Digital disruption in Wealth Management

Why established firms should pay attention to emerging digital business models for retail investors

Executive summary

Over the past ten years, numerous startup firms with digital business models have emerged within the Wealth Management (WM) industry. According to our analysis of over 50 WM startups, these firms are Business-to-Consumer (B2C) focused, and primarily serve retail investors in three ways:

1. **Connect**. Helping investors connect to their peers, multiple accounts, and multiple sources of advice.

2. **Advise**. Providing investors with advice tailored to their unique situations and delivered through a rich, digital experience.

3. **Invest.** Providing access to esoteric investment opportunities and investment strategies similar to those used by professional investors and institutions.

Although it's unlikely these new firms will draw large amounts of market share away from leading wealth management franchises over the next five years, they will likely continue to grow because they target investor needs that established firms are not currently satisfying. Also, they offer a convenient online client experience that retail investors have increasingly come to expect.

Leading WM franchises have been monitoring these digital startups for a while, but thus far only a few have responded with enhancements to their own digital presence. However, our research shows the tide is starting to turn and a growing number of incumbents are looking to selectively invest in building digital capabilities that will help broaden their appeal with younger clients and other digitally savvy retail investors.

The disruptive power of digital technologies business models is creating opportunities for new firms to make a big splash in the wealth management industry. However, other kinds of financial services firms — such as asset management and insurance companies — may be able to leverage similar capabilities to provide client advice and add greater value through their own distribution channels.

Established WM firms that do not learn from digital startups and adjust their business models accordingly could find themselves at a significant disadvantage in the marketplace. On the other hand, incumbents that learn to use digital technologies to address unmet needs and deliver a superior client experience may be able to leapfrog the competition and capitalize on emerging market opportunities.

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Introduction

Imagine two executives having lunch at a wealth management (WM) conference and discussing the recent emergence of small, digitally enabled WM firms that primarily focus on retail investors in the Business-to-Consumer (B2C) market — firms such as Betterment and Personal Capital. The first executive doesn't care about these startups or view them as a disintermediation threat, arguing that investors will always want direct, person-to-person relationships with their financial advisors. The second executive strongly disagrees, arguing that all incumbent firms should understand why these new firms exist, what clients like about them, and what capabilities should be developed in response to the threat.

This hypothetical scenario illustrates a real ongoing debate taking place in the WM industry about the relevance of digitally-enabled startups and their potential for disruption. Established firms are trying to decide whether it is worth their time, money, and effort to better understand these emerging businesses.

According to our research for this report, the answer is clear. Wealth management is an industry ripe for disruption, and WM startups are a leading indicator of what is anticipated to come. Studying the new digital firms can reveal evolving customer needs that are not currently being met by established firms, enabling incumbents to adjust their business models and take advantage of emerging trends.

