Retirement Income
JOURNAL

More Than a Nice Interface?

By Kerry Pechter *Thu, Jan 21, 2016*

Jon Stein, CEO of Betterment, the biggest of the 'robo-advisors,' talked with RIJ recently at Betterment headquarters--three converted lofts in an historic building just west of the Flatiron Building in New York City.

Fidelity's office tower soars over downtown Boston, and Vanguard's corporate campus sprawls near Malvern, Pa. Betterment, the "robo-advisor" that yearns to compete with those direct-to-investor giants, rents three post-industrial lofts in a landmark building with a white cast-iron façade on W. 23rd St. in New York.

Though still relatively small (about 130,000 clients and $3.5 billion under management) venture capital-backed Betterment has big ambitions. Its 35-year-old CEO, Jon Stein, a HarvardAB/ColumbiaMBA grad and son of Dallas urban planners, aims to disrupt the conventional financial services industry—not just at the individual level but at the advisory platform and institutional levels as well.

RIJ talked with Stein (above) for an hour recently at Betterment headquarters (below, right). The offices were open-plan, factory chic. Clusters of Millennials sat at screens on workbench-type tables under exposed ventilation ducts. No isolation-enforcing cubicles, no sound-absorbing carpets. Commuter bicycles mounted on the walls. It was lunchtime, so the bearded, tattooed chef—recruited from a posh Manhattan restaurant, Per Se—could be seen behind trays of hot shepherd's pie at the far end of the room.

RIJ: It seems like the Vanguard and Fidelity are more like the integrated steel mills that employed tens of thousands of people and produced millions of tons of steel, and Betterment is like the automated mini mills that came along in the 1980s. Would that be an accurate analogy?

Stein: Ironically, we do think of ourselves as more like the vertically integrated steel mill. We are a full-stack solution. That's our competitive advantage. We've rebuilt the plumbing, rebuilt the banking APIs [application programming interfaces], the trading, the recordkeeping, and the back-end infrastructure. That gives us efficiency advantages. We also have the user-experience advantages, like Apple. Because we make the products we sell, we can provide a better user-experience. So we have both. We do more than you think we do.

RIJ: How would you describe the business you're in?

Stein: We think of ourselves as having several businesses. One is the retail business. We have retail customers who are solicited to sign up, usually at the recommendation of a friend or family member. They tell us about their goals, and we create and manage their portfolios. That's the retail business. We also have the institutional business. We're selling to registered investment advisors. We have over 200 firms on the Betterment platform. That's a white label product, with the advisor's name on it. Schwab doesn't offer that. TDAmeritrade doesn't offer that.

RIJ: So, a company like Envestnet would be a competitor?

Stein: Yes, we compete with an Envestnet, or a Charles Schwab, in that space. Then we have the 401(k) business. We built the first recordkeeper that combines recordkeeping with ETFs.

RIJ: People with experience in the 401(k) business tell me that building a recordkeeping system from scratch is sort of an IT nightmare.

Stein: I guess I'm a glutton for punishment. Actually, recordkeeping is easier with ETFs. And the whole thing is easier because we have no legacy systems. We've been investing in recordkeeping on the retail side for eight years.

RIJ: But you outsource a lot of what the big fund companies do internally, right? You use

APEX, for instance, for clearing and execution.

Stein: APEX doesn’t do much for us. We send trades through them.

RIJ: What functions do you do in-house?

Stein: We’re the custodian. We manage the funds. We do the accounting, the statements, the confirmations, and all the regulatory functions. We’re not outsourcing any of that. We manage the money. It sits *with* Betterment. It’s true that we don’t offer anything like a Vanguard Windsor II Fund [an actively-managed large-cap value fund]. We provide a simpler, streamlined solution. But it’s still end-to-end, and the advice is more sophisticated than Vanguard offers.

RIJ: OK. I had the impression that your core competency was the way you on-boarded new customers—that you applied the kind of frictionless interface that works for an Uber or an Airbnb to the investment business. You’ve got sophisticated ways of keeping track of prospects, and automated e-mail programs that nudge new clients through the enrollment and payment process. I thought that was your key distinction.

Stein: The on-boarding is just the tip of the iceberg. We make it easier to fund your account. You can fund your account same day that you open it. You can’t do that with anybody else. To make that on-boarding experience better, we have the only e-signed paperless rollovers in the industry. You can rollover from 401(k) to a Betterment IRA with an e-signature and a click. We couldn’t do those things if we hadn’t built all the plumbing ourselves.

RIJ: But it’s still true that you’re benefiting in major ways from the accomplishments of companies that went before you. If custom asset allocation hadn’t become a commodity, you wouldn’t be here.

