



Robo Advisory vs. Wealth Advisory

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AGENDA

- SEC Regulatory Guidance
- Examinations of Digital Advisers
- Compliance Program Considerations
- Questions

SEC REGULATORY GUIDANCE

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- IM Guidance Update – February 2017
 - Substance and presentation of disclosures
 - Provision of suitable advice
 - Compliance program
- Investor Bulletin – February 2017
 - Information investors need to make informed decisions when considering a digital adviser
 - Level of human interaction
 - Information used in formulating investment advice
 - Approach to investing
 - Fees and charges

REGULATORY GUIDANCE

- SEC Fintech Forum – November 2016
- Investor Alert: Automated Investment Tools – May 2015
- FINRA Report on Digital Investment Advice – May 2015

EXAMINATIONS OF DIGITAL ADVISERS

OCIE EXAMINATION PRIORITIES

- 2017
 - Electronic Investment Advice
 - Wrap Fee Programs
 - Never-Before Examined Investment Advisers
- 2018 and 2019
 - Retail Investors, Including Seniors and Those Saving for Retirement
 - Cybersecurity

SEC EXAMINATIONS

- OCIE Sweep
- Document Request Lists
 - Tailored to relevant issues
 - Lengthy – 80-90 items
 - Fairly consistent nationwide

UNIQUE ISSUES FOR DIGITAL ADVISERS

- Rule 3a-4 under the Investment Company Act
- Suitability and fiduciary duty
- Diligence and oversight of algorithms/models
- Cybersecurity and technology infrastructure
- Compliance program and disclosure

RULE 3A-4 SAFE HARBOR

- “Explain to what extent Registrant has evaluated the applicability of Investment Company Act Rule 3a-4 (, i.e., Rule 3a-4 is a safe harbor to avoid status as an investment company). This would include providing a legal opinion with regard to Rule 3a-4, if available.”
- Ability to apply account restrictions
- Supporting policy, protocols, and disclosures

SUITABILITY AND FIDUCIARY DUTY

- Questionnaire
 - Ability to follow up and/or clarify
 - Flagging of inconsistent responses
- Human interaction
- Changes in financial condition or strategy preferences

PORTFOLIO MANAGEMENT AND ALGORITHMS

- Portfolio Management
 - Rebalancing
 - Order execution
- Algorithm/Model Management
- Testing

CYBERSECURITY

- SEC will review your control environment
- Examiners will expect to see results of a risk analyses
- Focus areas will include:
 - Governance and risk assessment
 - Access rights and controls
 - Data loss prevention
 - Vendor management
 - Employee training
 - Incident response plans
- SEC will cite firms under:
 - Rule 206(4)-7 (Compliance program)
 - Rule 204-2 (Records)
 - Rule 204A-1 (Ethical behavior)
 - Regulation S-P (Privacy)
 - Regulation S-ID (ID Theft)
 - Sections 206(1) and (2) (Anti-fraud)



SEC EXAM FOCUS AREAS

- Key Vendor Oversight
 - Subadvisors
 - Client information
 - Proprietary information
- Compliance Oversight
 - Lack of prior experience in financial services

DISCLOSURES

- Description of unique risks and controls
- Utilization of technology
- Human interaction
- Fees
- Location & language used
- Performance presentation
- Conflicts of interest

RECENT ENFORCEMENT ACTION #1

- SEC Order Alleged against Robo #1
 - False statements about the tax-loss harvesting strategy it offered
 - Violations of advertising rules, including use of testimonials, lack of disclosure and documentation regarding conflicts of interests related to client referrals
 - Failure to maintain a compliance program reasonably designed to prevent violations of securities law

RECENT ENFORCEMENT ACTION #2

- SEC Order Alleged against Robo #2
 - Misleading statements about its investment performance
 - Failure to maintain required documentation for performance reporting
 - Failure to maintain a compliance program reasonably designed to prevent violations of securities law

COMPLIANCE PROGRAM CONSIDERATIONS

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- How is compliance involved with product development?
- Oversight of algorithmic code
- Questionnaire and eliciting sufficient information
- Oversight of third parties - algorithm
- Disclosures
- Oversight of marketing activities
 - Social media

COMPLIANCE PROGRAM CONSIDERATIONS

- Cybersecurity and information security
 - Contractual considerations
 - User interfacing: Is it really your client entering in the information?
- Business Continuity
 - Website outage
 - Cybersecurity breach

ACA BEST PRACTICES SURVEY

WHAT ARE YOUR PEERS DOING?

QUESTIONS



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