What’s in a Name?

“That which we call a rose by any other name would smell as sweet.”

Much like the name “Montague” in Romeo and Juliet, names can be problematic in defined contribution (DC) plans. Plan options with names such as Odyssey Aggressive Growth Fund and International Intrinsic Opportunity Allocation Fund can confuse participants—and even plan sponsors—regarding the purpose of the fund. In contrast, the investment industry has adopted simplified names for target date funds, typically consisting of the series name and the target retirement date. Such simplified names help participants and plan sponsors focus on the objective of those funds: To serve as a single-decision investment for those participants who intend to retire around the given date.

Many fund options in a DC lineup do not have the same link between the name and the objective…but what if they did? That link can be created by using “white-label” funds, where the fund’s name is determined by the plan sponsor based on the fund’s objective, as opposed to the use of branded mutual funds.

This paper provides plan sponsors with a blueprint to design and implement a plan lineup consisting of white-label funds. White-label funds:

- Enhance how investment options are communicated, helping participants more readily differentiate the key aspects of each investment option.
- Enable more sophisticated portfolio construction to occur behind-the-scenes, which benefits plan participants without requiring them to become experts in portfolio construction.
- Allow sponsors to drive scalability and develop structure that can lower costs and leverage the plan lineup.

Much like the benefit of target date funds, the meaningful benefit of white-label funds is the power of the underlying components. White-label funds can be more effective for participants by incorporating investment options that work well in a portfolio context as a consolidated option in order to create simpler decisions for participants.

What Are White-Label Funds?

White-label funds are generically named funds that have no reference to a fund company. Instead, they are branded by their asset class or objective. They can be constructed as either a single investment strategy, or as a portfolio of multiple underlying investment vehicles structured to the fund’s objective related to any asset class, asset style, market capitalization, or geographic region. The approach is not new, as some plans have used it for decades, but interest in the approach has greatly increased in recent

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1 Additionally, section 35(d) of the Investment Company Act requires that a registered investment company invest at least 80% of its assets in the type of investment suggested by its name.
years. Today, technology advancements have made it easier to incorporate white-label funds within plans, and approximately one-in-four plans currently utilize some form of white-label funds².

White-label funds can be organized in different ways to satisfy plan sponsors’ goals and participants’ needs. The components of these funds often utilize a plan’s existing investment options, which may be supplemented as needed with other offerings to complete the portfolios that the sponsor is trying to construct.

As shown in Exhibit 1, two primary structures exist for white-label funds when multiple sub-advisors are employed. One approach is an asset class structure, which provides options with exposure to broad categories, such as U.S. equity, non-U.S. equity, fixed income, inflation protection, and cash. Alternatively, a plan sponsor could construct a white-label fund lineup using an objective structure that clearly identifies the role each investment option would play in an overall portfolio. Such an approach may contain a growth option, income option, capital preservation option, and inflation-protection option. In either case, the communication to participants switches from brand name to a focus on the purpose of the fund. This is consistent with the naming approach of target date funds.

Exhibit 1 – Evolution of Lineup Structures

² According to a 2014 Aon Hewitt Pulse Survey.
White-Label Funds: The Benefits

Simplified decision framework for participants

The most common structures of DC plans include many investment choices, with the average plan offering 25 funds (excluding target date and other premixed portfolios, the average is 15 funds\(^3\)). Participants often have to choose between value and growth within large-cap equity, mid-cap equity, and small-cap equity options. In addition, index fund options are also typically offered. These choices can be overwhelming for many plan participants.

Decisions are further complicated by names that reference the asset manager instead of the fund’s strategy or objective. White-label funds can be utilized to make it easier for participants to understand their options and thus make better choices. Exhibit 2 provides examples of a basic white-label approach, where a single investment fund is used in each category:

**Exhibit 2 —Single Managers per Plan Option**

<table>
<thead>
<tr>
<th>Traditional Approach—Branded Funds</th>
<th>White-Label Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Debt Index Non-Lendable, Collective Investment Trust</td>
<td>U.S. Bond Index</td>
</tr>
<tr>
<td>Institutional Index, Plus Shares</td>
<td>U.S. Stock Index</td>
</tr>
<tr>
<td>EuroPacific Growth Fund, R6</td>
<td>International Equity</td>
</tr>
</tbody>
</table>

A more comprehensive and powerful approach to white-label funds entails the use of multiple investment managers within a single plan option. Sometimes referred to as a “fund-of-fund” approach, this strategy allows plans to utilize multiple complementary investment strategies that are combined into a single easy-to-understand plan option for participants.

**Exhibit 3—Multiple Managers per Plan Option**

White-label funds that utilize a fund-of-fund approach can employ a range of investment vehicles, from typical mutual funds to institutional investment options, depending upon the requirements of the plan.

