CLS **ADVISOR IQ** SERIES

THE COMING AUTOMATION OF WEALTH MANAGEMENT AND WHAT IT MEANS FOR TODAY'S FINANCIAL ADVISOR

ADVISOR IQ

CLS INVESTMENTS

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Introduction

This white paper is part CLS's Advisor IQ series, which is designed specifically to help advisors succeed through actionable, industry-related content.

Recent CLS research on the impact of new consumer technology and automation in the wealth management industry reveals a marked discrepancy between advisors' thoughts and actions and the reality of the situation.

The emergence and early success of so-called "robo advisors" – online digital advice platforms – portends both a threat and opportunity for today's financial advisor. While robo advisor technology has some advisors on edge, the root of this is a genuine lack of understanding for how technology and automation may truly impact advisors going forward.

95.5%

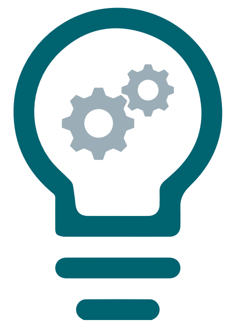
of respondents (all ages) believe themselves to be

"KNOWLEDGEABLE"

to

"*VERY* KNOWLEDGEABLE"

about technology



Advisors must recognize that automation is coming to wealth management and that they need to prepare now to leverage their core competitive differences or else face the risk of being marginalized in the near future.

Almost all industry experts agree that the personal, human element of delivering financial advice will not be replaced by machines. However, the fundamental economics and consumer expectations for working with advisors will forever change through new client-facing, automation technology.

Historically, financial services consumer technology changes have been slow to be adopted due to the highly-regulated nature of the industry. Examples include when email communication, websites, social media, and mobile devices showed up on the scene. Due to vague compliance concerns or a lack of understanding for how to manage these technologies, many firms initially prohibited them. Although it has taken some time, most of these innovations have now been broadly accepted. Simply put, technology cannot be stopped.

The risk is that if advisors and the industry take too long to embrace and adapt to these new technologies, it may be too late. Technology waits for no one.

As a result, the wealth management industry is now at a crossroads with the inevitable entrance of automated investment services. The good news is that the entry of this new technology brings opportunity: advisors have the unique chance to up their game by deploying the latest technologies available for continued growth and success.

To explore these issues in detail, this report focuses on consumer technology trends impacting advisors today, provides an analysis of the various options advisors can consider, and recommends a clear path to capitalize on these same technologies to build an enduring and sustainable business. This report will also provide a view into what the future of financial advice may be 10, 15, or even 20 years down the road.

Industry Trends: The Emergence of Robo Technology

A firestorm of media hype has erupted over the last several years with the entrance of robo advisors. Additionally, unprecedented amounts of venture capital (VC) money has been raised to support this new technology.

Many advisors are rightfully concerned, as they are not sure what this means to their businesses. Despite the fact that some industry experts believe automation is the biggest change to occur since the introduction of discount brokers 40 years ago, many advisors fail to realize the potential it has to rapidly change the financial services industry.

While investment automation is still in development and the current crop of robo advisors is small, the implications within client engagement, onboarding, and ongoing servicing will be far-reaching. Not all robo advisors will win; in fact, a few firms have already found an early exit to this threat.

Financial Engines

Automated, online investing platforms are not a new thing. Nobel Prize winner Bill Sharpe co-founded Financial Engines, one of the first algorithmically driven investment platforms in 1996.

Financial Engines struggled initially until it found its niche in 401(k) plans. Once it became accepted and was blessed by regulators, it took off and, as of the end of 2014, had surpassed $895 billion in assets under contract and $104 billion in assets under management for nearly 9 million people. This is proof that automation in wealth management is here to stay.

However, big online brands are now playing, and are fundamentally shifting the conversation. For example, in the first part of 2015, Charles Schwab introduced its Intelligent Portfolios, a "free" robo advisor that gathered more than $1.5 billion in assets in less than six weeks.

