

ROBO-ADVISERS

Automated advisers, which are often colloquially referred to as “robo-advisers,” represent a fast-growing trend within the investment advisory industry, and have the potential to give retail investors more affordable access to investment advisory services as well as change the competitive landscape in the market for investment advice.¹ While many robo-advisers were initially geared towards millennials, their popularity has been expanding among all age groups and classes of investors.² Robo-advisers, which are typically registered investment advisers, use innovative technologies to provide discretionary asset management services to their clients³ through online algorithmic-based programs.⁴ A client that wishes to utilize a robo-adviser enters personal information and other data into an interactive, digital platform (e.g., a website and/or mobile application). Based on such information, the robo-adviser generates a portfolio for the client and subsequently manages the client’s account.

Robo-advisers operate under a wide variety of business models and provide a range of advisory services. For example, robo-advisers offer varying levels of human interaction to their clients. Some robo-advisers provide investment advice directly to the client with limited, if any, direct human interaction between the client and investment advisory personnel. For other robo-advisers, advice is provided by investment advisory personnel using the interactive platform to generate an investment plan that is discussed and refined with the client. Robo-advisers may also use a range of methods to collect information from their clients. For example, many robo-advisers rely solely on questionnaires of varying lengths to obtain information from their clients. Other robo-advisers obtain additional information through direct client contact or by allowing clients to provide information with regard to their other accounts.⁵

The Staff of the Division of Investment Management, in coordination with the Staff of the Office of Compliance Inspections and Examinations, has been monitoring and engaging with robo-advisers to evaluate how these advisers meet their obligations under the Investment Advisers Act of 1940 (the “Advisers Act”), given the unique



challenges and opportunities presented by these programs. In addition, on November 14, 2016, the Commission held a Fintech Forum that included an informative panel on these programs.⁶ Based on input at the Forum and the Staff's observations, the Staff believes that, depending on their business models and operations, robo-advisers should keep in mind certain unique considerations as they seek to meet their legal obligations under the Advisers Act. This Staff guidance offers suggestions for how robo-advisers may address some of these issues. The Staff recognizes that there may be a variety of means for a robo-adviser to meet its obligations to its clients under the Advisers Act, and that not all of the issues addressed in this guidance will be applicable to every robo-adviser.

This Staff guidance focuses on robo-advisers that provide services directly to clients over the internet. This guidance, however, may be helpful for other types of robo-advisers as well as other registered investment advisers.⁷

Potential Considerations under the Advisers Act

Robo-advisers, like all registered investment advisers, are subject to the substantive and fiduciary obligations of the Advisers Act.⁸ Because robo-advisers rely on algorithms, provide advisory services over the internet, and may offer limited, if any, direct human interaction to their clients, their unique business models may raise certain considerations when seeking to comply with the Advisers Act. This guidance focuses on three distinct areas identified by the Staff, listed below, and provides suggestions on how robo-advisers may address them:

1. The substance and presentation of disclosures to clients about the robo-adviser and the investment advisory services it offers;
2. The obligation to obtain information from clients to support the robo-adviser's duty to provide suitable advice; and
3. The adoption and implementation of effective compliance programs reasonably designed to address particular concerns relevant to providing automated advice.

While this guidance focuses on the obligations of robo-advisers under the Advisers Act, robo-advisers should consider whether the organization and operation of their programs raise any issues under the other federal securities laws, including the Investment Company Act of 1940 (the "Investment Company Act"), and in particular Rule 3a-4 under that Act.⁹ To the extent that a robo-adviser believes that its organization and operation raise unique facts or circumstances not addressed by Rule 3a-4, such adviser may wish to consider contacting the Staff for further guidance.

