SEC PROPOSED RULE ON ROBO-ADVISORY SERVICES

- ❖ The Securities and Exchange Commission (SEC) recently released an exposure draft of the Proposed Rule on Robo-Advisory Services **"proposed Guidelines"** pursuant to its powers under Section 13 of the Investment and Securities Act "ISA" 2007. Robo - Advisers which could be referred to as automated advisers are registered investment advisers using innovative technology to provide investment advisory services with limited direct human interaction and or using an interactive platform to provide investment advice to clients through algorithmic based programs.

- ❖ The provision of the proposed Guidelines shall be applicable to all Capital Market Operators and persons (Individual & Corporate) offering or seeking to offer Digital (Robo) Advisory Services in the Nigerian Capital Market.

- ❖ **REGISTRATION REQUIREMENTS:** Robo-Advisers will be required to comply with the registration requirements set out under Rule 96 (1) and (2) of the SEC Rules and Regulations, with the implication that they must first obtain a license from SEC as an investment adviser.

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# ADDITIONAL REGULATORY REQUIREMENTS FOR DIGITAL (ROBO) ADVISER

1.   A Robo Adviser shall comply with all applicable business conduct requirements set out in the ISA, and the Rules and Regulations, Notices and Guidelines issued pursuant to the ISA.

2.   Where a Robo Adviser outsources the development and maintenance of their client-facing tools to a third-party provider, the third-party provider is not required to be registered by the SEC. The Robo Adviser is however required to undertake due diligence process with the third-party provider to assess the risks associated with the outsourcing arrangement.

3.   A Robo Adviser who wishes to perform the function of portfolio management shall apply to the Commission to be registered as a Fund/Portfolio Manager and shall comply with the Rules and the Regulations governing Fund/Portfolio Management Function under the Guidelines.

DIGITAL INVESTMENT ADVISORY PROCESS

❖ Under the proposed Guidelines this would involve a client answering a series of questions on his risk tolerance, investment objectives, investment time horizon, inputs an investment amount. The input of the client is analyzed using algorithms, and a portfolio is recommended thereto.

❖ Where a client accepts the recommended portfolio, the Robo Adviser shall relay the client's orders directly to the relevant CMO for execution except the Robo Adviser is registered to perform that function.

❖ Where the client decides on an alternative product or recommendation which is different from the Robo Adviser's advice and recommendation, the Robo Adviser shall seek the express consent of the client and rely on the client's order. The client's decision shall also be documented.

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PROCEDURE FOR REBALANCING A CLIENT'S INVESTMENT ASSET ALLOCATION

❖ Under the proposed Guidelines, there is option for the client to accept the previously rejected recommended portfolio (referred to as rebalancing)

❖ The Robo Adviser shall ensure that the rebalancing activity is carried out only for portfolios initially identified by the client as forming his/her investment asset allocation

❖ Obtain a one-time prior written authorization from the client to rebalance the portfolio in addition to other disclosures and authorization procedure.
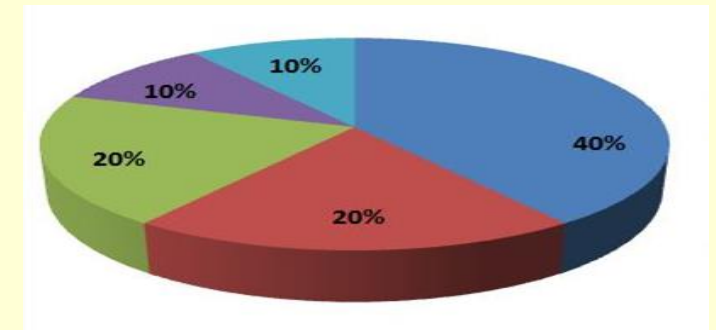
GOVERNANCE AND SUPERVISION OF ALGORITHMS

To safeguard the algorithm-driven client-facing tools the following shall be required:

❖ The Robo Adviser should be adequately staffed with persons who have the competency and expertise to develop and review the methodology of the algorithms. Adequate training should also be provided to all staff who use the client-facing tool.

