Competing with robo-advisors & increasing regulation

The importance of leveraging technology to create efficiencies within workflows

A digital whitepaper
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There are an abundance of tools that financial services firms can leverage to increase efficiency and advisor productivity. Due to shifting advisor, client, and industry expectations, it can become difficult to determine which tools will allow the firm to combat the various pressures throughout the industry. Ultimately, firms must empower advisors to generate more revenue, remain competitive, and ensure compliance with efficient and repeatable processes. It is imperative to consider major industry trends when determining the tools that will best fit—and enhance—the digital strategy of a firm.

In order to remain competitive, this forces advisors to drive down the price charged for their services.

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Firms must remain competitive in a shifting industry

The financial services industry in the U.S. is currently facing a very difficult situation. On one hand, robo-advisors are becoming increasingly competitive in their pricing schemes. With low fees, they are growing market share across demographics that would have been difficult for an advisor to win. As those individuals grow their net worth, they are unlikely to leave the robo-advisor since they have already grown accustomed to and actively leverage their services. In turn, they will likely assume that the cost of working with a human advisor is prohibitively expensive.

On the other hand, increasing regulations are requiring advisors to provide retirement advice with a fiduciary mindset. An example of this would be if there were two investment products, one which would charge the investor a higher fee, resulting in a higher commission for the advisor; and another one which would charge the investor a smaller fee, resulting in a lower commission for the advisor. If both of these products anticipate the same return, then the advisor would be required to recommend the latter product. This is a simplified situation, but a straightforward representation of the rule that conveys both the requirements and the spirit of acting in the best interest of the client. Simply put, increased regulation is driving down the opportunity for revenue which ultimately increases the cost of planning.
Financial services industry firms and advisors are experiencing fee compression from robo-advisors, and an increased cost of delivering advice due to expanding regulation. So, how will advisors compete? The answer is much simpler than some might lead firms to believe.

In order to combat this two-pronged “attack,” firms and advisors will have to develop efficiencies within their practices. Before we can fully understand how these best practices can alter the way an advisor does business, we must first take a closer look at the catalysts driving this change.

Robo-advisors are increasing competition and driving down fees

For years, technology actually helped advisors compete against each other. This competition increased value for advisors who leveraged back office tools to be more efficient, manage portfolios, etc. However, the advisor’s relationship with technology became more complicated — it was both increasing efficiencies and changing client expectations. The result: technology provided to advisors became an alternative delivery model. This has seemingly reached a crescendo in the last few years with the emergence of robo-advisors.

The rise of the robo-advisor and self-directed planning added an entirely new competitor, challenging the industry to approach advisory models differently. While most agree that human advisors will never be completely replaced by robo-advice, they will add mounting pressure to provide more value relative to the cost of an advisor. Increased competition, fee transparency, and changing regulation are also acting as a downward force on the cost to consumers. The value gap is shrinking between the perceived value provided by advisors compared to a robo-offering.

Robo-advisors are well-positioned to capture a large amount of market share. Some reports are estimating an almost 3x increase from a projected $600 billion in 2017 to $1.5 trillion in 2018, ultimately commanding around 10 percent of global AUM—or $8 trillion—by 2020 (Kocianski).

The key appeal to robo-advisors is the simplicity of accessing, investing, and growing wealth. When many people think of a traditional robo-advisor client, they think of Millennials. Initially, the target demographic for robo-advisors were Millennials who were underserved in the financial services industry. However, as time progresses, we are witnessing a diverse amount of investors begin to enter the robo-advisor space. Betterment claims that about one-third of its clients are over 50 years old (Weisser).

Why would clients utilize a robo-advisor?

- Ease of transferring funds
- Always up to date
- Native digital experience
- Cheaper maintenance fees than traditional advisor
- Lower minimum initial investment
In order to understand the full breadth of the robo-advisor appeal, consider the last time you went to a bank branch or a retail store. What was the appeal? Did you not simply use a bank app or order online? In many cases, it is more convenient or easier to do these types of tasks online. According to a recent survey, over 50 percent of those who are moderately or extremely familiar with robo-advisors are employing their services (LIMRA). There are many reasons why people are adopting this type of investment, but the pervasiveness of technology in everyday life is certainly a major contributing factor.

Increased regulation is driving up the cost of delivering advice

The industry shift toward a more client-centric model has changed the way firms monetize financial advice. Regulation implemented around the globe is driving advisors to act in the best interest of their clients, as well as prove it through documentation. This, in and of itself, is not a bad thing but does heavily restrict how an advisor is able to monetize on clients with smaller investable assets; ultimately, leaving that demographic underserved.

