PRESS RELEASE

A Look Under the Hood 2.0.: Robo-Advice Holds Great Promise but Disappoints on Suitability

27 November 2019 - For years now BETTER FINANCE has been calling for Capital Markets to be returned to their natural participants: European households and EU Citizens as individual long-term savers and investors. Robo-advice could pave the way for their return, provided the platforms abide by EU investor protection rules and comply with basic requirements such as fair, transparent, clear and non-misleading investor information.

Over the last decades individual investors have been gradually driven out of equity markets and pushed into underperforming packaged products. These complex products with multiple layers of high and opaque fees have eroded trust in capital markets, leaving individual European long-term savers with poor returns on their investments and destroying the purchasing power (real value) of people's savings.

Robots to the Rescue

BETTER FINANCE, therefore, has been keeping an eye on the continuous expansion of automated investment advice. In the ongoing environment of low capital market returns these new players could make a real difference on the actual performance of financial advice and investment management.

The rise of robo-advice holds a lot of promise for individual investors, potentially killing two birds with one stone: by allowing EU citizens to invest directly in equities, it brings individual savers closer to the assets they are invested in and the real economy, and by leaving out the middlemen and opting for low-cost index funds, robo-advice can keep prices down.

The success of robo-advice hinges on its capacity to keep costs low. Most providers use a simplified fee model, usually limited to an "advice" fee and underlying fund fees. It is providing better value for money by combining low overall pricing with the use of low-cost index funds which, on average, have over-performed most active funds over the mid- and long-term. But there is a flipside to the coin.

Caution Advised

Although promising in many respects, robo-advice is no silver bullet. Many of the platforms covered in the latest study by BETTER FINANCE on this emerging sector left a lot to be desired in terms of transparency and suitability. Given the relatively low level of financial literacy amongst EU citizens, clear and non-misleading is key, yet many of the platforms are still taking individual investors for a ride:

- In as far as transparency is concerned, the study found important divergences between the platforms as it analysed the degree to which essential information on fees, portfolio allocation, risk and past performance is clearly disclosed. Unfortunately, providing "*fair, clear and non-misleading information*", as required by the Markets in Financial Instruments Directive (MiFID II), is one of the least enforced investor protection rules in the EU. The robo-advice sector is no exception.
- Perhaps even more important than transparency is the suitability of the investment advice provided. The very essence of this emerging industry is to provide individual investors with adapted advice based on information gathered through questionnaires. Worryingly BETTER FINANCE is compelled to issue a warning with regards to the reliability of the algorithms used

to provide so-called "adapted" advice to individual investors. Mystery shopping uncovered very important divergences between platforms with regards to future potential returns and equity allocation and, in many instances, a failure to take risk profiles into account.

Investor Education & Sustainability

Robo-advisors offer a simplified way of investing in capital markets and most platforms provide informative tools that allow investors to better understand the investment process and related costs and risks. Yet, it is important to keep in mind that robo-advisors still deal with products and services that require clients to be financially literate and familiar with certain financial concepts in order to fully understand the products on offer.

"As long as EU Authorities do not ensure comparability, transparency and simplicity of investment products", stresses Guillaume Prache, the Managing Director of BETTER FINANCE, "*no amount of investor education will be able to provide EU Citizens as investors with the necessary tools to make an informed investment choice."*

Disappointingly only a small minority of the robo-advisors covered by the BETTER FINANCE Report also try to keep up with the times and propose sustainable investments. Again, similar worries in terms of suitability and reliability arise, in that the incorporation of ESG factors in the proposed portfolios does not seem to impact potential returns or affecting portfolio performance at all, raising concerns about the methodologies used to determine sustainable asset allocation.

Robo-advice has the potential of being a great financial education tool and fitting vehicle to better inform individual investors about investing in general and sustainable finance in particular. That being said, much more can be done to help investors understand the products on offer and their related risks, especially with regards to sustainable finance, which in most cases seems to have been added as a trendy afterthought.

➔ Report: Robo-Advice: A Look Under the Hood 2.0.

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