Robo-Advisers: How should you evaluate them?

This week's article focuses on how you, the investing public, should evaluate a robo-adviser to determine whether it meets your needs. Robo- Advisers 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. It offers the convenience of being able to access financial advice from your smartphone or computer.

Robo-Advisers have had a global presence since 2008. In Trinidad and Tobago, there have been platforms in existence since October 2019. According to Statista[1], assets under management in the robo-advisors segment within the United States, are projected to reach US$937 billion in 2021 and are projected to be US$1.9 trillion by 2025. No specific guidelines for robo-advisers exist locally, however the provisions for investment advisers within the Securities Act (as amended) 2012, provide the basis for regulating potential market entrants which provides a foundation for a regulatory framework.

Any potential entrant 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 Trinidad and Tobago Securities and Exchange Commission (TTSEC), in a 2018 research paper titled, "Automated Advice Tools in the Securities Industry of Trinidad and Tobago: The Regulatory Challenges", identified a non-exhaustive list of six (6) areas of importance to investors and advisors. These are integral to the development of proper customer care relationships between the investor and the adviser and include:

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.

2. **Client Profiling and On-Boarding Procedures**: Monitoring of the firm's client profiling and on-boarding procedures are important. On-boarding questionnaires should be rigorous and comprehensive in terms of the data collected.

3. **The Review of Algorithms and their Methodologies**: The complexity of the algorithms is undeniable and therefore, specialised expertise is required by the regulator to properly conduct evaluations.

[1] Statista is a German company specializing in market and consumer data. According to the company, its platform contains more than 1,000,000 statistics on more than 80,000 topics from more than 22,500 sources and 170 different industries. Its website is www.statista.com.

4. **<u>Suitability of Recommendations</u>**: 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.

5. **<u>Conflicts of Interest</u>**: The concern 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.

6. **<u>Development of Effective Compliance Programmes</u>:** This was one of the three (3) main issues discussed in the U.S. Securities and Exchange Commission's 2017 Guidance document[2]. 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 regulatory framework.

There are three 'steps' that an investor can use to evaluate Robo-Advisers:

1. **<u>Identifying its Services</u>:** Before you invest, you should take a look at the services provided by the robo-adviser and decide what type(s) of financial advice and services you need. While most manage your money, there are some firms that focus solely on providing advice on budgeting and financial planning with no actual investment services. There are also firms in the United States which offer tax-loss harvesting (i.e. a programme that helps investors pay the lowest taxes possible in non-tax-sheltered accounts according to guidelines set by the various tax authorities). Others become niche specialists (e.g. focus on retirement accounts).

2. **<u>Cost Considerations</u>**: Investors should always look at the associated costs of investing whether it is with a traditional investment adviser, or a robo-adviser. Each firm has a different fee structure based on the services rendered. In the United States, fees for robo-advisers generally range from 0.15% to 0.50% of the assets under management although some may charge a one-time setup fee as well. Another important aspect is that there might also be transaction costs for trading various investments, especially if the investments are concentrated in exchange-traded funds or mutual funds. One should also note that a robo-advisers generally earn income on the uninvested cash in your account, while paying little interest.

3. **<u>The Desired Level of Human Interaction</u>:** You should make this determination before taking the plunge with a Robo-Adviser. This concept began with the idea that minimal human involvement could lower costs and people could "just set-it-and-forget-

[2] See the following link: https://www.sec.gov/oiea/investor-alerts-bulletins/ib_robo-advisers.html.

it" letting the algorithms run the show. However, there are some investors who still would like to talk to a professional from time to time. Betterment[3] was the first Robo-adviser to bring in actual financial advisers to help field questions and give investors peace of mind.

Now, several other robo-advisers have followed suit and many even assign users a personalised adviser. One should keep in mind that these professionals need to be paid, and so the robo-advisers that have financial advisors on staff may charge higher investment management fees or a one-time fee for a consultation.

Also, it should be noted that the financial advisers at many of these platforms do not have the ability to make direct investment changes or recommendations. Instead, they are there to answer questions, field general financial advice, and keep users' emotions in check.

The choice of an investment adviser is crucial as it can ultimately determine the success or lack thereof of one's investments. We encourage you to do your homework before making any investment decision. Check to see whether the investment adviser is registered with the Trinidad and Tobago Securities and Exchange Commission. A list of all registered Investment Advisers, Companies, Individuals and securities that are offered are available via the EASi platform on the Commission's website www.ttsec.org.tt.

END

For more information, please visit our corporate website, **www.ttsec.org.tt**.
You may also visit our Investor Education website at **www.investucatett.com** or connect with us via any of our social media handles:

Published Article – Business Express Newspaper
April 28th, 2021

[3] Betterment is an American financial advisory company which provides robo-advising and cash management services. Its website is www.betterment.com.