



Robo advising

**Catching up and
getting ahead**

Banks and brokerages are scrambling to compete in this emerging area of financial investing.

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A man in a dark grey suit, white shirt, and patterned tie is smiling and looking down at a tablet computer he is holding. The background is a blurred conference or event space with warm lighting and architectural details.

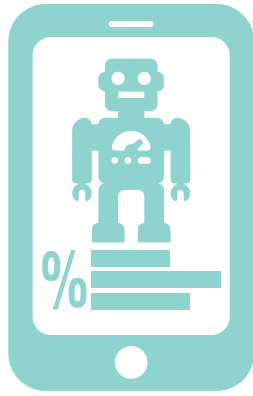
“Whether we build or buy
it, we should have it.”

— James Gorman, CEO, Morgan Stanley*

* DealBook Conference 2015



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Hype or opportunity?

People spanning the financial spectrum are buzzing about “robo advisors,” automated, digital wealth management solutions that have proven attractive to both high net-worth clients and mass market customers. A quick Google search on the term produced more than 683,000 hits and 31,000 news results.

Is your bank and affiliated brokerage competing in this emerging area of financial investing?

Although digital upstarts have jumped in with both feet and established brands are solidifying their position, it is not too late for banks to launch a successful robo advising service. KPMG LLP’s (KPMG) proprietary research of 1,500 bank clients—conducted in partnership with MFour, a leader in mobile survey technology—reveals overall customer awareness of available solutions in the robo investing space remains relatively low. Moreover, investors have strong interest in their banks providing digital portfolio solutions.

This publication explores the current robo advising market and how it’s expected to grow, learn what it means for banks and brokerages, and key business and operating model questions to consider in order to successfully capitalize on the exciting opportunities for digital wealth management.



A dynamic market

\$26 billion The value of new client assets managed by four prominent firms with digital advice solutions at the end of Q2 2015¹.

\$55-60 billion Forecast for digital advice assets under management/advisement (AUM/A) by the end of 2015².

\$500 billion Projection for the value of the digital advice market in 2020³.

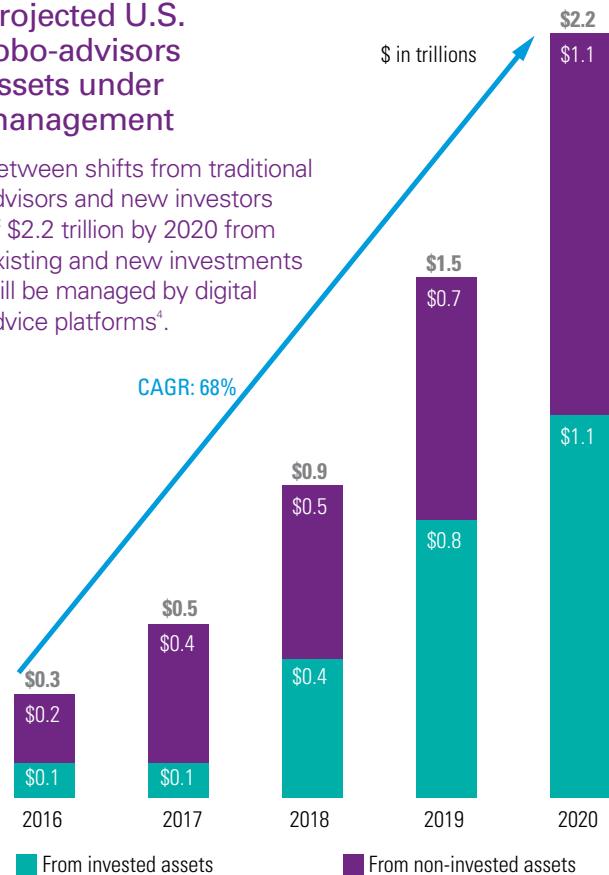
\$2.2 trillion Projection for the value of robo advisor controlled AUM in 2020 – a growth rate of 68 percent, driven by both existing and newly invested assets⁴.

Whether the low or high ends of the various projections are realized, digital wealth management is clearly changing the investing landscape.

