Will Robo-Advisors Eat the Big Banks' Profitable Lunch?

Description

It's no secret that Canadians pay a hefty premium when saving their money. Mutual funds often come with fees of 2%+ per year, among the highest in the world. Registered accounts often come with administrative fees. And if you want to trade stocks yourself, you may still end up paying $25 per trade.

For this reason, the wealth management industry is ripe for disruption. Enter the so-called robo-advisors, who are providing us with a lower-cost alternative. So, what exactly do robo-advisors do, and how worried should banks like **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) be?

What do robo-advisors do?

To put it simply, robo-advisors provide a technology-based solution for investors, one that is simple and low cost. All told, investors should expect to pay between 0.6% and 1% in fees every year.

How is this possible? Well for one, robo-advisors use exchange-traded funds, rather than mutual funds. So, robo-advisors don't need to pay anyone to pick stocks. They also don't need to compensate an investment advisor, since asset allocation is done automatically.

Why the banks should be worried

Banks simply can't offer this kind of product. They rely on big fees from mutual funds to support their portfolio managers and wealth advisors, not to mention their expensive branches. And mutual funds typically aren't able to outperform exchange-traded funds. So, there's very little stopping robo-advisors from taking the banks' business.

Why the banks will be fine

Let's not get carried away here. The banks still have the upper hand in the wealth management industry for a number of reasons.

To start with, investors often have a strong relationship with their financial advisor. These relationships often last for many years, and breaking this relationship is very difficult.

Secondly, Canadians generally trust their banks, and for good reason. They are viewed as big, stable, money-making machines. They've been around for more than a century. They're subject to strict regulation. And even if they fail, they'll probably get bailed out.

Robo-advisors are much newer and are viewed as a riskier option. In actual fact, there really isn't any increased risk. All your savings (up to $1,000,000) are protected through the Canadian Investor Protection Fund, and robo-advisors can't use your money to cover their operating expenses. Yet this trust gap may be too hard to overcome.

But there's another reason why the banks will be fine: a lack of transparency. Too many Canadians simply don't realize how much they're being charged for investing their money, and don't understand how much they can save by switching to a robo-advisor.

So, if you're investing in a Canadian banks' shares, you shouldn't concern yourself with robo-advisors. But if you're investing in their mutual funds, then robo-advisors are certainly worthy of your attention.

CATEGORY

1. Bank Stocks
2. Investing

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1. Editor's Choice

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1. NYSE:RY (Royal Bank of Canada)
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Date
2025/07/21
Date Created
2015/06/04
Author
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