Where next?
The future of automated financial advice

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Much has been written about how automated advisers, more commonly termed ‘robo advisers’, could disrupt the market for investment advice. But where could they spread? Deloitte recently concluded a primary research project to help answer this question. We examined the potential for automated advice to grow in the UK over the next decade, across the following six markets (see Figure 1).

The research included discussions with key players and start-ups as well as a Deloitte survey of over 2,000 consumers. In this article we distil our key findings and the major opportunities for players in the investing, defined contribution (DC) pension saving and at-retirement markets. Although our analysis focuses on the UK, and non-UK firms will need to take into account their local commercial, attitudinal and regulatory dynamics, we believe the key trends and findings will be of interest for firms across the EU.

The UK offers a rich opportunity for automated advice. There is a significant ‘advice gap’, driven by the high cost of advice, low financial literacy, low engagement and a lack of trust.1 With individuals increasingly having to manage their own pensions, automated advice can play a key role in generating low-cost solutions by leveraging its advantages over face-to-face advice (see Figure 2).

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1 The Financial Advice Market Review defined the advice gap as a situation in which consumers are unable to get advice and guidance on a need they have at a price they are willing to pay. Responses to the Call for Input indicated strongly that there is an advice gap, and that this is particularly significant in relation to pensions and savings and, to a lesser extent, protection. The Financial Advice Market Review Final Report, HMT and FCA, March 2016 https://www.fca.org.uk/publication/corporate/famr-final-report.pdf
Our analysis suggests there is high potential for automated advice across investing, defined contribution DC pension saving and at-retirement, with over a third of consumers in each of these markets willing to pay for automated advice (see Figure 3).

The amounts consumers are willing to pay, however, are generally low. For example, 68 percent of working DC scheme members who would pay for automated advice would demand a discount of at least 75 percent on the typical cost of face-to-face advice on investing contributions. Pricing these services affordably will therefore be key.

We asked those who were unwilling to pay for an automated solution to explain their motivations. They are similar across the three advice scenarios, and speak to the reassurance consumers seek, as well as the need for an affordable price. A significant number of respondents said they would find it easier to speak to a financial adviser than use a website, implying that building easy-to-use customer interfaces is key to success.

With the exception of at-retirement, more than a fifth of respondents in the other two scenarios said they would not want help with these decisions. In our view this makes it clear that provider marketing will need to educate consumers about the value of advice and tackle low engagement including, but not limited to, financial literacy and inertia.

Despite these concerns, even among those unwilling to pay for automated advice, a tenth or less of respondents in each scenario believe their financial affairs are too complex for a website to handle. While some may well be under-estimating the complexity of their financial affairs, this suggests that if providers can devise and price appropriate services, the market for affordable automated advice could be large.

We believe that coupling many customers with highly efficient and engaging digital solutions will be the key to create the economies of scale necessary to make automated advice both affordable for the consumer and viable for investment managers.

Regulatory risk is also a key barrier. Firms recommending specific financial products based on a customer’s individual circumstances are subject to suitability requirements and may be liable to pay redress and potentially regulatory fines if they are shown to have given unsuitable advice. Providers in the UK frequently report that uncertainty in determining which services are regulated is a big inhibitor. The UK Financial Conduct Authority (FCA) is supportive of the development of automated advice models and is planning to publish regulatory guidance and feedback that should help reduce the degree of uncertainty.2

Other regulatory challenges include the clarity of customer communications, the design and oversight of algorithms and cyber risk. Firms will need to adjust their risks and control frameworks and management information to reflect the different customer journeys and to identify, review and manage the different types of risks presented by automated advice. At the same time, automated advice gives rise to potential regulatory benefits.

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2 In April 2017, the FCA published a consultation setting out proposed guidance to support firms offering ‘streamlined advice’ on a limited range of consumer needs. In summer 2017, the FCA will publish another consultation on proposed revised guidance on the amended advice perimeter and non-advised services. In summer 2017, the FCA also expects to set out further guidance informed by the Advice Unit’s work with firms. For more information, see GC17/4, FCA, April 2017, https://www.fca.org.uk/publication/guidance-consultation/gc17-04.pdf
It allows firms to maintain consistency of advice, and provides an audit trail of customer interactions as part of the advice process, as well as an opportunity for firms to make communications more visual, interactive and engaging, including through exploring the use of virtual reality technology.

