Position Paper

EBA consultation of automation in financial advice

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Page 1

Federal Association
for Information Technology,
Telecommunications and
New Media

Steffen von Blumröder
Head of
Banking, Financial Services & FinTechs
P +49 30 27576-126
s.vonblumroeder@bitkom.org

Albrechtstraße 10
10117 Berlin
Germany

President
Thorsten Dirks

CEO
Dr. Bernhard Rohleder

Bitkom represents more than 2,300 companies in the digital sector, including 1,500 direct members. With more than 700,000 employees, our members generate a domestic turnover of 140 billion Euros a year, exporting high-tech goods and services worth another 50 billion Euros. Comprising 1,000 small and medium-sized businesses as well as 300 start-ups and nearly all global players, Bitkom' members offer a wide range of software technologies, IT-services, and telecommunications or internet services. They produce hardware and consumer electronics or operate in the sectors of digital media and the network industry. 78 percent of the companies' head-quarters are located in Germany with an additional amount of 9 percent in other countries of the EU and 9 percent in the USA as well as 4 percent in other regions. Bitkom supports an innovative economic policy by focusing the modernization of the education sector and a future-oriented network policy.

Introduction

Bitkom welcomes the opportunity to answer the EBA Discussion Paper on automation in financial advice. We believe that the regulatory framework in the European Union provides an adequate environment for business and innovation in the area of e- and m-commerce, including payments. EU legislation on data protection, financial regulation and consumer rights, is among the most advanced globally, and serves as examples for many countries around the world that want to achieve similar market integration, innovation and prosperity. We strongly support the initiative to foster a single European market for retail banking and protection of consumer interests. We are certain that the prospect of economic reward is the key driver for innovation.

The pace of development in new financial services has increased significantly with the development and increasing prevalence of the internet and more recently multi-functional smart phones. The evolution is still ongoing and any final scenario cannot be predicted. We therefore insists that any regulatory interference deemed necessary must not disrespect regulatory neutrality.

I. Consultation questions

1. Do you agree with the assessment of the characteristics of automated financial advice tools presented in this Discussion Paper? If not, please explain why.

   Yes, Bitkom fully agrees
   Note: The vast majority of automated financial services platforms do not offer specific recommendations to customers based on their clients individual information but rather provide a very easy and simple process that allows the customers to decide on their own. I.e., they operate either as "execution only" models or with a discretionary portfolio mandate.

2. Are there any other relevant characteristics of automated financial advice tools?

3. Are you aware of examples of automated financial advice tools being used in the banking, insurance, and/or securities sectors? Please provide examples, giving details of their operating process.

   Two examples:
   Robo Advice: questionnaire based assessment of investment goals and risk appetite that concludes in an investment recommendation

   Buying Life Insurance: questionnaire based assessment of the client situation and occupational status followed by health self-assessment concludes in an indicative quote that is subject to submitting an independent health check

4. Do you offer/are you considering offering automated financial advice tools as part of your business model? If so, please briefly describe: i) what type of entity you are, e.g., long established, start-up, a product provider, an intermediary; ii) the service you provide (e.g. to what extent do you integrate human interaction in the tool you provide?); iii) the nature of your clients; iv) your business model; v) who developed the automated tool (i.e. an external company or developed internally?); and vi) the size of your activity and/or forecast activity?

   As the leading industry association in the digital sector we represent most robo advisors in Germany and some of the leading players in Europe (e.g., vaamo, fairr.de, scalable capital, moneymeets).

5. Do you consider there are barriers preventing you from offering/developing automated financial advice tools in the banking, insurance and securities sectors? If so, which barriers?

   Regulation makes it sometimes very difficult to provide advice for investment products online while at the same time diverging regulation on insurance products makes life even more complicated (pension products in Germany can be regulated as investment products or insurance products with different consequences for financial advice, although from a customer's perspective they are all pension products)

   i) Startups can currently not advise clients on investment products. They can only provide support to their own decision making process because
   ii) German legislation is geared towards human advisors and foresees a written protocol and extensive documentation to allow potential recourse in cases of misselling. Hence if advice is provided, the advisor has to generate a protocol and have it signed by the client. This is not possible on an online platform. Also the protocol requires much more information than is needed to actually create a recommendation for the customer. Bitkom believes that this is out fashioned these days.

