

Distribution through Robo Advisors - Best Practice Tips

In this paper, Alpha Baid provides an overview of best practice considerations for implementing a robo-advisor solution. Best practice tips are based on simplified Stradegi frameworks and discussions with asset management firms and robo-advisory platform vendors. Considerations covered include: clarifying objectives, defining the user offering, different development options, vendor selection and implementation. Contact us for a more detailed conversation or if you'd like more information on any themes covered.

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September, 2018
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Alpha completed her master's in business administration from the National University of Singapore and is a Chartered Accountant from the Institute of Chartered Accountants of India. She has keen interest in Fintech and the overall technology landscape for the investment management industry.



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Introduction

One of the largest and most interesting trends in the global investment management industry is the rise of the robo-advisor. These automated digital advice platforms made their debut in around 2010 and their growth has accelerated ever since. Robo-advice is expected to reach USD 4.1 trillion in assets under management ('AUM') and USD 25 billion in revenues by 2025¹. While robo-advisors may divide opinion on whether they will replace the advisors or not, the fact that they are here to stay cannot be disputed. The debate has moved beyond 'should we implement a robo-advisor' to 'how should we implement a robo-advisor'. Leading asset managers such as BlackRock, Schroders and Aberdeen Standard Investments have already invested in robo-advisor start-ups².

Partner, build, or buy? Non-response is no longer a viable strategy

Initial skeptics now view robo-advisors as a credible threat.



Robo-advisors provide traditional investment managers with an opportunity to evolve their operating models, target new customers, digitally engage with customers, and improve operational efficiency. Banks and wealth managers are further ahead in terms of adopting the trend of robo-advisors given that these are quickly becoming an important part of the distribution channel mix.

However, robo-advisors come with a specific set of challenges to overcome.

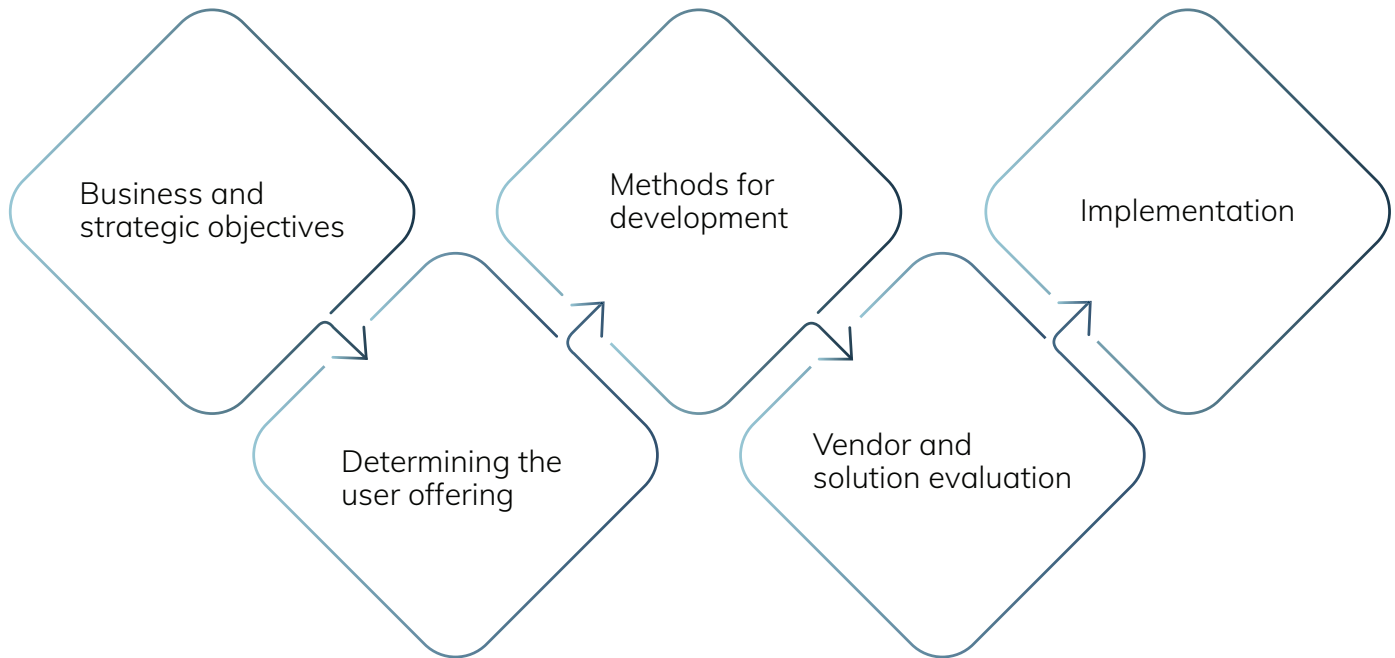
Why implement a robo-advisor?
Direct to consumer distribution channel
Focus on client relationships rather than on administrative tasks
Customers need for a digital interface, on-demand access and unique client experience
Service lower value accounts in larger volumes
Higher operational efficiency, as routine tasks are automated
Regular engagement with customers, amassing customer data on preferences, habits, etc

Challenges faced implementing a robo-advisor
Achieving scale to be profitable
High client acquisition costs
Regulatory licensing
Intense competition, low barriers to entry
Complexity finding the right solution due to the wide variety of robo-advisory business models

In this article, we highlight key issues to consider as part of a robo-enhanced distribution strategy.