**Investing Opportunity**

We believe there is a significant unsatisfied demand for efficient ways to invest smaller sums of money. Forty percent of respondents in our survey would pay for automated advice to help with such investment decisions. This is remarkable in the context of low engagement and financial literacy, and in the absence of any major initiatives by UK incumbents. In addition, even among wealthier investors, cost consciousness is rising and we believe that many will allocate a portion of their assets to a low cost digital adviser.

**Barriers**

Risk aversion - With many sitting on cash, provider marketing will need to convince potential clients to invest money in higher return assets as well as educate and reassure them about the capabilities of their automated products.

Profitability - Low thresholds will be key to attracting consumers from the less wealthy target market who do not have access to traditional, higher-end wealth managers. In addition, low fees are vital to bring in price-sensitive consumers who inhabit all segments of the wealth spectrum. However, customer acquisition costs will be high, especially for new entrants and those with little brand awareness in this market. As a result, making a profit on stand-alone automated advice business is challenging, particularly in the early years. We estimate that a stand-alone automated advice business is likely to need anywhere between £4 billion to £10 billion in assets to break-even, skewed in all likelihood towards the higher end of that range, a level substantially higher than where we are today.

**Industry implications**

Asset managers largely see themselves as ‘manufacturers’ of investment products. Few have sizeable direct-to-consumer (D2C) businesses, and most are reluctant to spend the money to build a brand with high recognition among mass market consumers. However, rapid adoption of digital advice has the potential to accelerate an ongoing shift to passive investments. To maintain growth, asset managers will need to focus either on differentiated products and/or find a way of participating in this change through, for example, building or partnering to create a D2C route.

Retail investment platforms and wealth managers are the best positioned to add on digital investment advice services given their branding and direct access to consumers. They can add this service at relatively low incremental cost, although they will need to build or buy technological expertise (for example, acquiring white-labelled software to provide the customer front end).

Retail investment platforms are especially well placed, as they can attract business away from wealth manager clients looking for lower-priced passive solutions.

Given banks’ access and ongoing relationships with their customers, targeting investors with small sums to invest is an opportunity with a relatively low acquisition cost. However, the challenges here are likely to be low financial literacy, high risk aversion and the need to keep this solution affordable.

Start-ups have certainly led the way in terms of delivering digital advice models that can deal with smaller sums of money. Their focus has generally been to attract customers through lower fee products, enabled by their digital platforms. However, since most consumers have a low awareness of start-up brands, customer acquisition costs are likely to be magnified to uneconomic levels.

![Figure 4. Future advantaged players in automated investment advice](image-url)

**Notes:**

- B2B - Business-to-Business
DC pension savings

Opportunity
The dominant workplace pension providers are typically large insurers and asset managers. In our view, automated advice on workplace pensions presents two major opportunities for incumbents to defend their dominant position.

The first opportunity is to increase customer engagement and we see three main ways in which automation can achieve this.

Second, automated advice can improve pension saving decisions by making advice more affordable. For employees who cannot afford to see a pension adviser, advice could be provided via a workplace pension portal with minimal human intervention. The website could help with key decisions, such as which fund to invest in. This would likely be much cheaper than traditional advice because it would save financial advisers’ time and fees and because the costs of the technology could be spread across many scheme members creating significant economies of scale.

Barriers
Small pots - A key challenge for providers is the small size of many DC pension pots. This necessitates a low-cost solution to keep fees affordable. This need is amplified by the low levels of engagement and awareness typical among DC scheme members. The key to making this viable will be scale – higher volumes could compensate for low individual account fees.

Acquisition costs - Marketing campaigns to persuade savers to try the service could prove costly. A successful campaign would need to overcome low consumer engagement and financial literacy, especially for plans with a large number of auto-enrollees.