❖ The Board and Senior Management of the Robo Adviser shall be responsible for maintaining effective oversight and governance of the client- facing tool; designing and development of the algorithms; ensuring that there are sufficient resources to monitor and supervise the performance of algorithms; put in place policies and procedures to ensure a sound risk management culture and environment; designating appropriate personnel to approve changes to the algorithms; having security arrangements to identify and prevent unauthorized access to the algorithms as well as compliance with the relevant rules and regulations

❖ While the Board and Senior Management may delegate responsibilities, they remain liable and accountable for the governance and supervision of the algorithm-driven client-facing tools.

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TECHNOLOGY RISK MANAGEMENT

To mitigate technology risks, the Robo-Advisers are required to:

❖ implement internal policies and procedures to address technology risks.

❖ comply with the requirements of SEC on Technology Risk Management (TRM)

❖ refer to the TRM Guidelines for industry best practices which they are expected to adopt.

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COMPLIANCE WITH THE ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM ACT

❖ Robo Advisers shall have in place adequate policies, procedures and controls to mitigate against money laundering and terrorism financing risks and comply with SEC's Regulations on Anti-Money Laundering and Combating the Financing of Terrorism Act, 2013.

❖ Take steps to address specific risks associated with Non-Face-To-Face ("NFTF") business relations with a client. In this regard, Robo Advisers shall employ additional checks to mitigate the risk of impersonation when on-boarding clients through a NFTF means.

DISCLOSURE OF MATERIAL INFORMATION AND INFORMATION ON ALGORITHMS

- Robo Advisers shall be required to provide sufficient information to their clients to enable them make informed investment decisions
- Disclose in writing the assumptions, limitations and risks of the algorithms; and any material adjustments to the algorithms.

RISK WARNING STATEMENT FOR OVERSEAS-LISTED INVESTMENT PRODUCTS

- The proposed Robo-Advisory Rules contemplate the possibility of Robo-Advisers advising their clients on investment products listed overseas.
- When advising on overseas-listed investment products, Robo Advisers are required to assess the merits of the products, investment objectives, financial situation and particular need.
- Required to issue a risk warning statement to their clients.

CONFLICTS OF INTEREST	**ASSESSING CLIENTS' KNOWLEDGE AND EXPERIENCE**
• Robo Advisers are required to comply with the Code of Conduct for Employees of Capital Market Operators on conflicts of interest • Disclose in writing to their clients, any actual or potential conflict of interest, including any material information or facts that may compromise their objectivity or independence. • Disclose situations where their algorithms are designed to direct clients to invest in products managed by their affiliates.	• Robo Advisers are required to assess client's relevant knowledge and experience to invest in complex instruments using Customer Knowledge Assessment (CKA) or Customer Account Review (CAR). • Have the relevant framework to collect information from clients to enable them conduct CAR or CKA assessments for products suitability.

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OTHER RELEVANT PROVISIONS OF THE PROPOSED GUIDELINES

❖ Robo-advisers are to ensure that all principal officers responsible for the design, operation and/or oversight of the digital advisory platform have relevant experience in fund management and technology;

❖ Ensure Portfolios offered to clients are within the regulatory purview of SEC

❖ Undergoes a post-technology authorization technology audit conducted by an independent third party at the end of each operational year.

❖ Comply with the advertisement requirements of the Rules and Regulations of the SEC

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CONCLUSION

This proposed Guidelines is a step in the right direction to monitor and engage with robo-advisers (who operated within Nigeria without any form of approval or license) to evaluate how these advisers meet their obligations under the Investment and Securities Act given the unique challenges and opportunities presented by these programs. By this proposed Guidelines robo-advisers should keep in mind certain unique considerations as they seek to meet their legal obligations under the Investment and Securities Act 2007.

Kindly reach us for more information

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