Further, if there is ever a need to replace a given manager, it can be done more quickly and easily as compared to situations where a single manager is used for a fund.

\(^3\) 2013 Aon Hewitt Trends & Experience in DC Plans
Better diversification

Most DC plans have avoided niche investment strategies and approaches that tend to be inappropriate as single investment options for a majority of DC participants, such as commodities and emerging market debt options. A white-label fund can widen the universe of investment options by adding these as “sleeves” within the fund so they can be included with less potential for participants to misuse them. This opens up a range of investments that can better diversify portfolios.

Additionally, white-label funds can be structured to incorporate allocations to diversifying and less-liquid investment options, such as private real estate and hedge funds, while utilizing other components to maintain the liquidity required for daily participant transfers. Such asset classes historically have been out of reach of DC plans because of structural constraints.

Improved active management

White-label funds can improve active management by incorporating high-conviction managers that take too much active risk to be suitable standalone options for participants, but could be effectively paired with other active or passive managers. Using high-conviction investment managers has the potential to deliver more alpha (i.e., better performance). Research has demonstrated that equity managers who take more active risk are more likely to perform well—a conclusion that makes intuitive sense because differences from a benchmark are needed for outperformance⁴.

White-label funds also are more likely to involve more disciplined approaches to portfolio rebalancing. Even where participants initiate diversified portfolios, they will tend to let outperforming fund styles “run” and fail to rebalance (or even fail to terminate) fund styles that underperform. Rebalancing is more likely to be disciplined and effective within a white-label fund.

Potential for cost reduction

Designing a white-label fund can create cost-saving opportunities. Specifically, larger pools of assets could open up options—including institutional vehicles such as commingled trusts and separate accounts—that go beyond using mutual funds as the underlying investment vehicle. Such vehicles typically have higher investment minimums than mutual funds, allowing them to offer lower fees. Usually commingled trusts and separate accounts have sliding fee schedules, so participants benefit from lower fees as assets rise.

Creating a white-label fund with multiple managers engenders certain fixed costs such as calculating a daily net asset value or developing a portfolio structure, so these options are generally more attractive above certain fund asset thresholds. Depending upon the managers employed and the overall desired structure, a given fund-of-funds white-label option may need to have $50 million in assets for it to be worthwhile to use commingled funds and separate accounts. However, white-label funds can be constructed at much lower levels through the use of mutual funds. The costs involved with white-label creation may be mitigated by better investment performance or lower underlying component fund expenses.

White-Label Funds: The Role of the Fiduciary

When a fiduciary decides to pursue white-label funds with multiple underlying managers, the investment policy should clearly define:

- the structure to organize the funds,
- the selection and evaluation process of the underlying managers, and
- the rebalancing rules.

These decisions are very similar to those typically made by plan sponsors for defined benefit (DB) plans. The initial decision made when constructing a white-label fund is determining the fund’s objective in the DC plan structure.

Exhibit 1 highlighted three primary DC structures that are observed in DC plans: 1) asset style; 2) asset class; and 3) objectives. Although plans typically use some version of the asset style structure today, many fiduciaries are considering or are actively transitioning to asset class, objectives, or hybrid structures. White-label funds are being used to facilitate the transition to these evolved structures.

In constructing a white-label fund approach, a fiduciary will need to address three primary decisions:

**Number and type of underlying investment managers.** A white-label fund may consist of a single underlying fund. However, it will often combine multiple strategies. There are a few things to consider when determining the number of strategies to include, ranging from the pragmatic—(e.g., the overall size of the fund and how that relates to investment minimums for the underlying vehicles)—to the theoretical, such as the active share and risk profile of the constituent investments.

**Active versus passive strategies.** A white-label fund can leverage the benefits of both active and passive strategies. A passive component may allow a vehicle to maintain market exposure and inexpensively manage cash flows in and out of the fund. The active components of a white-label fund, intended to deliver alpha, can be disrupted less—enabling the time needed for longer-term investment ideas to generate excess returns. Such hybrid (active/passive) structures may also facilitate the use of higher value-added potential strategies, which commonly have high tracking error that would not be considered appropriate on a stand-alone basis.

The desired tracking error also factors into the active/passive allocation. Generally, clients desiring lower tracking error will target higher allocations to the passive allocation.

