STAYING AHEAD OF THE TREND: AUTOMATED ADVICE SERVICES

Financial Services Perspective

Automated Advice, also known as robo-advice, uses sophisticated investment advisory algorithms without the presence of a traditional Financial Advisor. The service, which is delivered through digital channels that leverage simple, intuitive user interfaces, is disrupting the industry, forcing firms to evolve. The industry's increasing shift towards automation and digital has opened the door for automated advisory firms that now possess nearly $19B in assets under management (AUM).[1] Vanguard's combination of virtual investing services and human Financial Advisors saw a thirteen-fold increase in assets in 2014 alone (reaching $10.1B) even before a public offering.[2]

Today, the typical investor fits a profile of technologically proficient, growing in individualism, and increasingly millennial.[3] Advice value propositions are changing; assets are quickly flowing to automated advice services; pricing models are being challenged; operations and practice management processes are being redesigned to be more efficient; and the role of the Financial Advisor as investment manager is changing.

Automated advice continues to grow exponentially primarily due to the opportunity to provide high-quality advice to clients who do not meet the asset thresholds needed for full-service advisory. The value proposition of automated advice is further enhanced by an average annual fee of $35 on $10,000 accounts[4] and its ability to be delivered effectively for starkly lower basis points when compared to a full-service firm.

As more performance history is gained with automated advice engines, it is likely that performance parity with full-service advisory will exist and sway even more investors to seek firms with automated solutions. Major industry players such as Charles Schwab are introducing automated advice offerings in 2015,[5] and similarly sized firms have an opportunity to provide this service to cast a wide net for investors. What began as a mass affluent / affluent play has now broadened into many, other segments in both the retail and institutional channels. Major wirehouses, banks, and retirement firms are all trying to discern how automated advice could and should be integrated with their products, services, and fee structures.

CLIENTS ARE NOW ASKING "WHY SHOULD I PAY 1.5% TO MY ADVISOR OR WEALTH MANAGEMENT FIRM WHEN I CAN PAY 0.3% FOR THE SAME SERVICE?"

AUTOMATED ADVICE IS CHANGING:

- Value propositions
- Pricing models
- Operations and practices management processes
- Role of the Financial Advisor

1. http://www.businessinsider.com/robo-adviser-growth-2014-12
2. http://www.investmentnews.com/article/20150225/FREE/150229931/vanguard-may-expand fast-growing-virtual-investing-service-to?utm_source=Morning-20150226&utm_medium=in-newsletter&utm_campaign=investmentnews&utm_term=text
3. http://news.morningstar.com/articlenet/article.aspx?id=679599
4. http://online.wsj.com/public/resources/documents/Online_Financial_Advisors_Infographic.pdf
5. http://www.forbes.com/sites/greatspeculations/2014/11/21/charles-schwab-introduces-its-robo-advisor-is-this-the-next-big-thing-in-investing/2/

CAPTURE THE MILLENNIAL MARKET

Because millennials observed the 2008 financial crisis first hand, have limited income to invest, and are burdened with student debt, they regularly think about their financial future but struggle to make saving and investing a priority.[6] Automated advice offers an opportunity to engage this generation with advisory services and proactively capture business as the youngest and largest customer segment group obtains wealth and affluence – at a price point that they can understand and appreciate.

THE DIFFICULTY OF ATTRACTING MILLENNIAL CLIENTS IS COMPOUNDED BY A GENERATIONAL DISTRUST TOWARD FINANCE AND BANKING.

NEARLY THREE QUARTERS OF MILLENNIALS WOULD PREFER TO GO TO THE DENTIST THAN TO LISTEN TO FINANCIAL ADVICE[7] AND BELIEVE THEIR PARENTS TO BE THE MOST RELIABLE SOURCE OF INFORMATION WHEN IT COMES TO WEALTH MANAGEMENT AND RETIREMENT.

From a net wealth and trust standpoint, the millennial generation is not ready for a full-service advisory model, and perhaps the inverse is true as well: a full-service advisory model is not ready to cater to millennial needs and preferences.

PLAN FOR RETIREMENT

Americans across all age and asset segments face a planning capabilities deficit when it comes to retirement. Many investors struggle with the complexity of investing with so many options like 401(k)s, Traditional IRAs, Roth IRAs, 403(b)s, VULs, Annuities, etc. However, as automated advice services continue to grow in popularity, the model as we know it is beginning to shift.

