Fiducient Advisors, Nonprofit Investment Stewards Podcast
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403(b) Retirement Plans Optimized for Nonprofits — With Vin Smith

[00:00:00] Welcome to Non-profit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo. Great as always to be joined by co-host Devon Francis. As many listeners know, Devon and I, and our colleagues at Fiducient, we advise a wide variety of clients. It spans from private clients to endowments and foundations to retirement plans, including pensions and 401(k) and 403(b) plans.

[00:00:53] You probably know that on this show, we often focus on endowment [00:01:00] or foundation asset pools, but today, we're going to shift our focus to the retirement side for nonprofits and drill down on 403(b) plans. We'll go beyond asset allocation and portfolio construction, and we'll tackle the challenges that nonprofit leaders face when overseeing a 403(b) plan.

[00:01:20] We're super pleased to be joined by one of our talented colleagues and partners who specializes in the 403(b) space. Devon, let's turn things over to you for an introduction. Thanks, Bob. So, I am so happy to have Vin Smith with us today. Vin has been with Fiducient for 10 years. He's a partner at the firm and he serves as the practice leader of our nonprofit defined contribution practice.

[00:01:44] He serves a wide variety of higher-ed institutions and he has a wealth of knowledge when it comes to this space, which you'll hear a lot about today. Vin is based in our Boston office and is the proud dad of a young child. He also serves on the board of directors for Mentor [00:02:00] Rhode Island, which focuses on creating quality youth mentorship programs.

[00:02:04] And when it comes to personality, if we were giving out high school style superlatives, he would definitely be voted most sarcastic. So, Vin, welcome to the show. Happy to be here. Hi Devon. Hi Bob. Vin, thanks so much. It's great to have you on the show. And why don't we start with your story? How did you end up in this role serving nonprofits and even more so becoming such an expert in this retirement plan space?

[00:02:29] I don't want to let Devon down with my most sarcastic introduction. So, I would like to be able to tell our audience and both you and Devon that I showed up at career day in second grade with the little picture of me in a suit and a briefcase saying I'd like to be a 403(b)-plan consultant when I grow up.

[00:02:51] So spoiler alert, that's not exactly how the story goes, but I'll try to make it relatively quick and painless. I was home one summer from [00:03:00] college and playing in a men's softball league where I met a guy on my team who I thought was so much older than I was, probably about the same age as I am now.

[00:03:08] And he happened to work at a large institutional consulting firm that focused on higher ed and hospitals and other tax-exempt type organizations. Uh, we became friendly. I was lucky enough to get an internship with his firm and apply for a job out of college. And, and again, be fortunate enough to get the role, and over time, grew to love the different type of work that we did and how varied it was.

[00:03:32] There was a regulatory, or is a regulatory component, an investment component, kind of behavioral participant type component as well. And just a lot of change over time. So, it's been a rewarding career so far. I've been at it for 20 years. And luckily, my first job out of college was in this space and kept going ever since.

[00:03:51] So Bob mentioned in our, in his introduction that, you know, typically on this podcast, we talk about our endowment foundation [00:04:00] services. So, I think most listeners are probably familiar with what we do in that space. So, Vin, can you describe at a high level, what services we provide for our defined contribution clients and how we really add value in that space?

[00:04:15] Sure. So, I think of it a few different ways. I suppose I'll start with what we consider to be our core services. So, by that, I mean, we essentially design and execute a fiduciary governance or oversight process for our clients. Let me turn that into English for our listeners. So, what that means is, as we work through the oversight approach and process, we do things like fee reviews and fee benchmarking, and that's on the administrative side and on the investment side.

[00:04:44] We work through RFP projects around selecting service providers, record-keepers in particular. We help our clients design investment menus for participant utilization. We work to select and monitor funds or managers.

[00:04:59] We work [00:05:00] through plan design. So, think how do you use automatic enrollment or Roth features, et cetera? We work directly with participants on financial wellness and financial wellness campaigns. We help with governance documents, et cetera. And through those core services, the value that we add tends to be lower and competitive fees, which has been a huge trend in 403(b) over time.

[00:05:22] Good investment menus, good competitive plan design, et cetera. So, at a high level, I would say that's a list of some of our core services that are likely intuitive to most of our listeners. But then, I would drill down a second level and say that our culture, which is driven on service to our clients and clients come first.