Led by Vanguard's Personal Advisor Services, Schwab's Intelligent Portfolios, Wealthfront and Betterment, registered investment advisors and financial technology companies continue to add these capabilities. Personal Capital, SigFig, Motif Investing, Financial Guard, Trizic, Folio Investing and FutureAdvisor (acquired this summer by BlackRock) are all in the mix. And Wells Fargo, Bank of America - Merrill Lynch, and Fidelity Investments have discussed or announced automated financial advice services.⁵

Projected U.S. robo-advisors assets under management

Between shifts from traditional advisors and new investors of \$2.2 trillion by 2020 from existing and new investments will be managed by digital advice platforms⁴.



¹ "Betterment Is Now the Biggest Independent Robo With \$3 Billion in AUM" (WealthManagement.com, November, 6, 2015)

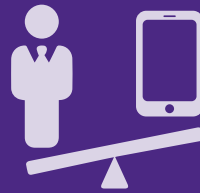
² "Digital Wealth Management Market Update: A Mosaic of Models Emerges" (Aite Research, March 2015)

³ "2,500% asset growth projected for robo-advisor platforms—according to Cerulli Research" (Investment News, November, 4, 2015)

⁴ "The Coming Waves of Robo Adoption" (A.T. Kearney, June 18, 2015)

⁵ "Wells Fargo Considers Robo" (The Wall Street Journal, July, 14, 2015)

Fidelity Joins Growing Field of Automated Financial Advice" (The New York Times, November, 23, 2015)



Weighing the risk of cannibalization

What's driving the high-degree of interest in robo investing?

From a consumer perspective, there are a number of trends fueling the growth of digital advice:

- Increased transparency into investment options and decisions
- Increased accessibility through low or no minimums and fees
- Enhanced customer experience via Web and mobile apps
- The use of exchange-traded funds (ETFs) to build diversified portfolios.

Indeed, robo investing often appeals to less-wealthy investors, given the availability of low-minimum and low-cost portfolios.

What's more, the rise of robo investing coincides with expanding interest in passive investing.

According to the Investment Company Institute, between 2007 and 2014, there was an inflow of more than \$1 trillion into domestic equity index funds, coinciding with a \$659 billion outflow from actively management domestic equity funds⁶.

Given this trend, it's no surprise that investors are interested in digital advice products and services.

Inside the business

Robo advice business models vary.

Some firms provide only investing advice—asset allocation models and security selection primarily comprised of ETFs that best match the investor's risk preference, time-horizon and goals.

Others recommend portfolios of diversified ETFs that include periodic rebalancing for an asset-based fee on the value of the account.

Although new and inexperienced investors are prime candidates for digital wealth management services, many existing clients are also interested in transitioning from more expensive managed account programs into lower-cost automated alternatives.

Schwab's no fee Intelligent Portfolios, with its \$5,000 minimum investment, competes directly with eight other Schwab portfolio programs with minimum investments and fees starting at \$25,000 and 0.90% for their Managed Portfolios, all the way to their Separately Managed Accounts program where minimums for Equities start at \$100,000 and fees begin at 1.35%.⁷ Will some existing clients transition from more expensive service offers to Intelligent Portfolios? The answer is yes but each program is unique and Schwab is willing to experience potential cannibalization as it highlights the specific features and benefits of each offer.

More dramatically, according to RIABiz, Vanguard proactively transferred almost half the assets in Personal Advisor Services Program (0.30% fee structure) from their more expensive Asset Management Services (0.70%). After the program officially exited their beta in May, Vanguard felt the platform could be scaled. According to Will Trout, a senior analyst at Boston-based Celent, "By cannibalizing existing clients, these firms are making less money on the same assets. But so what? It is short-term pain, long-term gain," and "the movement of these clients into automated channels should be considered a sort of discreet segmentation, i.e. a client-driven process that will ultimately help rationalize the firm's sales structure."⁸

⁶ Investment Company Fact Book (Investment Company Institute, 2015)

⁷ www.schwab.com/public/schwab/investing/accounts_products/portfolio_solutions#compare

⁸ Vanguard's white hot 'hybrid robo' just added \$4 billion in 3 months – a heat that may cast a chill on 'pure' robos (RIABiz, Jul. 16, 2015)

Should you ride the robo advising wave?

To get a sense of the market opportunity for established financial firms, KPMG surveyed 1,500 bank clients about their awareness of and interest in digital wealth management.

Our findings were revealing.

