

**A Promise Unfulfilled.  
Why Online Investment Advice Has Failed To  
Live Up To Expectations....And What To Do  
About It**

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# Overview

- I. Dumb and Dumber: Investors Still Don't Get It. Or, The Failure of Investment "Education".
- II. The Unfulfilled Promise of Online Investment Advice.
- III. Guidance Plus: The Alternative Model that Works.

# I. Dumb and Dumber

John Hancock 2002 DC Plan Survey: Summary of Major Findings:

- "Despite claims of 'increased familiarity', many respondents do not fully understand basic investments, such as stocks, bonds, stable value."
- "Enron has not affected participants' risk perceptions on company stock."
- "Their responses and actions are not those of people with a good grounding in the basics of investing."
- "People continue to make many of the same mistakes they have in previous years."
- "Participants need unbiased and comprehensive investment advice."

# I. Dumb and Dumber

- Same margins as previous years believe company stock is less risky than diversified domestic and international stock funds.
- 42% have “little or no investment knowledge” vs. 38% in 1997.
- 20% “relatively knowledgeable” about investments vs. 24% in 1997.

# Poor Understanding of Money Markets

Types of Securities Found in Money Market Funds (2002/1992 Results):

- Short-term investments: 45%/52%.
- Bonds: 47%/46%.
- Stocks: 40%/48%

## Poor Understanding of Fixed Income Risks

- 27% believe cannot lose money in stable value.
- 40% believe cannot lose money in a bond fund
- 67% believe cannot lose money in a gov't bond fund.

# Poor Understanding of Bond Pricing

The best time to transfer into a Bond Fund (2002/1992 Results):

- Rates decreasing: 18%/11%.
- Rates increasing or unchanged: 82%/89%.

# Unreasonable Near-Term Expectations

Expected 5-year average returns:

- Stocks: 10.9%
- Bonds: 8.1%
- Money Market: 7.7%
- Stable Value: 7.6%

# Unreasonable Long-Term Expectations

Expected 20-year average returns:

- Stocks: 15.8%
- Bonds: 10.3%
- Money Market: 9.8%
- Stable Value: 9.9%

# Unreasonable Long-Term Expectations\*

- Mean expected stock market return: 24%
- Median expected stock market return: 15%

\*Vanguard 2001 Survey of DC Plan Participants

# Poor Understanding of Risk

Risks of each type of investment? (2002 survey\*):

- Money Market: 2.5
- Bond: 2.4

\*1 = no risk; 5 = very high risk.

# Hancock Survey Conclusions

- “Participants show confidence about retirement security, but this confidence comes without thought or planning.”
- “Their responses are not those of people with a good grounding in the basics of investing.”
- “Even those with the skills required to manage their portfolios would rather spend their time doing other things.”
- “People continue to make the same mistakes they have in previous surveys.”
- “Most participants will fund less than the 75% recommended income-replacement ratios.”
- “More than three-quarters would like some investment advice.”

## The \$64,000 Question: Why Has Education Failed?

- Investors do not want to be “educated”!
- They want usable TOOLS that provide ACTIONABLE recommendations.
- They want to make a decision and get on with their lives.

## II. The Unfulfilled Promise of Online Investment Advice

### Current Usage of OLA:

- NewRiver, Inc. (9/2002): Used by 2% of plan participants.
- ICI and Spectrem Group (2002): Offered by 16% of employers.
- PSCA (2002): Used by less than one-third of eligible employees.
- Hewitt (2001): Offered by fewer than 20% of employers.

## The Resources are There

- “The web is the most dominant 401(k) delivery channel.” (TPF&C, 2002).
- 88% of employers provide Internet access to 401(k) accounts (Hewitt, 2001).
- 86% of employers provide education (Hewitt, 2001).

