**Robos Falling Behind on Fiduciary Standards: Report**

Article published on November 2, 2018
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Robo-advisors have room for improvement in complying with fiduciary standards, according to a new report.

Swiss research firm **MyPrivateBanking** ranked 20 digital advice platforms from around the globe, including **Schwab** Intelligent Portfolios, Fidelity Go, Wealthfront, Merrill Edge, TD Ameritrade Essential Portfolios and SigFig. The providers were judged on criteria including the technical features of their platforms, portfolio options and how appropriate the portfolios they recommend for clients actually are — a weak link for many firms.

“The industry’s greatest vulnerability relates to its weak compliance with fiduciary standards and the general suitability of portfolio recommendations,” the report says.

The researchers put two hypothetical investors with different financial backgrounds through each provider’s account-opening process, and then compared the robo recommendations to benchmark portfolios the researchers deemed suitable.

**Merrill Lynch**

- NUMBER OF ADVISORS

  17456

- FIRM-WIDE ASSETS

$2,385,479 Million

- FEE-BASED ADVISORY ASSETS

  $1,144,375 Million

- DISCRETIONARY ASSETS

  $273,057 Million

- KEY PLATFORMS

  Merrill Lynch - Merrill Edge Advisory Account Program (MEAP), Merrill Lynch - Strategic Portfolio Advisor, Merrill One - Custom Managed Strategy, Merrill One - Defined Strategy, ...

- Profile updated as of 10/29/2018
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**Merrill Edge Guided Investing**

- TYPE OF INVESTMENTS

  ETFs

- DISCRETION TYPE

  Online Investment Advisory ("Robo")

- ACCOUNT MINIMUMS

  $5,000

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**TD Ameritrade**

- NUMBER OF ADVISORS

  6000

- FIRM-WIDE ASSETS

  $650,000 Million

- FEE-BASED ADVISORY ASSETS

$128,400 Million

- DISCRETIONARY ASSETS

$19,400 Million

- Profile updated as of 11/07/2018
- Click for full profile.

In the fiduciary standards category, robos were assessed against a rubric designed to cover regulatory expectations in different jurisdictions, winning points on criteria such as whether investors were prompted to disclose outside assets or asked about risk appetite. Researchers also examined how robo platforms determined investors' risk ratings, MyPrivateBanking analyst Katrina Pirner says. Pirner wrote the report with senior analyst Onawa Promise Lacewell.

The tested robos were particularly poor at measuring risk capacity, or a client's ability to weather a loss, as opposed to their appetite to take on risk, Pirner says. As a result, clients can be recommended portfolios that are potentially too risky.

“You could have a really strong risk appetite portion of the onboarding process, but that of course doesn't make up for a lackluster approach to risk capacity,” she says.

Eliciting the necessary information from clients to determine risk tolerance is a problem for all advisors, not just robos, says Georgia State University professor Nicole Iannarone. Investors may resist providing personal financial information, or not recognize why an advisor needs certain details.

Providers that don't design their onboarding questionnaires thoughtfully can miss key information, says Beth Haddock, CEO and founder of compliance consulting firm **Warburton Advisers**.

For example, if a robo asks clients about their income but not their debt, the platform may recommend investments that are too risky, **Haddock** says.

In the U.S., robos are typically registered investment advisors, and as such must act in their clients' best interest. And in February 2017, the Securities and Exchange Commissionissued guidance urging providers to review whether their questions were “sufficiently clear” and comprehensive enough to collect the information necessary “to allow the robo-advisor to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client.”

Merrill Lynch keeps things simple in its Merrill Edge Guided Investing program, which scored highest of any U.S. firm in the MyPrivateBanking report. Investors using that service answer five questions to assess their risk tolerance.

The questions, as well as linked explanations of why each question is asked, were designed to obtain accurate information without confusing novice investors, Merrill Edge director of online brokerage strategy Todd Carver says.

“We’ve definitely gone through a lot of rigor to find the way to position some of these challenging concepts with clients that don’t rely on a ton of financial jargon, so that individuals who may be investing for the first time will understand the risks and the benefits of getting into a robo-advisor platform,” he says.

TD Ameritrade, which ranked third overall among American providers, balances getting enough information without overwhelming investors in its Essential Portfolios program, director of guidance platform management John Bell says. Essential Portfolios had $1.8 billion in assets under management as of Sept. 30, according to company information.

“We know that too many questions could lead to confusion and indecision in the process, negatively impacting the overall client experience,” Bell says in an e-mail.

Human advisors are also available to answer clients’ questions over the phone, and the firm also contacts existing clients annually to make sure that their information remains accurate. Changes in an investor’s time horizon or risk tolerance, or life events like job switches or income changes, may prompt moving a client to a different Essential Portfolios model, Bell says.

Betterment, which was not rated in the MyPrivateBanking report, encourages investors to link outside accounts, associate general counsel Seth Rosenbloom says. After their initial enrollment, clients receive periodic prompts to add accounts, and the firm explains how that and other information will be used.

“When we’re collecting that information, we try to be really clear about why we’re collecting that information and how that will inform our portfolio recommendations,” he says.

In its guidance, the SEC suggested design features that could address inconsistencies in client responses. For example, if an investor says he or she can accept significant amounts of risk but needs liquidity, the robo’s software should be smart enough to notice, **Haddock of Warburton Advisers** says.

“Maybe you just don’t allow the investor or the client to keep going and get a portfolio based on their answers without highlighting the inconsistencies to them,” she says.

The MyPrivateBanking report also found some robos were allowing clients to simply enter their own risk ratings, Pirner says.

“We think that’s problematic,” she says.

Instead, the researchers recommend that robo-advisors assign risk ratings, but allow clients to manually change them.

Betterment clients can manually change their allocations, but doing so prompts feedback explaining why the switch may not be appropriate.

Updated projection graphs also show investors how their expected returns could change, Rosenbloom says.

Merrill Edge Guided Investing doesn't allow investors to change their risk tolerance without redoing the initial questionnaire. But ensuring that questions resonate with investors helps limit such client-directed switches, Merrill Lynch SVP and marketing product manager Robert Bell says.

"That was part of the rationale for us to keep things as simple as possible but also relevant, so that folks didn't feel that they had to go play with things," he says.

Once the hypothetical investors made it through onboarding, the MyPrivateBanking researchers found reports on the recommended portfolio often lacked transparency or detail.

"Explanations had a tendency to be quite cursory," Pirner says.

The SEC in its 2017 guidance warned providers that disclosures should not be "buried or incomprehensible."

But digital advice providers may struggle balancing required disclosures with the desire to provide an elegant user experience, **Haddock** says.

*Contact the reporter on this story at cgermaine@ignites.com or 212 390-7329.*

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