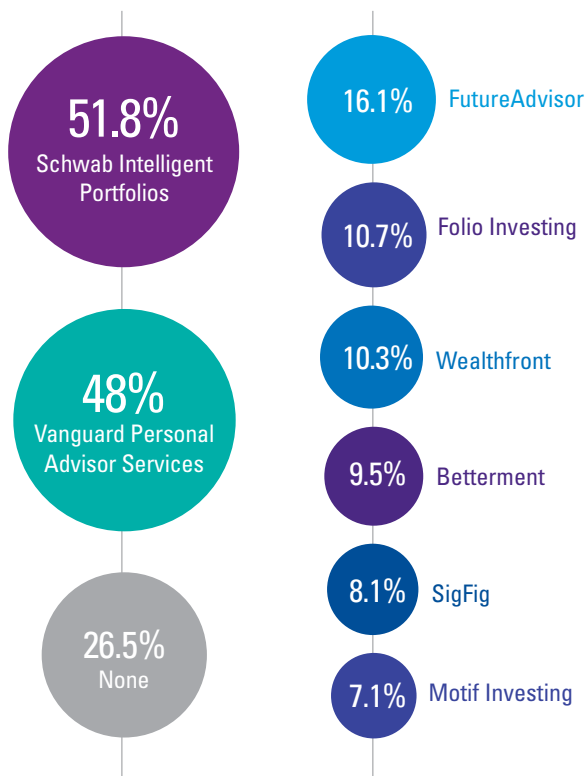
Fortunately for straggler banks, our survey indicates that **it's certainly not too late to enter the digital wealth management space.**

We found relatively low awareness (8 percent to 15 percent) of the robo advising services of SigFig, Betterment, Wealthfront and FutureAdvisor.

But you cannot afford to wait. Approximately 50 percent of respondents knew of Schwab's Intelligent Portfolios and Vanguard's Personal Advisor Services (PAS).

Awareness of online investment providers

Below are answers from respondents who were asked to select all those products that they were aware of.

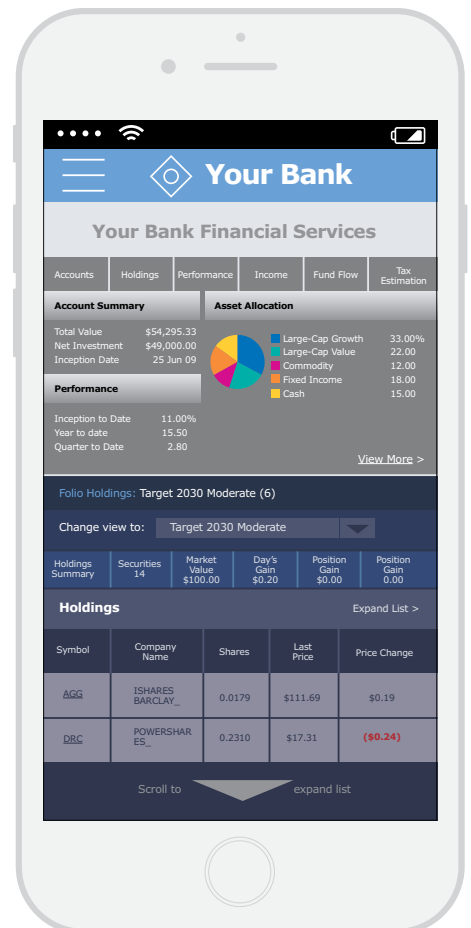


And competitive activity is picking up. The world's largest asset manager, BlackRock, recently acquired FutureAdvisor for a reported \$150-200 million⁹. JP Morgan recently announced a partnership with Motif Investing to offer retail clients access to IPOs for as little as \$250¹⁰. And in June, Pershing, the largest correspondent clearing firm, announced a deal with Marstone, which created a tool to help advisers engage and retain client assets as they transfer to a younger generation expected to soon be worth \$30 trillion¹¹.

Of course, measuring the competition is only part of the challenge. Banks also need to know if their current banking clients are interested in digital investing advice, and if so, if they would consider obtaining it from the bank.

To answer these important questions, we asked respondents if they would consider this offering from the bank where they have either a checking or savings account:

“Assume your bank recommended portfolios comprised of ETFs based on your investing experience, risk preference, financial goals and time horizon. There are no trading commissions and a management fee is based upon the amount of assets under management. You would access your accounts and make transactions over the web and with any mobile device such as a smart phone or a tablet. It could look like the illustration at right.”

