Robo-advisors: the rise of automated financial advice

Has digital disruption in the financial industry created a win-win-win scenario for consumers, financial service companies and upstart FinTech companies? Or can the existing market dynamics support the growth everyone is banking on?

POINT OF VIEW

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Our Point of View: *At Ipsos, we've been tracking financial technology trends on behalf of our financial services clients, keeping an eye on emerging new technology and patterns. We're particularly interested in the current state of digital advisory services that debuted on the scene over five years ago: robo-advisors.*

Robo-advisors sit at the intersection of some of our favorite topics—innovation, new technology, and digitization of services.

Our take is that while the rhetoric and hype may rile the skeptics, the impact of this new technology, and its consumer adoption, is significant. We see more market expansion than market disruption, and barring any significant market downturn, this will be a win-win-win for consumers, financial service companies, and the new FinTech players in automated financial advice.

What Does Robo-advisor Mean to Us?

Let's start with getting our terms straight. Defined broadly, robo-advisors are automated portfolio management services that act with little or no direct human intervention, providing those services at costs lower than those provided by financial advisors. Some new financial technology firms with venture capital backing may have assumed a more prominent role in media attention, but the market is actually more than just a single business model. We see the "robo world" in three parts:

- **Pureplay** companies offer investors easy onboarding with questions about risk, age, income, and goals. They offer a limited number of funds, and little or no personal interaction with customers. Their interfaces show investments, growth, and projected returns. At most basic, these are "set-and-forget" investment vehicles with personally-motivated contributions toward goals like home purchase, education, or retirement.
- **Robo "Hybrids,"** launched from established investment companies, offer mostly automated portfolio management with some human advisors available at higher rates. They also have investment minimums, but provide services at lower rates than their traditional offerings.
- **Robo Platform Providers** who "white label" their technology for banks and wealth management firms to offer basic portfolio management to beginning investors.

Based on currently available numbers, the global rise of robo-advisory services show great success. Worldwide users grew from 2.8 million in 2015 to 5.7 million in 2016, worldwide, with assets under management (AUM) rising in turn from $66 billion to $126 billion.[1] Here in the United States, where coverage of robo-advisors tends to focus on pureplay firms like Betterment, Wealthfront, Personal Investor, Blooom and SigFig, growth has been swift, rising from $11.5 billion in April 2014 to an estimated $61 billion in June 2016.[2]

[1] Statista: "Digital Market Outlook: Robo-advisors" 2016.
[2] Benefits Pro / Business Research Inc: "Robo-advisors will disrupt market: study," Aug 8, 2016.

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Market Disruption or Market Expansion?

We almost hate to use the D-word, but disruption has dominated the reams of reports and commentaries over emerging financial technologies (FinTech), and it's also been central to industry coverage of robo-advisories. There were over 5,100 articles published since 2012 that refer to robo-advisors, and eight in ten also use the word "disruption."[3] With so many kinds of financial services providers facing encroachment from FinTech companies in payments, retail banking and insurance, this scale of coverage was not surprising.

However, we think that disruption is more than just a buzzword. It's a fundamental shift in the quality or essence of the industry affected. It's also a lasting impact that goes beyond the excitement of a fad, and has the potential to change related industries and consumer behaviors.

In the case of robo-advisors, where is the disruption? After all, online financial service platforms are widely known and used by today's consumers. A majority of adults bank online (61%) and many by mobile phone (43%).[4] More than half (56%) have used mobile payment services.[5] With robo-advisors, there is no Blockbuster Video falling to Netflix or taxi industry losing share to Uber.

In today's online financial environment, would adoption of automated investing show a significant behavioral shift? We don't think so. Online financial services have long been embraced, so robo-investing will feel familiar to many. More likely, customers will be attracted to easy online onboarding, goal-setting, and personal profiling to tailor an account to their needs. We also find that this innovation-by-reduction—the simplified offers, automatic rebalancing, and limited selection of investment products—to be a winning approach to getting a new customer to invest.

