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5 Questions Most Advisors Aren't Asking When Selecting a Robo

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As debates about Robos continue to rage on, it's hard not to flashback to similar stages for innovations that transformed other industries or daily life. For example, there was a time when social media was viewed as a fad. Some of the early providers in this space didn't last too long (MySpace comes to mind), but other services such as Facebook and Twitter have obviously experienced broad adoption.

Was it critical to embrace first generation social media services? Clearly not, but these first generation services gave consumers a taste of what's possible in the digital world and offered various lessons to learn for future providers to consider. And, has social media replaced in-person interactions when building relationships? Generally not, especially for the more important relationships in one's life.

Advisors and financial institutions should keep these things in mind as they monitor and research the robo space. Given the assets robo advisors have gathered to-date and the rate of growth most are experiencing, it is only prudent to consider a robo strategy. Even if fully automated advice isn't appropriate for your clients or your practice, there is a role for the technology in augmenting your client relationships and improving your operation. Exactly what to do inevitably varies by firm, and it's important not to rush to market with something that may not be right for your clients or practice. The challenge and the opportunity for advisors is to think about how to best meet the current and future investment needs of your clients and how to scale the business at the expense of client service or increased operational risk. In our experience, here are 5 critical questions that advisors should consider as they develop a robo strategy.

What is your value proposition?

Many firms that provide robo technology to advisors also provide investment services directly to consumers. Are your client relationships strong enough and is your value proposition differentiated enough to retain your clients over time? Advisors should be thinking about this as a general matter, but it's even more important if you are going to steer your clients to an external Robo service. Which leads to the next question...

Who owns the client?

Many Robos structure contracts such that they control the advisory agreement and therefore effectively own the client. At the onset, this might seem a trivial matter. After all, many advisors are seeking to use a Robo to service their smallest accounts. But advisors need to consider their long term business strategy when choosing a Robo. Today's small accounts are tomorrow's core book of business. Robos are constantly evolving but it's an important issue to raise during the due diligence phase.

Is the advice being provided consistent with your overall practice and the advice you're providing elsewhere?

With the specter of new DOL rules hanging over their heads, advisors would be wise to carefully scrutinize how Robo will fit into their practices.

Consider the potential contrasts between your largest and smallest clients: Are the capital market assumptions being used consistent, as well as the asset allocations being recommended? Take for instance that you have two clients with similar profiles in terms of their investment objectives and risk tolerance, yet one is served by a Robo and the other is being directly managed by you. If the Robo advisor has a different outlook on emerging markets than you do, this would lead to differences in the asset allocations being recommended to each client.

The same concept goes for the products and securities being used – if not consistent they should at the very least not be contradictory. You might choose to sell out a mutual fund or ETF with an account you're directly managing while the Robo is choosing to buy into those securities for the other. These differing underlying assumptions could drive completely different outcomes for two clients – one portfolio could tank whereas the other might perform particularly well – how would you reconcile this to a regulator and explain it to your client?

Do the Robo solutions offered meet the needs of your clients?

Robo solutions are generally algorithm driven, providing a range of portfolios that are "tailored" to the investor profile and risk tolerance. That's fine on the surface, but they are not all created equal. Advisors need to consider:

- What information do clients desire and how will they access it?
- Is there room for the advisor to provide advice on the portfolio construction for a specific client?
- Does the platform offer sufficient investment and manager options to effectively meet the client's needs?
- Mainly for financial stability — who is the underlying clearing and custody firm?

Are the assets custodied to the Robo account the same place you custody your other accounts?

The answer to this question could have far reaching effects on the time and resources that you allocate towards your reporting function. If the robo does not custody at the same institution as your other accounts, the reports that you and your clients will receive will be different. Statements from Fidelity, are different from statements Betterment produces. It will be incumbent on you to reconcile the differences or explain to your clients why they are receiving two separate reports for your service.

As an increasing number of RIAs and broker dealers consider Robo advisors, it's important to note the ability to achieve these augmented services without necessarily shifting to a purely Robo advisor solution but by embracing platform consolidation. Another of the industry's major trends, platform consolidation enables one platform to manage all accounts, delivering your advice consistently across all channels. The big differentiator among providers is found in the scalability and flexibility of the platform. If a client wants to open an account for a child, for instance, will you maintain a single view of the client's household?

Can the Robo technology effectively integrate with other critical systems?

Integration is the Holy Grail for every solution. Advisors need to gain a clear understanding of the Robo's ability to integrate into other systems, custodial as well as best of breed third party apps that advisors may incorporate into their practices. Integration is especially critical for client reporting, and even more so if a client could have an account managed by a robo and another account managed by you. If you plan to rely on the Robo to aggregate client accounts and drive client reporting, see questions (1) and (2) again…and then consider each yet again.