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SEC Issues Risk Alert on Investment Advisers that Provide Electronic Investment Advice

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November 15, 2021

On November 9, 2021, the Division of Examinations of the Securities and Exchange Commission (the Staff) issued a risk alert highlighting notable deficiencies and related industry best practices observed by the Staff in a recently completed national examination initiative of investment advisers that provide their clients with automated digital investment advisory services (otherwise referred to as robo-advisers). Through the examination initiative, the Staff identified deficiencies with a majority of advisers examined, most often relating to (i) compliance programs, including policies, procedures, and testing; (ii) portfolio management, including, but not limited to, an adviser's fiduciary obligation to provide advice that is in each client's best interest; and (iii) marketing and performance advertising, including misleading statements and missing or inadequate disclosure. Robo-advisers would be well-served to take note of the Staff's observations regarding industry best practices:

- *Adopt, implement and follow written policies and procedures that are tailored to the adviser's practices.* Policies and procedures should be specific to an adviser's use of an online platform and/or other digital tools for the provision of investment advice. Policies and procedures should assess, among other things, whether the adviser's: (i) algorithms perform as intended, (ii) asset allocation and/or rebalancing services occur as disclosed, (iii) data aggregation services, if any, present any custody implications. Advisers utilizing white-label platforms should have policies and procedures addressing the platform providers' attention to such matters. Compliance programs must be tested at least annually.

- *Gather sufficient information from clients to form a reasonable belief that clients are receiving investment advice that is in their best interest, based on each client's financial situation and investment objectives.* Initial questionnaires used to formulate investment advice for clients should elicit sufficient information in order to reasonably determine initial and ongoing suitability of each client's investment strategy. Advisers should follow up with their clients periodically to inquire about any changes to their financial situation or investment objectives, or require them to retake the initial questionnaire.

- *Test algorithms periodically to ensure they are operating as expected.*

- *Create information barriers to safeguard algorithms.* Advisers should limit code access to authorized personnel. Compliance should be notified in advance of a substantive algorithm change or override. If using a white-label platform, the platform provider should notify the adviser of any such changes.

If you have any questions regarding the topics discussed in this article, please contact **Jeff VonDruska** at +1 (312) 609 7563, **Rachel Behar** at +1 (212) 407 7641 or any Vedder Price attorney with whom you have worked.