Automated financial advice in South Africa

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Cognitive technologies used in the automation of business processes, for gaining insights through data analysis, and in engaging with customers and employees are starting to demonstrate real and significant business value in the financial services industry. These emerging technologies are shaping the way financial services are bought, sold, and consumed. They have not only allowed financial services providers (FSPs) to tap into new markets and offer new products but also to reduce the cost of service provision, respond more swiftly to regulatory changes, increase speed to market, and ultimately improve customer experiences.

The adoption of advanced technologies in the financial services industry has led to the emergence of innovative and agile FinTech companies that are able to challenge traditional FSPs in what used to be a market with high barriers to entry. While the incumbents still enjoy significant scale and access to customers, the rise of FinTechs has forced them to reassess their business models and align their strategies to embrace technology more effectively.

In investment management, investment advice is a knowledge-based service, so cognitive technologies are appropriate for supporting its delivery. Automated advice (also known as robo-advice) can take over many of the tasks associated with investment advice, including the construction of customized portfolios, the rebalancing of portfolios over time and tax-efficient investment selection. For advisers, this new working process allows them to take on a new role as more of an investment coach who encourages healthy financial behavior.

Compared to the United States and the United Kingdom—markets with sizeable automated advice offerings—South Africa's investment management market is very small. Only a few market players have a large enough customer base and investment portfolio to achieve the required economies of scale that justify the implementation of automated advice solutions.

