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The Evolution of Advice: The Current Regulatory Landscape for Digital Investment Advisers

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Automated investment advisory services are currently in a period of transformation. These services, which leverage automated processes to deliver a low-cost alternative to a traditional investment adviser, have experienced tremendous growth in assets under management over the past few years. Industry analysts expect that the sponsors of these investment advisory programs, known as "digital" or "robo" investment advisers, will manage nearly $285 billion in assets by 2017.[1] While still a fraction of the estimated $20 trillion wealth management space, the impact of stand-alone digital investment advisers has been felt throughout the industry as incumbent financial services firms have either expanded their services to include digital investment offerings or acquired stand-alone digital investment adviser upstarts. Industry analysts expect incumbent full-service investment managers to continue developing and offering digital advisory strategies and capabilities, as either a low-cost alternative to their existing offerings or as part of the suite of tools used by investment professionals.[2]

The growth of digital investment advice is attributable to the confluence of a number of different factors, including developments in financial technology (FinTech), demographic trends, the growth of mobile-enabled personal finance applications, the high barrier to entry for traditional investment advisory services, and economic trends pushing greater segments of the investing public toward self-directed retirement investing. Against this backdrop of technological change and increasing market share, digital investment advisers should remain cognizant of their obligations in a heavily regulated industry. This article surveys the current regulatory landscape for robo-advisers (digital investment advisers), and provides practical guidance that firms may wish to consider when applying the regulatory regime governing investment advisers to the unique challenges of the digital investment advice model.

A New Twist on a Tested Product

Although digital investment advisers may be a disruptive presence in the industry, the investment strategies they offer – diversified portfolios of low-cost exchange traded funds (ETFs) offered through separately managed accounts – are not. In this respect, digital investment advisers are not offering a new product, but rather leverage technological enhancements to deliver a well-established advisory product through new channels, to an expanded segment of the investing public, and at comparatively low cost. Although there is a wide spectrum of offerings, features that distinguish digital investment advisers generally include:

- Simplified mobile-accessible platforms offering account access and a suite of investment and educational tools to assist clients in identifying their financial goals;
- Low-cost diversified portfolios typically comprised of passive ETFs;
- A range of available investment options for taxable and non-taxable accounts, including individual retirement accounts and accounts for participants in employer-sponsored 401(k) and 403(b) plans;
- Lower minimum balance requirements; and
- Automatic account rebalancing and tax optimization services.

The Current Landscape of Regulatory Guidance on Digital Investment Advisers

State, federal, and industry regulators have addressed the growth of digital investment advisers, and the use of automated investment advice tools by market participants, through a number of public statements and interpretive releases. The current regulatory focus is oriented toward educating prospective investors about the nature of digital investment advice, including its assumptions and limitations, as well as providing guidance on how digital investment advisers (and other firms who use, or offer, automated investment advice tools) can meet regulatory expectations. Following is a description of the current posture of regulators who have weighed in on digital investment advice.

SEC and FINRA Joint Guidance (May 2015)

In May 2015, the Securities and Exchange Commission's (SEC) Office of Investor Education and Advocacy (OIEA) and the Financial Industry Regulatory Authority (FINRA) jointly issued an Investor Alert (the Joint Alert) that provides retail investors with an overview of automated investment tools as well as a number of general considerations for the selection of digital investment advisers.[3] While recognizing that online investment management programs offer "clear benefits" such as their low cost, ease of use, and broad accessibility, the Joint Alert cautioned investors to consider their risks and limitations and offered a number of factors and observations that investors should consider before using automated investment tools. The Joint Alert encourages investors to consider the following for any automated investment advice tool the terms and conditions of the tool, including applicable fees and expenses and investment cash-out provisions; the tool's limitations and assumptions, including the fact that the tool may rely on assumptions that could be incorrect or inapplicable to an investor's individual situation; and that certain tools may only offer a limited universe of investment options or consider only a subset of an investor's particular circumstances when making an investment recommendation. The Joint Alert also emphasized that investors should remain mindful of safeguarding their personal financial information when using automated investment tools.

