Is the wealth management business ready for artificial intelligence?

By Rhea Wessel

With so-called robo-advisers taking over process steps in the wealth management business, will investment advisers have to radically change their business models?

Robo-adviser services were estimated to have global assets under management of $14 billion by the end of 2014, with 83% of that total managed by robo-advisers in the United States, according to MyPrivateBanking. Within five years, that number could reach $255 billion globally, not including assets that are invested with the recommendation of an automated financial adviser but controlled by private investors (e.g., the so-called do-it-yourself investors).

The range of services differs from company to company, but generally, web-based robo-advisers automate elements of investment advising, such as basic advice, account aggregation, risk assessment, financial planning, rebalancing, tax optimization, and reporting.

Once a user has everything set up with an automated provider, the investor has (at least in theory) access to high-quality investment advice that may not be personal but is personalized algorithmically. Often, the investment vehicle provided along with the advice is a passive investment, such as an ETF.

"Robo-advice is a wake-up call for the investment management industry—in terms of pricing, creating a great customer experience, and being fair to the end customer," says Srini Venkateswaran, a partner at strategy and general management consultant Marakon in New York who advises investment management firms on how to run their businesses.

Essentially, robo-advisers mean the empowerment of the investor, according to a report by MyPrivateBanking GmbH titled "Robo-Advisors: Threats and Opportunities for the Global Wealth Management Industry." Previously, investment managers had all the expert knowledge, and people went to their wealth advisers for help. Now, the clients are getting their hands on the expertise. "All the professional knowledge is getting put into software," says Steffen Binder, research director at MyPrivateBanking.

ADVISING INTERRUPTED

Indeed, robo-advisers are already shaking up the "traditional" industry, and their initial success is making established players rethink their approach. Millions of people currently lack traditional advisory services, and younger people in particular are likely to be more comfortable using robo-advisers for their investing needs rather than dealing directly with a person.

Another risk traditional players face is losing out to startups that say they can get the same or better investing results as professional managers—for far lower fees—by automating parts of the advising process and supplying clients with low-fee, passive investments. They say an algorithm is less biased than a human adviser and will help the investor keep emotion out of the investing equation.

One of the traditional advisers watching developments closely is Charles Lewis Sizemore, CFA, CIO of Sizemore Capital Management in Dallas, Texas. Sizemore does not rule out that he might offer his clients (or at least some of his clients) forms of automated advice, perhaps through a white-labeled robo-adviser that he can brand as his own. Such a tool would allow him to take on smaller clients that might be unprofitable at first because of overhead expenses.

In October, Betterment, one of the robo-advisers with the most assets under management, launched Betterment Institutional for

advisers like Sizemore. And Charles Schwab & Company has said it will offer free, web-based advice starting in 2015 for investors with $5,000 or more through Schwab Intelligent Portfolios.

Already, Sizemore refers investors who cannot meet his minimums to his Covestor portfolios, giving them the opportunity to "copy-cat" his investment moves at a much lower minimum. Advisers using the Covestor platform split the management fee with Covestor, and they also have to be willing to publish their most recent trades, which potential investors can view for free.

Sizemore says he's not worried about giving away his investment expertise for free by opening up his trading strategy on Covestor. In fact, he welcomes it. "Allowing would-be clients to see my latest trading moves builds trust and credibility," he says. "My approach may seem like it undermines my own business, but it actually boosts it by allowing a potential client to get comfortable with my investing style before committing a larger piece of their nest egg."

NAYSAYERS

As investment advisers take stock of the implications of the new technology, it's tempting to shrug it off and say there will always be a need for the human touch or to point to the inability of computers to calm panicked investors during a crash. Especially during the needs-analysis phase, research shows that people want to work with humans, according to Kira Dubas, an associate principal at Marakon.

And advisers may be able to learn lessons from the market disruption that will help their firms. "Investment advisers need to improve the experience and provide more online interaction," says Dubas. "People are used to conducting more parts of their lives online. Larger firms need to find ways to get around the weight of incumbency to improve the experience."

For one, automated advisers simplify and shorten the onboarding process, which can still take days or weeks with a traditional adviser. The advice may be cheaper and more tailored than with traditional advisers. And robo-adviser websites and platforms may offer more opportunities for investors to discuss strategies with peers and hear each other's advice, an important part of any transaction for many digitally savvy people. (Some research has shown that digitally savvy people place more trust in their peers than in institutions.)

THE UPSIDE

On the sunny side, some observers say that automating certain steps in the advisory process will free up advisers for more interesting and challenging work and bring investment advice to the mass-market retail investor who now gets no such direction.

For example, FutureAdvisor, a San Francisco-based firm that uses proprietary algorithms to provide free asset allocation advice, is targeting "the rest of America which has never had financial advice before and deeply needs it," in the words of spokesman Chris Nicholson. The growing firm had $13 million of assets under management in late 2013 and increased the total to $300 million by late 2014. Beyond the free algorithmically generated advice, for the actual investing, FutureAdvisor's customers are asked to upgrade to a premium account in which FutureAdvisor aggregates funds from existing brokerage accounts and executes the trades for customers. FutureAdvisor fees are 0.5% of assets under management. According to the MyPrivateBanking report, automated advisers' fees range from zero to 1.3% of assets under management.

Ian McKenna, the director of the London-based consulting firm Finance & Technology Research Centre, challenges the idea that robo-advisers are uninteresting for sophisticated investors with larger portfolios and complex investment cases. On the contrary, he says high-net-worth individuals are among the first to adopt new technologies and expect their advisers to do the same. A new report by Capgemini and RBC Wealth Management found that 65% of high-net-worth individuals expect to run most of their wealth relationships digitally in five years.

McKenna recommends that advisers work to embrace robo-type advising and see how they can use it to their advantage, instead of pitting themselves against the new technology. "Wealth management has been pretty much unscathed by new technologies compared to other industries," says McKenna. "We believe that there is strong evidence, led by what's going on in the US, that this is not actually going to be the case for much longer." [For more about the impact on wealth management, see "The Future of Automated Advice" on page 39.]

COMBINING TECHNOLOGY AND ADVICE

Don't expect robo-advisers to hold back on any bells and whistles in making the technology lifelike. Already, web users are accustomed to seeing comic-figure avatar faces wearing headsets who pop up and offer customer service, help paying a bill, or other kinds of support.

When people balk at the idea of a machine providing effective advice, they usually say that computers cannot pick up on subtle clues from the client. The field of facial biometrics is working on this very problem. Some companies, such as global market research firm GfK, have the ability to measure human emotion through facial movements using a webcam and software. The nonverbal information can be evaluated to provide a fuller psychological profile. Such technology is frequently used in advertising and allows marketers to evaluate, for example, the emotional impact of their video ads.

With companies combining facial biometrics with financial technologies that provide advice—and delivering the results with financial adviser avatars—users may actually have the feeling they're getting personal advice from a human instead of a computer.

"It's all about changing the fundamental operating model of the financial advice business," says McKenna. "Realistically, there will always be a need for help and guidance. The question is how you deliver it."

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