



Managed Accounts Menu Considerations

Fairfax County Public Schools

October 2023

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Today's Discussion

Part 1

Background

- Education and overview on managed accounts
- New Menu's impact on Morningstar service and resulting disruption

Part 2

Decision Points

- What if anything should the Committee do in response?

Part 3

Passive Suite

- BlackRock vs. Vanguard

Part 1

Background

AON



Introduction to Managed Accounts

Managed Account Review Objective

- Benefits & Considerations
- Landscape
- Plan Level Evaluation

Fiduciary Responsibility

- Similar to any other option in the plan, the committee is responsible for monitoring the discretionary manager currently offered or considered to be offered

Managed Accounts Definitions

- Managed Accounts (MA) is a **discretionary portfolio management** service that makes personalized investment decisions for a participant using the options within the plan

Spectrum of Participant Options

- Do-It-Yourself (DIY) — participant driven portfolio design
- Target date funds (TDFs) — most commonly the plans' QDIA
- Advice - point-in-time portfolio review & recommendation at little to no cost
- Managed accounts (MA) — ongoing asset allocation using the core lineup for a fee
- External Wealth Management - Seek advice outside of the plan

Managed Accounts

- Handle investment decisions
- Make portfolio changes
- Rebalance the portfolio
- Recommend deferral rates

Key Benefits and Considerations of Managed Accounts

	Benefits	Considerations
Plan	Provider takes on role of discretionary investment manager over an enrolled participant's portfolio. 57% of plans offer MA ¹ 7% of participants typically enroll ²	Plan sponsor has fiduciary responsibility for oversight and monitoring of the MA provider as a discretionary investment manager, including monitoring and evaluating the investment methodology, fees, value derived, participant utilization, etc.
Engagement	Communication is frequent, generally to both enrolled participants and to broader plan Additional tools available, though usage is low	Communication strategies to non-enrolled participants typically focus on soliciting enrollment rather than true engagement Claims of value outside portfolio management have issues ³
Portfolios	Goal is to reflect unique circumstances based on data entered by the participant	Not all data entered will meaningfully affect asset allocation, and some data may only be used for forecasting/projection purposes Most participants are expected to receive a TDF-like experience ³
	Underlying funds used by the MA are already selected and monitored by the Committee.	Many MA providers build simple portfolios with less diversification than even the most "vanilla" TDFs
Personalization	Personalizations can help craft an asset allocation based on a participant's unique financial situation that will help them achieve a more appropriate risk adjusted return as they approach retirement	Currently, the responsibility for providing personalization data lies solely with the participants. There is no industry standard incentive for MA providers to get more of this all-important personalization data from the participant
Fees	Fees may be less than those of an outside retail advisor, though providers are increasingly focusing on out-of-plan advisor services	"All-in" fee: 1) MA provider fee + 2) fees of the underlying funds used Portfolios are often meaningfully more expensive and less diversified than other in-plan asset allocation options
	May be incorporated into recordkeeping infrastructure, facilitating a consistent participant experience consistent	Recordkeepers often receive a significant portion of fees charged. In many cases, this fee is not disclosed and can be difficult for a plan sponsor to evaluate the value provided for the fees paid ^{4, 5}
Outcomes	Participants using MAs or TDFs have consistently better performance than non-users ⁶	Participant engagement is often lacking and may erode value ³ TDFs outperformed MA in median, upside, and downside cases ^{3, 6}

¹ PSCA's Annual Survey of Profit Sharing and 401(k) Plans. Data is for plans with 5,000+ participants; ² Vanguard's How America Saves.; ³ Aon. Are Managed Accounts More Efficient Than Target Date Funds? 2020.; ⁴ Aon. Unfolding the Managed Accounts Fee Enigma. 2019; ⁵ Aon. Can You Truly Evaluate Managed Accounts Through Marketing's Rose-Colored Glasses? 2019; ⁶ Alight Solutions. 2018 PROFESSIONAL INVESTMENT ASSISTANCE REPORT: The impact of managed accounts and target date funds in defined contribution plans 2007–2016

