



Memorandum

To: Zachary A. Hanna, CFA, Chief Investment Officer
Bob Williams, Board Chair

From: Steven J. Center, CFA, Senior Vice President
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Subject: Best Practices for a Recordkeeper Search

Callan has been asked to provide input regarding what we believe to be best practices when conducting a search for a potential recordkeeper for a defined contribution plan. The goal of such a project is to ultimately identify a firm that can provide a high-quality experience for the plan participants while also providing ongoing responsiveness to the needs of the Department of Retirement and Benefits (“DRB”) at a reasonable/competitive price point. When Callan conducts service provider searches like the one being undertaken by DRB, we would focus on the unique characteristics of the multiple participant-directed plans sponsored by the state of Alaska including the current investment menu and additional services offered to participants by the recordkeeper (such as education, investment advice, or managed accounts). Below are some key items we would recommend when conducting a recordkeeper search.

Establish a Timeline Early: A thorough recordkeeper search involves multiple steps and can take many months to complete. We recommend working backward from a potential conversion date, identifying milestones and deliverable dates based upon inputs from responsible parties. The goal is to keep the project on-track from the outset.

Cast a Wide Net: While consolidation has heavily impacted the recordkeeper space over the last few years, and the list of firms with the capability to properly service a larger public defined contribution plan like the one overseen by ARMB has shrunk, we would strongly recommend sending an RFP to the larger recordkeepers. This list will likely include Empower, Alight, Voya, and Nationwide. It is essential to be certain how many payroll feeds and formats need to be accommodated by the recordkeeper in question, as very few providers have the capability to service statewide plans—such plans more commonly resemble the features of a multi-employer plan.

Provide as Much Detail as Possible: In order to obtain detailed, accurate pricing proposals from potential recordkeepers, be prepared to provide as much detail about the defined contribution plans as possible. This should include plan documents, summary plan descriptions (if applicable), participant volumes and transaction activity, mail vs. electronic delivery volumes, and participant location data. Additionally, a description of any unique features, custom processes, or complexities should be included in the RFP. These should also include the details of any payroll feed formats accommodated, specific legislation or statutes to which a plan provider is subject within the state of Alaska, and any preexisting agreements that should not be abrogated with respect to an external fund custodian. Notably, Empower’s common service structure requires that cash custody and payment services must be serviced by Empower, which therefore will require thoughtful description of the scope

with respect to custody, as asset/securities custody is different from cash custody, and only one of these is typically flexible for Empower, while they are flexible for competing providers.

Given Alaska's struggles with monitoring managed account services, and the existing decision to close them, pricing quotes that do not clearly specify that managed accounts are explicitly out of scope will result in pricing that is materially lower than pricing without managed accounts, and lack of specificity in this regard can serve to cause immense and damaging confusion to the process. No two plans are the same, so providing as much information to the potential candidates as possible is very important. The goal will be to obtain sufficient information to review the state of the current plan, the quality of each respondent, and the potential impact to participants. Additionally, should managed accounts be included within the scope of the RFP, it is essential to understand that not all providers that service this marketplace are equally capable of offering the same service as Empower offers. Further, the asset allocation methodologies of the common providers are materially distinct from one another. As a result, acceptance of a bid that incorporates managed account services with a provider other than Morningstar, even for a time, would result potentially in the participants within those services being mapped to wholly different portfolios, with different inputs to the service (as these customizations do not transfer), and different fees. Careful scenario testing and planning for implementation in this regard (if such a bid is to be entertained, which in Callan's opinion, it should not) would be essential to avoiding an extremely undesirable outcome.

Review and Score RFP Responses: Callan recommends the RFP responses be compiled in a manner that facilitates easy comparison and scoring in a side-by-side format. There are numerous ways to analyze potential recordkeepers, and we recommend dividing responses up into similar categories (e.g., organizational structure/ownership, client base, service offerings, call center/web site functionality, investment platform, and pricing, as examples). These responses should be scored based upon a weighting scheme that favors factors that are the most important to ARMB.

Callan recommends a thorough review of the direct revenue to be paid to the recordkeeper. This should be broken down into recurring plan administrative fees, communication and education expenses (including printing and postage fees), and event-based transaction fees. Additionally, indirect revenue should also be reviewed. This may include revenue from managed accounts, small dollar cash-out services, or float income generated by the plan.

A Special Note Regarding Managed Accounts: The historical utilization of managed accounts within the defined contribution plans has likely resulted in reduced per-participant fees from the state's current provider versus what one would expect to pay for recordkeeper services without a managed account product. The review committee should be prepared for the possibility of per-participant fee proposals that differ dramatically from what the state is currently paying, assuming the new provider does not propose a managed account service.

Conduct Finalist Interviews/On-Site Visits: Once responses have been scored and finalists have been selected, Callan suggests checking references as a method of differentiating finalists. When checking references, it is important to have both a base set of questions and specific questions related to any issues or concerns raised by the RFP responses. After reference checks, Callan strongly recommends conducting finalist presentations and on-site visits as a way to interact with both senior management and day-to-day service provider contacts face-to-face.



Final Thoughts: Recordkeeper searches, and potential replacement activity, can be daunting. If a replacement is ultimately selected, the conversion process can be time consuming and costly. As such, we recommend a comprehensive review process that confirms the best decision for the participants, DRB, and ARMB is ultimately reached.