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THE FUTURE OF ADVISORY: EXPLORING THE IMPACT OF ROBO ON WEALTH MANAGEMENT

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01
FOREWORD

TIME FOR A MEASURED RESPONSE TO ROBO

By Panos Archondakis, Senior Director
Wealth Management, EPAM

The amount of media devoted to robo advisory in recent months is a good indicator of how much influence this phenomenon has had. One of the most talked-about areas of fintech, robo has been positioned as the fatal disruptor of traditional wealth management. The influx of technology-driven start-ups into this space has prompted almost every established player to formulate its own robo strategy, whether by building the capability in-house, or by partnering – or acquiring – to obtain it.

Without a doubt, established banks must have some reaction to the advent of robo, and what that reaction is will depend on their own business model and digital ambitions. Where there has been a tendency to adopt a knee-jerk response – doing something quickly to avoid being left behind – a more measured approach may prove to be more fruitful. Banks can afford to take a step back, take a look at what they really want to achieve from their digital strategies, and decide whether that means they need to go down the robo route, and if so in what way.

In all probability, the future of wealth will be a combination of services based on robotics, automation, and a more traditional in-person advisory piece, with investors floating between them. Portfolio rebalancing against a certain target will be performed by an automated process, but when investors want to change their portfolios, they may want to leverage in-person advisory. In short, a combination of robo and traditional advice may prove to be the most powerful.

There are certainly ways in which established firms – and their customers – can benefit from automation. Advisors typically have too many clients to service properly. They cannot possibly process all the information required, such as data, market news, research and product recommendations, in order to give the same level of advisory service to each customer on their books. Banks can leverage digital capabilities to process

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that flow of information and identify leads, opportunities, and recommendations that then can be provided to the advisor in a summarised form. This enables the advisor to focus on relevant talking points and specific opportunities with each client.

And by addressing some of the operational and administrative workload the advisor has to get through just to have a client meeting, the automation of these processes will allow them to get in front of more clients with more relevant topics for discussion.

While it is unlikely to result in their extinction, robo will clearly change the role of advisors, and the adoption of robo also has implications for the technology and business models of established wealth managers. At the same time, robo is still nascent; it is not yet clear how far an algorithm can go in terms of either portfolio management or strategic planning, and the attitudes of regulators and clients to further automate the investment management process are still being formed. Therefore, determining the route to integrate robo is not always straightforward for institutions.

In the spirit of taking a step back to think about how to create a robo strategy that complements an institution's wider digital strategy, EPAM decided to work with Finextra to provide a research white paper that addresses a number of key questions firms could consider when planning their approach to robo. Included below is an assessment of the strengths and weaknesses of robo, the opportunities and risks it presents for wealth managers, and the likely impact of automation on the advisory model going forward.

I hope you find the information in this paper insightful and useful, and I invite you to contact EPAM if you would like to discuss any of the findings, or any aspect of robo, digital and the evolution of the advisory function in wealth management.

02 INTRODUCTION

On the face of it, the fintech story – technology-powered start-ups with strong customer propositions disrupting technology-challenged, lumbering incumbents – resonates nowhere more strongly than in the wealth management business. Established players face revenue and cost challenges and are being squeezed by regulatory pressure on one side and increasingly demanding customers on the other. They have also fallen behind in the technology stakes, just at a time when the coming generation of investors is more tech-savvy than ever. Into the breach have come the robo advisors – leveraging digital, providing ease of access and transparency, running a low cost operating model and attracting some $50 billion in assets under management by 2015, according to analyst Aite Group.

In reality of course the story is more complex and, in common with the fintech narrative across the financial industry as a whole, is tending more towards collaboration than competition. In other words, financial institutions need fintechs, but fintechs also need financial institutions (at least for the most part), and rather than the newcomers eating the lunch of the incumbents, a model of traditional advisory powered by digital capabilities is already emerging.

That said, just because the wealth management industry may not be ripe for disruption doesn't mean it isn't ripe for change. A fully automated model may not be on the cards in the short or even medium terms, but it is important to

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>
> STEPHEN WALL, SENIOR ANALYST, AITE GROUP

Whatever the perceived or actual limits of technology when it comes to either portfolio management or advice today, it's a safe bet that over time they will be breached, and it would be unwise to underestimate just how much algorithms will be able to do in the future.

remember that robo advisory is attractive to more than just millennials. The start-ups are leveraging the changed buying habits of many people – comparison shopping, self-service, omni-channel, 24x7 – and the imminent shift of wealth to a next generation which certainly favours P2P, groupthink and social prods is a demographic fact.

At the same time, whatever the perceived or actual limits of technology when it comes to either portfolio management or advice today, it's a safe bet that over time they will be breached, and it would be unwise to underestimate just how much algorithms will be able to do in the future.

In short, though the impact of robo on traditional wealth advisory is unlikely to be as disruptive as some have predicted, these trends must be taken seriously if established firms want to ensure that their investment in digital is more than a 'me too', yields genuine competitive advantage and helps to secure their future relevance in an evolving business.

As Stephen Wall, Senior Analyst, Aite Group, told listeners to a recent Finextra webinar on trends shaping the future of the wealth management business: "At the mass affluent level, digital advice is going to become a must. It is no longer something that might happen. It is something that is happening and needs to be in place moving over the next couple of years. Firms that don't have it will probably be left behind. What they end up doing is open to question but they won't be relevant as the market moves forward.

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The purpose of this report is to assess the progress of robo advisory, to explore the likely ways in which digital will continue to impact the wealth management industry going forward, and to determine the future of advisory in light of the evolution of technology and its continued adoption by new and established players.

03
WHY ALL THE FUSS ABOUT ROBO?

As Wall at Aite put it during the recent webinar, "there's a lot of heat and noise now around the technology-driven wealth management start-ups". They spotted an opportunity as a result of weaknesses in the current model, he said, and are seeking to exploit that opportunity through technology-driven propositions. "A lot of what they are aiming to do is target young, tech-savvy customers to start off with, but we certainly see that expanding," he continued. "It's not true that those are the only customer groups they can aim for."

