Invasion of the Robo-Advisor: Is the Threat Real?

A White Paper commissioned by EquiSoft

EquiSoft

February 2016

Table of Contents

FOREWARD

More change is coming to the Canadian retail investment industry.

The Robo-Advisor phenomenon is the most talked-about recent evolution in investing. There's plenty of news and information to sift through: press coverage in both the trade and consumer media, white papers, research studies and conferences, but there remain far more questions than answers.

In fact, over the past year or so, many of our clients have been asking us our thoughts on whether the Robo-Advisor buzz is for real and whether the phenomenon poses a real threat to the traditional dealer and advisor business. In this document, EquiSoft's second White Paper delving into the key issues challenging the Canadian retail investment industry, we explore the potential threats and opportunities presented by the invasion of the Robo-Advisor.

We would like to thank the many industry leaders who contributed their thoughts and ideas to this study. As with our previous White Paper, *CRM2 and its impact on the Canadian Retail Investment Industry,* the interview subjects are not identified – a decision that enables greater candour from the participants.

The key takeaway from this study is that industry experts believe the future doesn't lie exclusively in the up-start Robo model or the traditional distribution model, but a blending of the two.
There is clearly an opportunity for traditional dealer and advisor businesses to harness powerful Robo technology solutions to improve efficiency, enrich the customer experience, build new customer bases and grow their businesses. We trust that the insights contained in the following pages provide clarity and direction during a time of rapid and significant change to the Canadian retail investment landscape.

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INTRODUCTION

Will traditional advisors be "Uberized"?

The Robo-Advisors have arrived. Online advisor shops have set up in Canada, promising investors low-cost automated portfolios all at the click of a button from the comfort of their Smart Phones.

You've heard of Uber, the global car-sharing service that is threatening to send the taxi industry the way of the dinosaur. Is the Canadian retail investment industry next?

Are advisors about to be "Uberized?" Are the Robos simply "smoke and mirrors" and to be ignored? Or, is there a third possible outcome, where advisors adopt powerful Robo technology, creating a new and compelling advice offering for consumers?

> ***A Robo-Advisor refers to a type of financial advisor offering online portfolio management services with little or no human intervention.***

WHAT IS ROBO-ADVICE?

The terms digital investment advisor, automated investment advisor services, Robo-advice and Robo-Advisor are certainly being thrown around more and more these days. While the meaning of these new terms vary depending on who you are speaking with, generally, a Robo-Advisor refers to a type of financial advisor offering online portfolio management services with little or no human intervention.

From an investor's point of view, there's a lot to like about these new online solutions.

Convenience

Answer a few simple questions about your investment philosophy -- enter your name, income, and assets -- and within minutes you are presented with a portfolio matching your risk profile. Like what you see? Then simply open your account using the online (paper-less) onboarding process.

Once you've set up an account, your portfolio will be automatically rebalanced, dividend payments will be automatically re-invested, and, for larger accounts, your portfolio will be managed to maximize after-tax savings.

You can also follow your favourite Robo on Twitter. Link to them on Facebook. Or sign up for their blogs. Clear, succinct communications that are easily read on your device of choice – Tablet, desktop computer, or smartphone.

And this is all possible on your terms, when and where it's convenient for you.

Transparency

The Robo-Advisors pride themselves on transparency. It's all there on their web pages – fees, expense ratios, their model portfolios, and the investment products that are used to construct portfolios.

The home page of Canadian Robo-Advisor Nest Wealth states: "Nest Wealth combines smarter technology, lower fees and complete transparency to give investors a better way of saving for their financial goals."

"Unbiased. Low-cost. Transparent," extols the home page of another Canadian Robo-Advisor, Modern Advisor.

How are the traditional shops doing? Two recent studies point to transparency concerns in the Canadian retail investment business.

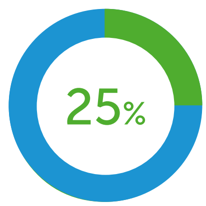
According to researcher J.D. Power, three in four Canadian investors do not completely understand the commissions and fees they pay their firm and 45% indicate their firm hasn't provided them with a summary of fees and commissions charged.

