CAN ROBO-ADVISORS ENHANCE SAVERS' DECISION-MAKING?

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Robo-advice is booming. Xavier Collot and Marie Brière provide an update on the new opportunities that it offers. Recent research on the investment behaviours of almost 80,000 employees who have been offered a robo-advisor's services for their company savings plan, have shed light on its benefits in propensity to save, investment decisions (diversification and rebalancing) and investment returns. Less well-off employees, who are the least likely to have access to traditional advice, benefit even more from robo-advice. These encouraging findings suggest that the automation of financial advice could promote financial inclusion.

The robo-advisor market is booming. Could you remind us what these new services offer and what their development outlook is?

Xavier Collot A robo-advisor is a digital tool offering personalised recommendations in portfolio choices. The robo-advisor market is indeed booming, with assets under investment expected to reach 1,400 billion dollars by the end of 2021 (up from just 100 billion dollars in 2016), split among more than 70 million users worldwide, according to Statista. By 2025, this market is likely to expand by about 20%[1]. Although robo-advisors' penetration rate is still low, they are likely to continue growing in the future, particularly among young generations, and in emerging market countries.

At Amundi, we introduced **a robo-advisor for our employee savings plans in August 2017**. The robo-advisor works simply and transparently. It starts by questioning savers on their objectives and preferences (investment horizon, risk appetite, etc.), then offers them a portfolio allocation matching their needs. If the client accepts the proposal, the robo-advisor implements the recommended allocation. An important feature of Amundi's robo-advisor is that, over time, it sends out e-mail alerts if the portfolio allocation moves too far from the targeted allocation. The robot then suggests that the employee connects to the platform and rebalances the portfolio, to move back closer to the target allocation. So, it is the saver, advised by the robot, who makes the final decision on reallocating his/her portfolio. We thought it was important that individuals keep control of their investment decisions over time.

Why do savers need help in their investment decisions?

Marie Brière Today, savers have to make increasingly complex financial decisions, but many of them are not well prepared to do so. Scientific research has found that **retail investors' investment decisions are riddled with biases**, including low participation in the equity markets, low diversification of investments, familiarity biases (home bias, etc.), that are often due to the lack of attention that individuals pay to their savings and their low financial literacy.

[1] *https://www.statista.com/outlook/dmo/fintech/personal-finance/robo-advisors/worldwide*

Xavier Collot In such cases, **financial advice is key**. In more than seven cases out of 10, retail investors consult with a human advisor to buy financial products, whether in Europe or the US[2]. But in practice, human financial advice has its limits. It is expensive and research has shown that it can be biased. For example, young people and women are often less well served by their financial advisor.[3] The boom in robo-advice is therefore being driven by several imperatives: (1) **to reduce costs** and serve clients better, particularly less well-off clients, who are less likely to receive financial advice; (2) **to improve the client relationships** through greater personalisation of offers; (3) possibly **to take part in clients' financial education** by offering them a chance to experiment over time with the robo-advisors' recommendations.

Do you expect the promise of robo-advisors to be kept?

Marie Brière In a recent research project[4], we analysed the investment behaviour of a sample of almost 20,000 users of the robo-advisor that Amundi introduced into its employee savings plans, compared to 60,000 non-advised clients, split into several test samples. Our findings show that after using the robo-advisor, employees save more and are more inclined to diversify their investments and to invest more in equities. An important finding is that most savers trust their robo-advisor and follow its recommendations, rebalancing their portfolios to keep their allocations closer to the target that the robot suggests. These enhanced choices give them higher risk-adjusted returns. In particular, **implementing a systematic rebalancing policy, a practice that is common with sophisticated institutional investors but seldom used by retail investors, is highly beneficial to their performance.**

It is also important to note that **these effects tend to be greater for investors with smaller portfolios and who are therefore less likely to have access to traditional advice.** These encouraging findings suggest that automation of financial advice can promote financial inclusion.

While our research is the first to highlight the importance of implementing of a systematic rebalancing policy for retail investors, robo-advising's favourable impact on financial inclusion has recently been highlighted on the US market[5]. Researchers looked into the impact of reducing the minimum investment required by a major US robo-advisor. They found that lowering this minimum from $5000 to $500 significantly raised the participation of "middle class" savers in the service, with a significant impact on the portion invested by savers in equities, and a beneficial impact on their performance.

Xavier Collot The fact that the robo-advisor's effects tend to be greater precisely for those investors who are the least likely to receive traditional advice and to take part in the equity markets, is an important finding for us. This confirms that **access to automated advice can be a key instrument in promoting financial inclusion**. Recent research has shown that the dynamics of long-term wealth accumulation and widening of inequalities are heavily affected by the fact that the wealthiest individuals obtain the highest returns on their investments[6]. It is therefore remarkable that automated advice can at least in part mitigate this general picture.

[2] *Inderst, R. and M. Ottaviani (2012). "Financial advice" Journal of Economic Literature 50-2: p. 494-512.*

[3] *Mullainathan, S., M. Noeth, and A. Schoar (2012). "The market for financial advice: An audit study" NBER Working Paper No. w17929.*

[4] *Bianchi M. and M. Brière, "Robo Advising for Small Investors: Evidence from Employee Savings Plans", Amundi Working Paper N°112-221. https://www.amundi.com/int/Local-Content/News/Robo-Advising-for-Small-Investors-Evidence-from-Employee-Savings-Plans.*

[5] *Reher, M. and Sokolinski, S. (2020), `Does fintech democratize investing?', Available at SSRN.*

[6] *Bach, L., Calvet, L. E. and Sodini, P. (2020), `Rich pickings? risk, return, and skill in household wealth', American Economic Review 110(9), 2703-47.*

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