Another Challenge Lies Just Around the Corner

A plan advisor’s best defense against robo-advisors is being an expert on robo-advisors.

Plan sponsor fiduciaries constantly stand toe-to-toe with plan-related risk. They address it every quarter by serving on investment committees, each year by signing a Form 5500 and whenever they select — or choose not to select — a plan service provider.

In most of those instances the risk arrives packaged as a known risk, and there are safeguards available to share or mitigate that known risk. But another kind of risk is approaching the doorstep of every plan sponsor — and it will be arriving soon. This impending risk will bring an additional and potentially catastrophic risk for retirement plan advisors. The source of this additional risk is the robo-advisor. The manufacturers of the risk fall into two major categories: disrupters (new entrants) and established industry stalwarts who have more to lose than they stand to gain.

Where the Industry Sits Today

It is a rare occurrence where industry professionals exhibit compassion for regulators of their industry; however, this may be one of those times. In the last 10 years, federal regulators have seen their sandboxes littered with technology, in the form of Internet websites, chat rooms, social media, high-speed trading and now the robo-advisor.

In an industry where change used to occur at the speed of cold molasses, technology has lit a fire under the wingtips of our regulators. Regulators now play catch-up instead of staying abreast of the industry. Today’s environment is a bit more exciting to observe, but it is significantly more painful to experience (e.g., Bernie Madoff, the UBS rogue trader Kweku Adoboli, Lehman Brothers).

In an industry where regulators seem to perpetually wear the black hat, they have been tasked with keeping one foot on the gas and one foot on the brake, embracing technology in search of faster, cheaper and better solutions while navigating today’s roadblocks and impediments.

Plan Sponsors Need to be Vigilant

The robo-advisor community has initiated contact with plan sponsors across the country. Those of us who have the opportunity to speak with plan fiduciaries are fielding questions along the lines of, “How can a robo-advisor really make a difference with a small plan like ours?” or “I have read a little about them; would a robo-advisor make sense for our plan?”

Plan sponsors are reading about robo-advisors; they are discussing the concept with trusted advisors (other than their current advisor); retirement committees are now being asked to investigate the merits and drawbacks of using robo-advisor technology; and plan fiduciaries and retirement plan committees are being approached by robo-advisor firms.

Plan sponsors struggle with who is actually managing the funds in robo-advisor arrangements. The robo-advisor Form ADV is difficult to comprehend. Plan sponsors are experiencing great difficulty in calculating the actual fees within the robo-advisor structure. Currently the communication of fees and the understanding of same is not even close to where it needs to be. (A recommendation: view at least three robo-advisor ADVs to obtain hands-on experiential data points of your own.)

Plan Advisors Stay Active and Educated

Marketing and sales pitches in this segment are polished. This is the time that many advisors have been anticipating — not welcoming, but anticipating. In most cases, low fees will be the bait, along with efficiency, technology and simplicity. Unfortunately, if a robo-advisor professional engages an advisor’s current client, then the plan sponsor may truly have a fiduciary duty to “listen” to what is being sold. A retirement advisor’s challenge is to remain at least two steps ahead of whomever may be approaching the plan sponsor client.

The first step is a retirement advisor’s need to inform clients about the impending onslaught of the robo-advisors entering the industry over the next three years due to the low barriers of entry and the ambiguity of what exactly constitutes a robo-advisor. (Rest assured: A large number of start-ups will occur from 2016 to 2018.)

The second step is becoming an expert in what constitutes a robo-advisor. Consider this a topic for discussion at future quarterly trustee or investment meetings. A retirement plan advisor’s best defense against robo-advisors is being an expert on robo-advisors.

Look at robo-advisors the same as target date funds, emerging growth funds or plan design. Make sure clients learn of the existence of robo-advisors from their human advisor. Otherwise, the client will hear the robo-advisor declare emphatically, “I’ll be back!”

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