PLAN SPONSORS SPEAK WITH ACTION

The Shift from Recordkeeper Proprietary Target-Date Funds to Nonproprietary Solutions

PROPRIETARY OR NONPROPRIETARY?

When the Pension Protection Act (PPA) was passed in 2006, target-date funds (TDFs) became the default option of choice for plan sponsors. Funds offered by recordkeepers—known as proprietary funds—quickly gained the lion's share of industry assets. Today, the top three target-date providers are asset managers who also provide recordkeeping services.

But the target-date landscape has been changing rapidly—and so have plan sponsors' preferences. Joint research conducted by AB and BrightScope shows that fewer plan sponsors are using their recordkeepers' proprietary TDFs —and that more plan sponsors are choosing nonproprietary TDFs from other managers. The survey is broad based, tapping BrightScope data that spans more than 6,000 401(k) plans, representing more than $2 trillion in assets and 25 million participants as of 2014—the most recent year for which data is available.

WHAT WE FOUND

1. **Recordkeepers' proprietary TDF share has declined by 16% since 2009, as the use of nonproprietary TDFs has increased by 16%.**
2. **Large recordkeepers have been hit the hardest: most have lost proprietary TDF share since 2009, and very few gained share.**
3. **More smaller[1] plans (approximately 60%) use recordkeeper proprietary TDFs. Usage among large[1] plans is much lower (32%), because "unbundling" of target-date decisions from plan administration decisions is more common.**
4. **The use of collective investment trusts (CITs) in TDFs has jumped since 2009, with some recordkeepers using CITs or passively-managed TDFs to reduce fees and keep their proprietary share.**

1 Small plans are defined as $100—$250 Mil and large plans as $1 Bil+.

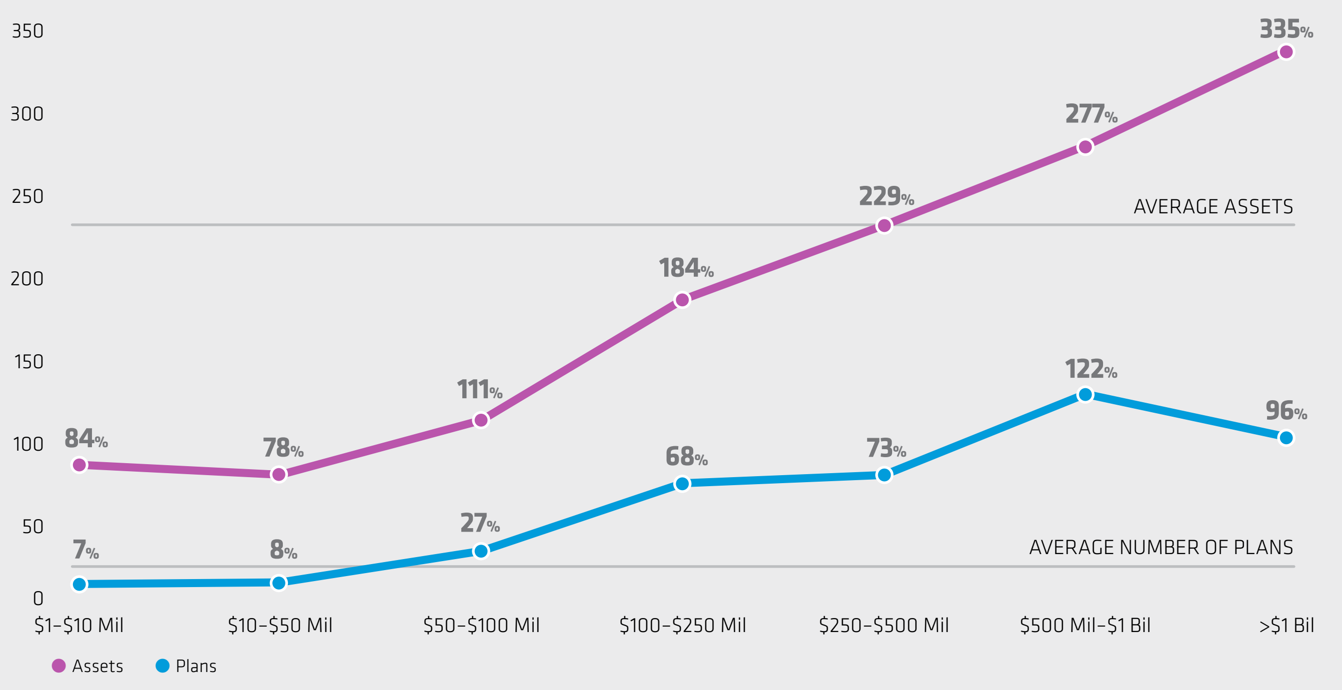
THE TDF MARKET IS EVOLVING

Today's target-date-fund market spans more than $1.69 trillion in assets.[2] TDFs are the principal default investment for most 401(k) plans, with our research focusing on approximately 23,000 plans now invested in these solutions. That's more than 70% of all plans.

And the growth has been fast. Between 2009 and 2014, the number of plans using TDFs has grown by 16% and assets have grown by 229%, with significant growth in larger plans with more than $500 million in assets. With the market already large and with growth expected to continue, asset managers are positioning themselves for greater share, launching new target-date offerings and enhancing existing ones.

The competition is a lot more crowded today. There are about 78 target-date providers in the market offering more than 139 different TDF series.[3] The total number of target-date providers has grown by about 16% from five years ago.

