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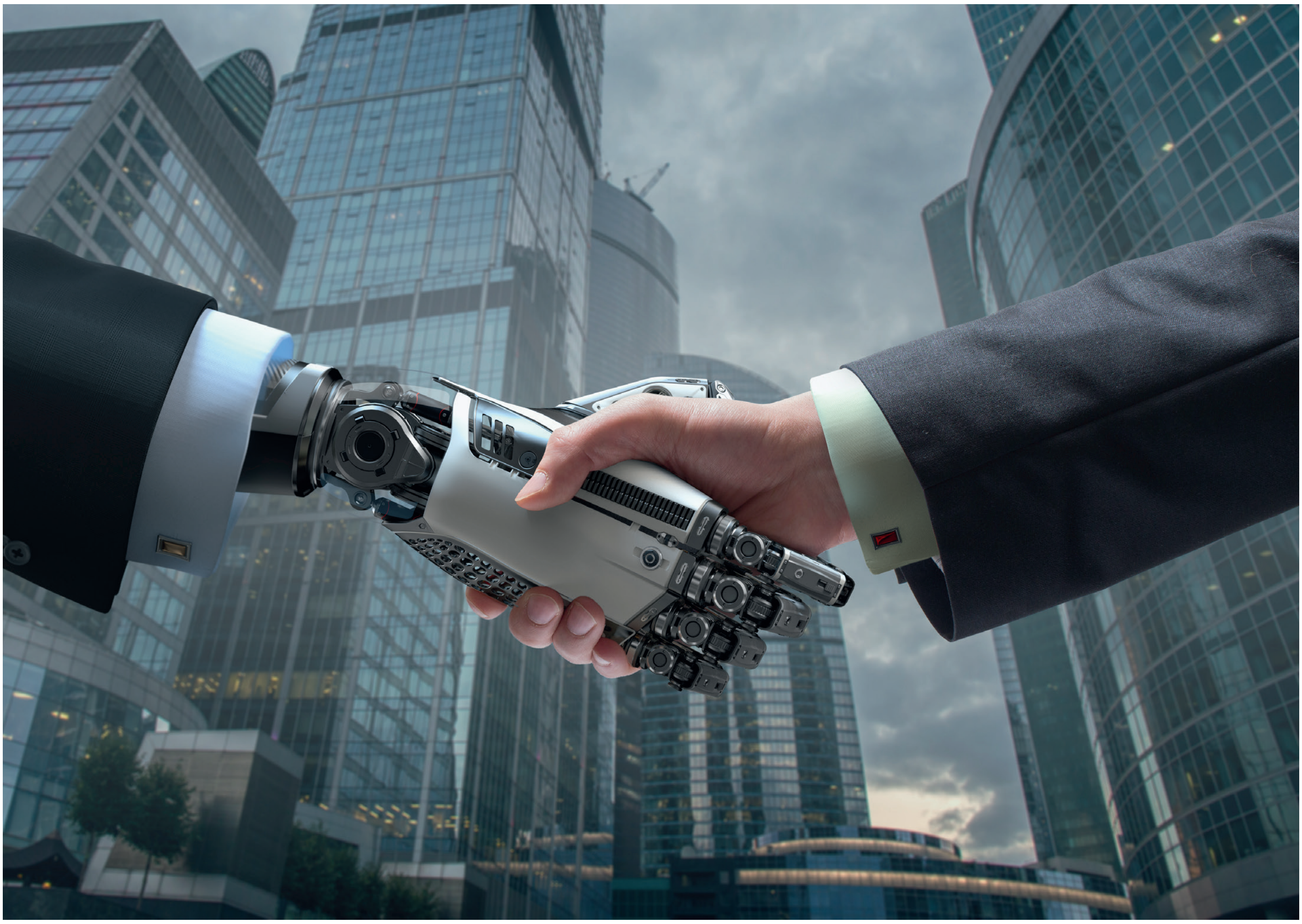


Robo-Advisory in Wealth Management

Same name, different game – a look at the German Robo-Advisor landscape.

Introduction

In the second part of our series on Robo-Advisory in Wealth Management, we at Deloitte take a close look at the state of the German Wealth Management market and examine the current Robo-Advisory landscape. Deloitte has analyzed over 70 Robo-Advisors that have the potential to drive the change into an era of digitalized Wealth Management services and explains their key characteristics as well as what impact they might have in the future.