Managed Accounts Factors

Factors that may be used to determine asset allocation

Target Date Funds

Age

Risk Tolerance (Plan)

Managed Accounts

Age

Gender/ Longevity

Planned Age to Retire

Calculated Risk Tolerance

Participant Selected Risk Tolerance

Salary

Account Balance

Outside Assets/Pension Composition

Savings Rate

Outside Assets/ Pension Amount

Social Security Impact

Factors Legend
 Time Horizon
 Risk Tolerance
 Financial Situation

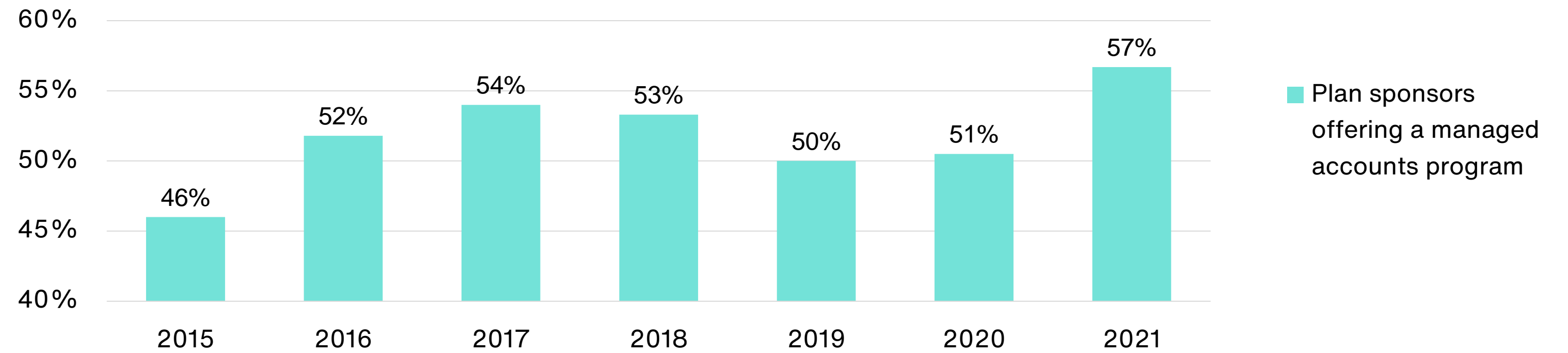
- Managed accounts providers may take a wide range of variables into consideration when determining asset allocation
 - Use, treatment, and significance of each factor's impact varies among providers
 - All factors are not used by all providers to set risk level, and some factors may only be used for forecasting
- Time horizon and risk tolerance are primary drivers of asset allocation for both TDFs and MAs

Managed Accounts Prevalence

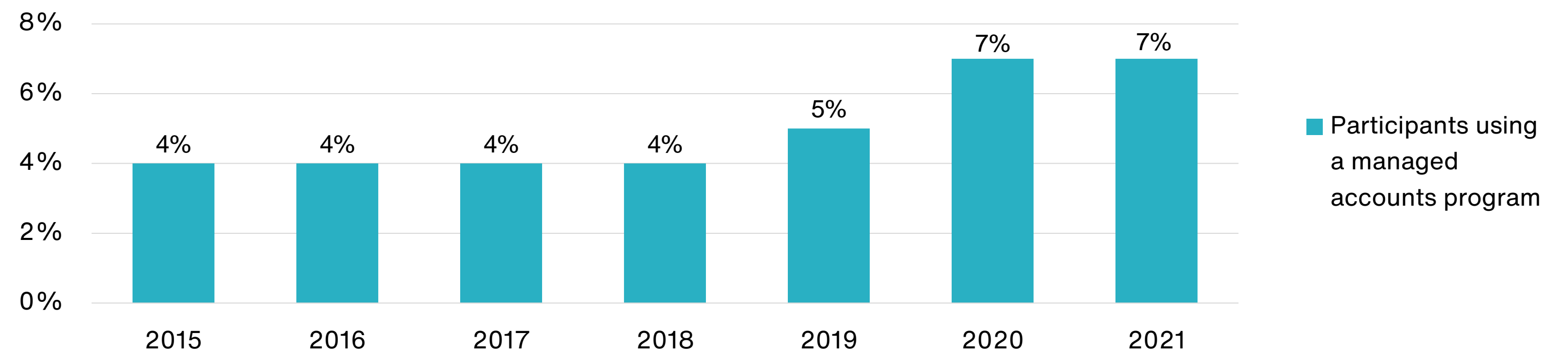


Though adoption of managed accounts is prevalent, usage by participants remains low

