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COMMENT: REDEFINING FIDUCIARY IN THE ROBOT AGE: HOW THE DEPARTMENT OF LABOR'S NEW DEFINITION WILL ENCOURAGE ROBO-INVESTMENT PLATFORMS AND REMOVE THE HUMAN ELEMENT FROM INVESTMENT ADVISING

Avery R. Barber†

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I. INTRODUCTION

This Comment explores the impact of the Department of Labor's ("DOL") expanded coverage of investment advice under its new Fiduciary Rule (the "Rule").[1] The Rule's impact on the market will give rise to the increased presence of "robo-advisers," or digital platforms powered by an algorithm that provide investment advice.[2] But while the aim of the new Fiduciary Rule is to create uniformity and heighten the standard for giving investment advice,[3] a more difficult question takes the place of old concerns, as regulatory concerns under the Employee Retirement Income Security Act of 1974 ("ERISA"),[4] Investment Advisers Act of 1940 ("IAA"),[5] and the fundamentals of fiduciary duty must be applied to technology rather than to human beings.

Part II of this Comment gives a brief overview of the importance of retirement security as a policy in the United States, the regulation developed in response to abuse of retirement funds, and the confusion created by the inconsistency in the standards to which individuals providing advice for investing retirement funds were held. Part III discusses the response of the Department of Labor ("DOL") in the development of its Fiduciary Rule and the impact the Rule will have on the investment market. One of the most significant developments, and the one at issue in this Comment, is the growing presence of automated investment algorithm technology, or robo-advisers, as a reaction to the Fiduciary Rule.[6] Section III-A acknowledges that robo-advisers provide some benefits for a narrow segment of the market. Section III-B discusses the risks and potential negative impacts, especially on vulnerable and unsophisticated investors who are the parties most likely to use this new investment platform. Finally, Part IV addresses the irony resulting from the Fiduciary Rule. Though the Rule was intended to create uniformity in how and from whom investment advice is

[1] 29 C.F.R. §§ 2509.75–5, .75–8, .95–1, .2015–01, 2510.3–21, 2550.403a–1 to .404a–1, .408g–2 (2017).

[2] *Robo-Advisor (Robo-Adviser)*, INVESTOPEDIA, https://www.investopedia.com/terms/i/investmentobjective.asp (last visited Feb. 20, 2018).

[3] Brian Menickella, *How the DOL's Fiduciary Rule Will Impact Your Retirement Accounts*, FORBES (June 6, 2016, 11:56 AM), https://www.forbes.com/sites/brianmenickella/2016/06/06/how-the-dols-fiduciary-rule-will-impact-your-retirement-accounts/#5ed54b332c16.

[4] Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001–1461 (2012).

[5] Investment Advisers Act of 1940, 15 U.S.C. § 80b (2012).

[6] *See* Janet Levaux, *Who Wins, Who Loses With New DOL Rule? $3 Trillion in Play*, THINKADVISOR (Dec. 31, 2015), https://www.thinkadvisor.com/2015/12/31/who-wins-who-loses-with-new-dol-rule-3-trillion-in?t=mutual-funds.

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dispensed, it instead creates new questions about the standard to which these robo-advisers must be held as they fill gaps within the market.

II. BACKGROUND

The creation of retirement schemes in America is not a new phenomenon. It began on a small scale after the Civil War and became more widespread with the passage of the New Deal.[7] For many Americans, investing and saving for the future is a goal and privilege to be protected, made clear through the many instances of legislative action in furtherance of this end.[8] In speaking about the Social Security Act in 1935, President Franklin D. Roosevelt said:

> Young people have come to wonder what would be their lot when they came to old age . . . . We can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age.[9]

But as the United States economy, demographics, and job markets have changed, so have the form and function of saving for retirement.[10]

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[7] *See* Dana M. Muir, *Contemporary Social Policy Analysis and Employee Benefit Programs: Boomers, Benefits, and Bargains*, 54 WASH. & LEE L. REV. 1351, 1358 (1997).

[8] *See, e.g.*, John J. Weiler, *Fiduciary Provisions of the Employee Retirement Income Security Act of 1974*, 36 LA. L. REV. 897, 899 (1976). President John F. Kennedy established the Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs on March 28, 1962, and commissioned a report. *Id.* at 898–99. This report was given to President Lyndon B. Johnson, and the legislative recommendations of the committee were the foundation for substantive provisions of ERISA. *Id.* at 899. *See also* Fiduciary Duty Rule: Memorandum for the Secretary of Labor, 82 Fed. Reg. 9675 (Feb. 3, 2017) ("One of the priorities of [President Donald Trump's] Administration is to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses.").

[9] Franklin D. Roosevelt, *Statement on Signing the Social Security Act, August 14, 1935*, AM. PRESIDENCY PROJECT, http://www.presidency.ucsb.edu/ws/index.php?pid=14916 (last visited Mar. 10, 2018).

[10] *See* James A. Wooten, *The Most Glorious Story of Failure in the Business: The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683, 686–87 (2001) (discussing the increasing coverage after World War II stemming from successful collective bargaining, increased litigation surrounding increased pension plan security, and the strength of the industrial industry in post-war America, highlighted particularly in the automobile manufacturing industry).

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When the economy was booming and post-World War II growth endured, businesses were willing to negotiate and contract for pensions—a large financial commitment as businesses diverted money into a retirement fund, away from what would otherwise have been wages.[11] Once the economy slowed, mergers began taking place in droves and surviving businesses sought cost-cutting solutions, which were found in weakly negotiated pension plans.[12] The lack of security in these pension plans left many employees vulnerable to receiving only fractions of the money they had been promised and some employees with nothing at all.[13] Many union leaders called for government involvement in guaranteeing retirement plan security.[14] In addition, because pension plans were rooted in state trust law at their inception, the administration of the plan favored the settlor, often the employer or third party holder of the pension plan funds, not the employee.[15]

ERISA was passed by Congress as a direct response to the need for oversight, security, and monitoring against abuse or mismanagement of retirement funds.[16] When introduced, the bill called for "improved and more stringent fiduciary standards."[17] ERISA, in essence, aims to protect retirement funds and ensure the people involved in making decisions about their use treat the funds with heightened care.[18] Retirement funds must be treated with heightened care because they are comprised of money that employees forgo in the present to build a more secure future in retirement.[19] In true capitalist fashion, ERISA also recognizes that idle money isn't growing, so safe investments are

[11] *See id.* at 692–93 (describing the "precarious" post-war boom in the consumer automobile industry).