Around that same time, Fidelity paid $250 million for eMoney, a comprehensive client portal and advisor operating system, in order to create a new business unit targeting both the advisor and retail markets. Vanguard has also joined the marketplace, gathering over $17 billion in its new robo advisor platform without any outbound marketing at all.

VC money, adoption from big name firms, and the successes of the first robo advisors all seem to indicate that automation is on the horizon for wealth management and, similar to just about every other industry that automation has touched, it will forever be changed.

96.7% OF RESPONDENTS
BELIEVE THAT HUMANS AND ROBO ADVISORS CAN
"CO-EXIST"

So, what is driving the early success of robo advisors?

It isn't their automated, algorithmic investing platforms – those have been around for decades in the form of Turnkey Asset Management Programs (TAMPs). What has brought about their recent and vast success is the introduction of a better customer experience.

This is exactly how big internet players – Amazon, Apple, Facebook, Google, Netflix, Uber, etc. – have seen exponential growth and have bankrupted legacy industry participants. The internet has drastically improved the customer experience for nearly every type of business.

For example, consider the experience of ordering a book right onto a Kindle, iPad, or similar device. Amazon makes it so easy, and fast. With just a few clicks in two minutes or less, consumers can read the latest John Grisham novel on their mobile device, all from the convenience of their couch at 3 AM. They don't have to wait until the next morning when the store opens, drive to the mall, fight for a parking spot, browse the shelves, and wait in line to check out. They just receive the book immediately on their mobile device, regardless of time or location. This type of online experience is now the status quo for all age groups and demographics.

The key to this enhanced customer experience is self service. Think of buying a plane ticket, reserving a hotel room, or checking out at the grocery store. Consumers can now do all of this themselves through an app on their phone or by scanning bar codes as they bag their own groceries. Powered by easy-to-use technology, this automation results in a brief, enjoyable, seamless experience.

Yet, when we try to apply the benefits of automation to the way wealth management services are currently delivered, the process often breaks down due to complexity, too many manual steps, paperwork issues, delays, constraints of traditional business hours, and poor service – all of which are the key ingredients to technology disruption.

48.1% OF RESPONDENTS
CATEGORIZED ROBOS AS
"A LOW COST, TECHNOLOGY-BASED ADVISOR FOR THE MASSES."

Big robo advisor technology innovations are centered around using account aggregation and planning, fee, and performance analysis to allow clients to see all of their investments in one place online (from whichever device they may be using). This technology can also onboard clients using a paperless, e-signature process, and provide them self-service options for common requests. This all leads to tremendous scale and client satisfaction.

It's not just millennials who are gravitating to automated wealth management solutions. Several independent advisory firms, such as Stronghold Financial, are deploying robo advisor technology, raising significant assets, and securing million dollar accounts.

Despite these documented trends and large asset movements, most advisors are still not embracing these technologies. The question then is: why not?

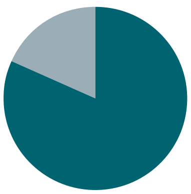
Advisor Perceptions: Research Results

CLS recently surveyed 134 independent advisors in an effort to find out why advisors are not embracing these new technologies. The survey was designed to gauge advisor perceptions about whether or not robo advisors are a viable option for investors and how they may affect the traditional approach to providing financial advice.

The results revealed some compelling evidence about the need for advisors to better understand this form of automation and how they can leverage it in their businesses.

Based on CLS research*, advisors:

- Are aware of robo advisors and the technology
- View robo advisors as a potential to significant threat
- Think the media is focusing too much on robo advisors
- Believe that the general public doesn't know what robos advisors are
- Recognize that phone, email, and face-to-face meetings are still valued by clients
- Feel that social media and online platforms are not as important as printed materials



81.1% OF RESPONDENTS HAVE A "CLEAR" UNDERSTANDING OF WHAT A ROBO ADVISOR IS

These perceptions contrast markedly with what investors are saying. Investors expect access to their advisor and financial information on any device at any time. According to a study recently released by global consulting firm Cap Gemini, 64% of affluent individuals in North America, including high-net worth (HNW) investors, expect their future wealth management relationship to be digital.