Plan Sponsor Adoption¹ of Professional Management



Participant Utilization of Professional Management

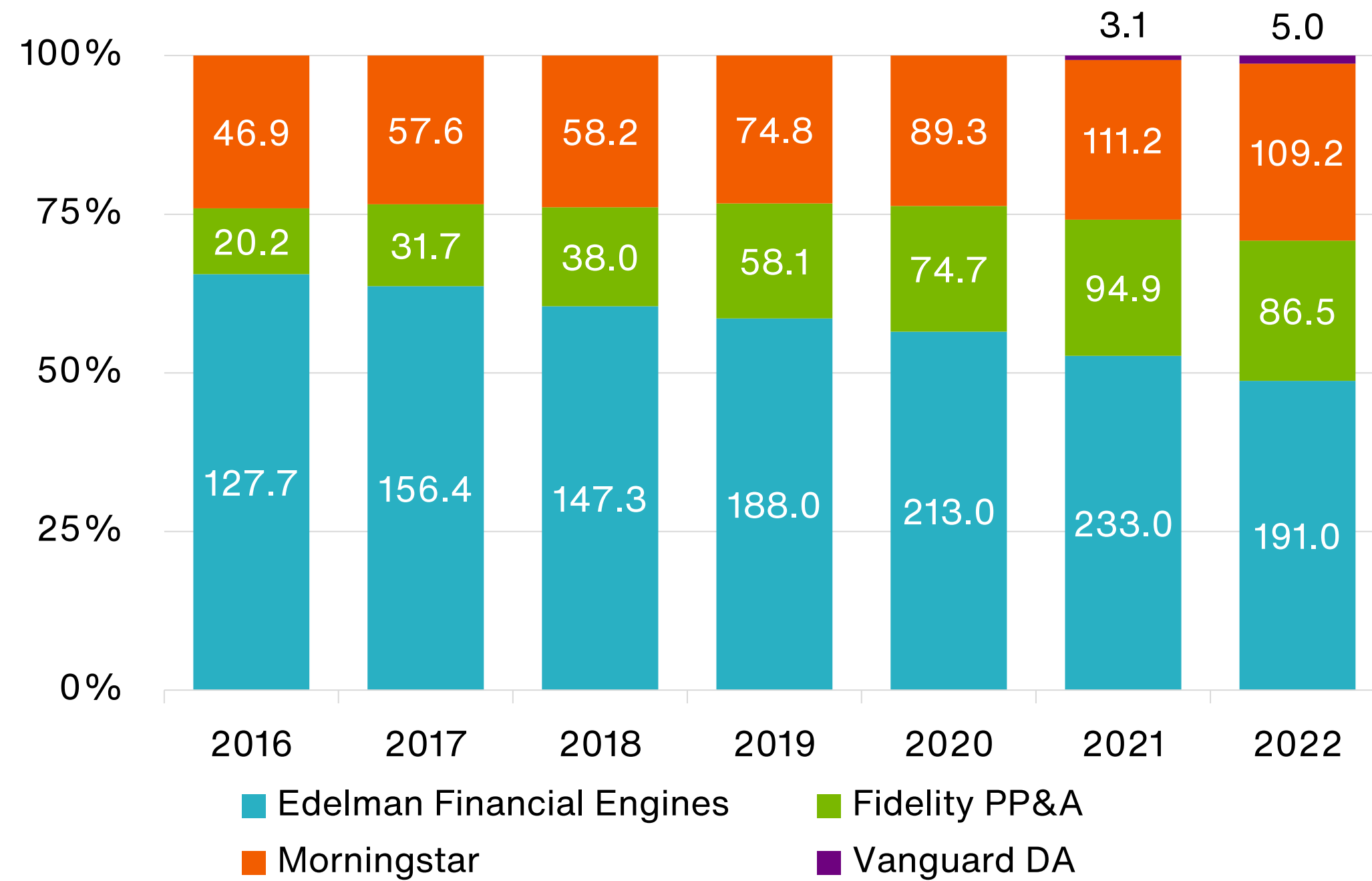


¹ Source: PSCA's Annual Survey of Profit Sharing and 401(k) Plans. Data shown is for plans with 5,000+ participants

² Source: Vanguard's How America Saves.

Managed Account Providers

Managed Account AUM¹



Top 3 Providers Represent **91%** of Total Market²

Managed Account Distributor / Recordkeeper

	Proprietary Engines	
	Fidelity	Vanguard
	Third-Party Engines	
	Edelman Financial Engines	Morningstar
Alight Solutions	✓	✓*
Bank of America		✓
Charles Schwab	✓	✓
Conduent	✓	
Empower	✓	✓
Fidelity	✓ (also offers proprietary)	
Principal	✓	✓
T. Rowe Price	✓	✓
TIAA		-
Transamerica	✓**	✓
Vanguard	✓ (also offers proprietary)	
Voya	✓	✓

* Limited offering and requires a client-by-client conversation with the recordkeeper if its available going forward.

** Transamerica exposure to Edelman Financial Engines is only through acquired legacy recordkeeping clients from another provider.

¹ Prior to 2018, the AUM provided is from The Cerulli Report U.S. Retirement Markets 2018. Data thereafter is sourced from the manager.

² The Cerulli Report U.S. Retirement Markets 2018, data as of December 31, 2018

Managed Accounts

Subcomponent ratings

	Business	Staff	Process	Risk	Performance	Terms & Conditions	Overall Rating
Fidelity PP&A Core	3	2	3	2	2	2	Buy
Fidelity PP&A Index	1	2	2	2	2	1	Qualified
Edelman Financial Engines	3	3	2	2	2	2	Qualified
Morningstar	3	3	3	3	3	3	Buy
Vanguard	3	3	2	2	2	3	Qualified

Qualitative Outcome

- 1 = Weak
- 2 = Average
- 3 = Above Average
- 4 = Strong

Overall Rating	What Does This Mean?
