

WHITE PAPER

Increasing the Efficiency and Effectiveness
of Financial Advice with Robo-Advisors



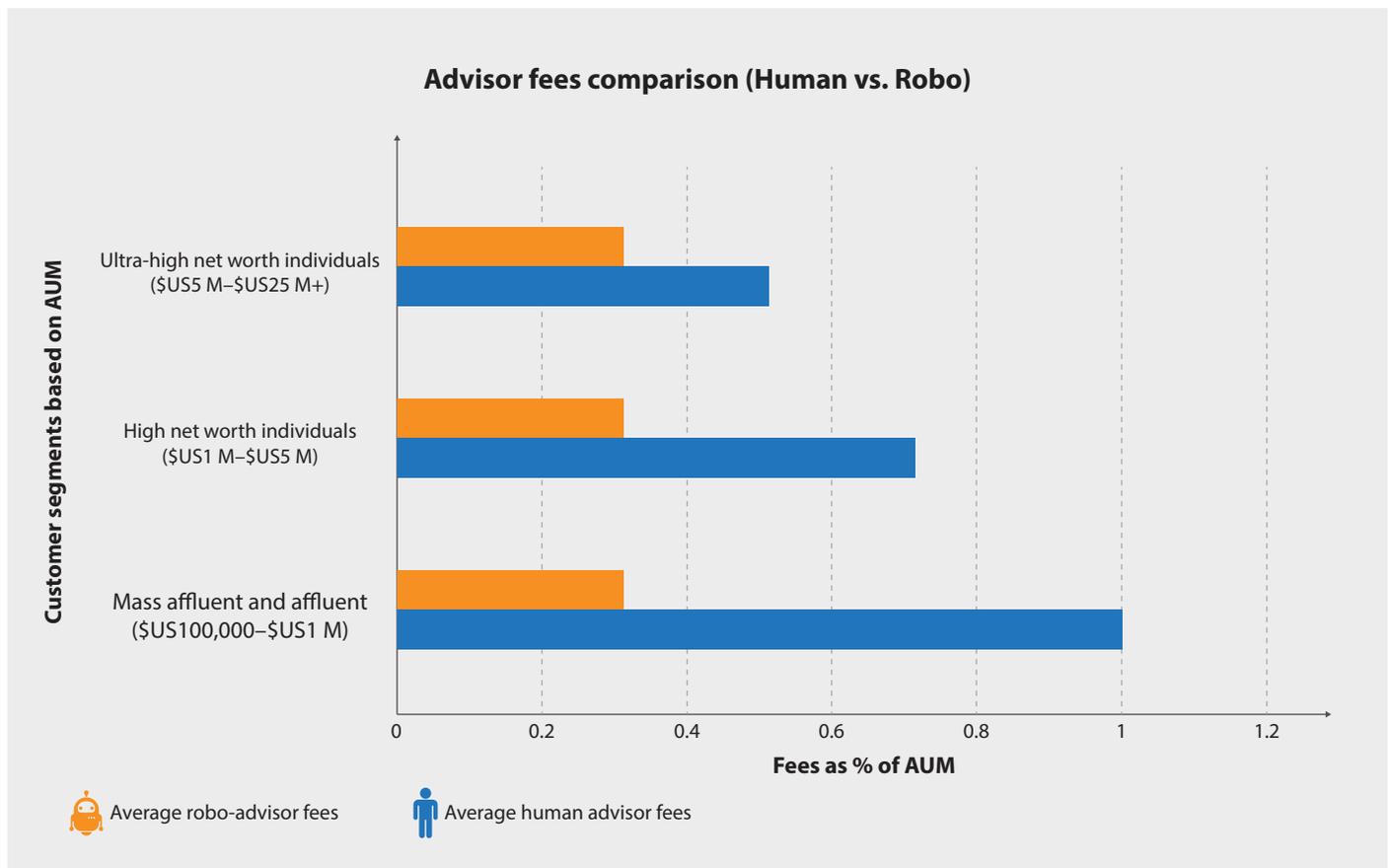
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Robo-advisor: Automation to enhance financial advisory

The service of providing financial and investment advice is undergoing a sea change! New FinTech start-ups are replacing human consultants with robo-advisors – automated, investment advisory platforms that ask questions and provide financial advice (asset allocation, portfolio management, periodic rebalancing, etc.) based on algorithms. And this automated service results in lower fees and greater reach, making it a promising trend in the financial advisory industry. Betterment and Wealthfront are just two of the many robo-advisors gaining popularity in the market.

