Robo Advisor Adoption in Korea: Current State and Implications

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Korea has seen many robo advisors come on the market since 2016. However, unlike earlier expectations, the rise of robo advisors has not acted as a catalyst to the proliferation of wealth management services, thus doing little to contribute to the facilitation of the wealth management market. Regulation of non-face-to-face transactions involving robo advisors has been often cited as one of the reasons why robo advisors fall short of their expectations. This makes robo advisors currently in the market come down to the following characteristics: First, robo advisors focusing on non-discretionary investment management dominate the market. Second, many robo advisors are partnering with banks or securities firms. Third, there are only a few independent robo advisors. Fourth, robo advisors are widely used as distribution channels for financial products. With significant regulatory improvements in 2019, robo advisors are allowed to directly enter into discretionary investment management with their clients in a non-face-to-face setting, and to manage fund or discretionary mandate assets entrusted to them. Consequently, robo advisors are expected to better serve their intended function as a wealth management tool. This calls for securities firms to consider how to make the most of robo advisors so as to enhance their capabilities of retail financial services, keeping up in the era of digital finance.

Since Korea's first test bed for robo advisors was launched in September 2016, robot advisors have been adopted by a number of banks, securities firms, asset management firms,

∗ All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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investment advisory firms and so on. However, unlike earlier expectations, the rise of robo advisors has not acted as a catalyst to the proliferation of wealth management services, thus doing little to contribute to the facilitation of the wealth management market. Against the backdrop, this article examines the adoption and characteristics of robo advisors in Korea, and then puts forward their prospects and implications.

Robo advisor adoption in Korea

Nine banks, nineteen securities firms, two asset management firms, and five investment advisory firms as of June 30, 2019 have launched robo advisors offering investment advisory or management services.[1] More than seven technology firms provide robo advisory platforms to banks and securities firms. Robo advisors in Korea can be divided largely into two types: One offers non-discretionary investment management; the other offers discretionary investment management. For non-discretionary investment management, there are two subtypes of robo advisors, including i) those used as distribution channels for financial products, such as investment funds and pension products (“product recommendation robos”), and ii) those providing stock selection and buy or sell recommendations (“stock picking robos”). For discretionary investment management, there are also two subtypes of robo advisors, including i) those managing wrap accounts, which are one wealth management product offered by securities firms (“wrap robos”), and ii) those offering automated asset allocation primarily comprised of domestic and foreign stocks, and exchange-traded funds (“asset allocation robos”).

Table 1 shows the breakdown of robo advisors by type and subtype as of June 30, 2019. Most banks provide product recommendation robos for funds, pensions, individual savings accounts (ISAs) or other products. Securities firms, unlike banks, offer stock picking robos and wrap robos. Asset managers and investment advisors have started to directly bring asset allocation robos to market, as Regulations on Financial Investment Business were amended on March 20, 2019 to allow them to enter into discretionary investment management with their clients on a non-face-to-face basis if a robo advisor is utilized.[2] Previously, they provided

1) All the websites of banks, securities firms, asset managers, and investment advisors that met requirements under the robo advisor test bed have been analyzed to figure out the current state of robo advisor adoption in Korea.

2) Financial Services Commission (FSC), March 20, 2019, FSC approves amendments to Regulations on Financial Investment Business, Press release with attachment.

advisor-focused robos to banks or securities firms because of restrictions on the execution of discretionary investment management contracts through non-face-to-face channels.