1. Substance and Presentation of Disclosures

The information a client receives from an investment adviser is critical to his or her ability to make informed decisions about engaging, and then managing the relationship with, the investment adviser.¹⁰ As a fiduciary, an investment adviser has a duty to make full and fair disclosure of all material facts to, and to employ reasonable care to avoid misleading, clients.¹¹ The information provided must be sufficiently specific so that a client is able to understand the investment adviser's business practices and conflicts of interests.¹² Such information must be presented in a manner that clients are likely to read (if in writing) and understand.¹³

Particularly because client relationships with robo-advisers may occur with limited, if any, human interaction, robo-advisers should be mindful that the ability of a client to make an informed decision about whether to enter into, or continue, an investment advisory relationship may be dependent solely on a robo-adviser's electronic disclosures made via email, websites, mobile applications, and/or other electronic media.¹⁴ Furthermore, given the unique aspects of their business models, including their reliance on algorithms and the internet as a means of providing advisory services, robo-advisers may wish to consider the most effective way to communicate to their clients the limitations, risks, and operational aspects of their advisory services. Accordingly, as discussed below, when designing its disclosures, it may be useful for a robo-adviser to consider how it explains its business model and the scope of the investment advisory services it provides, as well as how it presents material information to clients.

Explanation of Business Model

To address potential gaps in a client's understanding of how a robo-adviser provides its investment advice, the robo-adviser (like all registered investment advisers) should disclose, in addition to other required information,¹⁵ information regarding its particular business practices and related risks.¹⁶ Information a robo-adviser should consider providing includes:

- A statement that an algorithm is used to manage individual client accounts;
- A description of the algorithmic functions used to manage client accounts (e.g., that the algorithm generates recommended portfolios; that individual client accounts are invested and rebalanced by the algorithm);
- A description of the assumptions and limitations of the algorithm used to manage client accounts (e.g., if the algorithm is based on modern portfolio theory, a description of the assumptions behind and the limitations of that theory);

- A description of the particular risks inherent in the use of an algorithm to manage client accounts (e.g., that the algorithm might rebalance client accounts without regard to market conditions or on a more frequent basis than the client might expect; that the algorithm may not address prolonged changes in market conditions);
- A description of any circumstances that might cause the robo-adviser to override the algorithm used to manage client accounts (e.g., that the robo-adviser might halt trading or take other temporary defensive measures in stressed market conditions);
- A description of any involvement by a third party in the development, management, or ownership of the algorithm used to manage client accounts, including an explanation of any conflicts of interest such an arrangement may create (e.g., if the third party offers the algorithm to the robo-adviser at a discount, but the algorithm directs clients into products from which the third party earns a fee);
- An explanation of any fees the client will be charged directly by the robo-adviser, and of any other costs that the client may bear either directly or indirectly (e.g., fees or expenses clients may pay in connection with the advisory services provided, such as custodian or mutual fund expenses; brokerage and other transaction costs);
- An explanation of the degree of human involvement in the oversight and management of individual client accounts (e.g., that investment advisory personnel oversee the algorithm but may not monitor each client's account);
- A description of how the robo-adviser uses the information gathered from a client to generate a recommended portfolio and any limitations (e.g., if a questionnaire is used, that the responses to the questionnaire may be the sole basis for the robo-adviser's advice; if the robo-adviser has access to other client information or accounts, whether, and if so, how, that information is used in generating investment advice); and
- An explanation of how and when a client should update information he or she has provided to the robo-adviser.

Scope of Advisory Services

Robo-advisers, like all registered investment advisers, should consider the clarity of the descriptions of the investment advisory services they offer and use reasonable care to avoid creating a false implication or sense about the scope of those services which may materially mislead clients.¹⁷ Robo-advisers should be careful not to mislead clients by implying, for example, that:

- The robo-adviser is providing a comprehensive financial plan if it is not in fact doing so (e.g., if the robo-adviser does not take into consideration a client's tax situation or debt obligations, or if the investment advice is only targeted to meet a specific goal—such as paying for a large purchase or college tuition—without regard to the client's broader financial situation);
- A tax-loss harvesting service also provides comprehensive tax advice; or
- Information other than that collected by the questionnaire (e.g., information concerning other client accounts held with the robo-adviser, its affiliates or third parties; information supplementally submitted by the client) is considered when generating investment recommendations if such information is not in fact considered.