Buy	We recommend clients invest with or maintain their existing allocation to our Buy rated high conviction products
Buy (Closed)	We recommend clients invest with or maintain their existing allocation to our Buy rated high conviction products, however it is closed to new investors
Qualified	A number of criteria have been met and we consider the investment manager to be qualified to manage client assets
Sell	We recommend termination of client investments in this product
In Review	The rating is under review as we evaluate factors that may cause us to change the current rating

Managed Accounts Usage for FCPS Plans

As of September 30, 2023

Empower

	403(b)		457	
	Number	%	Number	%
Participants	493	21%	0	0%
Assets	~\$32,000,000	16%	0	0%
Fees	50bps first \$100k 40bps next \$150 30bps next \$250k 20bps above \$500			

CoreBridge

	403(b)	
	Number	%
Participants	2,442	27%
Assets	~\$161,000,000	25%
Fees	45bps up to \$250k 40bps over \$250k	

Unintended Consequences of New Menu

- On October 13th, 2023, the investment menu for Empower's 403(b) and 457 Plans was scheduled to transition to the new line up, as selected/vetted by the Investment Committee.
- Just prior to that, on September 22nd, 2023, Empower reached out to Aon and FCPS and reported that based on Morningstar's policies and procedures, the investment options were not sufficient to continue to offering the managed accounts service, specifically citing the lack of international core equity.
- Find an excerpt from the relevant parts of the report below:

There is only one fund providing core international developed market equity exposure among the investment options in P_PNP_0006196.

