

**Spurgeon, Melissa - EBSA**

**From:** Paul Charbonnet [paul@fasttrack.net]  
**Sent:** Tuesday, February 06, 2007 5:07 PM  
**To:** EBSA, E-ORI - EBSA  
**Subject:** Attention: 401(k) Plan Investment Advice RFI.

**Comments Regarding:  
Employee Benefits Security Administration  
RIN 1210-AB13  
Prohibited Transaction Exemption for Provision of Investment Advice to Participants In  
Individual Account Plans**

**From:** Paul Charbonnet, Investors FastTrack, 14520 Tiger Bend, Baton Rouge LA 70817

The RFI seeks comments about computer modeling of investment strategies. Paul Charbonnet dba Investors FastTrack, <http://www.fasttrack.net>, has offered such models since 1990 to the public independent of any other financial institution. Such models largely conform to the specifications of the RFI. The comments herein derive from Mr. Charbonnet's experience with the mathematics, data, investors, advisors, and computer strategies during his many years of work in this field.

**A. Background**

*Computer Model*

Section 408(g)(3)(B) requires, in particular, that the investment advice provided under the investment advice program must be provided pursuant to a computer model that,

(i) Applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time,

**Comment:**

Generally accepted theories based on return of different assets classes assert that past returns cannot predict future returns. This is true when consideration is given only to "historic returns" which are generally defined as gain/loss over fixed periods of time. There are, however, many other measurements, specifically volatility and correlation which, while based on returns, provide substantial guidance in the construction of a portfolio for an individual. I would encourage the agency to broaden the scope of acceptable investment theories and not to limit consideration to just those based on "historic returns". Specifically, I recommend and subsequent RFP incorporate additional data and statistical measurements including "daily closing prices, correlations, volatility measurements, and distributions".

The quality of the data used in any computer model is critical and essential. The great majority of data used within computer models today is of low quality especially the data of dividends paying mutual funds which are the best suited investments for retirement accounts.. However, good quality sources exist and are available to the general public at reasonable costs.

(ii) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types

of investments.

**Comment:**

**Add to the list of personal information, the need for income, the need for growth, and comparable statistics for the spouse and other dependents. Risk tolerance is a particularly difficult subject as it comprises not only the needs of the individual, but also those who depend on him.**

(iii) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan,

**Comment:**

**Here the RFI is especially narrow. Any "prescribed objective" is subject to change over time and circumstance. Failure to retune an investment strategy regularly is the major criticism most individuals have of their investment advisors. The involvement of a computer strategy in a retirement plan permits rapid adjustment of the "objective" as needed. Moreover, since individuals are able to make lifestyle changes, they must be given the power to fine tune their investments objectives based on a variety of scenarios which should be presented by the computer program.**

(iv) operates in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser,

**Comment:**

**This is a GOOD requirement. The means to implement this concept is via a general purpose computer-based facility via the Internet. All methods which require face-to-face contact between an investor and an advisor will have bias toward specific products and services. Financial Advisors could still work with clients to produce the "prescribed objective", but then the specific investments would be illustrated or chosen by the computer program.**

(v) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

**Comment:**

**"All investment options": While this is not a term that demands specific definition in the RFI, serious consideration should be given to limiting investments covered by the computer program to the universe of mutual funds, exchange traded funds, and other instruments with comparable volatility. It is impossible for a computer program to be used with common stocks and other highly volatile instruments to fashion an acceptably diverse retirement account for an individual.**

**B. Issues Under Consideration**

(1) What procedures and information would be necessary and adequate to determine whether a computer model used in connection with an investment advice program satisfies the criteria?

**Comment relative to sections A (i- v):**

**(i) The data used by the computer program must be rigorously tested. Garbage in, garbage out. Poor quality data not adjusted for distributions is rampant in the computer analysis industry. Daily data should be required and be distribution adjusted.**

**(ii) The computer program must provide selection and diversification strategies, NOT market**

timing. In this context, market timing is defined as the computer program suggesting trades based on the "Buy low, Sell High" theory. Instead of timing, the computer program must keep the portfolio's allocations appropriate. When everything goes up, then a conservative prescribed objective must trade parts of the portfolio regularly (weekly, monthly, quarterly) based on allocation and diversification criteria, not on price targets. All mathematics used must be disclosed in technical documents for peer review. Revisions to such algorithms annually is appropriate.

(iii Finally, testing "utilizes prescribed objective criteria to provide asset allocation portfolios" The answer is that the computer program must provide better risk adjusted returns than a standard index of prescribed objectives. In my work, I have found that strategies which provide good risk-adjusted return based on historical data, continue to succeed with regular portfolio adjustment.

(iv and v) The historical data sets that the computer operates upon for each plan must be comprise years of daily data. The strategies over the years must pick and choose data sets based on their price movement, volatility, and correlation. Should the strategy fail to pick the best risk adjusted alternatives based on historical data then its function would be considered biased. The program must log all historical trades for audit.

#### **Conclusion**

The value and impact of the comments made are readily illustrated in the author's products, which are commercially available.