Presentation of Disclosures

Robo-advisers may or may not make investment advisory personnel available to clients to highlight and explain important concepts. Clients may also be unlikely to read or understand disclosures that are dense and that are not in plain English. After reviewing the websites and disclosures of a number of robo-advisers, we have observed that robo-advisers utilize a variety of practices in providing important information to their clients. Because of robo-advisers' reliance on online disclosures to provide such information, there may be unique issues that arise when communicating key information, risks, and disclaimers.¹⁸ We therefore remind robo-advisers to carefully consider whether their written disclosures are designed to be effective (e.g., are not buried¹⁹ or incomprehensible²⁰). In particular, in presenting their disclosures, robo-advisers may wish to consider:

- Whether key disclosures are presented prior to the sign-up process so that information necessary to make an informed investment decision is available to clients before they engage, and make any investment with, the robo-adviser;
- Whether key disclosures are specially emphasized (e.g., through design features such as pop-up boxes);

- Whether some disclosures should be accompanied by interactive text (e.g., through design features such as tooltips²¹) or other means to provide additional details to clients who are seeking more information (e.g., through a “Frequently Asked Questions” section); and
- Whether the presentation and formatting of disclosure made available on a mobile platform have been appropriately adapted for that platform.

2. Provision of Suitable Advice

An investment adviser’s fiduciary duty includes an obligation to act in the best interests of its clients and to provide only suitable investment advice.²² Consistent with these obligations, an investment adviser must make a reasonable determination that the investment advice provided is suitable for the client based on the client’s financial situation and investment objectives.²³

Reliance on Questionnaires to Gather Client Information

We have observed that robo-advisers may provide investment advice based primarily, if not solely, on client responses to online questionnaires. The questionnaires we have reviewed have varied with respect to length and the types of information requested. For example, some robo-advisers generate a recommended portfolio based upon a client’s age, income and financial goals. Other robo-advisers may obtain through their questionnaires different or additional information such as investment horizon, risk tolerance, and/or living and other expenses when generating a recommended portfolio. We have also observed that some of these questionnaires are not designed to provide a client with the opportunity to give additional information or context concerning the client’s selected responses. In addition, robo-advisers may not be designed so that advisory personnel may ask follow-up or clarifying questions about a client’s responses, address inconsistencies in client responses, or provide a client with help when filling out the questionnaire. Given this limited interaction, when considering whether its questionnaire is designed to elicit sufficient information to support its suitability obligation, a robo-adviser may wish to consider factors such as:

- Whether the questions elicit sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client based on his or her financial situation and investment objectives;²⁴
- Whether the questions in the questionnaire are sufficiently clear and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through the use of design features, such as tool-tips or pop-up boxes); and

- Whether steps have been taken to address inconsistent client responses, such as:
 - Incorporating into the questionnaire design features to alert a client when his or her responses appear internally inconsistent and suggest that the client may wish to reconsider such responses; or
 - Implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the robo-adviser.²⁵

Client-Directed Changes in Investment Strategy

Many robo-advisers give clients the opportunity to select portfolios other than those that they have recommended.²⁶ Some robo-advisers do not, however, give a client the opportunity to consult with investment advisory personnel about how the client-selected portfolio relates to the client's stated investment objective and risk profile, and its suitability for that client. This may result in a client selecting a portfolio that the robo-adviser believes is not suitable for the investment objective and risk profile the robo-adviser has generated for the client based on his or her questionnaire responses. Thus, consistent with its obligation to act in its client's best interests, a robo-adviser should consider providing commentary as to why it believes particular portfolios may be more appropriate for a given investment objective and risk profile. In this regard, a robo-adviser may wish to consider whether pop-up boxes or other design features would be useful to alert a client of potential inconsistencies between the client's stated objective and the selected portfolio.