In that same study, 82% of affluent individuals under the age of 40, including HNW investors, said they expect digital wealth management interactions. Moreover, 65% of affluent individuals, including HNW worth investors, stated that they will leave their wealth management firm if an integrated channel experience is not provided. If advisors don't provide this functionality to HNW clients, then they will likely find someone who will.

According to Phoenix Marketing International's surveys of HNW investors, over half under 35 with $1 million or more in investable assets were comfortable managing their wealth on their smartphones, and 60% were comfortable managing it with online tools. For all age groups in sum, 44% said they were comfortable with online tools and 36% of HNW investors ages 45-54 noted being comfortable with using online tools.

According to David Thompson, Managing Director of an affluent practice at Phoenix Marketing International, “we’re not seeing any specific brand loyalty. It’s more about ease of use and applicability – is the tool something they can use quickly, easily, and intuitively? Does it make them comfortable right out of the gate, and can it be used when needed?”

“These investors take on responsibility for themselves, because they’ve been operating that way with information at their fingertips, empowered by data. It’s just a different mindset, that’s going to force traditional wealth management to change how they operate.”

Case in point, CLS and other research has shown a big disconnect between where advisors are now and where their clients expect them to be. So, what can advisors do to bridge this gap?

**see the Appendix for the specific results*

Practice Management: Implications for Advisors

Schwab's heavily advertised "free" robo advisor, along with the brand recognition of Vanguard and Fidelity, will likely educate investors to question asset management fees and what services they are getting in return for the fees. Advisors will soon need to find a new way to communicate the value they provide, perhaps by unbundling investment management from AUM fees, focusing on financial planning, and looking out for their clients' best interests as their differentiators.

The key takeaway from CLS's research is that advisors need to start embracing technology more broadly. Not just in the robo advisor category, but also for their front and back offices in order to enhance the client experience and drive needed efficiencies in a world of potential pricing pressures.

The majority of advisors have built their businesses over time on manual processes, legacy systems, and Excel spreadsheets – an infrastructure that is expensive to maintain, fragile, and not scalable. The good news is that the success of the independent advisor industry has brought an emergence of purpose-built advisor technology. Many new technology firms are increasing their investments in the tools and platforms that can bring the robo advisor technology benefits in-house to advisors.

Advisory firms using the latest technologies enjoy enhanced productivity and profitability. The firms focused on technology report a:

- 25% increase in assets per professional
- 18% increase in revenue per professional
- 45% increase in profit per professional
- 37% increase in households managed per staff
- 64% increase in households managed per professional

These data points reveal the potential for a powerful return on investment for participating in the latest technologies, and provide a compelling argument for advisors to start learning about the latest enhancements to advisor technology platforms and systems.

As a next step, advisors can begin identifying the core systems that can make the biggest impact on the client experience and develop a plan to deploy them. Some areas to consider:

- **Enhanced Website:** Not just a site filled with brochures, but one that is interactive, updated frequently, and allows clients and prospects to engage with their advisor online. Today, this is the industry standard, not the exception.
- **Client Portal:** These powerful online platforms, optimized for all mobile devices, enable advisors to communicate directly with their

clients by providing real time updates to their portfolios and financial plans, including account status. They also feature a document vault to securely deliver statements online, eliminating the need to spend time and money mailing hard copies.

- **Customer Relationship Management (CRM):** Comprehensive client management software that not only keeps track of client and prospect information, but also includes office workflow tools to automate many service requests and enable advisors and staff to answer any client questions.
- **Financial Planning:** Interactive, graphical, goals-based financial planning analysis that can be comprehensive or modular for specific issues, such as retirement or college planning, that is integrated into the client portal for online client viewing and access.
- **e-Signature:** By marrying digital signatures with common processes such as new account opening and other service requests, e-signature creates an elegant online client experience, speeds up transactions,and saves time and money for advisors.
- **Account Aggregation:** Provides clients a comprehensive view of all of their assets in one place to help them understand what they own, make better decisions, see where there cash expenditures go, and develop budgets. It also provides advisors with a view into held away assets that allows them to provide more holistic advice and potentially develop new business development.