The different degrees of automation of financial advice

Degree of automation

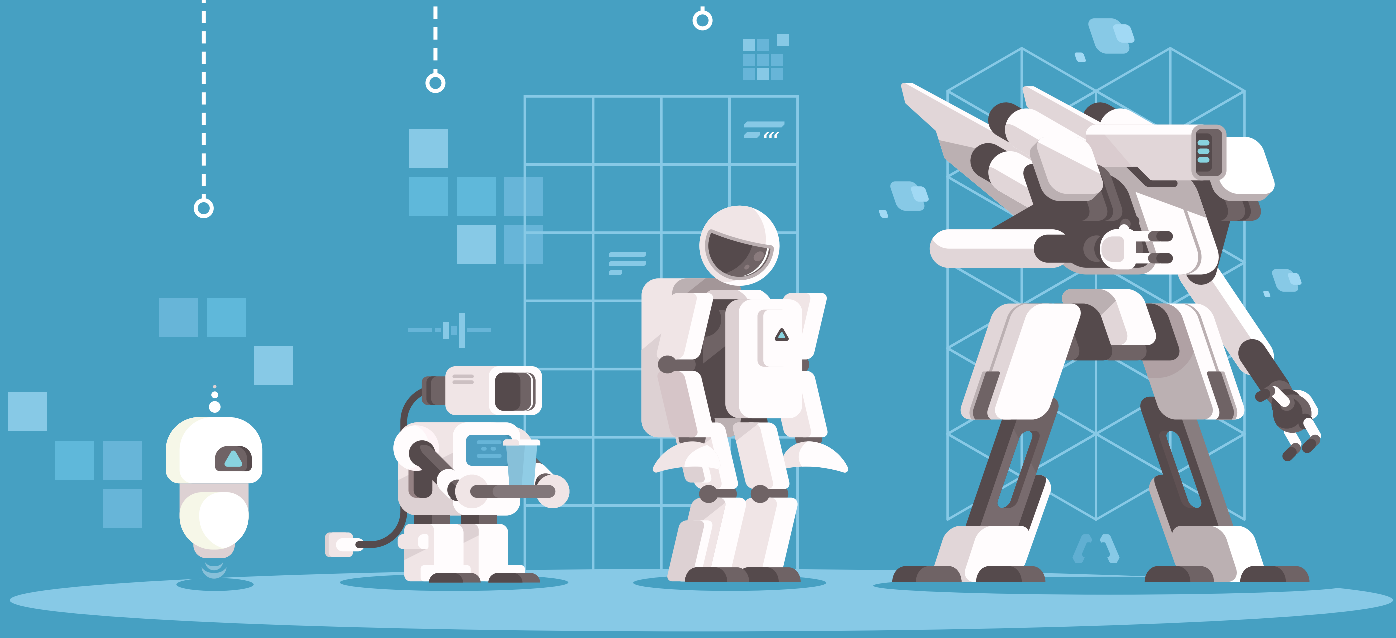
Low → *High*

Traditional face-to-face
Customers interact with a human, who generates advice, investment decisions or information (depending on the service provided), without the aid of a computer algorithm

Face-to-face assisted by algorithm
Customers interact with a human, who uses a computer algorithm to generate advice, investment decisions or information (depending on the service provided) but can override the algorithm if needed

Hybrid
Customers interact with a website but may also interact with a human (e.g. via a webchat or by phone), for example if customers have questions about their investment decision of the firm needs to ask for additional information

Fully automated
Customers normally interact with a website only, They may still be able to speak to resolve any IT issues, make a complaint or clarify terms and conditions



South African consumers seek affirmation from financial advisers

While only about two percent of South Africans have an annual income of more than R400,000[1], most people in this pool have bought a financial product in the last three years, reflecting the huge appetite for these products.

The vast majority sought advice—whether professional or informal—prior to purchasing a financial product and it is common for consumers to pay for this advice. This indicates that South Africans rely on advice and are prepared to pay for it.

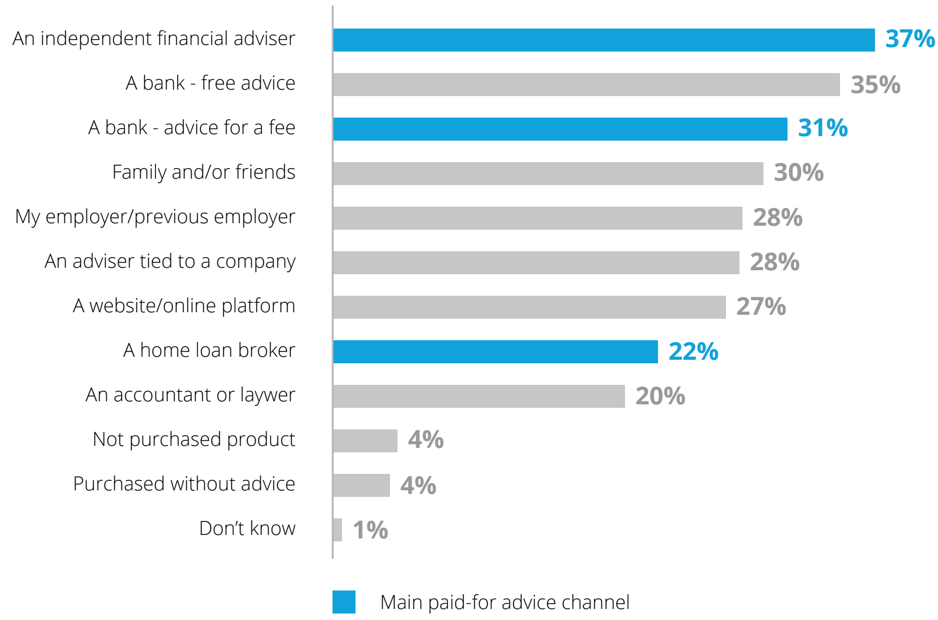
Among the consumers who had bought a product in the last three years, professional financial advice was used to confirm that the choice of product was correct or to identify the right product once the type of product had been chosen.

Affirmation from a financial adviser is particularly important for consumers over the age of 55, as well as affluent or high-income South Africans.

