The evolution of Robo-advisors and Advisor 2.0 model

The future of investment management and financial advisory

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Overview

In the last few years the wealth management industry has witnessed some impactful trends, such as a decrease in customers' trust of traditional financial services, more interactive client experience through goals-based planning, and a shift to digital as customers' primary channel preference for the services they receive from financial institutions.

The steady rise of digital entrants into this area and the significant shift in customers' channel preferences and spending habits have led to the development of two key groups for advice-based wealth management: software platforms that provide fully automated investment services (Robo-advisors or "Robos") and human advisors equipped with robust automated capabilities like analytics and digital tools ("Advisor 2.0").

In this paper we look at the emergence and maturing of Robo-advisors and review these along with the traditional human-advisor-based firms and their adoption of technology advances. The incumbent firms are exploring and investing in sophisticated tools and technologies such as advanced analytics and AI to provide a richer toolkit for the advisor and enabling a more insightful experience for the customer. While Robo-advice provides an efficient platform for investing, the importance of the human element cannot be emphasized enough, as seen by the gradual convergence by both sides towards a hybrid (human + robot) approach. It remains to be seen what the model will evolve to, but it is for certain that the human element will be at the center of it.

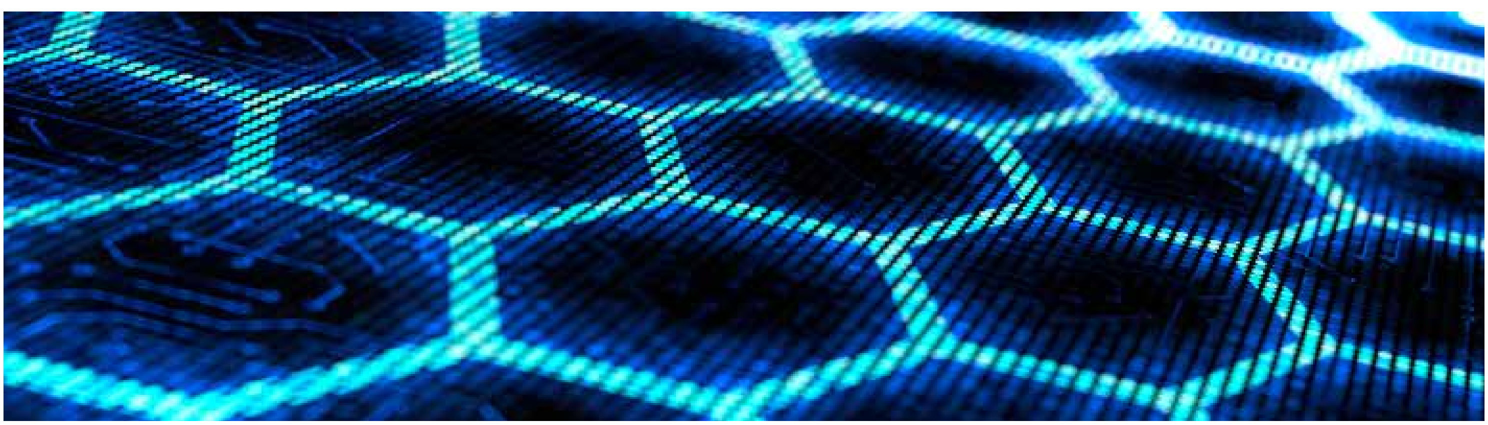
Robos provide a great investment medium for customers

Robo-advisors have been in the news lately due to the emergence of various startups, as well as partnership deals or acquisitions by larger firms. Some examples include LearnVest being acquired by Northwestern Mutual, FutureAdvisor by Blackrock and the partnership between Royal Bank of Canada, Fidelity and eMoney Advisor, among others[1].

Robo-advisors are online financial advisory platforms that provide algorithm-based investment management services, including automated portfolio planning, automatic asset allocation, online risk assessments, account rebalancing and numerous other digital tools. They eliminate the need to utilize a human financial advisor and provide customers with direct, 100% software-based access to their portfolios.