[12] *See id.* at 693–94 (pointing out the lack of "vesting" in the contractual rights of employees, meaning that if an employee quit or lost his job before he was eligible to retire under the plan's terms, he lost all rights to the pension he had accrued while working for the company).

[13] *See id.* at 716.

[14] *See id.* at 720; *see also id.* at 733 (quoting a letter that a labor economist sent to a labor union leader following the closing of Studebaker-Packard on December 28, 1963, which underlined the "urgent necessity" for pension reinsurance legislation).

[15] Norman Stein, *ERISA and the Limits of Equity*, 56 L. CONTEMP. PROBS. 71, 73 (1993).

[16] *History of EBSA and ERISA*, U.S. DEP'T LABOR, https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/history-of-ebsa-and-erisa (last visited Jan. 31, 2018).

[17] SUBCOMM. ON LABOR OF THE COMM. ON LABOR & PUB. WELFARE, 94TH CONG., LEGIS. HISTORY EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 91 (Comm. Print 1976).

[18] *See id.*

[19] *See* Benjamin A. Templin, *Social Security Reform: Should the Retirement Age Be Increased?*, 89 OR. L. REV. 1179, 1247 (2011).

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encouraged.[20] Those in charge of making investment decisions for retirement funds are tasked with making the decision with the care of a trustee.[21] The scope of ERISA is quite broad, regulating most employee benefit plans, including employer-provided retirement plans.[22]

There has been a trend over the past forty years in which "retirement-savings plans have shifted almost entirely from employer-directed plans to those in which individual workers make their own savings and investment decisions."[23] This dramatic shift from employer-sponsored defined benefit plans, under which employees passively contributed pre-tax income into a savings account, often accompanied by an employer matching program, to self-directed Individual Retirement Accounts ("IRAs") and 401(k)s changed the landscape of the financial industry as well.[24] This shift requires workers to make independent decisions on how to invest their own savings, in stark contrast to the defined benefit plans of the past.[25] This shift

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[20] *See* Employee Retirement Income Security Act of 1974 §§ 404(a)(1), 29 U.S.C. § 1104(a)(1) (2012); *see also* S. COMM. ON AGING, 98TH CONG., EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: FIRST DECADE 90 (Comm. Print 1984).

[21] *See* Varity Corp. v. Howe, 516 U.S. 489, 496 (1996) ("[W]e recognize that these fiduciary duties draw much of their content from the common law of trusts, the law that governed most benefit plans before ERISA's enactment.").

[22] 29 U.S.C. § 1051(2) (2012).

[23] Jill E. Fisch et al., *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 DUKE L.J. 633, 643 (2016).

[24] *A Financial System That Creates Economic Opportunities: Asset Management and Insurance*, U.S DEP'T TREASURY 65 (Oct. 26, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf ("In adopting the Fiduciary Rule, the DOL emphasized changes in the U.S. retirement savings landscape since the enactment of ERISA, particularly the shift from employer sponsored defined benefit pension plans to participant-directed defined contribution plans, such as 401(k) plans. The DOL also noted the widespread growth of assets in IRAs, identifying that individuals are increasingly responsible for managing their own retirement savings.").

[25] *See* Jason Furman & Betsey Stevenson, *The Effects of Conflicted Investment Advice on Retirement Savings*, WHITE HOUSE (Feb. 23, 2015, 9:45 AM), https://obamawhitehouse.archives.gov/blog/2015/02/23/effects-conflicted-investment-advice-retirement-savings. ("The share of working Americans covered by traditional pension plans—which offer a guaranteed income stream in retirement—has fallen sharply. . . . [T]he income available in retirement from a defined contribution plan depends on both the amount initially saved and the return on those savings. The shift from traditional pensions to defined contribution plans raises important policy issues about investment responsibilities and the roles of individual households, employers, and investment advisers in ensuring the retirement security of Americans."); *see also Types of Retirement Plans*, U.S. DEP'T LABOR, https://www.dol.gov/general/topic/retirement/typesofplans (last visited Feb. 6, 2018).

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especially impacted the middle class, because the rising costs of living, healthcare, and education affect take-home pay.[26] This presents two issues for the middle class. First, middle class members must decide how much to contribute to their individual retirement plan from their take-home pay.[27] Second, because fewer members of the middle class are receiving additional contributions to their retirement funds, now more than ever, there is a need to strategically invest in order to grow the money once it is in the retirement fund.[28]

The need to successfully invest and grow retirement money has led to an increased demand for investment advice.[29] In light of the shifting structure of retirement funds, the individual now bears a much greater risk in investment decisions.[30] This makes consumer access to responsible and accurate investment advice all the more important, as bad advice can mean a significant decrease in possible return or eradication of retirement money altogether.[31]

To protect against this risk, the DOL clarified the standard of care

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[26] Barbara A. Butrica & Mikki D. Waid, *What Are the Retirement Prospects of Middle-Class Americans?*, AARP 1–3 (Jan. 2013), http://www.aarp.org/content/dam/aarp/research/public_policy_institute/security/2013/retirement-prospects-middle-class-AARP-ppi-sec.pdf.

[27] *See* Gary Koenig, *The Elusive Middle in America— What has Happened to Middle-Class Income?*, AARP 2–3 (Jan. 2013), https://www.aarp.org/content/dam/aarp/research/public_policy_institute/security/2013/the-elusive-middle-class-in-america-AARP-ppi-sec.pdf; *see also* Templin, *supra* note 19, at 1247 (describing the behavioral term hyperbolic discounting, which "occurs when people intend to sacrifice an immediate reward for a longer-term gain but do not follow through with the sacrifice when actually faced with the choice").

[28] Butrica & Waid, s*upra* note 26, at 3; *see also Remarks by the President on Retirement*, WHITE HOUSE (Jan. 29, 2014, 2:05 PM), https://obamawhitehouse.archives.gov/the-press-office/2014/01/29/remarks-president-retirement ("[R]etirement used to be a three-legged stool, used to have a pension. Then you had your Social Security. Then you had your own private savings. And you put that all together, and you could retire. But today, most workers don't have a pension in America. Just half work for an employer that offers any kind of retirement plan. A Social Security check is critical, but oftentimes that monthly check, that's not enough. And while the stock market has doubled over the last five years, that doesn't help somebody if you don't have a 401(k).").

[29] *See White House Fact Sheet: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings*, U.S. DEP'T LABOR (Apr. 6, 2016), https://www.dol.gov/newsroom/releases/ebsa/ebsa20160406-0.

[30] Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 458 (2004).