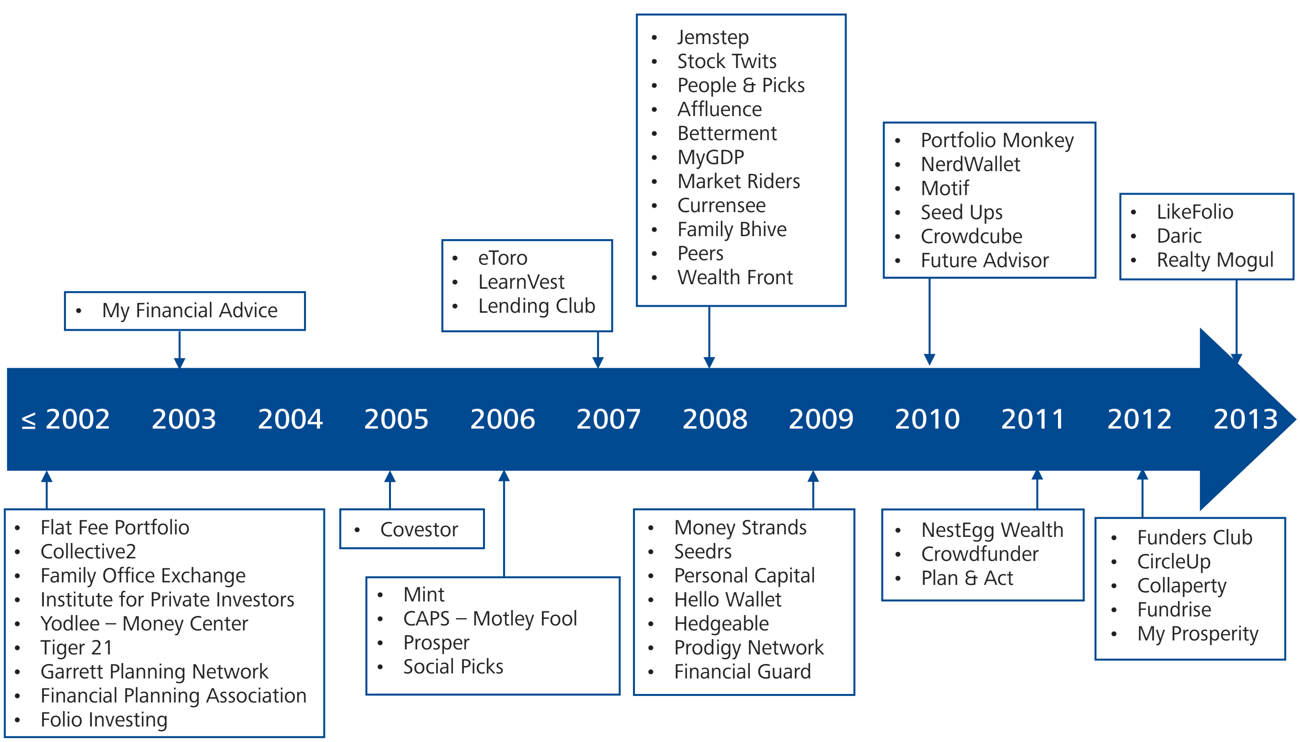
An overview of wealth management startups

Our study examined over 50 wealth management startups that are B2C-focused and digitally enabled, most of which were founded within the past ten years (Figure 1). According to our analysis, these fast-growing firms serve retail investors in three ways: they help investors **connect; advise** them on financial issues; and help them **invest** (Figure 2).

Connect. Consumers have a need to connect multiple accounts — often across multiple providers — in order to create a holistic picture of their wealth and more easily manage their finances across multiple asset classes and firms. Also, investors want to connect with each other to learn from their peers, and to connect with specialists and advisors that align with their needs. New firms are providing integration across traditional boundaries to help investors escape siloed investing.

Examples: Mint, SocialPicks, MyFinancialAdvice

Figure 1: Deployment Timeline



Digital disruption framework

Figure 2: WM Digital Disruption Framework

Connect

Allow investors to connect their accounts together, and connect with their peers and the right advisors

Account Aggregation:

- Money Strands
- My Prosperity
- Mint
- Yodlee – Money Center

Social:

- Peers
- Social Picks
- Affluence
- Family Bhive
- CAPS – Motley Fool
- People & Picks
- Tiger 21
- Institute for Private Investors
- Stock Twits
- Family Office Exchange

Client/Advisor Matching:

- Garrett Planning Network
- My Financial Advice
- Finanical Planning Association
- NerdWallet

Advise

Leverage digital interfaces and analytics to deliver tailored advice and enhanced experiences

Financial Planning:

(with Digital Store Front)

- Wealth Front
- Personal Capital
- Plan & Act
- Hello Wallet
- LearnVest

Portfolio Allocation:

(Algorithms-based)

- My GDP
- NestEgg Wealth
- FlatFee Portfolios
- Folio Investing
- Future Advisor
- Market Riders
- Hedgeable
- Financial Guard
- LikeFolio
- Portfolio Monkey
- Betterment
- Jemstep

Invest

Provide investors access to non-traditional, institutional-like investment strategies and opportunities

Non-Traditional Investment Strategies:

- Collective2
- Covestor
- Currensee
- Motif
- eToro

Alternative Products:

- Prosper
- Seed Ups
- Seedrs
- Lending Club
- Crowdfunders
- Prodigy Network
- Fundrise
- Funders Club
- Crowdcube
- Collaperty
- CircleUp
- Realty Mogul
- Daric

Digital disruption framework continues...

