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RIAs gaining in market for small 401(k)s

By Lisa Shidler
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CHICAGO — Registered investment advisers are the fastest-growing distribution channel for mutual-fund-based small-business 401(k)s. Starting from a small base, they are adding assets at the rate of about 14% a year, according to Boston-based Financial Research Corp.

FRC estimates that RIAs, often working in conjunction with third-party administrators, manage $30 billion to $50 billion of the $693 billion that is available in small and micro-401(k) plans. New small-business 401(k) plan sales by RIAs will grow by $5 billion to $10 billion each year, FRC estimates.

"We knew this was going to happen, because there was so much growth and a specific need, but it was fragmented," said Laura Varas, research partner with FRC and president of Mast Hill Consulting Inc. in Hingham, Mass. "We expect further growth in assets and plans."

Lack of bias seen

RIAs are winning more plan sponsor accounts because they are seen as non-biased advisers who can offer best-of-breed solutions, Ms. Varas said, noting that advisers are particularly successful in the small-business market because larger fund companies can't profitably serve many small businesses.

"It is difficult, for example, for a large corporation to divert resources from rollover programs to small-business retirement plans," Ms. Varas said. "Yet the category is begging to be grown."According to FRC data, the average micro-plan has assets of about $560,000, while the average small plan contains about $5.2 million.

In 2004, there were 463,000 small and micro-401(k) plans, with $464 billion in assets. FRC estimates that by the end of this year, there will be 560,000 such plans, with $693 billion in assets. This growth is creating a huge opportunity for RIAs, Ms. Varas said.

Making the RIA growth possible is an increase in the number of third-party-administrator firms, providing services at a lower cost than large mutual fund companies, she

said.

The Pension Protection Act of 2006 put a spotlight on 401(k) fees, said Tom Modestino, senior analyst with Boston-based Cerulli Associates Inc.

“I think an RIA is a best practice for sponsors when they’re buying these things,” he said. “An RIA has nothing at stake. Their business is all about finding the best solutions, regardless of fund or any commission. Pricing is a bit of a shell game, but RIAs make it simple and transparent. It’s a better and non-

conflicted situation.”

The fact that RIAs can be named a co-fiduciary is quite attractive to plan sponsors, said Nick Della Vedova, president of Aliso Viejo, Calif.-based RIA firm 401(k) Advisors. His company works with employers whose plan assets range from $10 million to $500 million.

“People like the feeling that we’re on the same side of the table, and wirehouses have been reticent to make that statement,” Mr. Della Vedova said.

He said that fee transparency is also attractive to plan sponsors who like having all of the fees detailed.

“The 401(k) marketplace is going through a lot of changes, and RIAs are able to be more nimble in going through those changes,” Mr. Della Vedova said. “That’s what is needed at this point.”

Even though he has seen tremendous growth in the small-business market, Mr. Della Vedova said, he has also begun to get larger customers. For instance, until recently, he was not working with plan sponsors who had $500 million or more in assets.

Mark M. Gutrich, president and CEO of ePlan Services Inc. of Denver, said he has also noticed that he has been getting larger clients.

“RIAs are definitely playing upmarket,” he said. In the past, Mr. Gutrich’s average conversion from a plan sponsor who had an existing commission-based plan was about $600,000. That has grown to about $1.8 million.

Plan sponsors like that RIAs provide open architecture with a wide choice of fund groups for their small-business clients, Mr. Gutrich said. Sponsors feel that they’re getting to choose the best available funds, he added.

Impact of new law

Greg Munson, senior vice president of The Online 401(k) in San Francisco, thinks that the Pension Protection Act of 2006 alerted plan sponsors to their responsibility to provide a suitable default option. He said RIAs are working hard to craft their own default options for plan sponsors rather than automatically recommending a traditional target date fund.

“The PPA with automatic enrollment and the default option has been very important and raised the consciousness about what plan sponsors need to do,” he said.

While RIA firms already in the 401(k) market are capturing more plan assets, Eric Lansky, managing director of The Reserve, a New York-based asset manager, has begun seeing more advisers getting into the 401(k) space for the first time, he said.

“When advisers would sit down with their clients and look at a client’s 401(k) assets, they’d say, ‘Why are you investing in these funds?’ Then they began speaking right to the plan sponsors,” said Mr. Lansky, who is based in Fairhope, Ala.

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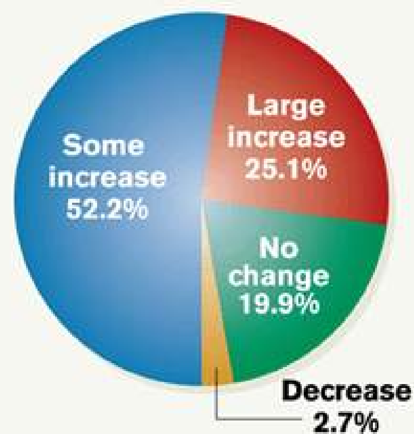

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