Robo-advisors have achieved significant success in recent years. The top four Robo-advisors managed $128 billion in assets as of November 2017, an increase of $88 billion from 2015. TD Ameritrade Holding Corp. launched its Robo-advisor solution in 2016 and has amassed $19 billion in assets during a one-year timeframe[2].

Robo-advisors can provide a number of benefits, including an easier onboarding process, a suite of automated capabilities and minimal investment requirements compared to traditional alternatives. Robo-advisors also typically use their reduced fees to target millennials and low-income households. The average fee charged by a human financial advisor in 2017 ranged from 59 basis points (bps) (investment amount of $30,000,000) to 118 bps (investment amount of $50,000[3]), whereas Robo-advisors can provide services in reasonably lower amounts.



1 Niels Pennings, "Are Robo Advisors the Future of Wealth Management," LinkedIn, 30 August 2016
2 S&P Global Market Intelligence dataset, November 2017
3 "Average Financial Advisor Fees & Costs," Advisory HQ, March 2018

But are they the most effective solution?

Despite the fast-paced growth of the major players, there are some concerns about the longevity of Robo-advisors in the marketplace. Some of the challenges they currently face include:

Increased competition	‣ It is becoming harder for Robos to differentiate themselves in terms of cost and suite of services provided.
High client acquisition costs	‣ High marketing and advertising spend drives client acquisition costs in the range of $300-$1,000 per client, challenging the feasibility of serving clients with only about $100 in annual revenues at the lower end[4].
Limited account growth	‣ Robo-advisors are unable to grow the average account sizes and scale their advertising to sustain growth rates.

As a result of these challenges, asset-gathering growth rates are falling rapidly for independent Robo-advisors. Also, it is still debatable whether they can fully compete with human financial advisors. Clients have dynamic financial goals, particularly as they progress through various stages of life, which can be more effectively conveyed through in-depth conversations with financial advisors. Human financial advisors can use their knowledge and experience to develop customized investment plans given their clients' financial goals.

Customers need human interaction and customization

While Robo-advisors appear particularly strong in the areas of account opening, enrollment and investment management, they seem to lag behind in areas such as customer relationship management, wealth planning and client servicing:

Product and relationship management	‣ Robo-advisors target low minimum assets under management (AUMs) and simpler account types that only vary based on the risk level, including traditional IRA, Roth IRA, SEP IRA, taxable, joint and trust investment accounts. For example, 529 college savings plan accounts are not typically offered.
Wealth profiling and planning	‣ Robo-advisors can't have deeper conversations as financial advisors do to further understand client interests and build a more customized goal plan. Also, they are not responsive to the changing goals and plans of the customers. It is the client's responsibility to reassess the risk profiling and online questionnaires, whereas human financial advisors can do that automatically on a set frequency. ‣ Simpler surveys make it easier to collect demographic and financial information and help perform client profiling in an automated fashion. ‣ Robo-advisors are lacking at adapting to changing circumstances and can't provide life-stage management effectively. They make static assumptions, unlike financial advisors, who adjust investment profiles and strategies over time to match clients' changing profiles.
Account opening and enrollment	‣ Investment policy statements are lengthy documents and Robo-advisors avoid the issues raised by the structure of their automated investment services disclaiming various duties in customer agreements. ‣ Fees can be either monthly or be a percentage of the money invested. For example, Betterment charges a 0.25% fee (as part of their Digital Plan) for all portfolio sizes. Wealthfront introduced a new pricing structure in 2018 with a 0.25% fee on all accounts. Prior, there were no advisory fees charged on the first $10K invested[5].
Investment management	‣ Rebalancing capabilities are automated, and asset allocation is based on the client's risk profile and market movements. Tax loss harvesting, order routing and trade executions are also automated. ‣ Embedded systems and algorithms that consistently track, monitor and help manage compliance.
Client servicing and reporting	‣ Clients can select and enroll in available services without worrying about long timelines or unexpected and high management fees. ‣ Although clients can look at FAQs to learn more about investment management, Robo-advisors have limited capabilities for providing research or investment commentary that is customized to each client's situation.

