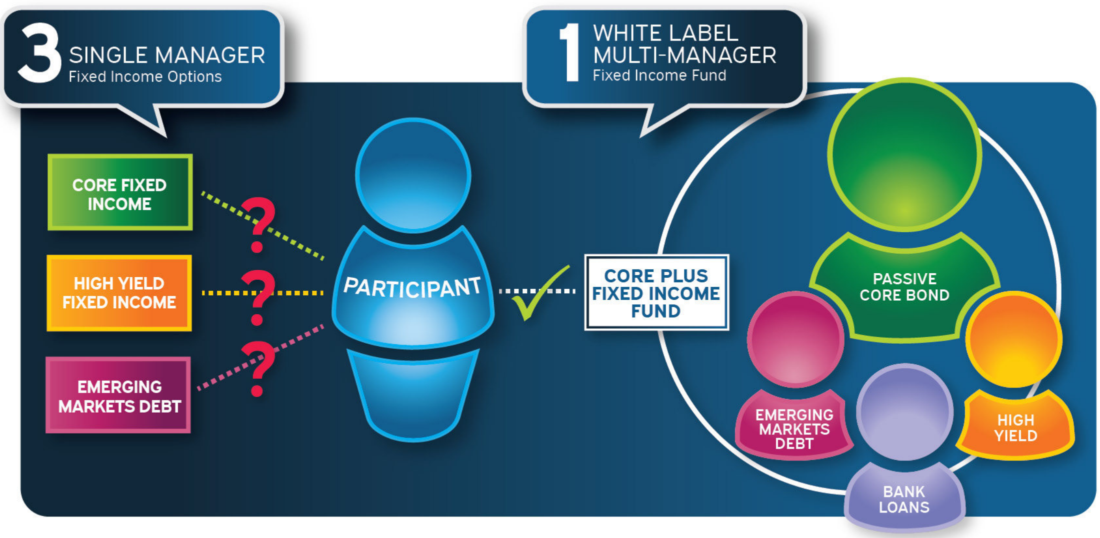

FIGURE 2
Single Managers versus Core Plus Fixed Income Fund
Source: Meketa.

The white label fund should also be regularly rebalanced in order to better manage risk and maintain the desired positioning for the strategy. In contrast, some participants may not proactively rebalance their portfolios, which means their portfolios may drift toward the asset classes that have done well in recent periods or that have the most risk. This results in a portfolio that may be taking on more risk than the participant originally intended or that represents a kind of inadvertent market timing. The automatic rebalancing of a white label fund on a periodic basis is one of the best ways for investors to take advantage of market volatility.

Lastly, white labeling allows plan sponsors to make investment strategy or manager changes more easily. Strategy changes over time regularly occur due to organizational issues, investment team turnover, weak performance, capacity constraints or some combination of these factors. If a white label structure is utilized, the plan can more easily make changes to the underlying managers. Communications are also simplified as participant notification is not required in advance of making a change within a white label fund. Likewise, a mapping or transfer process, or a blackout period, does not need to occur. The plan sponsor can execute on their due diligence process and efficiently make the necessary changes to improve the strategy.

In summary, white label funds can offer improved diversification, lower costs, enhanced ability for portfolio construction, easier plan management, and simplified investment line ups. Taken together, these could help drive better performance and outcomes for participants.

What are the challenges?

There are several challenges plans need to address when evaluating the decision of whether to implement a white label structure. To begin with, creating a white label structure requires coordination with the plan's recordkeeper and introduces some administrative complexity and cost. The recordkeeper may need to "unitize" the white label fund on a daily basis, consolidating the performance of each underlying investment option into a single daily Net Asset Value (NAV). Typically, the recordkeeper will leverage participant contributions, distributions, and fund dividends and distributions to maintain the white label target asset allocation. While the cost to perform this function has been decreasing rapidly, it is not typically a free service.

In June of 2021, Meketa surveyed five large defined contribution recordkeepers to gain an understanding of the current utilization of white label funds. These recordkeepers provide administration services on over $4 trillion in defined contribution assets.[3] In total, the five recordkeepers reported approximately $750 billion of DC plan assets being invested in white label funds across plans of all sizes on their platforms. One recordkeeper reported that 50% or more of their plans with AUM of $500 million or greater use a white label structure. The most utilized asset class for white label implementation was custom target date funds; however, the recordkeepers also reported single-asset class white label fund usage. There also appeared to be no standard rebalancing timing as recordkeepers reported daily, monthly and quarterly rebalancing by various white label funds. Based on Meketa's survey, the additional cost for unitization and administration ranged from approximately $3,000 to $20,000 per white label fund, based on complexity of the white label fund such as asset class, underlying number of strategies and vehicles used.