**Investment policies.** The administration of white-label funds with multiple managers entails certain investment policies, established by the fiduciary. One such policy is how cash flows will be handled. A potential approach is to direct the white-label fund administrator to use net flows to “true up” the asset allocation to targets. For example, a net inflow would be directed first to the underlying component that is underweight of its target allocation by the widest margin, and a net outflow would be taken first from the segment that is overweight of its target allocation by the widest margin. Such a rule helps keep the overall fund as close as possible to target allocations, while minimizing trading.
Rebalancing can also act as an important discipline. A fiduciary could consider setting an allocation range relative to the target allocations that allows the portfolio’s allocation to undergo minor shifts due to market performance without necessitating a need to rebalance. These issues are very similar to those involved in developing rebalancing strategies for defined benefit plans.

**White-Label Fund Considerations**

The potential benefits of white-label funds’ make them worthwhile alternatives to “branded” funds. However, plan sponsors should weigh several considerations before implementing white-label funds.

The costs of white-label funds must be evaluated on a case-by-case basis. Costs include any fees to develop the fund structure, as well as the recordkeeper’s and trustee’s fees for fund administration. In addition, there are fixed costs for creating, monitoring, and maintaining each white-label fund (typically reimbursable by the fund).

White-label funds may pay for themselves through the ability to replace underlying funds with minimal costs, improved investment performance, and/or lower underlying investment management fees. For example, a white-label fund that incorporates a passive sleeve or utilizes a vehicle such as a collective trust or separate account may entail lower combined investment management fees than similar assets invested with more expensive actively managed products or higher share class mutual funds.

Another consideration is participant-level communications. While some leading administrative organizations can readily support a white-label approach, others may need supplemental assistance that may then incur additional communications expenses.

Additional considerations are described in the chart below:

<table>
<thead>
<tr>
<th>Issue</th>
<th>Concern</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Options Reduced</td>
<td>Some participants want more granular options</td>
<td>Only applies to a small minority of participants; needs can be addressed with a self-directed brokerage window</td>
</tr>
<tr>
<td>No Ticker Symbol</td>
<td>Pricing can’t be viewed by financial sites/papers</td>
<td>Technology has allowed for pricing to be seen across platforms (e.g., phone and computer)</td>
</tr>
<tr>
<td>Short Historical Performance</td>
<td>Participants can’t make informed decisions</td>
<td>Historical pro forma composite performance can be shown with footnote, if needed</td>
</tr>
<tr>
<td>Challenging Communication</td>
<td>Participants won’t understand components</td>
<td>Report components similar to target date fund communications Focus participants on asset class rather than constituent components</td>
</tr>
<tr>
<td>Portfolio Design Complexity</td>
<td>Plan sponsors concerned with construction and development</td>
<td>Consider utilizing a firm with expertise in designing white-label funds</td>
</tr>
</tbody>
</table>
Implementation

Implementation of white-label funds requires a partnership among these entities:

- **Trustee.** Determines the net asset value, or price, of the white-label fund and executes cash flow and rebalancing.
- **Recordkeeper.** Communicates information including values, performance, and disclosures to participants.
- **Plan sponsor.** Determines the white-label framework (usually by committee).
- **Investment consultant.** Advises on the white-label framework and serves as project lead. They can have fiduciary responsibility for white-label decisions.
- **Investment managers.** Manage underlying portfolios and provide portfolio holdings and characteristics.

In addition to the involved parties, other aspects should be determined by the fiduciary:

- **Benchmark.** The appropriate benchmark for a white-label fund should be determined by its objective, be measurable, and characterize the investable universe appropriate to that fund.
- **Plan size.** A large DC plan (e.g., assets of more than $600 million) may choose to build white-label funds from existing funds, incorporating additional strategies as needed to accomplish the fund objective. Smaller DC plans can still incorporate white-label funds or leverage pooled funds available through a delegated relationship with the investment consultant.
- **Disclosure.** A prospectus is not needed, but fact sheets and fee disclosures can be produced for white-label funds, or underlying funds can be profiled.
- **Monitoring and reporting.** Occurs for both white-label funds and underlying funds.

Conclusion

The ultimate objective of white-label funds is to improve investment outcomes for participants. This is accomplished by simplifying the decision framework, diversifying the asset allocation, improving active management, and potentially reducing costs. Communication is key to leveraging the benefits of white-label funds and should be done with participant notices outlining the objective and structure of the fund.

Each white-label fund can be constructed and managed by a fiduciary or an investment consultant in a manner similar to DB plans. The creation of white-label funds is flexible, so white-label funds can be constructed to optimize their intended objective while maintaining the simplicity of a streamlined lineup for participants. Additionally, a simple white-label name of a “branded” fund can improve the usage and structure of a plan lineup.

While still a new concept to some in the industry, the white-label approach has a proven track record with a sizable number of plans. By adopting this approach, sponsors better optimize the DC plan design which allows participants to more effectively utilize the plan, and thus increases their odds of achieving retirement security.
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