Industry implications
The life insurers and asset managers that are the major workplace pension providers are well positioned to automate advice on workplace pensions. The main reason is that they have unrivalled access to customers. This gives them a good chance to side-step the challenge of high customer acquisition costs that has hampered pioneers of automated advice in the non-retirement investment space. Equally, start-ups faced by this challenge may be good partners because they have a track record of developing engaging customer interfaces.

Asset managers will benefit from higher flows into investment products in which savers will be advised to invest. We regard two distinct categories of asset manager as well-placed to capture this opportunity. Asset managers that are owned by major life insurance groups are well placed because they belong to the same groups as some of the major workplace pension providers. Leading passive fund managers also appear likely winners because their funds fit better within an ultra-low-cost model.
At-retirement
Opportunity
Many retirees are disengaged with their pensions. This helps explain why only around 20 percent of consumers at retirement use Pension Wise—a free Government-backed guidance service—even though it offers free guidance. In addition, for many advice is too expensive to be worthwhile.

Automated advice can help address both challenges. Engagement is won in the accumulation phase long before retirement. As discussed above, automated advice communications that are more proactive and accessible than today’s paper-based annual statements can build a customer’s interest and involvement in DC saving. Efforts here would likely gain regulatory support.

In addition to making advice more engaging, automation can radically lower its cost. In-person advice on converting £30,000 pension savings into a lump sum and a retirement income product, which is a typical advice scenario, costs around £800. We believe the combination of a website using algorithms and an adviser speaking with customers over the phone (to ensure advice is suitable) can deliver good quality advice at a fraction of this cost.

This is an opportunity for providers in two ways. First, it is a chance to earn new advice-based revenues. According to the survey, many people are willing to pay for automated advice at retirement. Second, more importantly, it is chance to win and retain customers at the crucial at-retirement stage.

Barriers
Regulatory risk - Firms giving regulated advice on pensions are likely to face a high degree of supervisory scrutiny given that large sums of money may be involved and that consumers could run out of money in retirement if they are given poor advice.

Given that both customer circumstances and retirement options are often complex, it is likely that firms will need to supplement their automated advice solution with a human adviser who can check the customer’s understanding and clarify any points if the firm needs additional customer-specific information.

Industry implications
The large life insurers and asset managers that are major workplace pension providers appear better placed than other players to win customers by providing automated at-retirement advice. Four reasons stand out. First, they have the greatest scale, and with it, ability to provide a low-cost service. Second, they can use their unrivalled customer data from the accumulation phase to provide more personalised advice than other players. Third they can use the same data to pre-populate forms making advice from them more convenient than elsewhere. Finally, for life insurers, only they can provide annuities which, for many risk-averse customers, could be a more suitable recommendation from advice than income drawdown.

Figure 6. Future advantaged players in automated at-retirement advice

To the point:
• We believe that the affordability and convenience of automated financial advice will be attractive to a wide range of consumers across investing, DC pension saving and at-retirement. The cost efficiency of automated advice, its objectivity and ability to maintain a clear audit trail are key positive attributes for providers. We think increased automation in the provision of advice on retirement products is imminent.
• Firms can overcome some of the key challenges (such low engagement, low fees, the risk of customers switching from higher to lower margin products) through innovative tools to encourage customer engagement, cost efficiencies driven by economies of scale and tailoring services to particular consumer segments.
• From a regulatory perspective, firms must invest to establish governance and compliance controls that are fit to deal with the different type and scale of risks introduced by automated advice.
• Incumbents are well placed to drive the adoption of automated advice as they have access to a large pool of existing clients.
• While our research is focussed on the UK market, many of the advantages and challenges of automated advice will have parallels across Europe.

3 The FCA found that in Q3 2015 20% of consumers told their providers they had used Pension Wise. Providers are only required to record whether a consumer said they used Pension Wise when consumers are not using a regulated adviser. Data Bulletin Supplement Retirement income market data, FCA, April 2016,