[31] *See* Furman & Stevenson, *supra* note 25 ("A retiree who receives conflicted advice when rolling over a 401(k) balance to an IRA at retirement will lose an estimated 12 percent of the value of his or her savings if drawn down over 30 years. If a retiree receiving conflicted advice takes withdrawals at the rate possible absent conflicted advice, his or her savings would run out more than 5 years earlier.").

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for retirement funds and who was expected to adhere to this standard.[32] A person is a "fiduciary" under ERISA in one of two ways. First, a person is within a fiduciary role if he or she is a plan sponsor, involved in the exercise of any discretionary authority or control in the management of retirement assets or has any discretionary authority or responsibility in the administration of a plan.[33] A plan's sponsor must adhere to the standard of "care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[34] Alternatively, a person is a "fiduciary" if he or she "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so."[35] In addition, ERISA requires fiduciaries to refrain from certain prohibited transactions, including conflicts of interest.[36] Under ERISA's prohibited transactions provisions, fiduciaries generally may not self-deal.[37] In other words, fiduciaries may not deal with plan assets for their own interest or account, or be paid by a third party in connection with a transaction involving plan assets.[38]

Though this definition on its face seems relatively clear, regulators, courts, and legislators have struggled to create a uniform standard for fiduciaries in an investment services sense.[39] The strictest interpretation

[32] *See generally* Norman P. Stein, *I, Fiduciary: Some Reflections on the Definition of Fiduciary Under ERISA*, 6 DREXEL L. REV. 555, 565–66 (2014) (explaining that before the new rule, there was a "five-factor" test under which a person is found to be a fiduciary only where a person renders investment advice to a plan on a regular basis, pursuant to an agreement or understanding that the advice will be a primary basis for the plan's investment decisions, and that the advice is individualized to the particular needs of the plan).

[33] *Id.* at 556 ("A person was an ERISA fiduciary if, among other things, he or she exercised any authority or control respecting disposition of plan assets or had any discretionary authority or discretionary responsibility in the administration of a plan . . . .").

[34] 29 U.S.C. § 1104(a)(1)(B) (2012).

[35] 29 U.S.C. § 1002(21)(A) (2012).

[36] *See, e.g.*, 29 U.S.C. § 1106 (2012).

[37] *See* 29 U.S.C. § 1106(b) (2012).

[38] *Id.*; *see also Regulatory Impact Analysis for Final Rule and Exemptions*, U.S. DEP'T LABOR 1 (Apr. 2016), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf [hereinafter *2016 Regulatory Impact Analysis*].

[39] Melanie Fein, Are Robo-Advisors Fiduciaries?, Address at the University of Oxford, Smith School of Enterprise and the Environment, AllianzGI-Oxford Pensions Conference: Coping with Disruptive Change 2 (Sept. 12, 2017) (transcript available at the Social Science Research Network), https://ssrn.com/abstract=3028268.

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of fiduciary would require them to "provide the lowest cost alternative; stop offering proprietary products; charge only asset-based fees, and not commissions; and continuously monitor all accounts."[40] Those results are not necessarily the current expectation, nor do they fit within the current market structure.[41]

Parallel to ERISA's investment requirements is the IAA, passed by Congress and administered by the Securities and Exchange Commission ("SEC"), which did little more than create a registration requirement for investment advisers.[42] In the same way that post-World War II economic success fostered a willingness to push for retirement plans, so too did it foster an increase in retail investment activity.[43] Just as ERISA would later be enacted to protect employees from failed promises of retirement funds, the IAA sought to protect consumers from fraud and the risks of inadequate investment advice.[44] Broker-dealers, seen as salespeople of securities and investment services, were left out of the IAA, while investment advisors were now expected to act in their clients' best interests.[45]

Between ERISA's requirements and the IAA, a loophole was created where a registered investment adviser and a broker-dealer could provide the same type of advice, but one was held to a much higher duty of care than the other. This loophole that allowed someone to provide advice while avoiding the classification of "fiduciary" created confusion about who was subject to which regulations and standards of conduct, and what disclosures were required.[46] Broker-dealers "provide services that play an important role in helping retail and institutional investors make significant financial decisions."[47] These retail

[40] Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,851 (Mar. 7, 2013).

[41] *Id.* at 14,851–52.

[42] *See* Roberta S. Karmel, *The Challenge of Fiduciary Regulation: The Investment Advisers Act After Seventy-Five Years*, 10 BROOK. J. CORP. FIN. & COM. L. 405, 415–16 (2016).

[43] *See id.*

[44] H.R. REP. NO. 76–2639, at 12, 28 (1940).

[45] Nicholas S. Di Lorenzo, *Defining a New Punctilio of an Honor: The Best Interest Standard for Broker-Dealers,* 92 B.U. L. REV. 291, 312–13 (2012).

[46] *See* Sean Ross, *Career Advice: Stockbroker vs. Financial Adviser*, INVESTOPEDIA (Sept. 29, 2015), http://www.investopedia.com/articles /professionals/092915/career-advice-stockbroker-vs-financial-advisor.asp; *see also* Ethan S. Braid, *Is My Financial Advisor a Fiduciary or a Stockbroker?*, HIGH PASS ASSET MGMT. (Mar. 2013), http://www.highpassasset.com/blog/58-is-my-financial-advisor-a-fiduciary-or-astockbroker.html (comparing the nature and obligations of advisers and brokers).

[47] Staff of the U.S. Sec. & Exch. Comm'n, *Study on Investment Advisors and Broker-Dealers*, U.S. SEC. & EXCH. COMM'N 8 (Jan. 11, 2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf [hereinafter *2011 SEC*

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customers may include inexperienced retail investors seeking more basic brokerage services and recommendations, as well as retail investors seeking sophisticated investment strategies to address their aggressive investment objectives or other unique situations.[48]

Investment advisers take a similar role. Clients seek the services of investment advisers to help them evaluate their investment needs, plan for the future, and develop and implement investment strategies.[49] Investment advisers provide financial planning and pension consulting services, or may select investment advisers for others.[50] They also manage portfolios of pooled investment vehicles, such as hedge funds and other private funds, pension funds, and registered investment companies.[51]

In this context, the crucial differences include the requirements that investment advisers, as fiduciaries, act in the best interests of their clients and appropriately manage and fully disclose conflicts of interest that could bias their recommendations.[52] The inability of consumers to distinguish which type of financial professional acts in a fiduciary capacity, and which type does not, impedes their ability to make informed decisions about their investments.[53] Without realizing the implications, consumers may forgo fiduciary obligations that they otherwise may have been owed by choosing a broker-dealer over an investment adviser.[54]

The DOL was prompted to reform the fiduciary standard because the lack of harmony between the less-stringent requirements applied to broker-dealers and the stricter requirements of investment advisers caused confusion for employees, sponsors, and even investment

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Staff Study]; *see also* Ross, *supra* note 46 ("Under the Investment Advisers Act of 1940, all registered investment advisors, which many financial advisors are, carry a fiduciary obligation to their clients. This is not so with stockbrokers. Instead, the nonfiduciary stockbroker must only follow the standard of 'suitability' . . . .").

