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THE TRANSFORMATION OF INVESTMENT ADVICE: DIGITAL ADVISERS AS FIDUCIARIES

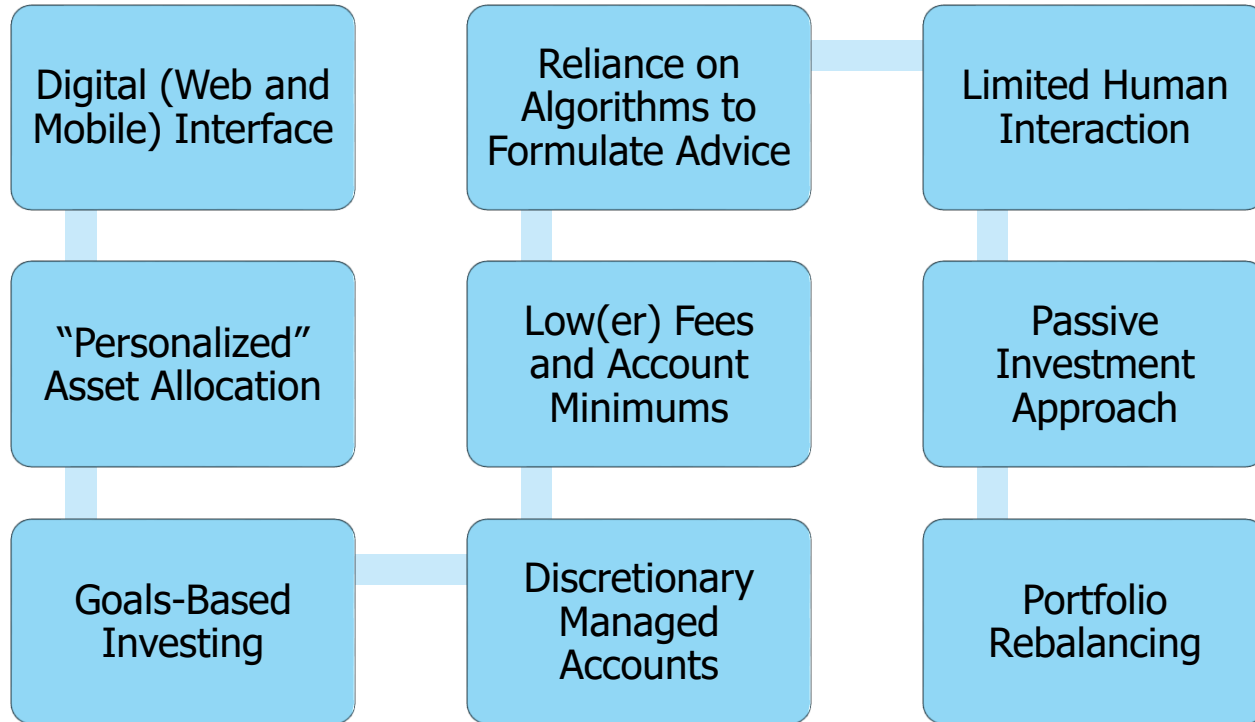
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Wharton Pension Research Counsel 2018 Symposium:
The Disruptive Impact of FinTech on Retirement Systems
May 3, 2018

Overview

- Robo Advisor Defined
- Growth Drivers
- Evolution of the Business Model
- Fiduciary Advice

Robo Advisor Defined



Growth Drivers

- Lack of confidence in retirement readiness
- Decline of defined contribution and employer-sponsored plans
- Higher barriers to entry for traditional advisory services
- Growing awareness of fees in determining investment outcomes, and passive index bias
- Increasing consumer adoption of digital solutions to manage financial lives
- Technological advances to UI and UX
- Reduced overhead of digital solutions

Evolution of the Business Model

- Hybrid human-robo advisers
- Proprietary funds
- Account aggregation
- Artificial intelligence
- Expanded models (ESG portfolios, Smart Beta strategies)
- Comprehensive financial planning
- Increased government regulation/focus