Advise. Retail investors often seek advice from reputable sources and want that advice to be tailored to their unique needs and circumstances. In the past, access to tailored solutions was largely limited to wealthy investors due to the high cost of customization. Now, digital platforms are democratizing the delivery of financial advice, with algorithmic tools giving the masses access to customized investment planning and portfolio allocation.

Examples: Personal Capital, Betterment

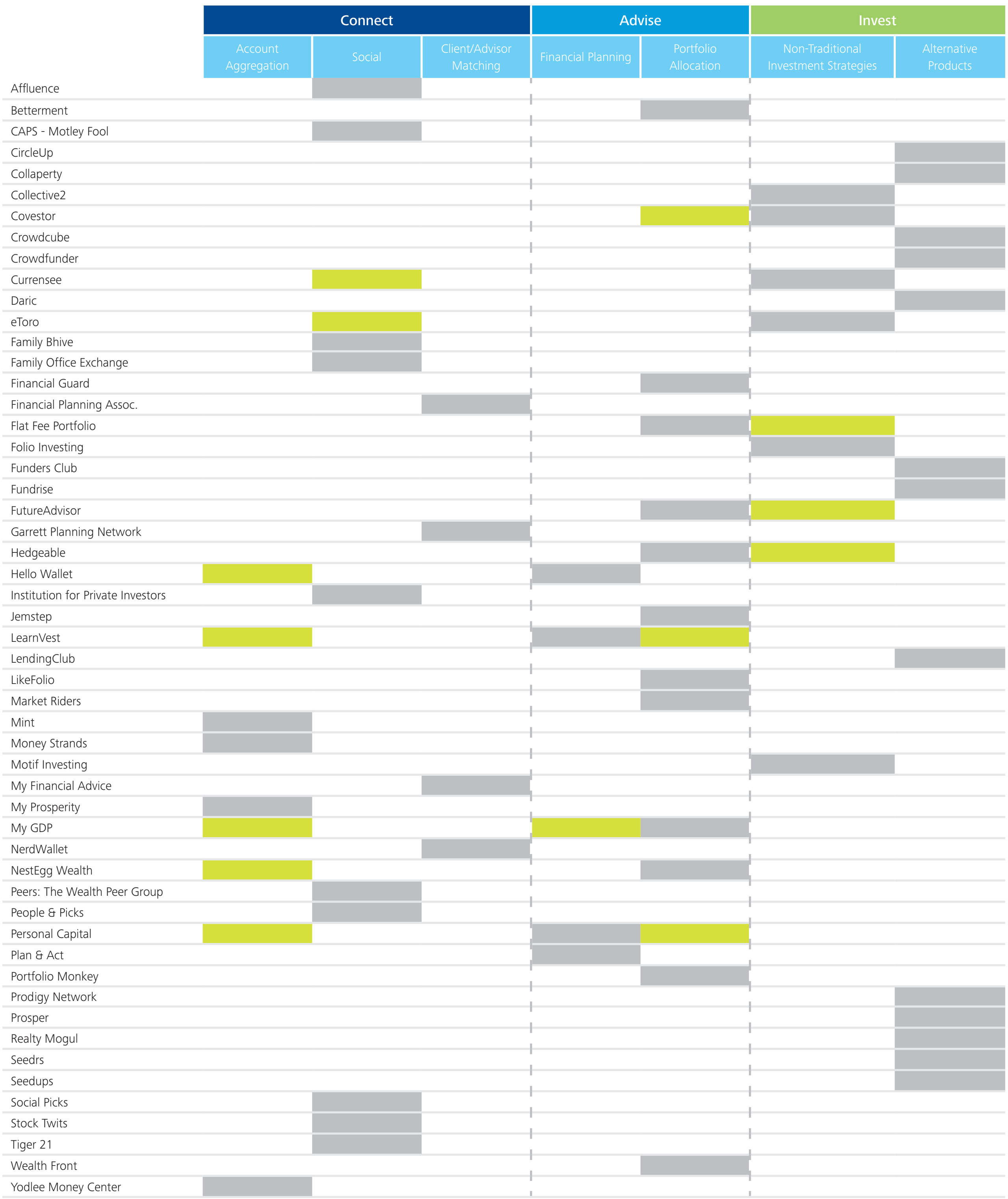
Invest. Some retail investors are ready to explore non-traditional investments or are looking to emulate professional and institutional investment strategies. In response, digitally enabled firms are starting to provide access to alternative finance products that were historically the sole purview of commercial or high net-worth investors.