[48] Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,851 (Mar. 7, 2013).

[49] *Id.*

[50] *See id.* at 14,857.

[51] *See* Staff of the Inv. Adviser Regulation Office, *Regulation of Investment Advisers by the U.S. Securities and Exchange Commission*, U.S. SEC. & EXCH. COMM'N 18 (Mar. 2013), https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

[52] *See* Inv'r Advisory Comm., *Recommendation of the Investor Advisory Committee Broker-Dealer Fiduciary Duty*, U.S. SEC. & EXCH. COMM'N 1 (Nov. 22, 2013), https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf.

[53] *See id.*

[54] Di Lorenzo, *supra* note 45, at 309.

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advisers.[55] Regulators and consumers called for change, especially following the 2008 financial crisis, where many blamed the financial services industry for making poor or even worthless investment recommendations.[56] Congress enacted the Dodd-Frank Act in 2010, followed by several amendments to the IAA,[57] and requested a study by the SEC to identify holes in the regulatory scheme.[58] The report recognized that investors may be harmed if they choose a financial adviser under a mistaken belief that the financial adviser is required to act in their best interest or provide ongoing account management, or they may receive recommendations that carry additional costs or risks without affording additional benefits.[59] The DOL offered the first version of the Fiduciary Rule in 2010 as well, though scathing criticism of the 2010 version forced the Department to withdraw the initial proposal.[60] The Financial Industry Regulatory Authority ("FINRA") stated that:

> A central failing [it] has observed is firms not putting customer's interests first. The harm caused by this may be compounded when it involved vulnerable investors (e.g., senior investors) or a major liquidity or wealth event in an investor's life (e.g., an inheritance or Individual Retirement Account rollover). Poor advice and investments in these situations can have especially devastating and lasting consequences for the investor.[61]

Five years later, with the continued goal of harmonizing the fiduciary definition to lessen investor confusion and prevent consumers from bearing the cost of receiving inconsistent or conflicting advice,[62] "[t]he final rule provide[ed] a more inclusive regulation for determining which advisers and types of advice require heightened duties of care."[63]

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[55] Duties of Brokers, Dealers, and Investment Advisers, 78 Fed. Reg. 14,848, 14,850 (Mar. 7, 2013).

[56] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule–Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,955 (Apr. 8, 2016).

[57] Karmel, *supra* note 42, at 415–16.

[58] Di Lorenzo, *supra* note 45, at 292–93.

[59] *Id.* at 293.

[60] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule–Retirement Investment Advice, 81 Fed. Reg. at 20,957.

[61] *Regulatory and Examinations Priority Letter*, 2015 FIN. INDUSTRY REG. AUTHORITY 2, http://www.finra.org/sites/default/files/p602239.pdf (alteration in original).

[62] Karmel, *supra* note 42, at 416–19.

[63] Ashley C. Vicere, *Defining "Fiduciary,"* 82 BROOK. L. REV. 1783, 1801 (2017) (alteration in original).

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The DOL stated:

> It is thus incumbent on the Department to protect IRA investors from harmful adviser conflicts. An examination of trends and evidence accumulated since 1974 suggests that such special protections, if anything, are even more critical today than when Congress first enacted ERISA more than 40 years ago. The Department's role in applying these protections is well established under law and in practice.[64]

Redefining who is held to the fiduciary standard closed the loophole that had previously allowed some individuals to avoid heightened standards of duty and loyalty to investors.[65] As a fiduciary, anyone dispensing advice related to retirement funds must meet certain compliance requirements and is prohibited from engaging in specified transactions or using designated fee structures.[66] The Rule also treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a pension plan or IRA as fiduciaries.[67] The new definition's expanded coverage helps to protect investors and to hold more individuals in the retirement investment space to this high standard of care, in the hopes of better securing the futures of more Americans.[68]

III. ANALYSIS

The DOL's Fiduciary Rule was promulgated on June 9, 2017.[69] Many government entities, independent bodies, and firms in the investment space have speculated about the effects the Rule will have on the structure of the investment, retirement, and securities industries.[70] One of the consequences of the Rule is that advisers will

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[64] *2016 Regulatory Impact Analysis*, *supra* note 38, at 106.

[65] *See* David Pratt, *Focus On . . . Lawsuits Challenging the Department of Labor's Fiduciary Rule*, 24 J. PENSION BENEFITS 4, 5–6 (2016) ("Today, as a result of the five-part test, many investment professionals, consultants, and advisers have no obligation to adhere to ERISA's fiduciary standards or to the prohibited transaction rules, despite the critical role they play in guiding plan and IRA investments.").

[66] *Id.* at 6.

[67] *See* Dan Butterfield, *The DOL Fiduciary Rule Explained*, KAPLAN FIN. EDUC. (July 31, 2017), https://www.kaplanfinancial.com/resources/business-resources/the-dol-fiduciary-rule-explained.

[68] *Id.*

[69] *See* Brian Menickella, *DOL Fiduciary Rule Implementation Finally in Sight*, FORBES (June 8, 2017, 4:39 PM), https://www.forbes.com/sites/brianmenickella/2017/06/08/dol-fiduciary-rule-implementation-finally-in-sight/#cb61bed7a563.

[70] Melanie Waddell, *Planners Fear Unintended Consequences as DOL Rule*

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weigh the risk and benefit of working with certain clients.[71] The market's fee structure will likely also change; while some fees will be reduced, other companies could shift their entire model to a flat-fee based approach, which will lead to increased costs of doing business for more hands-off investors.[72] Overall costs will likely increase due to the cost of compliance.[73] In fact, broker-dealers stand to lose up to twenty-two percent of their client assets by complying with the Rule.[74] As advisers learn to work comfortably within this new standard, there are concerns of increased liability, which will likely cause firms to have higher insurance costs.[75]

In anticipation of the Rule, fear of increased costs caused many traditional companies to get creative in providing services to clients and maximizing profits.[76] Technology tends to appear where changes in

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Compliance Date Nears, THINKADVISOR (June 8, 2017), http://www.thinkadvisor.com/2017/06/06/planners-fear-unintended-consequences-as-dol-rule.