3. Effective Compliance Programs

Rule 206(4)-7 under the Advisers Act requires each registered investment adviser to establish an internal compliance program that addresses the adviser's performance of its fiduciary and substantive obligations under that Act. To comply with the rule, a registered investment adviser must adopt, implement, and annually review written policies and procedures that are reasonably designed to prevent violations of the Advisers Act and the rules thereunder, and that take into consideration the nature of the firm's operations and the risk exposures created by such operations.²⁷ A registered investment adviser must also designate a chief compliance officer who is competent and knowledgeable about the Advisers Act to be responsible for administering the written policies and procedures adopted.²⁸

In developing its compliance program, a robo-adviser should be mindful of the unique aspects of its business model. For example, a robo-adviser's reliance on algorithms, the limited, if any, human interaction with clients, and the provision of advisory services over the internet may create or accentuate risk exposures for the robo-adviser that should

be addressed through written policies and procedures.²⁹ Thus, in addition to adopting and implementing written policies and procedures that address issues relevant to traditional investment advisers,³⁰ robo-advisers should consider whether to adopt and implement written policies and procedures that address areas such as:

- The development, testing, and backtesting of the algorithmic code and the post-implementation monitoring of its performance³¹ (e.g., to ensure that the code is adequately tested before, and periodically after, it is integrated into the robo-advisers' platform; the code performs as represented;³² and any modifications to the code would not adversely affect client accounts);
- The questionnaire eliciting sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client based on his or her financial situation and investment objectives;
- The disclosure to clients of changes to the algorithmic code that may materially affect their portfolios;
- The appropriate oversight of any third party that develops, owns, or manages the algorithmic code or software modules utilized by the robo-adviser;
- The prevention and detection of, and response to, cybersecurity threats;³³
- The use of social and other forms of electronic media in connection with the marketing of advisory services (e.g., websites; Twitter; compensation of bloggers to publicize services; "refer-a-friend" programs);³⁴ and
- The protection of client accounts³⁵ and key advisory systems.³⁶

Conclusion

Robo-advisers represent a fast-growing trend within the investment advisory industry, and have the potential to give retail investors more affordable access to investment advisory services. As registered investment advisers, robo-advisers should be mindful that they are subject to the fiduciary and other substantive requirements of the Advisers Act. This guidance is intended to provide suggestions to such advisers as they seek to meet their obligations under that Act. As the investment advisory industry continues to innovate and develop new ways to provide advisory services to clients, the Staff will monitor these innovations and implement safeguards, as necessary, to help facilitate such developments and protect investors.

Endnotes

- 1 See, e.g., Andrew Meola, *The Fintech Report 2016: Financial Industry Trends and Investment*, Business Insider (Dec. 14, 2016), available at: <http://www.businessinsider.com/the-fintech-report-2016-financial-industry-trends-and-investment-2016-12?r=UK&IR=T>; Marlene Y. Satter, *Robo-Advisors Will Disrupt Market: Study*, Benefitspro.com (Aug. 8, 2016), available at: <http://www.benefitspro.com/2016/08/08/robo-advisors-will-disrupt-market-study>; Sarah Kocianski, *Robo-Advisor Report: Market Share, Returns and Key Growth Drivers*, Business Insider (June 9, 2016), available at: <http://www.businessinsider.com/the-robo-advising-report-market-forecasts-key-growth-drivers-and-how-automated-asset-management-will-change-the-advisory-industry-2016-6>.
- 2 See, e.g., Richard Eisenberg, *Robo-Advisers: Not Just for Millennials Anymore?* (Dec. 6, 2016), available at: <http://www.forbes.com/sites/nextavenue/2016/12/06/robo-advisers-not-just-for-millennials-anymore/>.
- 3 For purposes of this guidance, the term “client” also includes “prospective client.”
- 4 For purposes of this guidance, the term “robo-adviser” includes both the registered investment adviser and any automated investment advisory program it offers.
- 5 We also note that some robo-advisers operate as stand-alone companies, while others are business units of larger, traditional investment advisers. Furthermore, some robo-advisers enable clients to access their services directly. Other robo-advisers are offered as digital portfolio management tools by traditional advisers that view these programs as components of their existing advisory practices.
- 6 See generally Fintech Forum, SEC (Nov. 14, 2016), available at: <https://www.sec.gov/spotlight/fintech> (“Fintech Forum”). An unofficial transcript of the November 14, 2016 Fintech Forum is available at: <https://www.sec.gov/spotlight/fintech/transcript-111416.pdf> (“Forum Transcript”).

