Robo-Advisers Are Here: What should you know?

With the emergence and phenomenal growth of financial technology (FinTech) globally, has been the rise of **Automated Advice Tools** or what is otherwise referred to as **'Robo-Advisers'**. These are digital platforms that provide automated, algorithm-driven financial planning services with little to no human supervision. Essentially, this involves a computer programmer creating software that provides investment advice to the clients of a financial services firm, based on parameters that are tied to their investment strategy. Just imagine the convenience of being able to access financial advice from your smartphone or computer.

Robo-advisers have been around globally since 2008, when Betterment first launched; and more recently in Trinidad and Tobago, in 2019. The global robo-advising market is expected to see impressive growth in the immediate future. In 2018, the total assets under management were approximately US$371 billion. By 2025, total assets under management by Robo-advisory services are expected to increase to US$16 trillion. A Deloitte (2016) report outlined the "four-step evolution" of the features and services offered by robo-advisory firms. This begins with clients purchasing and self-managing their portfolios of stocks, bonds, exchange-traded funds or other investment vehicles. The final evolutionary step involves the use of "sophisticated risk management and profiling questionnaires" which lead to investments via self-learning artificial intelligence (AI) investment algorithms. Investment funds are shifted between the different asset classes based on the prevailing market conditions and individual investment needs.

While no specific guidelines exist locally, there is a foundation for a regulatory framework. Any potential entrants will be subject to the same registration and renewal procedures that are currently applicable to investment advisers under the Securities Act (as amended), 2012 and the Securities (General) By-Laws, 2015. The Commission identified a non-exhaustive list of six (6) areas that should be of importance to investors and advisors, in its 2018 research paper, titled "Automated Advice Tools in the Securities Industry of Trinidad and Tobago: The Regulatory Challenges":

1. **Fiduciary Standard of Care**: This refers to the standard set by securities regulators that requires investment advisers to put their client's interest ahead of their own self-interest. It is comprised of a duty of loyalty and care; an obligation to ensure that investment advice is based on accurate and complete information, a best execution standard and the avoidance of conflicts of interest. The best execution standard essentially means that investment advisers must strive to trade securities with the best combination of low cost and efficient execution.

2. **Client Profiling and On-Boarding Procedures**: Monitoring of the firm's client profiling and on-boarding procedures is important, as any proposed regulatory framework should include policies and review mechanisms, which ensure that on-boarding questionnaires are

rigorous and comprehensive in terms of the data collected. This process, if carried out effectively, will address any potential deficiencies due to the use of an electronic questionnaire in the process of client on-boarding and due diligence.

3. **The Review of Algorithms and their Methodologies**: The complexity of the algorithms is undeniable and therefore, specialized expertise is required by the regulator to properly conduct evaluations. Many securities regulators may not possess personnel with the necessary skills for such evaluations. A determination would be needed on whether sufficient customer information is being collected to satisfy the suitability standard. Thus, the regulator would need to acquire this expertise either through new staff recruitment or by hiring consultants, which in turn becomes expensive. Such determinations are made more difficult when regulators are constrained by limited financial resources. Many regulatory bodies receive funding from their respective central governments, which can fluctuate. Despite this challenge, an evaluation of the algorithm must be a key component of the regulator's compliance and inspections review.

4. **Suitability of Recommendations**: The crux of the problem is that an investment adviser may be tempted to steer the client's decision in a manner that is in the best interest of the adviser and not of the client. This risk also exists when automated advice tools are used to profile investors and select investments. Any proposed framework for automated advice tools in Trinidad and Tobago would have to be predicated on the notion that suitability of these entities' recommendations is of utmost importance. There is a need for the TTSEC to provide "a meaningful articulation of the "best interest" standard of care and clarity on what it means to give **"suitable"** and personalised investment advice".

5. **Conflicts of Interest**: In the case of automated advice tools, the concern is that advisory firms will construct algorithms that are designed to recommend pre-packaged suites of financial products that have been put together by the products' issuers. There is a risk that recommendations on investment mix are made to prospective investors despite the existence of uncertainty as to whether they fit with the client's stated investment objectives (i.e. the suitability standard).

6. **Development of Effective Compliance Programmes:** This was one of the three (3) main issues discussed in the U.S. Securities and Exchange Commission's 2017 Guidance document. Each investment adviser registered in the U.S. is required to establish an internal compliance programme that addresses its fiduciary and substantive obligations under the Investment Advisers Act of 1940. The development of an effective review tool is important for the evaluation of the robo-adviser's compliance programme. This will ensure that potential players in the marketspace are abiding by the standards set forth in the framework.

The financial services industry has been quickly evolving with the rapid pace of technological change, being a major driver. Automated advice tools and other digital innovations will continue to shape the development of the financial services industry in Trinidad and Tobago. As a result, the Trinidad and Tobago Securities and Exchange Commission remains vigilant in creating an environment that balances both the fostering of financial innovation while upholding its investor protection mandate.

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