FINRA Guidance on Principles and Effective Practices (March 2016)

Recognizing that digital investment advice tools are "likely to play an increasingly important role in wealth management," FINRA released a report in March 2016 providing its observations on digital investment advice tools and identifying a number of effective practices that broker-dealers (and by analogy, investment advisers) providing digital investment advice tools may consider implementing.[4] FINRA's report focuses on the governance and supervision of four key aspects of digital investment advice: the design and implementation of the algorithms powering digital investment advice tools; the methodology used to construct client portfolios; investor profiling; and account rebalancing.

With respect to the design and implementation of algorithms, the report states that firms that develop digital investment advice tools, or acquire or private-label such tools developed by a third party, should understand the financial models embedded in the algorithms they use and assess whether the algorithms are consistent with the firm's investment and analytic approaches. This includes understanding the assumptions used to generate scenarios on expected returns and whether an algorithm's methodology has any biases or preferences. The report provides a non-exclusive list of principles and practices that would comprise an effective governance and supervisory framework for the data assumptions and algorithms that produce a tool's output. At initial review, this could include assessing whether the methodology a tool uses, including any related assumptions, is well-suited to the task; understanding the data inputs that will be used; and testing the output to assess whether those outcomes conform to a firm's expectations. The report states that, on an ongoing basis, this governance framework could include assessing whether the models a tool uses remain appropriate as market and other conditions evolve; testing the output of the tool on a regular basis to ensure that it is performing as intended; and identifying individuals who are responsible for supervising the tool.

The report also states that firms should implement governance and supervisory controls on the client portfolio construction process. FINRA stated that these controls should include processes for determining the characteristics of a portfolio for particular investor profiles (for example, return, diversification, credit risk and liquidity risk), and selecting securities based on criteria that are appropriate for such a portfolio. Further, FINRA noted that effective practices for portfolio construction include monitoring of pre-packaged portfolios to assess whether their performance and risk characteristics are appropriate for the type of investors to which they are offered, and identifying and mitigating any conflicts of interest resulting from the inclusion of particular securities in a portfolio. These control mechanisms, according to FINRA, should involve personnel who are independent of the business. FINRA also observed that firms should disclose to clients if a digital investment advice tool favors certain securities, explain the reason for the selectivity, and state that other investments not considered may have characteristics, such as cost structure, that are similar or superior to those being analyzed by the tool.

FINRA addressed investor profiling by digital investment advice tools by noting that the rules governing the suitability of recommendations by broker-dealer firms[5] and the requirement that firms use reasonable diligence to know the essential facts concerning a customer at account opening and thereafter, apply to the use of digital investment advice tools.[6] The report stated that effective practices for customer profiling in connection with digital investment advice tools include identifying the key elements of information necessary to profile a customer accurately; assessing a customer's risk capacity and risk willingness; resolving contradictory or inconsistent responses in profiling questionnaires; assessing whether investing, as opposed to saving or paying off debt, is appropriate for an individual; and contacting customers periodically to determine whether their profile has changed. Further, the report includes a list of questions that firms may consider to assess whether the output of a digital investment advice tool meets their suitability obligations under FINRA Rule 2111.[7] These include whether the digital investment advice tool used seeks to obtain all of the required investment profile factors; how the tool handles conflicting responses to customer profile questions; the criteria, assumptions, and limitations for determining that a security or investment strategy is suitable for a customer; and whether the tool favors any particular securities.

FINRA also included guidance to member firms on effective practices for automatic rebalancing of client portfolios invested through a digital investment advice tool. FINRA stated that effective practices include explicitly establishing customer intent that automatic rebalancing occur; apprising the customer of the potential costs and tax implications associated with a rebalancing; disclosing to customers how rebalancing works, including whether drift thresholds or scheduled rebalancing intervals are utilized; developing policies and procedures defining how digital investment advice tools will act in the event of major market movements; and developing methods that minimize the tax impact of rebalancing.