There is no singular solution for these client-focused regulations. With the correct combination of technology and workflow adjustments, however, a firm can further ensure they are acting in the best interest of their clients. In order for an advisor or firm to provide this “best interest advice,” it must develop an understanding of the clients — including their current financial situation, goals, risk tolerance, and values. One major change is how this will be regulated. Depending on regulators, different methods for enforcing rules will be applied. Typically, the DOL does not actively seek out those who violate their regulations; they usually enforce their rules through litigation and class-action lawsuits.

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This is a much different approach than current regulatory authorities in the financial services industry. The SEC, for example, actively researches indicators and activities within firms that beg additional investigation. The SEC also investigates information received from “whistleblowers” who may have access to information that suggests that firm is breaking the law.

When we consider regulation in the U.S., the current topic is the DOL Conflict of Interest Rule. According to a survey of state-registered advice firms, 49 percent of state-regulated RIAs do not have written policies or procedures to handle the DOL fiduciary rule (Secretary of the Commonwealth of Massachusetts). Although 50 percent of respondents feel that the new rule will have no effect on their business, 75 percent of the respondents think that additional training on the DOL rule and the BIC Exemption will be helpful to their business. This gap demonstrates that financial professionals are feeling the effects of increasing regulation, whether they admitted it or not.

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An interesting component of this rule is the anticipated increase in demand for financial advice. According to Allianz Life’s latest annual New Year’s Resolution Survey, 29 percent of respondents are more likely to seek out advice from a financial professional in 2017 (Fischer). One quarter of those who responded stated that they would be more likely to utilize the services of a financial professional, provided that those services were available for free. This was in comparison to several services, such as dentists, doctors, and others.

The key to creating a strong client-advisor relationship is a higher level of transparency between firm and client. This is especially important in an industry that has been disrupted by changing regulation. With regulations such as the DOL Conflict of Interest Rule in the United States, Retail Distribution Review in the UK, or Client Relationship Model 2 in Canada, advisors are seeking ways to create tangible evidence of best interest recommendations. Through the use of tools such as account aggregation and collaborative data gathering, advisors obtain a deeper understanding of their clients and foster a more transparent client-advisor relationship.

Transparency often comes with increased collaboration. Client expectations are shifting, and they expect the ability to interact with their financial plan 24/7 — on any device they choose. Simply put, clients want to play a larger role in the decision-making process. FinTech provides clients convenient access to their financial plan to foster a collaborative process, empowering a more continuous planning process — rather than episodic meetings with their advisor once a year.

The solution

Clients are no longer interested in simply purchasing financial products but are seeking interactive relationships with their financial services providers.

Further, additional regulation means that those retirement product sales and recommendations cannot be provided without meeting the best interest of the client. The only way to ensure an advisor or firm is acting as a fiduciary is to truly understand each client and their respective needs.

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It is clear that holistic financial planning will play a key role in developing strategies for compliance. Utilizing comprehensive financial planning software and collaborative client discovery tools will be the most effective way to understand a client’s unique situation and provide fiduciary advice. There is no singular software or process that can completely ensure that an advisor or organization will be compliant with regulation such as the DOL fiduciary rule; however, firms must understand that internal processes — coupled with a robust, well-positioned financial planning software — can greatly reduce the risk of noncompliance.

Competing with robo-advisors in the light of this increasing regulation is not an easy undertaking but is possible. By leveraging client-facing tools such as a client portal that augment the financial planning relationship, clients’ expectations of an exceptional digital experience will be met through 24/7 access to their financial plan. Firms must seek technology providers that empower them to build efficiencies into their practice, adopt a more enticing client engagement experience, and ensure that it can contribute to their compliance strategies.
3 key takeaways

Financial professionals must clearly show their added value to clients over robo-advisors

The rise of robo-advisors has brought an entirely new segment of competition to the advice landscape. Therefore, financial professionals must ensure their clients are able to clearly see the added value a human advisor provides to the financial planning process. With changing client expectations, advisors must learn to leverage available technology while clearly demonstrating their unique value proposition throughout the planning process.

Due to the increasing regulation, client expectations of financial professionals are shifting

Amid the global regulation shift to a more client-centric focus, it is clear that the public is now expecting a higher level of service from financial professionals. In order to provide advice in the best interest of the client, firms must continue to implement financial planning into their client-advisor relationships. A holistic financial plan builds trusting relationships with clients by establishing goals, defining time horizons, and prioritizing long-term goal achievement.

Financial technology empowers firms to build efficiencies into their practice to comply with increasing regulation while remaining competitive with robo-advisors

Firms can now develop more efficient planning and sales processes by implementing financial planning. By selecting a technology provider that allows firms to establish compliance workflows, these firms will ensure that every client is guided through the same documented process to defend recommendations made by the advisors. In addition to enhancing compliance strategies, firms can demonstrate their added value over robo-advisors through the deep understanding comprehensive financial planning offers to the client-advisor relationship that technology alone cannot provide.
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References