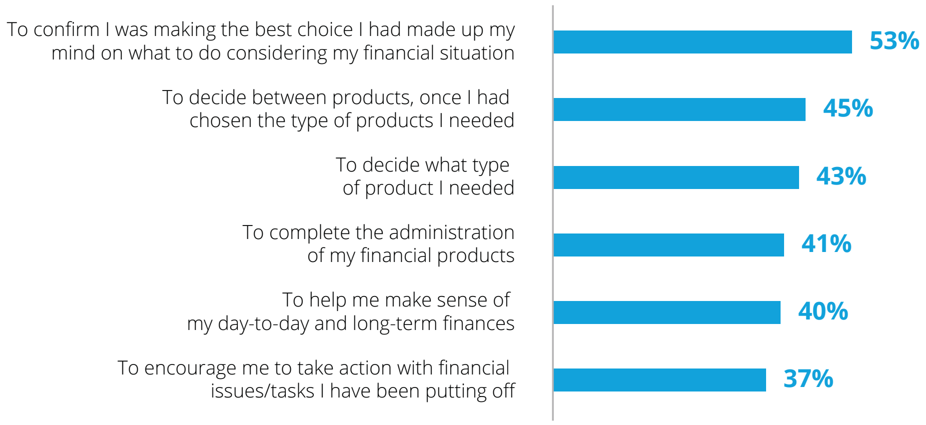
Consumers with an annual income above R1.5 million call on financial advisers to encourage them to act and stop procrastinating on matters related to financial planning.

In contrast to other age groups, young millennials use financial advisers to make sense of their day-to-day and long-term finances and to get assistance with the administration of their financial products.

Usage of advice on product purchases, 2015-2017*



Why financial advisers were used



* All graphs are taken from Deloitte, Automated Financial Advise Survey, 2018

1. South African Revenue Service, 2017 Tax Statistics 2017

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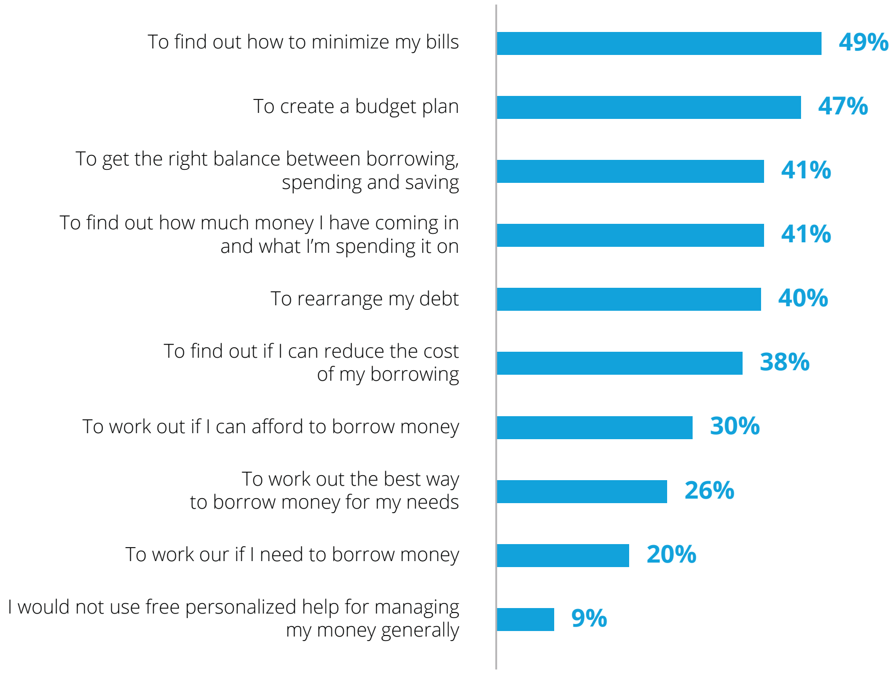
Simple financial planning

While most South Africans, irrespective of income, wealth or age, are open to using automated advice for simple financial planning, the type of advice they are looking for differs. It ranges from help with minimizing bills to creating budget plans, striking the right balance between saving and spending, and rearranging debt.