The report concluded by echoing many of the themes of the earlier Joint Release, reiterating that investors should seek to familiarize themselves with a digital investment advice tool's investment approach and key assumptions, including whether any applicable conflicts of interest compromise the objectivity of the investment advice they will receive. FINRA also emphasized that investors consider the account features and costs associated with the services they will receive.

FINRA has said that it will not examine broker-dealers to determine whether they are complying with the practices discussed in the report and there will be no deficiencies or enforcement actions if the effective practices are not followed. However, during examinations FINRA will ask questions about how the digital investment advice tools are being used in order to continue to stay informed as to how these tools are being used. We expect that FINRA will focus on the degree to which the digital investment advice tools comply with current obligations such as suitability and disclosure of the methodology and limitations of the tools.

Massachusetts Securities Division Policy Statement

In addition to the SEC's and FINRA's guidance, state securities regulators have begun to scrutinize digital investment advisers to assess their compliance with the current regulatory framework. The Massachusetts Securities Division (the "Division") released a policy statement in April 2016 taking the position that digital investment advisers, particularly fully automated digital advisers, may not be able to meet the fiduciary obligations required of an investment adviser registered in that state.[8] Specifically, the policy statement articulated the view that digital advisers may be "inherently unable" to act as fiduciaries if they fail to conduct sufficient initial and ongoing due diligence necessary to know their customers well enough and provide sufficiently personalized investment advice. The Division also noted that digital investment advisers may not fulfill their core fiduciary duties when they disclaim responsibility, in lengthy legal agreements, for either determining whether investments are in a client's best interest, or when managing a client's account based on outside assets or information not requested by the digital investment adviser. The Division stated that, until regulators determine the "proper regulatory framework" for automated investment advice, digital advisers seeking to register as an investment adviser with Massachusetts will be evaluated on a case-by-case basis.

Public Remarks by SEC Officials

The SEC has not issued any substantive interpretive guidance to date regarding the regulatory treatment or obligations of digital investment advisers. SEC Commissioner Kara Stein, in public remarks, has questioned whether automated investment advice requires regulators to make "tweaks and revisions" to the framework under the federal securities laws for regulating investment advisers.[9] Although Commissioner Stein did not definitively indicate that digital investment advice may require a distinct regulatory framework, she stated that regulators must "thoughtfully evolve with innovation."[10]

SEC Chair Mary Jo White has stated in public remarks that automated investment platforms have the "positive potential to give retail investors broader, and more affordable, access" to the capital markets.[11] Chair White acknowledged that, even though investment advice delivered through an electronic platform is different than the traditional adviser model, the SEC's regulatory assessment of digital investment advisers "is no different than for a human-based investment adviser." Chair White also addressed the concept of personalized recommendations. In contrast to the Division's position that digital investment advisers do not collect sufficient information from clients on which to base investment advice, Chair White rejected the notion that there is a one-size-fits-all approach that digital advisers must conform to, noting that even "live" conversations with human advisers may be "more or less robust" in terms of information gathered. Therefore, Chair White acknowledged that in both the digital and traditional advisory contexts, there may be "variation in the content and flexibility of information gathered" from clients. Chair White concluded by stating that SEC staff from the SEC's Office of Compliance Inspections and Examinations ("OCIE") are examining digital investment advisers in an effort to proactively convey the need for such advisers to "operate within the regulatory framework of the Advisers Act," while deepening the staff's knowledge of the range of services provided and their challenges. Jane Jarcho, Deputy Director of OCIE, has confirmed the examination staff's attention on digital advisers in public remarks, adding that a key focus in SEC examinations of digital investment advisers is their practices for collection of client information.[12]