The international developed market equity target in the most aggressive model requires an allocation of approximately 28%.. Due to the additional risk of allocating too heavily to a single investment (manager-specific risk) Morningstar Investment Management LLC limits the allocation that any one fund may receive. Based on the lack of core exposure to the targeted asset class of the fund(s) listed above and/or the prudent allocation constraints placed on each fund, we are not able to build one or more of the model portfolios given the available investment options.

Resulting Disruption

Any participant that was previously using managed accounts, and takes no action, will have their investment allocation moved based on the committee's mapping decision. No rebalancing will take place until, potentially, the line up is adjusted to resolve the issues noted in the failure report or until FCPS decides to take alternate action on those participants.

The expectation is that CoreBridge participants will experience the same disruption when line up changes become effective on that platform unless preemptive actions are taken to prevent that outcome.

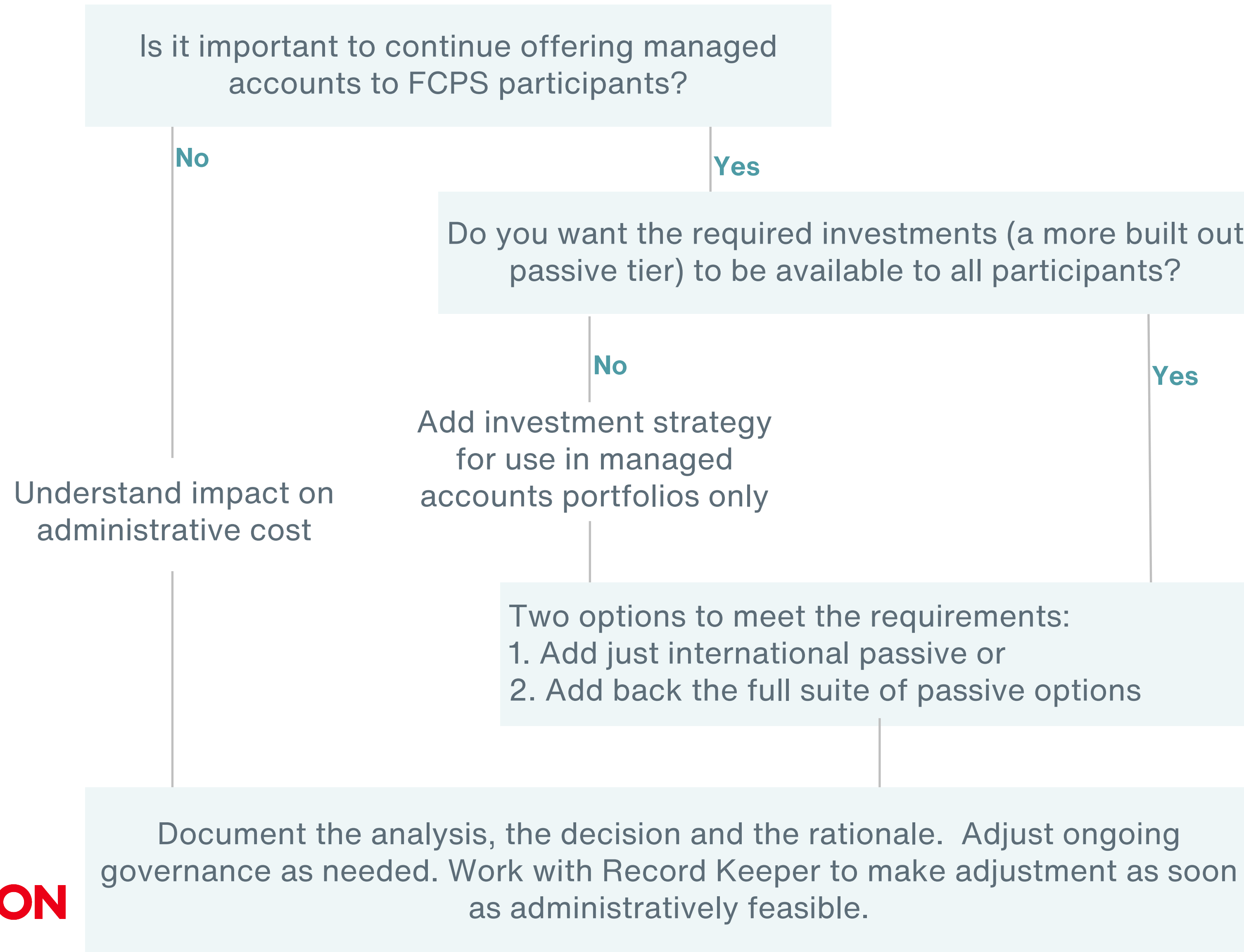
In addition to impacting participants using the serve, eliminating managed accounts also impacts recordkeeping pricing for all participants.