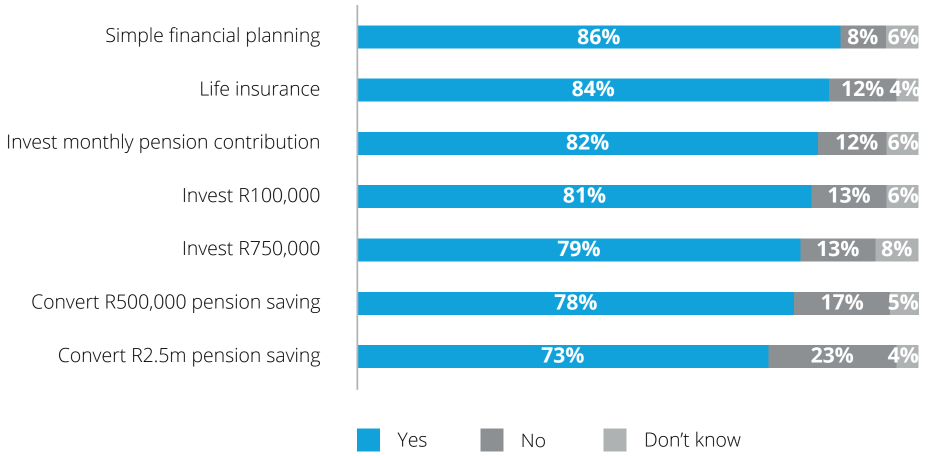
Consumers aged between 35 and 44 and low-income earners are mostly interested in minimizing their bills. Millennials and high-income earners are least concerned about minimizing bills. While millennials are more interested in assistance with creating budget plans, high-income earners are looking for assistance with rearranging their debt.

Considering price sensitivity among consumers in the low wealth segment, a digital-only solution is more likely to be successful for simple advice aimed at this segment and is something FinTech companies are looking to develop. Cases that are more complex and involve less price-sensitive and more affluent consumers could be handled using hybrid solutions that combine digital with face-to-face advice.

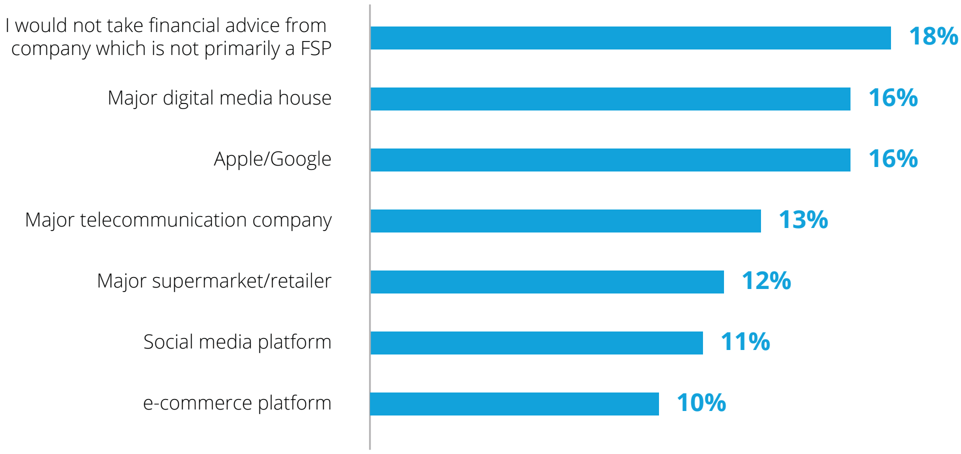
What would you use your free automated advice for?



Would you be willing to use automated advice for...?



Willingness to accept financial advice from non-FSPs



Investing

South Africans have significant unsatisfied demand for efficient and cost-effective ways to invest small sums of money. Automated advice is seen as a suitable solution to service this market segment. Our survey results show a strong bias towards using automated advice for small sums.