In terms of advisor guidance, 43% of investors did not receive an explanation of the firm's fee structure and 33% did not receive an explanation of their investment performance. [1]

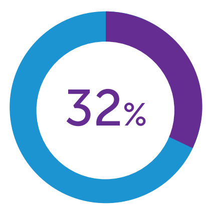
In another important study of advisor practices, investment and mutual fund dealer regulators teamed up with the Ontario Securities Commission to send "mystery" shoppers into randomly selected retail advisor shops. The findings were not encouraging. In an initial meeting shoppers [investors] were "less likely" to be asked about core Know Your Client (KYC) information or to hear about the risk-return relationship, product fees and advisor compensation. [2]

According to a joint study by the OSC, IIROC and the MFDA…

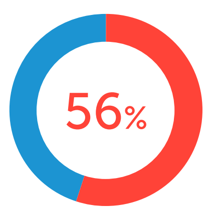
In only **1** in **4** shops (25%) advisor compensation was discussed;



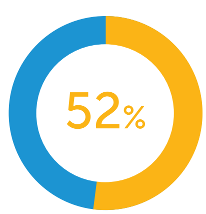
In only **1** in **3** shops (32%), did advisors gather "thorough KYC" information;



In only **1** in **2** shops (56%) were product fees discussed; and



In only **1** in **2** shops (52%) was the risk-return relationship discussed.



Low Fees

Another key component of the Robo-Advisor value proposition is cost. A simple indexing portfolio costs about 20 basis points (bps) or 0.2% annually. Assuming a Robo-Advisory fee of 35 bps, total investment management costs come to 60 bps annually, including taxes.

Wealthfront, the U.S. market leader, charges 25 bps. The ETF expense ratios amount to an additional 12 bps. Plus, the first $10,000 under management is free.

"We are offering a comprehensive product at a third of the price, including insurance and financial planning," says a Robo insider. "Definitely Robos will disrupt the industry."

"In Canada, as CRM2 comes in, there is going to be more and more motivation for the Robos to pound on [low fees of] 50 bps or less, including product cost," says an industry observer.

"We are offering a comprehensive product at a third of the price, including insurance and financial planning. Definitely Robos will disrupt the industry."

1 J.D. Power and Associates, 2015 Canadian Full Service Investor Satisfaction Study

2 Mystery Shopping for Investment Advice. A OSC/IIROC/MFDA report published Sept. 17, 2015. Research conducted July to November 2014 involving 150 firms including Exempt Market Dealers, Investment Dealers, Mutual Fund Dealers and Portfolio Managers

THREAT OR PASSING FAD?

The amount of money flowing to Robo-Advisors is certainly raising some eyebrows but assets still only represent a small percentage of the industry. Should financial advisors feel threatened?

GAINING TRACTION

A survey of the largest U.S. Robo-Advisors reported aggregate assets of US$21 billion by July 2015, up 34% over the previous year.[3] While yet another market survey projected online advice assets to reach between US$55 billion and US$60 billion by the end of 2015.[4] Two of the market leaders in the U.S. are claiming assets under management (AUM) of approximately US$3 billion each spread across 40,000 to 115,000 accounts. While Canadian industry numbers remain elusive, the Canadian market leader claims it has over 10,000 clients and $400 million in AUMs.

However, the growth of the Robo-advice segment is not expected to come exclusively from new market entrants such as Wealthfront, Betterment and Wealthsimple. Rather, much of the segment's growth is expected to come from traditional financial firms jumping into the digital advice game. Charles Schwab & Co. reported its Robo-platforms grew by more than 25% to US$4.1 billion in the quarter ending Sept. 30, 2015. Vanguard Personal Advisor Services, another online advice offering, is reported to have US$21 billion in assets under management.[5]

While U.S. market AUM forecasts for the year 2020 range anywhere from US$255 billion to US$2 trillion[6], all industry experts would agree, online advisory platforms are here to stay and will change the face of the wealth management industry as a whole.

AUM forecasts for the year 2020 range anywhere from US$255 billion to US$2 trillion.

3 Corporate Insights. 11 companies included in the survey (Betterment, Wealthfront, SigFig, Jemstep, Personal Capital, FutureAdvisor, Financial Guard, AssetBuilder, Covestor, MarketRiders and RebalanceIPA) continued to gather assets despite entries by Charles Schwab's Robo advisor Intelligent Portfolios or Vanguard's Personal Advisor

4 Accenture

5 Investmentnews.com, Oct. 15, 2015

6 Research firm MyPrivateBanking estimates the market at US$225 billion. Consulting firm EY estimates a US$1trillion market. Consulting firm A.T. Kearney estimates US$2 trillion

WILL ROBO-ADVISORS CHALLENGE TRADITIONAL ADVISORS?

According to several industry leaders, some advisors may want to look over their shoulders. “Advisors over the age of 50 should sell their books as soon as possible,” says an industry observer. “If they don’t want to do anything and change their practice they can expect their assets to erode.”