The increasing use of digital advice tools has also been the focus of other regulators and certain international bodies. See, e.g., *Update to the Report on the IOSCO Automated Advice Tools Survey*, International Organization of the Securities Commissions (Dec. 2016), available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD552.pdf>; *Report on Digital Investment Advice*, FINRA (March, 2016), available at: <http://www.finra.org/sites/default/files/digital-investment-advice-report.pdf>; *Regulating Digital Financial Product Advice*, Australian Securities

& Investments Commission (March 21, 2016), available at: <http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-254-regulating-digital-financial-product-advice/>.

- 7 See generally Forum Transcript, *supra* note 6, at 38 (Bo Lu, Co-Founder and CEO of Future Advisor at Blackrock) (“Digital advice actually underpins a whole spectrum of delivery models. And there will be places where . . . you’ll have an almost exclusively digital relationship, and places where you’ll have what appears to the end user an almost exclusively human-based relationship, underpinned by digital [advice] that the client never knew about.”).
- 8 As SEC-registered investment advisers, robo-advisers are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients. A general overview of the regulatory requirements of the Advisers Act can be found at <https://www.sec.gov/divisions/investment/advoverview.htm>. This guidance focuses on certain issues that robo-advisers should consider due to the nature of their business model.
- 9 See Rule 3a-4 under the Investment Company Act (creating a non-exclusive safe-harbor from the definition of “investment company” for advisory programs that meet Rule 3a-4’s requirements). See also Status of Investment Advisory Programs under the Investment Company Act of 1940, Investment Company Act Release No. 21260 (July 27, 1995) (discussing circumstances in which an investment advisory program may be considered an investment company).
- 10 See Amendments to Form ADV, Advisers Act Release No. 3060 (July 28, 2010) (“Amendments to Form ADV Adopting Release”). See also Advisers Act Rule 204-3(b) (requiring delivery of a brochure before or at the time an adviser enters into an investment advisory contract with a client). An adviser’s disclosure responsibilities are broad and delivery of the adviser’s brochure alone may not fully satisfy the adviser’s disclosure obligations. See Instruction 3 of General Instructions for Part 2 of Form ADV; Advisers Act Rule 204-3(f) (delivery of a brochure or brochure supplement does not relieve an adviser of any other disclosure obligations it has to its advisory clients).
- 11 See SEC v. Capital Gains Research Bureau, Inc., et al., 375 U.S. 180, 186, 194 (1963). See also H. R. Rep. No. 85, 73d Cong., 1st Sess. 2; General Instruction 3 to Part 2 of Form ADV.

- 12 See Amendments to Form ADV Adopting Release, *supra* note 10, at n. 28. See also Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, n. 531 (Jan. 2011) (the “Study”), available at: www.sec.gov/news/studies/2011/913studyfinal.pdf; Instruction 3 of General Instructions for Part 2 of Form ADV.
- 13 Amendments to Form ADV Adopting Release, *supra* note 10. See also In the Matter of Arlene W. Hughes d/b/a E. W. Hughes & Company, Securities Exchange Act Release No. 4048 (Feb. 18, 1947).
- 14 Robo-advisers should also be mindful to make disclosures in plain English. See generally Instruction 2 of General Instructions for Part 2 of Form ADV (providing guidance on drafting in plain English); Amendments to Form ADV Adopting Release, *supra* note 10. See also A Plain English Handbook, SEC Office of Investor Education and Assistance (August 1998), available at: <https://www.sec.gov/pdf/handbook.pdf>.
- 15 See *supra* note 10.
- 16 See Amendments to Form ADV Adopting Release, *supra* note 10 (“To allow clients and prospective clients to evaluate the risks associated with a particular investment adviser, its business practices, and its investment strategies, it is essential that clients and prospective clients have clear disclosure that they are likely to read and understand”). See generally Forum Transcript, *supra* note 6, at 71 (Mark Goines, Vice Chairman of Personal Capital) (“[T]he other area that I think is really important for us. . . [is] making sure . . . that the accountability to the clients is clear and that that’s fully disclosed.”).
- 17 See, e.g., In the Matter of T. Rowe Price and Associates, Inc., Advisers Act Release No. 658 (Jan. 16, 1979) (settled action) (a registered investment adviser “willfully violated Section 206 of the Investment Advisers Act of 1940 in that it failed to adequately and accurately disclose in certain promotional literature and otherwise to actual and prospective . . . clients the amount of individualized treatment provided to each . . . account and the extent to which investment decisions for . . . accounts would be made and implemented based upon ‘model portfolios.’”).