[71] *Id.*

[72] Jamie Hopkins, *New Fiduciary Rule for Financial Advisors Moves the Need, But in Which Direction?*, FORBES (June 14, 2017), https://www.forbes.com/sites/jamiehopkins/2017/06/14/new-fiduciary-rule-for-financial-advisors-moves-the-needle-but-in-which-direction/; *see also 2016 Regulatory Impact Analysis*, *supra* note 38, at 243 ("A client moving from a brokerage, commission-based account to a fee-based account as a result of the rule could face higher fees in that account.").

[73] Hopkins, *supra* note 72 ("For a consumer who does not want much additional planning but just wants to keep money invested in a few mutual funds for several years, an asset under management model could be more expensive than his or her current set-up. . . . While product services and fees might go down, the overall cost of getting advice could go up.").

[74] Liz Skinner, *Figuring Out Fiduciary,* INVESTMENT NEWS (May 9, 2016), http://www.investmentnews.com/article/ 20160509/FEATURE/160509939/the-dol-fiduciary-rule-will-forever-change-financial-advice-and-the ("Independent broker-dealers . . . face the greatest disruption. They'll need to craft new administrative steps and invest millions in technology and training to meet the rule's requirements. Many advisers will face changes in how they are paid.").

[75] *See* Hopkins, *supra* note 72; *see also Fiduciary Investment Advice: Regulatory Impact Analysis*, U.S. DEP'T LABOR 172–73 (Apr. 14, 2015), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/conflictsofinterestria.pdf ("[D]epending on how the fiduciary liability insurance is priced, premiums could increase to reflect additional exposure associated with the broker-dealer portion of their business . . . . The Department estimates that the total one year premium increase would be approximately $87 million . . . . [and] there could be a cost increase of $63 million per year in premiums and a transfer of $63 million per year from firms to plans or IRA investors.").

[76] *See* Carmen Castro-Pagan, *SEC, DOL Working Together on Advisers' Conduct Standards*, BNA (Sept. 26, 2017), https://www.bna.com/sec-dol-working-n73014467360 (citing the increasing use of robo-advisers as one result of anticipated increased costs).

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market lead to a need to capitalize on growth; robo-advisers have taken shape as a way to reach more people, make faster decisions, and perform investment duties at a comparably lower cost than bringing all advisers into compliance with the Rule.[77] Traditional advisory firms are looking for ways to acquire these existing innovative tools, or to develop their own, as a way to supplement their more traditional services to reach larger market segments at a lower cost than with traditional approaches alone.[78]

Currently, robo-advisers fall under the definition of "investment advisers" under the Investment Advisers Act of 1940 and are required to register under that Act.[79] Robo-advisers are therefore subject to the same fiduciary obligations as human advisors,[80] though admittedly the IAA "does not impose a detailed regulatory regime."[81] While the Rule is clear about which human beings now fall into the category of fiduciary, it fails to address how the change affects robo-advisers.[82] Due to their very nature as a product rather than a person, there are questions of how exactly to hold a machine to a duty of loyalty and a duty of care.[83]

The Secretary of the DOL has come out in support of robo-adviser tools as a way to benefit retirement investors.[84] But others have

[77] *See* Megan Ji, *Are Robots Good Fiduciaries? Regulating Robo-Advisors Under the Investment Advisors Act of 1940*, 117 COLUM. L. REV. 1543, 1561 (2017) (describing the market response to successful robo-investment platforms and the subsequent adoption of the technology by well-known investment firms Charles Schwab and Vanguard); Melanie Fein, Robo-Advisors: A Closer Look 1 (June 30, 2015) (unpublished manuscript) (on file with the Social Science Research Network), https://ssrn.com/abstract=2658701.

[78] *2016 Regulatory Impact Analysis*, *supra* note 38, at 181–82; *see also* Ji, *supra* note 77, at 1561.

[79] Fein, *supra* note 39, at 1; *see also* Grant Parr, *SEC Guidance: Robo-Advisers and the Investment Advisers Act of 1940*, RIA COMPLIANCE CONSULTANTS (Feb. 27, 2017) https://www.ria-compliance-consultants.com/2017/02/sec-guidance-robo-advisers-and-the-investment-advisers-act-of-1940.

[80] Div. of Inv. Mgmt., U.S. Sec. & Exch. Comm'n, Guidance Update No. 2017-02: Robo-Advisers 2 (Feb. 2017), https://www.sec.gov/investment/im-guidance-2017-02.pdf [hereinafter Robo-Advisers Guidance Update] (discussing issues that robo-advisers should consider in compliance with fiduciary standard due to the nature of their business model).

[81] Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054, 72,054 (Dec. 10, 2004) (to be codified at 17 C.F.R. pts. 275, 279).

[82] Definition of the Term "Fiduciary"; Conflict of Interest Rule–Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,948 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509–10, 2550).

[83] Fein, *supra* note 39, at 1.

[84] Mark Schoeffer Jr., *DOL Secretary Perez touts Wealthfront program as paragon of low-cost, fiduciary advice*, INVESTMENT NEWS (June 19, 2015), http://www.investmentnews.com/article/20150619 /FREE/150619892/dol-secretary-

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concerns with placing trust in robots to make investment decisions and recommendations about retirement money, money that legislation, regulation, and society in general have undertaken to defend and touted as a fundamental need for older generations to live comfortably.[85]

A. Narrow Benefits from the Growing Presence of Robo-Advisers

There are benefits to using technology to service the investment industry. With the increasing costs of operation in the investment space, robo-advisers are able to "fill the gap between no-frills discount brokerages and full-service wealth managers."[86] Retirement accounts that advisers deem too small to profitably provide conflict-free, fiduciary-level investment advice can be serviced by these robo-advisers, such as those developed by Betterment, Wealthfront and Personal Capital.[87] These platforms can make advice far more affordable for smaller and younger investors, with the added benefit of younger investors' pre-existing familiarity with technology-based applications.[88] Prior to the development of these robo-investing platforms, millennials were often an overlooked market segment because they tended to have small account balances and invested in retirement savings funds far less than older generations.[89] Now, robo-advisers give millennials access to investment advice that was previously unavailable or too expensive.[90]

Additionally, supporters of robo-advisers believe that the absence of human behavioral biases will benefit investors by removing the emotional element of decision making.[91] In fact, the DOL has expressly

perez-touts-wealthfront-as-paragon-of-low-cost.