> *“Advisors over the age of 50 should sell their books as soon as possible.”*

Says another: “Robos will shake out the industry.” Affected will be the bottom 20%, lower producers “who are dragging their feet.”

> *“Robos will shake out the industry.”*

“The strength of the Robo approach is technology,” says a Canadian Robo insider. “We open 10 to 20 accounts a day. And deal with 10 to 20 customers one-on-one through email and online chat. There is no way a traditional advisor can say that.”

“[Robos] will pull people out of traditional online investing spaces such as discount brokerages. There will be a migration of people who don’t necessarily enjoy doing it themselves. Also, there will be pressure on stock pickers who have not evolved their game to holistic wealth offers -- pure brokers focused on the next five minutes and commissions.”

Regardless of which advisor channel is most affected by the invasion of the Robos, it is clear that their arrival will force all advisors to change the way they do business.

“Steps to streamline the client online experience, provide greater transparency and improve the economics for the mass segment are irreversible.”[7]

Advisors will have to evolve to survive and thrive in this new environment. Those that do not adapt, may quickly find themselves part of the wave of departures from the industry originally started by demographic trends and accelerated by CRM2.

> *“Steps to streamline the client online experience, provide greater transparency and improve the economics for the mass segment are irreversible.”*

7 EY, Advice Goes Virtual: How new digital investment services are changing the wealth management landscape

WHAT IS THE MARKET POTENTIAL FOR ROBO-ADVICE?

A US$10 TRILLION OPPORTUNITY?

According to research by EY, a global professional services firm: "If we combine mass affluent, mass market and millennial assets (US$1.1 trillion) we estimate the current opportunity for digital advice to be above US$10 trillion in investable assets." [8]

Furthermore, many middle-class investors are "under advised" or unable to obtain portfolio management services because of the minimums imposed on investable assets by many traditional advisors.

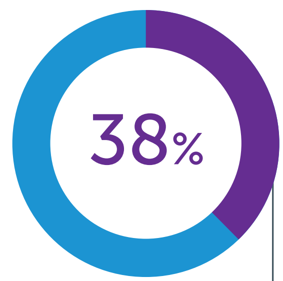
In the United States, "only 20% of 'mass affluent' Americans have a financial advisor [offering financial planning, asset allocation and investment management] because traditional firms have largely focused on HNW individuals." [9] These mass affluent households, defined as having US$250,000-US$1million in financial assets, hold about US$7 trillion of wealth "throughout a fragmented market." [10]

THE CANADIAN PICTURE

According to the most recent Statistics Canada data, there are 14.8 million Canadian households with aggregated financial assets of CAD$2.2 trillion, or CAD$152,000 on average.[11]

There is evidence that Canadian households may be poorly served by the advice business - only 38% of Canadians currently use a financial advisor. [12]

According to the Blackrock Global Investor Pulse Survey...



...of Canadians currently use a financial advisor

8 EY, Advice Goes Virtual
9 EY, Advice Goes Virtual
10 EY, Advice Goes Virtual
11 Statistics Canada. Survey of Financial Security, 2012. Table 205-0002. Excludes defined pension plan assets, principal residence, and business assets
12 BlackRock Global Investor Pulse Survey

MILLENNIALS: THE SWEET SPOT

"There is an advice gap. The 18- to 35-year-old crowd just starting out, a little lower on the age and the asset accumulation curve – with more basic investment needs than not – not particularly confident or having the knowledge to do self-directed but don't have enough for traditional advice. That's the sweet spot," says a Robo insider.

In fact, Canadian households headed by a person under age 35, have aggregated financial assets of CAD$200 billion. Plus, there are 3.3 million under-35 households, averaging financial assets of CAD$60,000. [13]

Wealthfront has made no secret of the fact that Millennials are its target client base. The firm believes this demographic is looking for a different type of investment advice. [14]

"There is not a single person who believes that Millennials will invest the same way their parents or grandparents did," says an industry observer.

> *"There is not a single person who believes that Millennials will invest the same way their parents or grandparents did."*

So, who are the Millennials? [15] They were born in the eighties and nineties. Today, the Millennial cohort is the biggest in U.S. history. In Canada, Millennials make up the largest portion (36.8%) of the Canadian workforce. [16]

If that doesn't impress you, Millennials are projected to inherit at least US$41 trillion through mid-century. [17]

The Millennials are defined as the generation "that lives online and buys online"[18] and living online extends to retirement planning. In fact, 76% of affluent Millennials would seek information about personal investing on a social network, as opposed to just 18% of the affluent Gen Xers. [19]

Also of note, is the fact that investment advisor satisfaction is lowest among younger investors, including Millennials. [20]

The Pew Research Center in the United States found that Millennials were "less trusting" – a finding that raises marketing and communication concerns.

