Attack of the Robo-Advisors

How the Digital Revolution is Disrupting Wealth Management

Introduction

The 2008 financial crisis wiped out key pillars of the financial industry and severely damaged banks that managed to weather the storm. The clouds of the crisis also obscured a new and growing threat that may have an even more devastating and permanent impact on traditional financial institutions. An onslaught of financial technology—or fintech—entrepreneurs from outside the ranks of traditional banking are now fully on the scene. Technologically savvy and nimble, these startups offer new ways—via new delivery channels—to meet people's financial services needs, initiating concepts in lending, payments, and investment that veer radically from the traditional. For brick and mortar banks that have worked hard to create an aura of safety and stability, innovation has often taken a back seat. To catch up, today's banks must learn to think like the competition—embracing data analytics and technology to interact with and serve customers increasingly comfortable in a digital world.

The Situation: Digital Disruption in Banking

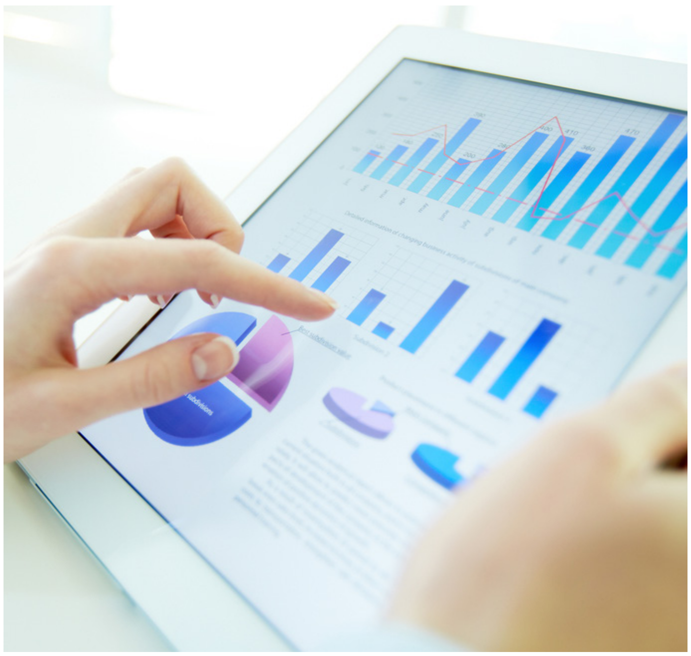
From 2008 to 2010, the worst financial crisis since the Great Depression of the 1930s wiped out leading financial-industry stalwarts and significantly damaged the reputations of those that survived. Five years later, banks appear to be recovering—record earnings have been reported for 2013—but upon closer examination, it's clear that these gains are largely the result of loan loss reserves rebounding from horrific lows rather than an uptick in new business or consumer faith.

In fact, banks are not growing as fast as they should be. Why? For one thing, banking is currently among the least-loved, respected, or trusted industries. According to industry web publication Finextra, "Nearly three quarters of America's millennials would rather go to the dentist than listen to what their banks have to say" about financial services.[1] Clearly, banks have a long way to go to put their reputations back on solid footing with consumers. More dangerous, however, is the emergence of a new breed of technology-driven online investment firm that doesn't fit the profile of the traditional licensed and regulated financial institution.

Dubbed "robo-advisors," these new services are changing the competitive landscape, whether or not traditional advisors like it or, in some cases, even realize it. Tech-savvy and agile, with an entirely different business model, these startup companies are rapidly gaining a foothold and capturing market share. In fact, they are digital natives—they start digital, and build a business around a flexible core, taking mobility, social media, the web, and aggregated data for granted. While traditional banks anchored by cumbersome technology lumber to catch up, these fintech companies are leveraging social media and other technology to enable interactions that are entirely reshaping customer relationships.

These firms are changing the game on several fronts. They are using data analytics software to guide investments, constantly improve their capabilities, and answer more and more complex questions. They are raising the bar for clients' expectations about investment firms' abilities. And they are leveraging new delivery channels, which may be the most profound disruption of all.

Digital financial advisors such as Personal Capital, LearnVest, and WealthFront are taking the industry by storm. WealthFront, for example, has amassed over $350M in a mere two years. Rather than robots, however, these firms have real, live strategists, advisers, and financial planners. They also have web portals, mobile apps, model portfolios, and interactive planning tools. Yet, so do the traditional firms. Then, what are these startups doing so differently?