The low margins in the mass market and the looming introduction of the new retail distribution review (RDR) regulation in the second half of 2018 are expected to increase the attractiveness of automated advice for price-sensitive segments.

Cost consciousness occurs across the various wealth segments; however, compared to UK consumers, it seems to be less pronounced among South Africans. The willingness to pay automated advice fees that are close to fees for face-to-face advice is relatively high.

Passive investment management is likely to be the best approach to offering low-fee automated advice for those investing small sums of money. However, even for managing larger sums, which typically earn higher margins, deploying passive automated advice for a certain portion of the overall investments of increasingly cost-conscious wealthy consumers might be a viable solution. A hybrid model that combines face-to-face or over-the-phone advice with automated advice is likely to be a viable option for servicing the wealthier market segment that is fee sensitive but invests amounts above a certain threshold.

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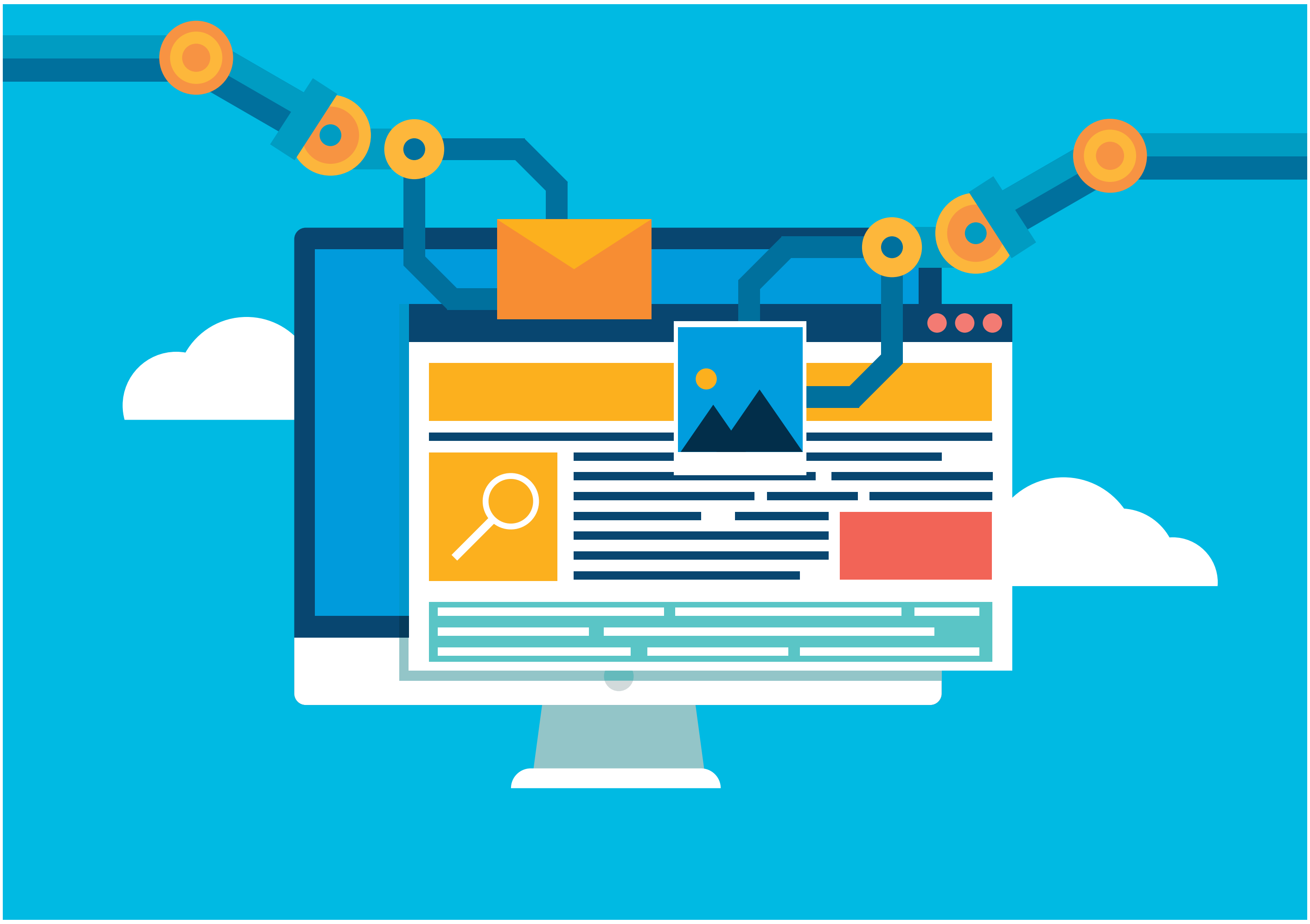

