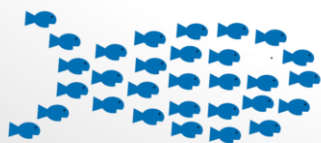




Better Finance response to the ESAs Joint Committee Discussion Paper on automation in financial advice

04.03.2016

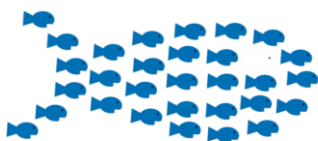
ID number in Transparency Register: 24633926420-79





Better Finance, the European Federation of Investors and Financial Services Users is the dedicated representative of financial services users at European level. It counts about fifty national and international members and sub-member organizations in turn comprising about 4.5 million individual members. Better Finance acts as an independent financial expertise center to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry.

Better Finance is the most involved European end user and civil society organisation in the EU Authorities' financial advisory groups, with experts participating in the Securities & Markets, the Banking, the Occupational Pensions and Insurance and Reinsurance Stakeholder Groups of the European Supervisory Authorities; as well as in the European Commission's Financial Services User Group. Its national members also participate in national financial regulators and supervisors bodies when allowed. For further details please see our website: www.betterfinance.eu



Executive Summary

The Joint Committee of the European Supervisory Authorities has recently issued a discussion paper on “automation in financial advice”. This is quite appropriate, since what is also known as “robot advice” is an emerging trend, first appearing in the US about 5 years ago and now slowly coming to Europe.

Better Finance – the European Federation of Investors and Financial Services Users – took a closer look at a sample of these new providers, both in the US and in selected EU countries (Belgium, France, Germany, UK): see annex I for the list of providers researched.

The research concentrated on the products on offer as well as prices (see Table in Annex II). The data collected can be examined in the attached tables. This limited research did not, and could not, analyse the algorithms used by these providers, nor the adequacy of the asset allocations designed and advised to clients. It is of course too early to evaluate the adequacy of the services provided, as investments are still very recent.

The following are the key findings of the research.

1. “Robot advice” in the field of investments: a misnomer

A European legal definition of investment advice can be found in the MiFID Directive: (Article(4)(1)(4)) *“Investment advice’ means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments.”*

All the providers we researched are indeed providing investment advice under this definition, although the degree of personalisation is debatable: all the providers ask the prospects/clients to fill out a questionnaire on their needs, on their tolerance to risk or on their risk appetite, and often on their existing financial situation, assets and debts. But quite a few of the providers researched then direct customers to a rather limited number of predefined investment strategies or portfolios: three only in the case of Vamoo (Germany), five for Money on toast (UK) and ten for Yomoni (France). Can it really be considered to be a “personal” recommendation when the



customer is merely placed in a limited number of pre-defined categories? Actually, the UK and the French providers are duly registered as financial advisors, but the German one is not.

But they are also all also providing asset management services, since they typically implement the personal recommendations provided to their clients by executing the investments proposed and accepted.

In fact, several of the providers researched are registered as asset management companies with their National Competent Authority, or partner with an asset management company.

Therefore, terms such as “robot investing” or “robot investment management” would designate this emerging business more appropriately.

2. Simpler, lower and more transparent fees, but still usually asset-based

As shown in the table in annex II, most “robot” providers display a much simplified fee scale, often a single “all-in” fee, or just two fees: “advice” and fund fees. There typically are no other fees such as entry fees, custody fees, transaction fees, performance fees, wrapper fees, etc. which are often to be found in standard “human” financial advice and private banking services. Fund fees are not always disclosed in the presentation of the robot services but their existence on top of the advice fee is usually mentioned.

The generally far simpler and more transparent¹ fees from robot investing are also much lower than fees charged by “human” financial advisors or private bankers:

- between 12 and 99 “basis points”² (fund fees included) in the US (between 0 and 89 bps for advice plus 10 to 17 bps typically for underlying fund fees)

¹ Traditional advisers and private bankers rarely disclose the total fees charged (including all types of fees, not only advice)

² A basis point or « bp » is one hundredth of one percent. 100 bps = 1%



- between 69 and 169 basis points (fund and wrapper fees included) in Europe, with much more recent and smaller providers (between 49 and 100 bps for advice plus 19 to 69 bps typically for funds).

This compares very favourably with traditional overall fees charged by financial advisors and private bankers that are typically far above 100 bps when one includes underlying asset management fees. This difference has a very important impact over time on the actual performance of financial advice, especially in an environment of low capital market returns. It can indeed make the difference between protecting the purchasing power (the real value) of people's savings and destroying it.