On the other side, the ability of traditional wealth management firms to respond "is being hampered", Wall suggested, by "limited online technology capabilities" and "limited tools to compete". "They are also limited by the legacy of their business – and legacy comes in all formats: there's elements of how to build technology in the new world, how to work in an agile manner, how to accept failure, how to bring on board senior teams who had a way of doing business and don't necessarily understand the new way." The fact that the "advisor community is aged compared to the new generation of clients" is another source of difficulty – as of course is the fact that "we are still living in a world of continued regulatory uncertainty and challenge".

Against this backdrop, the robo advisors – leveraging the rise of ETFs, mobile and cloud – have made quite a splash. There are any number of surveys out there gauging their impact, and just a small sample of the findings is enough to reinforce understanding of quite how significant that impact has been. For

Wall: Traditional firms hampered by limited online technology capabilities

A recent UK survey by Panacea Adviser found that a massive 89% of financial advisers feel traditional advice is under threat from its automated equivalent. Meanwhile, nearly half of North American bank customers are open to ditching human expertise in favour of automated, computer-generated advice and services, according to a survey from Accenture.

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Insights into the global picture come from a recent member survey by the CFA Institute – the global association of investment professionals. This found that robo advisors will have the biggest impact of any fintech innovation in the short and medium terms, and that an overwhelming majority of respondents – 70% – believe that mass affluent investors will be positively affected by automated financial advice tools in the form of reduced costs, improved access to advice and improved product choices.

However, the investment professionals surveyed for the research also have some concerns about the implications of robo: when it comes to the risks introduced, 46% think flaws in automated financial advice algorithms could be the biggest risk introduced by robo-advisers 30% reckon it could be mis-selling and 12% are most concerned about data protection.

04
PHASE 2... ENTER THE INCUMBENTS

The strongest indication of the degree to which robo has made an impact is the fact that – as Wall puts it – "the traditional market is fighting back". In this "phase 2" of robo, incumbents are coming to market with their own automated advice offerings, some built, some bought. To give just one example of recent activity in this area, San Francisco-based robo-advisor SigFig raised $40 million in a new financing round that included investments from UBS and the fintech venture fund of Spain's Banco Santander. UBS put its investment in the context of plans to create a joint advisor technology research and innovation lab, where UBS financial advisors, product experts and technologists can work with SigFig's digital experts.

Similar motivations drove Santander, according to Mariano Belinky, Managing Partner at Santander InnoVentures, who said at the time: "The ongoing need for affordable, accessible financial advice continues to be an area of focus for the investment industry. SigFig is at the forefront of tackling this need, providing enterprise-level wealth management technology that is secure, scalable and compliant – tailored to firms' unique corporate strategies and individual client needs. We hope to be able to now collaborate with the aim of ultimately bringing their platform to serve Santander's 122 million customers."

Eyal: The longstanding winners will be the big players that adopt the new concept and technologies

Many of the robo fintechs profess themselves keen to help incumbents up the curve by partnering and/or white labelling their solutions. As Gil Eyal, President and Co-Founder of Israel-based B2B provider of automated trading and investing platform Tradency says, "We strongly believe in the power of existing big financial institutions. We see that handling money is a matter of trust and long term stability, and that people putting their savings and their personal funds into the hands of providers are looking to those elements at least as much as the product itself. We see the big players as the strongest – and the longstanding winners will be the big players that adopt the new concept and the new technologies."

John James, Founder and CEO of Australian automated investment platform BetaSmartz, adds: "BetaSmartz applies a B2B2C model to robo advice, that is we provide an automated investment solution as a white-labelled tool to existing

advice businesses. We enable financial advisors to commercially deliver quality financial advice to a much wider range of investors than is possible using traditional delivery models. Australia was where the business evolved, but we are experiencing strong demand from the US and Asia. Both of these markets are undergoing regulatory change and there is a shift from commission-based to fee-based services occurring with product manufacturers looking to control the digital distribution channel."

Online investing firm Scalable Capital – which has operations in the UK and Germany – is also "happy to engage with advisors and partner with wealth managers, investment managers and private banks if they want to see the value that using technology like ours can bring to their clients", says its Founder and Managing Director Adam French. However, he makes a point that is often raised by robo advisors about the way in which established players are entering the space. "The incumbents will provide very simple robo solutions – robo 1.0," he says. "They won't offer the same as you can get from traditional investment management solutions, because that would cannibalise their existing businesses."

Joe Ziemer, Director of Communications at Betterment, says the entrance into the space of established providers is testament to the degree of change prompted by the online model – "all the large traditional incumbents are entering the space and the missing notables will be there soon", he says – but he adds: "The big incumbents are typically viewing robo as a distribution mechanism for products. One of the few things that could negatively impact the space is if some of the incumbents continue to put out not brilliant products. That could tarnish the whole business."

It's not surprising that technology-driven new entrants have some scepticism about the future of robo in the hands of traditional providers. There are also plenty of voices highlighting the benefits of the 'hybrid' model – where robo and human advisory work in tandem. The model can be beneficial for institutions, suggests John O'Connell, Founder of OwnersAdvisory by Macquarie. "For an institution, the hybrid model can go a long way to providing management with a degree of confidence in the robustness of their advice, across many different humans who actually deliver the advice. For example, the same inputs and same advice, and not a plethora of differing opinions based upon differing emotional states at the time of advice preparation," he says.

Armed with a hybrid approach "the incumbents have a shot" at retaining their dominance, believes Ishaan Gupta, CEO and Co-Founder of Indian robo advisory

French: The incumbents will provide very simple robo solutions – robo 1.0 – rather than cannibalise existing business

Wixifi: “Start-ups won’t suddenly replace the likes of JP Morgan with an app and a website.” The hybrid model also has benefits for investors, he says. “We can’t expect people to just switch from traditional wealth management to robo. Money is a different thing – it has emotion attached to it. A lot of people will be initially sold to by a human being who will then step back and be in touch once a year. That’s the model I see the business going towards.”