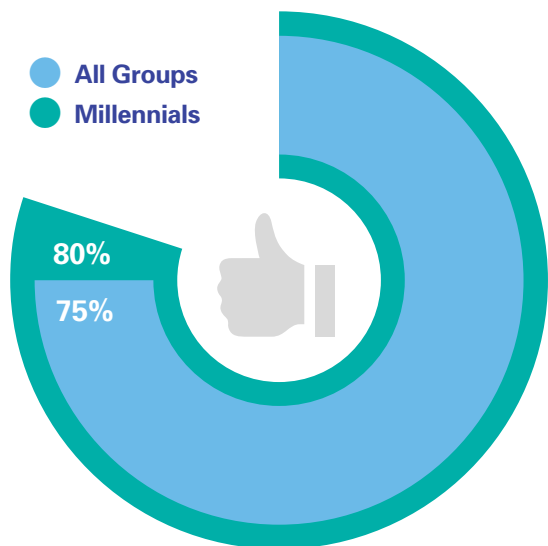


⁹ "The Future of Robo-Advisors: BlackRock's Latest Acquisition Is a Sign of Things to Come" (Tabb Forum, September, 28, 2015)

¹⁰ "J.P. Morgan, Motif partner to allow individuals to invest in IPOs" (MarketWatch, October, 21, 2015)

¹¹ "Pershing taps Marstone partnership to debut first advisor-focused robo" (InvestmentNews, June, 4, 2015)

Who's interested?



Our findings show that interest among existing banking clients is high, and banks would be remiss to ignore the opportunity to add robo advising to their product portfolios.

Across generations, income, and gender, more than 75 percent of respondents indicated they would be “very likely or somewhat likely” to consider the above offer from their bank, with 22 percent selecting “very likely.”

Furthermore, we found that 80 percent of millennials (age 18 to 34) said they would be “very likely or somewhat likely” to consider the described robo advising product—the highest level of interest among all surveyed demographic groups. This is inconsistent with previous research that found that 71 percent of millennials “would rather go to the dentist than listen to what banks are saying.”¹²

Banks should take note: If firms were to present new, innovative offerings like digital advice services, it seems millennial clients—with all of their buying power and future earnings potential—would be very likely to start listening.

¹² The Millennial Disruption Index (Scratch, 2014)

Deeper understanding of investing makes a difference

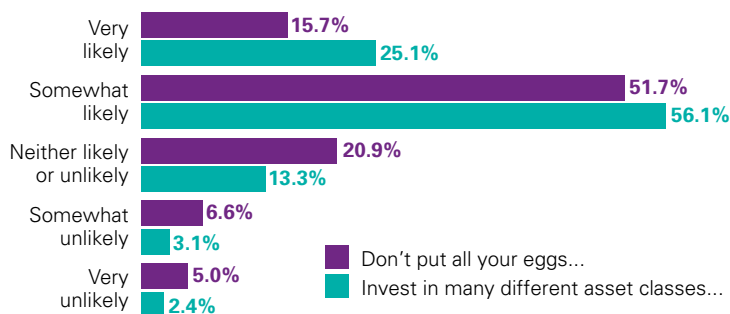
We learned that panel participants who had a more sophisticated understanding of diversification were significantly more interested in the robo advice concept. Given almost half (49 percent) of our respondents were unfamiliar with ETFs, there is an excellent opportunity to provide more education around investing in general and the potential benefits of leveraging a portfolio of ETFs in particular to deliver the level of diversification specific to your clients’ financial needs.

We presented our research participants three definitions of “diversification” and asked them to select the one that best describes their understanding to gauge respondents’ level of investing knowledge.

1. Don’t put all your eggs in one basket
2. Invest in a mutual fund that tracks a broad index such as the S&P 500
3. Invest in many different asset classes - stocks, fixed income, real-estate, commodities and cash because they do not all go up and down at the same time and/or same rate

Understanding diversification and interest in robo advice

When asked about their likelihood to consider a robo advisor offering, respondents with more sophisticated investing knowledge were significantly more likely to be interested.



