Decumulation and Regulatory Strategy for Robo Advice

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Overview

- Review behavioral barriers to optimal decumulation strategies
- Describe available automated decumulation tools
- Regulatory discussion:
  - What's different about *automated* advice?
  - What's different about *decumulation* advice?
  - Identify market structures that inhibit adoption of high quality decumulation tools
  - Potential regulatory strategies

Behavioral barriers to optimal decumulation decisions

- Incomplete/inaccurate mental representations
  - E.g., availability heuristic; goal activation (e.g., bequest, health, leisure)
- Incomplete/inaccurate evaluations of alternatives
  - E.g., loss, ambiguity, regret aversion; hyperbolic discounting
- Incomplete/inaccurate decision rules
  - E.g., default effects; order effects; rules of thumb

Robo decumulation tools and behavioral barriers

- Mental representations
  - Robos can expand the set and present empirically validated projections
- Evaluations
  - Robos can weight (all) the attributes, allow consumers to choose their weights, and offer digital environments that include future scenarios
- Decision rules
  - Robos can offer balanced decision rules, rank options in order of individualized predicted fit, and present options in small sets that promote considered choice

Available decumulation tools

- Investment allocation glide paths

- Annuitization decision support

- Social Security decision support

- Medicare plan decision support

- Spend down decision support:
  – Retirement paycheck
  – Optimizing the order of withdrawals

Market "photo" – current robo-advice

Firm	Biz Model	Spend Down Calc.	Annuity Support	Soc. Sec. Tool	Medicare Tool
United Income	Indep. B2C	✓	✗	✓	✗
True Link	Indep. B2C	✓	✓	✗	✗
Betterment	Indep. B2C	Advice Only	✗	✗	✗
Wealthfront	Indep. B2C	✗	✗	✗	✗
Vanguard	FundCo B2C	Advice Only	Off-line?	✗	✗
Schwab	FundCo B2C	✗	Off-line?	✗	✗
Fidelity Go	FundCo B2C	✗	Off-line?	✗	✗
Income Strategy	SAAS2C	✓	✗	✓	✗
Income Discovery	SAAS2B2C	Advice Only	✓	✗	✗
Retire Up	SAAS2B2C	✗	✓	✗	✗

What's different about automation?

- Provides transparency to regulators
- Facilitates comparison and tracking by third parties:
  - Morningstar type comparisons (already starting)
  - Personal financial services companies
- High fixed cost, rapidly declining marginal cost, raising concerns related to concentration & scale:
  - Traditional anti-trust type concerns
  - "Weapons of Math Destruction"
- **Regulatory strategy**:
  - Promote competition through "open banking" rules, performance competitions, and eyes on market share
  - Standardized disclosure *ex ante*; mandated data and process (algorithm) retention for *ex post* analysis
  - Returns to scale from quality-promoting regulation

What's different about decumulation?

- Poor compensation incentives: AUM & commissions not well-tailored incentive for high quality advice
  - Could annuity commissions work to debias consumers?
- Optimization strategies not well worked out = greater risk of exploitation?
- Resistance by incumbents to provide access to financial data and to product details (except securities/Medicare)
- **Regulatory strategy**:
  - Encourage research and development on decumulation strategies
  - Promote performance competitions, best practices development
  - Open banking

Conclusions

- The fundamental need:
  - Better decumulation advice
  - Better decumulation products
- Robo's are secondary, but can help:
  - Overcome behavioral effects
  - Provide transparency to regulators & market
  - Reach more people at lower cost
- Regulatory strategies for robo's:
  - Open banking
  - Standardized disclosure
  - Data retention policies (including process data)
  - Promote robo competitions, best practices development