Key Steps in developing a robo-advisory offering

In this section, we break down the five key steps to consider when developing a robo advisory offering: assessing your objectives, determining your robo proposition, considering methods for development, how to approach vendor evaluation, and implementation.



1. Business and strategic objectives

The first step is to assess why an investment manager wants to implement a robo-advisor and what value it will add to their proposition. Investment managers should evaluate benefits against cost and risk – considering the still-developing regulatory requirements and constraints.

2. Determining the user offering

Investment managers must consider in detail the kind of experience they would like to offer to their users (clients or advisors). Robo-advisor operating models vary based on the target market (advisors vs. investors, inexperienced vs. sophisticated investors, etc.), the products (ETFs, mutual funds, securities, etc.), the nature of investing (goal based, theme based), etc. Determining the offering also involves defining the pricing mechanism, distribution channels (web, mobile application), value proposition (superior returns vs product selection), etc. A wealth manager's criteria may differ, and it may choose to build a robo-advisor which is only advisor facing, in which case features such client monitoring, document management, risk analysis tools, analytics become quite important. Wealth manager's may want to build a financial planning module vis-à-vis just goal-based investing. Therefore, it is important to determine the digital experience before shortlisting solutions.

A simple categorization of robo-advisors is illustrated below:

Category*	Description
Operating model	
Fully-automated	<ul style="list-style-type: none"> • Completely automated platforms with advice exclusively generated by the investment algorithm • No access to a human advisor
Hybrid	<ul style="list-style-type: none"> • Advice from an investment algorithm combined with limited or full access to a human advisor • Models vary significantly, e.g. some offer limited access through periodic calls and chats, whereas others allow dedicated advisor guidance once over a defined minimum investment threshold
Advisor-facing platforms	<ul style="list-style-type: none"> • Platforms with tools which are meant exclusively for advisors • May or may not have a customer digital interface
Nature of investing	
Goal based investing	<ul style="list-style-type: none"> • Allows an investor to set specific savings goals - such as paid education, vacation, home ownership, etc. - and portfolios are constructed for each goal based on the risk profile, time horizon and liquidity needs
Theme based investing	<ul style="list-style-type: none"> • Client-facing robo-advisors that promote investment themes designed to attract a certain category of investor. Example themes include: <ul style="list-style-type: none"> • Retirement planning • Investment in specific asset classes or through specific instruments • ESG or socially responsible investing • Micro-investment • Shariah compliance

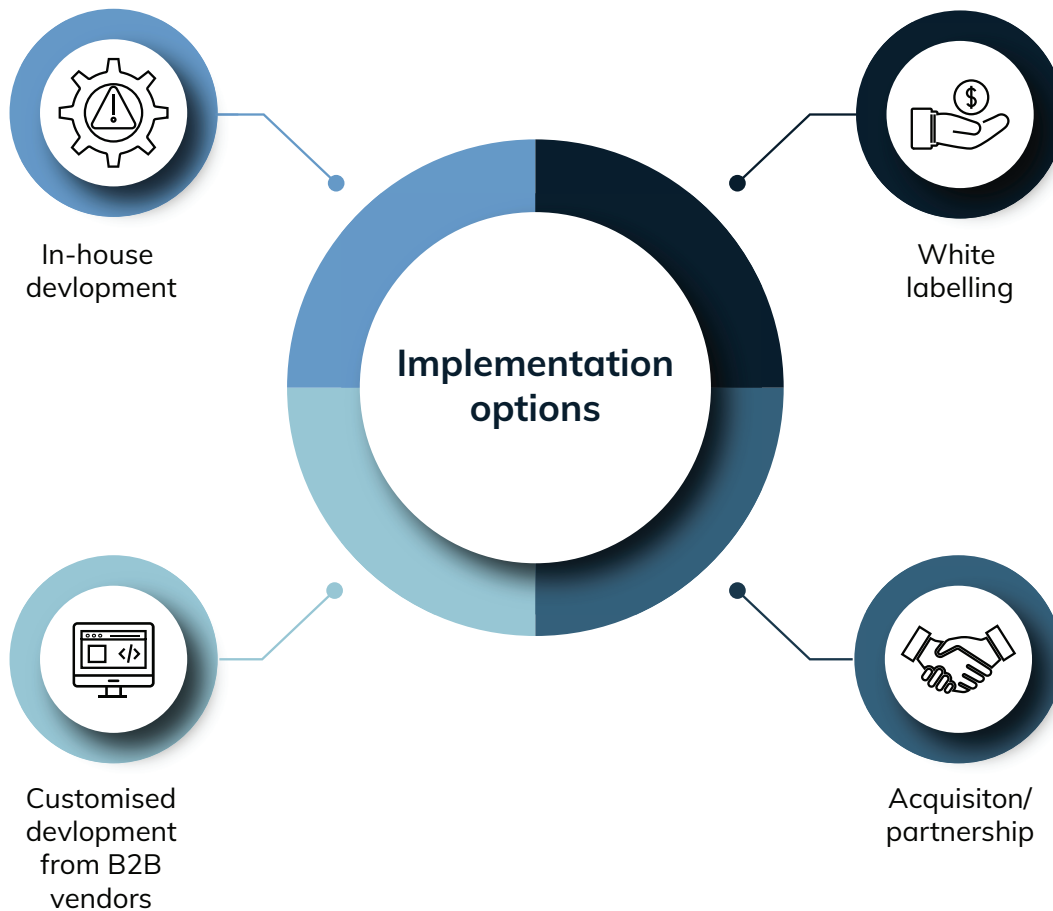
These wide categorizations demonstrate how important it is for an investment manager/ wealth manager to understand the market landscape, identify its target population and get clarity on the products and the breadth and depth of functionality to be offered to clients before finalizing a robo-advisory offering.