Department of Labor Fiduciary Rule and other Statements

Similar to Chair White's statement that digital investment advisers should be operating within the regulatory framework for investment advisers under the Advisers Act, the Department of Labor (the Department) has explicitly recognized that digital advisers may act as fiduciaries to retirement plans and plan participants and fulfill all corresponding obligations under the Employee Retirement Income Security Act (ERISA).[13] Further, in the adopting release for the revised definition of "fiduciary" and related exemptions under ERISA, the Department took the position that digital investment advisers are progressing toward a business model that may eliminate many of the conflicts of interest presented by traditional investment advisers in the ERISA context.[14] Secretary of Labor Thomas E. Perez has publicly stated in congressional testimony that digital investment advisory services help to provide investment advice as a fiduciary "at significantly lower fees" and in small savers' best interests.[15] The Department has additionally noted that technology-enabled services offered by digital investment advisers are a complement to traditional advisers, offering a narrower and more tailored service to a younger segment of the investing public who may later seek the expanded services of a traditional adviser once their wealth grows.[16] The Department additionally noted that automation of key investment advisory tasks that are "time-consuming" and "error-prone" when done manually, such as portfolio rebalancing and tax-loss harvesting, may be a strategic complement to traditional advisory services.[17] The Department stated that automating such services would enable human advisers to "more efficiently allocate their time to the tasks that can bring in more revenues."

Areas of Regulatory Focus for Digital Investment Advisers

The current regulatory regime governing investment advisers, when applied to the digital investment advice model, presents a number of compliance and operational considerations. It is important that digital investment advisers remain mindful of their regulatory obligations, particularly in light of the continued scrutiny from regulators and industry participants, and design and implement an appropriate governance and internal control framework. In this section we discuss select regulatory areas that present unique challenges to the digital advice model, and describe certain approaches and processes that digital investment advisers may consider to help defuse these challenges.

Status of Investment Advisory Programs: Investment Company Act Rule 3a-4

Digital investment advisers who offer discretionary asset allocation programs should be mindful that the structure of these programs may raise investment company status questions under the Investment Company Act of 1940 (Company Act). Rule 3a-4 of the Company Act provides a non-exclusive safe harbor from the definition of an investment company for discretionary investment advisory programs.[18] An advisory program that is organized and operated in accordance with the rule will not be deemed to be a *de facto* investment company so long as it complies with a number of conditions designed to ensure that clients receive individualized treatment and there is no pooling of assets. Among other things, Rule 3a-4 requires advisers to obtain information about the client's financial situation and investment objectives and manage each such account in accordance with any reasonable restrictions imposed by the client on the management of the account.[19] Not all digital investment advisers necessarily avail themselves of the rule. Whether the safe harbor is relevant depends on whether client portfolios are managed in a similar manner. The more unique and customized the portfolios are, the less likely they run the risk of being considered a *de facto* investment company in the first instance. If an adviser is relying on the rule, a key consideration for digital advisers becomes the treatment of reasonable restrictions. From an operational perspective, their platform should provide a mechanism for clients to communicate requests to impose reasonable restrictions, or modify existing restrictions. This may be done through a platform functionality that permits clients to designate particular securities or types of securities they wish to exclude from their accounts, or a prompt during account sign-up that directs clients to contact the adviser via a chat feature or toll-free number if the client wishes to impose a restriction on their account.

Further, the determination of whether a restriction is "reasonable" becomes more challenging in the context of a program that may already contain limited investment options. In this respect, the SEC staff has provided guidance that a restriction would be unreasonable if it is clearly inconsistent with the investment strategy or investment objectives of a client's account or if it is fundamentally inconsistent with the nature or operation of the advisory program.[20] The staff stated that the difficulty in complying with a restriction, the specificity of the restriction, and the number of restrictions imposed by a client are all factors that bear on the determination of whether a particular restriction is reasonable. In addition to implementing processes for capturing, documenting and implementing restrictions, digital advisers should also consider documenting the types of restrictions they consider reasonable or unreasonable for their advisory program, along with analysis and support for why certain types of restrictions may not be considered reasonable given the investment strategies that are offered and the nature and operation of the advisory program they offer to clients.