[3] Source: PlanSponsor 2020 Recordkeeping Survey.

In a traditional consulting arrangement, the plan sponsor will also need to work with their investment consultant to review and approve the investment allocation of the white label fund and to accept some additional fiduciary duties to oversee and monitor the allocation. These duties include setting a rebalancing policy such as quarterly or monthly, and monitoring the white label fund's performance relative to the respective benchmark. Just as the plan sponsor would monitor any single investment option, they should review the white label fund's allocations, diversification, number of underlying strategies, and all fees and expenses. Additional education for participants may be required to explain the white label fund's objective, risk level, underlying allocations, and performance history. In addition, at inception, there is no performance history for the white label fund for participants to reference, which could make them less likely to select it.

Some plan sponsors have considered or even moved to a discretionary outsourced consulting relationship (OCIO) as an alternative to the traditional consulting relationship. This structure allows plan sponsors to focus on more strategic issues and leaves the implementation of the investment options to the OCIO. It is important to note that this type of relationship does not alleviate plan sponsors of their fiduciary responsibilities and likely comes at an increased cost.

Where unitized white label fund's underlying investment funds distribute dividends, income and distributions, the white label fund itself must be reinvested as part of the unitization process in generating daily net asset values. As such, plan participants will be unable to elect to receive distributions from the white label structures. Plan sponsors will want to work with their consultant and recordkeepers to establish clear quarterly performance statements to address the reinvestment of earnings and dividends. Some mutual funds may have gates or trading limits, which could complicate the selection of appropriate investment funds. Likewise, some mutual fund structures cannot be included in unitized white label options such as R6 funds. Additionally, funds must be 40-Act compliant structures where leverage and derivatives may not meet the regulatory threshold. Depending on the how transparent the plan sponsor chooses to be about underlying managers and fees, white label funds may offer less transparency to plan participants.

An alternative to the operational complexities described above would be to hire a custodian to assist with the custody and administration of the white label funds. This structure adds an additional layer of fees to consider. However, there is more flexibility with custodians in using separately managed accounts, collective investment trusts, and investment options that are not standard in DC plans and therefore not available through a recordkeeper's platform. If there is a pension plan as well, plan sponsors may be able to leverage an existing custodian relationship and consider using the pension plan's investment options in the DC plan.

Lastly, there is no brand name recognition in the naming of the white label fund, which can be good and bad. In the white label structure, participants typically look into the fund details to see the names of the subadvisors managing the assets. Firm name recognition, however, is not always a benefit. For example, some participants may recognize large mutual fund firms, such as PIMCO or Fidelity, and feel safer about investing with those investment managers. However, it is the risk of the asset class or strategy in which the participants are investing, not that of the investment management firms, that will be primarily responsible for the performance they experience. For example, the returns of a China-focused equity fund managed by Fidelity will be far more volatile than those of an investment grade bond fund managed by a firm with which the participants are unfamiliar. Ultimately, we believe understanding the naming conventions of a white label fund can be managed successfully with participant education, and lack of brand recognition does not outweigh the benefits of a white label solution.

What is the decision-making process plan sponsors should follow when considering white label funds?

First, plan sponsors should evaluate their current investment line-up and participant base, asking whether participants would benefit from a simplified, yet more diversified, set of investment offerings. White label funds are most appropriate for a more passive (e.g., "set it and forget it") type of participant base. Plans that have participants who are in the investment industry or who like to trade their account more actively may not be good candidates for a white label structure.

Second, the plan sponsor needs to determine if staff, recordkeeper, Trustees, and the investment consultant all have the capability to assume some level of increased fiduciary or administrative responsibility to execute a white label structure.

If the answer to both of these questions is yes, then the plan sponsor can work with their consultant to discuss what white label funds or strategies would be most impactful.

Summary

While the additional complexity, cost, and administrative burden to establish a white label fund may sound daunting, once established, it is not much different from monitoring any other investment offering within the plan. Recordkeepers are equipped to assist with administration, and investment consultants can provide research and advice on portfolio construction. At the end of the day, we feel that white label structures help to foster better retirement outcomes through enhanced diversification and keeping participants focused on bigger picture decisions.

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