

Pardon the disruption: Online advice a growing threat

Some advisers aren't worried about Web-based services. They should be.

By Andrew Osterland

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Ric Edelman

Internet-based advisory firms aren't much of a concern for most traditional fee-based financial advisers. But they are for Ric Edelman.

The chief executive of The Edelman Financial Group, which manages more than \$9 billion in assets, thinks that technology platforms offering financial advice could become the preferred option for younger Americans who eventually will inherit trillions of dollars from their baby boomer parents.

Equally scary is the possibility that as the digital platforms improve, they will attract more high-net-worth clients who sustain the thousands of fee-based advisers across the country.

Research from consulting firms such as Cerulli Associates Inc. suggests that wealthier investors already have diverted a significant amount of assets to low-cost, self-directed accounts since the financial crisis. The proliferation of online investment services firms has been staggering.

Two years ago

Grant Easterbrook, an analyst with consulting firm Corporate Insight, reported on five online startup firms offering different levels of investment management or financial planning services. His latest assessment covers 37 such outfits.

"The services these firms provide range from investment advice based on algorithms to low-cost online financial advisers focused on either investment selection or financial planning. Their fees are cut-rate," Mr. Easterbrook said.

While few online outfits manage more than \$100 million in assets, and most serve small investors who aren't very profitable for traditional advisers, Mr. Edelman believes the technology they use will have a profound impact on his practice and the entire advisory industry.

WHO IS BEING SERVED?

"This is the direction the world is moving, and we're at the beginning stages of it," Mr. Edelman said. "Technological advances in the next three to five years will have a radical, disruptive impact on financial advice and how it's delivered."

Attracted by a relatively low \$50,000 client minimum, so-called mass-affluent investors have been advisory clients of Mr. Edelman's for a long time. On Jan. 7, however, he opened his doors to all comers, lowering his firm's investible assets threshold to just \$5,000.

His plan is to deliver his services to these low-end customers via a revamped Edelman Online platform he says offers the firm's investment management services without human intervention, though all clients will have access to an adviser if they wish.

Mr. Edelman calls it a long-term loyalty program. "When these customers earn more money and receive their inheritances, they'll give it to me to manage," he said.

Many of his peers think he's wasting his time and money targeting less affluent investors, but Bill Winterberg, founder of FPPad, a technology consulting firm for financial advisers, thinks it's worth the risk.

In fact, firms that don't prepare for the change run the bigger risk, Mr. Winterberg said. "Those who choose not to serve up-and-coming clients will miss the opportunity."

Conventional wisdom, however, suggests the opportunity isn't much to miss. Numerous studies of lower-asset advisory clients indicate that they rarely evolve into bigger, wealthier ones. Bank of America Merrill Lynch research showed that the asset levels of 92% of small clients remained about the same after a two-year period. The company cited the findings when it announced early last year that it was reducing payouts to advisers on clients with under \$250,000 in assets.

Wirehouses as a group continue to push advisers to shed smaller clients, but they're not ignoring them entirely. Merrill Lynch, for example, wants to serve clients with less than \$250,000 — but on its Internet-based Merrill Edge platform, which had \$75.9 billion in assets as of Sept. 30.

The optimistic view of low-cost tech offerings is that they are simply expanding the market for financial advice, reaching customers not currently served. A Society of Actuaries study in 2009 found that there were 14.9 million households in what they term the middle mass market between the ages of 55 and 74. With median net worth ranging from \$111,000 to \$348,000 depending on age and marital status, most of these pre-retirees and early retirees are not receiving financial advice, according to Betty Meredith, director of education and research for the International Foundation for Retirement Education.

Jude Boudreaux, a financial adviser whose company, Upperline Financial Planning Inc., has no minimum asset threshold for clients, believes the growth of online advice platforms is positive for the industry.

"We need more ways for non-high-net-worth people to access professional advice and technology," Mr. Boudreaux said. "I don't think it's a danger to the industry. Technology will never replace what a true financial planner does."

The more ominous possibility is that technology could undermine the economics of the advice industry just as discount brokers did to the brokerage industry and exchange-traded funds are doing to the asset management industry.

The marketing message of these online upstarts is easy enough to understand. "We're for the mass-affluent investor and anyone else smart enough not to want to spend 2% of their assets on a financial adviser," said Jonathan Stein, chief executive of Betterment LLC. Mr. Stein's firm, founded in 2011, serves investors online and charges as little as 15 basis points.

It asks customers a series of questions and recommends simple portfolios of stocks and bonds, depending on the answers. The portfolios can be automatically re-balanced for a little extra. The company doesn't offer tax and estate

planning or insurance, nor does it advise on philanthropic activities or the like — largely because most of Betterment's clients don't have those challenges.

"ROBO-ADVISERS'

That's not financial planning, said Michael Kitces, partner and director of research at Pinnacle Advisory Group Inc. He calls firms such as Betterment and FutureAdvisor “robo-advisers” and doesn't consider them a threat to true financial planners.

“They do what Vanguard and Schwab do. They're just \$2 trillion in assets behind them,” he said.

He sees a more substantial challenge from companies such as Personal Capital, a firm led by former Intuit CEO Bill Harris, and Learnvest, a website initially catering to women that offers financial plans for a flat fee but doesn't manage money. Both firms have increasingly elegant analytical tools and have hired dozens of certified financial planners.

“Financial planning done badly will be under siege by firms like these,” Mr. Kitces said. “If you only deliver passive portfolio design and management to your clients, these business models will take you down.”



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