It's Really About the Cost of Investing

New investors may be shocked by the costs for managing investments. Traditional wealth managers charge 1–3% of their clients' portfolios every year, even when there are few changes to the portfolio outside of occasional rebalancing of assets, or help to keep taxes low. When robo-advisers provide similar services, they will do it for 0.25% or so a year.

Largely because they quash fees, robo-services do a good job for anyone interested in starting a basic investment portfolio. Their simple onboarding process starts with a basic questionnaire—age, salary, investment aims and the like—that helps establish risk appetite relative to financial goals. Money is then allocated to low-cost funds provided by third parties. For those who believe that fees and human error are the main pitfalls of investing, the approach is hard to beat.

In that context, we see robo-advisors as market expanders more than market disruptors. By reducing fees and lowering or eliminating entry thresholds, they aim to attract more people into investing and participating in their personal financial growth.

So much of the coverage of robo-advisors is focused on the under-35 segment who make up a significant portion of first-time investors. However, it's not just Millennials who are showing interest in the category. Our Ipsos Affluent study, among Americans with $100k+ annual income, shows that robo-advisor usage exceeds 3 million. While that may be only 4% of the affluent segment, there are almost 5.3 million that say they are likely to use a robo-advisor in the next 12 months, and over 9 million interested in learning more.[6]

[3] Based on a targeted search in Factiva for all mentions of robo-advisors in US media. Jan 2012 – Mar 2017.

[4] US Federal Reserve Board of Governors. Base: adults with bank accounts in 2015. Mobile banking base among adults with phones.

[5] eMarketer September 2016 based on 136 million user estimate among Americans 14 years and older.

[6] Ipsos Affluent Survey in 2016 estimates 75.5 million affluent American consumers (HHI above $100K).

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Lack of Perceived Value

Wealth management professionals and registered investment advisors (RIAs) may be forced to recognize that new investors are questioning advisors' commissions and fees associated with investing. In recent investor forum posts, and in our own qualitative research, we noted skepticism about advisors—often derided as specialized salesmen pressuring customers into products that increased commissions.

Ipsos research shows (Figure 1) that among affluent GenX and Millennial groups, half consider the professional advisor just "nice to have." About an eighth of Millennials and a quarter of GenX think they are "unimportant." [7]

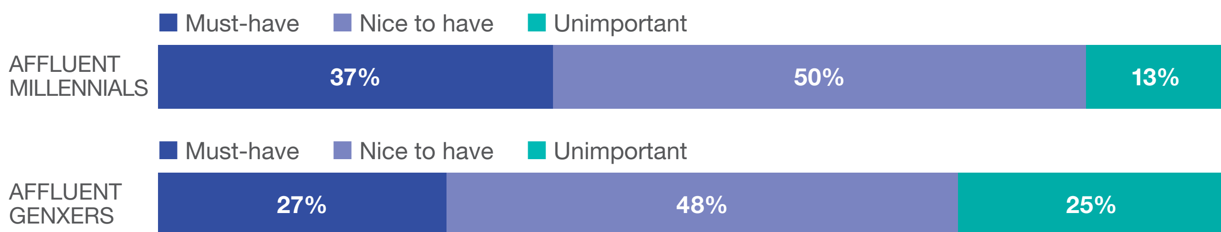
That's why we think the investment professionals may be the ones most likely to experience disruption. Strangely, they don't seem to care.

When asked in a 2015 survey if they were concerned about robo-advisors, 82% of RIAs said they weren't. When asked again a year later, the response was much the same. In both years, only 1% of RIA respondents said they were "extremely concerned." [8] In our view, the current wealth managers dismiss the robo-advisor models as something for small fry, and with most RIAs being compensated on a commission basis, robo-advisors are too small to be of any concern to them.

From a young consumer perspective, the investment advisors have serious perception barriers. Only 25% of Millennials work with a financial professional, although almost half have a 401K and a third have an IRA.[9] Two in five Millennials (41%) have not worked with a financial professional because they think they don't have enough money saved to begin. However, what should be most troubling to RIAs is a simple issue of value. A third of Millennials think investment professionals are too expensive.[10]

Figure 1:

A FINANCIAL ADVISOR IS A...