4 "The US still has the robo-advisor lead," Business Intelligence, 26 April 2017
5 Larry Ludwig, "Betterment vs. Wealthfront – Which is the Better Robo Advisor," Investor Junkie, 18 April 2018

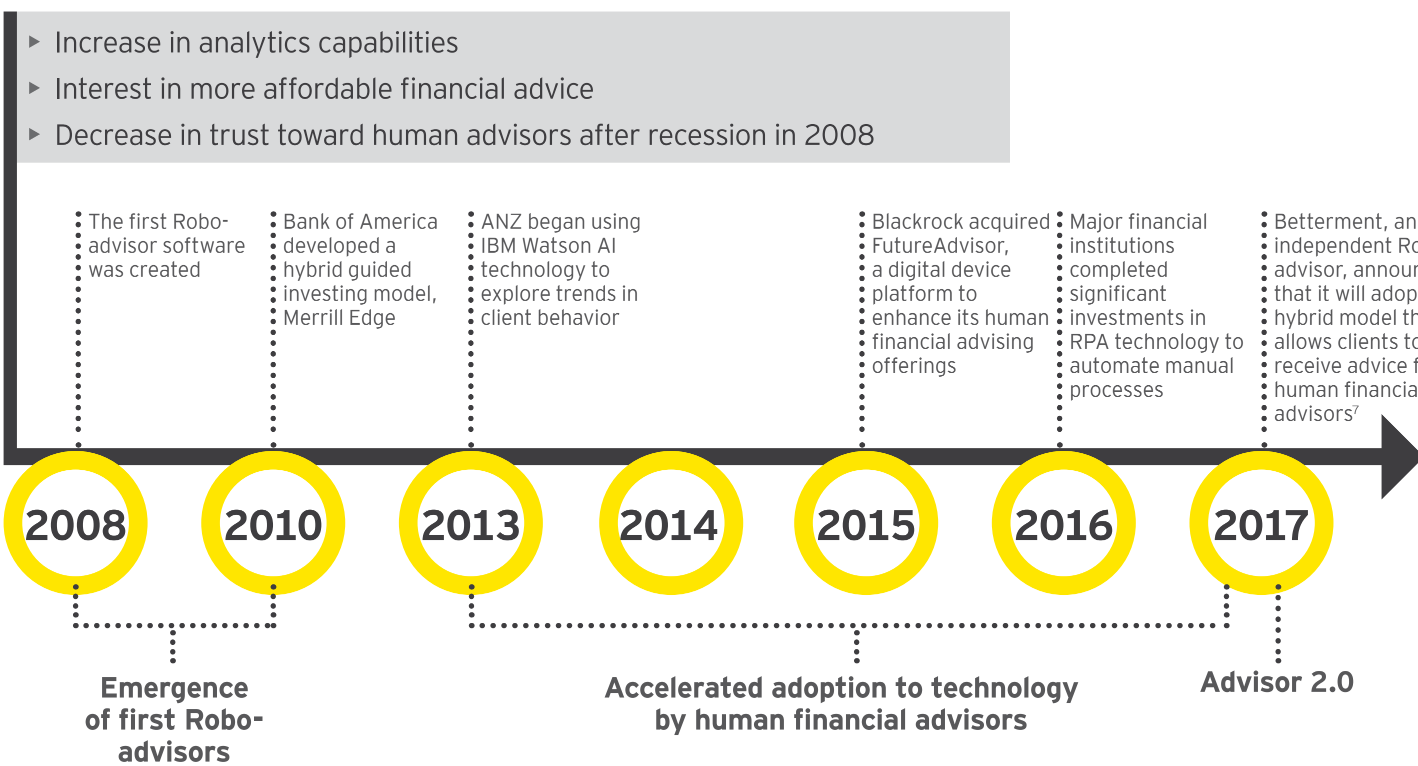
Although the above list is not exhaustive, it does highlight that, in spite of the impressive technological capabilities of Robos, there are critical aspects that human advisors bring to the table. For example, human advisors are able to have frequent and in-person touch points with clients to further understand their goals and fully customize the investment strategy. Also, these frequent touch points enable the advisors to train and exchange knowledge with the clients so that they are well aware of the current and future states of their investments. Last but not least, human advisors are able to invest in a variety of products and not only in entry-level account and product types.