GROWTH FROM 2009 TO 2014 SKEWED TOWARDS THE LARGER END OF THE MARKET

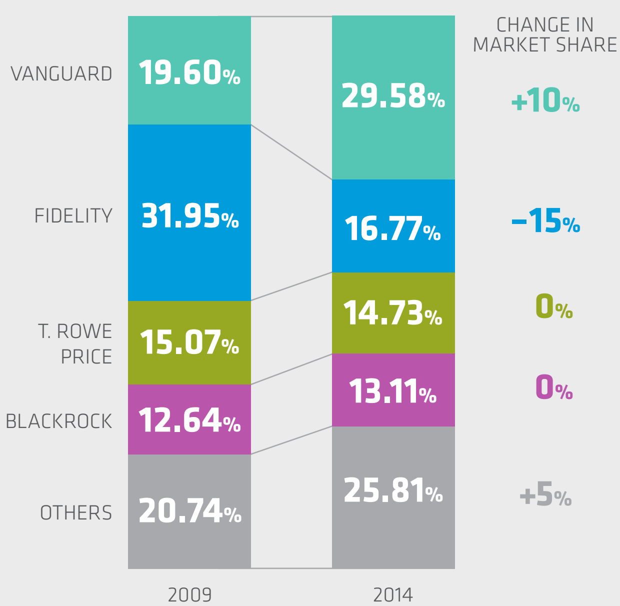


2 Represents target-date mutual fund assets according to Morningstar and CIT assets according to BrightScope.
3 Includes mutual funds, collective investment trusts and insurance company group annuity series.

But four providers still dominate the market today: 75% of assets are held by Fidelity, Vanguard, T. Rowe Price and BlackRock. That leaves 74 other providers fighting for what's left.

How did these "big four" get such a commanding position? A little history sheds some light. When the PPA was passed in 2006, most plan sponsors chose their qualified investment default alternative (QDIA), usually a TDF, by simply adding their recordkeeper's target-date offering. Many recordkeepers offer a discount on their services if sponsors select their TDF, making it even easier for plans to select proprietary offerings.

FOUR PROVIDERS DOMINATE 75% MARKET SHARE OF THE ASSETS



FACEBOOK'S PLAN EXEMPLIFIES BOTH THE GROWTH OF TDFS AND THE SHIFT AWAY FROM PROPRIETARY OFFERINGS.

In 2009, Facebook's retirement plan had $10 million in assets. Fidelity was the recordkeeper and the plan invested in Fidelity's class A-share TDF.

By 2013, the plan had grown to $131 million and moved into Fidelity's institutional target-date share class.

By 2014, the plan had $250 million in assets and had moved its target-date option into a lower-cost Vanguard fund, keeping Fidelity as the recordkeeper.

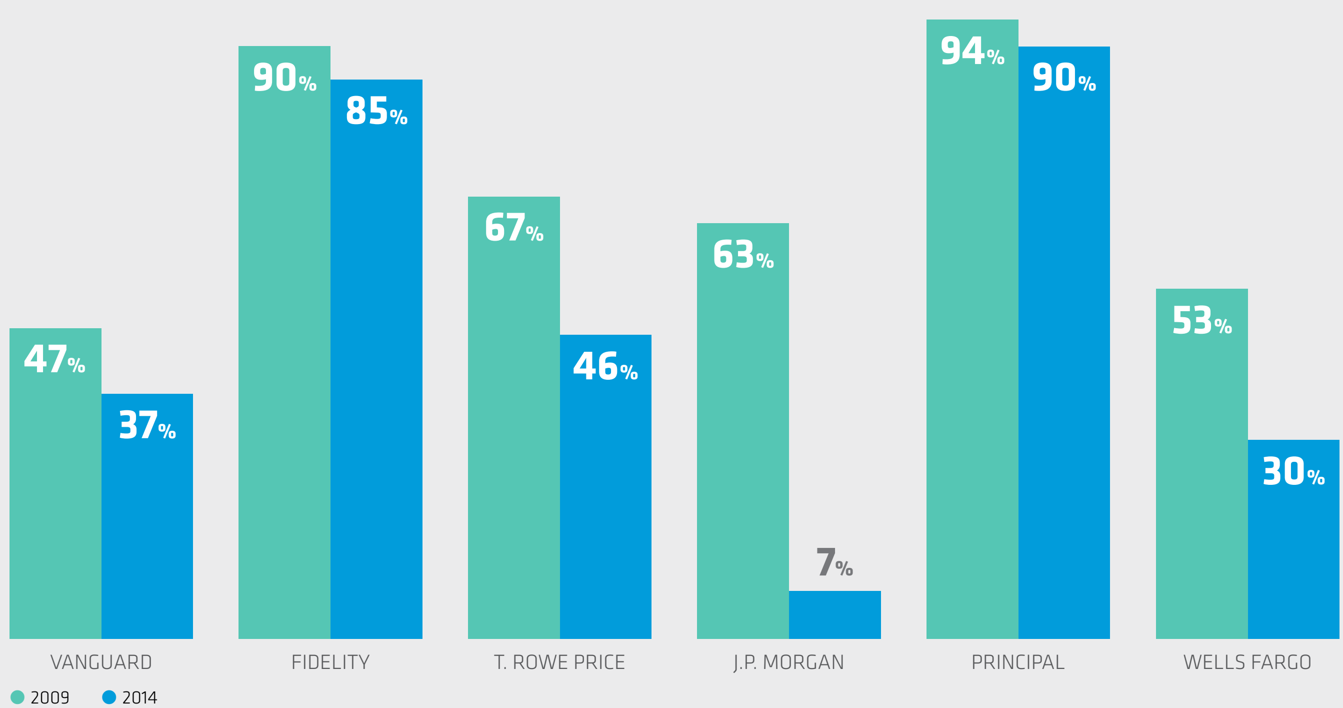
TARGET-DATE PROVIDERS FARE BEST WHEN LESS RELIANT ON THEIR OWN PLATFORMS.

