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THE LATEST ALTERNATIVES FRONTIER: DC PLANS

Three recent papers have highlighted the need to introduce alternative investments into Defined Contribution Plans. In our minds, this constitutes something of a major offensive and it could represent a significant market opportunity for alternative managers, particularly those managers who are either interested in fielding or are currently fielding liquid alternative products. We believe a primary factor for success will be investor education.

Key take-aways:

1. 3 significant papers in the last three weeks from three major players:
    a. From a major industry advocate: Defined Contribution Institutional Investment Association's "Is It Time to Diversify DC Risk with Alternative Investments?"[i]
    b. From a major industry manager: BNY Mellon's "Retirement Reset: Using Non-Traditional Investment Solutions in DC Plans"[ii] which is significant given their $1.4T asset base and prominent position.
    c. From a major industry provider: SEI's "The Retail Alternatives Phenomenon"[iii] which encompasses all retail alternatives but seems to focus on DC as an attractive venue.

2. Collectively, the papers put forth many arguments for alternative use in DCs. In general, they are as might be expected, but you should seek out the individual papers for details:
    a. Too much equity risk in DC plan portfolios…need diversification.
    b. Defined Benefit Plans have outperformed DC over multiple time frames, in part because of their use of alternatives.
    c. Liquid alts technology and availability are improving significantly.
    d. Education is a key issue and the DC format can help with that task.

3. We point out that the impact of DC plans on the liquid alternatives space, and perhaps even the entire alternatives space, could be significant.
    a. The DC market represents 58% of all pension assets in the US, or close to $10T.[iv]
        i. By comparison, the entire liquid alternatives market is less than $600b.[v]
    b. We believe that investor education is the main gating factor for investor acceptance of alternative investment products as a whole. To the extent that DC plans are well positioned to educate their constituents, this could be a boost for the whole industry.
        i. An FRC survey indicated that education was the #1 roadblock to initial/increased alternative use by registered investment advisors.[vi]
        ii. 64% of investors said they would need more education before investing in alternatives.[vii]

[i] Scott Brooks, David Zug, Kevin Vandoler, Kurt Walten, Jed Petty, "Is It Time to Diversify DC Risk with Alternative Investments?", *Defined Contribution Investment Association,* MAY 2013

[ii] Robert G. Capone, "Retirement Reset: Using Non-Traditional Investment Solutions in DC Plans" *BNY Mellon,* 6 JUN 2013

[iii] "The Retail Alternatives Phenomenon" *SEI,* 11 JUN 2013

[iv] "Global Pension Assets Study 2013" *Towers Watson,* JAN 2013. Note: SEI references a $5.1T number, but we could not locate their information source. It is possible that they are including/excluding IRAs or some similar category. We feel either number is still rather large relative to the size of the market.

[v] Strategic Insight SIMFUND via SEI

[vi] We have not seen this report, but we note that it was cited in at least two publications: "A lack of eduation may be impeding adviser usage of traditional alternatives" *planadviser.com,* 6 NOV 2012 and Robert Kapito, "Inovative Alt Strategies for Today's Financial Advisors: What You Need to Know" *Alts Virtual Summit,* 2013

[vii] This number is quoted in the SEI paper as coming from the Investment Company Institute. We could not find the cite, but we find the number to be believable, if not understated.