VALUE IN BENEFICIARIES

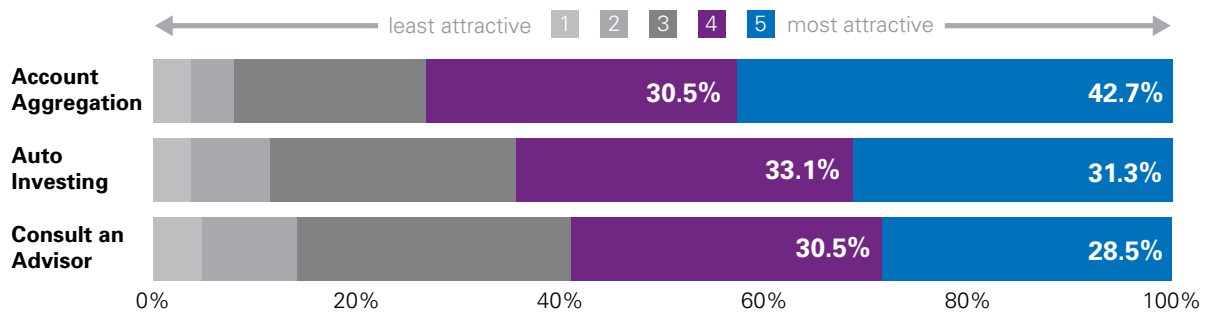
Our survey also measured whether another group of potential clients – beneficiaries of existing client accounts. Remarkably, 83.5% of beneficiaries who bank where their family members bank would be “very or somewhat likely” to consider digital advice services with almost 29% noting “very likely.”

This points to a clear opportunity for banks: Market robo advising products to the beneficiaries of your most valued clients—older, 65+ customers who generally comprise a disproportionate share of assets under management and or revenues.

The best digital advice products look like this...

What features matter most to users of robo advising solutions?
To find out what the ideal service offering would look like, we asked survey participants to rate the attractiveness of various features and capabilities.

Assume your bank and affiliated brokerage offered a diversified portfolio of low cost ETFs. Which of the following features would be of most interest to you?



Number 1 on the list? **Account aggregation**, which 73 percent of participants rate a 4 or 5 on the attractiveness scale. Investors strongly desire a unified view from their robo advisor of their banking, trust and brokerage accounts through a single sign-on experience via Web and mobile. Even better is having the option to also view accounts at other custodians.

The second most attractive feature (rating 5) is **auto investing**. Clients want the option to automatically transfer a set dollar amount or percentage from their savings or checking account into their investing account and have it automatically allocated across all holdings. This ability to move money between accounts is a core banking capability that can enable bank-brokerages to differentiate their services from many of the digital disruptors.

Another attractive feature to customers is the **ability to consult a financial advisor** about their investment approach and other financial matters. This suggests that digital advice services are not a “one-size fits all” model; there are opportunities to develop hybrid models—like Vanguard’s PAS—that combine the best of high-tech and high-touch.

“ With current fees for digital advice ranging from zero to 0.30 percent and operating expense ratios for key equity ETFs now below 5 bps, acquiring assets is an important piece of making the economics work. But bank-brokerages need to view digital advice as a critical component in deepening relationships with clients so that the bank and brokerage is viewed as their preferred financial resource.”

– Fiona Grandi, Partner and US FinTech Leader, KPMG LLP

Is the price right?

Our survey found that customers’ willingness to pay and the monetary value they place on digital advice services depends heavily on the features, functionality, and capabilities of the offering.

For example, respondents say they would pay an annualized fee between \$40 (0.8 percent) and \$50 (1 percent) for a digital service that periodically rebalances a portfolio of \$5,000 invested in 12 ETFs whose underlying holdings are all unique.

These price points are actually higher than we currently see in the market, pointing to an opportunity for competitive pricing models based on support services that traditional banks may be particularly well positioned to deliver. In other words, investors appear willing to pay more fees in exchange for the convenience and value of bundling digital advice with other banking services, like automatic money transfer.

Firm spotlights

Schwab's Intelligent Portfolios

Schwab's Intelligent Portfolios employs a unique pricing model with no management fees for its retail offering. The fees are embedded in the ETFs expense ratios with portfolios that are a combination of proprietary and third party ETFs that participate in Schwab's ETF OneSource platform. Schwab generates additional revenues through the spread on cash assets, as every portfolio has a percent allocation to this asset class.

Generally, Schwab's Intelligent Portfolios include a range of traditional and less-traditional asset classes, including real estate investment trusts (REITs), natural resources, and commodities. In addition, certain portfolios may include Schwab's Fundamental ETFs, the firm's take on smart beta, where the ETF tracks an index based on certain metrics, such as sales, cash flow, and dividends. Their ETF selection process results in the vast majority of ETFs excluded when constructing model portfolios.