"I don't want to say they are less trusting," says a Robo insider. "But they want transparency. They are a little less inclined to hand over the reins without a good sense of how the money is being taken care of. This serves Robos well because they are extremely transparent."

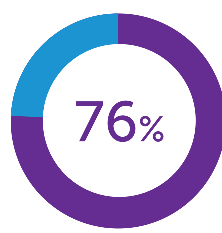
> ***Millennials are projected to inherit at least US$41 trillion through mid-century.***

Given their "trust" issues, it is not surprising that Millennials are 1.5 times more likely to have shifted or considered shifting banks in the past year compared to the general population. [21]

Millennials are also more open to financial goods and services from companies outside the traditional financial sector. In the future, will they seek investment advice from Nike, Google or Apple?

At first blush, Millennials may seem to offer the greatest potential for growth, but there are other segments that are turning to Robo-Advisors.

According to Forbes Magazine...



...of affluent Millennials would seek information about personal investing on a social network.

13 Statistics Canada. Holdings of under-35 households: mutual funds and other funds, $7.3 billion (186,000 families), stocks, $3.8 billion (226,000 family units), bonds, $680 million (168,000 family units), TFSAs, $7.4 billion (979,000 family units), RRSPs, $44.7 billion (1.4 million family units)

14 EY, Advice Goes Virtual

15 Authors William Strauss and Neil Howe are credited with naming the Millennials. They use 1982 as the Millennials' starting birth year and 2004 as the last birth year

16 Canadian Business Magazine

17 Forbes Magazine

18 Goldman Sachs information piece on Millennials

19 Forbes Magazine

20 J.D. Power and Associates, 2015 Canadian Full Service Investor Satisfaction Study

21 Canadian Business

THE DISGRUNTLED

The Disgruntled are the people who have had an unpleasant advisor relationship or experience. They are the people who are in expensive mutual funds that don't perform well. Or, they have discount brokerage accounts, but are uncomfortable managing their own portfolios.

"The market is people who do not have an advisor, people who are disgruntled with their existing relationship, but can't do it on their own," says a Robo insider. The "go-to" place for advice is a bank branch for 4 in 10 Canadians. And this group of Canadians is less likely to be satisfied with their advice experience. [22]

"There is a group of people out there who haven't found their feet in terms of wealth management, who are comfortable online, and are attracted by the low cost. A little guidance over the phone or through online chat really helps them," says a Robo insider. "Our prime customer was with a bank or an insurance company and was in mutual funds."

> *"Our prime customer was with a bank or an insurance company and was in mutual funds."*

Notes an industry specialist: "Not sitting face-to-face with someone will actually entice people who are sitting on the sidelines to go get advice."

Many Canadians are already there. Almost 90% of Canadians conduct routine banking online. And, one in two Canadians review their investments online. [23]

ROBOS AND THE BABY-BOOMERS

Given the Robo-Advisors' focus on Millennials, many advisors do not see the Robos as a threat.

"The expectation is that Robos will attract $35,000 to $40,000 accounts and advisors don't want those accounts," says an industry observer.

Others see wealth as more important than age. "Most [Millennials] don't have a ton of money," says a private wealth manager catering to wealthy individuals. "If they were sitting with $5 million, I don't know if a Robo would be the first place they would look. Our largest clients are not Millennials but they are younger than you think – late 30s, early 40s."

There is evidence that Robo-Advisors are gaining traction with older investors with larger account sizes. Betterment, one of the largest U.S. Robos, says 25% of its clients are over age 50. [24]

"They are getting more assets and more engagement from people who would qualify for more traditional wealth offers and pleasantly surprising them."

"In a way, it is easier to speak to an older person online. The process and products are familiar to them," says an observer with online experience. "They understand the value proposition. Millennials are more interested in technology and being able to open an account on their phone – it's a novelty. They are not really savers."

> *"Pre-retirees are cost conscious. Portfolio fees at a third of the cost are attractive to them -- that's an underserved market that the Canadian retail industry cannot accommodate."*

"The majority of our assets come from people who are just starting to retire – logically they have the biggest accounts – and because we offer retirement income planning."

According to Statistics Canada, there are about 5 million Canadians, aged 55 to 64, either retired or in their pre-retirement years. These Canadians are in, or entering, the de-accumulation phase of their lives, trying to preserve capital while spending money and not saving.

