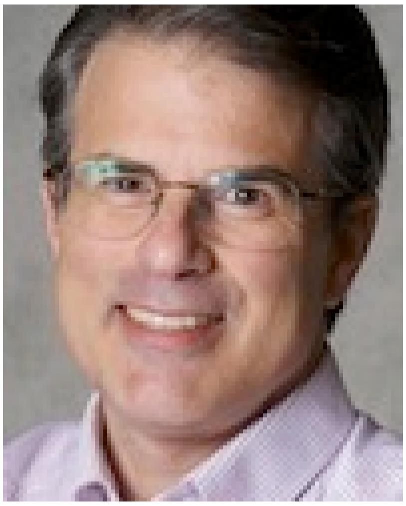
Will a Robo-Advisor Eat Your Lunch?

By Kerry Pechter *Thu, Nov 13, 2014*

"It comes down to this: 'How much personalized service am I willing to give up to save 75 basis points a year?" said Jack Waymire about the robo-advisors. He runs a client-advisor matchmaking service at iwd.paladinregistry.com.



Computers, software and the Internet are modern-day Trojan horses. You welcome them into your office and admire their economies. Then, one day, you find an algorithm sitting at your desk, downing the chicken-on-chibatta that you ordered (online, perhaps) for lunch.

Which raises the subject of robo-advisors.

They're eager to eat the lunches of overpaid investment managers and wealth management consultants. And they will. If your job as an advisor is mainly to meet clients, gather their personal data and present them with a computer-generated asset allocation plan, you might want to read *What Color Is My Parachute*. It's available on Amazon.

Automation isn't fair. It never has been. And the robos do have unfair advantages. Unlike established players, they're not married to legacy IT systems or distribution partners or Wall Street analysts. Heck, many of the young Next-Gens and Millennials who run robo-advice firms aren't married at all.

Still, you've got to give them credit. When the 2008 crisis exposed the costs of financial products and services, they recognized that distribution (i.e., sales) accounted for much of the expense. By using web-based platforms instead of salespeople and exchange-traded funds, they've been able to under-price established asset managers by 50-100 basis points or more a year.

A search for the best mousetrap

It's difficult to generalize about robo-advice and its impact on the financial services industry. So much of financial services has already been automated that no bright line exists between, say, a web-driven direct provider like Vanguard and a robo-adviser. Some robos seem built for do-it-yourself investors, while others cater to do-it-for-me investors.

The two dozen or so robo-companies (see Data Connection on today's *RIJ* homepage) have a wide range of specialties. Some aggregate and others allocate. Some advise and some auto-rebalance. Others auto-tax-harvest. To bring the evolution of advice full-circle, some now even offer live phone support. Some, like Betterment, offer a nearly full-service package.

"We are able to control the entire experience," a **Betterment** project manager told *RIJ*. "We are the broker dealer, the investment adviser, and for IRAs we provide the custodian. We create statements, tax forms—we want to own all of that. Vertical integration allows us to let you sign up and open an account in minutes with zero paperwork. It's literally two clicks."

There are certain tasks robo-advisors can't do well or may simple choose not to do, however. Building highly customized retirement income plans out of a combination of investment (for upside potential) and insurance products (for downside protection against longevity risk and health risk).

While researching today's cover story ("Two Robo-Advisors, Two Income Strategies"), I talked with people who've been watching the growth of the robo-advisor phenomenon. One of them was Jack Waymire, who runs a website, **iwd.paladinregistry.com.** It's an iconoclastic platform where prospective clients can meet advisors whom he has evaluated and blessed.

Waymire doesn't think the retirement market will ever get a lot of attention from robo-advisors. "If you're a robo-adviser, what do you care about trying to crack that market? It might sound good to the venture capitalists that are backing you, but I doubt that Boomers are going to put billions of dollars of retirement money on their platform. It's not a big threat anytime soon," he told *RIJ*.

At the same time, Waymire suggested, the robo-advisors may be inherently weak in the area of product sales, where much of retirement income planning takes place. "The robo-advisers are limited to the RIA side of the business," he said. "If they were to try to approach financial services from a broker-dealer or insurance point of view"—i.e., if they were selling complex products—"they'd have to ask themselves, 'Do I really want to be registered in 50 different states?' or 'Do I want oversight from FINRA?' The complexity of operating on the b/d or insurance side, just from a compliance standpoint, would be huge." Betterment is a broker-dealer, but it may be the exception among robo-advisors.

Bob Lonier, a retirement income-focused advisor who has created software for like-minded advisors (**rmap-planner.com**), gave a darkly humorous presentation about robo-advisors at the Retirement Income Industry Conference in Charlotte, NC, in October. He believes that robo-advisors could automate retirement income, but probably won't.

That's because building a floor income out of safe or guaranteed products and adding risky investments for growth—his understanding of retirement income planning—simply isn't all that popular to begin with. It flies underneath the robos' radar, so to speak.

"It would take about a year to develop a sophisticated income solution based on the flooring and upside approach—if the founder of the company and the technology guy and perhaps the marketing person are even aware that such an approach exists. I would be that they are not," Lonier told *RIJ*.

"There are lots of finance people who are entrenched in this business and have important jobs who know nothing about retirement income generation other than risk tolerance questionnaires and 60-40 portfolios," he added. "They think everything beyond that involves an annuity contract. But if the robo-advisers don't understand that, then they won't be developing any tools around it."

Celent, a global research unit of Oliver Wyman, has done a couple of studies of the robo-advisor phenomenon. One of the authors, Will Trout, notes that Betterment has already entered the retirement space with a systematic withdrawal method, and expects others to follow that path.

"The robo-advisers' client-set, because it's young, and mass-affluent, is not to a great degree focused on retirement income distribution yet, so the robos have focused more on planning for retirement, more than retirement distribution per se," he said in an interview. "Betterment has a retirement solution that focuses on a systematic withdrawal plan, but as far as focusing on income distribution specifically and on any customized level, that's not happening right now. But I think it will eventually happen."

Waymire, whose earns his bread from the personal advisor business, thinks that the robo-advisors' main competitive advantage—low cost—may not be decisive in the end. Their arrival may signal the beginning of the end for load funds and high managed-account fees, but a close relationship with a thoughtful planner will always have value.

"On the one hand you have the robo-advisors, and on the other hand you have the local advisers," he said. "And there are multiple shades of grey between. Everyone is trying to come up with the best mousetrap. Faced with each option, consumers will have to ask, ‘What will I get from this service? What will it cost me?’ It comes down to this: ‘How much personalized service am I willing to give up to save 75 basis points a year?’”