Asset allocation is the foundation for Intelligent Portfolios and Charles Schwab Investment Advisory combines traditional portfolio optimization techniques that seek to achieve the highest level of expected return for a given level of risk – generally

known as mean variance optimization, with the findings of behavioral economics such as loss aversion. Studies have shown that many investors feel the pain of losses can be twice as high as the joy received from a similar sized gain.¹³

Folio Investing

Digital pioneer Folio Investing is a self-clearing broker dealer with a fractional share platform that truly reflects the potential for democratization of investing by de-coupling the price of any security – stock or ETF – by whatever amount the investor can or is willing to make. Most digital advice providers are traditional whole-share trading platforms. With fractional-share systems, initial and follow on investments are allocated across all holdings regardless of the price of any one security. On the Folio Investing platform it's possible to purchase any dollar amount or percentage of any ETF or individual stock.

Many RIAs use the Folio Institutional platform to create their own models that can be individual securities, ETFs and mutual funds or combinations of all three. The Folio Institutional platform can even support multiple models within an account, enabling an efficient approach to goals-based investing.

¹³ Thinking, Fast And Slow," Kahneman, D. (2011), pg 285



Getting started with robo advising

Like any new product or service, launching a robo advising solution is a significant undertaking. To catch up and compete with current and upstart players, banks must transform their wealth management business and operating models – the people, processes and technologies that support it – to deliver a wholly new set of capabilities.

KPMG's 9 Levers of Value provides a framework to connect an organization's business model (your choices in how to generate revenue by deciding where to compete and how to win customers) with the operating model (how you deliver value to your customers and how to use your resources).

Using the 9 Levers of Value as a foundation, we believe your bank increases its chances to gain clarity by addressing the following questions in their initial business and operating model assessment:

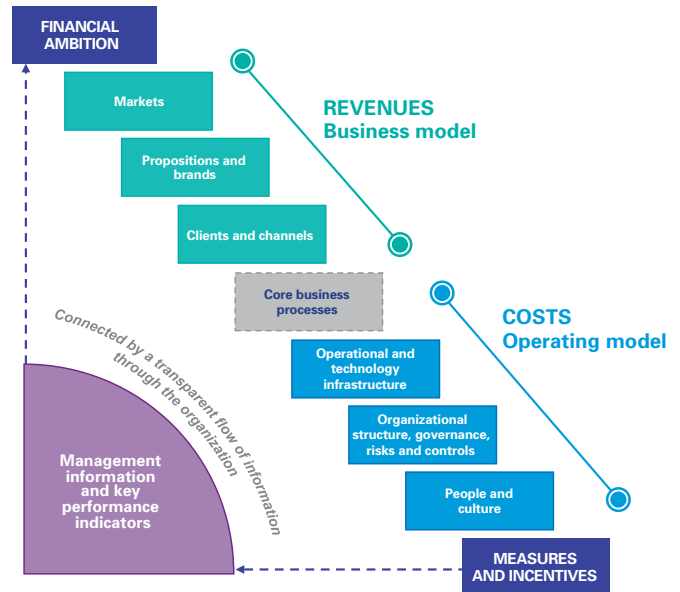
- 1. Competitive realities:** Robo advising might not be right for every traditional bank. With both emerging and established firms providing digital advice solutions, how critical is it for your organization to respond to rapidly changing market dynamics? How well do you understand the digital advice marketplace? How will you differentiate your digital advice offering?
- 2. Product options:** Digital advice providers generally offer diversified portfolios of low-cost ETFs across multiple asset classes. What product solutions will you offer? What specific bank-brokerage capabilities can you leverage to provide compelling and competitive products?
- 3. Client opportunities:** Existing bank clients are prime targets for robo advising services. What portion of your banking clients have investing accounts with your affiliated brokerage? Are you willing to potentially cannibalize a portion of your existing managed account programs? Do you have a good handle on current beneficiaries of your older, more valued clients, and are the listed beneficiaries existing clients of the firm?

4. Cultural

capabilities: As banks expand investing access to more of their bank clients and introduce broader bank-brokerage offerings, increased cooperation and coordination is necessary to create a seamless, unified customer experience. How integrated are your banking, trust and brokerage operations? How well do divisions work together today?

