Managed Advice as an Integrated Service

Reframing the Business Case for Managed Advice

Executive Summary

Over the last three decades, the private sector has seen a dramatic shift in retirement plan options companies offer their employees. Once the norm, defined benefit ("DB") pension plans have been largely eclipsed by defined-contribution ("DC") plans, transferring investment risk from employer to employee. DC plan participants took on the additional responsibility of selecting and managing their own investments—a complex, time-consuming, and often unsuccessful effort for those untrained to do so.

The development of the Target Date Fund ("TDF") in the early 1990s was a very welcome and prudent solution to the "DIY" model that accompanied the evolution from DB to DC plans. Basing an investor's asset mix on their planned retirement date made TDFs an easy, cost-effective option—one that gained significant traction through the mid-2000s. Developed as a key tool to help less engaged participants make sensible portfolio decisions, today, target date strategies are overwhelmingly selected as the qualified default investment alternative ("QDIA") option in millions of Americans' retirement plans, especially in those offering automatic enrollment.

Over the last decade, advances in financial tech and automation spaces gave rise to the "robo-adviser," an online portfolio management solution that automates client advisory services. This, in turn, provided institutions the opportunity to easily and scalably offer more personalized investment strategies—or "managed accounts"—using dozens of available data points specific to each investor.

Although the benefits of managed accounts, particularly when compared to TDFs, are well known and widely studied in the retirement planning industry, they have ultimately been slow to pick up steam. But, why?

> Simply, we were comparing apples and oranges; they are not the same. We also need to reframe the conversation—start thinking and speaking about managed accounts as a holistic, integrated service, versus a less comprehensive, off-the-shelf investment product like traditional TDFs. NextCapital refers to this—it's proprietary service—as "Managed Advice."

What is Managed Advice?

NextCapital takes the idea of managed accounts one step further. Its Managed Advice solution is more than just a personalized asset allocation; it's a plan that guides investors to and through retirement.

Managed Advice is a long-term, dynamic plan that guides investors through the accumulation phase of life (i.e., their working years, when they are saving money) and into the decumulation phase (i.e., upon and throughout retirement, when they are drawing from their savings) of life. Each investor's plan is uniquely personalized using data specific to them. The more participant data our advice engine can consume, the better the outcomes we deliver.

But what does that mean?

Managed Advice—the personalized advice relating to one's retirement age, income, savings, tax awareness, asset allocation, etc.—dynamically adjusts over time based on an individual's glidepath, but also as the individual's circumstances change (e.g., child goes to college, loss of a job, inheritance, salary increase, health event, etc.).

Managed Advice provides retirement plan participants with an integrated approach to planning and the evolving support they need to achieve the retirement they desire and deserve. It's not a product; it's a personalized, dynamic, and guided lifestyle service.

Managed Advice is primarily comprised of the following:

- Personalized portfolio advice
- Contribution rate recommendations
- Retirement and Social Security claiming age recommendations
- Tax awareness
- Advice implementation and plan maintenance

NextCapital's partners take advantage of the optionality, flexibility, and choice that we offer in order to meet the unique demands of their stakeholders—without sacrificing their own business needs.

Our partners can offer tailored Managed Advice solutions for each channel and segment, while providing intermediaries with the option of assuming an advisory role.

The Current Landscape

The TDF was an excellent innovation for its time. It solved for complexity, price, and distribution; it was simple for investors to understand and opt into. It was a prudent, acceptable QDIA (Qualified Default Investment Alternative) for auto-enrollments, and an easy benchmark.

For these reasons, TDFs today capture:

55%	70%	83%
of all new money	of savers in their 20s *(primarily new participants)*	of auto enrollments

However, a great limitation of TDFs is that they do not factor in personalized data. They are not agile, and cannot make adjustments or improvements to its set glidepath. TDFs are structured to assume a one-size-fits-all approach, and, unsurprisingly, not everyone who plans to retire in a particular calendar year looks the same.

And we're about to face a problem.

The first sizable wave of participants who auto-enrolled in TDFs post-2006 are starting to reach retirement age. In fact, as of 2019, over $1 trillion in TDF assets are invested in vintages for 2035 or earlier. This means that 60% of all TDF assets are held by investors aged 50 and older. The illusion that TDFs are "good enough" could mean that corrective action isn't taken in time to help these investors secure their retirement.

For example:

Investor A is 10 years from retirement and *overfunded*. Invested in a passive strategy that doesn't consider funding status nor has the ability to dynamically adjust over time based on that funding status, this individual is likely to stay in an overly aggressive TDF. Taking on more risk than is necessary, particularly with a recession looming, this has the potential to be a very dangerous situation.

Investor B is also 10 years from retirement, but *underfunded*. Fortunately, 10 years is enough time to make up some significant ground. But, investing in a passive strategy that doesn't consider/adjust for one's funding status, Investor B is likely to assume less risk than they should. Investor B will likely retire underfunded, having never truly addressed a very solvable problem.

What can be done?