Stein: It’s true that we couldn’t be building this business without the help of two things: The reduced cost of building information technology today, and the emergence of exchange-traded funds. Today you can get a globally diversified portfolio through an ETF, using one API—through one pipe—and you can go to any vendor [ETF manager] to get it. That’s good for us. We have access to one connection who gives us access to the whole world of ETFs, without any additional build and without any special distribution agreements. We can use iShares or Vanguard or Schwab ETFs. The money is spread out among multiple ETFs and multiple providers. With open architecture, we get the lowest costs and the most liquidity.

RIJ: Then there’s the arrival of the smartphone. That changed everything.

Stein: We now get 60% percent of our log-ins from our mobile app. What’s happening with phones is like the early stage of what happened with desktops. Everything moved to websites. Now everything’s moving to mobile.

RIJ: Let’s talk about fintech and the regulatory environment. The Secretary of Labor himself has said he welcomes the robo-advice industry and thinks it’s good for Baby Boomers who need help managing their retirement money. Some in the fintech industry have said the Department of Labor’s fiduciary proposal can only help their type of low-cost, unbiased advice. Have you personally spoken with people at the DOL about synergy between robos and regulation?

Stein: We have had meetings with policymakers and at DOL and we’ve written a letter supporting their initiative. I wouldn’t say there’s been ‘frequent’ communication between us and the Department of Labor. I’m not a policymaker. I don’t read the proposals or the bills; I rely on smart people for that. The gist of it is that the DOL wants to simplify things. Their goal, whether you think they’re going about it in the right way or the wrong way, is that anybody who gives advice to retirement investors should have their interests well-aligned with the client’s interests. I think that’s a noble ambition.

RIJ: Where do you think all of this is headed? The conventional wisdom is that there will be a convergence that combines robo-advice with a human touch. You already offer phone support, right?

Stein: We’ve got a dozen people answering the phones. We have customer support seven days a week, 12 hours a day. We’re recognized by Consumer Reports as having the best customer service. I think that’s a testament to the fact that we’re putting people first.

RIJ: Yes, but do you foresee combining your technology with in-house human advisors, the way Vanguard has.

Stein: I don’t see a big distinction between the human role and the role of technology. People have always used technology to give advice. I can’t imagine any investment advisor working without technology. We have advisors using our technology today. It’s a big deal for them because of our investments in a better customer experience. We don’t see ourselves as replacing human advisors. Our customers get great advice from talking to our phone team. But they also don’t have to talk to anyone if they don’t want to. I think we do a better job, even without an expensive call center.

RIJ: What about the status quo do you think isn't working, and what are you trying to fix?

Stein: On average, Americans have a real problem with saving enough for retirement. Today, only 10% to 15% of retirement spending comes from personal savings. A third comes from Social Security. Some comes from working in retirement and the rest comes from personal savings. In the system we've designed, most people are at a loss for how much they should be saving. We've done a disservice to our population. The way we designed the 401(k) system—it's like we said to people, 'You can have access to any medicine you want, but there's no doctors and no pharmacists.'

RIJ: Speaking of retirement spending, I noticed that you have a retirement income program that calculates monthly withdrawals that vary with the ups and downs of the market. But the example on the website uses a 20-year life expectancy for a hypothetical 65-year-old woman. A lot of planners are now using a 30-year life expectancy.

Stein: Even with a 20-year timeline, we set it up so that you could live for 99 or 100 years, and even when you get there, it's likely that you will still have significant savings left over. It's almost too conservative. You could probably spend more than we recommend. I don't worry about anyone who uses our method running out of money.

RIJ: What's your exit strategy for you and your venture cap backers? Are you planning to take Betterment public?

Stein: We want to go public. That's the ambition of the company.

RIJ: Do you think there's any danger that going public might hurt your relationships with your customers? The current version of the DOL's fiduciary proposal requires advisors to act 'solely' in the interests of their clients. But public companies have to put the shareholder first. Do you see a potential conflict there?

Stein: Not at all. An IBM or a General Motors or an Apple couldn't succeed if they didn't have their customers' interests in mind. When companies stop putting their customers first, the world punishes them. The capitalist system isn't perfect, but it produces great things. We all rely on it.

RIJ: I was wondering where the name 'Betterment' came from.

Stein: The name came from an old-fashioned word for making things better. I liked the idea and liked the name. I probably heard it at home because my parents used it. They were city planners in Dallas, where I grew up, and they would talk about the ‘betterment’ of public streets.

RIJ: What led you into finance?

Stein: I happened into financial services, and I was appalled at what I saw. I was frustrated by the products that the banks were building. I thought, ‘There’s got to be a better way.’

RIJ: You could have made millions on Wall Street, and then quit to do anything you wanted.

Stein: It’s true that I’m not making as much money as I could be right now, but I’ve got the best job in the world.

RIJ: Thank you, Jon.