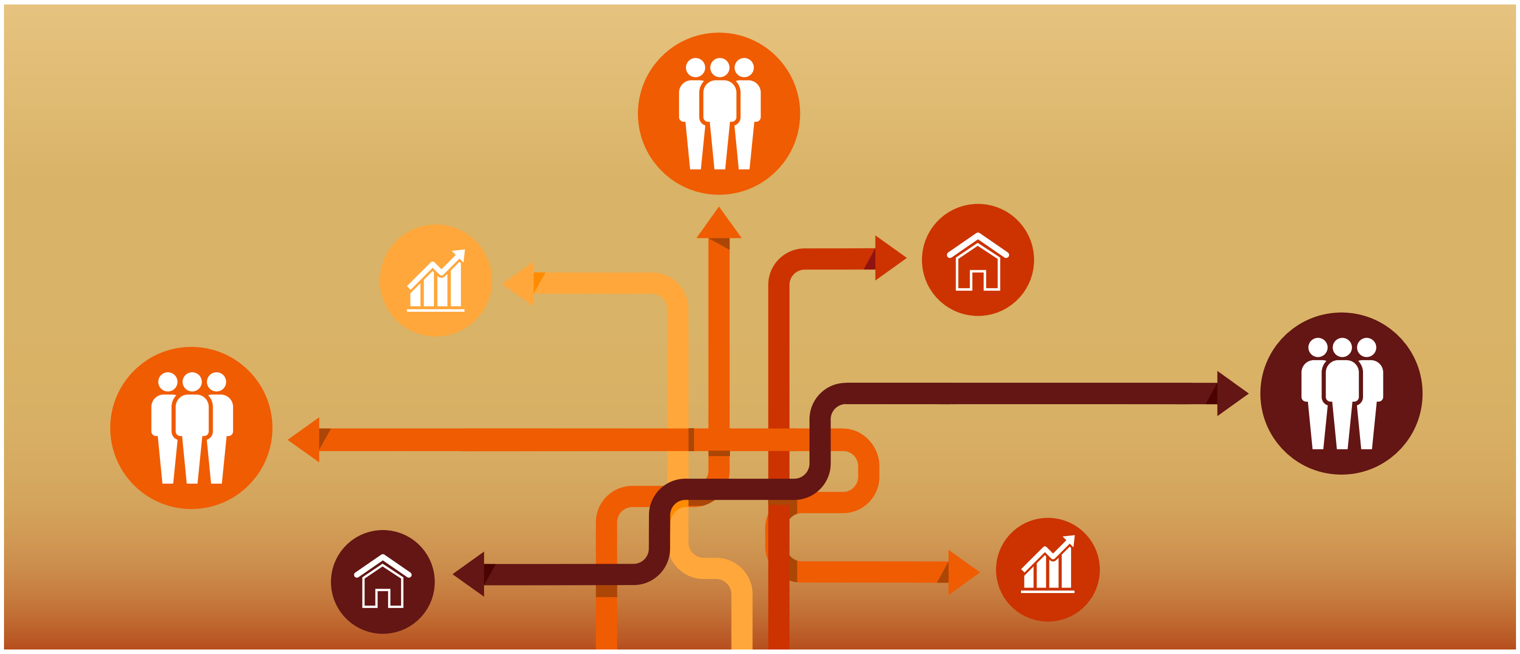
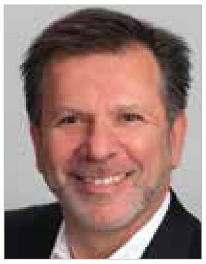


DC Power Shift



BY FRED BARSTEIN

For record keepers in the advisor-sold space, the key to winning and losing will be the ability to sell to the small and mid-to-large DC markets while shifting their sales focus to elite plan advisors.

> "Before you know it, those DCIOs now relegated to sitting in the back seat will not only be sitting in the front seat, but will be acting as the engine of growth for advisors."

There is a subtle but important power shift happening in the advisor sold DC market. Though it might take years to develop, this shift will forever change the industry's landscape. In the past, record keepers in the advisor-sold space did well because they focused on one market segment and were able to effectively wholesale to "blind squirrels." In the future, the winners (a.k.a. survivors) will have to be able to sell to the small and mid-to-large DC markets while shifting their sales focus to experienced plan advisors.

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It's hard to believe but, just as the profession of plan advisor is less than 20 years old, record keepers — today's winners in the advisor-sold market — started hitting their stride in the early 2000s. Though many fund companies that are now DCIOs owned record keeping divisions, there are now fewer than 15 major small market providers today. Many survived because they are very good making money in one market while building a sales force to service and sell to blind squirrels. Just 10 years ago, 90% of sales came from the less experienced advisors, especially in the under $10 million market. That takes a large sales force and lots of focus. But the world is changing — rapidly.

Today, about 50% of sales come from advisors that have more than five plans.

That's a dramatic shift. The number of elite plan advisors that have more than $100 million under management has doubled since the Great Recession, from 1,250 to 2,500 and growing. Plans are increasing too, driven by the bull market over the last five years and growing account balances due to in part to the adoption of auto features. Finally, with prices for advisory services declining and the sophistication of plan sponsors rising, more advisors are seeing the wisdom is joining teams. (See the feature article on page 54.) Meanwhile, as the focus shifts to outcomes, not inputs, and flows into TDFs grow exponentially, selection and monitoring of individual funds by asset classes is becoming less and less important.

So what does this mean to advisor-sold record keepers? Providers in the small market can no longer afford to watch mid-market record keepers pick off their plans as they grow and demand a higher level of service and product, primarily bundled. As more sophisticated advisors dominate the mid and large markets, record keeping prices have been negotiated down, with less tolerance for proprietary funds, causing provider margins to shrink. These mid-market providers have to move down market where the margins are healthier.

Both mid and small market record keepers need to leverage fixed costs across multiple markets to maintain profit margins. Every record keeper is scrambling right now to have a viable cross-market business. MassMutual, Fidelity and Transamerica are leading the charge; Principal has had a viable strategy for years.

Even more important is the emergence of advisor teams, which portends the coming power shift. Fees for both record keeping and advisory services are under pressure. Commoditization has hit both hard. Larger teams are already developing their own platforms, using a select group of record keepers and creating a customized managed investment strategy. These advisor teams are poised to take over the power position from the record keepers.

Being the "general contractor" for blind squirrels, which used to be the key to success, is less important today — a trend that will continue. That work is being taken over by the elite advisors, especially the teams. Developing the expertise to work with these more sophisticated advisor groups will become more essential for success, as will be the realization that record keepers need to step back and enable advisors who might also be taking a greater percentage of the fees for their efforts. And DCIOs that don't own a record keeper or have a viable TDF strategy will need to either own or work together to create either customized managed investment products or risk management solutions. That will become the engine and the GPS system, so to speak.

So is the sky falling for advisor-sold record keepers? For those unwilling to change, like the many fund companies 10 years ago that thought lame record keeping and administrative services would be enough to sell their proprietary investments, the answer is yes. But for record keepers that have multimarket strategies and are willing to enable elite advisors and teams to step back a bit (which also means wholesaling to them much differently), it's nothing but blue sky — especially since there will be less competition.