[85] *See, e.g.*, Brian S. Korn et al., *FINRA Reports on Robo-Advisors*, LEXOLOGY (Mar. 31, 2016), https://www.lexology.com/library/detail.aspx?g=1c1e6b0e-048d-40e5-82f1-c814bdb536b0.

[86] Aron Szapiro, Director of Policy Research, Morningstar, Inc., Comment Letter on SEC Chairman's Request for Information on Standards of Conduct for Investment Advisers and Broker-Dealers 6 (Sept. 7, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2433284-161040.pdf.

[87] Skinner, *supra* note 74.

[88] *2016 Regulatory Impact Analysis*, *supra* note 38, at 181.

[89] *See* Ilana Polyak, *Millennials and Robo-Advisors: A Match Made in Heaven?*, CNBC (June 22, 2015, 10:01 AM), https://www.cnbc.com/2015/06/21/millennials-and-robo-advisors-a-match-made-in-heaven.html ("16 percent of millennials say they work with a financial advisor, about half the rate that baby boomers do.").

[90] *Id.*

[91] *2016 Regulatory Impact Analysis*, *supra* note 38, at 182 n.410 (citing Wes Gray, *Are You Trying too Hard?*, ALPHA ARCHITECT (May 13, 2014), https://alphaarchitect.com/2014/05/13/behavioral-finance-and-investing-are-you-trying-too-hard/) ("Because models are not susceptible to unhelpful human behavioral biases, model-based advice may be superior to that formulated by an

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stated that one benefit it anticipates stemming from the Rule is "healthier development of business models that rely heavily on technology to generate and deliver advice."[92] There is an entire body of research in fields of medicine, engineering, and even finance dedicated to proving that algorithms will always outperform humans.[93] For example, John Bogle demonstrated this concept by comparing human stock-pickers to a Standard & Poor's 500 index fund, "an investment fund that operates on strict algorithmic rules about which companies to buy and sell and in what quantities."[94] The humans never outperformed the algorithm.[95] Many credit the success of the algorithm to the removal of human emotion and bias from the decision-making process.[96] However, removing emotions from the investment algorithm's process altogether ignores the same human emotion still present in the consumer. If robo-advisers cannot take into account the limits of human cognition and fail to recognize emotional reactions like fear and greed, they cannot properly assess their users.[97] Just because the investment tool is structured to operate without emotion does not remove the emotion from the input process of the investor.

Increased access to low-cost, automated investment platforms is beneficial for specific types of sophisticated investors.[98] Active investors can benefit from the platform's continuous monitoring of markets and the ability to set thresholds to balance and re-balance their portfolios.[99] But for those businesses, sophisticated investors, and government regulators that see the influx of robo-advisers as beneficial

adviser without benefit of a model.").

[92] *2016 Regulatory Impact Analysis*, *supra* note 38, at 181.

[93] Tom Baker & Benedict Dellaert, *Regulating Robo Advice Across the Financial Services Industry*, 103 IOWA L. REV. 713, 716–17 (2018).

[94] *Do Algorithms Beat Us at Complex Decision Making?*, FARNAM STREET, https://www.fs.blog/2017/03/algorithms-complex-decision-making/ (last visited Feb. 2, 2018); *see also* Robert Huebscher, *Jack Bogle: The Triumph of the Index Fund*, ADVISOR PERSPS. (Mar. 27, 2012), https://www.advisorperspectives.com/newsletters12/pdfs/Jack_Bogle-The_Triumph_of_the_Index_Fund.pdf.

[95] Huebscher, *supra* note 94. For more information on human behavior economics and decision making, *see* DANIEL KAHNEMAN, THINKING, FAST AND SLOW 140–45, 286–88, 331–33 (2011).

[96] *See, e.g.*, Huebscher, *supra* note 94.

[97] Andrew Lo, *Imagine if Robo Advisers Could Do Emotions*, WALL STREET J. (June 6, 2016), https://blogs.wsj.com/experts/2016/06/06/the-one-ability-robo-advisers-are-still-missing.

[98] Rob Berger, *7 Robo Advisors That Make Investing Effortless*, FORBES (Feb. 5, 2015, 10:28 AM), https://www.forbes.com/sites/robertberger/2015/02/05/7-robo-advisors-that-make-investing-effortless/.

[99] *See, e.g.*, *How and When is My Portfolio Rebalanced?*, BETTERMENT, https://help.betterment.com/hc/en-us/articles/115004257146 (last visited Nov. 20, 2017).

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for the investment market, there is a far more vulnerable market segment that will not reap the benefit of this technology and will instead suffer a great cost.[100]

B. Concerns Regarding Robo-Advisers

Attorneys, government officials, consultants, and this Comment agree that the growing robo-adviser presence should be approached with caution.[101] The Rule, in its attempt to heighten the duty owed to those investing in retirement funds, created the gap these robo-advisers are destined to fill.[102] Currently, there are far more risks than benefits and greater potential harms in allowing this technology to operate unchecked in the same space as human fiduciaries without clarifying operating standards.[103]

The DOL has estimated that broker-dealers will experience the greatest effect from the Rule because they have the most to change in aligning with the new fiduciary definition.[104] This will have a residual effect on a certain segment of the retail investor market—the middle class investor.[105] Former U.S. Secretary of Labor Thomas E. Perez emphasized the importance of retirement security for the middle class and that the Rule leaves the middle class particularly vulnerable to detrimental non-fiduciary level advice.[106] The increased cost of doing

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[100] *See infra* Section III.B.

[101] *See, e.g.*, Robert Powell, *Can Investors Trust a Robot to Work in Their Best Interest?*, MARKETWATCH (Mar. 22, 2017, 9:41 AM), http://www.marketwatch.com/story/can-investors-trust-a-robot-work-in-their-best-interest-2017-03-10 (quoting Elliot Weissbluth, founder and CEO of HighTower; then quoting William Galvin, Massachusetts Secretary of State) ("'Machines don't yet have the capacity to discharge a duty to a human being.'. . . '[F]ully-automated robo advisers . . . may be inherently unable to act as fiduciaries and perform the functions of a state-registered investment adviser.'").

[102] *See* Fiduciary Duty Rule, 81 Fed. Reg. 20,946, 20,946–47 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509–10, 2550).

[103] *See* Robo-Advisers Guidance Update, *supra* note 80, at 2, 8.

[104] *See* Greg Iacurci, *Anticipating Delay to DOL Fiduciary Rule, Broker-Dealers and RIAs Change Course*, INVESTMENT NEWS (Aug. 16, 2017, 1:10 PM), http://www.investmentnews.com/article/20170816/FREE/170819958/anticipating-delay-to-dol-fiduciary-rule-broker-dealers-and-rias.