Statistics reveal that from US\$19 billion in assets under management (AUM) in 2014, robo-advisors are projected to grow to US\$2.2 trillion in AUM by 2020. In other words, from being 0.2% of fee-based advisory AUM of traditional players in 2014, robo-advisors are estimated to grow to about 17% in a matter of six years with a compound annual growth rate (CAGR) of 120%. Thus, they have the potential to disrupt the current wealth management setup, which is dominated by human-only distribution channels.

Typically, robo-advisors use rich digital platforms. The advisory process begins by asking investors to fill up an online questionnaire. Based on the inputs received, they suggest a portfolio of exchange-traded funds (ETF) and move on to manage the investor's portfolio. This means that investors gain advice at much cheaper costs than the fees charged by human advisors. For instance, compared to an average 100 basis points charged by a human financial advisor, a robo-advisor costs just an average 30 basis points of AUM.



Thus, robo-advisors have targeted the bottom of the pyramid. They focus on mass-affluent millennial and affluent customer segments that are more tech-savvy and price-sensitive than high-net-worth-individuals (HNIs) and baby boomers.

Designed for organizations and individuals

Robo-advisors are mainly of the following two types:

- **For retail customers**

A B2C (business-to-consumer) model that directly engages with investors. Examples include Schwab Intelligent Portfolio, Wealthfront, etc.

- **For financial advisors**

A B2B (business-to-business) model that engages with financial advisors or financial advisory firms, and in which platforms are customized for end-customers. Examples include Institutional Intelligent Portfolio, Betterment Institutional, etc.

2015 was good, 2016 and beyond seems better

FinTech start-ups like Betterment and Wealthfront, who brought robo-advisors to the limelight, are facing competition from new entrants such as Schwab Intelligent Portfolio, Institutional Intelligent Portfolio, and Vanguard Personal Advisor. At the same time, many more new robo-advisors are estimated to invade the market. Fidelity, for instance, is planning to launch its own robo-advisor in 2016-2017 after its partnership with Betterment Institutional broke up in November 2015. Additionally, Blackrock's consulting and software services division has acquired a robo-advisor named 'Future Advisor' and plans to offer it to other broker-dealers and financial advisors.

The hybrid robo-advisor will champion better financial advice

In 2014, robo-advisors were perceived as an outright threat to their human counterparts. However, 2015 has indicated that robo- and human advisors can co-exist. In fact, a hybrid route seems to be the way forward where a robo-advisor complements a human advisor in giving advice. This can provide numerous

benefits: faster AUM growth, especially net inflows, newer opportunities in upcoming market segments comprising millennials, better empowerment of human financial advisors with time to think innovatively, and more opportunities to cross-sell high-margin advice.



Three approaches to onboard robo capability

Prior to onboarding robo capability, it is essential that an established firm analyzes its 'build vs. buy' strategy that is specific to its overall business strategy. Subsequently, it can adopt one of the following three routes to proceed with onboarding:

- **In-house development**

This approach seems to be working successfully for Charles Schwab, Vanguard, and Fidelity. Its merits include better control on project execution and the flexibility to customize to specific needs that complement the existing business. However, it can have a comparatively slower go-to-market (GTM).

- **Partnership**

This approach is potentially smarter, especially when the robo-advisor provider's solutions fit well and are synergetic with the firm. It also has a comparatively faster GTM than in-house development. However, integration and customization pose real challenges, as experienced by Fidelity with Betterment Institutional – it faced integration issues with its clearing and custody platforms, and a lack of flexibility to customize as per its financial advisors' requirements.

