Appendix 1

Market trends and regulatory developments

Latest available data testify that automated advice is becoming increasingly popular. At the end of 2019, assets under management (AuM) referred to robo advisors are estimated to exceed, at a global level, 980 billion dollars, with the average investment around 21 thousand dollars.[1] It is also expected that the AuM referred to automated advice, thanks to an average annual growth rate equal to 27%, will reach 2,552 billion dollars in 2023, when the total number of customers served should exceed 147 million of investors.

Currently, the U.S. market is the most mature, with almost 750 billion dollars of AuM (as of 2019) and 200 active operators (as of 2017), followed by the Chinese market (179.4 billion dollars) and the United Kingdom market (14.8 billion dollars), both with a number of operators equal to 20 (Burnmark, 2017).

With reference to the Italian market, it is estimated that in 2019 the assets managed by robo advisors exceed 400 million dollars (with an average investment equal to little more than 12 thousand dollars per customer), while the average growth rate expected between 2019 and 2023 is around 51%.[2]

Regulatory developments and international experiences

The growing spread of robo advice, especially in the Anglo-Saxon countries, has prompted the institutional debate on its cost and benefits and on the initiatives that should be undertaken in order to balance investor protection with technological innovation.

International institutions and several national authorities recognise that, together with some potential risks, robo advice might bring benefits to both industry operators and investors. The European Supervisory Authorities (ESAs, 2015 and 2016) and the International Organization of Securities Commissions (IOSCO, 2016 and 2017) highlight the contribution that the automation of advice may offer in terms of:

1 Data are available at the following link: https://www.statista.com/outlook/337/100/robo-advisors/worldwide.

2 The number of operators active in the sector in 2017 was five (Burnmark, 2017) or six (Lener, Linciano and Soccorso, edited by, 2019), depending on the classification criteria used.

greater financial inclusion, as costs and capital thresholds needed to access the service are lower compared to those set for the traditional advice; the reduction of the advice gap; increased competition made possible by the greater comparability of services and products distributed by several providers, also in the international arena.

Some jurisdictions (including Canada, Australia, the United States and New Zealand) have already regulated the phenomenon with the common goals of creating an environment conducive to innovation and increasing the certainty of the regulatory framework, while preserving market integrity and investor protection.

The Canadian Securities Administrators and the Australian Securities and Investments Commission have issued guidelines called, respectively, Guidance for Portfolio Managers Regarding Online Advice (CSA, 2015) and Regulatory Guide 255, Providing digital financial product advice to retail clients (ASIC, 2016), which provide detailed guidance to digital advice providers without introducing new regulatory requirements, in line with the principle of technological neutrality of the legislation. The U.S. Securities and Exchange Commission, after the Fintech Forum of November 2016, published some suggestions to help robo advisors meet disclosure, suitability and compliance obligations under the Investment Advisers Act of 1940 (SEC, 2017). Finally, the Financial Markets Authority of New Zealand has introduced an exemption allowing entitled entities to provide personalised services to retail clients where those services are distributed through a digital platform (FMA, 2018).

As for Europe, in implementing the MiFID II/MiFIR package, the EU legislator and ESMA have also taken into account the implications of robo advice. Given the technology-neutrality principle characterising the existing regulatory framework, ESMA (2018) issued certain 'particularly relevant' guidelines for firms providing automated advice that supplement the existing regulation (Paracampo, 2018).

In the UK, the Financial Conduct Authority (FCA) has also published a call for input for an updated assessment of the impact of the Retail Distribution Review (RDR) and the Financial Advice Market Review (FAMR), both directed at raising the benefits that investors may gain from investment advice. The assessment was aimed at ascertaining whether the supply of financial advice meets the current and potential needs of different segments of customers and whether the conditions for overcoming the advice gap are met (FCA, 2019a). The call for input takes up the results of an interim consumer research on the ability of the providers of automated, low cost advice to partially replace the traditional service and reduce the advice gap, by reaching out also those financial consumers who do not currently rely on human advisors (Ignition House and Critical Research, 2018).

Financial advice in Italy in the light of current technological developments

The supply side

Over the last decade, the supply of financial advice has evolved significantly in Italy. Since 2009 the number of domestic operators offering the service has gradually decreased, following the consolidation processes that have long been underway in the financial sector. As the categories of operators entitled to supply financial advice widened thanks to regulatory innovations (beyond banks and investment firms, also asset managers as well as financial advisors, independent and financial advice firms were included), different business models have been developed differing by the level of customization of the service, the target of customers served and the remuneration structure of the professionals involved.

Services range from basic to advanced advice (Sabatini, 2012). The basic advice, generally intended for the mass market and not remunerated autonomously, consists of personalised and specific recommendations referring to a limited range of products, typically issued by the bank; customers using this service usually interact with different professionals and not with an advisor specifically dedicated to them. The so-called advanced advice is an integrated, articulated and highly personalised service for the so-called private segment (i.e. High Net Worth Individuals - HNWI - and Ultra High Net Worth Individuals - UHNWI), remunerated either through fee-only or fee-on-top or performance fees; in this case, customers refer to a specific dedicated advisor holding technical and relational skills.