[105] *See* Nadia Yoon, *The Potential Effect of the Department of Labor's New Fiduciary Rule On Broker-Dealers and the Middle Income Retirement Investors Who Rely On Them*, 66 CATH. U. L. REV. 223, 224 (2016).

[106] STAFF OF S. COMM. HOMELAND SECURITY & GOVERNMENTAL AFFAIRS, 114TH CONG., THE LABOR DEPARTMENT'S FIDUCIARY RULE: HOW A FLAWED PROCESS COULD HURT RETIREMENT SAVERS 3 (Comm. Print 2016), https://www.hsgac.senate.gov/download/the-labor-departments-fiduciary-rule-how-a-flawed-process-could-hurt-retirement-savers ("[E]xperts emphasize that the rule

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business under this Rule will cause investment advisers to make strategic decisions about their client books, which will "likely increase the costs and burdens associated with servicing smaller plans . . . [which] could limit financial advisers' ability to offer savings and investment advice to clients . . . [which] could ultimately lead advisers to stop providing retirement services to small businesses."[107] The next best option for these middle class investors is to turn to robo-advisers for their investment advice.[108] While this shift might be fairly simple for younger investors, where thirty-eight percent of investors between the ages of eighteen and thirty-four are familiar with the technology of robo-advisers, only four percent for those ages fifty-five and over are familiar with the platform.[109] This discomfort with financial technology adds another layer of concern for investors, where those middle class investors over fifty feel a greater sense of urgency to invest for retirement, yet they may be forced to utilize a technology about which they are altogether unsure.

Robo-advisers offer investment advice based on the user's responses to online questionnaires.[110] These questionnaires seek to

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would actually harm the investors it is supposed to protect; the rule would drive up the price of investment advice and would ultimately decrease the availability of advice for low- and middle-income investors."); *see also* Carl B. Wilkerson, Comment Letter on SEC Chairman's Request for Information on Standards of Conduct for Investment Advisers and Broker-Dealers 2 n.5, 14, 16 (Oct. 3, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2640466-161282.pdf (The . . . robo-advice envisioned under the [R]ule does not fulfill retirement security and generated a harmful advice gap for moderate income retirement savers under a parallel UK initiative.").

[107] David Hirschmann & Randall Johnson, Chamber of Commerce of the United States of America, Comment Letter on Proposed Rule for Definition of the Term "Fiduciary" Under the Employee Retirement Income Security Act of 1974 11 n.12 (Sept. 24, 2015), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00370.pdf (alteration in original).

[108] Nir Kaissar, *Who's Afraid of Robo-Advisers?*, BLOOMBERG (Apr. 11, 2016), https://www.bloomberg.com/gadfly/articles/2016-04-11/robo-advisers-are-investors-best-friend ("[I]n light of recent threats by traditional brokerages to drop middle-class and working-class investors in response to the Department of Labor's recently released fiduciary rule . . . middle-class and working-class investors can turn to robo-advisers.").

[109] *FINRA Foundation Publishes In-depth Analysis of U.S. Investors*, FIN. INDUSTRY REG. AUTHORITY (Dec. 13, 2016), http://www.finra.org/newsroom/2016/finra-foundation-publishes-depth-analysis-us-investors.

[110] *See* Milton Vescovacci & Adam Miller, "*In Robo-Advisers You Trust: Or Do You?*" DAILY BUS. REV. (Aug. 31, 2017), https://www.law.com/dailybusinessreview/almID/1202796861738/ ("[A] robo-advisor . . . is a fully automated, algorithm based financial adviser that provides

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elicit information about a client's risk appetite, investment preferences, and personal goals.[111] However, the information a robo-adviser collects is limited and often superficial. Reg Warlop, Global Head of Digital-Wealth Management at HSBC, stressed the importance of forming "a trusted relationship" when seeking investment advice, stating that the path to building trust is "certainly more complicated than a robo advice journey that asks you five questions about your risk profiling and a few numbers about your saving aspirations."[112] A set of online questions is very different than the knowledge and understanding of a client's goals, fears, and tolerance assessed by a human adviser.[113]

A potential investor now has a choice between going to an investment adviser or using a robo-investment platform when making decisions about his retirement fund.[114] The human adviser has an obligation to understand the client, act in his benefit, put the client's interests first, and act with care.[115] The human adviser is able to ask follow-up questions, clarification questions, and interpret non-verbal cues like body language and tone.[116] If the client seeks the same advice from a robo-adviser, he or she will get an automatically generated list of investment choices as a result of answering a few questions, devoid of human interaction, emotion, and empathy.[117] The questions are limited to a narrow segment of the client's financial circumstances, and the client is only able to communicate information in response to the questionnaire with no room to qualify or explain the answer.[118] This limitation and lack of human interaction risks misunderstandings where

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investment advice based on a client's response to a preprogramed questionnaire—all done online with no human service.").

[111] *See, e.g.*, David John Marotta, *Schwab Intelligent Portfolios: Built on a Faulty Premise,* FORBES (Mar. 22, 2015), https://www.forbes.com/sites/davidmarotta/2015/03/22/schwab-intelligent-portfolios-built-on-a-faulty-premise/#196d0d0a4c5f (discussing the six questions asked in Charles Schwabs's Schwab Intelligent Portfolios); *see also 2011 SEC Staff Study*, *supra* note 47 (explaining that a broker-dealer has a duty of inquiry to obtain relevant information about the client's financial situation, based upon the client's age, income and financial goals, investment horizon, risk tolerance, and/or living and other expenses).

[112] Panos Archondakis, *The Future Of Advisory: Exploring The Impact Of Robo On Wealth Management*, FINEXTRA 16–17 (Sept. 5, 2016), https://www.finextra.com/finextra-downloads/surveys/documents/e47ab3d0-30bc-4ea6-994f-c67f701da9c4/fin_wealth_epamv5_090516.pdf.

[113] Scott MacKillop, *Can a Robot Be a Fiduciary?*, THINKADVISOR (Jan. 30, 2017), http://www.thinkadvisor.com/2017/01/30/can-a-robot-be-a-fiduciary?page=2&slreturn=1507820620.

[114] *See id.*

[115] *Id.*

[116] *Id.*

[117] *Id.*

[118] Powell, *supra* note 101.

