

# Summarizing the Risks That Threaten the Profitability (and Possibly Even the Survival) of 401(k) Providers

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**Author**

Richard D. Glass

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*The purpose of intelligence is to narrow the range of uncertainty when difficult decisions have to be made.*

—Brent Scowcroft

There is more than one way of characterizing the risks that are turning providers' business models upside-down and inside-out. For the purpose of this outline, the risks are divided into two categories:

- The first group includes the obvious ones that threaten immediate profitability:
  - much lower total contribution levels due to layoffs (which may be permanent);
  - participants reducing or stopping their contributions because they lost faith in the market;
  - reductions in company matches (which may also be permanent);
  - sinking account values;
  - shifts to asset classes (funds) with lower expense ratios;
  - the inability to fulfill client expectations due to shrinking budgets and staffs.
- The second category are the ill-defined and are still evolving risks. Overcoming these risks requires flexibility and will determine whether or not a provider will, in the long-term, be profitable in the 401(k) marketplace.

This second category includes all those risks that can destroy a provider's ability to win and maintain the trust of sponsors, fiduciaries, and participants. To win trust, a provider will have to demonstrate not only transparency and accountability, but also well-defined value propositions for sponsors, fiduciaries, and participants.

To win in both today's and tomorrow's 401(k) marketplace, a provider will have to be able to recognize and then capitalize on profit generating opportunities and/or head-off, where possible, revenue losses while simultaneously developing client loyalty. To create loyalty, sponsors, fiduciaries, and participants will have to feel they are getting a good value for the fees they pay. In addition, providers will have to accept that their performances will be evaluated by many who believe that 401(k) plans are an "experiment" that has failed in large part because providers' business models were not in sync with the needs of fiduciaries and participants.

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The ability to achieve the desired level of profitability will stem primarily from technology and the willingness of management and staff to use the technology effectively. A provider must determine whether it has all the data it needs to ask “hard” questions including:

- Can we critically and objectively evaluate our strengths and weaknesses (given the new emphasis on transparency and accountability)?
- Are we using the appropriate standards to evaluate our performance or are those benchmarks too narrow in their focus? For example:
  - Is our technology designed to assess retirement readiness (and other internal or plan-specific benchmarks) by demographic groups or does it emphasize generating statistics geared toward comparing our book of business and individual plans to external benchmarks?
  - Will “are we doing as good (or as bad) as everyone else” remain as the 401(k) industry’s standard for judging a plan’s success?
- Are we currently overlooking known risks? As an organization, are we “sticking our heads in the sand” because it is convenient or less painful, at least in the short run, to do so?
- Have we created an environment that enables some individuals or “fiefdoms” to conceal risks in order to avoid (possibly harsh) criticism?
- Are we ignoring risks because we don’t have the tools to quantitatively evaluate and then address them?
- Are the services and tools we are offering and/or endorsing (including how we describe them and their benefits) going to backfire on us? Should we be offering or making available to our clients additional products and services?
- Can our technology transform our data into the information we need to stabilize profits by:
  - identifying both current and evolving issues (fears, concerns and needs) confronting the different employee demographic segments;
  - then capitalizing on opportunities to protect current revenue streams and even generate new ones;
  - maintaining our competitive position and possibly even expanding our market share in spite of reduced budgets and manpower.