Wealth Management in Germany today

The German Wealth Management market is dominated by a few banks as well as specialist institutions that cater exclusively to wealthy individuals and the family offices of the ultra-wealthy. Historically, family offices exist for a small fraction of only the wealthiest individuals while the wealth departments of banking corporations and niche banks such as Hauck & Aufhäuser or Berenberg Bank cater to a much larger group of clients.

On average, a potential client needs to have somewhere between one and five million euros in liquid assets to be within the scope of a Wealth Manager's target client group. This elite segment of clients, which makes up significantly less than 1% of society in Germany, has access to sophisticated Asset Management services not generally available to the public. Such services traditionally include a wide array of alternative investment products, complex investment strategies, actively managed individual portfolios, and discretionary specialist advice.

Wealth Managers interact with their clients mostly by personal contact, which means visiting them at home, inviting them into their luxurious branches, or arranging events. Maintaining a touch of exclusivity is important to the business model, so there is a large amount of effort to enrich the overall customer experience with unique client events or individually selected benefits. For a premium experience and to ensure high client centricity, a Wealth Management advisor typically serves on average 50–75 clients (as opposed to several thousands in the affluent segment). Wealth Management clients mainly fall into the 55+ age range and, especially in Germany, have inherited a large portion of their wealth.

However, the industry is about to change. Most of these fundamental Wealth Management facts have already begun to be transformed, and in this publication Deloitte provides a look into the reasons behind this transition and paints a picture of Wealth Management in 2025.

Wealth Management trajectory – Drivers behind the change

The Wealth Management segment is facing a new generation of clients who think differently about advisory services and who have a changed mindset, with new attitudes and expectations of the Wealth Management business. The driver of this new reality is a massive inter-generational wealth transfer, from the older generations such as the baby boomers or Gen X to their younger and much more tech-savvy successors, Gen Y and Z.[1] This group has had their expectations set by tech companies such as Amazon, Apple, Facebook or Google, and demand digital services as well as high connectivity. As a Deloitte study on 10 Disruptive trends in wealth management (2015) shows, these new clients are also increasingly well-educated and like to stay in control, which is why they have less confidence in financial advisors and decreasingly consume classic financial advice from one source. Instead, they seek information from multiple channels and advisors (such as independent financial advisors, peers, social media etc.).

In this light, it becomes apparent just how big a challenge the demographic change is for established Wealth Managers. A good client relationship is not necessarily the key to success when wealth is transferred from one client to the next, as competition for the soon-to-be Wealth Management clients is fierce. Fueled by the technological affinity and love for digital content of the newer generation, highly innovative, digitally-enabled FinTech companies are challenging the established players. This change in clients' needs is already a reality. It will continue to increase, and it is affecting the channels as well as the products the industry is offering to their clients. Financial services products across all segments are increasingly moving towards more individualized, alternative, and niche solutions, replacing standardized off-the-shelf products.

Looking beyond the customer experience, new technologies can also modernize internal processes and help established players remain competitive from a cost perspective. In addition, digitalization offers opportunities to open up new revenue streams and force some incumbents to rethink their customer segmentation as affluent customers can be served at lower costs. The trend towards digitalization started much later in Wealth Management than, for example, in the ordinary Retail Banking business but the impact, speed, and destructiveness it will have will be manifold for Wealth Managers.

In line with digitalization, big banks as well as niche players are lagging behind other industries with the adoption of social media or social selling. For example, in the consumer goods industry social selling is a common way to employ social media effectively. Surveys among millennials show that these are counting heavily on "technology start-ups" to overhaul the way banks work. Among the successful early initiatives we find many companies that leverage the new generation's desire for collaboration.

Aside from the paradigm shift in clients' needs, the financial services industry has entered a new era of extensive regulation triggered by the financial crisis: MiFID, MiFIR, EMIR, PRIIPs, Dodd Frank, FATCA and ever new KYC challenges, to name just a few of them. Various national and international regulatory matters incur high costs with the result that cost-income-ratios have risen beyond the 90% level for a majority of players in the Wealth Management sector.

In addition to these largely international trends in Wealth Management, the German market is seeing a strong tendency towards the repatriation of foreign-held assets. The demise of Swiss bank secrecy and a global push for tax transparency have shifted client priorities in favor of onshore money, giving Wealth and Investment Managers a unique opportunity to increase their Assets under Management (AuM).

