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SCHWAB

Gaining
perspective
on automated
investing



Own your tomorrow[®]

Executive summary

Automated investment management is one of the most important new trends independent advisors are considering at the moment. The rise of these offers is fueled by a convergence of factors, including evolutions in technology, new market entrants, and the increasing preference among consumers for conducting business online. Many of these solutions target mass affluent investors, who typically fall below the account minimums of most RIAs.

But as more robust automated platforms become available, many advisors are considering how they might leverage this new technology within their firms, either to help them serve smaller accounts more efficiently or to extend their reach to new clients and market segments.

For the moment, most advisors are still researching options to help them assess the pros and cons of using an automated solution in their business. No matter how, or even if, your firm chooses to make these solutions part of your offer, gaining greater understanding of the trend is essential. Knowing how it could affect client expectations and the industry as a whole can help prepare you for the automated investing future and is an important part of your due diligence in addressing changing client needs.

As you develop your strategy to succeed, build scale, and serve new and existing clients, we hope the ideas and considerations you find here will help you make the right choices for your firm.

Over the next few pages, we'll discuss:

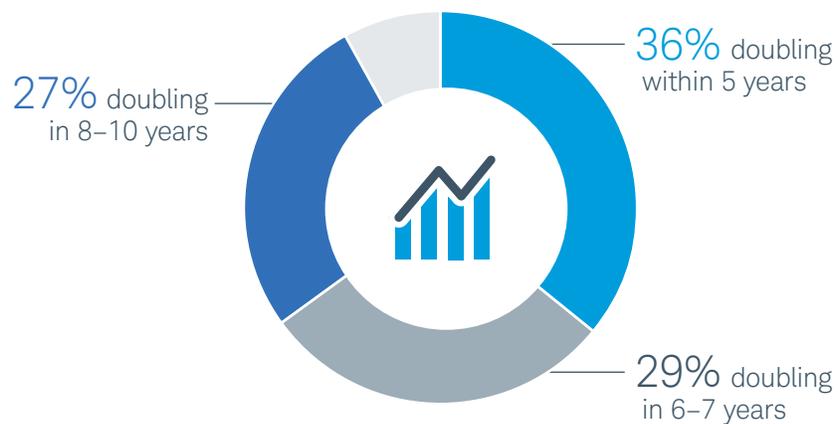
- How changing industry, technology, and investor preferences are increasing the demand for automated solutions
- The types of automated investment management solutions that are available
- How choosing the right solution could enhance firm efficiency and potentially open up new opportunities
- Some of the questions that advisors should ask when considering a digital solution
- Additional resources that can help with the decision-making process

The changing landscape

The investment landscape has evolved over the decades, and RIA firms have tended to benefit from these changes. From 2004–2014, the RIA industry as a whole enjoyed a 10% annual compounded growth rate.¹ In fact, 36% of firms participating in Schwab's 2014 RIA Benchmarking Study doubled in size within just the last five years, with another third doubling over a six- or seven-year period.²

As your firm has grown, you have probably seen a significant increase in the number of clients you serve and the number of accounts you manage. While that's a good problem to have, it can put a strain on your staff, making it hard to efficiently scale your services and operations to handle the increased demands. In fact, we often hear from advisors that increasing efficiency is one of their top goals for their firms.

Schwab Advisor Services™ clients on track to double assets since 2009



Fueling future growth

In addition, participants in the annual Benchmarking Study tell us that one of their chief priorities is maintaining growth. But the clients you serve are aging. Our annual RIA Benchmarking Study tells us that the average RIA client is 59 years old. And with almost 40% of firms' clients retired and another 30% nearing retirement, an increasing percentage of the client base is drawing down on their portfolios.³ This means that, even as these clients' assets are diminishing, their needs for complex services like income and estate planning can place increasing demands on a firm's attention and resources.

Seeing this change, many advisors are focused on developing a plan to identify new opportunities and clients that will fuel future growth.

This is where younger investors could become an important factor. According to a 2014 Cerulli study, investors age 30–45 control \$3.5 trillion in investible assets.⁴ And that figure is expected to grow as they inherit assets in the coming years.

Considering that the entire RIA industry currently manages assets of \$4 trillion,⁵ this unprecedented transfer of wealth could clearly present a great opportunity for growth. But to be successful, RIA firms may have to evolve their current business models, technology, and services to serve this new client base.



Changes in investor mindset

Younger investors are a great opportunity for RIAs to consider, but they may have needs and expectations different from those of the clients you're serving today. These investors came of age in the digital era and likely expect a rich, technologically enabled experience using the same devices they rely on in the rest of their lives. According to Schwab's 2014 Generation Now research, younger investors are looking for a deeper relationship with someone who knows them as an individual, is open to collaboration, and is easily accessible through a variety of channels, including texts and emails.⁷ Phone calls and face-to-face meetings alone are not enough.