Increasingly, the debate around the impact of robo on advisory centres on the question of how – and how well – incumbent providers respond, adapt and harness the best of technology to deliver optimal results for the customer. Some new entrants contend that over time it will be hard to out-perform robo services.

“What I think is that over time people will understand that technology-driven wealth management provides for improvements in predictability of returns through the implementation of consistent processes,” says Thomas Bunnik, CEO of Netherlands-based online wealth manager Pritle. “Digital in its first phase is creating a new market – enabling a higher percentage of people who should take care of their financial futures to do so. Over a medium/longer period of time, it will lead to the replacement of traditional wealth management services. So first it will create a new market, and then later replace an existing one.”

Janine Menasakanian, National Sales Manager at Vanguard Asset Management in the UK, doesn’t agree with this prognosis. “In the long term will robo replace traditional wealth managers? We really don’t believe that to be the case. We will use enhanced digital capabilities though some of the algorithms being developed to automate some more standard processes, but we still firmly believe in the need for an advisor – even for people who are accumulating,” she says.

However, she adds, traditional providers do need to take the impact of automation on advisory seriously. “Advisors really need to understand and articulate how they add value to the client. If investment services are available at a very low cost – even almost free – then as an advisor, if you are going to see a customer, you really need to think what value you are adding. You need to understand – and present – your value.”

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ISHAAN GUPTA, CEO AND CO-FOUNDER, WIXIFI

05 WHAT CAN ROBO DO BETTER?

There is a pretty strong consensus among both established players and new entrants about some of the key strengths of robo, such as the fact that automation enables improved efficiency and improved accessibility. Again, these attributes benefit incumbent and startup providers alike – as well as of course their customers. As Wall from Aite Group told the Finextra webinar listeners, there is a "significant element of need for improved advisor efficiency and productivity" among traditional wealth management providers – and this is exactly what robo underpins. "They key thing we bring to bear is operational efficiency," says Ziemer at Betterment. "We have over 200 advisors using our platform to more efficiently run their firms and better serve a wider swathe of clients."

Menasakanian at Vanguard also highlights the virtues of accessibility and empowerment. "Robo creates a great opportunity to serve a lot of clients who perhaps otherwise would not have any access to financial products, or guidance, and it is also a good way for self-directed private investors – who know more – to manage their own accounts without the need to interact with an advisor," she says.

Scalable Capital's French agrees. "The first generation of robo – what we see today and where it is going in the next couple of years – is one in which the functions of advice and investment management have been opened up to so many more people," he says. "This has enabled an accessibility that can't be offered through the standard investment management model."

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>
> JANINE MENASAKANIAN, NATIONAL SALES MANAGER, VANGUARD ASSET MANAGEMENT

As a consequence, "the end customer will be the winner", suggests Kim Fournais, CEO and Co-Founder of Saxo, a Danish bank specialising in online trading and investment. "Today, trillions of dollars are inefficiently managed and wealth management clients have not been given access to the requisite technology with which to manage their investments. This is because many traditional financial institutions by their nature are not disruptors. New solutions, however, are changing this, and wealth managers and their clients can both benefit from technological advances."

Gupta at Wixifi agrees that customers – especially the new generation of investors – are well served by robo. "It allows more accessibility, more reach, it is more meritocratic, more systematic, more based on performance, and it gives a faster response and instant gratification – which millennials need," he says.

Many new entrants highlight the opportunity to better serve specific segments through robo. "We don't think advisors are going away any time soon," says Charlie Kroll, Co-Founder, Ellevest – an online wealth management provider for women, "but we do believe technology can open up new markets in wealth management that advisors are not serving well today, while giving them better tools to focus on higher value activities for their core clients. For segments of the market which are traditionally underserved by advisors (women, for example, whom we serve at Ellevest), technology enables financial advice to be tailored to meet unique needs that don't fit the typical model."

Investors do stand to gain, agrees James of BetaSmartz. "We empower the advisor to draw on vast amounts of qualitative and quantitative data to create truly customised solutions for their clients," he says. O'Connell at Macquarie adds: "It potentially allows us to take institutional quality depth of thought leadership and customise this to fit each individual's needs at scale."

In addition, institutions will gain as well, suggest observers – whether they realise it yet or not. "I would say as of right now there are two camps," says Dave Nugent, Head of Investments at Canadian online wealth manager Wealthsimple. "One thinks robo advisory is a huge opportunity to reduce headcount and increase efficiency. The other camp is scared about their jobs. Advisers that think this way may have a rude awakening. The traditional investment firms that are embracing robo are very excited about how it will help them. For example, compliance costs are rising. If you have too many advisors doing different things, compliance becomes a complete nightmare. Robo offers an option to improve efficiency in this area."

Bunnik: Robo will first create a new market and then replace an existing one

James at BetaSmartz echoes this efficiency point. "We automate otherwise time-consuming and costly processes, such as compliance and automatic portfolio rebalancing, to assist advisors to scale their businesses and refocus on the clients."

06 HOW FAR CAN ROBO GO?

There is less consensus about how far the use of robo in wealth management can go. As Macquarie's O'Connell points out, it is important to think of what is a broad area along two axes – upstream (strategic planning) and downstream (asset management). The deployment of robo today in both types of activities is typically pretty simple, observers suggest.

On the advice side, "what we are seeing at the moment are baby steps", contends Bruce Moss, Strategy Director at fintech solution provider eValue. "Typically US robo advice offerings have a fairly basic risk questionnaire which assigns a risk profile to an investor and then presents them with a model portfolio usually of ETFs that matches that risk category, maybe with some forecasting to predict a range of outcomes. It's not at all personalised or reflective of consumers' particular circumstances," he says.

On the investing side, "while the business-to-consumer start-ups have presented a very attractive business model for retail users and a very clear marketing pitch, still the product offering is relatively simple", says Eyal at Tradency. "It tends to be a static portfolio, passive investment, buy and hold – it's still only at a basic level of investment services already available today."

A natural fit for portfolio management?

The likelihood of robo being applied to more complex environments on the investing side seems intuitively stronger in the short to medium term. As Ziemer at Betterment says: "People wildly underestimate the complexity of portfolios that computers can and will manage for clients." Indeed, applying more sophisticated technology to money management is already the goal of some new entrants.

