A New Robo-Advisor Eyes the 401(k) Space

By Kerry Pechter *Wed, Oct 8, 2014*

"blooom is like a dietician who doesn't just give you advice on how to eat. It's like a dietician who actually drives to your store, does your grocery shopping for you and comes back to your house and cooks all your meals for you," says blooom co-founder Chris Costello (above).

(Video no longer available)

Not long ago, a few retirement industry mavens were pondering the robo-advisor phenomenon. "If they break into the 401(k) space, it could be disruptive," one said. "That won't happen," answered another. "Financial Engines, GuidedChoice and Morningstar… they've got too big a lead."

The discussion was timely. Only days later, a suburban Kansas City startup named **blooom**—like the flower, but with three o's and a lowercase b—put out a press release. It had just won an award at the FinovateFall trade show in New York. Its business objective, the founders said, is to bring low-cost ($10/mo. or less), high-value investment advice to post-Boomer 401(k) participants.

The mid-life brainchild of a CFP with a $525 million RIA practice, and others, blooom aims to turn participant accounts into discretionary accounts, without necessarily going through the existing plan sponsor or recordkeeper. blooom isn't designed to be a broker-dealer, an aggregator, or a managed account provider. It simply plans to obtain usernames and passwords from its clients and to re-allocate and re-balance their accounts for them.

Here's what blooom co-founder Chris Costello said at the FinovateFall conference in New York in late September:

"blooom places the trades *for* the client. A number of other companies in this space offer advice on 401(k)s; blooom is unique in that we actually *invest* the account for our clients. blooom is like a dietician who doesn't just give you advice on how to eat. It's like a dietician who actually drives to your store, does your grocery shopping for you and comes back to your house and cooks all your meals for you."

Once the blooom engine gets inside a participant's account, it establishes an age-based asset allocation using the plan's investment options. Using an on-screen slider, the client can fine-tune the allocation to fit his or her risk tolerance. blooom re-balances the account each quarter.

The all-in cost for the service, billed to the participant's credit or debit card, is $1 a month for balances of $10,000 or less, and $10 a month for larger accounts. If you do the math, that's not necessarily cheap. It's only 12 basis points a year for someone with a $10,000 balance, but it's 100 basis points a year—on top of regular plan expenses—for someone with $12,000.

As of this week, blooom says it has signed up its first 100 participants. Costello and his co-founder, Kevin Conard, a Chartered Retirement Planning Counselor, have been splitting their time between their RIA practice, **Retirement Planning Group**, in Overland Park, Kansas, and blooom. On Tuesday, Costello took time out for an interview with *RIJ*. Here's an edited transcript of our conversation:

RIJ: What was the inspiration for blooom?

Costello: I'm 41, and during my 19 years in this business, there have been a hundred times when a friend or an acquaintance, or one of my clients' children, has come to me and said, 'I realize that I'm not your typical RIA client, but I have this 'four-oh-one' thing at work. Can you tell me what I'm supposed to do with it?' Then they send me a pdf of their quarterly statement and, nine times out of ten, they've messed it all up. They might be in a target date fund that doesn't match their retirement date, or they're 100% invested in one fund, or something else.

So blooom was inspired by years of seeing people my age doing inappropriate things with their retirement accounts. It's an epidemic that's been festering, and it's going to take more than blooom to change it. It's going to take a consortium of companies to stem the tide. Otherwise, in 30 years, a generation of people who are my age and younger will reach age 62 or 65 and try to retire on two or three thousand dollars a month in Social Security benefits and $97,000 in their 401(k). As a country, we need to do a better job of getting this right. With blooom, we're saying, 'Let's at least give these people a decent asset allocation.'

According to the Department of Labor, there are 88 million people in DC plans. So the potential market is huge and the problem is enormous. As an industry, we've not done a good job in giving people quality advice about their largest investment, which is their retirement account.

RIJ: How would you describe your target client?

Costello: In our presentation at Finovate, I told the story of my sister Annie. After we started blooom, about a year ago, I asked her for the log-in credentials to her 401(k). Now, she's a much smarter person than I am. She's 37, and she was the valedictorian of her high school class. But when I looked at her account, I saw that 100% of her money was in a money market fund. And she's been invested that way since 2009. It made no sense. She told me, 'I know I should have called you, but I didn't.'