In this context, robo advice is beginning to take its first steps. The major traditional banks are progressively automatizing processes related to one or more phases of the advice value chain, heading for the (total or partial) automation of the so-called 'last mile', i.e. the processes of customer profiling and asset allocation. In some cases, the bank is interested in using distribution channels other than the traditional one and/or in exploiting technological innovation in order to allow human advisors to remain focused on the relationship with the client (Lener, Linciano e Soccorso, edited by, 2019).[3] In addition to traditional banks, automated advice is also supplied by some stand-alone companies, differing by the extent of automation. In particular, by mid-2017, in Italy six hybrid robo advisors were providing a B2C (business to consumer) service, combining human support with digital features either along the whole value chain or in one or a few phases only. In addition, in the same period three robo4advisors were providing a B2B (business to business) model targeted to traditional advisors.

3 The survey in Lener, Linciano and Soccorso (ed., 2019) involved ten traditional banks (universal groups or network banks, representing more than 50% of assets under management in Italy by mid-2017) and nine robo advisors.

The hybrid B2C model places a high value on the 'human' relationship, by allowing investors to choose whether to combine the web channel with the interaction with the human advisor and to receive assistance in the phases preceding and following the investment (from the conclusion of the contract to profiling, from the elaboration of the investment recommendation to the possible execution of orders and the rebalancing of the portfolio). Recommendations by Italian robo advisors typically refer to model portfolios (i.e. portfolios consisting in classes of investment products – mainly Exchange Traded Funds-ETF and mutual funds - with different levels of risk referable to different investor profiles) and in general, do not include products of the banking group which the robo advisor may belong to.

Pricing and accessibility of the service are confirmed as critical success factors with respect to the service provided through non-digital channels. As of the first half of 2017, commissions applied to assets under robo advice range between 0.3% and 0.7% per annum (additional cost components may include performance fees and/or subscription commissions for recommended products), much lower than those of human advice.[4] This makes robo advice potentially very competitive, particularly if the low willingness to pay of Italian investors is taken into account. As for the accessibility of robo advisors' services, investors can operate online without time limits or logistical constraints.

As for the target reached by robo advisors, while in the international experience customers mainly belong to the so-called Millennials' generation, in Italy investors relying on online platform are mainly aged between 40 and 60 years, medium-high income male, and familiar with investment choices: in particular, in many cases they are individuals who have already invested with a bank and are accessing the digital channel to test its functionality and convenience (see par. 3.3). However, this evidence cannot be considered conclusive since it concerns a rather small sample of investors, being robo advice not yet widespread in Italy.[5]

4 According to BlackRock (2016), on average, the fee required by robo advisors for a balanced mutual fund is about 130/180 basis points lower than that required by a traditional intermediary.

5 In 2017, two robo advisors reported about 3,500 and 10,000 clients respectively (corresponding to approximately 160 and 200 million euros in assets under advice), while the remaining four still had an extremely small number of clients (less than 50; Lener, Linciano and Soccorso, edited by, 2019). According to the most recent data available for Italy on the Statista portal, in 2019 the AuM would have exceeded 400 million euro.

The demand side

Italian investors are characterized by a low propensity to use financial advice. According to data from the CONSOB Observatory on the investment choices of Italian households (hereinafter referred to as the Observatory), 20% of investors turn to an expert or to a portfolio manager, while around 40% prefer to rely on the advice of relatives, friends and colleagues (informal advice) or choose mainly autonomously (CONSOB, various years).

Among the most relevant drivers of the demand for advice and of the choice of a specific advisor, expert's skills play a central role, followed by trust and the word-of-mouth. Lack of trust is the main deterrent to entrusting a professional, followed by the belief that the service is not necessary (because the amount to invest is small) and the inability to assess the characteristics and added value of the service (CONSOB, various years).

The knowledge of the distinctive features of the advice service is actually not widespread. According to CONSOB Observatory, most investors do not know the characteristics of the service or the obligations that intermediary offering investment advice have to comply with. Moreover, 37% of the interviewees are convinced that the service is free, 45% do not know whether the advisor is paid, while about 50% of the investors are not willing to pay for the service (CONSOB, various years).

Finally, a CONSOB mirroring survey of a sample of advisors and their clients shows that the opinions of advisors and investors on some of the key features of the investment decision are frequently characterised by a certain degree of mismatch, which can affect both the expectations and the perception of the added value of the service by the investors themselves (CONSOB et al., 2018).

With specific reference to automated advice, data from the CONSOB 2016 Observatory indicate that 87% of savers are not familiar with the concept of robo advice and that only 15% of them are willing to use it once they have learned its characteristics (mainly men, subjects with high levels of education and financial literacy and young people). Most recent surveys show that interest is increasing, but confirm concerns about online fraud. To this regard, as shown by mirroring surveys (CONSOB, 2017 and 2018), digital champions such as Google, Amazon, Facebook, Apple (he so-called GAFA), may hold a strong competitive advantage, as they have long gained reputation for efficiency and reliability in the field of social networks and e-commerce (see also par. 3).