Examples: Covestor, Prosper, Seedups

Although firms are typically categorized based on their primary functions, many offer services that cut across categories (Figure 3).

Digital wealth management firms capabilities

Figure 3: Digital WM Firms Capabilities



Source: Deloitte Analysis, 2013

Key: Primary Capability Secondary Capability

Connect

Account Aggregation

Retail investors are increasingly frustrated with having to reconcile or aggregate transactional information across numerous bank, investment, and retirement accounts. They want an accurate, real-time, aggregated view of their financial assets, liabilities, and net worth across multiple accounts and providers. Also, such a view would help financial advisors provide more effective and timely financial planning and investment advice — and create opportunities for them to cross-sell a wide range of financial products and services.

One of the first movers in this market was Mint.com. Mint is a free online personal finance service that allows users to see all their balances and transactions in one place. Launched in 2007, Mint now has over 1 million users, making it one of the largest and fastest growing account aggregation services. Once a user provides their logins, Mint automatically pulls in daily information about bank accounts, credit cards, loans, property, and investments from nearly all banking and financial institutions in the U.S. — giving users an up-to-date view of their money with no data entry, import or synching required. Mint automatically categorizes transactions, calculates budgets by category, and shows cash flow for each month. To keep users engaged, the service also sends email and SMS alerts about upcoming bills, low balances, and unusual spending. In addition, Mint.com offers personalized recommendations on alternative products a user may be interested in. The recommendation engine is a source of revenue as affiliates pay to have their products put in front of desired clients.

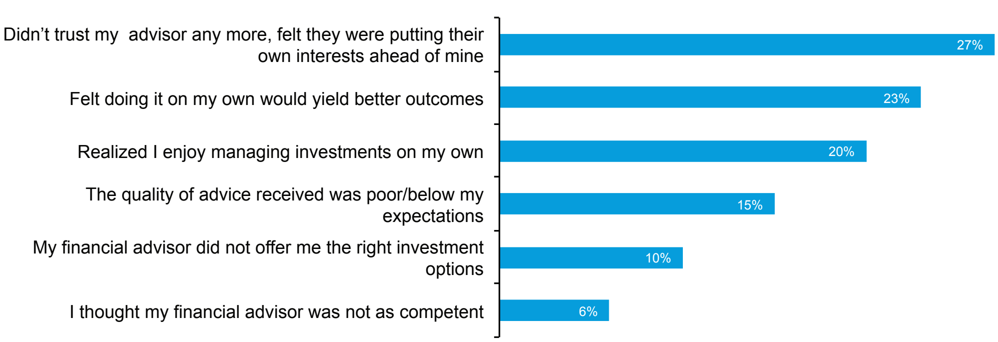
Myprosperity is conceptually similar to Mint, with a focus on financial planning. Myprosperity can aggregate bank, credit card, investment accounts, and assets (e.g. home, car) into a single dashboard, providing the user with a real-time view across multiple accounts and financial institutions. The site has a budgeting tool to help users monitor spending and manage savings goals. A "financial fitness score" is generated to measure against personal goals and preferences. It also facilitates users' need to share information with the financial and legal professionals through a limited access portal.