6. Do you consider the potential benefits to consumers to be accurately described? If not, please explain why.

   Yes, we believe this is the case.
   Automated financial advice will give a much broader segment of people access to fair, unbiased advice and cost-efficient products. An interesting scientific paper that will appear in the Journal of Finance soon, shows dramatically how financial advisors do not offer real individual financial advice to their clients but rather act on their own preferences: Retail Financial Advice: Does One Size Fit All? (Foerster, S. et al: http://www.nber.org/papers/w20712)

   Transparent automated solutions have the opportunity to overcome these structural shortfalls in our current system.

7. Are you aware of any additional benefits to consumers? If so, please describe them.

   i) Most robo advice platforms do not receive any kick backs or retrocessions form product providers as its common in the branch/human based system. Thus, incentives of consumers and product providers are properly aligned as provision-driven sales people are cut out of the supply chain.
   ii) Products are built for empowered and informed consumers

8. Do you see any differences in the potential benefits arising for consumers in each of the banking, insurance and securities sectors?

   No

9. Have you observed any of these potential benefits to consumers? If so, please provide examples and describe the kind of benefit that has accrued.

   These benefits are the core value proposition of the new business models. Many of the new players try to simplify complex regulated products to the point where clients are empowered to make decisions without the help of an advisor.

10. Do you consider the potential benefits to financial institutions to be accurately described? If not, please explain why.

    Yes

11. Are you aware of any additional benefits to financial institutions? If so, please describe them.

    Yes. Additional benefits arise from
    i) building products to suit the online process
    ii) integrating live customer service with online advice and content

12. Do you see any differences in the potential benefits arising for financial institutions in each of the banking, insurance and securities sectors?

    No.

13. Have you observed any of these potential benefits to financial institutions? If so, please provide examples and describe the kind of benefit that has accrued.

    Yes.

    B8: set up the marginal costs of client onboarding towards 0
    B10: the customer experience is consistent and improves incrementally with each bit of customer feedback that gets implemented in the process
    B11: before go-live every client facing process is subjected to a legal audit. There is no requirement for ex-post sampling in order to ensure the quality of delivery

14. Do you agree with the description of the potential risks to consumers identified? If not, explain why.

Partially agree. Many risks seem exacerbated.

In our opinion you describe very well the general risks with regard to financial advice, no matter whether this advice is provided offline or online. In fact, many examples of all of the described risks have been observed in the offline world over the last years and decades. So far, there are no such examples from automated financial services. The latter is obviously due to the fact that it's a rather new phenomenon. Hence, we do not agree that these risks are higher for online businesses as you describe in paragraph 48/49. In fact, we believe that a lot of these risks are actually lower due to a much higher degree of transparency and traceability.

An automated online process is by its very nature standardised and transparent. It is therefore under public and expert scrutiny, which will be reflected in blogs, message boards and press articles. On the other hand, matters of compensation and legal small print are rarely if ever addressed in an offline situation.

R1: We observe that most online services make a much bigger effort than traditional advisors to present the necessary information in a suitable and easy to understand way. They use also different media to do so, e.g., websites, videos, blogs, infographics. Most services offer a customer service via phone, mail and chat – so customers can actually ask questions if they need further information. In addition, customers of such online services often seek advice from peers or independent blogs in the internet. These possibilities are not available to this extent in the offline world.

R3: In the internet such potential biases are uncovered much faster than in the offline world (e.g., through websites that track customer experience such as www.bankingcheck.de or www.ekomi.de or through blogs and independent services like www.finanztip.de), where these biases are absolutely common. In addition, the vast majority of current business models do not receive any kickbacks and as a result have less potential conflicts of interest than traditional models.

R5: We are currently not aware of such fragmented models as described here. This would also be against current regulation as the regulator requires that the customer knows who is his/her counterpart. All these business models require some kind of license, which also goes along with annual audits. Thus, this scenario seems unlikely to us.