Saving for retirement

As in the UK, the dominant occupational pension providers are large insurers and asset managers. Given their unrivalled access to a large consumer pool, the deployment of automated advice tools would help them to drive down their cost of service provision and hence expand their customer pool.

While the FSB describes acting in the best interest of the members of the fund to ensure that they receive the best return on their investments as a key role of pension fund trustees,[2] giving members the choice of where and how to invest within the parameters set by the pension scheme is becoming increasingly commonplace. However, the majority of occupational pension fund members do not make use of member choice and hence end up in default funds that are not aligned to their specific needs or current life stages. Automated advice could be a powerful tool to increase the engagement of members and advise them on how to optimize their pension contributions.

Furthermore, automated advice is a cost-effective way to provide members with in-fund advice. Dynamic visual tools, which are more engaging than descriptive text-based communication, could be used to illustrate key points of members' savings journeys such as the build-up of funds at specific intervals, the impact of risk on returns, and progress towards goals.

In addition to increasing engagement, automated advice could also make advice more affordable and hence more accessible to a larger pool of people. While willingness to engage is high, South Africans are not prepared to pay high fees for automated retirement saving advice. This high level of price sensitivity presents a challenge for providers. Developing a workplace pension portal with minimal human intervention could prove to be a viable option to overcome price sensitivity issues.

At retirement

Consumers experience the greatest need for financial advice when they enter retirement. They have to decide how to fund retirement with the savings that they have accumulated over their lifetime. Consumers are faced with tough decisions—such as how much cash to withdraw while leaving enough invested to provide a suitable income—and complex products. Overall, South Africans are most interested in using automated advice that provides them with options to minimize their tax bill when they have retired.

Willingness to convert pension savings using automated advice declines with age. Consumers who are closer to retirement age are the least willing age group to replace a human adviser with automated advice.

To make automated advice attractive, many consumers would demand a large discount on face-to-face advice. In our sample, among those who would pay for it, almost 80 percent would only do so if they paid less than one quarter of the typical fee charged by a human adviser.

Given that both customer circumstances and retirement options are often complex, it is likely that FSPs will need to supplement their automated advice solution with an option of human interaction. In these cases, a human adviser can check the customer's understanding and clarify any points if the firm needs additional customer-specific information.

Over the longer term, as machine learning and artificial intelligence mature, we may see firms developing more fully automated advice solutions that can meet regulatory requirements and handle complex cases, but in the short and medium term, a hybrid model is more likely to be effective. A hybrid model could also put customers at ease as our survey indicated that South Africans are concerned about the capability of automated tools to deal with complex questions and situations.

Automation can allow advisers to spend less time on the more straightforward parts of the process, such as data capture, and instead focus on the high-value areas such as tax considerations in more complex cases–an area of significant concern for South African consumers.