The rise of Advisor 2.0

Can the financial services industry integrate appropriate technology into human advisors' daily processes, which would potentially make them as efficient and automated as Robos and provide even better service?

This question is answered when we take a closer look at the Robo-advisor space. The increasing market share for Robo-advisors has financial institutions to be more creative in their delivery method for advisory service by integrating advanced technology and automated tools. Instead of disrupting the industry, Robo-advisors have acted as a catalyst to boost technology features in the services provided by human advisors. Technological tools are changing the ways that human financial advisors market themselves, interact with clients, optimize processes and develop investment strategies.

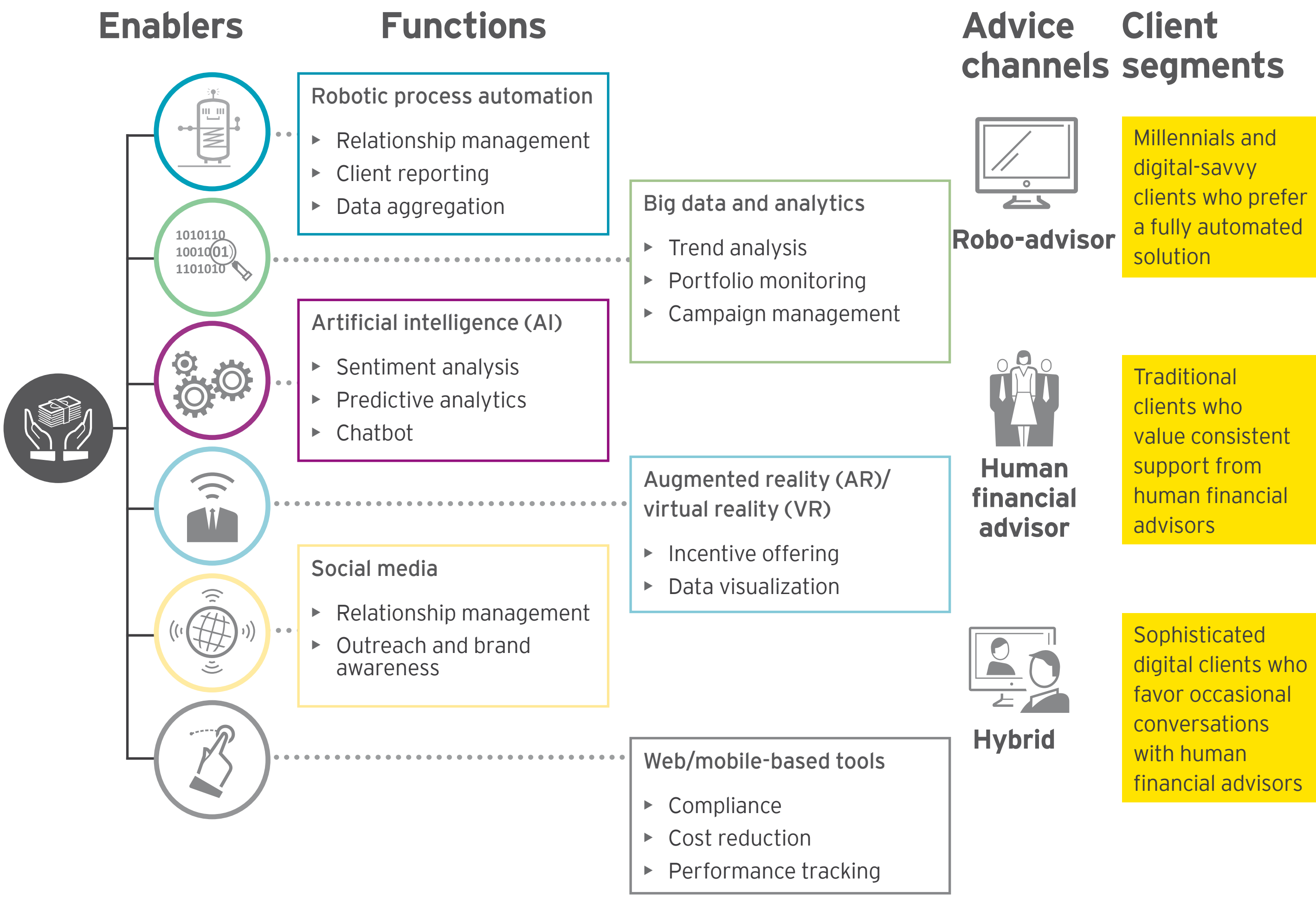
With the emergence of Robo-advisors in 2008, clients were able to get direct access to manage their accounts and have low barriers of entry. Since then, traditional wealth management firms have begun leveraging their huge customer base and resources to provide more digital services to clients. In 2010, Bank of America and Merrill Lynch launched Merrill Edge®, streamlining investing for clients. Australia and New Zealand Banking Group Limited (ANZ) was an early adopter of AI technology with the use of IBM Watson to understand client behavior. Blackrock acquired a digital advice platform in 2015 to enhance and inform on investment decisions. Financial institutions have made significant investments in robotic process automation (RPA) technology to automate manual processes, underlying the need for cost reduction and efficiency gains. Goldman Sachs, for example, is automating the initial public offering process[6]. In the wealth management sector. Charles Schwab and Vanguard have launched services that combine the human and automation aspect; other big corporations, including Morgan Stanley, Merrill Lynch and LPL Financial also have Robos integrated with their human advisor aspect.

