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Striking the balance: robo-advisory gains a human touch

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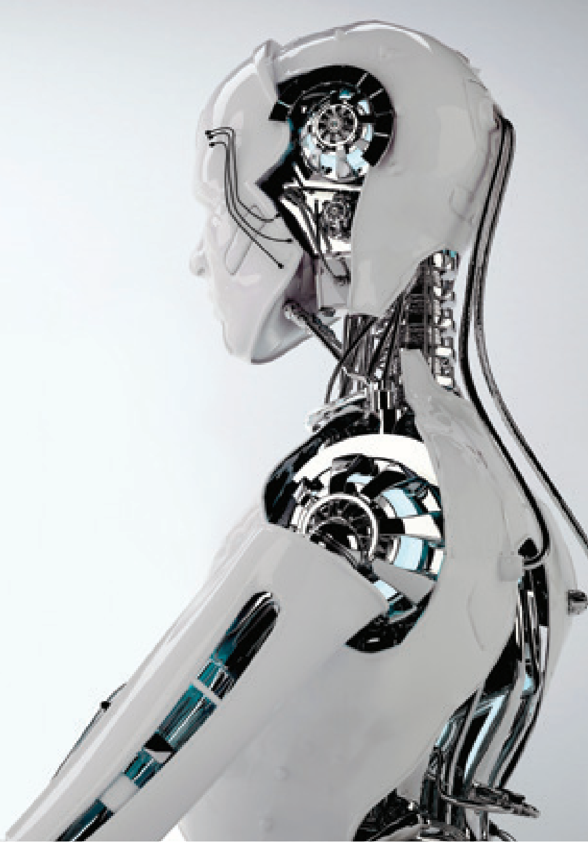

A new trend is emerging in robo-advisory services. Robo-advice, which uses algorithms to provide simple portfolio management solutions for wealth management clients, has emerged as a popular low cost, low maintenance investment management option. Yet, despite the success of robo-advisory FinTechs such as Betterment and Wealthfront, and offerings from wealth managers such as Charles Schwab and Morgan Stanley, it's clear that robo has its limits.

While robo-advice proves a great fit for many customers with simple investment needs, those with more complex investment requirements demand a more tailored solution. The market has responded via the emergence of "hybrid" models: robo-advised portfolio management solutions with human guidance. As this trend gains traction, many are now asking: how will the larger wealth management firms adapt their operating models to optimize profitability without cannibalizing their full service models, while meeting regulatory requirements for operating within a client's best interest?

The roots of robo

Historically, there were few wealth management products tailored to individuals with simple needs and/or lower value accounts. Robo-advice offered an alternative to "do it yourself" investing by providing a low cost solution to manage simple portfolios. Robo-advisors currently control over US$100 billion in AUM, up from US$30 billion in 2016, and that figure could surpass US$500 billion by 2020[1]. Providing investment solutions to underserved customer segments is not the only reason for this rapid growth; from leading technology firms, robo-advisors use advanced digital platforms that deliver a frictionless customer experience through mobile apps and online channels.

The past 2 years have seen rapid improvement in robo-advising capabilities. While robo-advising started by offering basic features such as low-cost ETFs portfolio options, automatic rebalancing, simple suitability analysis and tax loss harvesting, the algorithms — and thus the resulting quality of service — are constantly improving. As firms continue to accumulate data from both structured and unstructured sources, robo-advisors' decision capabilities become progressively better at providing advice based on customer behavior. Leading robo-advisors are now broadening their services with bigger and more complex challenges, such as needs-based planning, next-best-action, and retirement income planning.

[1] *Retail Direct Firms and Digital Advice Providers 2015: Addressing Millennials, the Mass Market, and Robo Advice;* Cerulli Associates

Evolving to meet changing customer needs

Although the technology continues to advance, pure-play robo solutions are starting to commoditize as the number of market participants increases. Furthermore, while robo-advice provides a great solution for simple portfolio strategies, challenges arise as customer needs become more complex. Robo-advice may be the right approach for a young individual with a low net worth, but what happens as that individual progresses through life stages and accumulates wealth? Hybrid models have emerged to better serve customer segments too sophisticated for pure-play robo but sensitive to the price of a full-service Financial Advisor (FA).

Hybrid models balance the economics of human versus digital advice and service, offering efficiency with a human touch. As these models take on less complex investors, the full-service FA is becoming more of a counselor to clients, with their value proposition built on knowledge, trust, and tailored solutions. Increasingly, the full-service FA is focusing less on investing and more on helping clients with complex topics such as trusts and estates, divorce, lending, legacy and wealth transfer, healthcare and aging parents, retirement income, tax avoidance strategies, and sophisticated financial planning.

With hybrid models gaining momentum, it has become crucial for wealth management firms to highlight the added value of the full-service model, and provide seamless mechanisms for clients to move in between hybrid and full-service as their needs change. In response to the DOL fiduciary rule stipulating FAs act in the best interest of their clients, demonstrating these high-touch value propositions also allows full-service models to justify their premium over hybrid models.

A new way of providing value

Hybrid robo-advisors are the vanguard of a new way of providing customer-focused wealth management services, combining technology-driven innovation and traditional human wisdom. According to a recent report, 10 percent or more of the world's investable wealth may be managed by hybrid robos by 2025.[2]

As technology and evolving customer needs continue to push the industry in new directions, wealth managers must ensure that their business models have the flexibility to adapt to changing patterns of demand. From FinTechs to incumbent players, winning strategies will be those that can seamlessly adapt to clients' changing needs throughout their lifetimes.

Hybrid models balance the economics of human versus digital advice and service, offering efficiency with a human touch.

[2] Robo Advisors vs. Human Financial Advisors: Why Not Both? 2017; Business Insider

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