O'Connell: Think of robo along two axes – upstream (strategic planning) and downstream (asset management)

"The first generation of robo has done a great job of making investment management more accessible, opening up online distribution channels, offering a great customer experience and smoothing onboarding, but under the hood, the technology is lacking," says French at Scalable Capital. By contrast, his firm is applying a Value at Risk methodology and "dynamically making changes to portfolios to ensure they are aligned with the risk weighting", he says. "This is an institutional investment management technique, and we are using cloud technologies to scale it up to provide it to private clients."

This serves as a reminder that of course quantitative approaches for managing strategies have been around for a long time, used by investment banks and institutional investment managers. Tradency also has a vision of providing institutional-grade money management to wealth clients, albeit as a business-to-business provider, says Eyal. "We are working with our partners to take the concept of digital investment, nice look and feel, availability on the internet, transparency – all those elements from the newcomers – and add to that hybrid services and more sophisticated product offerings, enabling active trading and supporting multiple assets. The start-ups can't support those today. Our vision is that the combination of leading edge technology with the content and knowledge available in the big financial institutions together will create the next generation of digital investment solutions."

The natural language analysis of unstructured content sources including research, news and investment opinion, tied with modern recommendation system techniques, machine learning, customer segmentation, behavioural similarity and advanced portfolio analytics including attribution to individual transaction level, can all be combined to determine optimal investment strategies and non-investment related recommendations.

These algorithmic and more advanced analytical methods could be deployed by the investment committees at incumbent banks, supplementing the existing processes of the committee and providing pre-packaged options that would allow them to respond more quickly – and effectively - to dynamic market conditions and other changes. Advances in computing scale would enable investment committees to scale in parallel, creating tailored solutions for more granular customer segments, thus giving the appearance of greater personalisation.

These analytic results can also serve as an input to the front office themselves - providing a pre-processed and prioritised list of investment recommendations and other interesting offers tailored to each client, bundled up and ready to action each morning. These kinds of inputs take away the grunt work for the advisor, freeing them from the need to manually process masses of data to determine the insights and relevant client matches. Using these techniques, the advisor could deal with a far greater number of clients to a high level of service than they do today, providing a path to additional growth beyond simply hiring more advisors.

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> **THOMAS BUNNIK, CEO, PRITLE**

Coupling robo with more complex investment strategies will not appeal to all providers of course. For one thing, they may be philosophically wedded to buy and hold as the strategy guaranteeing best performance. For another, traditional players may (as mentioned previously) shy away from additional complexity to avoid cannibalising their existing advisory businesses.

There is also the regulatory consideration. As Bunnik at Pritle points out: "Regulators have called a halt to the expansion of services driven by complex strategies delivered to lower end retail clients. We will have to keep it simple for the average investor."

However, given the pace of technology change and the ongoing democratisation of financial services it is hard to imagine that digital investment options for at least high and ultra-high net worth investors will not start to serve up more complex strategies in the future, and it would be dangerous for incumbents to rule this out as a possibility. As French at Scalable Capital emphasises: "I would never underestimate what might be possible 10 years from now: 10 years ago we couldn't have imagined the power of the smartphone."

Strategic planning: a step too far?

How far automation of the advice aspect of wealth management can go is a subject of debate among market experts. Some are firmly of the view that automation is for routine activities only. "Robo is great for simple, self-directed work, but not for complex planning activities," says Menasakanian at Vanguard. "Our Personal Adviser Service in the US uses a digital capability to automate some of the routine processes, but the guidance and advice is done by advisors speaking to clients and coming up with plans. Robo is still nascent and is very much geared towards simple requirements for investors who are accumulating – not for tax planning, retirement planning or other complex activities."

Kroll: Can technology ever be good enough to compensate for the lack of a helping hand in difficult circumstances?

Speaking at the recent Finextra webinar, Reg Warlop, Global Head of Digital – Wealth Management, HSBC, emphasised the breadth of a true wealth management offering. "We all know that wealth is much broader than deciding what to do with the 10K savings you may have on the side," he said. "The majority of effort on the wealth management side is establishing goals, prioritising them, building scenarios, supporting those difficult decisions and trade-offs. For wealth management firms, that's where the money is – getting the mandate to build out the whole plan. For that we need quite a trusted relationship with the customer which is not easy to establish, and regulators are always keen to make sure that

advice is given with the right understanding of the customer's broader situation and broader goals. All of this is actually not trivial to make possible via digital technologies, and it's certainly more complicated than a robo advice journey that asks you five questions about your risk profiling and a few numbers about your saving aspirations."

Warlop described the process by which trust is earned in a face-to-face environment. "You establish trust by getting a lot of pertinent questions answered, by eliciting a lot of relevant responses, through interactivity and a fine-tuning the questions based on the understanding of the customer's requirements in real-time. That's what an advisor can do. Perhaps artificial intelligence (AI) will make progress in this area, and will be able to adapt the questions as the conversation evolves online with a robot, but I haven't seen any technology able to do this in real time."

Even if the technology could do it, would regulators accept it? "There will be a time when you can train AI to do a lot of what the advisor does," says Nugent at Wealthsimple, "but from a regulatory standpoint we are very far away from that."

Regulators would not be the only ones that would need convincing of course: would investors accept totally automated advice? "The boundaries of how far an algorithm can go are expanding every day. The limits today are sufficient for many retail clients, and over time technology will improve to address more and more complex scenarios," says Kroll at Ellevest. "The unsolved question is how important validation and facilitation are in the advisor relationship. Can the technology ever be good enough to compensate for the lack of a helping hand in difficult circumstances? We see technology and advisors co-existing here for some time."

Adds O'Connell at Macquarie: "The upstream may require a bit more thinking about the application of technologies to get the best result, but the technologies themselves exist, albeit some (ala IBM Watson) are still in very early adoption in this regard."