- **Acquisition**

This is the best option from a faster GTM perspective, as long as a firm finds a robo-advisor that is a perfect fit. While it ensures better control in making changes, it also poses integration risks that mandate a thorough due diligence of functional and technical aspects



Roadmap for advice automation

The CEO of one of the wealth management firms rightly said, "Be it from human advisors or from an automated online advisor, it is ultimately about

'advice' and how well it is provided." Truly, the term 'robo-advisor' can sometimes be misleading, as wealth management is difficult to imagine without a human's personal and emotional connection that is so integral to this industry. With that in mind, we suggest a three-stage automation roadmap:



- **Include (Stage-1)**

Firms that are yet to adopt advice-automation can bring in basic robo capabilities with a focus on acquiring new mass affluent and affluent millennial clients. The plan should include both retail and advisor platforms.

- **Improve (Stage-2)**

To retain existing clients and advisors who might switch firms for better digital advisory platforms, existing client-facing applications can be enhanced to provide simulated online advice. Client

applications that otherwise provide only an account summary and other details, can be augmented to provide a review of the portfolio status through an advisory engine that then suggests plans, such as a plan to sell or buy some securities impacting asset allocation and diversification, for the portfolio. The client can further add to this plan, based on research and advice from a human advisor. The client can also simulate the plan to observe its impact on various aspects of the portfolio – such as impacts on cash, risk exposure, and

diversification – before executing it.

- **Innovate (Stage-3)**

To get ahead of the competition, it is important to explore the benefits of artificial intelligence and create an automated advisor assistant that improves the efficiency and effectiveness of financial advisors. A 'central intelligence hub' can be created as a learning system that learns with each case and gets perfected over time.

Central intelligence hub: A key to gain competitive advantage

The central intelligence hub can help organizations gain differentiation with a smart, automated advisor assistant. However, human advisors will need to monitor functionality to enhance the quality of automated advice from the hub. The following provides a workflow using which the central intelligence hub improves its quality of advice.



Workflow of central intelligence hub

After performing a detailed factor-analysis using inputs from financial advisors and other available data, investor profiles can be created to the most granular level, and suitable investment advice in terms of products offered, etc., can be mapped to each of those investor profiles. Every new case then gets run through this hub, which provides advice / proposals. This system-generated advice / proposal gets

reviewed by the human financial advisor, who makes corrections and then finalizes it. The corrections made by the human financial advisors are the gaps in the intelligence of the hub and need to be fed back into it, so that the hub stays updated and learns from such situations. Over a period of time, the central intelligence hub will get perfected and corrections required from the advisor will decrease. This way,

the hub becomes the 'advisory brain' that assists financial advisors. It provides more bandwidth for financial advisors to focus on building relationships and other fiduciary responsibilities. The hub becomes an asset for the firm, available even after a financial advisor quits the organization. It can also be used to train younger and lesser experienced advisors.

Conclusion

In the backdrop of ageing advisors, growing digitization, and the perennial pressure to reduce costs and increase revenues, robo-advisors can bring a significant competitive advantage. One must remember that no tool can ever kill the need for 'good' human financial

advisors. As robo-advisors evolve with time, both advisors and clients are going to benefit from smart automation of advice. While the US is the leading market at present, robo-advisors are positioned to become popular across all parts of the world soon. The following projects the future of robo-advisors and their impact:



		Robo-advisor - 2015				Robo-advisor – 2020 and beyond					
	Primary target market	Millennials		Mass affluent and affluent		Millennials	Mass affluent and affluent	Baby boomers	HNIs and UHNIs		
	Primary services	Automated asset allocation	Automated rebalancing	Tax-loss harvesting		Automated asset allocation	Automated rebalancing	Tax-loss harvesting	Financial planning	Tax planning	Estate planning
	Asset classes	Exchange traded funds (ETF)				Exchange traded funds (ETF)	Stocks	Bonds	Mutual funds	Alternative investments	
	Differentiating factors	Low fees	Rich digital experience	Simplicity of use	Transparency of fees	Quality of advice		Improvement in productivity of human advisors			
	Perception	Threat to human financial advisors		vs.	Complements human financial advisors		Advisory assistant to human financial advisors will be the accepted reality				
	Major applications	Client acquisition				Client acquisition	Client retention	Client delight	Advisor delight		
	Perceived and realized benefits	Lower cost to clients	Better customer experience	Digital offering to clients		Financial advisor as trusted financial coach	Higher efficiency	More bandwidth for advisors	More secured end clients		

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