Large incumbent firms could offer something similar to Mint and Myprosperity by building account aggregation into their current digital front-ends (websites/mobile apps), as it would likely require minimal integration with current systems. Many B2B financial services technology firms provide products to help incorporate aggregation into a company's infrastructure. Once a comprehensive picture of a client's wealth has been captured, incumbent firms may be better positioned to systemically provide effective financial advice and cross-sell new products and services — enabling more effective share of wallet strategies. Another potential use of account aggregation is to offer services to families and other groups of individuals, where different members would have different levels of access to the financial picture.

Social networks

Since the financial crisis, retail investors have become more skeptical of the advice they receive, while at the same time realizing they need this advice more than ever (See Figure 4). One way to mitigate the perceived risk of advice is to provide customers with access to a variety of different sources. Investor want to know what their peers think and

Figure 4: Why the mass affluent left their advisors



how they invest, not just learn from investment specialists. Furthermore, they value interactions with their peers beyond addressing their own immediate investment needs. Forums that began as chat groups and online discussions have quickly evolved into full-blown social platforms that allow for an open exchange of ideas and the ability to form affinity groups.

People & Picks, founded by Zack's Investment Research, is an example of a company that has created a social platform and online community for users to interact with one another. The platform allows users to rate any stock as a buy/sell and tracks performance against the market. Users can share ideas with fellow users, and keep track of past selections. The platform can also be used to blog and share ideas and opinions about the market, and it aggregates the data so people can review user sentiment for a particular stock.a

Family Office Exchange is a company in the social category that focuses on providing wealthy families (or their agents) with a financial education about how to effectively pass wealth onto future generations. Founded in 1989, the company has become a platform for sharing leading practices in family wealth management. It provides a global online community and listserv that gives members a place to network and have discussions. It also uses the relationship with wealthy families to connect them with advisors when needed.

For major financial institutions, social platforms can be an effective acquisition tool and increase client retention. These platforms can provide access to a wide range of qualitative and quantitative investor data that can be used to better design and target products and services. In particular, private banking arms can transform a client base into a valuable internal network of high net worth clients who have been vetted through Know Your Customer/Anti-Money Laundering processes.

Client/advisor matching

Although some clients want to make their own investment decisions, many would still like to find an advisor that is the best possible match in terms of competence, personal affinity, and/or cost. WM firms are often reluctant to help a client seek out an advisor who is a better long-term match for fear of upsetting the sales force. Digital startup firms have stepped in to fill this gap by building databases of financial advisors and matching engines that use targeted questions to connect clients with particular advisors based on a broad range of factors, including everything from financial needs and preferences to backgrounds and hobbies.

Garrett Planning Network is an example of one such firm. The company, which has been around since 2000, allows individuals to search for an independent advisor in their area and then read about the advisor's experience and background. Any customer can contact an advisor for answers to simple questions or for full financial planning services. The site provides a list of critical questions that customers can ask an advisor to help assess if there is a good fit.

"My Financial Advice" is a business that further automates the selection process by providing a list of initial questions that an individual might ask, and then providing a list of local advisors that can resolve those questions. Prospective customers can learn about an advisor's cost and ratings from previous customers, and can read the advisor's profile to see their certifications and past experience. The platform reinforces the idea of getting independent financial advice from the convenience of home via a telephone or email.

Established WM firms might be able to differentiate themselves by deploying more robust client/advisor matching. Currently, matching is mostly based on proximity and short-term needs (e.g., retirement planning or tax optimization). Enhanced matching could identify commonalities between clients and financial advisors (e.g., personality profiles, backgrounds, interests) that might help foster a long-term relationship.

The matching process is also a prime opportunity to capture additional details about current and potential customers, and could give traditional firms the option of leveraging analytics and big data to improve client acquisition strategies and on-boarding processes, and to better understand and respond to client needs. This analysis could also help financial advisors better understand their market.