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JOHN O'CONNELL, FOUNDER OF OWNERSADVISORY BY MACQUARIE

Others are more strongly convinced of the future role of technology in automating complex wealth management activities. “Cashflow planning and financial planning are all just maths,” says French at Scalable Capital. “There will always be people who need human intervention but the younger generation won’t need it, and the industry will work out how to optimise the use of chatbots, enabling investors to have a full-blown conversation online with a robot that understands natural language.”

Pritle’s Bunnik points out that “technology is not that new – we have trusted it for a long time” – so it is not hard to imagine sophisticated investors obtaining enough comfort from receiving automated alerts if a portfolio deviates from a risk profile. In Pritle’s current model “everything is automated”, he says. “The customer can contact a person via chat, phone, email… some of our clients even come in for coffee. In the future I see this could be done via AI-based communication with a chatbot, super accurate and very efficient.”

Another application of AI could be – to build on the financial aggregation that many robo advisors are already doing – factoring in other information to risk assessments. “If you have access to your client’s financial services data and know your customer is gambling on the weekend, then maybe you can assume he has a higher risk appetite on the one hand. On the other hand you can perhaps determine that the client has few other assets and inconsistent income and limit his maximum investment risk on that basis,” says Bunnik.

Moss at eValue also sees a role for AI in improving customer engagement. “To improve engagement will be necessary to make advice much more personal. Using AI you can get a better understanding of the nature of your customer. During the risk profile exercise you can measure specific factors – such as how quickly they went through the risk profiler and other questions, what they hesitated over, what they changed, whether they altered previous entries, if they had a nervous or hesitant disposition in the way they filled it in or if they raced through it. All of these factors can give you an idea of their character,” he says.

Moss: We will see greater cost advantages generated for consumers when we really start to see computer algorithms generating advice

> **“The systemic risk created by robo is no different from today: you could argue that every retail advisor says choose blue chip dividend investments. People forget that the ETF world is becoming more complex in terms of different methods. Don’t think about it as one size fits all.”**
>
> DAVE NUGENT, HEAD OF INVESTMENTS, WEALTHSIMPLE

"You can then look at your database, identify similar people, see the sorts of products they have chosen and then suggest these solutions to the customers as ones that 'people like you' have chosen. This is much more engaging. Like Google or Amazon, you are serving up information about products the customer might actually want to buy – using data to make your approaches much more relevant to the customer."

In Moss' view, only when the robo is put into advice will robo advisors start to deliver real value. "In the UK almost nobody is offering proper robo advice," he says. "In most cases it's guidance, and where advice is generally being given it's by human advisors behind the scenes. Real robo advice is not far away. We will see greater cost advantages being generated for consumers when we really start to see computer algorithms generating the advice."

James at BetaSmartz believes the next generation of robo advisors will democratise high end financial advice, precisely by replicating the face-to-face interactions with a financial advisor. These solutions will offer "the ability to intuitively develop and maintain a financial plan unique to their personal circumstances and preferences using multiple advice models ranging from fully online to primarily face-to-face based; access to investment techniques usually the domain of ultra-high net worth private bank clients, such as hedge funds and private equity, not just ETFs; and true artificial intelligence, both quantitative and qualitative, to assist users to navigate complex financial issues and achieve the best possible outcomes", he says.

07
WHAT ARE THE RISKS OF ROBO?

As the results of the CFA Institute survey showed, traditional investment managers have a range of concerns about the risk implications of robo – possible flaws in the algorithms, the potential for mis-selling and the danger of data protection breaches.

The robo advisors themselves are also concerned about risks because, as French at Scalable Capital puts it, "if something went wrong, we would all get tarred with the same brush". Of course, as Nugent from Wealthsimple points out, there is always risk. "The systemic risk created by robo is no different from today: you could argue that every retail advisor says choose blue chip dividend investments. People forget that the ETF world is becoming more complex in terms of different methods. Don't think about it as one size fits all."

Fournais at Saxo argues that in a digital environment risks are reduced. "There are rules and regulations in place already to ensure that mis-selling doesn't take place – such as suitability tests. When you are digital you also have a much better ability to make a digital audit trail and suitability tests and digitalisation also allows better comparisons. I would argue that greater transparency which comes from democratising investment and trading through digitisation also prevents mis-selling, in that it allows comparison against different offers and allows clients to find the best investment solution for their risk profile."

This confidence notwithstanding, in a discussion about what keeps robo advisors awake at night a number of issues do surface. One is quite simply staying in business. "We need to continue to grow because margins are so thin in this business," says Nugent at Wealthsimple. "Many businesses have received a ton of capital and need to scale at an incredible rate to justify that. At some point the numbers will have to do the talking, and that's at the back of everyone's mind."

Another is the possible implications of model portfolios in mass market investing. "When you have model portfolios with a preset risk weight allocation – for example, for medium risk it might be 50% equities and 50% bond – and you rebalance it back to that quarterly, there will be many clients with similar portfolios bucketed in the same way," says French.

"The risk dimension changes with the market but we can't say that other than relatively: we can't say what the absolute risk is. That's where there are problems with risk tolerances. Over time it might be fine. If the value drops by 50% some investors might be able to take it – but some won't. If everyone is getting bucketed together, with simplified onboarding, without checking tolerances for risk in a good way, I might get a bit nervous dealing with the mass market – because the mass market doesn't understand risk."

Another potential problem to be monitored closely is concentration risk, says Bunnik at Pritle. "If we all invest with the same strategies in the same market and underlying index investments, we could create a problem if we all suddenly pulled out. On a global scale this is not yet a major concern because the money flows in index are not resulting in stock price inflations predominantly driven by the growth of index investing. But if you look at the lesser diversification of exposure through funds distribution, since 99% of the flows goes into 1% of the funds, I am sure automation will lead to increased risk – even if it is not systemic yet. There could be some rules around modelling and a maximum sell, but traditional managers can pull out of 100% of assets – so what is wise for regulators to demand? Analysing the exposure of indices and liquidity flows seems wise. Implementing rules to limit buy or sell transactions would conflict with the free economic model of investing."