- 5. Investing approach:** There has been increasing emphasis on fee-based managed account programs, but digital advice is a strong fit for passive investing as executed through a wide range of ETFs. Do your internal stakeholders and clients understand the passive investing philosophy and the role ETFs can play? Are they familiar with ETF securities or interested in learning about them? Are you promoting your firm's ability to select winning funds or its ability to determine the appropriate asset allocation for each client? How can your firm's asset management expertise be leveraged to create competitive and differentiated portfolio offers?

The opportunity for banks is ripe, but you must act now to capture your share of the market. Otherwise your clients will eventually look for these solutions at other institutions.



- 6. Digital strategy:** As access to banking and investing products and services expands, clients increasingly expect a unified user experience. What degree of Web and mobile integration currently exists? Do clients have a single sign-on to their accounts via the Web and mobile applications or multiple and distinct platforms?
- 7. Partnership opportunities:** We believe partnerships may be the best approach to debuting robo investing solutions. What potential partners are available to work with? Do you know of firms with existing robo investing solutions that are actively pursuing white-labeling arrangements? How will you evaluate the options and what due-diligence process will be employed?

About KPMG strategy

Thinking about launching a robo advising business? KPMG Strategy can help.

Our industry-experienced strategy consultants are helping financial services companies:

- develop deep insights into the evolution of the robo advising market;
- vendor reviews and assessments;
- digital offer development;
- digital and mobile design and implementation;
- analyze the long-term potential for competitive advantage and profits;
- determine how to compete and win in the rapidly changing digital world.

Our focus is on business transformation - helping you deliver competitive products and services that meet the needs of clients and prospects by defining the optimal operational and technology infrastructure; taking into consideration your organization, governance, risk and controls, and most importantly, your people and culture.

Understanding that each client is unique, we develop customized solutions with end-to-end capabilities integrated from strategy through execution.

Learn more at kpmg.com/us/strategy.

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Dan is a principal in KPMG Strategy with over 30 years of experience working with marquee clients across the banking and wealth management sectors. Dan specializes in defining digital, IT and operations strategies for North American banking clients needing to achieve revenue growth, customer experience improvements, cost reductions and operating efficiencies.

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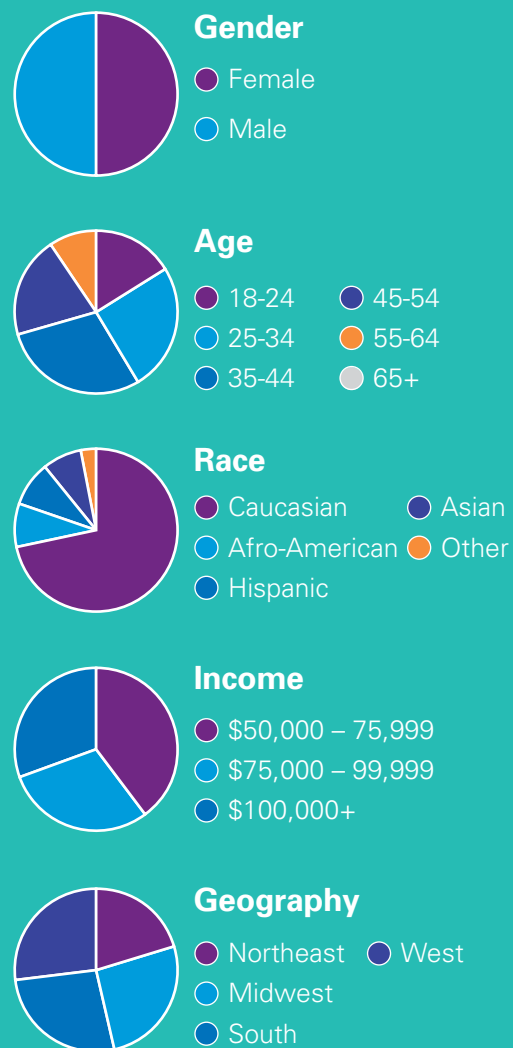
Jonathan is a director in KPMG Strategy's Financial Services practice with over 15 years of experience working at firms that have developed leading Fintech products and services. Most recently, Jonathan helped clients develop strategic business plans and products leveraging digital capabilities.

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Survey methodology

KPMG's proprietary research data published in this report is based on a survey of more 1,500 bank clients conducted in October 2015. The survey was conducted with MFour, a mobile research platform, which surveyed consumers anonymously, including a cross-section of demographics across the United States.



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