

SEC Brings First Enforcement Actions against Robo-Advisers

On December 21, 2018, the U.S. Securities and Exchange Commission ("SEC") announced enforcement actions against two robo-advisers, [Wealthfront Advisors LLC](#) ("Wealthfront") and [Hedgeable Inc.](#) ("Hedgeable"), for making false statements about investment products and publishing misleading advertising. "Robo-advisers" are investment advisers that provide automated, software-based portfolio management services. In a press release related to these actions, the Chief of the SEC Enforcement Division's Asset Management Unit stated that "[t]echnology is rapidly changing the way investment advisers are able to advertise and deliver their services to clients ... [but] [r]egardless of their format ... all advisers must take seriously their obligations to comply with the securities laws, which were put in place to protect investors." These enforcement actions, the first by the SEC against robo-advisers, highlight the nuanced risks and requirements for robo-advisers under U.S. securities laws.

Wealthfront

The SEC found that Wealthfront, a robo-adviser with over \$11 billion in assets under management, made false statements about a tax-loss harvesting strategy it offered to clients. Wealthfront disclosed to clients employing its tax-loss harvesting strategy that it would monitor all client accounts for any transactions that might trigger a wash sale. A "[wash sale](#)" occurs when a security is sold at a purported loss but the same security is also purchased within 30 days before or after the sale. Losses from wash sales are not recognized for tax purposes. The SEC found that Wealthfront's system failed to monitor for wash sales over a period of more than three years, during which period wash sales occurred in at least 31 percent of accounts enrolled in Wealthfront's tax-loss harvesting strategy. The SEC also found that Wealthfront improperly re-tweeted client testimonials without necessary disclosures, paid bloggers for client referrals without the required disclosure and documentation to comply with the [Cash Solicitation Rule](#), and failed to maintain a compliance program reasonably designed to prevent violations of the securities laws. The SEC fined Wealthfront \$250,000 for violating the antifraud, advertising, compliance, and other provisions of the Investment Advisers Act of 1940 ("Advisers Act").

Hedgeable

A separate SEC action found that Hedgeable, a robo-adviser which had approximately \$81 million in assets under management, made a series of misleading statements about its investment performance. According to the SEC, from 2016 until April 2017, Hedgeable posted on its website and social media purported comparisons of the investment performance of Hedgeable's clients with those of two robo-adviser competitors. The SEC stated that the performance comparisons were misleading because Hedgeable included less than 4 percent of its client accounts, which had higher-than-average returns. Hedgeable compared this with rates of return that were not based on its competitors' actual trading models. The SEC also found that Hedgeable failed to maintain required documentation and failed to maintain a compliance program reasonably designed to prevent violations of the securities laws. The SEC found Hedgeable violated the antifraud, advertising, compliance, and books and records provisions of the Advisers Act and fined Hedgeable \$80,000.

SEC Is Focused on Robo-Advisers

Prior to the two enforcement actions, and because of the unique issues raised by robo-advisers, the SEC's

Division of Investment Management in 2017 issued [guidance](#) for investment advisers with suggestions on meeting disclosure, suitability and compliance obligations under the Advisers Act. A second publication, an [Investor Bulletin](#) issued by the SEC's Office of Investor Education and Advocacy, provides individual investors with information they may need to make informed decisions if they consider using robo-advisers. Since February 2017, the SEC's Office of Compliance Inspections and Examinations has included robo-advisers as a focus in its annual priorities in [2017](#) and [2018](#).

Key Takeaways

The Wealthfront and Hedgeable actions demonstrate the risks for investment advisers, including robo-advisers, in using social media and the internet. In both actions, the SEC found that electronically posted information constituted "advertisements" for purposes of the Advisers Act. While social media provides cost-effective and simple methods for distributing marketing information, these enforcement actions demonstrate how an investment adviser must have and use adequate policies and procedures to ensure that all social media posts are truthful and contain any necessary disclosures. In addition, the Wealthfront action demonstrates some of the unique risks for robo-advisers, specifically that a robo-adviser's computer programming may fail to execute what it has promised to its clients.

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