But things are changing for proprietary target-date providers. Simply put, they're finding it harder to maintain share of target-date assets on their own platforms, as plan sponsors continue to "unbundle" their target-date-fund and recordkeeper decisions. Many plan sponsors now choose TDFs from outside managers.

The proprietary target-date managers who are faring the best have made themselves less dependent on their own recordkeeping platforms. Instead, they've focused on placing their TDFs on other recordkeepers' platforms, broadening distribution. Vanguard, T. Rowe Price and Wells Fargo, for example, had a much lower percentage of target-date assets on their own recordkeeping platforms in 2014 compared with 2009. Managers like Fidelity and Principal Financial Group, on the other hand, still depend a lot on target-date assets from their recordkeeping clients. The significant difference for J.P. Morgan is likely attributable to Empower's acquisition of J.P. Morgan's recordkeeping business in 2014.

SUCCESSFUL TDF MANAGERS ARE NO LONGER DEPENDENT ON THEIR OWN RECORDKEEPING PLATFORMS

Proprietary TDF Assets (Percent)



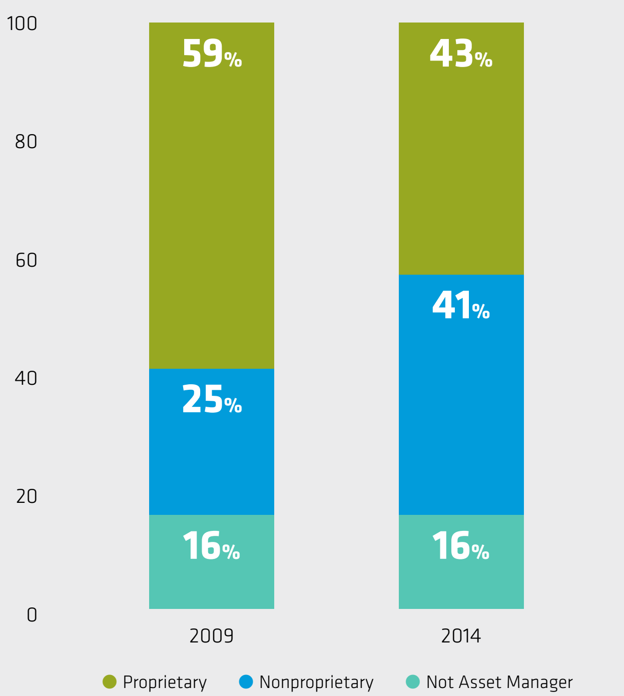
PROPRIETARY TDFS ARE LOSING GRIP ON THEIR OWN PLATFORMS

The shift in proprietary TDFs is evident from the changing composition of recordkeepers' target-date assets from 2009 to 2014.

As a percentage of recordkeepers' target-date assets, proprietary fund share has tumbled from 59% to 43%. On the other hand, the share of nonproprietary TDFs on platforms has leapt from 25% to 41%. Target-date assets on the platforms of recordkeepers that don't offer their own TDFs—such as Ascensus and ADP—have remained flat at 16%. Clearly, nonproprietary target-date solutions are gaining steam.

USE OF RECORDKEEPERS' PROPRIETARY TDFS IS DECLINING

Recordkeeper Target-Date Assets (Percent)



PROPRIETARY TDF ASSETS BY RECORDKEEPER

Plans with Proprietary TDFs

Recordkeeper	2009 Proprietary Assets ($)	2014 Proprietary Assets ($)
Fidelity	31,966,966,166	56,239,706,805
Vanguard Group	12,318,711,856	48,464,415,809
T. Rowe Price	11,891,143,287	29,376,171,089
Principal Financial Group	3,134,126,624	8,480,216,404
Empower	20,828,502	6,852,449,717
Charles Schwab	1,592,290,356	5,084,843,782
Wells Fargo	1,152,715,666	2,743,997,725
J.P. Morgan	2,222,518,237	1,454,214,785
TIAA	95,632,316	717,895,640
MassMutual	339,388,866	480,712,989
Prudential Financial	215,806,772	345,895,921
American Funds (Capital Group)	95,949,978	260,594,087
John Hancock	75,682,203	248,427,052
BMO Harris Bank	61,287,398	196,565,544
Putnam Investments	7,615,085	181,137,027
New York Life	88,674,999	112,265,785
Bank of Oklahoma	33,382,136	94,362,125
Voya Financial (ING)	103,656,356	80,934,792
Nationwide Mutual Insurance	–	7,439,381
Transamerica	–	5,780,094
Mutual of America	171,611	4,887,363