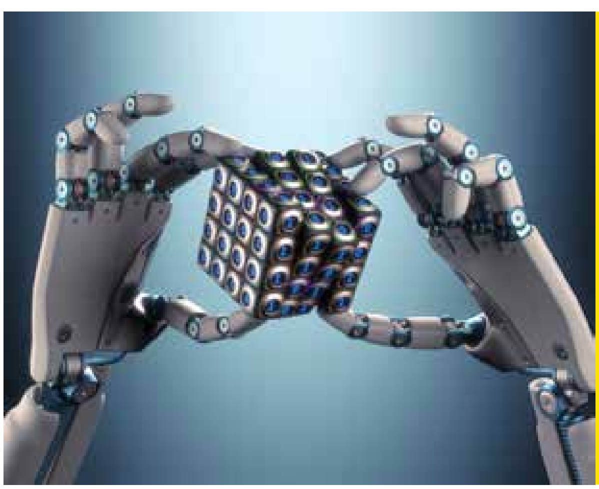


6 Hugh Son, Jennifer Surane, "How to Survive Wall Street's Robot Revolution," Bloomberg Business Week, 25 September 2017
7 Robo-adviser Betterment adds human advice, Reuters, January 2017

Financial advisors have access to variety of tools

We see Advisor 2.0 as an evolution of delivering wealth management to investors. Technology and tools are changing the ways that human financial advisors market themselves, interact with clients, optimize processes and develop and implement investment strategies. Firms will continue to develop their channels to suit investors' preferences, and these will coexist for the foreseeable future.





Robo-advice will likely continue as a channel, in parallel with touch-heavy channels such as in-person and virtual experiences and supported by technology such as augmented reality and virtual reality. As the landscape continues to evolve, it will leverage technology enablers to enhance and integrate aspects across the value chain.