The basis for charging fees, however, remains traditional: it is asset-based, not performance based. This still constitutes a limit to a better alignment of interests between providers and clients. There is a notable exception though: the French robot adviser "Marie Quantier" has developed a rather revolutionary and investor-friendly fee model: € 5,90 fixed per month plus 5% of annual gains.

3. A fee-based model in Europe: a way for low cost index funds to enter the European retail market and for ending conflicts of interests in distribution?

One striking common feature shared by nearly all providers³ researched is the investment tools they use. They almost exclusively use low cost index funds, predominantly ETF ones. This is actually the principal tool to reduce overall costs and fees, not only the automation technology itself. For instance, instead of using typical "active" retail equity funds (with average annual fees around 70 basis points in the US, and 170 basis points to 180 bps in Europe) they use only low cost index equity funds (most often the "ETF" – exchange traded funds – type), which charge from 5 (US) to 40 bps for developed country equities.

This generates huge fee savings especially in Europe due to the much higher fund fees there. One reason for these higher fees in Europe is the still dominant commission-based distribution model in Continental Europe. This is why the low cost index ETF market still only represents about 10% of the retail market in Europe

³ All except Money on toast (UK) which uses low cost index funds extensively but not only, and Vaamo (Germany) which exclusively uses Dimensional (a US fund manager) funds: active funds that are quantitatively managed and are much cheaper than ordinary active funds, although a bit more expensive than ETFs.



versus 50 % in the US, since ETFs provide distributors with no or only very small commissions. All the robot providers researched in Europe seem to be fee-based instead of commission based. The fee based model has a very important advantage: it massively reduces the issue of conflicts of interests in the retail distribution of financial products. They exclusively use index ETFs and little else. “Robot advice” is one of the few retail distribution channels in Continental Europe to promote and advertise index ETFs to citizens. Better Finance sees this as a real benefit should “robot” investing develop a significant market share.

4. Overall “robot” investing fees still much higher in Europe than in the US

For example, one French offer stands at 1.60% overall annual fee (including asset management and other fees), which is most probably quite a bit cheaper than traditional private bankers or financial advisers, but still three to six times more expensive than the US leader for example.

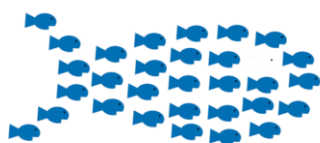
Of course, size matters to cover fixed costs and most European robot-investing providers are still in start-up mode. But this also reflects other findings from Better Finance⁴ and others⁵ indicating that investment-related fees are much higher in Europe (for example, fees 2 to 2.5 times higher for equity investment funds on average). In turn, this is linked to the fragmentation of the European markets and to the lack of product standardisation as well as insufficient competition.

Also, in France, overall fees are increased by the use of costly wrappers⁶: another fee/cost layer is added by wrapping the investment funds into unit-linked insurance contracts for tax reasons. This adds 60 bps per annum to the pricing of Yomoni for example. Better Finance research on the real return of long term and pension savings found that French unit-linked contracts have on average been one of the worst performing long-term financial savings products over the last 15 years in Europe, mainly due to the very high multi-layer fees (2.75% per annum on average

⁴ For example: “ [Pension Savings: The Real Return](#)”, September 2015 edition, Better Finance

⁵ [Study](#) on the performance and efficiency of the EU Asset Management Industry, IODS for the European Commission’s Financial Services User Group (FSUG), October 2014

⁶ In the UK, Money on toast does propose a wrapper (ISA) but with no wrapper fee.



for life insurance contracts invested in equity funds⁷). It seems the tax advantage granted to life insurance unit-linked products in France is more than totally captured by providers, to the detriment of retail clients.

5. Supervision by Public Authorities

Nearly all providers researched were duly registered as financial advisors in their respective jurisdictions like traditional, non-automated financial advisors. In addition, as mentioned above, many are logically also registered as asset managers or have a contractual relationship with a registered investment company.

The German provider is an exception. Vamoo claims that they are not providing investment advice or asset management services but rather act as an investment intermediary, an agent placing clients' money with their product partner on an execution only basis. The law seems to require for them to submit to Bafin (the German financial watchdog) supervision and the trade supervisory centres (which by the way also control restaurants, bars etc) are the entities in charge of their supervision. Up to now, there seems to be no court case to challenge this classification and we are not aware of any issues raised by Bafin or the trade supervisory centres.

Therefore, and contrary to some critics of “robot” advice, we could not really spot a weaker regulatory framework for automated financial services when compared to traditional financial advice, except for in Germany⁸. Better Finance recommends for the European regulators to more precisely define “investment advice”, and more specifically “personal recommendations”.