LARGE PLANS ARE AHEAD IN THE SHIFT TO NONPROPRIETARY

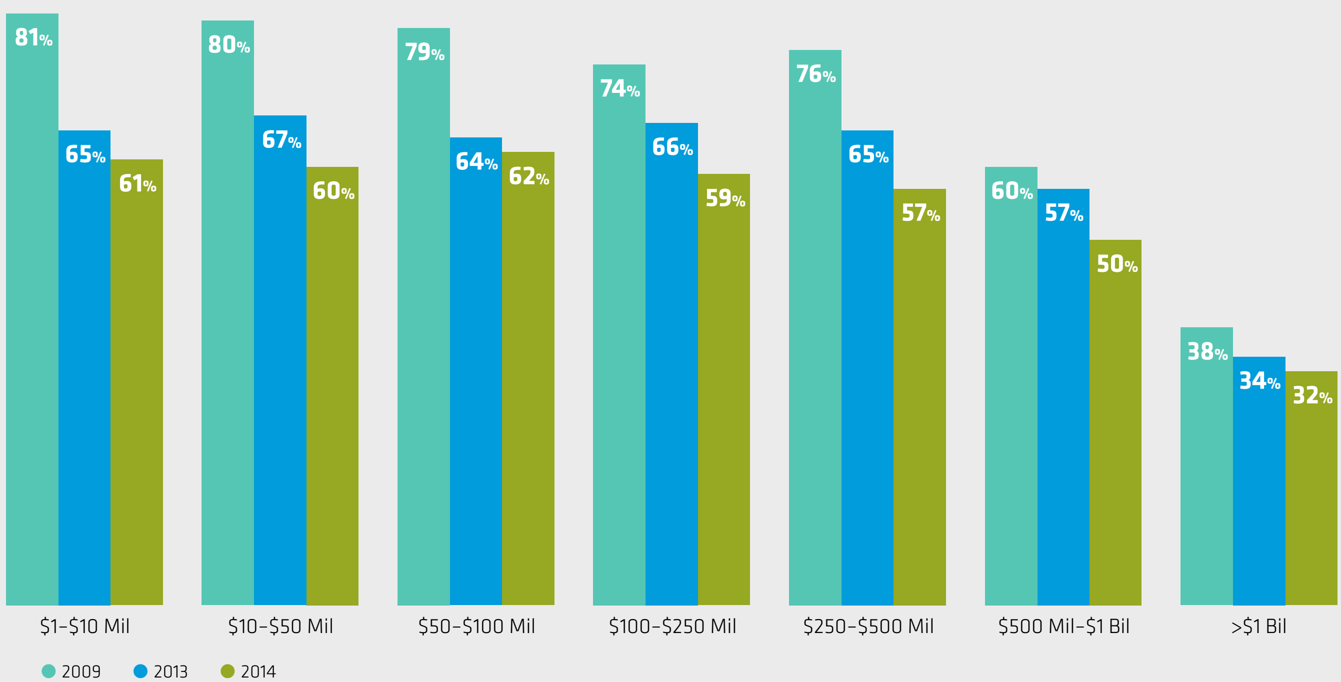
The use of proprietary TDFs has declined for plans of all sizes, but there are distinctions when we break the numbers down by plan size.

In the very largest plans with over a billion dollars in assets, the penetration of proprietary TDFs is the lowest at 32%. That's down from 38% in 2009 and 34% in 2013—just after the Department of Labor's Tips for ERISA Plan Fiduciaries on target-date selection were published. These Tips encouraged plan sponsors to consider nonproprietary and custom funds. But it's not likely that plan sponsors reacted to the DOL Tips so quickly that they moved away from proprietary funds by 2014; time will tell if the Tips are having an impact.

Regardless, many large plans have already unbundled their target-date and recordkeeper decisions. On the other side of the coin, more than 60% of smaller plans with under $100 million in assets still use proprietary TDFs.

PROPRIETARY TDF ASSETS ON RECORDKEEPER PLATFORMS HAVE DECREASED IN ALL PLAN SEGMENTS

Assets by Plan Size (Percent)



CITS GENERALLY COST LESS THAN MUTUAL FUNDS, MAKING THEM MORE ATTRACTIVE TO PLAN SPONSORS.

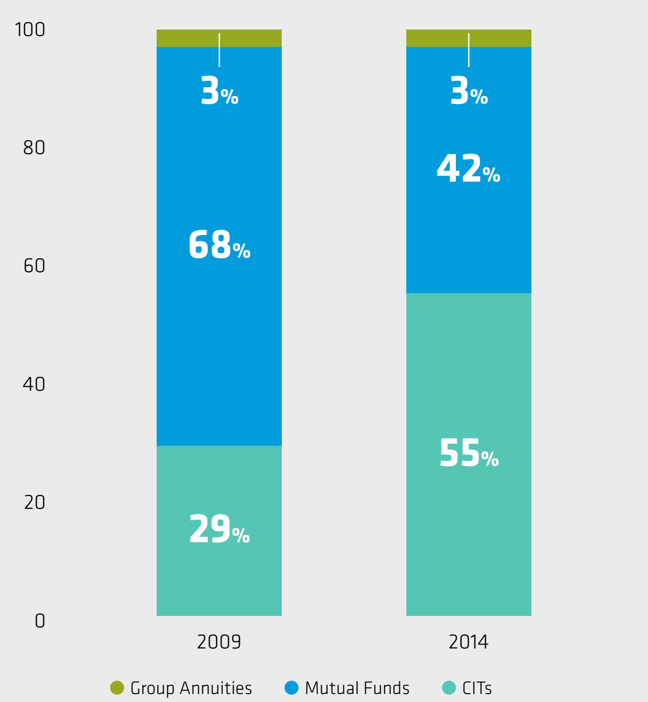
MORE PLANS ARE CHOOSING COLLECTIVE INVESTMENT TRUSTS

CITs have been gaining traction in DC plans, primarily as a way to help reduce costs—that's a continued focus for plan sponsors in the current regulatory and litigious environment.

From 2009 to 2014, the use of target-date collective investment trusts (CITs) nearly doubled as a percentage of target-date assets, from 29% to 55%. This growth came at the expense of target-date mutual funds, which saw their usage fall from 68% to 42% over the same period. This is consistent with much industry research that documents the shift to CITs across all defined contribution (DC) assets. Large plans have led the way in CIT adoption, but smaller and midsize plans are also stepping in, as providers begin to make these vehicles more accessible by reducing minimum required investments.

THE USE OF TARGET-DATE CITS IS GROWING RAPIDLY

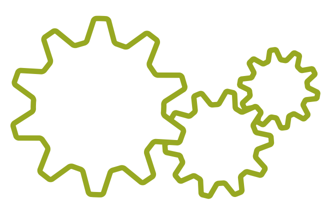
Target-Date Assets by Vehicle (Percent)



WHAT ARE THE POTENTIAL BENEFITS OF CITS?

1 Low Cost & Transparency

2 Efficiency of Operation



3 Easy Access to Information

WHICH RECORDKEEPERS ARE—AND AREN'T—GETTING THEIR SHARE?

