**TESTIMONY**

**Before the**

**Subcommittee on Health, Employment, Labor & Pensions**

**Committee on Education and Labor**

**U.S. House of Representatives**

# Retirement Security: The Importance of an Independent Investment Advisor

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**GuidedChoice.com, Inc.**

Thank you, Chairman Andrews, Ranking Member Kline, and members of the Subcommittee. My name is Sherrie Grabot, President and CEO of GuidedChoice.com, Inc., an independent advisory firm.

**GuidedChoice.com, Inc.**

GuidedChoice is one of the leading independent investment advice services firms, providing services to over 42,000 defined contribution plans with more than 3.5 million participants and approximately $156 billion in assets. The plans we service range in size from a single participant to over 300,000 participants. With our clients we set up over 1,000 plans per month on our advisory system. We offer services through plan providers such as Merrill Lynch, Hewitt, Charles Schwab, ADP, and Smith Barney as well as directly to plans such as Atmos Energy, Freescale Semiconductor and McDonalds.

**A Historical Perspective**

GuidedChoice began as a division of Trust Company of the West (TCW) in 1997. As you may be aware, TCW was issued a Prohibited Transaction Exemption[1], which later served as the model for the SunAmerica Advisory Opinion[2]. While conducting market research amongst TCW's client base, which consists primarily of companies from the Fortune 200, we found employers wanted to provide advisory services to their employees but were extremely concerned with an asset manager being the one to provide the advice in spite of the relief provided by the Exemption. Given that information along with the high cost of developing a robust system to meet the market's needs, we made the decision in June 1999 to spin off the division. I joined forces with Harry Markowitz, PhD, Nobel laureate for Modern Portfolio Theory, and GuidedChoice became an independent advisory firm.

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[1] See DOL Pension and Welfare Benefits Administration [Prohibited Transaction Exemption 97-60; Exemption Application No. D-10319]. Grant of Individual Exemptions; TCW Group, Inc., Trust Company of the West, TCW Funds Management, Inc., TCW Galileo Funds, (Collectively; TCW)

[2] See DOL Advisory Opinion 2001-09A (December 14, 2001)

## Independent Advisory Services

There are a variety of delivery models in the market. At the core of our services are complex software tools that enable participants to receive investment advice via the internet, phone, paper or through face-to-face consultation that complies with both the regulatory as well as the plan rules. The Plan administrator, plan sponsor, participant or any combination thereof can pay for the services. Most commonly, the plan administrator or plan sponsor pays for advice services. To avoid any conflict of interest, if a Plan administrator is an affiliate or interested party of an asset manager, we comply with the SunAmerica Advisory Opinion.

## The Benefits

All appear to agree advice can benefit participants, and our data supports that. In our 2008 independent survey, 92% of participants said the advice received was extremely valuable for their retirement planning. We consider savings rate the most important aspect of retirement planning. We undertook an initial study on the retirement adequacy of future retirees of the plans who used the advice services.[3] The results made it clear that there is a significant shortfall for many participants. Participants who use our advisory services increase savings rates on average 112%. Yet the focal point of most advice and managed account services, including target date funds, is solely on the investment allocation.

## Investment Performance

In analyzing our database of expense ratios and quarterly returns for

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[3] This study undertaken in 2004 included 25,000 401(k) plan participants. Participants were encouraged to enter in assets that were not employer related, including spousal plan assets, previous employer plan assets, Individual Retirement Accounts, annuities and any other assets held for retirement purposes. On average, the recommendation to participants was to increase savings rates by 258%. The data revealed that those covered under a pension plan and lower-wage workers, for whom Social Security provided a higher income replacement ratio, fared far better. For those covered by a pension plan, the average required increase to savings rates was 38%.

over 30,000 plans, we have found performance can be degraded in plans with constraints – whereby a certain number of the investment options in the Plan must be from a specified asset manager, i.e. a bundled type of arrangement. These arrangements are typically found in the small plan market but are similar to target date funds created by an asset manager whereby the underlying investments are from a single fund family. In recent years, plans with constraints have tended to underperform plans without any constraints between 0.25% and 2.01% annually.

**Investment Performance**
**Variance between Unrestricted and Restricted Plans**
**For the period 1/1/2005 to 12/31/2008**

| **Cash 69%<br>Bond 22%<br>Equity 9%** | **Cash 36%<br>Bond 42%<br>Equity 22%** | **Cash 5%<br>Bond 63%<br>Equity 32%** | **Cash 0%<br>Bond 51%<br>Equity 49%** | **Cash 0%<br>Bond 34%<br>Equity 66%** | **Cash 0%<br>Bond 17%<br>Equity 83%** | **Cash 0%<br>Bond 0%<br>Equity 100%** |
|---|---|---|---|---|---|---|
| 0.58% | 0.45% | 0.25% | 0.34% | 0.30% | 0.34% | 2.01% |

Source: GuidedChoice.com, Inc. database of plan investment options. Data calculated by optimizing plan investments to selected points on the efficient frontier, then calculating an annualized weighted return based on the investment options' underlying performance. Investment performance of plans without restrictions on investment options is compared to that of plans with restrictions.

## Risk Level Selection

The lack of knowledge regarding the risk of investment options and the associated participant behavior of investing has been the subject of numerous studies[4]. One key finding was people's tendencies to be more sensitive to decreases in wealth than to increases in wealth. Empirical estimates found that losses were weighted approximately twice as much as gains.[5,6] In other words, the pain a participant experiences losing $50,000 on a $100,000 account is roughly twice the pleasure of gaining $50,000. Our experience reveals the same, which is why conventional wisdom with regard to the allocation of fund of funds, target date funds and the like may understate risk aversion.

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[4] See Bernartzi and Thaler (2001)
[5] See Tversky and Kahneman (1992)
[6] See Kahneman, Knetsch and Thaler (1990)

Ninety eight percent of advice users are invested in allocations of between 30% equity to 80% equity. Fewer than a half percent of advice users elect an all equity portfolio after viewing the effects of risk on return volatility. Of those over age 50, forty six percent hold approximately 30% in equity and fifty three percent have 25% or less in equity holdings. Though the allocations may be deemed conservative by industry standards, our experience with participants receiving advice is consistent with the academic studies. The obvious impact of taking less risk to obtain the same income replacement at a chosen retirement age is increasing the savings rate. Since the data cited above indicates most participants elect not to save the recommended amount to reach their goal, we can extrapolate that they prefer to retire later or live off less income.

## References

Bernartzi, Shlomo, and Richard H. Thaler, 2001, "Naïve Diversification Strategies in Retirement Savings Plans," *American Economic Review* 91.1, 79-98.

Kahneman, Daniel, Jack Knetsch, and Richard H. Thaler, 1990, "Experimental Tests of the Endowment Effect and the Coase Theorem," *Journal of Political Economy*, XCVIII, 1325-1348.

Tversky, Amos, and Daniel Kahneman, 1992, "Advances in Prospect Theory: Cumulative Representation of Uncertainty," *Journal of Risk and Uncertainty* 297-323.