[7] Ipsos Affluent Millennial Study.
[8] TD Ameritrade Survey 12/2016.
[9] Principal Financial Group: Millennial Study 2015.
[10] ibid.

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The Entry of the Hybrid Robo

In our view, the traditional banking and investment industry's fear of disintermediation and replacement was a good thing for all involved—consumers, banks and FinTech firms. The broad industry reaction to a perceived threat has strengthened the overall offerings available to consumers, as banks and investment firms expanded their digital offerings, and FinTech firms found tie-ups with financial companies to expand their customer bases.

This is simply giving people what they expect. Even as early as 2014, a survey of 1,600 investors asked if in the future, "technological advances in providing financial advice will better serve individuals with regard to value and cost than financial advisors." More than 76% of Millennial respondents, 67% of Generation X and just over half of baby boomers (54%) answered yes.[11]

By the end of 2015, some of the nation's largest banks and investment firms moved to expand their offerings to include automated advisory services, but with a key difference to pureplay robos. Each promised some form of personal advice available on demand (usually at a higher management fee). Most of the hybrids maintain minimum investment thresholds.

Whether through acquisition, partnership, or internal development, the investment companies recognized that some of their clients and prospects would want automated advisory services on some level. They were not going to wait for FinTechs' pureplay robo-advisors to steal their clients. Since 2015 we've seen the launches captured in the following table.

Company	Market Entrants Since 2015	Minimum Investment as of 2017
Vanguard	Personal Advisor Services	$10,000
Merrill Edge	Guided Investing	$5,000
Charles Schwab	Intelligent Portfolios (online only)	$5,000
Capital One	Advisor Connect	$25,000
Fidelity	Fidelity Go	$5,000
Blackrock	Acquired FutureAdvisor to provide B2B automated platform management services to RBC Wealth Management, LPL Financial, and BBVA Compass Bank.	NA
Wells Fargo	Partnership with SigFig to develop a new robo-advisory for Wells Fargo Advisors for 2017 pilot.	NA

Based on awareness alone, the hybrid development was a great success. Just months after launch, 51% of these companies' bank clients surveyed by KPMG knew about Schwab Intelligent Portfolios, and 48% knew of Vanguard Personal Advisor Services. That was triple the awareness of FutureAdvisor (16%), and five times that of Wealthfront (10.1%) or Betterment (9.5%).[12] The AUM of Vanguard's Personal Advisor Services after a year reached $41 billion, and Schwab Intelligent Portfolios' hit $8.1 billion.[13] Even if their success was from poaching current customers—and Schwab says half of its hybrid customers are long term investors saving for retirement—awareness and AUM show the competitive power of established brands in the automated investment space.

[11] State Street Center for Applied Research.
[12] FinTechNews.ch, Feb 24, 2016, quoting KPMG study data.
[13] Vanguard AUM reported in RIABiz, Aug 2, 2016.
Schwab SEC filings cited by Financial Planning Magazine, Jul 16, 2016.

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Outlook–What's Ahead?

We think that there is still growth ahead for the category. Both affluent investors and new Millennial savers have shown significant interest, and with broader deployment of Robo-style tools into 401Ks (like the Betterment for Business or FutureAdvisor offerings) it is likely that more corporate employees across age groups will use them in company savings plans.

When the hybrid robos launched, industry watchers rushed to declare the imminent demise of pureplays. The Economist, for example, reported in 2015 that with slowing AUM growth, and pressure from venture capital backers, leaders like Betterment and Wealthfront would not be able to scale sufficiently to turn a profit. Morningstar analyst Michael Wong estimated that pureplay robo-advisors need somewhere between $16B and $40B of AUM just to cover core operating costs and recoup advertising expenses.[14] With a current linear growth pace of even $150M per month, Betterment and Wealthfront may not even reach $10B of AUM by 2020. More troubling, the average account size for Betterment has flatlined around $20,000, and declined at Wealthfront from $80,000 in Q1 2015 to $45,000 a year later.[15] Our quick math says that a $5 billion AUM pureplay robo would only generate $12.5 million gross revenue at a 0.25% fee structure. Would that adequately support the staff and marketing budgets required to sustain operations and customer acquisition?