The difference is, these companies have designed their client experience and built their internal processes around the latest technological innovations, rather than bolting new technology onto 1970s-era architecture and processes. They use technology to make advice delivery both more widely available and more comprehensive. For example, their technology allows them to start a relationship with an aggregated view of their clients' total holdings—a claim only 10 percent of advisers can make today, according to CEB TowerGroup.[2]

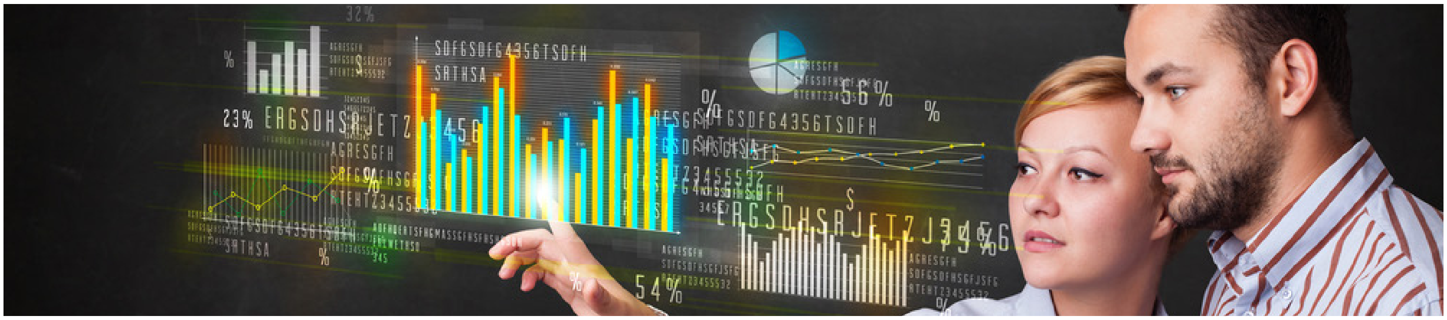
Now that these firms have caught the attention of an increasingly younger and more technologically savvy audience, they are in a neat position to offer new products and services (either their own or others) directly to this already engaged audience. This could eventually lead to disintermediation in the category as product and pricing transparency becomes the norm, and financial institutions struggle to maintain their brand relevance. A good example is Netflix, an online digital service that began poking holes in the traditional video rental business model. Now Netflix is making its own movies and series.

In contrast, consumers' perceptions are that traditional banks have historically invested in technology only when it served their own purposes—for example, offering self-service options because it was advantageous (less expensive) for the bank. Innovations have been about improving transactions, rather than relationships. In addition, banks are conflicted about data mining. Unsure of who actually owns the data—banks or consumers—they have been reluctant to reveal what they do know about their customers' holdings and financial situations. As a result, 68 percent of advisers rate their own technology as "fair" or worse, and 63 percent rate the integration of their tools the same way, according to Patrick Yip from Pershing and David McClellan from Albridge Solutions Inc.

In addition, the digital revolution is arriving later to wealth management than to other industries such as media and retail because the wealthiest investors are older. However, as a $41 trillion bubble of wealth works its way down to Generations X and Y, it will behoove banks to cater to these populations who have grown up with technology, often prefer online services, and eschew relationships with traditional advisers. According to a KPMG survey of more than 100 bankers, nine out of 10 banks said that they have re-examined, are in the process of re-examining, or will re-examine their operating models.[3] In addition, 40 percent of the respondents said that asset and wealth management would be essential to expand revenue over the next few years.

The Opportunity: Emotional Intelligence + Data Aggregation

The great irony of the current situation is that it was banks that began aggregating data about fifteen years ago. However, they failed to understand the potential this data held, treating it as a self-service option and using it to cross-sell products. It was Mint that first used data aggregation to



actually help the customer—by taking all that data and putting it in one place. Now, digital natives are leveraging the troves of customer data to create exciting new financial services.

But all is not lost. Banks can repair their reputations and increase business by rethinking everything from who their customers are to how they reach them and the products that they will offer. Now that the opportunity is clear, smart banks can and should analyze the technology and mindset of the leading fintech companies and forge their own brand of modern-day financial advisor. Affluent consumers in particular are utilizing a wide variety of software-as-a-service offerings with increasing regularity, and a slew of investing and financial planning options have arrived on the scene in the past five years.

Like traditional Hollywood studios with their summer blockbusters, banks are still churning out ETFs, mutual funds, mortgages, and other financial products for the investor to consume. But instead of visiting their local branch, digitally savvy investors now expect to be able to perform these tasks online. This is where the robo-advisors pose a significant threat to the distribution channel of the financial institution. These new firms are not shy about harnessing all of the digital touch points at their disposal—including mobile, social, and the Web—to conduct business and serve their customers.

