Creating a sustainable digital wealth management platform

Catching up and getting ahead

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As demand for robo advising and robo investing services rises, many bank brokerages and investment houses are starting to recognize that they may have 'missed the boat' on digital wealth management. Yet, while the existing market may be dominated by a handful of players, our experience suggests that it's not too late for banks and investment managers to create a viable, sustainable and compelling value proposition in the robo market.

The democratization of investing

One would be hard-pressed to deny the impact that digital wealth management is having on the investing landscape. In the US market alone, estimates suggest that — by 2020 — more than US$2.2 trillion in assets under management will be flowing through digital advice platforms, growing at a rate of around 68 percent over the next 5 years.

In part, this massive growth in digital wealth management is being driven by the continued shift in investment patterns — away from actively managed portfolios and towards investment vehicles such as passive exchange traded funds (ETFs). Indeed, according to the Investment Company Institute, more than US$1 trillion flowed into US domestic equity index funds between 2007 and 2014 while, at the same time, more than US$650 billion flowed out of actively managed equity funds.

Interest in digital wealth management services — often known as 'robo investing' — is also being catalyzed by massive growth in demand for investment services from less-wealthy investors attracted by low fees and low minimum balances. Millennials, in particular, are likely to see robo investing as a smart and easy way to invest their growing wealth. But the proposition is also deeply attractive to Gen X and even Baby Boomers, who are looking to diversify their retirement savings.

The important point is that digital advice services are a growing demand for investment solutions rather than simply cannibalizing existing assets under management (AUM) from managed account programs. People (particularly existing banking clients) want to invest their wealth but far too few have had access to investment advice given the high initial minimums for many managed account programs — often starting at $25,000 for mutual fund or ETF-based portfolios

The competitive environment heats up

Not surprisingly, investment houses, bank brokerages and wealth management advisors have started to rethink their approach to digital wealth management. Whereas most had originally viewed the introduction of robo-investing as more of a marketing or mainstream play, today's investment executives are recognizing the massive value that could be captured — or retained — through digital advice services.

The problem is that — while the vast majority of wealth managers and brokerages opted to take a 'wait and see' approach to digital wealth management — four key players were busy investing significant time, effort and capital into creating digital capabilities. And, as a result, these four players currently dominate the existing market.

Led by two traditional powerhouses — Vanguard and Schwab — and two digital upstarts — Wealthfront and Betterment, — they have brought lower cost investing solutions to the market.

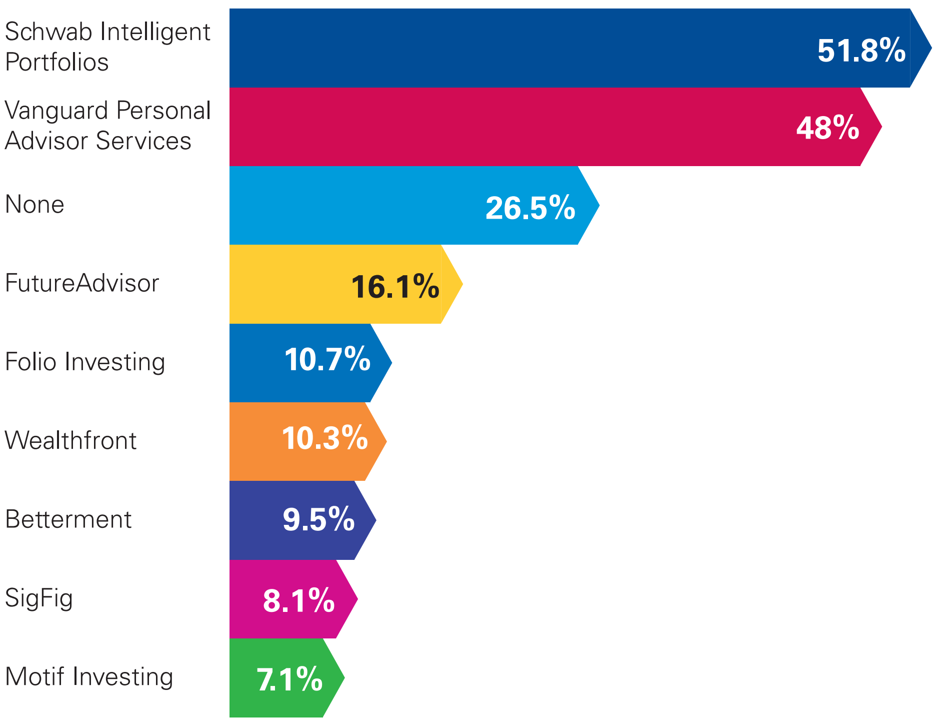
Fractional platforms transform investing

Digital pioneer Folio Investing is a self-clearing broker dealer with a fractional share platform that suggests the potential for democratization of investing by de-coupling the price of any security — stock or ETF — by whatever amount the investor can or is willing to make.