Advertising and Performance Projections: Advisers Act Rule 206(4)-1

Digital investment advisers subject to registration with the SEC as an investment adviser are subject to Advisers Act Rule 206(4)-1 (Advertising Rule). The Advertising Rule includes a number of specific prohibitions on the content of investment adviser advertising, in addition to a general catch-all prohibition on advertisements that contain any untrue statement of a material fact, or are otherwise false and misleading. An "advertisement" under the Advisers Act is defined broadly to include (1) any "notice, circular, letter or other written communication addressed to more than one person," or (2) "any notice or other announcement in any publication or by radio or television, which offers […] any […] investment advisory service with regard to securities."[21] The concept of an advertisement is similarly interpreted broadly to encompass materials designed to maintain existing clients or to solicit prospective clients.[22] Consequently, content posted on a digital investment adviser's platform or mobile application is likely to be regulated as an "advertisement" irrespective of whether it is available pre- or post-login. The Advertising Rule is of heightened significance to digital investment advisers who often rely exclusively on advertising to capture the interest of a retail audience and prolifically use social media to create and maintain their profile, and presents a range of considerations as discussed below.

Testimonials: The Advertising Rule prohibits the use of any testimonial concerning the investment adviser or any advice, analysis, report, or other service provided by the investment adviser, in an advertisement.[23] Use of social media by digital investment advisers may present testimonial issues where a digital adviser prioritizes, endorses, promotes, or "likes" posts by clients or prospective clients. The SEC staff has stated that, depending on the facts and circumstances, public commentary made directly by a client about their experience with, or endorsement of, an investment adviser may be a testimonial.[24] The SEC Staff further stated that public comments by third parties about a client's experience or endorsement of an investment adviser may also be a testimonial.[25] Digital advisers should also consider the testimonial rule when referencing or including third-party reviews of its services or ratings on its website or social media platforms.

Use of Graphs, Charts, and Formulas: The Advertising Rule prohibits advertisements that represent, either directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to make trading decisions, unless the advertisement prominently discloses the limitations or difficulties in its use.[26] Digital advisers may include graphs or charts in advertisements to illustrate how particular investment approaches may assist clients with realizing particular goals (for example, retirement savings by a particular age, house purchase, or college savings). The advertisement may be structured as an interactive widget permitting clients to input certain information such as current age and desired retirement timeframe, and see an illustrated graph that projects how the digital adviser's investment approach can assist the client in reaching his or her investment goal. However, it is also worth noting that the algorithms used by digital advisers may themselves be considered a "device" designed to make trading decisions and otherwise provide advice. Accordingly, digital advisers should ensure that advertisements that contain graphs or charts, or that promote the investment decisions made by the adviser through its algorithms, be accompanied by disclosure about applicable limitations and assumptions.[27]

Use of Projected/Back-Tested Performance: The use of performance in investment adviser advertising is governed by the Advertising Rule's catch-all provision, which prohibits advertising material that contains an untrue statement of material fact or which is otherwise false or misleading.[28] Digital investment advisers who include performance projections in advertising materials should ensure that their advertising is consistent with the SEC Staff's guidance on the use of performance results in investment adviser advertising. The SEC Staff has addressed the circumstances under which the use of actual or hypothetical performance in investment adviser advertising is false or misleading, or would imply, or cause a reader to infer, "something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts."[29] As a result, it is critical that projections be identified as such (meaning that they are positioned as hypothetical, forward-looking statements that often are provided for illustrative purposes) and that the advertisement discloses the limitations inherent in those projections, including those based on standard disclosure.

Claims of Free Services: Investment advisers may not publish or distribute any advertisements that contain any statement to the effect that a report, analysis, or service offered is free unless it actually is.[30] Digital investment advisers who provide free portfolio analysis, plans, or recommendations to prospective clients should ensure that their characterization of such services in advertisements is truthful and not misleading. For instance, if free portfolio analysis or recommendations are only offered for client portfolios that meet a certain threshold of assets, these services should not be characterized as "free" in advertising.