Cyber is also a headache for the robo advisors. "When the first fintech company is robbed by cyber-criminals, we will see increased attention on the security of our systems," says Bunnik, and Nugent at Wealthsimple adds: "From a security standpoint we are only as good as our security. We take that component very seriously."

The soundness of their algorithms is another preoccupation. "As we build more sophisticated tools they might be misused," acknowledges Eyal at Tradency. "Robo advisors are a beneficial tool for investors. They take down a lot of barriers and have a very positive impact, but at the same time they need to be

Fournais: When you are digital you also have a much better ability to make a digital audit trail

"The risk dimension changes with the market but we can't say that other than relatively: we can't say what the absolute risk is. That's where there are problems with risk tolerances. Over time it might be fine. If the value drops by 50% some investors might be able to take it – but some won't. If everyone is getting bucketed together, with simplified onboarding, without checking tolerances for risk in a good way, I might get a bit nervous dealing with the mass market – because the mass market doesn't understand risk."

ADAM FRENCH, FOUNDER AND MANAGING DIRECTOR, SCALABLE CAPITAL

protected from misuse. We do not take the route of social trading and investment exactly because of that element: we believe managing money is not the same as a Facebook party recommendation and should be managed, regulated and carefully monitored."

"We have to be very responsible with the technology," agrees Gupta at Wixifi. "The soundness of the mathematics behind it is extremely important, and robo advisors will have to be focused on the technology play. As you scale, the algorithms have to change and adapt – an algorithm for half a million dollars versus one for 100m dollars. So I think the technology has to evolve and the robo advisors have to realise their capacity and the limit to that capacity as they evolve."

"A very interesting discussion", Gupta continues, "is around massive market events like Brexit. Algorithms should certainly be smart enough before they go to the retail customer to handle market events like that."

Betterment received some negative publicity around its decision to prohibit trading the day after the UK Brexit vote. Ziemer plays down the challenges created for its business by events such as these. "We do think about the consequences of major market events for our business, and we don't see any massive concerns there," he says. "Brexit was a good example. Ours are discretionary accounts and we opted to extend our normal non-trading window. After the ETF flash crash last year, we put all the proper measures in place to protect our customers. We focus on good client outcomes, and always put our clients' best interests first. A lot of serious investors thought our stance on Brexit was the smart thing to do. We have discretion on the accounts, and we didn't not trade because of the price, but because execution can get very erratic in the wake of major market events."

Nugent also plays down the challenge of negative market activity for robos. "The common assertion is that people think that robos are not ready for a recession," he says. "It's very much misunderstood. We launched two years ago and have seen Greek bankruptcy, China go slow, Brexit… we send an email to investors to explain how the market will react. The ideas behind passive investing and algorithms are very powerful and the average investor understands them. The

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>
> GIL EYAL, PRESIDENT AND CO-FOUNDER, TRADENCY

traditional industry will say robo won't be able to weather a recession, but I just don't buy the fact that investors need to have a personal conversation to manage these issues."

Menasakanian at Vanguard argues that it is exactly at times like this – post the Brexit vote – that advisors come into their own. "They provide a good behaviour guide. We know that trading activity has increased since Brexit, and that is how self-directed investors tend to react. Advisors can offer that calming reassurance – your goals are still there, don't make any hasty decisions."

Human beings are full of biases and computers are not – and sometimes negating biases is good, she says, and sometimes it is not. "If robo advisers such as Betterment have to protect customers when markets go down, won't allow customers to redeem above a certain limit, put brakes on change decisions, is that too much paternalism? And if you do have to build the capability into the algorithm to prevent people from doing the 'wrong' things, that isn't easy. You have to go through a lot of scenarios to get to the right approach: you can't just replicate everything an advisor can do overnight."

Whether robo is more or less risky or better or less well prepared to manage risk than traditional investment management, one thing is absolutely certain: there will be issues with robo advice. "There have been umpteen mis-selling scandals in financial services in the past," says Moss at eValue. "Why would we assume that robo is not going to be the same? There will be problems and because it is a mechanised process they are likely by definition to be systemic. It would be naïve to assume otherwise."

If robo advice is "not done carefully it will cause problems", he continues – but they can be avoided, he suggests. "It is critical to go through an extended period of testing of algorithmic advice against the output produced by existing human delivered advice Ideally this should be done with real-life customers with advisors reviewing and adjusting outputs along the way, to ensure the most robust possible implementation going forward."

Nugent: People think robos are not ready for a recession but it's very much misunderstood

Rich Messina, SVP, Investment Product Management, E*TRADE Financial, echoes the importance of testing. "Confidence is critical," he says. "To that end, we built Adaptive Portfolio through an exhaustive research and testing battery, constantly identifying where the investor had questions, and then building the answers into the digital experience itself, so in the end, our customers walk away feeling confident that they made the right decision. As for the future of Adaptive Portfolio, it's still early days, so our complete attention is on customer feedback, refinement, and improvement based on what we learn."

08

WHAT ARE THE RISKS OF IGNORING ROBO?

Institutions eschewing digital and automation risk missing out on a major opportunity to improve efficiency and scale. Says Bunnik from Pritle. "The advantages of robo are lower costs, accessibility and automation of processes. Robo can be offered at a higher quality and a lower price. Financial planners have the opportunity to serve more clients, in a more consistent manner, with instant rebalancing without manual work – and with the ability create sophisticated reporting." In his view, traditional banks should – as we have seen in other industries – "continue to replace all labour-intensive services with standardised, automated processes, and can then differentiate on asset allocation and product usage across different segments."

The improved functionality achievable through automation should not be underplayed, says Betterment's Ziemer. "We can do a lot of things on a transactional level which are substantially amplified over doing them on your own – how we rebalance accounts, the fact that we can do continual tax harvesting, which would take an age to do manually. Take the example of our tax impact preview. If you are making a transaction our platform can tell you the tax implications. This is a key piece of information, and when we first rolled it out there was a 70% decrease in transactions by those who looked at the tax implications. Our advisers love this feature because they can prevent bad decisions by surfacing the information."