The footprint of proprietary TDFs on recordkeepers' own platforms is generally shrinking, but the trend isn't uniform. In fact, proprietary TDF share as a percentage of both plans and assets on any given platform varies widely.

On the left-hand side of the display below, we rank recordkeepers according to the percentage of plans on their platforms that use the proprietary TDF. On the right-hand side, we rank recordkeepers by the percentage of plan assets on their platforms that are in proprietary TDFs.

American Funds tops both lists. Of the plans on its platform, 100% use American Funds' proprietary target-date series. And all of the target-date assets on American Funds' platform are in the proprietary offering. The same is true for Mutual of America.

For Vanguard, there's a slight disparity in the two numbers: 96% of the plans on its recordkeeping platform are in proprietary TDFs, but only 93% of the target-date assets on the platform. It may be that Vanguard's larger plans want Vanguard as their recordkeeper but have chosen to use another manager's TDFs.

Fidelity is another such example, with a much bigger split: 67% of plans on its recordkeeping system use proprietary Fidelity TDFs, but only 37% of the target-date assets are invested in these proprietary funds.

RECORDKEEPERS WITH HIGHEST PROPRIETARY TDF SHARE: 2014

Plans with Proprietary TDFs		Proprietary TDF Assets	
Recordkeeper	Percent of Plans	Recordkeeper	Percent of Assets
American Funds (Capital Group)	100	American Funds (Capital Group)	100
Mutual of America	100	Mutual of America	100
Vanguard Group	96	T. Rowe Price	93
T. Rowe Price	94	Vanguard Group	93
John Hancock	92	Principal Financial Group	74
Principal Financial Group	81	John Hancock	70
Fidelity	67	J.P. Morgan	47
J.P. Morgan	57	Empower	45
TIAA	53	Charles Schwab	43
Charles Schwab	49	Fidelity	37
Empower	39	TIAA	31
Wells Fargo	38	Bank of Oklahoma	26
Putnam Investments	30	BMO Harris Bank	26
Voya Financial (ING)	29	Wells Fargo	24
Prudential Financial	29	Prudential Financial	23
BMO Harris Bank	28	MassMutual	15
Bank of Oklahoma	22	Putnam Investments	13
MassMutual	15	Nationwide Mutual Insurance	9
Nationwide Mutual Insurance	14	New York Life	4
Transamerica	5	Voya Financial (ING)	1
New York Life	4	Transamerica	0

BOTTOM LINE: MOST RECORDKEEPERS HAVE LOST PROPRIETARY SHARE

Although the numbers vary considerably among recordkeepers, since 2009 only three of them were able to increase their share of proprietary target-date assets.

Nationwide, Empower and Hancock all fall above the diagonal line, which indicates that they've gained proprietary assets over this five-year period. The majority of recordkeepers fall below the line—they've lost share in proprietary assets since 2009.

Keep in mind that a lot of change and consolidation continues to take place among recordkeepers—that needs to be factored in when looking at the data.

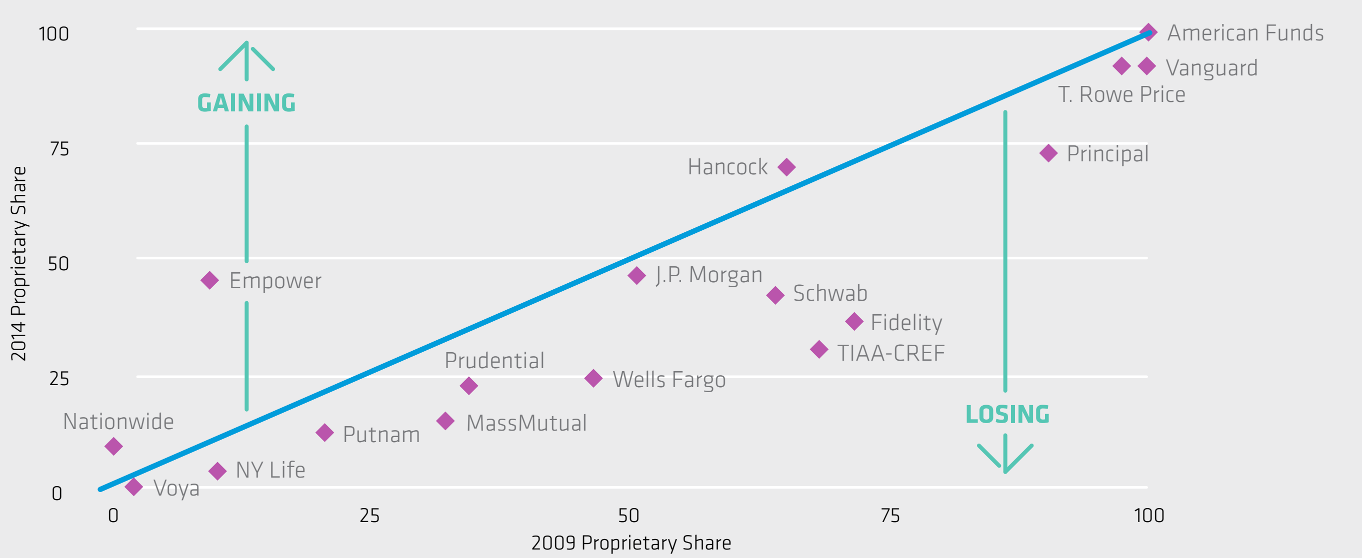
In the case of Empower, this recordkeeper acquired J.P. Morgan's Retirement Plan Services recordkeeping unit in October 2014. For this research, which used 2014 Form 5500 data, if a plan reported having an Empower TDF and Empower as its recordkeeper, the fund was appropriately considered proprietary.