* It should be noted that such categorization is not mutually exclusive and given the rapidly evolving landscape, this list is not exhaustive.

3. Methods for development

Investment advice is increasingly commoditized and so are the technology platforms. Once it is decided that an organization would like to implement a robo-advisory solution, the implementation methodology must be determined. Factors such as timeframe, talent availability and expertise, budget and customization needs must be considered.

A summary of main implementation options, and their corresponding considerations are illustrated below:



a) In-house development

The organization builds its own platform - with its proprietary investment algorithms (e.g. for asset allocation, risk management, risk profiling etc.) - and the digital front-end, data management systems, compliance systems, system integration, etc. In-house development examples include Fidelity Go, Schwab Intelligent Portfolios and Vanguard Personal Advisors Services.

Considerations:

- Can be built to suit; offers complete control and data ownership
- Involves much higher cost and time for development
- Despite employing a development team with deep technology expertise, may need external support or recruitment of skillset
- Unique on-going maintenance and support needs

b) Development using business-to-business (B2B) technology platforms

Technology providers generally offer three robo-advisory options: full suite solutions, modular API solutions, or cloud-based SaaS. These can provide the flexibility to pick and integrate the modules investment managers require instead of building or acquiring an entire offering. Some solutions combine one or more of the above options - building a robo-advisor using the technology platform from one vendor, integrated with the APIs of another. Wealth managers may consider smaller advisor facing modules vis-à-vis integrated retail platforms. Examples of B2B technology platform providers include Hedgeable, InvestCloud, Beta Smartz, FNZ.

Considerations:

- Less expensive in terms of both time and cost compared to in-house development
- A flexible front-end can be customized, as most of these solutions are modular
- Still offers less control and overall customization compared to in-house development
- Vendors are technology companies, focusing on product development and enhancing features which is important to stay ahead of the rapidly evolving marketplace
- Availability of development as well as on-going support from the technology vendors

c) White-labelled solution

A white labelled offering is a solution that a business can buy from a provider, integrate with existing processes and offer to the clients as its own offering. Examples of white-labelled solutions include Betterment for Business, Jemstep by Invesco.

Considerations:

- Easiest and cheapest to implement
- As above, the technology vendors are well-placed to keep pace with market developments
- Least amount of customization possible and least flexible in terms of products and strategies to be offered, portfolio allocation and risk profiling.
- Limited availability of development as well as on-going support from the technology vendors

d) Acquisitions

Acquisition of existing robo-advisor has been a popular route particularly for large financial institutions. Examples include BlackRock acquiring FutureAdvisor, Invesco acquiring Jemstep.

Considerations:

- Fastest route to market
- Hard to find the right acquisition target
- Most expensive option and usually an option only for large companies

e) Partnerships

Another alternative is to seek partnerships with robo-advisors. This is a mid-path allowing an organization to test the market and the platform. Examples include OCBC's partnership with Weinvest, Fidelity's partnership with Betterment.