Part 2

Decision Points



Decision Points



Part 3

Passive Suite



Passive Tier Decisions

The Fairfax Passive Suite currently consists of just BlackRock S&P 500 (Large Cap Equity).

- Fairfax to consider adding just a passive international equity option, or the full passive suite (fixed income and SMID cap U.S. equity)

We identified the below investment manager candidates that we believe are appropriate for consideration:

Asset Class	BlackRock, Inc. (BlackRock ¹)	The Vanguard Group, Inc. (“Vanguard”)
Fixed Income	US Aggregate Bond Index	Total Bond Market Index
Large Cap Equity	Equity Index (S&P 500)	Institutional Index
SMID Cap Equity	Russell 2500 Index	Extended Market Index
Non-US Equity	All Country World Ex-US Index	Total International Stock Index
Aon Rating	Buy	Buy



¹Fidelity Passive Fixed Income is rated as Qualified

Vehicle Availability by Asset Class and Manager

Passive Fixed Income	BlackRock	Vanguard
Mutual Fund Name	iShares Total U.S. Aggregate Bond Index	Vanguard Total Bond Market Index Fund Admiral Shares
Ticker	WFBIX	VBTLX
Stated Benchmark	Bloomberg U.S. Aggregate Index	Bloomberg U.S. Aggregate Float Adjusted Index
Expense Ratio	0.050%	0.050%
Passive Large Cap Equity		
Mutual Fund Name	iShares S&P 500 Index Fund - Class K	Vanguard Institutional Index Fund
Ticker	WFSPX	VINIX
Stated Benchmark	S&P 500 Index	S&P 500 Index
Expense Ratio	0.030%	0.040%
Passive SMID Cap Equity		
Mutual Fund Name	iShares Russell Small/Mid-Cap Index Fund	Vanguard Extended Market Index Fund
Ticker	BSMKX	VIEIX
Stated Benchmark	Russell 2500 Index	S&P Completion Index
Expense Ratio	0.070%	0.050%
Passive International Equity		
Mutual Fund Name	iShares MSCI Total International Index – Class K	Vanguard Total International Stock Index Fund
Ticker	BDOKX	VTIAX
Stated Benchmark	MSCI ACWI ex-US Index	FTSE Global All Cap ex-US Index
Expense Ratio	0.100%	0.110%