And failing to leverage this opportunity to reduce costs could have a significant negative impact, warns French from Scalable Capital. "There is a lot of intermediation in the business which is removed by robo advisory, which will drive down costs and potentially make it harder for traditional providers to compete," he says. As Macquarie's O'Connell says: "Robo ushers in an era where

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>
> JOE ZIEMER, DIRECTOR OF COMMUNICATIONS, BETTERMENT

investors can get a better engagement with the management of their money at a lower price point as a result of technology."

The cost narrative will overlap with the performance narrative at some point, French adds. "Better performance will end up being more of the story. It's not a major driver yet because the concept that lower cost means better performance over the longer term has not filtered down yet. But if you consider that only 50% of firms can ever outperform the market – because it's a zero sum game – if you then add in the costs then it's fewer than 50% can outperform. The data is more freely available, we can see in broad daylight what everyone is doing – and if cost is a negative function for outperformance, then the advantage of the robos being cheaper because of scale will be clear."

Another risk institutions face by not grappling with robo is that of being perceived as less than leading edge, says Wixifi's Gupta. "It is in the interests of all institutions for the world to believe they have the best technology – in this world of millennials and Uber." What millennials want – as well as what they think – is also critical, adds French. "There is a generational issue: the next generation won't expect human advice and human advisors. As we see the change of wealth over to the new generation, they will demand accessibility, and they would probably pay more for that if it meant they didn't have to talk to someone."

Certainly, the buying habits of millennials will be critical for wealth managers to accommodate. As HSBC's Warlop told the Finextra webinar audience: "The demographic shift will require wealth managers to step up on three levels. One is transparency. The second is control. The third is usability. This is a generation that comparison shops everything instantly from their mobile phones. According to Google about 70% of people now read reviews before making a purchase decision for any kind of product. So for them to take up a recommendation made by an advisor or any online tool they will want to unpick it, compare it, read reviews and independent benchmarks. Overall they will require greater transparency of options – the ability to drill down, change options to see the effect, to play around with it, to try before they buy. I suspect they will expect this as well for wealth products. As you flick between your Uber app and your retirement dashboard you will expect the same level of usability – and bad usability will stop the engagement quite rapidly. From a wealth managers' perspective, this increase in transparency will have a big impact on the way they design their user experiences."

Warlop: Increase in transparency will have a big impact on how wealth managers design user experiences

James at BetaSmartz points out that "whether a client is a Gen Y or a boomer, it is hard to escape the technology that is all around us, from social media, to smartphones and big data". "The uptake is hastened by new user experiences and customer-centric points of engagement designed to provide ultimate transparency. It is not just younger clients that want to engage electronically.

Investors over the age of 55 are increasingly tech-savvy and seek not only to communicate with their advisors, but to collaborate with them as well," he says. And Nugent reports that while the typical Wealthsimple customer is "early 30s, educated, good income, doesn't want to get bogged down by minutiae", increasingly "the baby boomers are becoming clients through their kids" – in a reversal of the traditional pattern of children choosing their parents' financial advisers.

Menasakanian plays down the impact of the generational shift – "we have always had to adapt to new client generations: it is not the first time we have had a new generation coming through, it's a given and I am not sure why people are making such a song and dance about it" – but emphasises the importance of understanding clients, segmenting them, and meeting their needs.

Also relevant in this context is the change in behaviour of clients as the use of social networks and online collaboration grows. There is certainly a trend towards validation before making decisions, and the use of the crowd, or a select circle of trusted partners, could change the online digital advisory process as, either through integration with existing social platforms, or the provision of similar capabilities, the banks could tap into the social behaviour of clients to support the advisory process.

"I'm not a millennial but I still want the ease of transacting online after the call centres are closed," continues Menasakanian. "These habits are common across the whole population. If you look at the way we all buy things, we all check TripAdvisor before we travel. Every time I want to buy a product, I will see what the reviews are like. When I am shopping on Ocado I will be swayed by how many stars products have. Behaviour biases, groupthink, P2P, come into play and impact the way we all buy.

"You need to understand the client and if you don't, you won't do well," she says.

> "According to Google about 70% of people now read reviews before making a purchase decision for any kind of product. So for them to take up a recommendation made by an advisor or any online tool they will want to unpick it, compare it, read reviews and independent benchmarks. Overall they will require greater transparency of options – the ability to drill down, change options to see the effect, to play around with it, to try before they buy. As you flick between your Uber app and your retirement dashboard you will expect the same level of usability – and bad usability will stop the engagement quite rapidly."
>
> **REG WARLOP, GLOBAL HEAD OF DIGITAL – WEALTH MANAGEMENT, HSBC**

09

WHAT DOES ROBO MEAN FOR ADVISORY, AND HOW SHOULD ADVISORY EVOLVE AS A RESULT?

Though they may differ in their view of which providers will prevail and in how far AI can go in replicating the advisory function, almost all observers believe that some form of hybrid model will predominate going forward.

Says Messina at E*TRADE Financial: "As an original digital disruptor, we understand intimately that digital has its place, as does the human element. The former cannot always take the place of the latter. We don't see the rise in robo advice driving an either/or situation. While digital tools are a necessity in catering to today's investors, at the same time, investors seek human support. They want to be able to talk to a professional, especially during extreme market volatility and when financially planning for a significant live event, for example retirement, buying a home or college tuition.

Moss of eValue describes his vision: "In the not too distant future consumers will go on to a portal – a trusted brand – where there is lots of information to read. If they wish they can buy on their own initiative as a self-directed investor. For other issues or periods in their lives, they may feel less confident and could benefit from advice. Robo advice would be an option but if the issue is complex and is not eligible for robo advice, or the consumer wants the reassurance of talking to a human adviser, full advice will be available. These options should be omni-channel, I should be able to move between them at will, and my data should follow me – so any data I've keyed can be used in any mode, making the process efficient and cutting the cost of advice.

Messina: We don't see the rise of robo driving an and/or situation

"Human and robo advisors will coexist. Some customers will want the personal touch at the beginning and others may be quite happy online. This could be a generational thing or just a personal thing. But either way, advisors are not a doomed species: they will simply spend less time doing mundane and administrative tasks and focus on the areas of highest value to their clients."