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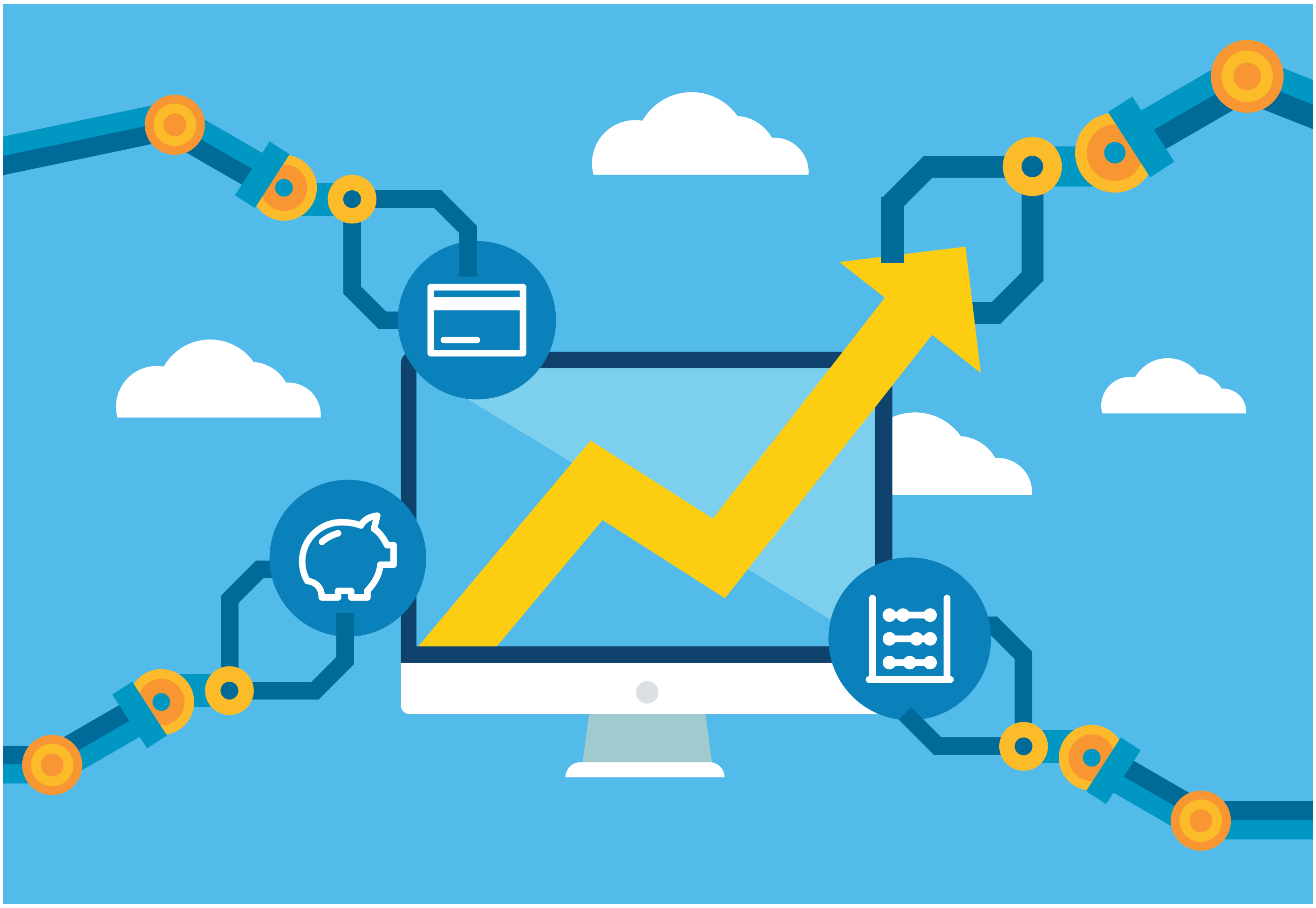
2. Financial Services Board, Role of Trustees, 2011



Individual protection

According to the Association for Savings and Investment South Africa, the insurance gap has tripled over the last ten years to about R30 trillion[3]. Financial literacy and affordability are key reasons for this large gap. Around two million risk policies lapsed within their first year in 2016, mostly because policyholders were unable to afford to pay their premiums[4].