Deploying Robo Technology

Once these key areas of advisor technology have been implemented, the next step is to consider how a firm wants to deploy robo advisor technology directly to clients and prospects to potentially automate core processes, target new markets, and provide an outstanding online client experience.

Of course, this is not a universal dictate. Not every firm needs to deploy robo advisor technology directly. There will always be a need for human advisors, particularly for complex situations and to provide personal services. Thus, firms have ample opportunities to brand themselves as such, and enhance their profitability and service offering by leveraging the client engagement technology listed in the previous section.

For advisors who do want to target new markets and build out capacity through robo advisor technology, there are several paths they can take:

1. Create a stand-alone robo advisor business, branded and operated separately from their current firm.
2. Outsource investment operations to a robo advisor platform, similar to a TAMP model.
3. Integrate robo advisor technology into current back office operations to create a new offering for smaller, accommodation accounts, or to service clients' children in order to capture the great transition of wealth coming soon, as well as the next generation of investor.

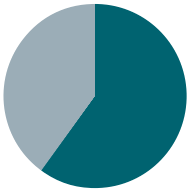
Creating a Stand-Alone Business

The key to having a separately-branded robo advisor offering is being able to drive internet traffic to the advisor's website. In this strategy, the advisor will go direct to consumers with this model and will need to spend significant marketing resources to gain that interest. Before going this route, advisors should ask questions such as: what will be the cost of client acquisition? How will consumers find the advisor's website?

If advisors don't have national, mass appeal or access to a media outlet, then it will most likely be prohibitively expensive to drive traffic their way. On the positive side, by using this direct-to-consumer model, advisors may be able to be create a pool of leads (at a cost) and then encourage clients to upgrade to their more profitable, full-service offering over time as account balances grow. The key analysis will be what cost per acquisition calculation makes economic sense for the business.

Outsourcing Operations to a Robo Platform

In the robo advisor TAMP model, advisory firms outsource their entire investment management operations to a robo advisor platform. This may allow the firm to gain operational efficiencies that translate into higher profitability. As a result of this transition, advisors are able to focus the majority of their time on relationship management and providing a broader service model that includes financial planning and wealth management services. However, the downside to this route is that clients' investment portfolios will be passive and fairly simple. Advisors may not be able to accommodate higher-net worth clients who are looking for alternative investments or more advanced investing needs.



60% OF RESPONDENTS WOULD TRUST ROBO ADVISORS TO HELP MANAGE & OVERSEE CLIENT ASSETS

Integrating Robo Advisor Technology into Existing Back Office Systems

Advisors are currently seeing success through integration of robo advisor technology into existing back office systems. This strategy is targeted at investors who are below profitable minimums, current clients with accommodation accounts for their children, or referrals from important centers of influence that advisors take on in order to maintain relationships. With the emergence of advisor-friendly robo advisor platforms, advisors can choose this option to bring in the best of robo advisor technology, brand it under their firm name, and integrate it into their existing processes.

Autopilot

As advisors begin exploring the opportunity to deploy robo advisor technology, they'll find there are a number of business-to-business platforms available, including Autopilot, powered by CLS and Riskalyze.

Autopilot is an automated asset management tool that allows advisors to segment their client base and provide various tiered levels of service to enhance profitability and target new markets.

For example, for next generation investors, clients, or prospects who don't meet the firm's minimum, advisors can deploy Autopilot to provide a basic investment service that doesn't require a lot of resources, time, or personal attention. The automated nature ensures that accounts are properly managed and the digital interface provides online account opening, reducing overhead, and creating operational leverage in order to profitably service these client segments.

Embedding Autopilot into an advisor's existing website gives clients the ability to generate their specific Risk Number™, sync in their outside assets, open their account, and e-sign all necessary forms.

This client engagement platform is designed to give advisors an edge by reducing the cost and complexity of serving different segments of clients. To learn more, visit autopilotadvisor.com.