Of course, new expectations aren't limited to younger investors. All of us have had experiences in our personal lives that have reshaped our preferences and perceptions about service. Whether it's ordering shoes online, calling for a car with an app, or catching up with friends and family through social media, our assumptions regarding responsiveness, personalization, transparency, and access are much higher than they were even five years ago. For example, 93% of ultra-high-net-worth investors use mobile devices to check their account balances and info, and 65% use them to research their investments.⁸ While these elements may once have seemed nice to have, they are now must-haves in the world of financial services.

Fortunately, many fundamental attributes of RIAs are likely to appeal to both today's typical RIA client and emerging investors, a combination that provides the greatest opportunity for growth. So really, the opportunity lies in finding the right technology and tools to help you improve efficiency and deliver the outstanding experience that clients, both existing and new, are looking for. For many firms, automated investing could be an important part of their strategy.

As investor mindset changes, remember to:



Be
open



Be
knowledgeable



Be
available

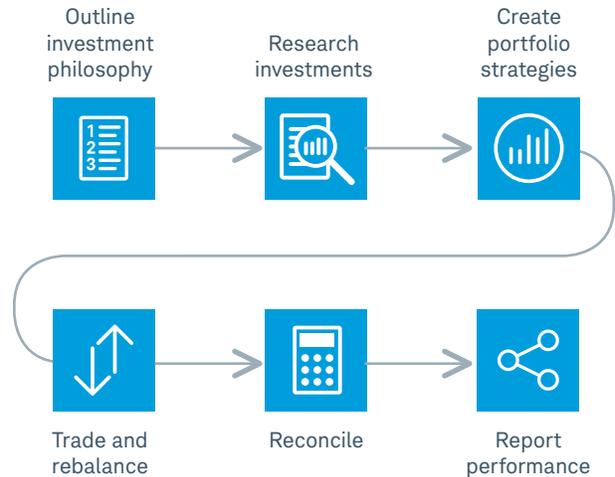
Putting automated investing in context

As you start to consider automated solutions, be sure to think of them in the context of your broader strategy, which should encompass your firm's plan for developing and enhancing offer segmentation and technology. A comprehensive, forward-looking strategy will likely embrace a variety of channels and approaches.

When considered as part of your strategic plan, you may find that automated investing could be a great tool for helping to attract, serve, and retain new clients. It provides a scalable, technology-rich experience that meets many clients' expressed desires while allowing you to serve more cost-effectively. Of course, it's not necessarily a one-step solution, but it can form an important part of an evolving service offer.

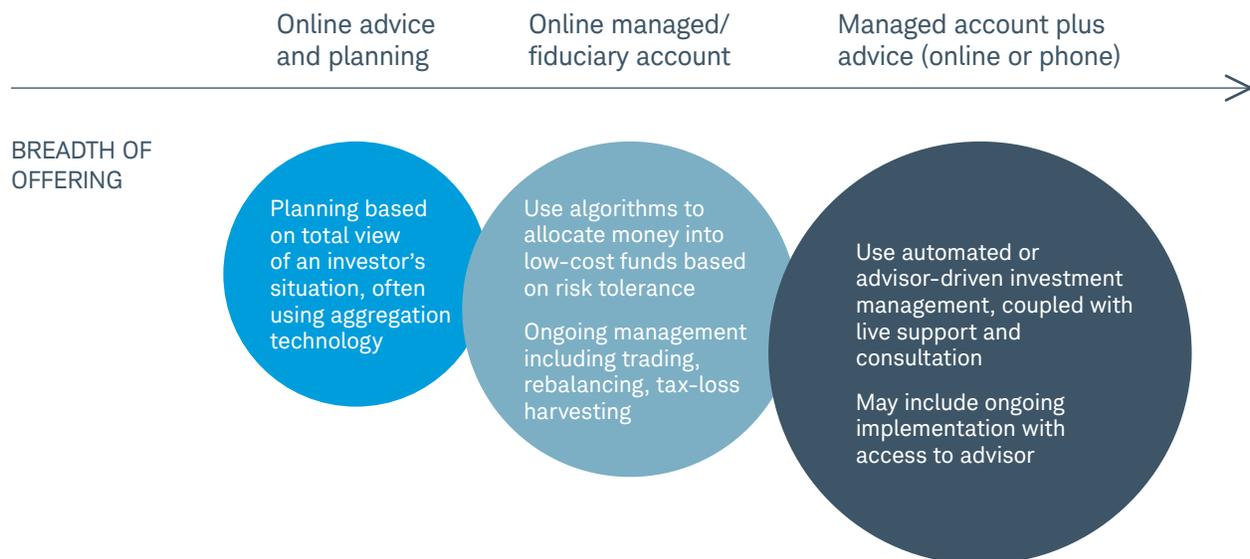
So what are people referring to when they talk about automated investing? That answer turns out to be more complex than it might appear. When you look at all the players in the broader automated or digital investing marketplace, there's a large and varying list of providers. It's a young category, but it's growing rapidly. In fact, according to Envestnet, the leading automated providers grew their assets by more than 65% between April and December of 2014.⁹