Trailing Performance

As of September 30, 2023

	Performance %					
	1 Quarter	1 Year	3 Years	5 Years	7 Years	10 Years
Fixed Income						
BlackRock iShares Total U.S. Aggregate Bond Index	-3.21 (64)	0.68 (67)	-5.21 (65)	0.11 (63)	-0.12 (76)	1.07 (77)
Vanguard Total Bond Market Index	-3.09 (54)	0.73 (64)	-5.21 (67)	0.13 (59)	-0.10 (74)	1.11 (70)
<i>Blmbg. U.S. Aggregate</i>	<i>-3.23 (69)</i>	<i>0.64 (68)</i>	<i>-5.21 (65)</i>	<i>0.10 (65)</i>	<i>-0.09 (74)</i>	<i>1.13 (70)</i>
Large Cap Equity						
BlackRock S&P 500 Index	-3.28 (59)	21.58 (52)	10.11 (28)	9.90 (36)	12.21 (42)	11.88 (34)
Vanguard Institutional Index	-3.28 (59)	21.58 (52)	10.12 (28)	9.89 (37)	12.21 (42)	11.88 (34)
<i>S&P 500 Index</i>	<i>-3.27 (59)</i>	<i>21.62 (52)</i>	<i>10.15 (27)</i>	<i>9.92 (36)</i>	<i>12.24 (41)</i>	<i>11.91 (33)</i>
SMID Cap Equity						
BlackRock iShares Russell SMID Cap Index	-4.85 (46)	11.19 (59)	8.32 (19)	4.51 (57)	7.94 (70)	-
Vanguard Extended Market Index	-3.34 (25)	14.49 (33)	4.71 (45)	4.53 (56)	8.10 (64)	7.92 (60)
<i>Russell 2500 Growth Index</i>	<i>-6.84 (82)</i>	<i>10.61 (65)</i>	<i>1.01 (72)</i>	<i>4.05 (61)</i>	<i>8.78 (43)</i>	<i>8.37 (47)</i>
International Equity						
BlackRock iShares Total International Index	-4.46 (26)	20.56 (43)	3.31 (26)	2.37 (55)	4.54 (55)	3.17 (75)
Vanguard Total International Stock Index	-4.02 (48)	20.46 (82)	3.86 (74)	2.74 (57)	4.78 (58)	3.60 (63)
<i>MSCI EAFE IMI</i>	<i>-3.96 (44)</i>	<i>25.16 (40)</i>	<i>5.57 (44)</i>	<i>3.36 (25)</i>	<i>5.59 (16)</i>	<i>4.35 (16)</i>

Appendix



Appendix – Morningstar Failure Report



22 West Washington Street
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Date: 10/3/2023

From: Shanawaz Khan
Investment Analyst

To: Empower Advisory Group, LLC

Re: P_PNP_0006196
Lacking International Developed Markets equity exposure

Purpose

The purpose of this letter is to notify you of the portfolio construction failure encountered with P_PNP_0006196. As a result of this failure, Morningstar Investment Management LLC is unable to construct diversified fund-specific portfolios under the Program.

Morningstar Investment Management LLC utilizes a proprietary methodology for building portfolios for Program participants. An investment option must meet certain criteria to be considered for inclusion in the Program's portfolios. Further, sufficient exposures in all relevant asset classes are required in order for Morningstar Investment Management LLC to construct properly diversified portfolios. The specific issues with the above-mentioned investment lineup are described below.

Current Situation

There is only one fund providing core international developed market equity exposure among the investment options in P_PNP_0006196.

The international developed market equity target in the most aggressive model requires an allocation of approximately 28%. Due to the additional risk of allocating too heavily to a single investment (manager-specific risk) Morningstar Investment Management LLC limits the allocation that any one fund may receive. Based on the lack of core exposure to the targeted asset class of the fund(s) listed above and/or the prudent allocation constraints placed on each fund, we are not able to build one or more of the model portfolios given the available investment options.

The following three 3 asset classes represent the *recommended* minimum asset class exposure and Morningstar recommends at least two qualifying investment options that closely track the benchmarks listed next to each asset class:

Large Cap (Morningstar US Large Cap Broad Growth and Morningstar US Large Cap Broad Value),
International Developed Market Equity (Morningstar Developed Market ex-US),

Fixed Income (Morningstar US 1-5 Yr Core Bond, Morningstar US 5-10 Yr Core Bond and Morningstar US 10+ Yr Core)

In addition to exhibiting sufficient and consistent exposure to its target asset class(es), a fund must also meet the required R² minimums and demonstrate an appropriate tracking error as discussed in the *Advice by Morningstar Fund Selection and Portfolio Construction Overview*.

Resolution

In light of the lineup lacking sufficient investment options that provide the required International Developed Market Equity exposure, this lineup no longer meets the diversification requirements for Morningstar Investment Management LLC to serve as independent financial expert to Empower Advisory Group with respect to the Plan line-up identified above.

In order to serve as the independent financial expert to P_PNP_0006196 and resume regular quarterly rebalances for this plan, we strongly recommend additional investment options that provide exposure to International Developed Market Equity.

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