The Future of Wealth Management

While we are definitely in the early days of the wealth management automation movement, recent developments, acquisitions, and investments in advisor technology can provide a glimpse of what the future holds.

Many recent strategic moves by large industry players to consolidate the emerging technologies will have great impact on the delivery of wealth management in the future. These acquirers are looking to influence or control the advisor home screen, dashboard, and wealth management operating system that advisors will access to process all of their wealth management business. In doing so, these large firms will be able to strategically capture new revenue streams by leveraging the automation and technology they are integrating. It will also offer competitive differentiation against their rivals.

Consider that in just the first few months of 2015:

- Fidelity acquired eMoney and its cutting edge eMX operating system platform to combine into a separate software rollup division, as well as to deploy through its core advisor and retail brokerage platforms.
- Envestnet acquired robo advisor technology player Upside, and financial planning innovator Finance Logix, to combine into its already robust Tamarac platform of CRM, Portfolio Management, and Rebalancer.
- TD Ameritrade advanced its Veo One and Veo Open Access integration platforms, with over 90 integration vendors participating.
- SS & C acquired Advent Software and its Black Diamond advisor platform.
- Schwab rolled out its Intelligent Portfolios' robo advisor platform with plans to enable advisors to white-label it for their clients.

Clearly, there is a high stakes race to control the operating system for advisor technology. The result is likely to be a much more integrated platform for advisors to use in working with their clients and prospects.

This consolidated, feature-rich integration of systems promises to bring needed efficiencies for advisors. However, this consolidation may limit choice and flexibility for advisors in accessing products and services that sit on competing platforms. Advisors may want to think about maintaining their own independent technology stack to preserve open architecture and their ability to execute their fiduciary duty.

While this is one trend in the future of wealth management, CLS believes that this same "wealth management operating system" trend will also be reflected in the tools and types of access clients have when using wealth management services.

Ultimately, the dashboard or home screen concept that the industry is pursuing for advisors may very well end up looking like the iOS operating system on Apple devices. Imagine if clients had a wealth management “app store” that they could use to allow their advisors, attorneys, mortgage brokers, insurance agents, CPAs, and financial planners, to access their information, manage their investments, and provide holistic wealth management advice.

Despite the industry’s efforts to gain market power by controlling the technology that advisors use, client-facing technologies – the same ones that have changed the industry all along – may very well disrupt those plans. Clients will always be the center of any wealth management relationship. The battle of the future will not be humans versus robots; rather, it will be advisors who use technology to provide an outstanding client experience versus those who don’t.

Going forward, the one thing that remains the same in the wealth management industry is change, which is constant. Advisors and industry participants who continue to embrace that change are the ones that will come out on top.

Appendix: Market Research Results

This white paper was informed by research CLS conducted on advisor attitudes toward the coming automation of wealth management. Beyond the conclusions included above, there were a number of additional insights from the survey, including:

- While the vast majority of the respondents see that robo advisors and advisors can co-exist, the overwhelming majority perceive them as a threat. Almost 80% of the respondents said that the robo advisor threat is significant or potentially real.
- Regardless of age group, almost all respondents said that they were at least knowledgeable when it came to technology.
- The vast majority of respondents feel that the general public doesn't know what robo advisors are and a smaller majority feels like the public would like to know more.
- **The youngest cohort clearly thinks that robo advisors have the potential to be a partner; the remaining respondents are evenly split.**
- Almost all respondents say they know what a robo advisor is, but the 45-65+ respondents have more uncertainty about them.
- Respondents are evenly split on whether robo advisors will help, hinder, or have no discernible impact. Yet, when comparing this data to the threat level, respondents are conflicted, where about 25% of the respondents who said that the robo advisor threat is potentially real, also said that robo advisors would help their practice.
- **There is confusion amongst respondents on the threat of robos versus their ability to co-exist. Only 26% of respondents said that the threat is insignificant and that robo advisors can co-exist. 62% said the threat is potentially real and co-existence isn't an option.**

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