Compliance Program Maintenance

SEC-registered digital investment advisers are required by Advisers Act Rule 206(4)-7 to adopt and implement written policies and procedures reasonably designed to prevent violation by the adviser and its supervised persons of the Advisers Act.[31] Such advisers are also required to designate a chief compliance officer responsible for administering its policies and procedures, and to conduct a review at least annually of the adequacy and effectiveness of the adviser's policies and procedures and the effectiveness of their implementation.[32]

Automation of investment management functions presents a number of considerations for digital advisers' ongoing compliance programs. Digital investment advisers should consider whether they have designed and implemented appropriate procedures for oversight, supervision, and implementation of changes of the quantitative models, or algorithms, used to manage client accounts. The SEC has under certain circumstances brought enforcement actions against investment advisers who fail to correct errors in quantitative models used to manage client accounts, disclose such errors to clients or senior management, or comply with policies and procedures requiring escalation of an identified breach of risk management protocols or internal controls.[33] Procedures for the oversight of digital advisers' algorithms may include the following:

- Regular review and surveillance of an algorithm's performance across client accounts, including evaluating the performance of algorithmic functions against particular accounts or internal benchmarks;
- Guidelines and authorization procedures for implementing changes to an algorithm, including appropriate audit trails and documentation of all such changes and their supporting rationale;
- Appropriate processes to test changes and consider any downstream implications before they go live; and
- Identification and escalation of any errors associated with the algorithms, and documentation of such processes.

Compliance personnel have a role in testing under Advisers Act Rule 206(4)-7 to make sure that business and technology personnel are implementing controls appropriately and in a manner consistent with the adviser's written procedures for oversight, supervision, and change management.

Conclusion

Digital advice offers an exciting opportunity to democratize advice and make it available to a broader swath of investors. As regulators have only recently begun to weigh in on digital advice, advisers should continue to pay close attention to public statements and other actions by the regulators that may shed light on how digital investment advisers may best meet their regulatory obligations. However, even as digital advice continues to evolve and transform the market, digital investment advisers can and should rely on long-standing regulatory principles to develop appropriate controls around these transformative services.

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NOTES

1 Morningstar News (Apr. 8, 2016), *http://mfi.morningstar.com/Purchase.aspx?referid=AMFGNRCT.*

2 Deloitte Consulting LLP, "Robo-Advisers: Capitalizing on a Growing Opportunity" (2015), *http://www2.deloitte.com/content/dam/Deloitte/us/Documents/strategy/us-cons-robo-advisors.pdf.*

3 SEC Office of Investor Education and Advocacy and FINRA, Investor Alert on Automated Investment Tools (May 8, 2015), *https://www.finra.org/investors/alerts/automated-investment-tools.*

4 FINRA Report on Digital Investment Advice (March 2016), *https://www.finra.org/sites/default/files/digital-investment-advice-report.pdf.*

5 FINRA Rule 2111.

6 FINRA Rule 2090.

7 These questions include whether the tool seeks to obtain all of the required investment profile factors, including risk capacity and risk willingness (and if not, whether the firm has established a reasonable basis to believe that any particular factors are not necessary; how the tool handles conflicting responses to customer profile questions; the criteria, assumptions and limitations for determining that a security or investment strategy is suitable for a customer; whether the tool favors any particular securities and, if so, what the basis for such treatment is; and whether the tool considers concentration levels and, if so, at what levels (*e.g.* particular securities, class of securities, industry sector).

8 Massachusetts Securities Division, Policy Statement on Robo-Advisers and State Investment Registration (Apr. 2016), *https://www.sec.state.ma.us/sct/sctpdf/Policy-Statement--Robo-Advisers-and-State-Investment-Adviser-Registration.pdf.*

9 SEC Commissioner Kara M. Stein, "Surfing the Wave: Technology, Innovation, and Competition," Remarks at Harvard Law School's Fidelity Guest Lecture Series (Nov. 9, 2015), *https://www.sec.gov/news/speech/stein-2015-remarks-harvard-law-school.html.*

10 *Id.*

11 SEC Chair Mary Jo White, Keynote Address at the SEC-Rock Center on Corporate Governance Silicon Valley Initiative (Mar. 31, 2016), *https://www.sec.gov/news/speech/chair-white-silicon-valley-initiative-3-31-16.html.*

12 "SEC Targets Robo-Advisor Client Info Gathering, 12b-1 Fees," Financial Advisor IQ (April 21, 2016), *http://financialadvisoriq.com/c/1340093/150533.*

13 Best Interest Contract Exemption, 81 Fed. Reg. 21002 (Apr. 8, 2016).

14 *Id.* ("The Department is of the view that the marketplace for robo-advice is still evolving in ways that both appear to avoid conflicts of interest that would violate the prohibited transaction rules and minimize cost. Therefore, the Department included robo-advice in the exemption only if the advice is provided by a Level Fee Fiduciary to enter into the arrangement for robo-advice, including by means of a rollover from an ERISA plan to an IRA, and if the conditions applicable to Level Fee Fiduciaries are satisfied.")