[00:05:43] I think when we talk to our clients and survey them, the things that they appreciate as much, or as a result of our model. So, things like working directly with HR and benefits on reviewing record-keeping amendments and participant communications and working with [00:06:00] CFOs and board chairs, going to the appropriate trustee meetings, whether it's audit or investment committee, and helping to articulate the value that the internal committees do and the oversight process, et cetera.

[00:06:12] I think it’s a whole another level of value that's as appreciated as our core services. That's great. So, let's talk about the 403(b) landscape broadly. And can you maybe provide a comparison? What was it like, let's say, 10 years ago? And where do we stand now? To say that the environment 10 years ago versus today is very different, is likely the understatement of our discussion.

[00:06:37] But I would, to make it really simple, it's been about 10 years since the 403(b), excuse me, the 403(b) regulations have become final. So, 10 years or so ago, there was no need to have an oversight process in place for tax exempt organizations, hospitals, museums, colleges, and universities, etc.

[00:06:57] So from a practical standpoint, what that means [00:07:00] is high level, if you're a hospital or a higher-ed institution, really your role is a conduit to send money to service providers on behalf of participants. It is literally that simple. And in those instances, many institutions had several record-keepers to choose from.

[00:07:17] So that was the landscape 10 or 11 years ago. No oversight because there was no requirement to have any oversight. If you fast forward to today, and again, it's only been about 10 years and many of these programs have been in place for more than 50 years. The ERISA oversight requirement exists.

[00:07:36] So, plan sponsors in that short amount of time have had to create committees, have had to create and implement governance documents, committee charters, et cetera. Investment policy statements have had to go through fee reviews and record keeper analysis and investment menu design discussions and contract discussions. And 10 years sounds like a long time.

[00:07:58] But really, we remain in the early [00:08:00] innings of oversight for our tax-exempt organizations. So, there's a lot of work that has been done. And I would argue there's a lot more to do going forward. And along the way, at least for our clients, there's been tremendous amount of positive change to the retirement programs that we work on, really for the benefit of the participants in those plans.

[00:08:18] Vin, can you give an example of the type? Is it a hospital? A university? Did they have to form a committee? What, what does it look like now compared to what it looked like then? And what are some of the trends and things that they're focusing on? So that's a good question, Bob. So, I would say the short answer is, uh, yes, they had to form committees. And I'll focus on higher ed, colleges and universities, because I feel like that's where the change has been most impactful.

[00:08:43] So we're lucky enough to work with, call it 120, different higher-ed institutions, give or take. In most of those cases, when we started working with institutions, there was no committee in place. All they had was an auditor, because that was also a requirement of the new [00:09:00] regulations where you had to put forward and work through a benefit plan audit.

[00:09:04] So in many of those cases, our very first step was actually working with general counsel and HR and CFOs to create a committee to oversee the program. And in many cases, that program or that committee, excuse me, was comprised of both faculty and staff. So, the legacy of committee structure has stayed the same over the last decade or so, and early on, much of the work was in and around looking at the vendor structure.

[00:09:35] So once we have the fundamentals in place, again, documents and oversight committees and so on, one of the first exercises was to look at the vendor structure. And again, in many cases, higher ed had 2, 3, 4, 5, 10 vendors in place because remember really the goal was just to send money to service providers. So, you work through, request for proposal, and vendor structures, RFPs.

[00:09:59] Then you [00:10:00] get into investment menu design and fee structures and so on. Fast forward to today, some of the current items that are, I'm going to be somewhat liberal with the word current, because as I mentioned, this is still a relatively new effort, but today, I'll say post COVID, but in light of the global health pandemic that we've had, and the huge impact for a lot of our not-for-profits, top of mind for virtually all of our institutions is contribution schedule.

[00:10:27] So plan design. So probably no surprise that lots of our institutions had to either suspend or eliminate employer contributions during the pandemic. And hopefully, as we've made some progress and get closer to the end of the height of the pandemic, anyways, many of the same institutions have had to think about how they structure matches.

[00:10:48] For example, what the contribution schedules will look like going forward? Will we be able to maintain the legacy structures or will they have to be some modified contribution schedule going forward? [00:11:00] So a lot of it is around budgets and operations and so on. I think a couple of the other items that are somewhat ubiquitous and top of mind for our institutions are socially responsible investing or ESG.