We could not, however, test the adequacy and performance of the advice itself, i.e. of the algorithms used. First, because most providers lack the sufficient track record in terms of years of operation, second because the advice is usually fully personalised⁹, and third because they – like most standard advisors – typically do

⁷ 1,60% only for Yomoni thanks to the exclusive use of low cost index funds

⁸ But another German robot advisor, Scalable Capital, is supervised by Bafin because they offer asset management services.

⁹ Not always though: Money on toast seems to offer only five different standard risk-adjusted portfolios, and Yomoni ten.



not disclose performance yardsticks¹⁰.

6. Simple investment advice: “robot” advice does not replace the need for more customised advice

All providers researched mostly offer portfolio advice based on standardised questionnaires. For one, two quite different stated objectives – “regular income” and “retirement” delivered the exact same portfolio advice. The investment management is not always fully personalised as indicated above, as some robot advisers seem to allocate all prospects and clients to a pre-determined and rather limited number of standard portfolios. In that case, the value added compared to risk-adjusted balanced funds or to life cycle funds (for retirement needs) seems more or less limited to the selection of the portfolio/fund, and most often regular rebalancing (but life cycle funds typically do that as well).

There is little taking into account of more complex situations (like varying income needs for example), of tax optimisation, asset/liability management (debt issues), or generational issues, etc. In our view it does not fully replace a face-to-face interview relationship and more customised advice that goes beyond the asset allocation and the selection of investment products for quite simple time horizons.

However, these findings have to be balanced by the fact that several robot investing providers offer the possibility to speak to an adviser over the phone or electronically, in particular for the assessment phase.

Anyway, asset allocation and investment product selection are still an important part of the value generated by financial advice, and “human” financial advisors could most probably benefit from expanding their own use of automated tools.

7. Conclusion

Robot investing is still at a very early stage – especially in Europe - but it does carry some real promises for savers and individual investors.

¹⁰ Money on toast does disclose the historical returns of its five portfolios.



Below:

Annex 1: List of “robot” providers researched

Annex 2: Offerings and fees – USA

Annex 3: Offerings and fees - Europe



ANNEX 1

BELGIUM

EASYVEST

<https://www.easyvest.be/>

FRANCE

YOMONI

<https://www.yomoni.fr/>

MARIE QUANTIER

<https://mariequantier.com/>

GERMANY

VAAMO

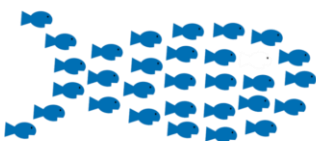
<https://www.vaamo.de/> & <https://www.vaamo.com/>

UK

MONEY ON TOAST

<https://www.moneyontoast.com/>

NUTMEG

<http://www.nutmeg.com/>

ANNEX 2

	US		
	BETTERMENT	WEALTHFRONT	PERSONAL CAPITAL
			FUTUREADVISOR
ASSETS UNDER MANAGEMENT	\$3 billion	\$2 billion	\$695 million
NUMBER OF CLIENTS	125,000	355,000	12,600
ANNUAL FEES (% IN \$ OR €) - DETAILED	Annual fee of between 0.15% and 0.35% of assets under management, assessed quarterly. Those with at least \$100,000 invested will pay 0.15%. This includes commissions, but not individual securities' fees. Investors with a balance less than \$10,000 and who deposit less than \$100 per month will be charged a \$3 monthly flat fee.	Wealthfront manages the first \$10,000 for free. After that, the company charges 0.25% per year on amounts over the initial \$10,000, assessed monthly. Customers aren't charged trading commissions, but will pay fund expense ratios.	Personal Capital charges one, all-inclusive fee of between 0.49% and 0.89% of assets under management. Customers with less than \$1 million invested will pay 0.89%, and, for assets above \$1 million, fees decrease progressively toward 0.49% above \$10 million.
ANNUAL ADVICE FEES- €/€10,000 INVESTMENT	0,35%	0,00%	0,50%
ANNUAL ADVICE FEES IF INVESTMENT 100,000 €/€	0,15%	0,25%	0,50%
PRODUCTS AVAILABLE	Financial Planning, Retirement, IRAs, Trusts, Tax Loss Harvesting	Individual accounts, Joint accounts, trust accounts, IRAs, 401k rollovers	Retirement planning, college savings, investment tax management
UNDERLYING INVESTMENT FUNDS	Equity & Bond ETFs (index funds)	Equity & Bond ETFs (index funds)	Equity & Bond ETFs (index funds)
TYPICAL UNDERLYING REGIONAL OR NATIONAL EQUITY INDEX FUND	Vanguard U.S. Total Stock Market Index ETF (VTI)	Vanguard U.S. Total Stock Market Index ETF (VTI)	Vanguard S&P 500 ETF (VOO)
UNDERLYING FUND ANNUAL FEES	0,05%	0,05%	0,05%
AVERAGE UNDERLYING FUND FEES	0,11% estimated average	0,12% estimated average	0,17% estimated average *
TOTAL ADVICE + MGT FEES FOR 10,000 €/€:	0,46%	<u>0,12%</u>	0,67%
TOTAL ADVICE + MGT FEES FOR 100,000 €/€:	<u>0,26%</u>	0,37%	0,67%
Legal Status	Betterment.com is operated by Betterment LLC, an SEC Registered Investment Advisor. Securities products are offered to clients of Betterment LLC by Betterment Securities, a registered broker dealer and member of FINRA/SIPC.	Wealthfront Inc. is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended. Wealthfront does not provide personalized financial planning to investors, such as estate tax, or retirement planning.	FutureAdvisor Inc. ("FutureAdvisor") operates an online financial advisor at www.futureadvisor.com (the "Site") and is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.
SOURCES	support.betterment.com/customer/portal/articles/934265	research.wealthfront.com/whitepapers/portfolio-review/	www.personalcapital.com/assets/whitepapers/PC_Fees_WhitePaper.pdf