At Ipsos, we see four key factors beyond AUM impacting the future of automated advice services.

1. First, the growth we've seen in the sector has happened in a thriving market with low interest rates. That means people want to do more with their money than put it into safe savings with a 1% return. If a market downturn occurs, new investors will need to slow down or liquidate savings. Or, if interest rates increase and a savings account provides FDIC security and a decent return, that might change the minds of young savers. In either case, it's likely to most adversely impact pureplay robos.
2. As American workers continue to participate in the "Gig Economy" there will be fewer 401K investors and more self-directed savers. Nearly 54 million Americans participated in some form of independent work in 2015, which represents about a third of the workforce.[16] About 10 million workers get more than half of their income this way. This should bode well for automated investing's low cost and self-directed approach, especially among younger, tech-savvy, self-employed professionals without a lot to invest, and generally unsure of the value RIAs provide.
3. The Bureau of Economic Analysis reports that Americans' personal savings rate is just 5.7%.[17] An independent study by Fidelity that factors in employer contributions puts the number higher, at 8.5%,[18] but both are below the 10% most industry analysts recommend for retirement. Wages have been stagnant in real dollar terms for years, so the anticipated new inflow of funds into investments may be unrealistic.
4. Compliance may hinder traditional financial service companies but, as of now, pureplay robo-advisors have avoided regulatory scrutiny that generally comes with providing financial advice. The algorithms and modern portfolio theory that guides investments is not personally driven—or is it? As more personal advice becomes available on a fee basis, pureplay robos may come under greater government scrutiny. Compliance will always present operational costs.

[14] CNBC report "Is the twilight of the robo-advisor already at hand?" cites Wong's research, 14 Jun 2016.

[15] Industry Analyst Michael Kitces, *Nerds Eye View,* blog, 2 May 2016.

[16] smallbusinesstrends.com Paul Chaney. "20 Surprising Stats About the Gig Economy" July 25, 2016

[17] blog.bea.gov/category/personal-savings/

[18] www.fidelity.com/about-fidelity/individual-investing/americas-savings-rate-improves Jan 7, 2016

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All About Acquisition

The challenge for robo-advising, as we see it, will still be primarily about customer acquisition. This is true for all players in the robo space, but perhaps a bit more pressing for pureplays. Traditional financial service providers like banks and large investment firms will likely be conflicted about shifting price sensitive, small investment customers away from higher-fee-generating products. We expect they will approach the growth of their new hybrids cautiously, and wait for customers to request those options rather than seek to poach customers away from pureplay robo-advisors.

RIAs in middle or large scale wealth management firms may find their toolkits adapting to and benefiting from new white label platforms like BlackRock's FutureAdvisor. This presents an opportunity to capture a new investor who wants only to start a small account, but who may grow into more lucrative products and services. An RIA might say, in effect, *"Start saving here, and I'm ready when you want to talk."* That is a long-term, relationship-building approach that could develop from a robo-style platform.

It is the pureplay robos that must work hard to increase awareness and attract customers. By adapting to some B2B offerings with corporations, they may find new customers—the half of consumers with 401Ks—more familiar with their brands and services when they change jobs or rollover accounts. They may also find that customer data on top savers and account growers will show a path to new customer acquisition.

Oddly enough, their new brands may work to their advantage. In so many of our concept tests, we see good financial service ideas grabbing customers' interest, but then see the market scores drop when associated with established financial service brands. It is possible that the pureplay robos will continue to attract customers and grow as "challenge brands" that play Startup Davids to Big Financial Goliaths. Their scale, simple onboarding, limited number of funds and no-advisor-meeting-to-start might continue to win over those who are fee averse or distrusting of RIA motives.

At Ipsos we continue to believe that true consumer understanding is critical to the success of automated investment services, no matter who is offering them. As conditions change, and major players shift and partner and acquire to expand their investment service offerings, financial institutions will need to pay careful attention to customer needs and how online capabilities will change with them.

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