"Pre-retirees are cost conscious. Portfolio fees at a third of the cost are attractive to them -- that's an under-served market that the Canadian retail industry cannot accommodate," says an industry observer.

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22 BlackRock Global Investor Pulse Survey, 2015

23 BlackRock Global Investor Pulse Survey, 2015

24 *Robo firms gaining traction with traditional advisors*, CNBC, April 17, 2015

THE CHALLENGES OF THE CANADIAN ROBO-ADVISOR

The growth opportunities are great but the hurdles may be even greater.

Changing demographics, exciting new technologies, emerging and changing investor needs, new rules demanding more transparency around the delivery of advice and investment products -- the times seem right for the arrival of Robo-Advisors in Canada.

But there are head winds. There are entrenched behaviours around investors and their advisors and how investment products are sold. Regulatory restrictions could also limit the growth of Robos. There are also questions about how effective Robos will be at prospecting online and about their low-cost claims.

FINDING CLIENTS

How do Canadians normally find an advisor?

Most investors (38%) find an advisor through an existing relationship with a financial institution, according to research by the Investor Education Fund. This is particularly true among younger investors. In the 20-39 age group, half are "assigned" an advisor by their financial institution. [25]

Another large group of investors (33%) find their advisors through referrals from friends, family and co-workers. Only 15% of investors proactively seek out an advisory firm.

Interestingly, only 7% found their advisor as part of the advisor's marketing or prospecting activities.

So, how will Robo-Advisors build their businesses? Will referrals come from social media?

> *"The struggles of most Robo-advisor platforms have been so significant, they've been increasingly pivoting to work with established financial services firms, or to become available to individual financial advisors, in the hopes that such partnerships will allow Robo-technology firms to gain the volume and scale they need to succeed."*

According to at least one White Paper chronicling the rise of Robo-Advisors, social media is critical. "Key to these firms rapid growth has been their ability to take the proven approach of referrals that traditional players use, but with a digital twist: leveraging the multiplier effect of social networks like Facebook, Twitter and LinkedIn to create awareness and building trust through recommendations from peers." [26]

Consumers who follow businesses on Twitter feel more engaged with the business and therefore are more likely to purchase from, recommend, retweet from and share positive experiences about the business. In fact, 72% of small- and medium-sized business followers are more likely to make a purchase after following the company. [27]

How effective have the Robo's social media initiatives been? In December 2015, U.S. market leader Wealthfront had approximately 22,500 Twitter followers. Betterment had 19,800 followers. By comparison, bond manager Pimco and index fund manager Vanguard had 199,000 and 208,000 Twitter followers, respectively.

In Canada, Wealthsimple leads the social media parade (approximately 3,500 Twitter followers in December 2015), followed by Wealthbar (2,300 Twitter followers). By comparison, Tangerine Bank and PC Financial had 29,200 and 10,400 followers, respectively.

Are these levels high enough to feed the referral pipeline? And, if not, do the Robos have the marketing clout to build those numbers?

25 Investor behaviour and beliefs: Advisor relationships and investor decision-making study. Research by the Brondesbury Group for the Investor Education Fund, 2012

26 EY, Advice Goes Virtual

27 82% are more likely to recommend an SMB they follow to friends / family than before they followed it. 86% are more likely to visit a SMB if a friend recommends them, Research by Market Probe International commissioned by Twitter, 2013

Says an industry observer: "The struggles of most Robo-advisor platforms have been so significant, they've been increasingly pivoting to work with established financial services firms, or to become available to individual financial advisors, in the hopes that such partnerships will allow Robo-technology firms to gain the volume and scale they need to succeed." [28]

Robos are resorting to some traditional and not so traditional marketing activities to bring in new customers:

- Wealthfront's CEO regularly conducts seminars for Millennial tech employees at companies like Facebook and Dropbox;
- Tea Nicola, Co-Founder and CEO of WealthBar, writes a regular blog on the Huffington Post;
- Nest Wealth has a relationship with Metroland, a southern Ontario publisher of community newspapers;
- Wealthsimple offers Lunch & Learns, including an "awesome" lunch and a presentation on personal finance;
- Refer a friend is another Wealthsimple initiative. For every successful referral investors receive management services at no charge for assets to $5,000. In the U.S., Wealthfront offers a similar incentive. Betterment will provide one year of free management for three successful referrals; and
- Betterment offers a paid affiliate program for personal finance bloggers who target Millennials. Bloggers are paid up to $50 for every new account – a practice that could pose problems for those seeking transparency.

> ***Conventional wisdom has it that investment products are sold, not bought.***

Another consideration is that conventional wisdom has it that investment products are sold, not bought. Consumers buy the investment products because they trust the advisor and the institution they are buying from.