Table 1. Current state of robo advisors in Korea (as at end-June of 2019)

<table>
<tr><th rowspan="2"></th><th colspan="4">Robo advisors for non-discretionary investment management services</th><th colspan="2">Robo advisors for discretionary investment management services</th><th rowspan="2">Total</th></tr>
<tr><th>Fund</th><th>Pension</th><th>ISA</th><th>Stock/ETF[1)]</th><th>Wrap account</th><th>Asset allocation</th></tr>
<tr><td>Banks</td><td>9</td><td>6</td><td>1</td><td>-</td><td>-</td><td>-</td><td>9</td></tr>
<tr><td>Securities firms</td><td>7</td><td>2</td><td>1</td><td>10</td><td>13</td><td>-</td><td>19</td></tr>
<tr><td>Asset mangers</td><td>-</td><td>-</td><td>-</td><td>-</td><td>-</td><td>2</td><td>2</td></tr>
<tr><td>Investment advisors[2)]</td><td>-</td><td>-</td><td>-</td><td>2</td><td>-</td><td>-</td><td>5</td></tr>
</table>

Note: 1) If multiple robo advisory services are offered by a financial institution, they are counted as one per institution in the table above.
2) Three investment advisors provide robo advisors in cooperation with banks or securities firms.

Among banks and securities firms offering robo advisory services, many of them have formed alliances with asset management firms, investment advisory firms or tech firms, though some created their own robo advisors. As seen in Table 2, three of nine banks developed robo advisors on their own. The other six banks provide robo advisors in collaboration with one or more tech firms. Furthermore, only five securities firms developed their own robo advisory platforms. The rest provide robo advisory services in collaboration with one or more asset managers, investment advisors or tech firms. Notably, three securities firms have partnered with five or more tech firms to offer stock picking robos.

Table 2. Robo advisor collaboration of banks and securities firms (as at end-June 2019)

	In-house development	In collaboration with robo advisor providers	
		Investment advice	Technology
Banks	3	2	5
Securities firms	5	15	6

Note: If a financial institution has collaborated with multiple robo advisors, it is counted as having collaborated with just one robo advisor.

Characteristics of robo advisors in Korea

Robo advisors are automated wealth management tools that use algorithms to allocate assets and manage investment risks. Robo advisors can be aware of market changes faster than human advisors, and timely respond to them. For that reason, people in general expect higher investment returns from robo advisors than from human advisors. But it is not easy to compare robo advisors and human advisors in terms of investment performance in the case of Korea because robo advisors providing only non-discretionary investment management dominate the market. As for non-discretionary services, if the robo advisor recommends rebalancing, but its client does not act upon such advice, the resulting investment returns cannot be considered as the returns generated by the robo advisor. Meantime, as for discretionary services, it is possible to compare the investment performance of robo advisors and human advisors. In reality, however, such comparison is difficult to make because wrap robo advisors are based on discretionary investment management contracts entered into with each of clients, and asset allocation models came to market only recently.

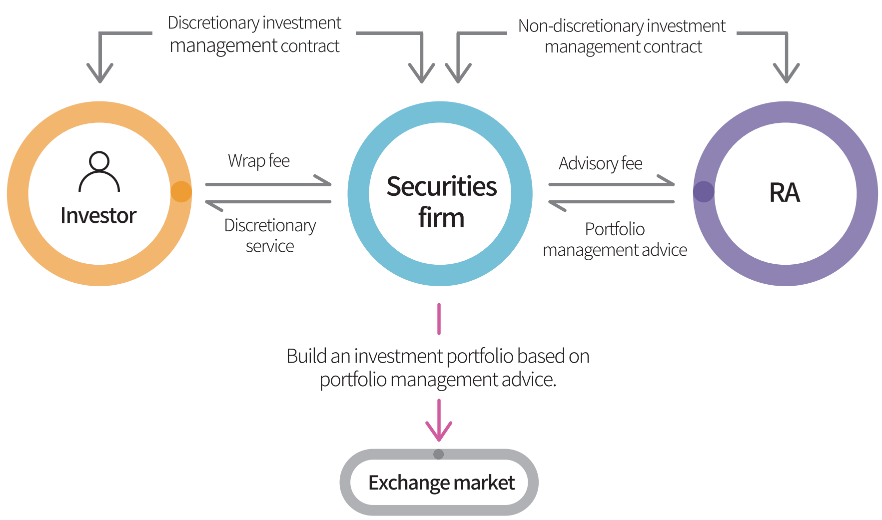
As mentioned earlier, robo advisors focusing on non-discretionary investment management prevail in Korea, in contrast to other countries where asset allocation models (one of discretionary robo advisor models) are most common. That is because it was hard for financial services firms to make discretionary investment management contracts with clients through non-face-to-face channels prior to the revision of Regulations on Financial Investment Business on March 20, 2019, although non-face-to-face opening of accounts was permitted in March 2016, enabling non-discretionary investment management contracts to be made without in-person interactions.[3] Non-face-to-face account opening was virtually impossible for discretionary services, due to regulation requiring the fulfilment of the duty to explain in a face-to-face setting. Taking that into account, the regulation was somewhat eased through amendments to Regulations on Financial Investment Business on June 27, 2018.[4] Still, however, financial services firms other than securities firms found it difficult to fulfil the duty to explain without a face-to-face meeting because they must satisfy either a capital requirement of KRW 4 billion or more, or a video call requirement.