Macquarie's O'Connell describes a more advisor-centric vision of the future. "In the near future, every human advisor could have the benefit of a deeply granular robo engine in their dashboard – much the same way most cars have a GPS

guidance system today. This could be used in a hybrid approach, with the robo doing the 'donkey' work of the rigour analysis and the human adviser handling the 'gamma' of managing the client's emotions and behaviour biases around this – most likely over video phone chats," he says, adding: "Robo technology engines provide real-time and deep analysis of clients' investment situations, wealth needs, options and best path forward, all delivered through a human 'concierge' that makes the experience enjoyable and personable."

Another view is that models will evolve to support an escalation of service levels: investors may have a threshold below which they are happy to work with the machine and take the automated advice, but once a decision crosses that boundary it becomes significant enough that external validation and/or validation with an advisory becomes part of the decision process. Clients could be offered a more a la carte approach; rather than assets under management or fixed fees driving levels of service, they could pay for personal advice when they felt they needed it, and consume digital advice or be self-directed at other times. In other words, there could be a continuum from static recommendations through to chatbot interaction through to social validation through to personal service.

Obviously the evolution of a hybrid model has implications for traditional providers, not least from a technology perspective. As Ashley Globerman, Wealth Management Research Analyst at Celent, says: "One of the ways in which advisors can work alongside robo advice platforms and address the challenges posed by such platforms is by offering dynamic and 360-degree financial advice, which in turn will further segment their client bases. Segmentation will be key for advisors to demonstrate their value in the post-financial crisis and digital world where clients demand that their unique needs are met in real-time.

"Predictive analytics will also aid the customer segmentation models and ultimately empower firms to offer custom-designed products and services. Another area where advisors and traditional wealth managers can improve is on the mobility/social side where they have often fallen fall behind more technology-nimble firms (online brokerage, personal financial management (PFM) tools and robos). As such, by further improving these capabilities, in addition to servicing clients remotely, they will be able to compete with such platforms."

Globerman: Segmentation key for advisors to demonstrate their value

Customer-centricity will be vital, emphasised Aite's Wall during the Finextra webinar. "There needs to be more emphasis on goals-based wealth management, and a move from an inside out approach to an outside in approach – what does the client want, and how can we deliver it? There needs to be far more focus on the client dictating what a wealth manager is and how they want to be serviced."

> "From an institutional standpoint, the co-collaboration model is key to ongoing success. Institutions need to be able to provide a transparent platform for clients to engage. They need to draw on all of the data surrounding a client to provide smarter and truly customised advice, and they need to meet compliance standards in a cost-effective manner that can only be provided with a digital platform."
>
> JOHN JAMES, FOUNDER AND CEO, BETASMARTZ

From a technology standpoint, institutions will need "a very secure, single instance core banking system with integrated and golden source data to deliver up the customised front end experience customers want", Wall added.

The challenge for established players of fitting their technology to the challenge should not be under-estimated, warns Saxo's Fournais. "The industry is on the cusp of change. If big banks start to develop their offerings to accommodate this trend they will see a big jump in assets under management. The main challenge they face is making the right decision when it comes to upgrading or replacing their technology: many legacy systems are too expensive to run and upgrade, so unsurprisingly they are looking to outsourcing as a way of reducing costs and growing their AUM and profitability. The notion that everyone should develop their own systems is dead."

BetaSmartz's James agrees. "From an institutional standpoint, the co-collaboration model is key to ongoing success. Institutions need to be able to provide a transparent platform for clients to engage. They need to draw on all of the data surrounding a client to provide smarter and truly customised advice, and they need to meet compliance standards in a cost-effective manner that can only be provided with a digital platform."

In addition, the role of advisors will clearly have to change. Talking to Finextra TV in New York, David Lo, Associate Partner, Head of US Client Insight, Scorpio Partnership, said: "If you think about the wealth management industry, traditionally clients would have an advisor. There would be a lot of discussion around picking stocks and your investment performance. Historically that has really been the important part of the discussion. Moving forward, because of robo advice, and the fact that people believe in efficient markets before anything, that isn't really the conversation any more. So the advisor becomes more of a

relationship manager, a quarterback, a mentor – and they have to think about how they go about their day to day business differently, managing a relationship, and talking about a whole financial plan, not just investment performance."

This is not necessarily a threat, emphasises French at Scalable Capital. "Advisors will shape the technology, working with the providers to help them do a better job," he says. "You don't add value with asset allocation, you do it with life coaching. Once that gets automated, then the advisors should move on to focus on something else. They should keep focusing on what they're good at."

Eyal at Tradency agrees that handled correctly, robo is an opportunity for the advisor community. "I recently had a meeting with one of the biggest advisory companies in the world, and they shared with me that they view more than 50% of their role as psychologists rather than economists," he says. "Those that understand the potential of this technology will not be extinct – they will flourish, using the tools to reach additional markets."

There will be a reduction in the number of advisors, says Nugent at Wealthsimple – "but most advisors will tell you there are too many of them, and they shouldn't all be treated the same way", he adds. "A poor advisor won't have a value proposition, but a good advisor can say what a robo doesn't say – here is my value add. The good advisors can partner up with technology to create something special, and we are always seeing this happen."

The reshaping of business models and a reduction in human involvement in processes in the wake of automation is hardly a phenomenon unique to wealth management after all. Echoing the view that "good advisors have nothing to worry about", Ziemer at Betterment says: "If you are just another advisor, providing portfolio management, asset allocation and transactional services, you might have to reinvent your model. Lots of work can be done by technology, but a good advisor can offer rational evaluation, goal advice, insurance, multi-year wealth plans, estate planning et cetera.

> **"Because of robo advice, and the fact that people believe in efficient markets before anything, the advisor becomes more of a relationship manager, a quarterback, a mentor – and they have to think about how they go about their day to day business differently, managing a relationship, and talking about a whole financial plan, not just investment performance."**
>
> DAVID LO, ASSOCIATE PARTNER, SCORPIO PARTNERSHIP

10 ABOUT

Finextra

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