Technology and investment management



There are a variety of available solutions advisors can leverage to streamline and automate some—or all—steps in the process.

The breadth of available automated investing solutions



When we dig a bit deeper to understand the different options, we find a number of very distinct types of solutions whose capabilities, approach, and features vary significantly. They represent a spectrum ranging from those narrowly focused on a single component of financial management to others that are far more comprehensive. Beginning on the one side:

- Starting with the most narrowly focused providers, they begin with a specific goal in mind—planning, for example—and develop an online experience to deliver those precise capabilities. They often include some sort of account aggregation, providing self-directed investors with the opportunity to get more input and insight into their financial lives without the system actually handling any direct investment or turning over management of their accounts to an advisor.
- In the middle of the spectrum are providers that offer a platform that uses algorithms to allocate money into (usually low-cost) ETFs, typically based on an asset allocation that the solution provider has derived. These offers often provide online management, including automated trading, rebalancing, and sometimes tax harvesting.
- As you move to the far right of the spectrum, offers become more holistic. While delivering resources and tools through an automated platform, these providers add a component of advice to the offering—and in some instances that advice may be provided by humans.

Of course, building relationships remains the foundation of any successful RIA business—but the nature of those relationships may be changing. Consider this in light of your own experiences over the past few years. You may have noticed your clients coming into the office more informed yet still wanting your advice to help make decisions.

Keep in mind that across the spectrum of the available automated investing solutions, you have different business models and levels of maturity. Most are focused exclusively on business-to-consumer models, though a few have begun modifying their tools to appeal to advisors and other professionals.

Now on the horizon you see more robust, customizable solutions that may help to address some of the most pressing needs advisors are looking for in an automated investment platform. Ideally, solutions designed for advisors would provide:

- Customization features, letting you design portfolios to reflect your investment philosophy
- Co-branding or white-label solutions
- Integration with your current technology
- The ability to serve clients more efficiently and cost-effectively
- An enhanced client experience that delivers convenient 24/7 access and information

Potential benefits of automated investing

While many of those who seek out these solutions are younger than the average, the reality is that automated investing can appeal to investors of all ages. Regardless of age, common sense tells us that any value-conscious investors with an interest in passive investing and a focus on technology would likely consider these offers.

So how can the right automated solution help you attract and serve these clients? According to the 2014 Charles Schwab Independent Advisor Outlook Study, nearly half of respondents could envision automated portfolio management helping them serve smaller clients more efficiently. In fact, many advisors see younger and smaller investors as the main beneficiaries of an automated investment solution.



In addition, automated investing could help you:

- Build relationships with children and family members of current clients so you're positioned to capture intergenerational wealth transfer when it happens
- Provide a more cost-effective way to serve clients you have taken on as an accommodation or favor to support an existing relationship
- Explore and test options for evolving your business model without disrupting your current client service
- Attract new segments using a more streamlined, tech-enabled version of your current offer, or potentially even launch a distinct new business line designed to serve new client segments
- Offer a way to build and develop your firm's talent by giving less experienced or new-to-firm advisors a way to work with clients and build their relationship skills via an automated system

Before moving forward, it can also be helpful to validate some of your assumptions with some real-world testing, using your own clients as an informational resource. Consider taking the following steps:

- Ask clients with adult children about their plans for their future investments.
- Survey clients and prospects about their digital preferences.
- Make a short list of available solutions you'd like to investigate or validate that could help to automate your investment or portfolio management process.
- Assess what impact, if any, an automated investment management platform would have on your firm's value proposition, service and segmentation approach, and fee structure.
- Network with other advisors at industry or Schwab events to share ideas and best practices.

Questions to consider

As you start to evaluate options, it's good to begin with some broad, high-level questions to help you consider the opportunity and your firm's readiness to capitalize on it. While not comprehensive, the following list of questions provides some examples of what you might ask yourself:

- Have we turned away clients who could have been a good fit with our service model if we had been able to reduce the cost of serving them?
- Can we increase the number of profitable relationships we have by identifying ways to serve smaller clients more efficiently?
- Are we currently serving clients who are below our account minimum (perhaps family and friends of current clients)?
- Would we be interested in expanding our team by adding a new advisor whose typical account size is below our firm's account minimums?
- Am I open to taking on younger investors with smaller portfolios but high potential as a way to fuel future growth?