In the Robo-Advisor world, investors will be required to find the Robo online, digest the online material and open an account with little or no human interaction. A quick look at Amazon is proof that "automated" selling works for a whole host of consumer products from books and movies, to clothes and children's toys. Will it work for investment products?

"The client misinterpreting the value proposition -- misinterpreting the offering. Misunderstanding – assuming something that makes them de-select," that is the weakness of the Robo model says an industry participant. "This is not a problem that traditional advisors have because they are there -- face-to-face -- to breakdown barriers."

28 Michael Kitces Blog, Sept. 7, 2015

LOW FEES: DO CANADIANS EVEN CARE?

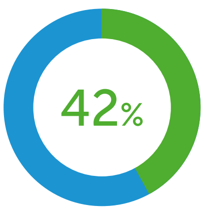
"Save time and money with efficient, low-cost, ETF portfolios," -- WealthBar

One of the key marketing messages of Robo-Advisors is cost.

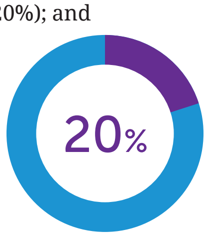
However, according to Investor Education Fund research, cost is the least important criteria in making a buying decision. [29]

According to the Investor Education Fund...

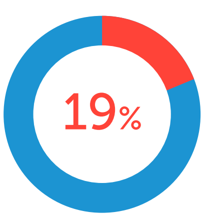
4 in **10** investors cite past performance as criteria in buying mutual funds (42%);



2 in **10** cite costs of an investment product as criteria in buying mutual funds (20%); and



2 in **10** cite the cost charged by the fund company as criteria in buying mutual funds (19%).



So, if the investing public doesn't consider costs, why is low price important? Says an industry observer, "Canadians are unaware of, or don't care about fees."

However, many believe this attitude towards fees is likely to change with the advent of CRM2 and its fee disclosure requirements. So, if Canadian investors do start to care about fees, will the Robos deliver on their promise?

ARE CANADIAN ROBOS ACTUALLY LOW-COST ALTERNATIVES?

The Robo-Advisor concept is built on low costs. But costs in Canada may be double those available in the U.S. market.

Let's look at a $50,000 portfolio, which, many would claim, is the Robo-Advisor sweet spot.

U.S. market leaders Wealthfront and Betterment charge advisory fees of 25 bps for a $50,000 portfolio. This includes all trading, custodial, rebalancing and administrative costs.[30] Add to that the costs of building ETF portfolios. Wealthfront says its portfolios average 12 bps in ETF expense ratios. Betterment provides a range of 9 to 17 bps.

> *"They are not as cheap as they could be."*

In total, a $50,000 portfolio purchased from Wealthfront or Betterment would range in cost from 34 to 42 bps.

In Canada, most Robos charge advisory fees of 45 to 60 bps for a $50,000 portfolio. ETF expense ratios range from 15 (Nest Wealth) to 55 bps (Robo Advisor Plus).

In total, a $50,000 portfolio purchased from a Canadian Robo-Advisor will range in cost from 63 to 88 bps.[31] On top of that, some Canadian Robos charge for trades. [32]

"They are not as cheap as they could be", says an industry observer. "They have opted for something other than plain vanilla ETFs. There is active management in their strategies. They are employing "quant" active strategies, using somewhat exotic funds and overlaying a tilt. It's a bit of a contradiction — part of their popularity is using low cost ETFs and "poo-pooing" active management."

29 Investor Education Fund research

30 Wealthfront charges no fees on the first $10,000

31 There are exceptions. BMO's adviceDirect charges 150 bps for a $50,000 portfolio which includes a limited amount of trades. Not included are the expense ratios of the investment products in a client's portfolio

32 Nest Wealth charges $9.99 a trade up to a maximum of $100 per annum. Smart Money charges one cent a share for trades. Invisor charges two cents a share

SELF-DIRECTED INVESTING IN DECLINE

The waning interest in the self-directed segment should also be on the Robos' radars.

In the United States, despite a continuous stream of developments in the technology available for investors to monitor and manage their portfolios, the self-directed segment has been in decline since 2010, according to Cerulli Research. "During this period the self-directed investor segment declined from 45% to 33% across all households." [33]

Cerulli concludes that electronic advice models won't be able to replace live advisors for most investors. "It's expected that purely electronic service models will attract market share, these clients will come from those already predisposed to handling their own finances, not from households that were in the advice market in the first place."