RPA	▸ RPA can automate rules-based processes and add benefits such as cost savings through reduced error and effort. They also increase the productivity of financial advisors by enabling them to focus on high-value tasks instead of manual processes. ▸ RPA has a high efficacy in automating processes related to relationship management, client reporting, data aggregation, cash management and administration.
Big data and analytics	▸ Big data technology enables the analysis of large volumes of market data to provide deeper insights into areas such as finances, client interactions and user preferences, which can be used to drive the marketing and outreach campaigns. ▸ Advanced analytics can monitor customer portfolios, automating margin management and daily money market sweeps. It can also provide metrics on all past and ongoing campaigns, allowing advisors to identify successful methods for building and maintaining a client base. ▸ Predictive analytics can be utilized to improve outcomes by determining the products and services most suited to specific clients.
Artificial intelligence	▸ Natural language processing can be used to consume inputs such as research documents, news stories and social media content, and to perform sentiment analysis, which can be used to identify investment opportunities, while taking human behavior into consideration. ▸ Complex rules and models can compare current market data to that of previous periods to potentially predict upcoming market trends (e.g., crash in emerging markets leading to a bull market). ▸ Chatbots are able to interpret and respond in various languages, allowing financial advisors to increase the scope of their client base. They also provide 24/7 support to resolve clients' routine issues, thus freeing financial advisors' time.
Augmented reality/virtual reality	▸ AR and VR can be used to improve client engagement by providing immersive digital solutions that are tailored to a client's profile, providing a customized user experience. ▸ AR can be used to provide incentives to clients for valuable activities (e.g., upsell to a new product offering, visit to physical location), improving margins. ▸ VR can be used as an immersive experience for the client to explore and simulate life cycles through retirement in order to emphasize all aspects of wealth management (like planning, investing, etc.).
Social media	▸ Social media tools such as LinkedIn can increase the scope of outreach and brand awareness by allowing financial advisors to publicly post content and display their experience. ▸ Sites provide new and alternate channels for financial advisors to communicate with current clients, such as tweeting relevant articles and scheduling webinars. ▸ Social media activity provides effective and targeted advertising at certain customer segments, allowing for increased customer growth and revenue.
Web/mobile-based tools	▸ Advanced, self-documenting collaboration platforms (such as MashMe and Novastone) can help financial advisors scale their books of business while maintaining compliance, as well as efficiency, by moving communication with clients away from email and onto auditable audio, video and texting channels. ▸ Client portals and mobile apps can reduce operational costs associated with distributing printed materials by allowing financial advisors and clients to securely share information. ▸ Mobile apps can allow clients to monitor their assets in real time and track their performance as it relates to overall financial goals. ▸ Usage of notification and alert systems can inform clients when their attention is required.

The automated capabilities available to financial advisors are constantly expanding. As client satisfaction and value differentiation become more and more important, there are advancements made in other industries (like e-commerce, retail, etc.) that can be potentially leveraged within wealth management.

Some aspects still need to be addressed for Advisor 2.0

As new technologies develop, human financial advisors will have greater opportunity to enhance the efficiency, cost and effectiveness of their wealth management offerings. By 2025, the market size projected for Robo-advisors is about 1.6% of global investable wealth, leaving the rest as a potentially great opportunity for Advisor 2.0[8].

There are, however, areas of improvement that Advisor 2.0 still needs to address:

Potential bias	Human financial advisors cannot guarantee objectivity, as Robo-advisors do, because their strategies are not entirely machine-automated.
Inertia against change	Larger organizations need to make greater investments in making changes to the monolithic systems and processes. There is also a learning curve involved with any change to which the financial advisor population needs to adapt quickly.
Fees and account minimums	Human financial advisors typically charge greater fees and tend to have higher account minimums.
Limited straight-through processes	Legacy processes and platforms make it difficult to implement straight-through processes.

Evolution of Robo-advisor and Advisor 2.0

The emergence of Robo-advisors has led to increases in the wealth management customer base and AUM globally. They are especially useful for millennials, who are looking for an affordable and self-driven alternative for investing. Robo-advisors have significant potential for disruption, with smaller companies emerging as major players within the wealth management space. The evidence suggests that Robo-advisors will continue to serve a niche market. This emerging trend is also driving established financial players to enter into this space and improve their overall advising capabilities.

Robo-advisor firms like Betterment are now looking to adopt a more touch-heavy model that will allow clients to receive advice from human financial advisors.

The newer focus on bringing in the human element exemplifies the importance of human advice in wealth management.

The recent global wealth management report by EY lists three essential components that clients value most:

- Performance (Does my financial advisor understand my objectives?)
- Engagement (Do I have enough touch points with my advisor?)
- Trust (Can I trust my financial advisor with my financial health? Does my financial advisor have my best interest in mind?)