- 18 In other contexts, the Staff has taken the position that a relevant factor to consider when determining if potentially confusing disclosures are misleading is whether such disclosures are individually highlighted and explained during an in-person meeting. See, e.g., Heitman Capital Management, LLC, SEC Staff No-Action Letter (Feb. 12, 2007) (addressing the use of certain hedge clauses in certain advisory contracts).
- 19 Under the “buried facts” doctrine, a court would consider disclosure to be false and misleading if its overall significance is obscured because material information is “buried,” for example in a footnote or appendix. See Commission Guidance on the Use of Company Web Sites, Investment Company Act Release No. 28351 (Aug. 1, 2008) at n. 68.
- 20 See generally *id.*
- 21 A tooltip allows additional information to be shown in a text box when a mouse cursor hovers over a particular item on a web page.
- 22 Status of Investment Advisory Programs under the Investment Company Act of 1940, Investment Company Act Release No. 22579 (Mar. 24, 1997) at text accompanying n.32 (“Investment advisers under the Advisers Act owe their clients the duty to provide only suitable investment advice, whether or not the advice is provided to clients through an investment advisory program. To fulfill this suitability obligation, an investment adviser must make a reasonable determination that the investment advice provided is suitable for the client based on the client’s financial situation and investment objectives.”) (“Rule 3a-4 Adopting Release”), *citing to* Suitability of Investment Advice Provided by Investment Advisers, Advisers Act Release No. 1406 (Mar. 16, 1994) (“Suitability Rule Proposing Release”) (proposing a rule under Section 206(4) of the Advisers Act that would expressly require advisers to give clients only suitable advice; the rule would have codified existing suitability obligations of advisers). See also The Study, *supra* note 12, at 22, 27. We note that the Commission has brought a number of enforcement actions against investment advisers for failing to provide suitable investment advice. See, e.g., In re David A. King and King Capital Corp., Advisers Act Release No. 1391 (Nov. 9, 1993) (investment adviser recommended investments in a risky pool of first, second and third mortgages to retirees and others of limited means); In re George Sein Lin, Advisers Act Release No. 1174 (June 19, 1989) (investment adviser with discretionary investment authority invested funds of clients desiring low-risk investments in uncovered option contracts and utilized margin brokerage accounts); In re

Westmark Financial Services, Corp., Advisers Act Release No. 1117 (May 16, 1988) (financial planner recommended speculative equipment leasing partnerships to unsophisticated investors with modest incomes); *In re Shearson, Hammill & Co.*, 42 SEC 811 (1965) (sections 206(1) and (2) violated when adviser recommended investments unsuitable to child and widow).