Advise

Investors have always been interested in advice about their assets and investments that could help them manage their finances more wisely. But with the move to online platforms, digital interactions have naturally become as an important extension of the overall client experience. Clients today expect their Wealth Managers to provide the same level of experience and ease-of-use as other online businesses, such as Amazon and Google. New analytics technologies enable financial planning and portfolio allocation tools to automatically deliver tailored advice directly to retail customers. Armed with more data from client profiles,

firms can better understand the psychology of the investor. And while a financial advisor might still be the preferred solution, these new technology-driven insights provide investors with a useful amount of automated advice tailored to their unique goals.

Financial Planning

Online wealth management startups have entered this market and successfully attracted financial planning customers by setting up digital storefronts based on well-designed platforms that have a low learning curve. These companies can form a complete picture of a client's financial situation by taking into consideration personal financial goals, risk tolerance, diversification, and/or investment strategies.

Examples of these digital storefronts include Personal Capital and Learnvest. Personal Capital offers an investment platform with multiple options, from tracking and analyzing investments to financial advisor services (for investors with over $100,000 in assets). Account aggregation enables users to monitor their finances as part of a single, integrated dashboard that shows asset allocations, potential portfolio risks, and how different product fees might impact their goals. Personal Capital aims to merge online money management with personalized case-by-case guidance.

It features an integrated dashboard and also provides personal advisors to help investors navigate their financial data and challenges.

Learnvest goes even further by acting as an online coach. The company provides an online tool that helps users track their spending, visualize their budgets, and attain their financial goals. It also facilitates discussions by allowing users and their financial planners to both view the user's dashboard at the same time. In addition, Learnvest offers ten-day boot camps on finance-related subjects such as becoming a parent, shopping for clothing, and navigating one's career. Learnvest also offers financial education by connecting users with Certified Financial Planners (CFPs) who can answer questions and perform complimentary evaluations. For young adults interested in working one-on-one with their assigned financial planner, a variety of service bundles are available to help them accomplish their life goals. CFPs use information about a person's spending habits, budget, and financial goals to offer specific advice and help individuals understand how money, expenses, and debt will continue to affect their lives as professionals.

Portfolio Allocation

Some digital startups offer customized investment portfolio allocations, based a person's unique needs, using pre-defined proprietary algorithms. They also provide user interfaces with interactive controls that dynamically illustrate a variety
of scenarios, making goals-based investing much easier.

Startups that provide tailored portfolio allocation services include Betterment and Hedgeable. Betterment is a relatively new company that offers automated investing to the public. For a monthly fee, Betterment automatically creates a customized asset allocation based on clients' financial goals and then invests their money in a blend of two baskets: Bond Exchange Traded Funds (ETFs) and Stock Market ETFs. Betterment gives clients control over their level of investment risk by letting them adjust the proportion of money invested in each basket.

Hedgeable is an online portfolio management company that provides retail investors with an accessible method of growing their portfolios in fluctuating markets by recommending portfolio allocations. Based on a client's unique profile, the company sends out alerts when a trade is recommended. After executing the trade, risk and performance analytics are both calculated and delivered to the user to provide guidance.

Today, many wealth managers have a robust online presence, and a few firms have already begun to establish online platforms that aim to pair the advisor experience with online details and transparency. However, the remaining firms have an opportunity to leapfrog the competition by delivering advice both to the mass market and to affluent clients that fall below the wealth tier where truly personalized advice is economical. The key is to provide a rich, digital experience that complements person-to-person advisory relationships and increases advisor productivity. Real-time trading ideas and access to market and company research can be delivered by the advisor to enhance the client relationship. Each of these components can also be provided directly to customers online in order to attract investors who are more self-directed.

Invest

In the current low yield investment environment, investors are constantly looking for better risk/return opportunities. In response, startups have emerged that provide mass market access to sophisticated, institutional-like trading strategies. Whether by copying the trading strategies of professional portfolio managers (PMs), or using automated trading strategies developed by hedge fund managers, companies are finding ways to give retail investors access to services that historically have been the purview of institutional or high-net-worth investors.

