The Rise of the Machine

Could robo-advisors be the nudge plan sponsors need to offer members investment advice?

By **Brooke Smith**

Need new shingles? Hire a roofer. Bothered by that wisdom tooth? See the dentist.

Most people seek out professionals for activities they can't or don't want to do themselves.

But what about Canadians and financial advice? Well, it's complicated. *Benefits Canada*'s 2012 *CAP Member Survey* found just 8% of plan members sought out advice from an employer-provided financial advisor.

"People are looking for help," says Larry Ketchabaw, manager of international benefits at Veritiv Corp., a North American company providing print, packaging and publishing services. "They say to me, 'I know you can't tell me what to do, Larry, but I don't know what to do.' In the end, I try to help on a regular basis by educating employees on resources available, while, at the same time, being careful to make sure those asking understand I'm not a financial professional and so can't give advice."

A full 61% of the plan sponsors surveyed support this view, expressing concerns about the liability of providing investment advice to plan members.

"Our pension investment committee has discussed the possibility of the role our service provider could play in offering advice, but at this time, we're not looking to add that service," says Ketchabaw.

The common perception of receiving advice conjures images of a traditional sit-down with an advisor. But there's a new way to get it. Enter robo-advisors, which may be a solution for employers that don't want to offer full advice due to liability concerns.

MyPrivateBanking Research, which analyzes how financial services companies should develop their digital presence, estimates global AUM of robo-advisor services will reach $20 billion by the end of this year and grow to an estimated $450 billion by 2020.

With names in the U.S. like Wealthfront, Betterment and FutureAdvisor, robo-advisors provide investment management using algorithms—usually with little human contact. However, U.S. robo-advisors have begun adding a human element, says Mark Yamada, president and CEO with PUR Investing.

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— Larry Ketchabaw, Veritiv Corp.

"Some of the larger broker-dealers—for example, Schwab—will say that you get an advisor assigned to you. So it's a robo plus a body," he continues. But Yamada adds any good investment manager will have an algorithmic-based discipline behind it. "So, are you seeing the robo first and then the human, or the human first and then the robo? It's morphing into the same sort of thing. You get what your preference is."

Regulations in Canada mandate a hybrid model. An Ontario Securities Commission report says, "The online advisers operating in Ontario are offering hybrid services that utilize an online platform for the efficiencies it offers, while ARs [advising representatives] remain actively involved in decision making."

Clients fill out an online risk profile and are then allocated to one of 10 profiles, ranging from conservative to aggressive growth. "We follow up with a phone call to ensure that the client's asset mix is appropriate," says David Nugent, portfolio manager and chief compliance officer with Toronto-based Wealthsimple, which opened its digital doors last fall and just secured a $30-million investment in its team and products from Power Financial Corp. in April.

But robo-advice is still relatively new here in Canada and is so far confined to the retail space. According to Brett McDonald, an analyst with Canadian research firm Investor Economics, there are six firms in Canada registered as portfolio managers that provide advice through a mainly online channel.

And, stats from Boston-based consultant Aite Group say U.S. robo-advisors were managing only about $4 billion in assets as of October 2014.

"We haven't considered robo-advisors,"

DWIGHT ESCHLIMAN/GETTY IMAGES

59% of Americans have not worked with a financial advisor

45% of Americans said they weren't comfortable going online to save, invest or manage their finances

SOURCE: 2014 HARTFORD FUNDS SURVEY

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Less Is More

One advantage of robo-advisors is their cost. In a November 2014 Hartford Funds survey of 1,000 consumers and 100 advisors in the U.S., 46% cited lower cost as the most attractive feature for robo-advisors over their human counterparts.

Neil Lloyd, a partner with Mercer, says this low cost could attract investors. "They're often quite sensitive to fees, so they might like this idea," he says. "Maybe they could have obtained better advice paying a higher fee, but that's hard for people to judge."

Cost is also an issue for plan sponsors, since it would be expensive to provide members with traditional financial advice, says Investor Economics analyst Anthony Yeung. "Given the average group plan balance ($20,000 to $50,000), it is not cost-effective to provide financial advice to all plan members given the current pricing levels—but robo-advice may be a practical solution," says Yeung. "At least members are given some form of advice."

Another benefit is, robo-advisors rebalance portfolios automatically. Some plan members do a good job of asset allocation the first time, says Yeung, but many don't review yearly and rebalance.

You Get What You Pay For

Lloyd compares robo-advisors with U.S. managed accounts, which are owned by 401(k) investors and looked after by professional money managers, and have a long track record.

While these accounts and robo-advisors have many similarities, managed accounts do sport the advantage of highly regarded research and advisory boards. "These are people you know from finance textbooks. You know these people are

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very strong in their fields and will evolve over time," Lloyd says.

"On the robo-advisors side, that's not as clear at this point in time. If an individual is looking for a robo-advisor, I'm not sure how they're going to know which one to pick—or decide between one that has strong research and one that has not."

There's also the active versus passive management debate. Many robo-advisors use ETFs (to keep fees low), and the majority of ETFs are passive. Some investors may like the cheaper fees. "We know that paying 2% fees, which often happens in the retail space, is quite prohibitive. That puts a lot of people off," says Lloyd.

Retail to Corporate

While robo-advisors are today tailored to the retail space, Nugent says group RRSPs and DC plans are ripe for exploring.

But Wealthsimple isn't at the corporate stage yet. "We've started a pilot project with group RRSPs," says Nugent. "And we're seeing more and more employers ask if and when we're going to go full fledge into that business."

Nugent isn't setting a timeline, however. Right now, Wealthsimple has a group RRSP for its employees, "so we're working through that on our own plan to get something that would make a lot of sense for the masses."

Yamada says some form of advisor will have to replace the dwindling number of traditional financial advisors in North America, which have generally taken care of baby boomers' needs.

"There has to be something to fill the gap, and online advice is a way of leveraging the time of existing advisors," he says. "Wittingly or unwittingly, advisors will [one day] be relying more on systematic approaches to portfolio construction—which is a good thing, as long as they're constructed by people who understand the dynamics of the marketplace."

Ketchabaw agrees. "I think [robo-advice] can be an effective tool if used properly," he says. "I get many questions from employees, and I know they're looking for tools to help them make better investment decisions." BC

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