Source: Deloitte Consulting GmbH

[1] "Baby boomers": post World-War II generation born around 1946 to the 1960s characterized by a high birth-rate, followed by "Generation (Gen) X" with birth years ranging from the early 1960s to the early 1980s who are known for being modest and hard-working. Whereas "Gen Y" (also called "Millennials"), born from the early 1980s to the early 2000s, are typically characterized as being digitally native, generally enjoy living and working in urban areas. "Gen Z, born from 2000 onwards, are known for their high usage of the internet and are typically known for being technology-savvy and interacting on social media websites extensively.

The Robo-Advisor Landscape – Differentiators in a fragmented market

At Deloitte, we have taken a close look at over 70 Robo-Advisory companies, 31 of them operating in Germany, and identified key differentiators among the multiple offerings. The result is a comprehensive Robo-Advisory landscape with an emphasis on the German-speaking market. Overall, but especially for the region, automated investment advice is still a young yet quickly developing field. As such, it does not come as a surprise that not all Robo-Advice is alike. Various competing business models have emerged in the last years in the German, Austrian, and Swiss markets and they vary widely in their approach with regard to target groups, investment vehicles, management services, and degree of automation, to name but a few.

Germany's start-up center Berlin and the financial metropolis Frankfurt have developed as major hubs for Robo-Advisors. Nevertheless there is wide regional distribution of Robo-Advisors in Germany. One can also see that the business models vary between B2C, B2B or both approaches being followed. This is especially interesting as the level of evolution of new market players varies from 0.0 (i.e. social trading platforms) to more sophisticated algorithm-based offerings which can be classified as Robo-Advisors 3.0.

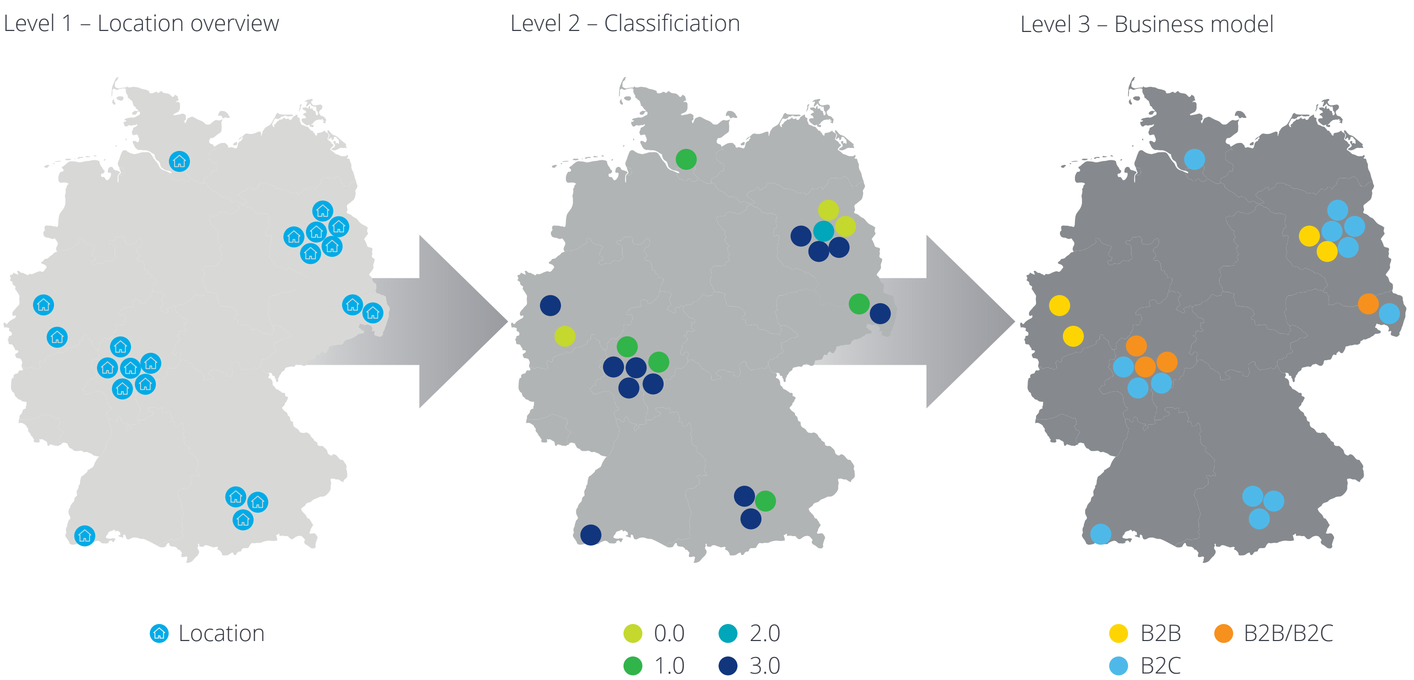
For Germany it is worth pointing out, that a game changing Robo-Advisor 4.0 has yet to be created. Thus it is fair to say that the German Robo-Advisory market is very heterogeneous without a clear trend towards one level of evolution. However, there is a distinct trend towards B2B platform offerings based on aggressive growth targets fueled by significant venture capital pouring into the German Robo-Advisory market.