Our survey suggests that South Africans are very open to using automated advice for selecting personal protection. This might be linked to the existence of web-based insurance quotation platforms, which are widely known and used for car insurance comparison services. Automated advice can contribute to consumer education by demonstrating the need for protection and the risk related to non-payment in a proactive way and could help close the protection gap. Consumers at risk of missing a payment could be targeted with timely communication explaining why they need protection, what the implications of non-payment are, and what to do about it, with a link to an automated advice portal. We would envisage this as being provided by life insurers or face-to-face advisers in partnership with another organization with access to a wider pool of customers, such as a bank or retailer.

Leveraging automated advice tools can help to encourage more advisers to recommend protection by giving them quicker, light-touch sales channels. Two opportunities for advisers stand out. First, by using existing data that was captured in, for instance, a bond application process, application forms for the protection to cover this bond could be prepopulated. This would free up valuable adviser time on the phone asking customers for basic information. Second, websites could be used to guide customers through the relatively simple steps in the advice process before speaking with an adviser to complete the process.

3. I.e., the aggregate cover that is needed by South Africans is R30 trillion less than the total cover provided by the insurance industry.

4. Personal Finance, Times may be tough, but don't cancel your life cover, 2017

The future of automated advice in South Africa

While it is now common for traditional FSPs in South Africa to use computer algorithms to automate their financial advice process and to embed this into their overall digital strategy, the degree to which the automation has been implemented differs among providers.

Most providers have put digital tools into the hand of their advisers to empower them to serve clients more efficiently. Initial concerns that sophisticated algorithms might crowd out human advisers seem to be unfounded. On the contrary, in an environment where the margins of FSPs have come under pressure due to factors such as changing regulations, these powerful tools enable human advisers to serve a larger client base at lower cost.

Leveraging technology also enables advisers to be better informed about a broader range of products, serve more clients than normal, and decrease their own business overheads—thereby mitigating against margin pressures. Better-informed advisers are an important step towards customer-centric advice.

Some advisers have started to put digital tools directly into the hands of their clients through online platforms or mobile applications. These tools provide FSPs with new ways to engage their customers and, by cutting out face-to-face interaction, financial advice is becoming more affordable and accessible even for lower-income earners.

While acceptance of digital tools has increased, fully automated advice still faces certain limitations and is usually only used for single-goal or simplistic investments. Given the novelty of fully automated advice, market players have observed that most clients still require a human "nudge" such as a phone call or webchat with an adviser to complete an investment decision online.

The introduction of automation in the financial advice space affects the relationships between various industry players. FinTech companies are often seen as agile and innovative players that have spearheaded the disruption in the industry. However, due to factors such as scalability, trust, and brand recognition, some FinTechs find themselves stretched to their limits and have to consider forging new alliances and partnerships to become or stay viable.

Partnerships between FinTechs and FSPs tend to be mutually beneficial. FinTechs are able to leverage the brand power of traditional FSPs—an important advantage in a trust-based industry—and hence are able to reduce customer acquisition costs and scale their operations faster compared to a stand-alone offering. On the other hand, by collaborating with FinTechs, traditional FSPs are able to implement automated advice platforms faster and at a lower cost.

Leveraging automated advice tools can help to encourage more advisers to recommend protection by giving them quicker, light-touch sales channels.

To the point:

- South African consumers seek affirmation from financial advisers
- South Africans are open to using automated financial advice and are prepared to pay for it
- The smaller the amounts involved, the more prepared South Africans are to use automated financial advice
- Digital tools provide FSPs with new ways to engage with their customers and, by cutting out face-to-face interaction, financial advice is becoming more affordable and accessible