

## **Robo-Advisor Service**

**Provisions proposed to be included as an addition to the glossary of terms in the Rulebook**

### **Definitions**

|                                |   |   |
|--------------------------------|---|---|
| <b>Robo-Advisor Service</b>    | : | An algorithm-based technology platform for providing automated investment advice and recommendations within the portfolio management activity, with the aim of creating, managing and rebalancing a client's investment portfolio based on data provided by the client.   |
| <b>Robo-Advisor Algorithms</b> | : | Complex mathematical programs used to analyze market data, evaluate investment decisions, and automatically allocate assets based on specific criteria with the aim of building and continuously adjusting investment portfolios according to market fluctuations, the client's investment goals, and his risk tolerance. |
| <b>Stress Testing of</b>       | : | Rigorous testing procedures to evaluate the   |

|                                |   |
|--------------------------------|---|
| <b>Robo-Advisor Algorithms</b> | performance of an investment portfolio under extreme market conditions by simulating extreme economic scenarios to analyze how automated investment strategies are affected under high market pressures, such as recessions or market crashes to ensure the reliability, stability and effectiveness of algorithms under different market conditions. |
|--------------------------------|---|

**Provisions proposed to be included as an addition to Article (9) of Chapter (5) of Part (3) (Business Practice)**

**Article (9) Portfolio Management**

**First: The entity licensed to practice portfolio management activity shall be committed to the following: .....**

**Second: Dealing through the Copy Trading System: .....**

**Third: The Robo-Advisor Service**

The licensed entity may provide the robo-advisor service to its clients, provided that it adheres to the following:

1. Contract with an external IT auditor that has no interest or relationship with the licensed entity or any of its board members or executive management.
2. Obtain a report from the IT auditor before operating the platform, provided that the report includes at least the data listed below:
  - a. A comprehensive description of the platform, its capabilities, and the used robo- advisor algorithms.
  - b. A statement of the adequacy of the procedures, employees, and workers responsible for designing, implementing, testing, operating, and monitoring the platform at the licensed entity.
  - c. A statement of the methodology and strategy on which the platform relies in building the robo- advisor algorithms, and the assumptions and data it follows to provide advice.
  - d. A statement of the tests conducted on the platform to ensure that the applied methodology and strategy result in correct outputs consistent with the inputs.
  - e. Risk assessment, scope of operations, and target categories of clients.

- f. Methodology for determining the degree of risk of the financial products being invested.
- g. Methodology for determining the degree of risk accepted by the client and how to include this degree in the advice issued by the platform.
- h. Evaluation of risk management systems related to administrative, technological, financial, and other key aspects related to providing the service.
- i. Confirmation that the platform documents all services provided to the client.
- j. Confirmation of the ability of the robo-advisor platform to make immediate adjustments to investment portfolios when material changes occur in client data or market conditions.
- k. A statement of the procedures for managing conflicts of interest, and the procedures for monitoring and disclosing incidents in which there is a suspected conflict of interest, including the platform's outputs related to the financial products of the licensed entity's financial group.

3. Provide the robo-advisor platform, which includes the following features:

- a. Disclosing to the client any limitations of the robo-advisor algorithms, and providing information on how they make investment decisions.
- b. Disclosing to the client any potential conflict of interest in his transactions or robo-advisory services provided to him.
- c. Disclosing to the client the total cost of the robo-advisor services, the risks associated with robo-advice and reliance on the robo-advisor algorithms, and the expected performance of the investment portfolio.
- d. Disclosing to the client any potential limitations in executing automated orders, such as market liquidity limitations, processing delays, or any other factors that may affect the results of trades to ensure that the client understands these limitations.
- e. Updating client files based on risk tolerance, investment objectives, and significant changes in financial status, in accordance with the client's suitability criteria.
- f. Providing clear educational materials to the client explaining the robo-platform operations, the limits of robo-advice, and the importance of the accuracy of the data provided for the performance of the investment portfolio.

- g. Explaining the mechanism for rebalancing or adjusting the investment portfolio based on market conditions or client profiles.
- h. Implementing immediate rebalancing mechanisms to maintain asset distribution in accordance with the criteria agreed upon with the client.
- i. Saving client data in accordance with the data protection laws applicable in the State, and the data storage period shall not be less than the minimum period stipulated by applicable legislations.
- j. Encrypting all customer data and storing it securely to protect client privacy.
- k. Encrypting all clients trading data and storing it securely so that it is only available to authorized employees.
- l. Providing mechanisms to detect and report errors in execution immediately upon their occurrence, such as incorrect pricing, duplicate orders or incorrect trades, and notifying the client immediately upon an error, with the implementation of a clear protocol to resolve the problem in a manner that protects the client's interests.

