JUL 08
Victor Chatenay

The SEC will call for more transparency from robo-advisors

Article

Here's what's happening: The US regulator's recent probe into **Charles Schwab**'s robo-advisory service suggests the industry will receive greater scrutiny.

Some context: The **SEC** first took action against two robos, **Wealthfront** and **Hedgeable,** in 2018 over false disclosures on their investment performance, fining them **$250,000** and **$80,000** respectively. Since then, little regulatory activity occurred until last week, when an

SEC investigation led to **Charles Schwab Intelligent Portfolios** agreeing to pay a **$200 million** fine due to a lack of disclosure on how it allocates portfolios.

What drew the SEC's attention: Charles Schwab lacked transparency on its fees and portfolio allocations, creating potential conflicts of interest.

While the SEC hasn't disclosed specific details of the Charles Schwab case, experts point to discrepancies between the company's "no fee" advertising and the way it actually collects revenue, such as through cash allocations. Schwab Bank keeps the cash in "a deposit account ... which earns income on the deposits, and earns more the larger the cash allocation is," per the **small print** on its website.

This can create a conflict of interest: The robo-advisor could be tempted to allocate more of the customer portfolio to cash to earn more, even if this does not generate the best returns for the customer: "I think it is a strong reminder that there are conflicts of interest across the industry," says **David Goldstone, Manager of Research and Analytics at Backend Benchmarking**. "It is really important that advisors have transparency into what they do, and why they make the decisions they make."

Why it matters: Following record asset growth among robo-advisors, the charge levied on Charles Schwab signals greater SEC scrutiny of the industry.

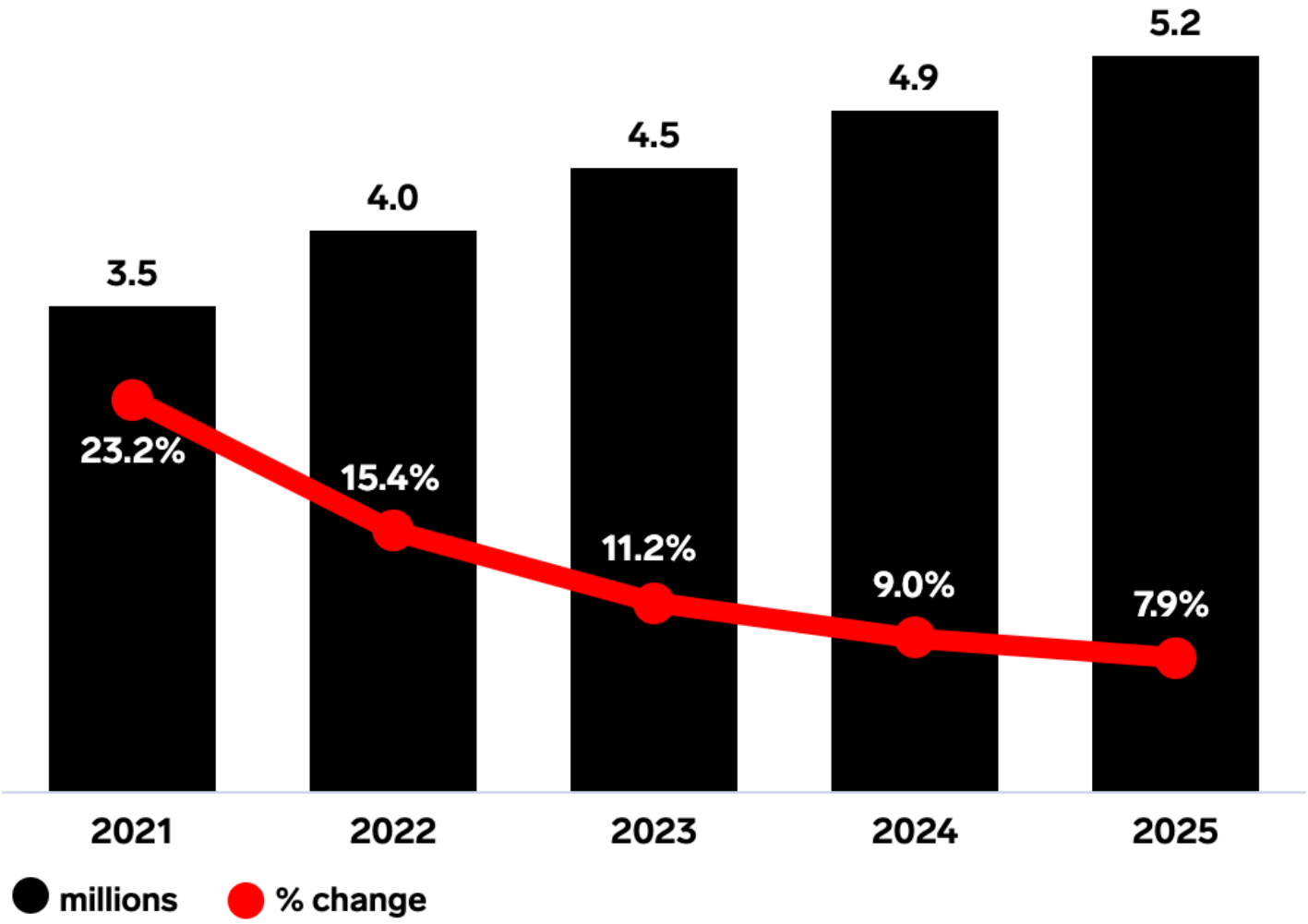
First-time investors were attracted by the robo-advisors' slick interfaces and cheap services, per Insider Intelligence forecast. This year in the US, **3.5 million** adult investors will use a robo-advisor to handle their portfolio. That's up by **23.2%** over 2020.

- **Vanguard Personal Advisor**, the biggest incumbent robo advisor in the country, now holds **$231 billion** in AUM, up from **$172 billion** in AUM at the same time last year.
- **Betterment**, the biggest startup robo-advisor, has over **$29 billion** in AUM, up from **$21 billion** in 2020.
- Other players joining the fray include **Goldman Sachs' Marcus**, which launched its own robo-advisory service last February.

This heightened activity is likely putting robo-advisors on the SEC radar. Charles Schwab may only be the first. The large fine comes just over a month after **SEC Chair Gary Gensler**stated during testimony before U.S. Congress that robo-advisors' business models "put additional demands on SEC resources and raise a variety of policy questions around gamification, behavioral prompts, the use of data analytics, and more."

Robo-Advisor Account Holders and Penetration

US, 2021-2025



Source: eMarketer, June 2021

InsiderIntelligence.com