Target group

While this article scrutinizes the specifics of Robo-Advisory in Wealth Management, observations show that many of the providers see no need to segregate the wealthy from the affluent clients. Enabled by a very low cost base, most providers offer their services at a very low initial investment amount. Higher AuM are incentivized through specific pricing models, by lowering the average management fee for larger accounts. While for some participants this may just be a market entry strategy, it is very likely that a significant portion of Robo-Advisors will continue to serve the affluent segment for years to come.

Deloitte has observed a fair number of Robo-Advisors in the German market serving exclusively on a B2B level, providing platform solutions and white-labeling services. Others include B2C relationships, bringing their offering to private investors via their online Robo-Advisory platform. As for those providers that have an active end user offering, the target groups vary from affluent to UHNWI. Almost all providers do include at least the mass affluent segment in their target group. This becomes obvious when taking a look at the required initial deposit size, which can start from as low as 1 €. In fact, 80% of the assessed companies take in accounts from 10.000 € and below. This being said, the recommended portfolio size, depending on the provider and chosen service, ranges from 10.000 € to 5.000.000 € at the top end of the range. This shows that

Fig. 1 – German Robo-Advisor Landscape



Source: Deloitte Consulting GmbH

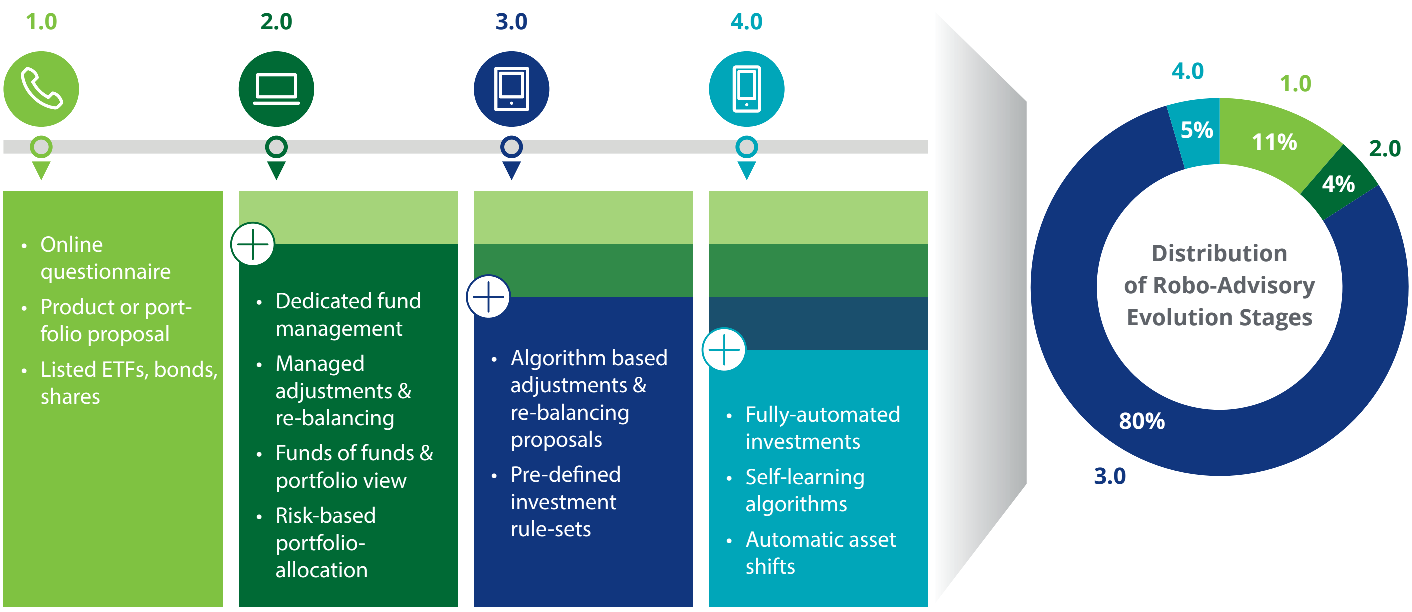
Robo-Advisors are significantly more accessible to the public than traditional financial advisors who typically require a minimum of 1.000.000 € of investable assets from their clients. When analyzing this circumstance, Deloitte found that most of them still require a minimum investment in the lower four-digit range in order to operate profitably on a per-client basis.

