Robots and your money

How could robo-advisers change the wealth management sector?

BY CARLO LACOTA CA AND DUSHYANT KAPOOR

AUSTRALIA HAS A mature and robust superannuation system that is the fifth largest in the world.

With more than A$1.5 trillion in assets, Aussie super represents the second largest asset base (after banking) accounting for 24% of all assets held by Australian financial institutions.

The Australian wealth management sector operates mainly through intermediaries comprising of independent or aligned financial planners who primarily deliver advice and hence "own" the relationship with their end customers.

The rise of robo-advisers

The emergence of robo-advisers, supported by the high adoption of digital technologies in Australia, is disrupting the traditionally intermediated wealth market. Robo-advisers use computer programs to provide investment advice online. They typically charge less than half the fees of traditional brokerages, which cost at least 1% of assets under management.

As low-cost services gain acceptance, traditional brokerages are under increasing pressure to justify their fees.

Most robo-advisers direct investors to exchange traded funds (ETFs) based on generic goals and risk profiles. While most robo-advisers include rebalancing, some also include tax-efficient investing. According to consulting firm AT Kearney, wealth management services delivered through a robo-advisory model will surge, managing as much as A$2.2 trillion by 2020.

Robo-advisers are appealing to not only the millennials, but also do-it-yourselfers, possibly looking to access ready-made portfolios in which to invest. At Charles Schwab Corp about 15% of those in automated portfolios have at least US$1m invested with the company.

Robo-advisers also work for passive investors who put their money into a black box of investments.

Goals-based investing

When an investor needs to align investment outcomes with overall life goals (for example, mortgages, debt, income goals, retirement plans, estate planning, or school and college education planning for kids) a financial adviser may be needed to "link" these goals with the investment portfolio.

While it is possible for robo-advisers to evolve and support goals-based investing, this service is not currently available.

Robo-advisers v humans

While the jury is still out on whether robots will take over wealth management, some guiding parameters are emerging that may help investors choose between robo-advisers and their human counterparts. For example, a robo-adviser may appeal to investors who:

- want a "low-touch" mode of investing (ie set and forget)
- feel more comfortable working online rather than just with a person
- aren't investing a large amount of money or in complex products
- are looking for cost optimal avenues of investing.

On the other hand, investors may opt for a human financial advisor if they:

- want to be involved in their investments
- are interested in strategic risk-taking
- are investing a large amount of money
- are willing to include complex investment products in their portfolio.

In today's connected world, access to information such as products, markets, investment returns and historical trends is available to anyone with a mobile device or computer. The challenges lie in identifying what to look for, being able to analyse search results and drive meaningful investment outcomes. Robo-advisers deliver this expertise by presenting relevant information/analysis.

A financial adviser, on the other hand, masks all the complexity involved in collating and analysing information and presents the analysis in an easily understandable and customised manner to a customer.

An adviser's expertise lies not just in

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analysing data and presenting insights, but also in educating customers while answering their financial and non-financial queries to help address their anxieties around investing. This process of building trust is extremely difficult to replicate in an advice model delivered via a set of algorithms.

The trust factor

Many people prefer human advisers to online avatars due to perceived trust and accountability attributed to humans. But this attitude may be changing not just for the wealthy, but also in the general investor community.

A recent survey in Asia carried out by Cognizant's Centre for the Future of Work (The Business Value of Trust) shows that consumers trust digital start-ups more than their traditional rivals. Robo-advisers are no exception as they are perceived to have no conflict of interest, and are not prone to human errors and biases. They are perceived as being more transparent and deliver far superior customer experience.

Psychological factors around investing "nest eggs" through a computer program need to be overcome for robots to win the "mass" and "mass-affluent" customer segments.

The underlying philosophy that is emerging for robo-advisers as well as traditional wealth managers is that customers want both slick technology and the ability to speak to a person. This is particularly true in volatile markets or if their overall market exposure is high or spread across a number of asset classes.

Evolving value proposition

The mathematical objectivity and perceived lack of bias of robo-advisers/software algorithms makes them attractive, especially to the younger generation and to the retail and mass affluent segments.

This lack of bias may well just be a perception, as the algorithms could have a bias based on their design. However, similar biases, if they exist in human financial advisers, may be harder to rectify than in a computer program, once identified.

Since robo-advisers have only been around for a short time, it is difficult to objectively judge the longer-term implications of investment decisions based on algorithms versus those made by their human counterparts, especially in riding out volatile market conditions. However, the influx of robo-advisers (standalone or as part of a traditional wealth manager) is heralding structural changes in the wealth market.

Several instances point towards this. The cost to deliver advice has lowered, especially for smaller portfolios and for investors preferring low touch advice models. Customers have come to enjoy enhanced visibility into investment portfolio performance and greater ease of switching wealth managers. Customer relationships are moving away from financial planners (intermediaries) to wealth managers, at least for customers managing their investment portfolios, either in whole or part, through online/robo-advice channels. Fulfilment capabilities supporting traditional and online channels of delivering advice have evolved. Hybrid models of delivering advice have emerged and may include robo-advisers supporting traditional advisers with growing customer trust in computer algorithms to provide advice.

It is no surprise that financial institutions are taking robo-advisers seriously, even though the latter have a relatively small share of the market today. Their digital-native character, coupled with lower fees, makes them a potent disruptive force, setting new terms of engagement with customers that financial institutions need to adopt.

This does not mean the end of the traditional advice model, but potentially the start of a complementary or hybrid advice model that builds on the individual strengths of robo-advisers and human advisers. The extent of involvement of robots in the advice delivery model will be determined by the end customer who, in the evolving world, will have more flexibility in choosing the appropriate advice model. ●

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