[00:11:14] We have lots of clients today in the tax-exempt side asking about what their peer institutions are doing with ESG, how their plan compares to others, how we can help them select managers, determine value sets, et cetera. Just generally what the space looks like today, what we think it might look like going forward, and how that compares to history.

[00:11:36] A couple of the other things that are the top of mind for a lot of our committees are around target date funds. So, like in many settings, target date funds have garnered a material proportion of assets over the last 10 years, that's caused a lot of our clients to stress test their thinking around manager selection in this space.

[00:11:55] So if they're using active to compare that to passive, if they're using passive, compare [00:12:00] that to active, if they're using what we call an off the shelf glide path in product, how that might compare to custom products, et cetera. So now that we're kind of 10 years out from the regs and some of the decisions being made, we see a lot of stress testing around certain investment asset classes, some kicking of the tires on different products like managed accounts, retirement income.

[00:12:21] Certainly, there's some pending regulations that would make collective investment trusts to be available. So, as I mentioned upfront, a lot of work done, but a lot of things to consider going forward as well. So, Vin, you mentioned a couple of times, um, plan menu design, and the structure of record-keepers and that sort of thing.

[00:12:40] What are some best practices that you're seeing in the space? What do you advise your clients to be doing as it pertains to fund menu? You know, the active versus passive debate, the record keeper structure, all that sort of stuff? So, few things in, in that discussion, I would start with what we call open [00:13:00] architecture.

[00:13:00] So what that means is, historically, if a 403(b) plan worked with a certain vendor and that vendor had asset management capabilities, all the different options available to participants would be proprietary or offered via that particular firm. So, we've started with high level, utilizing flexibility and capabilities to offer non-proprietary funds and investment menu.

[00:13:26] So, said more simply, if you're with Fidelity, going forward, just don't use Fidelity investment options or TIAA with on the TIAA platform and so on, to start to work with our manager research group to identify good managers in different asset classes, to diversify for participants, diversify for organizations, to reduce entity risk.

[00:13:47] So starting there, to simplifying menus use. In many cases, we've walked into situations, where, with no exaggeration, there are literally 2, 3, 4, 500 investment options available for participants. [00:14:00] Obviously with a set that large, there's lots of asset class overlap. There's lots of funds that are not competitive, at least historically, et cetera.

[00:14:08] So to streamline and simplify investment menus, to make sure that we have a tier of low-cost index funds available. So, I would say, in short more efficiently, utilizing the investment platform flexibility, which has not always been available, making sure we have a reasonable number of asset classes, a diverse set of managers and a tier of low-cost index funds for folks.

[00:14:31] And Vin, you talked about ESG and frankly, it's a topic that comes up on most episodes. Can you share with listeners really how we're helping clients assess that and then maybe even more so, what are you actually seeing in terms of ESG and its adaptation and, and use in 403(b) plan? Sure. So, I, my perspective is perhaps unlike the corporate side, ESG has a somewhat of a long history on the tax [00:15:00] exempt side.

[00:15:00] And I would say the vast majority of our clients at least have, and have had for some time, one or more, at least one ESG option in their retirement plan. So, there is somewhat of a heritage on the tax-exempt side to offer these types of options. But as to your point, Bob, the discussion has become more prominent.

[00:15:22] We do have many committee members thinking about, do we want to offer a full tier of socially investment options within the program? And in most cases, what's in place today is a balanced fund, call it an old school 60/40, 60 equity, 40 fixed income option for folks that has to be ESG. And candidly, until recently, it's been a little bit of a set it and forget it.

[00:15:46] Yes, we have an option in place, but again, in light of the environment, some are exploring, building out tiers, and we've done that for a handful of our clients. And by tiers, I mean expanding the opportunity set, having [00:16:00] dedicated fixed income, dedicated domestic equity, dedicated international equity, et cetera, to allow participants who want to be ESG with all of their assets in the plan to have a little bit more flexibility on the asset allocation.

[00:16:14] We have a handful of schools, like I'd say who built that out over time. And a little bit to my surprise, candidly, there's been pretty fair utilization. So, 10, 15, 20% of contribution flows that is now starting to guard some assets. So, we have helped, in these cases, identify managers, talk through what value sets they're looking to invest for.

[00:16:38] So the short answer is we help clients, one, on one side of the equation. Think about what is it that you're trying to accomplish through adding ESG? Are there certain issues that are important to your plan and to your plan participants, whether it's climate or some other item, right through manager selection and monitoring?