Investment philosophy
Investment philosophy is also a distinguishing factor in the current Robo-Advisory landscape. On the one hand, about 50% of providers offer a broad range of services, offering a vast variety of target investments, management styles, and customization options, priding themselves on proprietary strategy expertise and sophisticated alpha generating systems. On the other hand, 50% of providers have a rather purist approach, excluding everything but bonds and equities from their target investments and following purely passive strategies in the pursuit of long term growth at minimum cost. These different philosophies manifest in different ways and should be considered when choosing which firm to partner with or invest in.

Service level
Another way to differentiate between Robo-Advisors is the service level they provide. Clients will be able to find providers that suit those who wish to stay on top of their investment decisions, actively keep themselves informed at all times, and prefer to make their own choices, simply aided by robotic advice on a suggestion basis. But there is also the highly sophisticated investment manager, suited to serve the care-free, hands-off investor. In the latter case, clients might prefer to give away investment management responsibility to the Robo-Advisory firm because they trust in the expertise or the promise of sophisticated, low-cost, automated investment strategies.

Given the large variety of firms that consider themselves Robo-Advisors and the number of different business models and approaches, Deloitte has identified clusters based on the depth of service they provide. This was elaborated on in our first abstract, *The expansion of Robo-Advisory in Wealth Management*. In short, it can be differentiated between those firms who work with a more or less sophisticated version of an online questionnaire to propose a certain product mix or portfolio allocation to the consumer and stop their service at this point (Robo 1.0), and firms who go further by offering the appropriate accounts (2.0), manage accounts and/or provide ongoing advice (3.0) or even apply machine learning techniques/artificial intelligence to the management process (4.0).

Fig. 2 – Robo-Advisory Evolution Stages



Source: Deloitte Consulting GmbH

As one can see in figure 1 the German market has evolved to a point where there is a concentration in the 3.0 space: firms who offer investment advice, integrated account management, and either active or passive portfolio management. Roughly 80% of identified providers who serve the German market fall into this category. The most significant difference within the Robo 3.0 segment is the portfolio management approach. Apart from the philosophy differences addressed, this is where a Robo-Advisor can show sophistication and expertise.

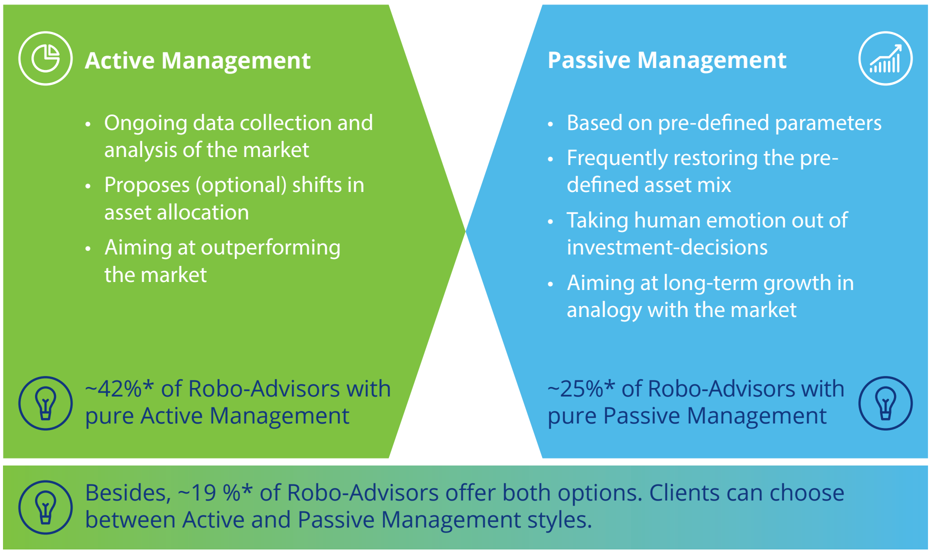
The market is divided into active and passive management styles. Twenty-five percent of assessed companies provide exclusively passive investment management strategies. Passive portfolio management frequently restores a pre-defined asset mix if a portfolio's asset allocation falls out of range due to an asset class's out-/under-performance or executed trades, in order to keep the diversification constant.