I think she represents 60 or 70 million of the people in 401(k) plans. These are people who have ignored the advice they've been given, or have procrastinated, or who tried to get into their plan's website but have been overwhelmed or confused by the complexity. That was the reason we decided to start blooom. We saw that while companies like **Betterment** and **FutureAdvisor** built phenomenal platforms, they weren't attempting to tackle the DC channel beyond scraping some data and telling people how to reallocate. We're not merely giving advice. We are actually placing the trades. We're basically doing with $5,000 401(k) accounts what RPG does for its $5 million clients.

RIJ: There are already a lot of players in the robo-advice space, inside and outside 401(k) plans. Do you think you can challenge an established giant like Financial Engines?

Costello: Yes, we will be trying to compete with Financial Engines, GuidedChoice, and Morningstar. They're entrenched, but a lot of people aren't using them. When average people try to use that kind of service, they get intimidated. Also, Financial Engines goes after the employers. To have access to Financial Engines, you have to be lucky enough to work at a Fortune 500 company. Our market is everybody else. If you work at a Boeing or a Coca-Cola, you can still use blooom. But we're not going to call on companies to pick blooom for their employees. We will be trying to get blooom offered on [benefits] exchanges. We just signed a deal with **Connected Benefits**, and they have relationships with tens of thousands of employees.

RIJ: How are you financing blooom?

Costello: We've bootstrapped it. We've put about $450,000 of our own into blooom in the last year and a half. Now we're at a point where we're looking for venture capital. It's not that we need new sources of money. We have plenty of clients and friends who could provide it. But we're looking to partner with a VC firm that has experience in scaling up a business. Retirement Planning Group serves 700 families, but neither Kevin nor I know how to grow to a million clients. So now we're talking to VC partners. Since we presented at Finovate, a lot of people have reached out to us.

RIJ: What makes you confident that participants will share their usernames and passwords?

Costello: This is an issue that **Mint** ran into. The core concept of Mint is that it can link all your accounts. You provide all your usernames and passwords, and Mint does the data aggregation. When Mint started in 2007, the big objection was that people wouldn't share their passwords. But nine million people did. The SEC says that if you maintain log-in credentials for clients, you must check a box that says you have custody of the assets. Then you must hire a third party accounting firm that does an annual independent audit of your books and operations. That costs $7,000 to $10,000 a year. It's a cost of doing business.

RIJ: But gaining access to a recordkeeping platform has to be more complicated than just sharing usernames and passwords. How do avoid setting off all kinds of security alarms?

Costello: We're using **Yodlee**,which already has relationships with firms like Fidelityand 18,000 other companies. If a person with a Fidelity 401(k) signs up with us, for instance, we would ordinarily have to jump through what's called an MFA (multi-factor authentication) portal. If the portal doesn't recognize us, it sends a text to the client. Then we'd have to get on the phone to the client, and tell her, 'You'll be getting a test message with a code that will allow Fidelity to recognize our computer.' Yodlee gets to bypass MFA. We need Yodlee for that. But Yodlee merely shows us the data. To access the account, we use a discretionary authorization that the client has signed, giving us power of attorney.

RIJ: Once you're in there, is there any particular theory behind your asset allocation strategy? Financial Engines can point to Nobel Prize winner Bill Sharpe as the architect of their strategy. GuidedChoice has Harry Markowitz. Dimensional Fund Advisors has Robert Merton.

Costello: We're not saying that our asset allocation beats all others. But it's going to be better for people than ignoring their accounts. It just has to be delivered in such a way that people won't turn away from it. You don't need a Nobel Prize winner designing your investments, as long as people understand and use it.

RIJ: So what happens next for blooom?

Costello: Right now we're gearing up for an 'all hands on deck' situation. We're meeting tomorrow with twenty stay-at-home moms who have some available time now that their kids have gone back to school. Once blooom hits the [benefits] exchanges, we could have a thousand people or more sign up overnight. So far Kevin and I are handling the investment-related questions by email. We're looking for partnerships with CFPs, so that if people are pinging blooom and asking for planning services, I can refer them to a planner.

RIJ: How about your exit strategy? Venture-backed firms are designed to be sold in seven to 10 years. Morningstar recently paid $52 million for **HelloWallet**. Is that what you envision for blooom?

Costello: We didn't start this for the exit strategy. The genesis of blooom was the recognition that we have an opportunity to make a significant dent in a big problem in a big way. At our brick and mortar firm, we feel like we already make a difference for clients. But truthfully, most of [RPG's] clients have arrived at retirement and they're doing OK. With blooom we have a chance to really move the needle and make a difference for a lot more people—people like my sister. For just $10 a month we can put people in an asset allocation that gives them a chance at retirement security.