Most digital advice providers are traditional whole-share trading platforms. With fractional-share systems, initial and follow on investments are allocated across all holdings regardless of the price of any one security. On fractional share platforms, it's possible to purchase any dollar amount or percentage of any ETF or individual stock.

Many registered investment advisors (RIAs) use the Folio Institutional platform to create their own models that can be individual securities, ETFs and mutual funds or combinations of all three. The Folio Institutional platform can even support multiple models within an account, enabling an efficient approach to goals-based investing.

Awareness of US online investment providers



Source: KPMG Robo Advising

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According to our survey, around 50 percent of US-based banking clients are already aware of both Vanguard's Personal Advisor Services offering and Schwab's Intelligent Portfolios offering. Around one-in-ten are aware of Wealthfront and Betterment.

And competitive activity has been picking up. Blackrock, the world's largest asset manager, acquired FutureAdvisor for an estimated US$150–200 million; JP Morgan recently struck a partnership with Motif Investing; and Pershing (the largest correspondent clearing firm) partnered with Marstone in June 2015 and is now working with IBM to leverage Watson's cognitive computing into digital advice through self-learning technology that incorporate data, patterns and natural language.

It's not too late

Fortunately, our survey indicates that it's not too late to enter the digital advice space. In part, this is because awareness is still fairly low — less than 10 percent of existing banking clients had heard of SigFig, Betterment or Motif Investing — three of the 'upstart' robo advising services. The potential market is also largely untapped; most robo investing solutions have been targeted to existing investment clients leaving a massive market of lower-wealth customers up for grabs.

Our experience and our survey data suggest that there are still significant opportunities for those banks, investment houses and wealth managers able to create a compelling digital model. Bank brokerages, in particular, have a unique opportunity to capture market share and new customers by offering account aggregation services that provide a unified view of their banking, trust and brokerage accounts across multiple custodians through a single sign-on experience. Almost three-quarters of our survey respondents said this would be a highly attractive offering.

Bank brokerages can also capitalize on their position by offering auto investing services that provide clients the option to regularly transfer a set amount from their checking or savings accounts to their investment portfolio and automatically allocate funds across all holdings (a service almost two-thirds of banking clients said would be attractive to them).

And many banking clients are also interested in working with a financial advisor to supplement digital solutions. From purely 'self-service' to a more extensive high tech and high touch, there's a spectrum of potential business models to consider.

Ultimately, what this means is that there is no 'one-size-fits-all' model for robo investing and digital wealth management. Customers are open to a new value proposition that makes investing easier, and our survey suggests they are actually willing to pay more fees in exchange for the convenience and value of a bundled service offering.

Time to act

While there is significant opportunity still to be won by those with new and compelling value propositions, investment firms and bank brokerages will need to start moving quickly if they hope to capture and retain customers. But with a wide variety of potential business models and services available, many are still unsure about how they might best enter the market.

When we work with bank brokerages and investment houses, we often start by helping executives discover what their customers want. What services would current and new clients value most? What monetary value would they place on digital advice services? What fees would they be willing to pay for digital services, such as platforms that periodically rebalance their portfolios?

Once you know what your clients want and what they will pay for it, investment houses and bank brokerages can then start to develop a strategy and service offering that recognizes their current capabilities and culture, and provides a road map for delivering the right mix of services at the right cost.

However, with competition for investment-related FinTech running high and companies in this area achieving impressive valuations for their technology, most bank brokerages and investment houses will likely find it difficult or cost prohibitive to simply acquire the technologies and capabilities they need to deliver a robust, secure and effective offering.

As such, most organizations are now focusing on building smart partnerships with FinTech and other potential partners to develop and deploy new robo investing solutions. Many of the digital advice leaders have announced or are currently looking to license their technology. BlackRock — Future Advisor recently signed deals with BBVA and RBC. Understanding what partners are available and what 'white-label' arrangements can be created will be key to assessing the best approach to developing digital wealth management services.

Ultimately, we believe that the opportunity for banks and investment houses is ripe. But organizations will need to move now if they hope to capture their share of the market. Those that do can look forward to a more diversified client base, more loyal clients and more stable fees. Those that do not will eventually find their clients looking for these services from other institutions. ■

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