Advisor 2.0 addresses these aspects with central human advice along with other desired capabilities, including alternate channels of interaction, client transparency and value for fees. Advisor 2.0 will enable traditional financial advisors to provide a cost-effective and efficient solution, while retaining the functional advantages that traditional human financial advisors provide to their clients.

EY has predicted that the current Robo-advisor landscape will continue to change over the next few years as firms continue to evolve their models to differentiate themselves, maintain revenue growth and achieve economic sustainability. This evolution will go beyond the development of the underlying products and service[9].

8 "Robo Advisors vs. Human Financial Advisors," MyPrivateBanking Research, 21 November 2017, via Business Insider
9 Advice Goes Virtual, EYGM Limited, 2015

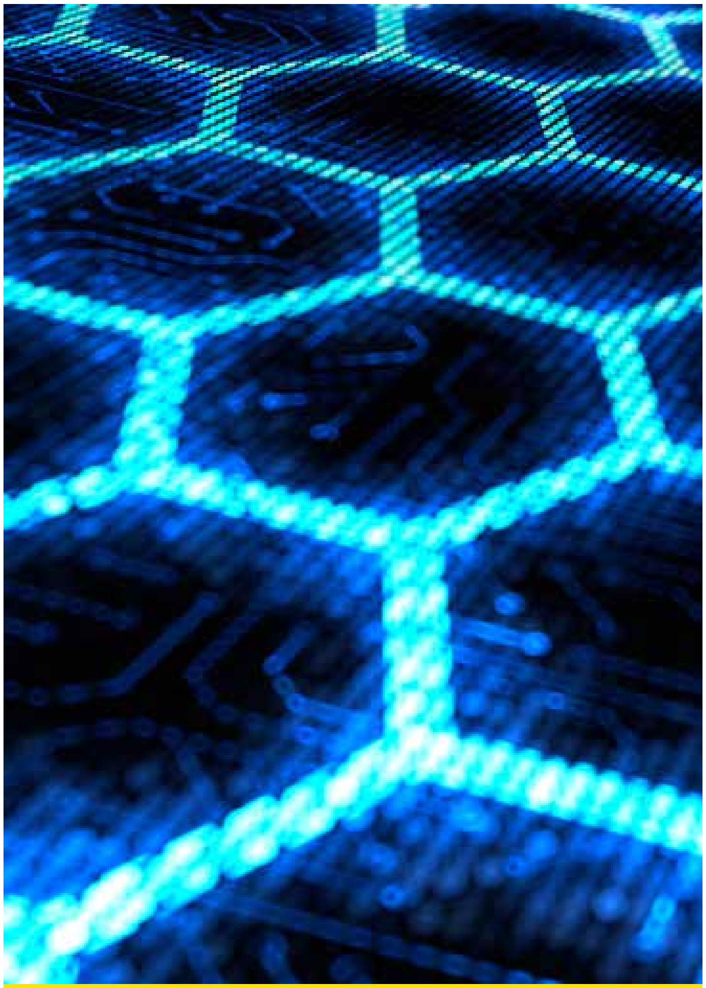
Advisor 2.0	Robos
Greater focus of financial advisor-client relationship	Intuitive and functionally rich client portals
Experienced financial advisors who can connect with client goals	Lower fees and account minimums
Support for custom investment strategies	Easy to understand investment strategies (passive index based)
Wide range of investment products and account types	Straight-through processes
Advanced efficiency and optimization of client goals	Client objectivity

As the sector evolves, it will be interesting to observe the evolution of Robos and Advisor 2.0. Although Robos may not be able to match the human interaction factor now, they are fast catching up with progressing toward a more Advisor 2.0 model. Some of the emerging automated tools like chatbot, AI, etc., can be leveraged by Robos as well, presenting an interesting dynamic to the equation of Robos and Advisor 2.0.

It is clear that we will continue to see developments on both sides, with a potential crossover between the Robo model and the human advice model. The multitude of options ultimately benefit the client and also promise an increase in prospects and growth for the wealth management industry.

It remains to be seen, however, what the optimal evolution of this equation will be:

Will the Robos become more human or will the humans become more robotic?



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