15 Statement of Thomas E. Perez, Secretary of Labor, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, US House of Representatives, June 17, 2015; *and* Testimony of Thomas E. Perez, Secretary US Department of Labor Before the Employment and Workplace Safety Subcommittee Committee on Health, Education, Labor and Pensions, United States Senate, July 21, 2015 ("I simply don't believe the argument that small savers cannot be served by advice that is in their best interest, especially with the advent of new, technology-based and technology-assisted models" and further noting a digital investment adviser that has "a platform that enables them to significantly lower fees, and allows them to operate as a fiduciary.")

16 US Department of Labor, Fiduciary Investment Advice, Regulatory Impact Analysis at Section 8.3.5, *https://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf* (Apr. 14, 2015) ("Robo- and traditional advisers serve different populations. Robo-advisers or other low-cost investment firms often attract young technology-savvy investors with low balances, whereas traditional advisers often target older investors with high net worth […] If a firm provides a simple technology-only platform for young investors with low-balances and helps such investors accumulate more wealth over time, later those investors can be easily brought into a full service program within a more traditional firm. Due to this generational component, it would not be surprising to *see* traditional firms acquiring robo-adviser firms or robo-adviser firms partnering with traditional firms.")

17 *Id.* ("Robo-advisers and traditional advisers have advantages in different tasks related to investment services. Beyond portfolio management, human advisers provide a wide range of services such as tax and estate planning. In contrast, robo-advisers offer

a somewhat narrow range of services within portfolio management. Using computer algorithms, robo-advisers automate a few elements of investment services, such as portfolio rebalancing and tax-loss harvesting. These are typically time-consuming and error-prone tasks if done manually. If human advisers automate these tasks using technology, human advisers can more efficiently allocate their time to the tasks that can bring more revenues. This difference in comparative advantage makes robo-advisers and traditional adviser firms complement rather than substitute each other.")

18 Investment Company Act Rule 3a-4.

19 Investment Company Act Rule 3a-4(a)(1).

20 *Status of Investment Advisory Programs under the Investment Company Act of 1940*, Investment Company Act Release No. 22579, 62 Fed. Reg. 15098 at 15104 (Mar. 31, 1997).

21 Advisers Act Rule 206(4)-1(b).

22 Munder Capital Management, SEC No-Action Letter, 1996 WL 282742 (pub. avail. May 17, 1996).

23 Advisers Act Rule 206(4)-1(a)(1).

24 Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04 (March 2014).

25 *Id*.

26 Advisers Act Rule 206(4)-1(a)(3).

27 *See* FINRA Rule 2214. Broker-dealers that offer investment analysis tools under Rule 2214 are subject to similar requirements, including that any investment analysis tool (i) describe the criteria and methodology used, including the tool's limitations and key assumptions; (ii) explain that results may vary with each use and over time; (iii) describe the universe of investments considered by the tool, and include explanation and disclosure where the tool favors certain securities; and (iv) include disclosure that the output of the tool is hypothetical in nature, does not reflect actual investment results, and is not a guarantee of future results.

28 Advisers Act Rule 206(4)-1(a)(5).

29 Clover Capital Management, Inc., SEC No-Action Letter (pub. avail. Oct. 28, 1986).

30 Advisers Act Rule 206(4)-1(a)(4).

31 Advisers Act Rule 206(4)-7(a).

32 Advisers Act Rule 206(4)-7(b) and (c).

33 *In re AXA Rosenberg Group LLC, AXA Rosenberg Investment Management LLC and Barr Rosenberg Research Center LLC*, Investment Advisers Act Release No. 3149 (February 3, 2011).