For plans that reported Empower as their recordkeeper when they filed in 2014 and J.P. Morgan as their TDF provider, these target-date offerings were also considered proprietary to Empower, since the plan sponsor originally made the active choice to have the same recordkeeper and TDF provider, regardless of the status of the acquisition.

Fidelity, as noted earlier, has seen a significant drop in the asset share of its proprietary offerings. In 2009, 71% of the target-date assets on its recordkeeping platform were in Fidelity TDFs. That number had fallen to only 37% in 2014. The trend has been fairly consistent across all plan sizes, but it's a bit more pronounced in larger plans.

LARGE RECORDKEEPERS ARE LOSING PROPRIETARY SHARE

Proprietary Share of Assets in 2009 and 2014 (Percent)



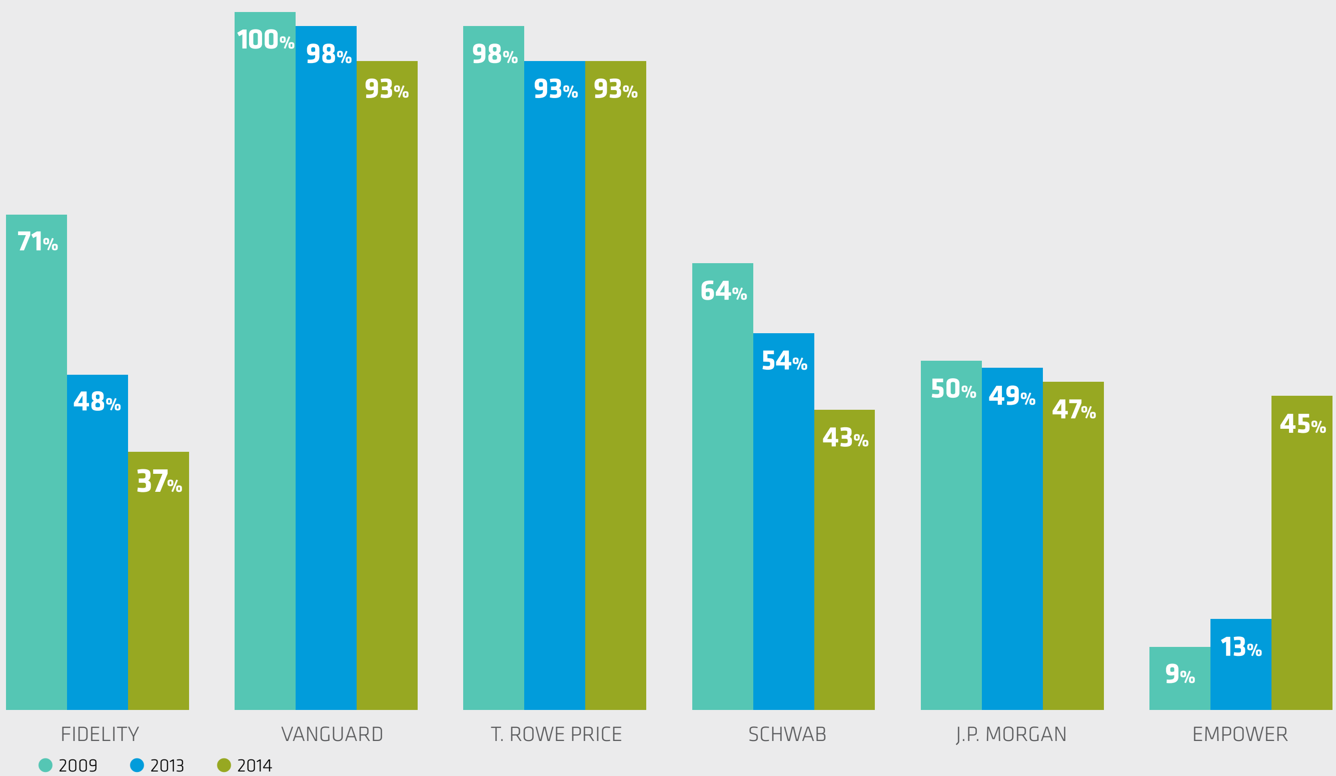
DOL TIP: "INQUIRE ABOUT WHETHER A CUSTOM OR NONPROPRIETARY TDF WOULD BE A BETTER FIT FOR YOUR PLAN."

WHAT IMPACT HAVE THE DOL TIPS MADE SO FAR?

As we mentioned earlier, we wanted to find out if the 2013 DOL Tips for ERISA Plan Fiduciaries, which encourage plan sponsors to consider nonproprietary or custom funds, made an impact in the nonproprietary migration we've seen.

The data shows a decrease in proprietary target-date asset share for some top recordkeepers between 2013 and 2014, but it's likely too soon to say whether the DOL Tips affected—or will affect—target-date choices. Recordkeepers like Fidelity and Schwab have been losing proprietary share since 2009, but Vanguard, T. Rowe Price and J.P. Morgan's small-market recordkeeping businesses have seen only modest decreases. In fact, they've been able to hang onto most of their share.

PROPRIETARY TARGET-DATE SHARE FOR TOP RECORDKEEPERS
Proprietary Share of Assets (Percent)



WHAT'S A RECORDKEEPER TO DO?

What have recordkeepers done to try to keep their proprietary target-date share? The data suggests that some recordkeepers have introduced a target-date series in a CIT or passively-managed format.