R8: Mistakes can and do also happen in the offline world. We believe that due to the higher numbers of users potential errors will be unveiled much quicker on an automated online platform. Its also worth mentioning that correct algorithms produce reliable and constant correct advice, whereas the quality of human advice varies.

R10: In fact, many customers tell us the opposite: they often feel under pressure to make a decision before they are ready with an advisor sitting next to them. "Time to think things through and no advisor who pressures me to sign" is a benefit mentioned by a lot of customers of Robo Advisers.

R11: this proposition appears out of scope as the consumer is ultimately responsible for actions taken in his name

R77: it is our opinion that independent advice is- and will be available at a cost. From a German perspective, your proposition reflects the fact that "free advice" has been confused with effective selling, resulting in a perception that sophisticated human advice is, in fact, free of charge.
A similar argument is often brought forward with regard to ETF investments. As to our knowledge there is no scientific evidence for this. Also, volumes of assets managed by automated platforms are so tiny compared to the overall asset management industry that such an influence is not likely in the coming years.

R78: In Germany, we observe that more and more banks do not offer advice any more for customers with less than 50.000 Euros investable assets because its unprofitable mainly due to high regulatory cost. Robo Advisors are actually a big opportunity to provide advice to this big and otherwise neglected customer segment.

15. Do you consider there to be any risks to consumers missing? If so, please explain.

A tool may provide the right advice, yet frame a purchasing decision in such a way as to incentivize a consumer towards a certain product.

16. Do you see any differences in the potential risks arising for consumers in each of the banking, insurance and securities sectors?

Yes.

Whereas many financial products tend to be – often by definition - limited in their downside risk, leveraged transaction in securities and betting on spreads or contracts for difference can expose the customer to potentially unlimited losses.

17. Have you observed any of these risks causing detriment to consumers? If so, in what way?

No.

18. Do you agree with the description of the potential risks to financial institutions identified? If not, explain why.

    Most of the risks described seem to be generic and can be applied to any new product and technology. They are therefore not really relevant in this context.
    R15: we have not observed this risk

19. Do you consider there to be any risks to financial institutions missing? If so, please explain.

    Yes.
    If a product is provided to an online intermediary by a partner institution on a contractual basis it is unclear what happens when the contract between the partner and the online provider is altered or discontinued or one of the parties to the contract faces liquidation. In such cases it is conceivable that the online intermediary is held liable but has no ability to provide the service itself, or that the providing partner does not hold the capacity to service the client according to the terms of the existing product.

20. Do you see any differences in the potential risks arising for financial institutions in each of the banking, insurance and securities sectors?

    No.

21. Have you observed any of these risks causing detriment to financial institutions? If so, in what way?

    No.

22. Would you agree with the assessment of the potential evolution of automated advice? Please provide your reasoning.

    Partially agree.
    i) the potential effect of building products to suit the online channel has been omitted. We believe that a lot of market potential resides in simplifying and commoditizing products to the point at which they can be easily explained and fitted to a customer's need through an online process. This is particularly true for non-life insurance.

23. How do you think that the market for automation in financial advice will evolve in the near future in the banking, insurance and investment sectors? Please also provide details of any relevant data or information to support your views, where available.

i)Automated support in distributing financial products of any sort is bound to grow, regardless of whether these products are of a stand-alone type or support a human advisor. This is because automation enables best practice to be deployed consistently.
ii)The market place for consumer facing fin-tech solutions is currently fragmented. We are likely to see either a consolidation, or the rise of integrators competing to be the single or preferred channel through which the customer accesses the products he owns.
iii)We are likely to witness increasing breadth and complexity of the platforms offered. New players are likely to include payroll, tax services, accounting and bookkeeping, complex actuarial calculations in combination with corporate pension services and the substitution of proprietary insurance data by data monopolies such as google into the insurance value chain.

24. Are there any other comments you would like to convey on the topic of automation in financial advice?

It would be desirable that legislation acknowledges automated advice as a new and different form of distribution, and not as an extension of the human sales and advice channel.