Traditional banking institutions can compete for the distribution by changing the way they view technology from one that focuses on the transaction to one that focuses on the relationship. Advisers with a pulse will always have an edge in emotional intelligence and the ability to help protect clients from their own worst instincts, but they will need to make the best use of those advantages to create real value on the clients' terms. How? By moving from information management to relationship management. It's been shown that direct interaction—the experiences people have as a customer—makes a big difference to improving reputation and garnering trust.

Umpqua Bank is one example of a bank that's done a fantastic job of putting the customer first—making sure they are solving a problem or meeting a need that their paying customers actually care about. How? Through technology, of course. But—and this is key—the experience for the customer is decidedly not about technology. Rather, from the customer's perspective, it's all about authenticity. Sound easy? Not quite. The truth is, it's hard work to make it this simple. When advisors have a customer's complete financial picture at their fingertips, they can understand underlying causes and are free to be real with their clients, and to provide real value as well.

It's never been more crucial for banks to build positive personal relationships with their customers. How can banks keep digital and mobile users happy and provide positive and helpful customer experiences? It starts with adopting a relationship-based view of technology that leverages sophisticated data analytics, telling an advisor enough about a customer to anticipate their needs and wants at the various junctures of a conversation and in fact throughout their lives.

To make this work, financial institutions need to be sure they have the highest-quality investment data possible to meet customers' needs, especially in the wealth space where people commonly have assets housed with several different institutions. Robo-advisors start with aggregated data—a significant advantage. In fact, the use of aggregated data is a win-win, benefitting both the advisor and the customer. Digital natives just assume they can provide the best advice when they have the clearest picture of a customer's entire financial situation. Banks that manage to get a handle on their technology can provide the best of both worlds to today's digitally savvy customers who seek a nurturing experience from a trusted advisor who can actually help them.

How Yodlee Can Help

The days of the one-on-one client-adviser relationship are not over, but they are changing. The digital revolution is very real, but it need not be a threat. In fact, the integration of human and digital is the most effective strategy. Rather than supplanting relationships, banks can use digital capabilities to supplement them.

It's been said that there are those who make the simple complex and those who make the complex simple. Yodlee is making it simple for banks to forge meaningful connections to customers by combining digital touch points with human contact. We know better than anyone what data analytics can do. In fact, it's Yodlee's data engine that is powering the best of the new breed of digitally-native financial services.

The more granular the data, the better advisors can help their wealth customers. Wealth data is different from banking data. It's more complex to use for product recommendation and cross-selling because it's less congruent across different banks and financial institutions. The breadth and depth of Yodlee's data aggregation make it possible for advisors to understand the subtle nuances of a real person's situation. It allows advisors to intimately know their customers, to plainly see their situations, and to offer simple and pointed solutions that make sense and can really help.

Conclusion

Robo-advisors are taking the industry by storm. They are agile, powerful, and fast. And they are terrifyingly accurate. But, they are also remote. Armed with the right tools, traditional advisors are ten times stronger because they have the all-important quality of emotional intelligence to add to the mix. The fact is, sometimes, customers need a little help. Sometimes they just want to talk to someone who will listen. Today's technological advancements have the potential to make seismic changes. Smart financial institutions who adopt and utilize these new tools in ways that clients actually value can build lasting, profitable relationships with their customer base, forging trust and positioning them to leverage new delivery channels for product offerings down the road, should the opportunity present itself.

The Yodlee platform uses the power of investment data to consciously build trust and loyalty. Contact Yodlee today, and find out how we can help you win in the new era of financial services.

[1] http://www.finextra.com/news/fullstory.aspx?newsitemid=25834
[2] Multiple Hands on the Wheel: Top 10 Wealth Management Technology Initiatives for 2012, presented at the 2013 Tower Group Financial Services Technology Conference
[3] http://www.americanbanker.com/issues/177_108/kpmg-survey-finds-banks-rethinking-operating-models-1049900-1.html

About Yodlee

Yodlee is a leading technology and applications platform powering dynamic, cloud-based innovation for digital financial services. More than 750 companies in over 10 countries, including 9 of the 15 largest U.S. banks and hundreds of Internet services companies, subscribe to the Yodlee platform to power personalized financial apps and services for millions of consumers. Yodlee solutions help transform the speed and delivery of financial innovation, improve digital customer experiences, and deepen customer engagement.

Yodlee is headquartered in Redwood City, CA with global offices in London and Bangalore. For more information, visit www.yodlee.com.