While this leads to a built-in, anti-cyclical "buy low, sell high" effect, it leans heavy on the assumption of long-term growth in the underlying benchmark investments and the "random walk".

In contrast, active management styles use proprietary algorithms to propose shifts in a portfolio's asset allocation, underweighting one or multiple asset classes in favor of another during a respective market phase to create outperformance. Forty-two percent of the Robo-Advisors examined offer solely active portfolio management. Nineteen percent offer both passive as well as active portfolios, and the rest do not offer managed portfolios at all and belong to groups 1.0 or 2.0.

Advanced Robo-Advisors employ machine learning techniques/artificial intelligence to continuously improve their algorithms and improve performance, but to date such providers are rare. However, as this technology is advancing it is very likely that this offering will be developed further and employed more frequently.

Fig. 3 – Active vs. Passive Management



* Based on a Deloitte analysis of the Robo-Advisory landscape with over 70 Robo-Advisors in 2016. These figures do not include Robo-Advisors that do not manage portfolios for their client because they only suggest trades on request.

Source: Deloitte Consulting GmbH

Another distinguishing factor among Robo-Advisors is the degree of individualization when assembling a portfolio allocation. The number of risk classifications or individually offered portfolios varies between 2 and more than 30 possible portfolios. Our observations show that, currently, providers with fewer portfolio selection options offer a rather simplified asset allocation towards bonds and equities. In contrast, providers who offer more variations provide a more complex portfolio composition including other asset classes such as commodities and currencies.

One central observation is that the vast majority of Robo-Advisors base their investment approach on ETFs. About 70% of the examined providers even operate on an "ETF-only" approach, to maximize cost-efficiency for highly diversified yet small portfolios. After all, the marketed USP of most Robo-Advisors is a very low management fee, when compared with your average Wealth-/Investment Manager. Only a small group of Robo-Advisors add direct investments such as stocks, bonds or physical commodities to their investment spectrum.

Even though some of the most mature local market players have already been operating for more than four years in the German market, Robo-Advisory is still quite a new phenomenon and is rather unregulated. Thus it will be interesting to see how regulators and consumer protection initiatives will affect the business. A central topic in this respect is cost transparency, which is why some providers have already been criticized by local centers of consumer protection.

In addition, to date a fair number of the Robo-Advisors in the German market do not have an investment management license, which is why they operate solely as intermediaries between their clients and the broker. If attempts to acquire such a license fail, in most instances it is due to a lack of professional competence.

Approved asset managers are required to have at least three years of experience in a senior position with a licensed institution. In order to provide a more sophisticated investment advisory service and true value for their customers, it is important to acquire such a license from the German financial services regulator (BaFin). With the license at hand Robo-Advisors can officially offer elaborate investment advice, which is a major benefit for marketing as well as operations. It effectively enables the advisor to act on the client's behalf in order to rebalance the portfolio.

Whether you are a consumer, affluent or a UHNWI, or you are an established Wealth Manager looking for an as-a-service-solution, there is plenty of choice, once you know where to look.

What the German market can learn from the US/the UK

Knowing the German market and its players, Deloitte also examined players abroad, to see what the future may hold in terms of features and processes that could catch on from more advanced markets such as the US and the UK. Those markets have seen the first and to date most developed Robo-Advisors. Adoption in this particular market is very quick, and first lessons learned abroad have already been adopted by German players such as expanding services to the B2B segment with white label solutions, customized third party products, or integrated solutions for business partners. For instance, United Signals chose a multi-channel strategy and offers B2B as well as B2C Robo-Advisory services. There are additional features and processes local providers might want to integrate in the future. The next wave of new features for German Robo-Advisors are likely to include the following:

Customization options

The established Robo-Advisors may base their approach on low-cost passive investment products such as ETFs, but offer plenty of options to individualize the personal portfolio by adding or reducing exposure to certain assets.