> ***Since 2010, the self-directed investor segment declined from 45% to 33% across all households.***

REGULATORY HURDLES

According to regulators, in Canada, there is no such thing as a Robo-Advisor. [34]

"The online advisers that have been approved to carry on business in Canada are not 'Robo-advisers' of the kind that are operating in the United States, which may provide their services to clients with little or no involvement of a registered advising representative (AR)," says the Canadian Securities Administrators in a recent memorandum.

"By comparison, Canadian online advisors can be seen as providing hybrid services, in that they use an online platform for the efficiencies it offers, while ARs remain actively involved in (and responsible for) decision-making."

In other words, a human is responsible for determining that sufficient KYC information has been gathered to support the investment recommendations for the client or prospective client.

> *"The online advisers that have been approved to carry on business in Canada are not 'Robo-advisers' of the kind that are operating in the United States..."*

> ***According to regulators, in Canada, there is no such thing as a Robo-Advisor.***

Say the regulators, "An online adviser's KYC process must amount to a meaningful discussion with the client or prospective client, even if that discussion is not in the form of a face-to-face conversation."

"You can set up an internet platform to collect information for efficiency's sake," says an industry observer. "You can hire a secretary to sort out the documentation and figure out a prospective client's risk tolerance. But at some point you need to put it before a portfolio manager who will look at it and decide if the model portfolio you are going to be allocated is applicable and relevant. There has to be someone to talk to."

Given the regulatory constraints and other challenges, the Robo platform providers may have to consider some creative strategies to continue their growth trajectories.

33 Scott Smith, director at Cerulli Research

34 Canadian Securities Administrators, CSA Staff Notice 31-342, Guidance for Portfolio Managers Regarding Online Advice

The future: ROBO-ADVISORS AND THE TRADITIONAL RETAIL INVESTMENT INDUSTRY

Is there a marriage in the offing? Will the Robo revolution evolve to combine the best of both worlds? Recent industry activity seems to point in that direction.

TRADITIONAL FIRMS LEVERAGING ROBO TECHNOLOGY

Traditional financial firms around the world have jumped into the Robo segment. A few examples:

- In March 2015, Charles Schwab, the wealth-management giant with US$2.5 trillion in assets under management, rolled out its automated wealth service, Schwab Intelligent Services targeting people with as little as $5,000 in savings. It charges no fees upfront but guides clients towards some of its own investment products. [35] Schwab pulled in almost $3 billion into the program in only four months;
- Vanguard piled up over $7 billion within three months of their official launch;
- JPMorgan Chase and Goldman Sachs have backed Motif, a startup that builds baskets of stocks based on investment themes;
- Northwestern Mutual acquired LearnVest for $250 million; [36]
- BlackRock acquired FutureAdvisor in September 2015 for $200 million;
- Schroders, a large European asset manager, has backed Nutmeg, Britain's largest newcomer.

There are also many examples of Canadian financial firms and their foray into the Robo world:

- John Nicola of Nicola Wealth Management is an investor in, and an advisor to, WealthBar, an "online financial advisor";
- Power Financial has provided up to $30 million in backing to Wealthsimple;
- De Thomas Financial, a MFDA dealer, has launched RoboAdvisor Plus;
- QuestTrade, a registered portfolio manager, IIROC dealer and discount brokerage has launched Portfolio IQ.

Furthermore, Bank of Montreal (BMO) announced the launch of BMO SmartFolio scheduled for January 2016, making them the first Canadian bank to formally launch a Robo-advice platform. Other banks have indicated that they are looking into digital advice options.

How quickly will the other Canadian banks follow BMO into the fray? "First, we need to see somebody succeed – and nobody has yet," says an industry observer. "Then the banks will be in."

35 Economist, May 9, 2015
36 Innotribe

ROBOS LEVERAGING TRADITIONAL FIRMS

The strategy of Robos licensing their platforms to traditional dealers and advisors, is also gaining traction. For example:

- Betterment Institutional, which launched in October 2014, provides advisors with a self-branded, automated platform;
- Motif is offering advisors an "automated investment management platform" to serve Millennials;
- Jemstep Advisor Pro is an "automated platform for advisors to sign up and service clients"; and
- UpsideAdvisor offers advisors paperless account opening, portfolio selection, automated trading and re-balancing, a client portal and data analysis.

Not too long ago, the difference between the Robo-Advisors and the traditional financial institutions was as clear as black and white. With each passing day, the number of industry participants in the "gray zone", falling somewhere between the two extremes, is growing.

Conclusions

A ten trillion-dollar Robo-Advisory industry may be on the horizon. The Robo-Advisors are clearly gaining assets at an alarming rate.