3) FSC, February 18, 2016, Non-face-to-face account opening will be allowed for non-banking financial services firms, Press release with attachment.

4) FSC, June 27, 2018, Regulations on Financial Investment Business: Revision and Implementation, Press release.

The regulation requiring the performance of the duty to explain in a face-to-face setting for discretionary services appears to have impacts on the structure of robo advisory wealth management because that regulation kept asset managers and investment advisors from offering robo advisors directly to clients, even if they were to develop robo advisors. Asset managers and investment advisors, therefore, had no choice but to collaborate with banks or securities firms that have face-to-face channels. For the same reason, a number of robo advisors chose to remain tech firms, rather than becoming direct providers of wealth management services. For example, most wrap robo advisors offered by securities firms manage client assets, relying on investment advice from robo advisors developed by asset managers or investment advisors. This also holds true for banks. Five banks have formed technological alliances with one tech firm, which was spun off from an asset management firm that developed a robo advisor on its own.

Figure 1. Structure of wrap robo advisors offered by securities firms



Another characteristic of robo advisors in Korea is that robo advisors are considered financial products by domestic banks and securities firms, unlike their counterparts in other countries that view robo advisors as platforms that provide automated wealth management services without meeting face to face with clients. In Korea, robo advisors are widely used as distribution channels for financial products. For instance, wrap robos offered by securities companies are not much different from other wrap accounts, except that the wrap account is managed based on investment advice from the robo advisor. The same is also true for banks' fund recommendation robos.[5)]

Prospects and implications

The Financial Services Commission (FSC) unveiled measures to improve regulatory arrangements for facilitating the use of robo advisors on May 15, 2019.[6)] This reflects that the wealth management market has not been buoyed by the rise of robo advisors, falling short of previous expectations. In 2019, however, the regulatory environment becomes more favorable to robo advisors. First, financial services firms are allowed to provide discretionary investment management involving robo advisors for non-face-to-face clients. Second, independent robo advisors can be commissioned by asset managers or securities firms to manage fund or discretionary mandate assets. Third, individuals are allowed to participate in the robo advisor test bed. All these regulatory changes are expected to greatly enhance the intended function of robo advisors to provide wealth management services. The significantly improved regulatory environment has resulted in the launch of robo advisors by four asset management firms and investment advisory firms. Given all, it is time for securities firms to mull over how to leverage robo advisors from different perspectives. More specifically, securities firms need to further strengthen their digital wealth management capabilities by capitalizing on robo advisors, in order to keep up in the era of digital finance or to be better prepared for rising wealth management demand from retail clients.

5) Fund recommendation robos offered by some banks recommend investment funds or a portfolio of investment funds tailored to customer investment propensities.

6) FSC, May 15, 2019, Regulatory improvements to facilitate the use of robo advisors, Press release.