Planning for retirement requires great foresight, deep understanding of proper portfolio allocation, and how to adjust plans as market forces affect savings. Automated advice has removed much of the mystery around retirement planning and has simplified investments based on the investor's stated goals. And, at a starkly lower fee compared to a traditional advisory service model, this can mean significant savings over time.

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MITIGATE RISK

Firms take on significant risk in the delivery of investment advice. Whether fiduciary risk or operational risk, firms can incur substantial financial losses when things do not go as planned.

6. https://www08.wellsfargomedia.com/downloads/pdf/com/retirement-employee-benefits/insights/2014-millennial-study-report.pdf

7. http://www.millennialdisruptionindex.com/wp-content/uploads/2014/02/MDI_Final.pdf

More and more, clients are suing firms to recoup fees and investment losses due to poor decisions made by a rogue Financial Advisor or account churn. Handing control of core portfolio management functions to an automated advisor can mitigate the risks associated with bad advisor behavior and operational snafus.

AUTOMATED ADVISORS CAN MITIGATE RISKS ASSOCIATED WITH BAD ADVISOR BEHAVIOR.

Additionally, the government and regulatory agencies are continuously working to expand fiduciary standards, fee transparency rules, suitability standards, and the list goes on and on. Automated advice may be one way firms can mitigate and control the known risks of today, as well as potential risks of the future.

EMBRACE THE NEXT GENERATION ADVISOR ROLE

With the proliferation of information on the internet, easy-to-use digital investment solutions, and the commoditization of financial products, the Financial Advisor's role has become more a relationship manager and educator, rather than a stock picker.

THE FINANCIAL ADVISOR'S ROLE HAS BECOME MORE A RELATIONSHIP MANAGER AND EDUCATOR, RATHER THAN A STOCK PICKER.

Automated advisors have done a great job in marketing and explaining their value proposition with well-designed websites and a simplified investment model that attracts new clients by making the process look easy. While a full-service Financial Advisor typically has a smaller book of business, the average automated advisor has 21,000 clients. In order to grow their business, maintain their clients, and attract new investors, traditional advisors must make the choice to embrace their evolving role. Investment management is no longer the value proposition it used to be for a Financial Advisor, but understanding a client's goals, fears, dreams, and priorities is a service clients seek – and are willing to pay for.

INTEGRATING AUTOMATED ADVICE SERVICES

All wealth management firms should embrace an automated advice strategy. The spectrum of strategies will range from how to fully integrate automated advice to how to defend the current business model against it. In building the right strategy, firms will be forced to take a hard look at their current environment and answer key questions. Where are the demographics of our business taking us? Is our current advice delivery model scalable? Would more of our clients seek advice if the price point and/or engagement model were different? What is our value proposition outside of investment management and how are we articulating it to our clients?

THE FIRM THAT CREATES TRUST AND VALUE BEFORE THE INVESTORS HIT THE HIGH-NET-WORTH MARKER WILL BE THE ONE TO MAINTAIN THOSE ASSETS THROUGHOUT THE CLIENT LIFECYCLE.

Automated advice is complementary to the full-service advice model. Firms should leverage automated advice to maximize coverage within its client base. Bridging the gap in advice coverage for institutional retirement clients, millennials, or those who otherwise fall into the mass market and mass affluent categories is paying it forward. One day some of those investors will be affluent and want the broad range of services that can only be provided by a traditional Financial Advisor.

PROVIDING ADVICE FOR CLIENTS OF VARYING INCOME LEVELS IS PAYING IT FORWARD.

The potential for efficiency gains is significant. Using automated advice engines to manage the investment aspect of a client relationship will put a tremendous amount of time back into a Financial Advisor's practice. Advisors can use this extra time to do what they do best - deepen relationships through coaching to help their clients achieve life goals.

Commoditization of advice is real. Firms that fail to adjust their business model will find themselves in an advisory "no-man's land." Even though high-net-worth clients are less sensitive to higher fees, that does not mean they will continue to pay more for commoditized products and services. There must be service differentiation at the high end in order for firms to have any immunity to this commoditization dynamic that is happening at an accelerating pace.

FIRMS THAT FAIL TO INNOVATE WILL FIND THEMSELVES IN AN ADVISORY NO-MAN'S LAND.

INNOVATION THROUGH DISRUPTION

With the disruption brought by automated services to the financial services industry comes opportunity for innovation, digital advancement and acceleration, practice management efficiencies, and a more focused goal of providing value-added services that clients cannot get from a machine.

Want to explore how to seize the automated advice opportunity in your business? Contact us – a live team of experts is here to advise.

ABOUT NORTH HIGHLAND

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