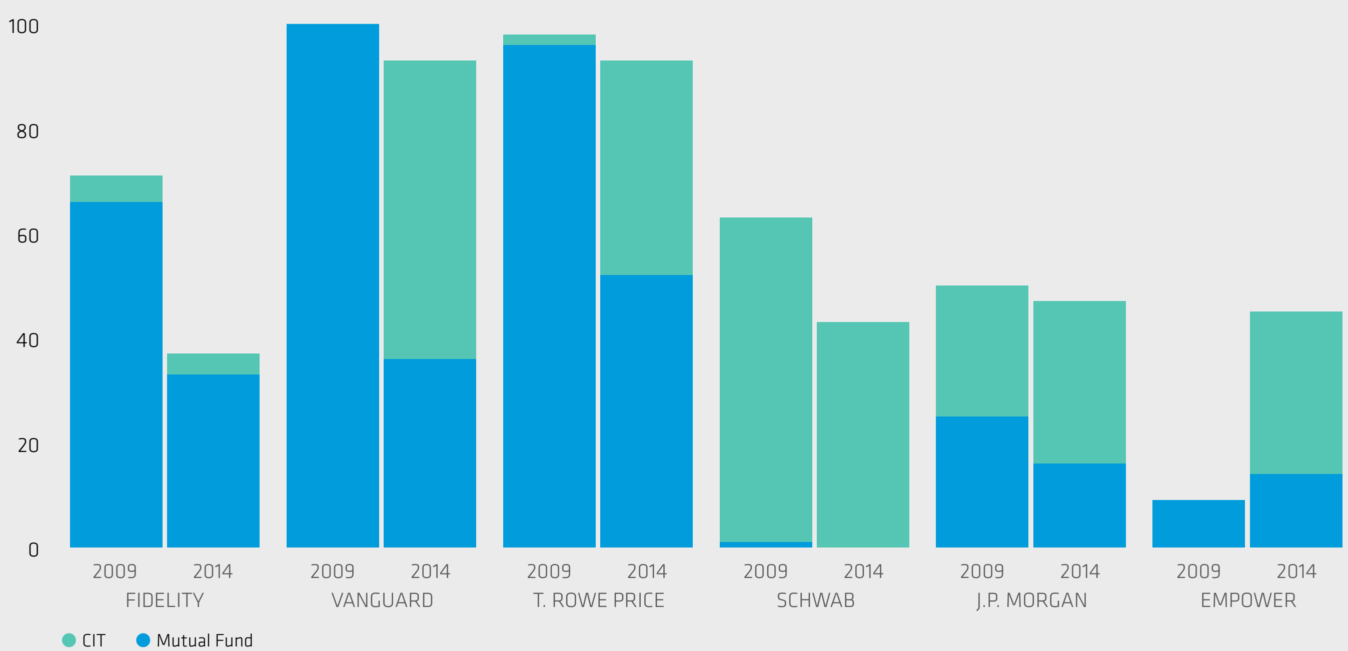
CITs generally cost less than mutual funds, making them more attractive to plan sponsors. This could indicate a move by record-keepers to keep their business with a plan sponsor who might want to shift to another manager's lower-cost target-date series.

Take Vanguard, for example. In 2009, all the target-date assets on its platform were invested in Vanguard target-date mutual funds. By 2014, 61% of the assets were in Vanguard's target-date CIT series and only 39% in its mutual fund series. The data shows a similar shift for T. Rowe Price: 98% of its target-date assets were in the firm's target-date mutual fund series in 2009, but by 2014, only 56% were in the mutual fund series, with 44% in the CIT series. This is a significant transition in a relatively short time.

Some recordkeepers may have taken a different approach to hold onto their proprietary shares: introducing a passively-managed target-date series. In 2009, about 5% of Fidelity's proprietary share of target-date assets was in its passively-managed target-date series. But by 2014, that share had more than doubled to 12%. Schwab's proprietary share was 100% actively managed in 2009.

CERTAIN RECORDKEEPERS HAVE USED CITS TO HOLD PROPRIETARY SHARE...

Proprietary Share of Assets by Vehicle (Percent)

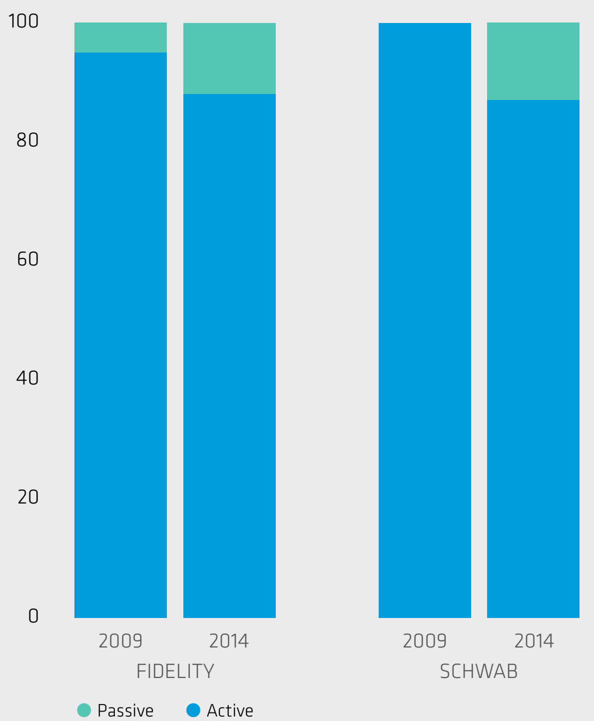


The firm introduced a passively-managed CIT series in 2009, and by 2014 it accounted for about 13% of Schwab's proprietary share.

Today, many target-date providers are doing even more to hold their ground and compete for new business by reducing fees and expenses. How will these strategies impact the proprietary share? That will be something to examine in future research.

...AND SOME HAVE RELIED ON PASSIVE TDFS TO RETAIN PROPRIETARY SHARE

Proprietary Share in Active and Passive TDFs (Percent)



MYTH

It's complicated to educate participants about CITs, and participants can't easily get pricing or performance information.