- m. Providing immediate notifications to the client of changes in the status of orders, with a regular summary report on executed and pending orders to ensure that the client understands the current status of their investment portfolios and any unexecuted orders.
  - n. Providing guidance to clients on secure access protocols to protect their information and ensure compliance with data protection laws.
  - o. Disclosing to the client the potential risks associated with automated trading in the fluctuating conditions, and explaining any measures taken to protect their interests against these risks during periods of fluctuation.
- 4. Provide staff to manage the robo- advisor algorithms, design, implement, test and operate the platform, comply with the supervision of its operations and ensure compliance with the Authority's regulatory standards or outsource such work to a specialized entity in accordance with the outsourcing controls.
  - 5. Provide clear protocols for updating and modifying the robo- advisor algorithms.
  - 6. Provide clear protocols for managing or stopping automated trading during periods of high market fluctuations.

7. Ensure that the implications of any modifications made to the robo-advisor algorithms are assessed and clients are notified, when necessary, particularly if such modifications affect portfolio management results.
8. Document the decision-making methodology and technical specifications of each algorithm used, including data inputs, risk management criteria, and any modifications made thereto.
9. Ensure that the composition of the client's investment portfolio is based on the diversification criteria agreed upon with the client, taking into account avoiding focusing on specific assets or sectors in line with the client's risk profile.
10. Ensure the client's explicit consent before executing any automated operations resulting from advisory recommendations, and ensure that the client is aware of the risks associated with them and acknowledges their suitability for his investment profile.
11. Include in the contract with the broker, when linking with it - in cases where the client requests the provision of automated financial advisory services and automated execution of trading operations resulting from those advisories - which confirms that its electronic systems provide the following:



- a. Notifying the client of the necessity of his commitment to the rules of disclosing the percentages he owns, whether alone or with his related parties.
- b. Ensuring that financial products in which the client is aware are excluded and not dealt with.
- c. The possibility of dividing buys and sell orders in the event that the market is unable to absorb the entire order.
- d. Notifying the client of the status of trading orders for his investment portfolio immediately, and keeping all previous and current trading operations that were carried out in his favor.
- e. Obtaining the client's approval to the operations executed in his favor in cases where he does not wish those operations to be executed automatically.

12. Make necessary improvements to the platform based on audit reports and observations.

13. Conduct an audit by the IT auditor at least once a year, and in every time a material modification is made to the service in order to verify the following:

- a. The integrity, accuracy, and compliance of the robo-advisor algorithms with the standards and the client's interest.
- b. The accuracy of the robo-advisor algorithms in interpreting market data.
- c. The performance of risk management systems and mechanisms to reduce deviations or errors that may result from the robo- advisor algorithms used.
- d. Documenting the audit results and making the necessary improvements.

14. Conduct an annual cybersecurity audit of the platform by the contracted IT auditor or another auditor who meets the same requirements to verify data protection practices, detect vulnerabilities and ensure compliance.

15. Conduct performance and stability testing of the robo-advisor algorithms on a semi-annual basis to ensure compliance with clients' risk profiles and performance expectations, document the test results and provide the Authority therewith upon request.

16. Conduct stress test of the robo-advisor algorithms and market simulation on a semi-annual basis, document the test results and provide the Authority therewith upon request.
17. Notify the Authority of any security breach within three business days of becoming aware thereof, provided that the notification includes details of the breach, its impact on clients and the measures taken to address it.
18. Provide the Authority with quarterly reports on the platform's operation follow-up procedures and the results of its operation, including in particular the following:
  - a. Main developments in all administrative, technological, financial and other key aspects related to service provision.
  - b. A statement of the number of clients who trade through the platform and their total transactions.
  - c. Platform performance metrics.
  - d. A description of client complaints.
  - e. Amendments made to the robo-advisor algorithms or risk criteria.
19. Provide the Authority with any reports it request within the period specified by the Authority.

20. Any amendments or improvements requested by the Authority and within the period specified thereby.

**Terms of Contracting with an External IT Auditor:**

The portfolio management company shall provide an IT auditor (not approved by the Authority) when providing the robo-advisor service, who meets the following requirements:

- a. Obtaining a Certified Information Systems Auditor (CISA) or Certified Information Security Manager (CISM) certificate from the Information Systems Audit and Control Association (ISACA).
- b. Obtaining a Certified Information Systems Security Professional (CISSP) certificate from the International Information Systems Security Certification Consortium (ISC).
- c. Accreditation from a recognized and reputable entity to certify the compliance with the relevant ISO/IEC 27000 series standards.