Futhermore, Robo technology is clearly very compelling and most would agree it is here to stay.

However, while the upstart Robo-Advisors have compelling technology, they clearly have their challenges. Ironically, the Robos may need to rely on traditional financial services firms and their advisors to survive. There are the obvious regulatory hurdles that mitigate parts of the Robo value proposition. Also, there is evidence that some Robos are finding it difficult to sign up new investors. Many will be challenged to survive as digital businesses.

Already, alliances are being formed between the Robos and traditional financial institutions. This marriage provides Robos with the distribution infrastructure required to grow and the advising representative oversight required to satisfy regulators. Meanwhile, the traditional financial institutions benefit from much needed operational efficiencies and the ability to leverage underserved growth markets.

All indications point to this hybrid solution as being the winning formula going forward.

EQUISOFT WealthElements

New Client Portal Module

Since 1994, EquiSoft has specialized in the design and development of business solutions for the global financial services and insurance industries.

Through WealthElements™, an integrated suite of investment, insurance and financial planning tools, EquiSoft has helped thousands of advisors efficiently manage every element of their clients' wealth. Configurable and customizable to a dealer's specific needs, the web-based software can also be integrated with back- and front-office systems to streamline advisor processes.

Since the inception of WealthElements, EquiSoft has strived to continuously evolve the platform to meet the ever-changing needs of the industry. As such, the company has recently announced the launch of its new Client Portal module of WealthElements. Available as a stand-alone solution or as an integrated part of WealthElements, the Client Portal module is an automated wealth planning platform designed to help traditional dealers and advisors leverage Robo technology and grow their business.

Jonathan Georges, Vice-President, Wealth Management Solutions at EquiSoft, was interviewed about the launch of the Client Portal module.

Q: What is the Client Portal module of WealthElements?

JG: Client Portal is an online, mobile-friendly, investor-facing platform designed to automate many of the time-consuming prospecting, onboarding and servicing tasks usually performed by the advisor or their support staff. These include:

- Client or prospect data capture, including contact information, assets and liabilities, and income and expenses;
- Investor profiling;
- Investment portfolio selection and design;
- Completion of account opening and transfer forms;
- Electronic signatures;
- Account access, including current market values, transaction history and performance; and
- Simple financial and insurance planning.

Q: How does the Client Portal module interact with the traditional advisor-facing modules of WealthElements?

JG: In designing the Client Portal module, we felt it was important to provide automated solutions to improve operational efficiencies yet still allow the advisor to monitor and track digital client and prospect activity. As such, the integration will allow seamless transition from automated service to advisor service (and vice versa) when warranted.

For example, let's say an advisor has a prospect who, at first glance, doesn't seem to offer much revenue potential. For efficiency sake, the advisor invites that prospect to use the Client Portal. While using the automated platform, the prospect states they have over $1 million in investable assets. This will trigger a notification to the advisor and allow them to transfer the captured data from Client Portal to their WealthElements account to generate a more comprehensive financial plan for the prospect.

Q: Will the clients and prospects see WealthElements branding?

JG: No. The Client Portal module is a white-labelled solution. The dealer and/or advisor branding is featured on the client-facing site.

Q: Why should dealers and advisors consider adopting Client Portal for their business?

JG: There are two main reasons to start using Client Portal (as a stand-alone solution or as part of the broader WealthElements offering): improving operations efficiencies and building a client base for future growth.

Q: How does Client Portal improve efficiency?

JG: More and more we are seeing successful advisory practices carefully analyzing their book of business to identify less profitable accounts and clients and culling them from their books. Instead of essentially "firing" these clients (who may have growth potential), wouldn't it be great if you were able to reduce the amount of time and cost required to service them while retaining the assets? This approach can allow advisors to spend more time with bigger clients and on prospecting.

Q: How does Client Portal contribute to future growth?

JG: Client Portal allows a dealer firm to create a client "incubator" system for advisors to attract and retain Millennial clients. Millennials live online and living online will extend to financial planning. Why should you build your Millennial client base? Ask yourself: Where are tomorrow's clients? Already the Millennials make up the biggest portion of the Canadian workforce. Those 20- and 30-year-olds, who live online, may not have significant assets today but they are earning and saving for tomorrow. Add to that, the fact that Millennials are projected to inherit trillions of dollars through the mid-century and you've got an opportunity no one can afford to ignore.

Have questions?

Please contact Jonathan Georges, Vice-President, Wealth Management Solutions at (888) 989-3141 x 201 or jonathan.georges@equisoft.com

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