ANNEX 3

	UK	FRANCE	GERMANY	BELGIUM
MONEY ON TOAST				
ASSETS UNDER MANAGEMENT	£150 million	?	Completed 1st fundraising round of €2.5 mln	€2.5 million
NUMBER OF CLIENTS	5,000	?	250 (in 2014)	20
ANNUAL FEES (% IN \$ OR €) - DETAILED	There is a 1% annual management charge, plus underlying fund charges of 0.69% = 1.69%	All-inclusive fees of 1.6 per cent per year, including: Yomoni management fee (0.7 per cent), life insurance fee (0.6 per cent) and underlying portfolio costs (exchange-traded fund fees of 0.3 per cent). You can invest from 1000€.	From 1000€ up to 30,000€ (0,99%) - From 30,000 up to 50,000€ (0,79%) - More than 50,000€ (0,49%)	5,000€: FREE 5.001-24.999€: 1,00% 25.000-49.999€: 0,90% 50.000-99.999€: 0,75% 100.000-249.999€: 0,60% 250.000€: 0,50%
ANNUAL ADVICE FEES- €//\$10,000 INVESTMENT	1,00%	0,7% + 0,6 life insurance fee	0,99%	1,00%
ANNUAL ADVICE FEES IF INVESTMENT 100,000 €//\$	1,00%	0,7% + 0,6 life insurance fee	0,49%	0,60%
PRODUCTS AVAILABLE	Investment, ISAs, Pensions	Savings, retirement, real estate project and transmission	Savings and Investments	Savings and Investments
UNDERLYING INVESTMENT FUNDS	Broad range of funds including unit trusts, OEICs and ETFs (index funds)	Equity & Bond ETFs (index funds)	Equity & Bond ETFs (index funds)	Equity & Bond ETFs (index funds)
TYPICAL UNDERLYING REGIONAL OR NATIONAL EQUITY INDEX FUND	Vanguard FTSE 100 UCITS ETF	Amundi ETF CAC 40	Dimensional Funds (Global Core Equity Fund)	iShares MSCI ACWI ETF
UNDERLYING FUND ANNUAL FEES	na	0,30%	0,38%	0,33%
AVERAGE UNDERLYING FUND FEES	0,69% covers all underlying fees	0,3% covers all underlying fees	Ranging from 0,38% to 0,48% depending on risk-based portfolio	na
TOTAL ADVICE + MGT FEES FOR 10,000 €//\$:	<u>1,69%</u>	1,60%	1,41%*	1,33%
TOTAL ADVICE + MGT FEES FOR 100,000 €//\$:	<u>1,69%</u>	1,60%	0,91%*	0,93%
Legal Status	Money on Toast® is a registered trading name of CN Investment Management LLP and is fully authorised and regulated by the Financial Conduct Authority, (no.) 579506, registered in England and Wales, no. 07972042.	Yomoni, registered under number 811 266 170 in the Register of Trade and Companies of Paris, is authorized as an investment management company by the A.M.F. (Autorité des Marchés Financiers).	Vaamo Finanz AG has permission according to § 34f para. 1 no. 1 of the Industrial Code (GewO) to provide investment advice and investment brokerage of investment fund shares. Competent licensing and registration authority: Chamber of Commerce Frankfurt	Easyvest SFRU is authorized and regulated by the Belgian Financial Services and Markets Authority, no. FSMA 114522 CB as agent in banking and investment for Leleux Associated Brokers.
SOURCES	www.moneyontocast.com	www.yomoni.fr	www.vaamo.com	www.easyvest.be
2016 Copyright © Better Finance				
* Calculations based on medium fee of 0,42%				
** Assuming a 5% annual nominal return				