## Do Employees Like OLA?

- Very positive: 12%
- Positive: 98%
- Negative: 0%

(Source: ISCEBS 2001 Census of CEBS)

# Why Employers are Reluctant to Adopt Online Investment Advice

- Legal Fears
- Cost Concerns

# Legal Concerns

- “The fundamental problem now is, employers don’t want to be sued.” (David Wray, Profit-Sharing/401(k) Council, 2002)
- “Regulatory confusion.” (Hewitt, 2001).
- “Fiduciary liability concerns” cited as most important reason for not offering OLA (ISCEBS, 2001)
- “89% of plans not offering OLA cite concerns over fiduciary liability.” (BARRA RogersCasey, 2000)

## Cost Concerns

- 48% say, "Investment advisory services are too expensive." (Hewitt, 2001)
- "Cost to employer" cited as 2<sup>nd</sup> most important reason (after liability), for not offering OLA. (ISCEBS, 2001)

## Where Does This Leave Us?

- Plan participants desperately need actionable help with retirement planning.
- Education is a fatally flawed solution.
- Corporate commitment and employee-communication infrastructure exist, but resources are misdirected.
- For administrative reasons employers are resisting current advice models.
- Result: Current advice systems work for employees, but not for employers.
- A solution that works for everyone is urgently required.

### III. *Guidance Plus* An Alternative that Works for Employers and Employees

- Analytics from Investment Technologies licensed through MasteryPOINT Financial Technologies.
- Addresses the major concerns:
  - Legal: Everyone protected from fiduciary liability:  
*(Parties) should not be deemed a fiduciary with respect to plans and participants participating in the program as a result of services provided through the (Guidance Plus) program. (Stephen M. Saxon, GROOM Law Group).*
  - Costs: About \$1 per user per year.

### III. *Guidance Plus*

## An Alternative that Works for Employers and Employees

- Additional Benefits of Guidance Plus
  - Less complex.
  - Potentially more accurate
  - Closer to institutional DB model.

# Main Elements of Online Investment Planning

- Personal information collection
- Stochastic portfolio construction
- Risk-tolerance assessment
- Outcomes analysis
- Fund selection
- Implementation

## Guidance Plus and DOL IB 96-1\*

- If "advice" is given, provider is a "fiduciary".
- "Safe harbors":
  1. Plan information.
  2. General financial and investment information.
  3. Asset allocation models.
  4. Interactive investment materials.

\*Dept. of Labor Interpretive Bulletin Relating to Investment Education  
96-1

# SH1: Plan Information

OK to Provide:

- Investment choices: Investment objectives, risk & return characteristics, historical return information, etc.
- Benefits of plan participation, increasing contributions, etc.

*No difference between Guidance Plus and Advice.*

## SH2: General Financial and Investment Information

OK to Provide:

- General financial and investment concepts.
- Historic differences between different asset classes, based on standard market indices.
- Effects of inflation.
- Materials estimating future retirement needs.
- Determining investment time horizons.
- Assessing risk tolerance.

*No difference between Guidance Plus and Advice.*

## SH3: Asset Allocation

	<b>Guidance</b>	<b>Advice</b>
Portfolio construction	Asset classes	Individual funds
Forecasting requirements	Major asset classes	10,000+ funds
Use generally accepted investment principles that consider historic asset returns	Mandatory	Not required – always done
State availability of alternate investments	Mandatory	Not required – generally not done
State that user should consider other assets, income, investments	Mandatory	Not required – commonly done

## SH4: Interactive Materials

	<b>Guidance</b>	<b>Advice</b>
Proposed allocations must correlate with individual's personal information	Mandatory	Not required – always done
Provide all assumptions	Mandatory	Not required – generally not done
Provide sources of information on alternative investments	Mandatory	Not required – generally not done

# The Main Difference Between Guidance Plus and Advice

- Advice: Generate portfolios in terms of *specific funds*.
- Guidance Plus uses 2-step process:
  1. *Strategic* asset allocation generates portfolios in terms of *asset classes*.
  2. *Tactical Fund Filter*® identifies specific funds to populate each asset class.

# Investment Selection Under Guidance Plus

Step 1: Strategic asset allocation:

1. Mean-variance optimization to generate 100 asset-class level portfolios using all asset classes represented in the plan.
2. Monte Carlo simulation to generate distributions of future wealth and retirement income.
3. Sensitivity analysis on income requirement, contributions, retirement age, risk tolerance.
4. Selection of appropriate asset-class level portfolio.

# Investment Selection Under Guidance Plus

Step2: Tactical Fund filtering and selection:

1. Display all plan funds for each asset class.
2. If only one fund exists, display it.
3. If more than one fund exists, provide a ranking.
4. User accepts defaults or reranks and/or reallocates.

# Summary

## *Guidance Plus*

- Provides employees all the benefits of traditional advice: Investment information that is specific, actionable and rigorous
- While eliminating the legal and cost problems that have held back the adoption of advice
- And does so more simply and more accurately.