[00:16:56] The one unique item or [00:17:00] maybe at least somewhat unique item for defined contribution plans unlike endowment and foundation is it's an ERISA pool, which comes with a whole another set of complexity and nuance. There's been some back and forth from the regulators around how plan sponsors need to think about ESG or just investment selection in general.

[00:17:20] And again, we have to make sure we're picking options that can stand up on their own in terms of investment merit, and so, definitely, as a firm, as a plan sponsor, we cannot have a different set of monitoring and selection criteria for ESG than non-ESG in this setting. So, Vin, you made mention of, um, how we add value in terms of fee analysis, fee negotiation, reducing costs, can you talk a little bit more about that?

[00:17:50] What kind of work do we do in this space? What trends are we seeing? How are we helping our clients lower some of their overall costs? And also, what are [00:18:00] trends in terms of let's say fee-levelization, that sort of thing? What are some, some cost-related trends in, in this space?

[00:18:10] The fee evaluation process has gotten incredibly complex over the past five or six years due to litigation, due to improve technology from the record keepers, et cetera. It wasn't that long ago where the main charge of a plan sponsor was to understand what the fees are, associated with their program, and then determine if they're reasonable. Over time, that's evolved to really making affirmative elections around once you determine the fees are reasonable, how you want to structure them?

[00:18:42] And this comes with some of the, as a result of, excuse me, some of the litigation, as some of the long side, as some of the improvements in technology. And by that, I mean, how do you want to allocate record-keeping fees to participants?

[00:18:56] Do you want to do it on an asset-based model? Do [00:19:00] you want to do it on a per participant model? Do you want to use revenue sharing to offset fees, et cetera? So, there are a bunch of other decisions around fee structures that are still relatively new for plan sponsors. And I would say don't shoot the messenger.

[00:19:16] I'm just the messenger here. The trend has been towards per participant pricing. And the reason for that is meaning every participant, at least mathematically, has a fee assigned with him or her to be a participant in the plan. And the reason for that is largely anyways, not to allow total administrative fees to increase as plans have grown, and to be fair, they have grown over the last decade or so mostly because of capital markets, and then to move away from revenue sharing.

[00:19:48] So the trends have been to fix the fee per participant level and to use low-cost institutional investments without revenue sharing, to lower total investment fees for participants. [00:20:00] The other piece that Devon mentioned around fee-leveling and indulge me and allow me to translate what that means is every participant in the plan is charged a consistent fee to offset record keeping costs.

[00:20:13] So, whether it's a hundred dollars ahead or 10 basis points or, or what have you, what that does is, again, create consistency or fairness, as well as transparency for participants. And the, the great debate, I think, most agree that all participants and programs should share in the costs.

[00:20:31] There are, I guess, what I would call spirited debates amongst our different committees on the best method to do that, whether that be asset-based or percentage of assets or per participant, that piece is, is philosophical. But clearly, the trend has been away from asset based to per participant. Vin, you mentioned litigation and there's been a lot of litigation in this space.

[00:20:51] And I actually had one attorney talk about the space as being under-litigated and that that's a bit frightening in and of itself, [00:21:00] but, uh, what else do you want to mention on that front? Maybe any case development that you'd like to share with our listeners? So, as Bob mentioned, litigation is a little scary for me to hear because there has been what I think to be a ton of litigation in this space.

[00:21:15] And I'll focus on obviously 403(b) in college and university and healthcare et cetera. Back in 2016, if my memory serves correct, over a 10-day window, a relatively well-known firm issued 12 lawsuits against some of the biggest universities in the country. And now, three, four or five years removed from that, reading through the documentation, reading through the summaries, I suppose this is the part where I should mention I'm not an attorney, but have spent the time going through all the documents and settlements and so on.

[00:21:51] In my simple mind, in one way, shape or form, much of the claims or many of the claims, excuse me, have been focused on [00:22:00] excessive fees. And the plaintiff's attorneys have gotten there a few different ways, starting with multiple record keepers. If university X is using 5, 6, 7 record-keepers, obviously, according to the plaintiff's attorney, they're not creating efficiencies and economies of scales, at least not at the level they could be, to reduce fees for participants.