Part of a holistic plan

Trillions of dollars in investable assets are currently held by—or are on the verge of being transferred to—younger generations. In addition, investors in these (and other) age ranges are interested in new technologies and desire on-demand access to information.

There is a tremendous opportunity for RIAs to capture a piece of these markets. And automated investment management could offer a flexible solution to help advisors serve these clients in increasing numbers, and do so more efficiently and profitably.

But while there's no doubt that automated investing can be a powerful tool, it's not a panacea. No single set of capabilities is right for all advisors. The models and structures incorporated by various automated investing solutions vary widely and may need to be customized to meet the needs and interests of a firm, its business model, and its clients.

Whether or not you plan to adopt this technology, automated investing is clearly an attractive option for some investors. The key is to develop a holistic strategy for how your firm is going to evolve its technology and client experience to meet the demands of the next generation of clients. By looking at your technology, your approach to segmentation, your service offer, and the client experience you deliver, you can gain a realistic perspective on how—or whether—solutions like automated investing can help your firm reach its goals.

56% of advisors believe
automated investment management
could supplement their current offer
and help grow their business.¹¹



Resources

Schwab is always working to develop new solutions that can help your firm and clients. We're currently building technology capabilities and partnering with leading providers to offer you a range of options to enhance your client experience and improve the efficiency of the investment management component of your practice.

Below we've outlined resources available to help you think through the impact that automated investing and other technology and client service trends will have on your business.

Schwab Insights Hub™	Explore this site to find the tools and insights you need to build your strategy and plan.
What's New page in Schwab Advisor Center®	Stay up to date with technology and solutions, from the latest enhancements on the Schwab platform to new integrations with leading providers.
Institutional Intelligent Portfolios® website	Learn more about this automated investment management platform for RIAs.



For illustrative purposes only.

Institutional Intelligent Portfolios offers:

- Robust ETF portfolios—designed by you
- Sophisticated, advisor-branded digital experience for your clients
- Automated rebalancing, tax-loss harvesting, and client onboarding
- Unmatched value, competitively priced to help you grow and serve clients efficiently
- The strength and support of the industry-leading custodian: Schwab

Tax-loss harvesting is available for clients with invested assets of \$50,000 or more in their Institutional Intelligent Portfolios account. Clients must be enrolled to receive this service.

Accounts must maintain a minimum balance of \$5,000 to be eligible for automatic rebalancing.

Brokerage Products: Not FDIC-Insured • No Bank Guarantee • May Lose Value

Institutional Intelligent Portfolios® ("IIP") is a technology and service platform made available by Schwab Performance Technologies ("SPT") to independent investment advisors ("Advisors") who maintain a business relationship with Schwab Advisor Services™, a division of Charles Schwab & Co., Inc. ("Schwab"). IIP is used by Advisors to provide their clients with an automated investment management service. Schwab, a registered broker-dealer and member SIPC, provides custody, trading and support services. Brokerage products, including the Schwab One® brokerage account, are offered by Schwab. SPT and Schwab are separate companies affiliated as subsidiaries of The Charles Schwab Corporation, but their products and services are independent from each other.

1. Charles Schwab 2014.
2. Charles Schwab 2014 RIA Benchmarking Study.
3. 2014 Independent Advisor Outlook Study by Charles Schwab.
4. Cerulli Lodestar 2012.
5. Charles Schwab.
6. Charles Schwab.
7. Charles Schwab Generation Now Study for RIAs.
8. Spectrem's Millionaire Corner study, Q2 2014, *Using Social Media and Mobile Technology in Financial Decisions*.
9. Robo Strategies, Karen Lanzetta, Director of Market Research, Envestnet, 3 Feb. 2015.
10. Charles Schwab 2014 RIA Benchmarking Study.
11. 2014 Independent Advisor Outlook Study by Charles Schwab.

Important disclosures

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The Charles Schwab Generation Now Study for RIAs was conducted for Schwab Advisor Services by Egg Strategy, a strategic research firm. The study, which was released in 2014, included 40 participants, men and women ages 30–45 with earned or inherited investable assets of \$500,000 (excluding real estate and business holdings) or a household income of at least \$150,000. The term Generation Now reflects the immediate opportunity that this incoming cohort of high-net-worth investors may represent for RIAs. All data was self-reported by participants and not validated or verified. Egg Strategy is not affiliated with or employed by Charles Schwab & Co., Inc. Investors participated in this study between March 24, 2014, and April 11, 2014.

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