Startups in this segment fall into two main categories: those offering non-traditional investment strategies, and those offering access to esoteric asset classes.

Non-Traditional Investment Strategies

Startups focused on non-traditional investment strategies offer individuals access to strategies that can help them invest like professionals. Covestor is a company that allows its members to view, study, and mirror the portfolios of professional PMs — and will help match investors to PMs that share their risk tolerance. Covestor offers access to over 150 PMs, and once a client selects a PM, the company will automatically recreate that PM's account with the client's assets and then mirror all subsequent trades that the executed. Covestor earns money by charging a fee based on the assets invested with PMs.

Another company in this segment includes Collective2, which uses trading algorithms originally developed by hedge funds for ultra-high net worth individuals. Collective2 brings a previously exclusive product to the mass market, and is particularly appealing to investors looking for new, complex investment strategies. Additionally, the company will connect investors to a limited number of brokerage firms that provide auto-trading. Investors are charged a monthly fixed fee set by the system developer, plus a flat monthly fee to auto-trade stocks and options.

These investment products could help established wealth management firms capture a larger share of wallet. In general, traditional WM firms already have all of the underlying components needed to address this gap in the market. Their in-house trading desks already design high end strategies and share them with the firm's most profitable clients. Now, firms have an opportunity to market a subset of these pre-defined trading strategies to another tier of digitally savvy customers.

Alternative Products

In addition to gaining access to advanced trading strategies, some investors may want to diversify into exotic asset classes. A number of startups have emerged that offer investors access to investments that were previously unavailable. These startups fall into two types: (1) platforms that allow investors to become creditors and offer direct loans to borrowers for a fixed rate of return, and (2) platforms where investors "crowdfund" a company and own a portion of the equity. Both types essentially serve as a central point for bringing investors together with people that need funding.

LendingClub falls into the first category of direct peer-to-peer lending, and is one of the largest companies in this niche market. Borrowers go on the company's website and, once screened, create a listing with their information, including the desired loan amount and purpose of the loan. Loan investors view the listings and invest in those that meet their lending criteria. Once the process is complete, borrowers make fixed monthly payments and loan investors receive a portion of those payments directly into their LendingClub account. LendingClub makes money by charging a loan origination fee to the borrower and a servicing fee to the loan investor.

In October 2013, the SEC opened private investments to the general public in response to the crowd funding provision (Title III) of the JOBS Act. This will enable startups to reach a much broader investment audience than securities laws used to allow. Although there are still certain limitations based on income and net worth, this law is expected to have a significant impact on firms involved in crowdfunding. Companies such as Crowdfunder provide an online platform for startups to post company information and funding request. Investors can then behave like venture capitalists by funding startups looking for capital. The Crowdfunder website provides key information about each company and shows how much funding is currently committed to it.

Although WM startups have begun to establish a foothold in these new areas, incumbent WM firms can leverage their strong brand names to defend their market leadership and capitalize on emerging opportunities. In particular, they can retain client assets by offering new investment opportunities similar to those described here.

Looking ahead, Title III of the JOBS Act is likely to create new growth opportunities in marketing and financing of startups. Also, there may be a significant opportunity in niche crowdfunding (e.g., there has recently been a surge in websites exclusively focused on the crowdfunding for real estate.

Conclusion

Established wealth management firms have many reasons to care about the new startups, technologies, and solutions that are emerging in the sector. Although WM startups probably won't disintermediate financial advisors for all customer types, they may increasingly poach clients who no longer feel the need to consult with a human expert for basic investment decisions.

Startup firms in wealth management are targeting an evolving set of client needs. These needs are increasingly important for a new generation of clients, and as such are driving fundamental changes for companies in the business of providing financial advice. WM startups are disrupting the industry by democratizing access to tailored advice and non-traditional investments — and mass market investors are embracing the new offerings.

