

Promise & Challenges of Robo-Advise on Decumulation

New Roles & Responsibilities for Regulators and for Plan Sponsors & Fiduciaries

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My Perspective

- Papers focus on robo-advice to address decumulation in individual retail market
- My experience is with employer plans
 - —mainly very large DB and DC plans, including
 - implementing robo-advice on DC plans
- Contrast could offer helpful perspective

Overview of Comments

- Historical employer plan perspective
- The promise of robo-advice
- Its challenges
- Some thoughts on solutions



Employer Plan Perspective

- Modern portfolio theorists built strategic asset allocation models in 1980s
 - —to allocate DB plan investments across asset classes using a digital economic model, and
 - to schedule asset tranches to mature to meet plan's cash needs to pay retiree benefits
 - -accumulation & decumulation, at plan level

Employer Plan Perspective

- Bill Sharpe ported his strategic asset allocation model to Internet in mid-1990s
 - grew dramatically in 401(k) plans to help individual participants manage accounts
 - limited to asset allocation in accumulation
 - now includes decumulation tools as well
 - multiple providers today + target date funds

Employer Plan Perspective

- Shifting management from plan level in DB plan to individual level in 401(k) plan poses much tougher decumulation problem to solve
 - longevity risk: can't ask the actuary any more
 - investment risk: hard to manage efficiently without knowable time horizons
 - decision-making risk: multiples worse

- Papers view robo-advice as potential solution to these issues in retail space
 - both agree robo-advice seems to be working well during accumulation phase
 - both acknowledge more is needed to address individual needs in decumulation phase

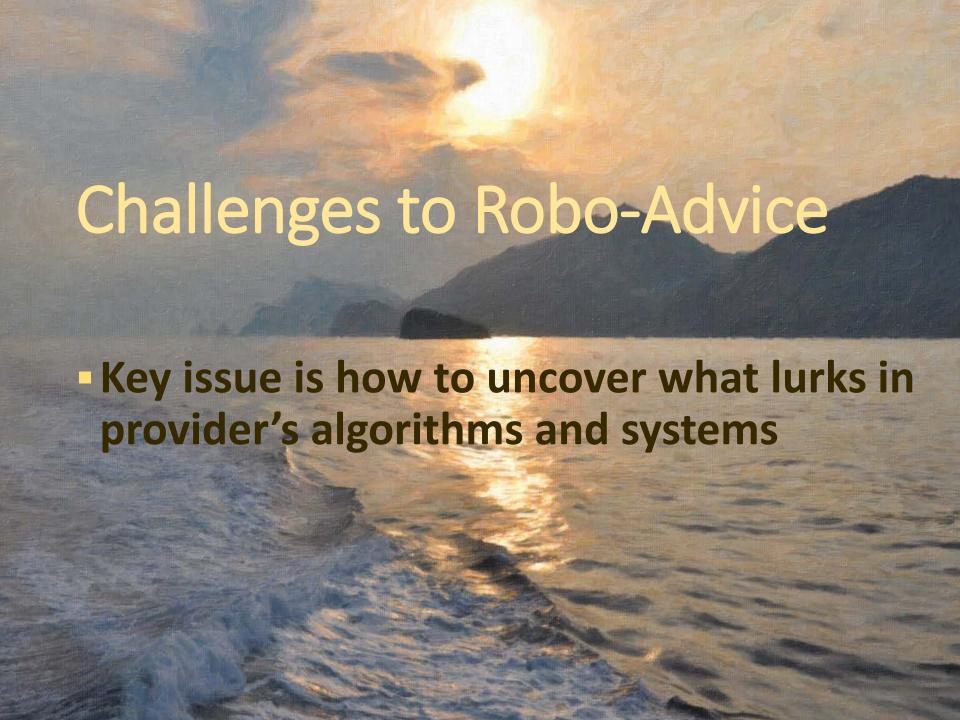
- Papers view robo-advice as most helpful with behavioral & decision-making risks
 - by framing and informing critical decisions
 that individuals typically misperceive or get
 wrong

- Particularly like Baker & Delleart's broad vision of decumulation robo-advice
 - includes investment alide paths, annuitization advice, Social Security-Medicare optimization, withdrawal advice, and tax optimization

- Not hard to imagine more additions
 - long-term care advice, debt management,
 optimizing use of housing and other non investment assets, health maintenance,
 utilization of medical and genetic information
 - —plus integrating all this data and advice to maximum extent possible

- Papers acknowledge break-through still is needed in decumulation area
 - —something comparable to modern portfolio theory break-through on accumulation side
 - recognize critical role of academics and other thinkers in meeting this challenge

- Papers acknowledge more work is needed on compensation-business models
 - to align interests of robo-advice providers and consumers of their services
 - in the retail space, the authors are skeptical government regulation can overcome absence of sound business models in marketplace



- The possibilities include:
 - —undisclosed preferences in methodology (highlighted by Polansky, Chandler & Mottola)
 - undisclosed financially conflicted assumptions (highlighted by Baker & Dellaert)
 - security vulnerabilities (discussed yesterday)
 - programming and system errors

- These are not just theoretical possibilities
- In the real world, they actually happen
 - one example from my experience helping implement robo-advice on employer-sponsored DC plans
 - —there are many others

Fundamental Conundrum

- Individuals with no technical expertise and all their behavioral flaws are hardly in a position to evaluate which roboadvice provider to select in the individual retail market
 - informational asymmetry

Some Thoughts on Solutions

- As suggested by Eldar Shafir last night, individuals need a way to become informed consumers of robo-advice
- To do this, they need access to a trusted independent expert intermediary who will do digging and analysis for them

Who Will That Be?

- Online individual reviews?
- **A financial Consumer Reports?**
- Regulatorily mandated certifications?
 - -see DOL reg 29 CFR § 2550.408g-1(b)(4)
- Fiduciary liability regime?
 - —with agency enforcement or private lawsuits?