[00:22:21] Others are saying university X used asset-based pricing and plans have grown, and again, participants are paying more than they should have for the plan. Another avenue is share class utilization, using more expensive versions of funds, again, to the detriment of participants, not doing RFPs, et cetera.

[00:22:40] So while not all of the claims are fee focused, a good majority of them in my mind are. There's other stuff around liquidity with certain products and poor performance and so on. But most of it is on the fee side. And, you know, I wish I had a really exciting answer as to how you can mitigate that risk, but I think what we can all [00:23:00] agree on, the best way for a sponsor to mitigate that risk is around, uh, the good process.

[00:23:04] So for better or worse, there is a process-driven effort or oversight as a process-driven effort. And from, again, my simple vantage point, the best way to create good outcomes and good competitive programs for participants and protection for institutions is to have a comprehensive process that's well-documented and consistent and diligent over time.

[00:23:26] That's really the only way to, again, create good outcomes for your participants and protection for your organization. So, Vin, let's maybe shift focus a little bit and talk about some best practices in terms of governance. And, you know, you did mention, uh, having a strong governance process as providing protection.

[00:23:44] What are some of the principles of good governance that non-profit organizations should be practicing, specifically as it pertains to their 403(b) plans? So, I think high level, I would fall back on the items I just mentioned around having an approach that is [00:24:00] comprehensive and well-documented and consistent.

[00:24:02] I think those are the key fundamental items. But if you drill down that drill down on that a little bit further, our approach is around a calendar. So, what we do each year is we develop a system. Or over the course of that year, we'll ensure that our committees review all their most relevant items associated with their plan. Fees, investment menu design, a review of the qualified default investment alternatives, a review of participant outcomes, a review of their service provider, uh, look at their fiduciary insurance and bonding and all the elements there.

[00:24:37] In addition to that, to provide education through podcasts like this and client conference and research papers, et cetera. That way we can help our clients be good, educated citizens of their retirement program. Vin, this has been incredibly helpful. Is there anything else that we haven't addressed that you'd like to share with listeners in this space?

[00:24:57] I think the one thing that always comes to mind, we're in new [00:25:00] business meetings and client meetings, is that 403(b) within the defined contribution landscape is very different than the other markets that we serve and other markets that are out there. So, I always tell committee members and prospective clients to make sure that you're working with a firm that understands 403(b), understands the participant profile and uniqueness and the vendors that play in this space, because it is a different world with a different language.

[00:25:26] Uh, and there's no substitute for experience in this space. That's great. So, before we close out, Vin, let's get to know a little bit more about you on a personal note. What is your idea of the perfect Saturday? Well, that is both a fun and cruel thought exercise as I have a four-year-old, but I would like to say I'm relatively simple.

[00:25:48] There are many that live in my house that would disagree, but I would say strong coffee or good coffee on a Saturday morning. I am a little embarrassed to admit I have a little coffee station in my kitchen with a couple of [00:26:00] different options from espresso to other ways to caffeinate myself, to get things going.

[00:26:05] Maybe from there, I can jump on my bike. I'm fortunate enough to live in Providence, Rhode Island, near the east bay bike path that I can get 40 miles along Narraganset Bay, which is a nice treat for me. And if my family's gone, I can, I can then sit on my porch with a John Irving book. That's a good Saturday, but, uh, thank you, Devon, for letting me fantasize a bit about a quiet Saturday.

[00:26:26] I haven't had one of those in a while. They usually involve cooking pancakes and going to swim lessons and whatever else the universe has in store for me that day. Perfect. Well, thank you so much for joining us today. You've provided so many great insights. If listeners want to learn more or perhaps access resources, where should they go?

[00:26:43] I would first direct them to our website fiducientadvisors.com. I'm happy to share my personal email as well. We have a nice section on our website to plug that around the work we do in this space. And I'll share my email is, VSmith@fiducient.com. Anybody is more than welcome [00:27:00] to reach out to me directly as well.

[00:27:01] Well, thanks, Vin. We're so appreciative of your time and your expertise. So, thanks so much for joining us. Vin, thanks. This was absolutely terrific. Thanks for joining us. Great insights, and we're so appreciative of your time and the expertise. And, and we want to thank our listeners as well. Vin provided a ton of valuable information.

[00:27:21] And as he said, there's a lot to be found on our website in the retirement plan section. So, to all you good stewards, thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards podcast.

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