FACT

Many CITs are simply clones of mutual funds. Every plan must disclose information about the product type, but the vast majority of participants won't care about the legal technicalities that distinguish them. In fact, CITs look the same as mutual funds to participants.

WILL SMALLER PLANS FOLLOW THE TREND?

In terms of keeping proprietary target-date share, recordkeepers have been more successful with smaller plans—with a few exceptions (these may be caused by a few larger plans distorting the data for those recordkeepers' larger plan segments).

Many larger plan sponsors have already separated the recordkeeping and target-date decisions, evaluating each on its own merit. In many cases, the recordkeeper's TDF may be a strong choice. But generally, smaller plans haven't yet moved away from using their recordkeepers' proprietary TDF to the extent larger plans have. It remains to be seen whether smaller and midsize plans will follow suit over time, but the greater scrutiny on fiduciary decision making may influence these decisions.

WHAT DOES THE FUTURE HOLD FOR TDFS?

The target-date marketplace continues to change, with growing emphasis on the fiduciary role of plan sponsors, consultants and advisors.

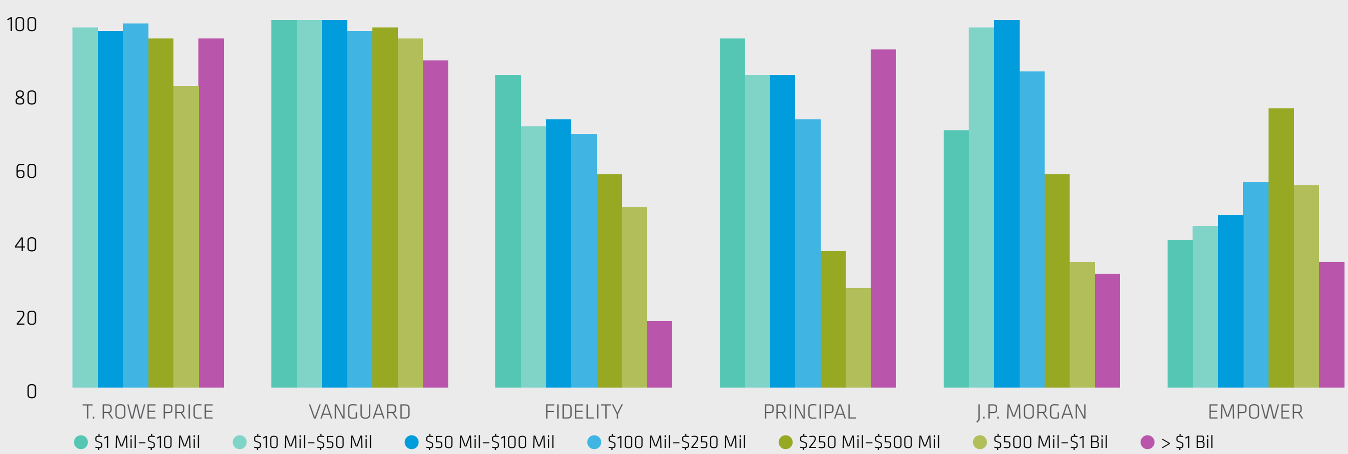
Will decision makers for plans of all sizes continue to look more carefully at their target-date decisions? Will recordkeepers face tougher challenges in trying to keep market share in their own TDFs on their platforms? Will the DOL Tips have more of an impact on target-date selection as we look at 2015 plan data and beyond?

The jury is still out on many of these questions, pending the availability of newer data, but the numbers in hand clearly show a shift toward nonproprietary TDF offerings. The competition is stiff, with more and more asset managers offering TDFs—and the battle seems likely only to intensify.

With more choices than ever before, many plan sponsors are decoupling their choice of recordkeeper from their target-date-solution choice. Plan sponsors are seeking the best possible outcomes for plan participants—by keeping them on a path toward being more financially prepared for retirement. Better-quality portfolio management, lower fees and solid investment performance all help—and plan sponsors are now looking at a broader set of options before making a decision.

PROPRIETARY TARGET-DATE SHARE IS SIGNIFICANTLY HIGHER FOR SMALL PLANS

Proprietary Share of Assets by Plan Size: 2014 (Percent)



RESEARCH METHODOLOGY

The data set in this report covers a total of 6,393 plans with $2.2 trillion in assets and 25.8 million participants in 2014. All data was gathered from Form 5500 and the attached Schedule of Assets for 401(k) plans with more than 100 participants and $1 million in assets.

The data sample includes all 401(k) plans for which BrightScope has investment lineup information and an assigned recordkeeper for each year from 2009 through 2014. Recordkeepers were assigned to plans based on Form 5500 Schedule C provider codes. If multiple providers were listed, the recordkeeper that receives the highest fee is assumed to be the plan's recordkeeper.

BrightScope excluded State Street, Hartford Financial and Lincoln Financial as recordkeepers. Pyramis/Fidelity Institutional Asset Management funds are proprietary to Fidelity. Proprietary funds for Empower are Great-West, J.P. Morgan and Putnam, as the result of an October 2014 merger.

The "Facebook effect" is present in our time-series data. In other words, a plan may be in the $10 million–$50 million group in 2009, but as the plan grows over the course of the analysis period, it could end up in the $100 million–$500 million group in 2014.

White-label target-date funds are included in the data, and the asset manager may not be apparent. For example: "AT&T Target Retirement 2040."

ABOUT AB

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BrightScope categorized Alight Solutions (the recordkeeper that was formerly known as AON Hewitt and recently acquired by the Blackstone Group) as a recordkeeper that is not an asset manager which is the case as of the publishing date of this paper. Although AON Hewitt launched a target-date CIT series in 2013 when the recordkeeping unit was associated with them, the assets and number of plans in it were relatively low in 2014. Due to the recent transaction, Alight Solutions no longer has a proprietary target-date offering.

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