4. Vendor and solution evaluation

In the case of acquiring all or part of the solution from a B2B robo-advisor vendor, it is critical to evaluate the solution to ensure the platform will deliver the requirements now, and in the future. We have developed a detailed evaluation framework to help investment managers identify the right vendor partner and solution. For other modes of implementations, our framework serves as an essential checklist.

A simplified version is outlined below:

SI No.	Criteria	Illustrative evaluation points*
1.	Platform features and functionalities	Determine if the solution / platform can meet business requirements. Examples of key questions are: <ul style="list-style-type: none"> • What are the products / asset classes that can be supported? Any geographic or jurisdiction-specific constraints? • Capability to support companies' strategies as well as model strategies from external providers?
2.	Team	Determine if they have the skills and experience to build, test and constantly improve the platform / solution and whether they have the adequate financial and technology expertise.
3.	Algorithms	The objective is to understand the algorithms, what are they intended to do and that they perform consistently. Every investment algorithm captures the assumptions and behavioural biases of their investment committees, risk management teams, etc. It is critical to clearly understand and evaluate these algorithms. Some examples of the key points to consider are: <ul style="list-style-type: none"> • What are the algorithms running on the platform, are these proprietary? • What are their model assumptions? Are they in line with generally accepted investment practices and principles? • How have they been back-tested, and stress tested? How have they performed in recent years?
4.	Risk management	Risk management and mitigation must be fundamental to the platform. It is necessary to understand what those techniques are and what additional safety valves need to be built. Some examples of key questions are: <ul style="list-style-type: none"> • What are the built-in risk management methodologies, trading halts, draw down limits, etc.? • Have business continuity/ disaster recovery procedures been established? • What are the limitations of the platform?
5.	Performance	This relates to how the robo-advisor supports measurement of performance of its strategies/ investments. Examples of key questions here: <ul style="list-style-type: none"> • How does the robo-advisor measure performance? • Does the robo-advisor provide functionalities for reporting on performance and analytics at a customer, advisor and enterprise level?

*These are illustrative only, and in no way exhaustive.

SI No.	Criteria	Illustrative evaluation points
6.	Execution	<p>Not all robo-advisors support execution and may simply pass an order file to the designated broker. If the robo-advisor does support execution, examples of key questions here are:</p> <ul style="list-style-type: none"> • Is there an execution algorithm? How is best execution achieved? How are trading errors dealt with? • How can the platform connect with brokerages – APIs, FIX, File Transfer?
7.	Data management and protection	<p>Robo-advisors are privy to sensitive client information. With the increased scrutiny and regulatory need for data protection, it is critical to ensure data is not compromised and that there is adequate governance. Examples of key questions here:</p> <ul style="list-style-type: none"> • What are the customer data sets aggregated and stored on the platform? • How is data protection managed? What is the data encryption standard?
8.	Compliance	<p>Regulations around robo-advisors are evolving. Requirements such as suitability, disclosures, stress testing, governance must be dealt with by the robo-advisors. Further, for robo-advisors operating in multiple jurisdictions, the regulatory requirements may vary materially. Examples of key questions include:</p> <ul style="list-style-type: none"> • Is the solution compliant with the regulatory requirements of the jurisdiction in which it will be deployed? If not, can those features be modified or built-in? • Does the solution require integration and interoperability with existing compliance systems?
9.	Technology	<p>The underlying technology must be evaluated for factors such as:</p> <ul style="list-style-type: none"> • Is the platform scalable and stress-tested? • Has the interdependency of the various modules of the platform been determined? • Cloud based vs hosted – How is the platform hosted? Explore whether the solution provider offers dedicated cloud hosting for the organization. Is the server a common server or a separate server? • Integration – evaluate the integration of the new solution with the firm's existing platforms?

5. Implementation

Undertake the next steps to bring the robo-advisor solution onboard. Once initiated, the implementation project should go through well managed and structured phases, such as, analysis, planning, development and comprehensive testing before the robo solution is considered ready to go-live. The methodology, expertise and tools used heavily depend on the robo-advisor solution type and the investment manager operating model.

Conclusion

Robo-advisory is a critical part of the overall business mix, particularly when these are consumer facing. Investment managers need to be cautious to build a proposition that differentiates the business, reaches existing and new customers and gives clients a brand new and seamless digital experience. Investment managers must devote time and resources to build a sustainable robo-advisor strategy and ensure their robo-advisors are marathon runners, not tired sprinters!

Disclosure: Alpha Baid, is a Business Consultant at Stradegi Consulting. Stradegi offers consulting in the robo-advisory space, in addition to other emerging technologies and fintech solutions, to its buy-side clients

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¹Fintech Futures, Juniper Dec 2017. The study found that robo-advisors AUM will be driven up twelve-fold to USD 4.1 trillion in 2025 from an estimated USD 330 Billion in 2017.

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This paper is also based on discussions with personnel from asset management firms and executives from robo-advisory platform vendors.