- 23 See Rule 3a-4 Adopting Release, *supra* note 22, at text accompanying n.32. See also *The Study*, *supra* note 12, at 27; Suitability Rule Proposing Release, *supra* note 22.
- 24 See generally Forum Transcript, *supra* note 6, at 66 (Mark Goines, Vice Chairman of Personal Capital) (“[Does the robo-adviser] have enough of an understanding of the client to be able to apply the algorithm, or is the algorithm actually collecting enough data to actually apply its applied rules effectively? . . . We have to be very careful that the algorithms are very good but that the inputs are robust, so that we really truly understand the client before we apply it. . . . [A]lgorithms with minimal input run the risk of not fully understanding the client.”).
- 25 For example, a client could indicate that he or she wants a conservative strategy, but would like to invest primarily in high-yield bonds. Similarly, an elderly client may indicate a long-term investment time horizon.
- 26 For example, some robo-advisers allow a client to adjust his or her portfolio away from the strategy the adviser has recommended — including by allowing the client to adjust a slider or risk score to select a portfolio that is more or less aggressive than the portfolio recommended by the robo-adviser.
- 27 Compliance Programs of Investment Companies and Investment Advisers, Advisers Act Release No. 2204 (Dec. 17, 2003) at n.10 and n. 17 and accompanying text (“Adopting Release to Rule 206(4)-7”) (“Each adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm’s particular operations, and then design policies and procedures that address those risks”). The Commission has generally stated that these policies and procedures should cover at a minimum (to the extent they are applicable to the adviser), such areas as portfolio management processes, trading practices, proprietary trading, personal trading activities of supervised persons, disclosure requirements, custody, maintenance of books and records, marketing and cash solicitation activities, valuation, privacy concerns and business continuity plans. See *id.* at nn.17-22 and accompanying text (setting forth a detailed list of areas where the Commission expects registered investment advisers to adopt policies and procedures).

- 28 *Id.* at n.73 and accompanying text.
- 29 *See supra* note 27 and accompanying text.
- 30 *See id.*
- 31 *See generally* Forum Transcript, *supra* note 6, at 59 (Jim Allen, Head of Capital Markets Policy Group, CFA Institute) (“[Many CFA Institute members believe] the biggest risk in the Fintech space is . . . flaws in the algorithms behind these technologies.”).
- 32 *See, e.g.,* In the Matter of AXA Rosenberg Group, LLC, et al., Advisers Act Release No. 3149 (Feb. 3, 2011) (settled action) (In a settled administrative proceeding, the Commission found that two affiliated investment advisers that used a quantitative investment model in managing client accounts breached their fiduciary obligations to their clients by concealing and delaying to fix a material error in the model. One of the investment advisers was also found to have failed to adopt and implement policies and procedures reasonably designed to ensure that it did not make false and misleading statements to clients and investors, including failing to ensure that the model performed as represented, in violation of antifraud provisions of the Advisers Act).
- 33 *See, e.g.,* Cybersecurity Guidance, IM Guidance Update No. 2015-02, April 2015. *See also* Adviser Business Continuity and Transition Plans, Advisers Act Release No. 4439 (June 28, 2016) at n. 77 and accompanying text (“An adviser generally should consider and address as relevant the operational and other risks related to cyber-attacks”).
- 34 *See, e.g.,* Advisers Act Rule 206(4)-1 (addressing advertisements by investment advisers and prohibiting client testimonials); Advisers Act Rule 206(4)-3 (making cash payments to solicitors by registered investment advisers unlawful unless certain conditions are met); Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04, March 2014.
- 35 *See, e.g.,* Advisers Act Rule 206(4)-2 (addressing custody of funds or securities of clients by investment advisers). *See also* Staff Responses to Questions About the Custody Rule, Question II.6. (Sept. 1, 2013) *available at:* http://www.sec.gov/divisions/investment/custody_faq_030510.htm (an investment adviser is deemed

to have custody of client assets if the adviser is provided password access to an account and such access provides the adviser with the ability to withdraw funds or securities or transfer them to an account not in the client's name at a qualified custodian).

- 36 See, e.g., Adopting Release to Rule 206(4)-7, *supra* note 27, at n. 22 (“We believe that an adviser’s fiduciary obligation to its clients includes the obligation to take steps to protect the clients’ interests from being placed at risk as a result of the adviser’s inability to provide advisory services.”).

IM Guidance Updates are recurring publications that summarize the staff’s views regarding various requirements of the federal securities laws. The Division generally issues IM Guidance Updates as a result of emerging asset management industry trends, discussions with industry participants, reviews of registrant disclosures, and no-action and interpretive requests.

The statements in this IM Guidance Update represent the views of the Division of Investment Management. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. Future changes in rules, regulations, and/or staff no-action and interpretive positions may supersede some or all of the guidance in a particular IM Guidance Update.

The mission of the Securities and Exchange Commission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

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