Fiduciary Advice

- Imposition of fiduciary standard on advisory relationships is by law
 - U.S. Investment Advisers Act of 1940 and applicable case law set the fiduciary standard
 - Federal fiduciary standard for registered investment advisers enforced by the U.S. Securities and Exchange Commission
 - Advisers that manage assets on a discretionary basis do so as fiduciaries
- Parameters of the federal fiduciary standard
 - Principles-based standard that is inherently flexible to different types of advisory relationships
 - Predicated on duties of care and loyalty
 - Full and fair disclosure of all material facts, including actual or potential conflicts of interest that may impede impartiality
 - Reasonable basis for advice

Fiduciary Advice

- SEC Division of Investment Management Guidance Update (February 2017)
 - Robo advisers are subject to fiduciary obligations and substantive provisions of the Advisers Act
 - Acknowledged wide variety of business models and “variety of means” to meet regulatory obligations:
 - Range of methods to collect client information
 - Limited information may be considered
 - Varying levels of human interaction
 - Ability of clients to contract for narrowed scope of services
 - Heavy emphasis on disclosure

Fiduciary Advice

- SEC Division of Investment Management Guidance Update (February 2017)
 - Substance and presentation of disclosures
 - Provision of suitable advice
 - Reliance on questionnaires to gather client information
 - Client-directed changes in investment strategy
 - Effective compliance programs
 - Testing
 - Suitability
 - Algorithm Modifications
 - Oversight

Fiduciary Advice

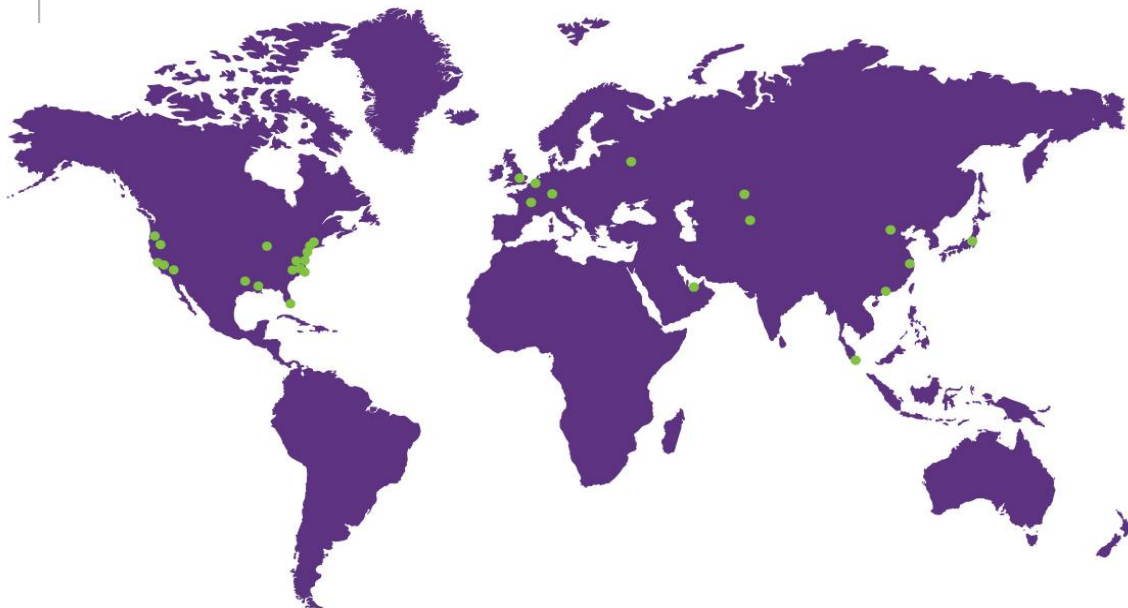
- SEC Office of Compliance Inspections and Examinations – Examination Priorities (February 2018)
 - Electronic Investment Advice
 - Continued focus on advisers and brokers that offer investment advice through automated or digital platforms
 - Examinations to focus on:
 - Compliance programs, including algorithm governance
 - Advertising and marketing
 - Formulation of investment recommendations
 - Investor data protection
 - Disclosure of conflicts of interest

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