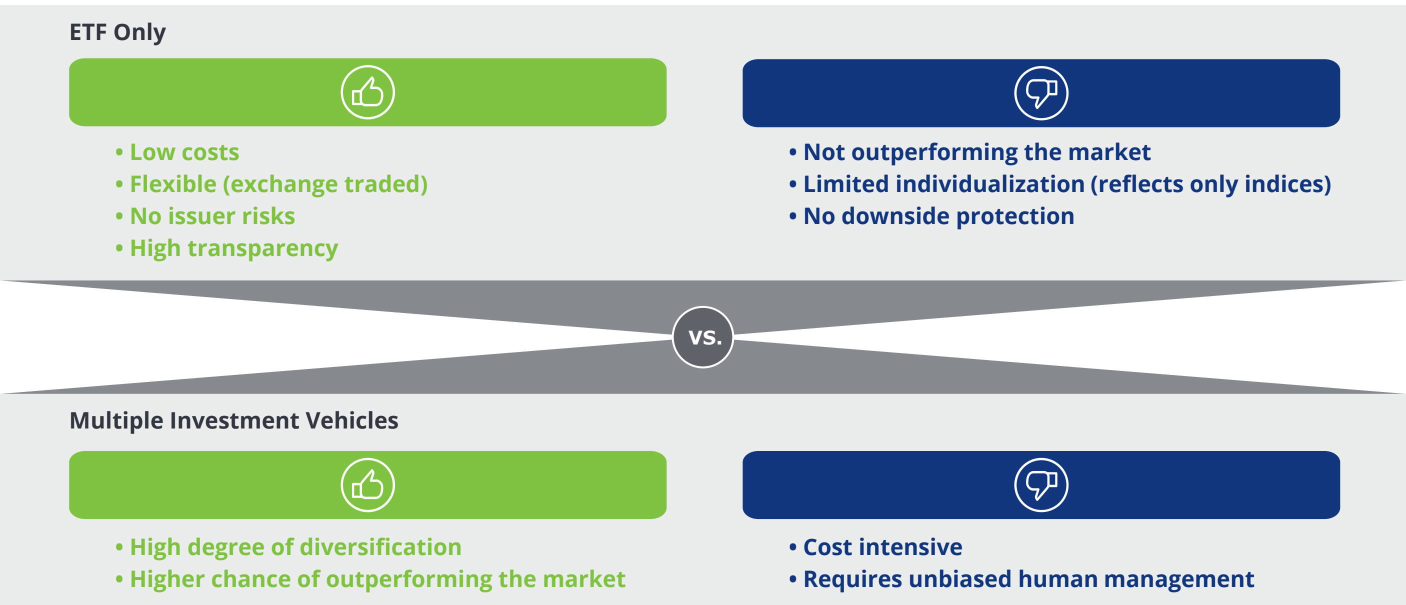
Risk reduction and hedging services

All Robo-Advisors preach diversification, but only few offer the full range of risk reduction services. Abroad, Robo-Advisors have started offering alternatives such as Private Equity, Venture Capital, Hedge Funds, and BitCoin to further increase diversification and also offer to track individual asset risk and apply downside protection for individualized portfolios.

Account aggregation

Forward-looking Robo-Advisors have started collecting financial data from their clients by aggregating account, card, and payment data for them in a central, digital, and easily accessible way. The added value for clients, apart from an integrated all-in-one experience, is access to extensive data analysis on their spending behaviors,

Fig. 4 – Robo-Advisory: Investment Approach



Source: Deloitte Consulting GmbH

cash flow forecasts, and active suggestions for budgets by expense type as well as suggested savings plans.

Deloitte will continuously monitor the development and are curious about future innovations. This is why Deloitte will keep in touch with Wealth Managers and Robo-Advisors in the future and encourages interested parties to join in.

Outlook

Robo-Advisory is a rather new, technology-backed solution to serve an existing market in an innovative manner. Recently, the Robo-Advice phenomenon experienced great progress and expansion in a short period of time which has drawn public attention to new players in the financial services market. We estimate that Robo-Advisory will attract further attention in the years to come as it is approaching the peak of the hype cycle, which shows in a phase of high public awareness, frequent press reporting on the matter, and exaggerated enthusiasm as well as extremely high expectations. At the same time, more and more providers enter the market in expectation of going with the trend and participating in the growth.

At some point over the next five years we expect a market consolidation to take place. First steps in this direction can already be seen as initial players are seeking to enter into partnerships and cooperation on the B2B level. In the German market, easyfolio was the first Robo-Advisor to be acquired by an established player. While for now it seems that consolidation is limited to established players merging with young Robo-Advisors, there will be additional consolidation among Robo-Advisors as unsustainable business models fail and close competitors will need to combine forces.

For the established Wealth Managers, partnerships with Robo-Advisors may be another feasible option as opposed to acquisitions. A variety of platform offerings and open APIs already offer a lot of options. A cooperation with a Robo-Advisor is an excellent shortcut to providing a classic Wealth Manager’s clients with an innovative digital investment experience and it may serve to seamlessly lower operating costs and extend the customer segment to affluent customers with a net worth below 1.000.000 €. Another advantage is that it gives the Wealth Manager an opportunity to identify high potentials among the affluent customers at an early stage who can be supported throughout the whole customer life cycle with special attention as they may become an HNWI in the future.