By considering dozens of variables (beyond one's retirement date) and by building and managing a personalized, fluid glidepath that adjusts in lock-step with these variables, Managed Advice solves for such scenarios.

So, we have the data, we have the technology, and we can support that better outcomes are achieved through Managed Advice. So, why then have we not reached the tipping point where Managed Advice is the preferred solution over traditional TDFs?

Why?

Overcoming Misconceptions and Historic Barriers to Success

Historically, managed accounts were seen as expensive, cumbersome, and overly complex. While quite far from the truth today, the circumstances of yesterday still seem to hold some weight in the marketplace. We describe such barriers to success below, and how NextCapital is helping to re-frame the conversation and the pathway to retirement success.

I. Managed accounts are perceived as having typically higher fees versus TDFs or a "DIY" model.

Historically, managed accounts were distributed more like a product—one that was not fully differentiated versus a TDF. Managed accounts traditionally offered less customization than they do today, and were fairly inflexible in terms of configurability with advice/methodology. On top of that, they were more complex vehicles and charged more in fees than a TDF. Given the same, it is not surprising that the market tended to avoid managed accounts.

But that's changing.

NextCapital addresses the problem of re-positioning Managed Advice by enabling its partnering firms with the awareness, education, and market expertise needed to frame the solution appropriately, thereby strengthening its path to success.

We support our trusted, advice-focused partners, and collaborate with them to configure and customize the exact Managed Advice solution they need. We address pricing through scalable technology and configurability, and, because of the high degree of personalization that we build into the service, we are able to defend its value and benefits.

II. Managed accounts traditionally were not integrated within the enrollment flow.

NextCapital understands the critical importance of a seamless, frictionless user experience.

Most providers treat managed accounts like a standard investment product. A typical enrollment flow often includes an investor *first* enrolling in their plan, *then* going back in to select managed accounts. This can be a confusing and inefficient process.

To combat this issue, NextCapital reconfigured the enrollment process. We make Managed Advice *part* of the enrollment flow, as it provides guidance over much more than just one's investable assets (e.g., retirement age, contribution rate, etc.).

In addition, we create consistency among investors by integrating with providers' retirement income calculators. Investors often receive disparate retirement income calculations: one from the provider's calculator, and another once they navigate to the managed account experience. These results differ because two parties will, unsurprisingly, build in different calculations and underlying assumptions. NextCapital uses the same set of assumptions and calculations and embeds them across all of the solutions it powers .

III. Managed accounts have a general lack of advisor support

Historically, advisors were unable to assume a *true* advisory role within managed account structures. Within this misaligned model, advisors would have to take on the risk of recommending managed accounts to their plans, but had no fiduciary responsibility (and therefore, could not charge a fee and were without incentive). The lack of advisor support, coupled with the perception of high fees when compared to a TDF created the perception that managed accounts were a "hard sell."

NextCapital corrects this lack of engagement and misaligned incentive structure by putting advisors directly in the driver's seat. We work with advisors to help them design a Managed Advice solution where they can inform the advice that is given, feel confident about that advice, and charge for their services. Importantly, this solution structure incentivizes advisors, and motivates them to offer Managed Advice to their investors.

IV. Managed accounts lack effective personalized engagement and communication strategies

Many managed account solutions have historically suffered from limited engagement due primarily to poorly designed or non-existent communications strategies.

At NextCapital, we believe that by consuming more participant data, we can deliver better outcomes—and in a more engaging way. Our data-driven approach to participant engagement and communication is foundational to our mission of helping everyone retire successfully.

But, what does that mean?

Personalized managed advice adjusts over time, not only based on one's glidepath, but also on his or her ever-evolving life circumstances (e.g., salary change, marriage, birth of a child). The ongoing and dynamic nature of an individual's plan calls for event-based engagement on behalf of the managed advice provider and its stakeholders—leading to more targeted coaching and communication.

Such event-based data is also critical on the macro level to advice manufacturers and the institutional consumer (plan): Are people executing the savings advice that was recommended? How many are not realizing employer match? Who is getting ready to retire? Who might be overfunded and could annuitize? This information is also used to consistently monitor and improve the advice we provide.

With a data-driven approach, the opportunities for personalized, event-based communication and engagement are profound.

Conclusion

Retirement is one of life's most important goals. But, the road to retirement is very long and rarely smooth. Successful retirement goals are achieved through continuous evaluation and dynamic planning—throughout the course of one's working career, and beyond. Managed Advice provides retirement plan participants with a holistic approach to planning.

> It's a personalized path to and through retirement, guiding each participant towards their unique retirement success while adding additional layers of value.

We estimate the actual value-add of managed advice versus traditional TDFs is roughly 95-785 bps/year, depending on how much of the advice one considers and incorporates.

NextCapital succeeds in lockstep with its partners. Together, we build scalable digital advice solutions, fully customized to serve each partners' unique and evolving needs.

Creating an environment where institutions can offer sophisticated retirement advice in a digital, scalable manner allows our partners to vastly expand their reach, giving them the ability to serve investors of all types and income levels.

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