Practical Applications of White Label Funds: A No-Nonsense Design Handbook

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Overview

As defined-benefit (DB) plans continue to give way to defined-contribution (DC) plans in the US retirement landscape, white label funds offer plan managers a way to provide individual participants with the advantages of active management while fulfilling their fiduciary responsibility to pursue the best possible returns for the lowest possible fees.

In White Label Funds: A No-Nonsense Design Handbook, published in the Spring 2017 issue of The Journal of Retirement, Rod Bare, Jay Kloepfer, Lori Lucas, and James Veneruso move beyond the common conception of white label funds as simple unitization vehicles to champion a customized structure that affords the greater pricing efficiency and rigorous governance of DB plans. The authors, colleagues at investment consulting firm Callan, have compiled their insights into a how-to guide that lays out who should use such funds, what the benefits are, and the nuts-and-bolts of how to construct and manage them, using a hypothetical non-US equity white label fund as an example.

Practical Applications

- **Best for large DC plans that offer active management options.** Fiduciaries should have at least $500 million AUM to absorb implementation costs. Smaller plans have some options, too, but they will still face strong demands on institutional capacity.

- **Scale up without being locked in.** White label funds can curtail expensive and confusing proliferation of similar funds on the plan menu, can obtain volume discounts by working with DB managers,
Key Definitions

**White label fund**
Generic investment structures that use a mix of underlying funds to provide multi-manager exposure to an asset class.

**Defined-contribution (DC) plan**
A DC plan is a savings plan where the money is the employee’s to spend during retirement; the employer’s contribution is defined in advance, and the employee may also make contributions.

**Active management (active investing)**
Any strategy whereby a manager attempts to outperform a given benchmark through customized portfolio construction and asset allocation.

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*“The goal behind an appropriate structure is broader exposure to the key asset classes.”*
—James Veneruso

and aren’t constrained by the capacity of a single manager. Underperforming asset managers can be swapped out more easily without challenging participants’ brand loyalty.

- **Blend strategies.** Mix passive and active strategies and create hybrid security selection methods to refine risk–return profiles.

**Discussion**

White label funds bundle one or more branded investment products into a single, generic fund, usually within a single asset class. Customized white label funds go beyond mere unitization, say the authors, with structural differences that provide scalable capacity and access to active management and reduce user error and administrative costs.

“We’re out in the trenches with the plan sponsors and specialist groups in Callan, who help us design various aspects of these white label funds,” explains Rod Bare, when *Institutional Investor Journals* interviewed him and co-author James Veneruso about their article. “We wanted to collectively document our method and our recipe and create a field manual that could be given to plan sponsors.”

According to the authors, such funds can eliminate the often-confusing proliferation of funds on a plan’s menu, making it easier for participants to make smart choices that safely maximize returns without incurring high fees.

Customization means that plan managers can mix active and passive strategies and select the best vehicle structure to meet their investment objectives. “The goal behind an appropriate structure,” explains Veneruso, “is broader exposure to the key asset classes. Does that mean developing markets? Does it mean emerging? What about small cap? All those questions quickly overwhelm your typical sponsor or participant. The idea of the white label fund is a thoughtful implementation on their behalf.”

Bare explains that white label funds can also solve problems that some active management strategies encounter, such as liquidity issues that constrain capacity: “A classic example is of US small-cap equity: Those managers can only put about $2 billion to $2.5 billion to work in their strategy.” For larger plan sponsors, the problem is different, with AUM of $500 billion to $800 billion sitting with a single manager. “You want to offer broad exposure to the asset class,
but does one manager’s individual product sufficiently represent exposure, especially when you layer in the idiosyncrasies of active management?” Bare asks. “Probably not. We’re really trying to get appropriate exposure to active management.”

Large DC plans that want to broaden exposure in an asset class will often end up with a proliferation of offerings from multiple managers, which creates customer confusion and adds to their administrative burden. The “white label” also helps plan managers sidestep brand issues, making it easier for them to make changes without upsetting brand-loyal participants. “It keeps people focused on overall performance rather than getting attached to particular brand names and allows you to direct an active management strategy that works,” Veneruso says.

White label funds can also allow sponsors to use high-quality DB plan managers within their DC plans. “The original idea behind white label funds was that if a sponsor had both a DB plan and a DC plan, they could reach across to their DB assets and just use that option—even though it wasn’t a mutual fund,” explains Bare.

White label funds also limit plan sponsors’ exposure to legal scrutiny regarding excessive fees. “These white label funds allow plan sponsors to design menu offerings that have the flexibility and institutional-grade construction attributes that should help them execute their fiduciary duties,” says Bare.

Not every plan sponsor can handle the demands of designing and managing white label funds, though. They require substantial internal resources of investment and operational skills and enough cash flow to support the overhead. Other considerations include governance and compliance issues and the need to create a communications program aimed at getting participants on board.

Implementation can also be a tricky balancing act. Because white label funds are made up of underlying multiple managers, they work well only at large scale. Even when white label funds are scalable, other qualified default options, such as target-date funds, can starve them of assets, making it hard to get them off the ground. Such assets should be mapped onto the new white label fund at creation to ensure adequate pacing of asset growth.

“They don’t make as much sense if the sponsors are going to remain committed to using components within the target-date funds that are not part of the standard lineup,” cautions Veneruso. Growth
and scale increase operational costs, in terms of trust and custody services, as well as reporting requirements. However, such services usually have set fees that get spread across a larger asset base as the fund grows.

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