Consolidation or not, Wealth Managers should keep a close eye on the topic as a significant shift in Assets under Management can be expected from traditional investment managers to Robo-Advisors. Globally, Robo-Advisors have amassed around 50bn USD in Assets under Management so far, as Bloomberg reports, and the influx of assets is accelerating fast. Projections show that the compound annual growth rate (CAGR) will reach about 78% over the next 10 years. As Germans are known to be rather cautious, predictions are steeper for some foreign markets, but the appeal of low-cost automated investment management is highly likely to succeed in Germany just as much as anywhere else.

As digitalization is progressing and the population is getting increasingly tech savvy, more and more people can be expected to be attracted by the easily accessible, digitally integrated, gamified offerings of Robo-Advisors. Affluent customers have been a widely underserved segment so far and with the rise of Robo-Advice gain access to sophisticated investment advice at low prices. Institutional clients and HNWIs are likely to follow the trend in order to lower management fees. This is why Deloitte predicts an exponential increase of Robo-Advice AuM over the next decade.

Since Robo-Advisors have a very low cost base on average, they can and will offer services for a fraction of the cost that traditional Wealth Managers charge to their clients. Such competition on the cost-income-ratio will pose serious challenges for the Wealth Management industry and drive transformational change. Established players will have to considerably challenge and overhaul their existing approach to business. In this regard it would be advisable to assess own strengths and weaknesses and then scan the Robo-Advisory landscape for potential partnerships or acquisition targets that complement the personal strategy in order to make an informed make-or-buy decision.

All in all, the situation can be summarized by stating that established Wealth and Investment Management firms will need to undertake comprehensive restructuring processes and overhaul their operating models in order to remain competitive and maintain their position in an increasingly fragmented market. Early adopters may even walk away with a significant competitive advantage.

How Deloitte can assist

Deloitte is already working with a number of banks and Robo-Advisory companies to assess the impact on the traditional Wealth Management business and define client-centric business strategies. To grow with confidence, Wealth Managers need to make clear choices about where to play and how to win. As Deloitte gained an in-depth insight into the Robo-Advisory market, Deloitte’s teams support the market entry strategy development for incumbents who want to enter this Robo Advisory field. In addition, Deloitte supports UX and UI design tests working with selected clients at the Greenhouse facility in Berlin, Germany. This is particularly interesting for new market entrants as they receive direct feedback on design and haptic of their Robo-Advisory platform. Going one step further and adding some additional analytics sessions allows for a deep client interaction and strong customer growth. Something inevitable for new market entrants to win a piece of the Wealth Management market. But established market players can also benefit from a different form of client feedback compared to the classic questionnaire or survey.

In addition, Deloitte founded Deloitte Digital GmbH in 2014 to bring together the global Deloitte network and the startup world. The Deloitte Digital team has extensive expertise in all types of digital innovation topics. Our dedicated practitioners are passionate about digital, and work with our clients to bring digital strategy to life, helping to meet the realities of today and tomorrow. In Deloitte Digital studios around the world, professionals combine a high level of creativity with profound business and technology experience to define and deliver digital experiences for the world's leading brands.

A central goal of Deloitte, looking into and helping to define the Robo-Advisory landscape, is to take on the client perspective driven by security, perceivability, and usability and allow established market participants as well as new entrants to address these within their Operating Model.

Deloitte has a team of dedicated consultants, scientists, and developers who create meaningful insights, enabling clients to outperform their competition. Deloitte's breadth and depth of industry knowledge helps you achieve innovation not just once, but consistently over time. Working with Deloitte's Wealth and Investment Management practice we will help you understand your opportunities in the Robo-Advisory space.

Deloitte services include:

- Market Development Analysis
- Customer Analysis & Segmentation
- Customer Experience Strategy
- Business Strategy
- Product Leadership
- Applied & Predictive Analytics
- Data Security

The sheer number of Robo-Advisors who have already penetrated the Wealth Management market as well as their enormous speed and ruthlessness in attacking traditional business models imposes one conclusion: Wealth Managers who allow themselves to be prisoners of cost-saving topics, regulatory requirements, or are busy defending "the old way of doing things" will experience extremely tough times in coming years – being innovative is not a matter of extracurricular activity, but it is essential to survive.

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Issued 10/2016