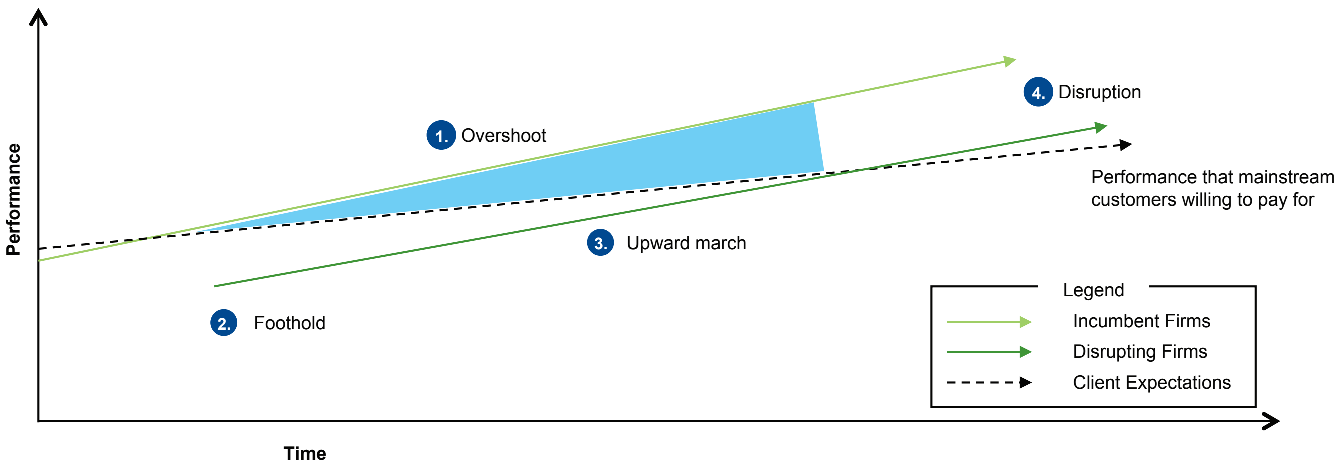
Established WM firms have traditionally focused on the needs of their most profitable (and most demanding) customers. This focus has allowed digital startups to establish a foothold by addressing the simpler needs of customer segments that are less profitable, but also less demanding. In the future, these startups — enabled by emerging technologies — will likely be able to improve and expand their offerings to an ever-increasing audience without sacrificing the economic advantages that allow them to be profitable at the lower-end of the market (Figure 5).

Although this report focuses on wealth management, the findings also apply to other types of financial services. For example, insurance companies and asset management firms have their own unique distribution channels, and some are already expanding beyond the sale of a narrow product range (e.g., life and annuity insurance). Lessons and insights from wealth management can equip these other types of financial services firms with new tools to provide broader investment advice and more effective financial plans.

Many leading financial firms are taking notice of the trends in wealth management and are looking to selectively invest in building similar digital capabilities to broaden their appeal to younger, digitally savvy clients. Account aggregation could help make a firm the advisor of choice in its segment, and provide an entry point for clients looking to change or enhance their portfolios. Client/advisor matching and social platforms can also serve as entry points, and both enable a company to demonstrate to clients that it places their needs first and is willing to provide them with a tailored experience.

All of these tools can be used to enhance the financial advisor relationship — not replace it. By empowering advisors, incumbent firms can deliver a better client experience, address needs that are not currently being met, and capitalize on emerging market opportunities. On the other hand, established WM firms that do not learn from the digital startups and adjust their business models accordingly could find themselves at a significant competitive disadvantage.

Figure 5: While startups may provide a lower performance point, they can grow to disrupt traditional WM firms.



Source: Adapted from Clayton M. Christensen and Michael E. Raynor, The Innovator's Solution: Creating and Sustaining Successful Growth. Boston: Harvard Business School Press, 2003.

Authors

Gauthier Vincent
Principal, Deloitte Consulting LLP
gvincent@deloitte.com

Robert Berini
Director, Deloitte Consulting LLP
rberini@deloitte.com

Rohit Gera
Manager, Deloitte Consulting LLP
rgera@deloitte.com

Contributors

Joshua Skelly
Consultant, Deloitte Consulting LLP