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the customer answering the questions is not an experienced high net worth individual, but rather an unsophisticated investor who is unsure how to define his risk appetite.[119] Robo-advisers are far more suited to serving investors that are comfortable taking on the task of making decisions themselves, not customers seeking professional guidance to make some of their most important long-term investment decisions.[120] Yet the resulting market forces could leave middle and low-income investors with little option but to forgo traditional investment advice because they fail a firm's cost-benefit analysis for electing potential clients.[121]

FINRA and other bodies tasked investment firms with developing their financial technology in the best interest of the investor[122] or place the assumption of risk on the consumer.[123] The SEC also indicated a middle-ground approach for any conflict of interest concerns arising out of the creation of robo-investment algorithms.[124] Supporters of this approach feel that transparency is achieved as long as investors are informed of the competing interests programmed directly into the platform.[125] The purpose of the Rule is to protect investors from adviser's ability to circumvent duty.[126] The result, however, has created

[119] *See generally* MacKillop, *supra* note 113 ("[T]here is very little established science behind most risk tolerance questionnaires. Moreover, research has shown that a person's risk tolerance changes over time and that people are notoriously bad at assessing their own tolerance for risk.").

[120] Marcia E. Asquith, Senior Vice President & Corporate Secretary of FINRA, Comment Letter on Proposed Rule for Definition of the Term "Fiduciary" Under the Employee Retirement Income Security Act of 1974 6 (July 17, 2015), https://www.regulations.gov/document?D=EBSA-2010-0050-0610 [hereinafter FINRA Comment Letter].

[121] *See, e.g.*, *infra* note 140 and accompanying text.

[122] *See, e.g.*, *Report on Digital Investment Advice*, FIN. INDUSTRY REG. AUTHORITY 14 (Mar. 16, 2016), https://www.finra.org/sites/default/files/digital-investment-advice-report.pdf ("Firms need to establish and maintain an investor protection foundation that accounts for the considerations raised by digital investment advice.").

[123] *Joint Investor Alert: Automated Investment Tools*, U.S. SEC. & EXCH. COMM'N (May 8, 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/autolistingtoolshtm.html.

[124] *See, e.g.*, *Form ADV (Paper Version) Uniform Application For Investment Adviser Registration Part 2*, U.S. SEC. & EXCH. COMM'N 1, https://www.sec.gov/about/forms/formadv-part2.pdf (last visited Feb. 13, 2018) (stressing that the fiduciary duty extends only to conflicts between the advisor and the client's interests, and it does not mention conflicts between the advisor and the firm for which he or she works).

[125] Ji, *supra* note 77, at 1580–81.

[126] Definition of the Term "Fiduciary"; Conflict of Interest Rule–Retirement Investment Advice, 81 Fed. Reg. 20,946, 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509–10, 2550).

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a vehicle by which investment firms can avoid outright compliance with the fiduciary standard.[127] The current middle class investor is ill-equipped to evaluate the quality of automated investment platforms.[128] There is also the risk of the unsophisticated investor misunderstanding the disclosures and explanation of the business model.[129] The SEC requires disclosures to be in "plain English" to avoid investor confusion, but an explanation of how the algorithm is structured, circumstances in which an algorithm may override the account's programming, and the risks associated with automated platforms may be lost on the average consumer.[130] Those same complicated disclosures occur where robo-advisers are able to limit or disclaim fiduciary duties altogether, placing the risk fully on the user to understand the implications that disclaimer has in the long term.[131]

There is, however, a particularly concerning human element in the robo-advising platform: the creation of the program itself. At the core of the robo-adviser is an algorithm that uses various financial models and assumptions to translate data inputs into suggested actions at each step of the advice value chain.[132] These algorithms, designed to operate without human involvement upon completion, are nonetheless created by humans,[133] with all potential biases, human error, and self-dealing embedded in the algorithm.[134] However, unlike the regulation in place for human advisers, there is little guidance in place for those in charge of building these digital tools.[135] This presents a stark contrast from the duty of loyalty fiduciaries are charged with—the prohibition from entering a transaction for the purpose of benefitting a third party, rather than the trust beneficiary.[136] This rigorous duty of loyalty is tempered by the many exceptions under ERISA, leading many to believe that

[127] Fein, *supra* note 39, at 14.

[128] *See FINRA Foundation Publishes In-depth Analysis of U.S. Investors*, *supra* note 109.

[129] Robo-Advisers Guidance Update, *supra* note 80, at 3.

[130] Fein, *supra* note 77, at 8.

[131] Fein, *supra* note 77, at 23–24.

[132] *See* MacKillop, *supra* note 113.

[133] Baker & Dellaert, *supra* note 93, at 715 ("*People* design, model, program, implement, and market these automated advisors." (emphasis added)).

[134] *Digital Investment Advice: Robo Advisors Come of Age*, BLACKROCK 5, 11 (Sept. 2016), https://www.blackrock.com/corporate/en-gb/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf.

[135] *See* Ethan L. Silver & Scott H. Moss, *Compliance Tips for Robo-Advisers As They Take the Spotlight*, LAW360 (Mar. 7, 2017), https://www.law360.com/articles/898196/compliance-tips-for-robo-advisers-as-they-take-spotlight.

[136] RESTATEMENT (SECOND) OF TRUSTS § 170 (1959); *see also* Stein, *supra* note 15, at 76.

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these exceptions highlight the human difficulty to act fairly in two capacities to administer a plan for the benefit of employee-investors and the employer.[137]

With robo-advisers, that duty of loyalty is further removed because it is not a person but a platform serving the client. The algorithm's creator has the ability to structure the investment scheme in any way and "selfishness is apt to lead him to give himself an advantage" while altogether removing himself from a direct violation of conflicts of interest.[138] The industry has already seen this risk play out in a class action suit brought against Morningstar and Prudential, in which the Plaintiffs claimed injury resulting from the robo-adviser program built to steer clients towards investment that paid Prudential high fees.[139] The language in the Complaint reflects the same objectives the new fiduciary definition seeks to prevent, where "instead of steering Plan participants into the best and most cost effective investment options available . . . [the robo-adviser] sent Plaintiff and other Class member investors into high-cost retirement funds because doing so benefitted Defendants."[140]

Regulators must be cognizant of industry practice and whether, while still complying with existing laws, firms and broker-dealers can manipulate their algorithms to favor their own accounts,[141] enable kickback schemes, and limit the options given to client.[142] "As we build more sophisticated tools they might be misused," acknowledged Gil Eyal, President and Co-Founder of Tradency.[143] Robo advisors, if they are to be a beneficial tool for investors, must be structured to prevent their misuse.[144] If human nature is to favor benefit to oneself where possible, the risk of self-dealing in the algorithm's programming process cannot be ignored.

[137] *See, e.g.*, Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1107 (1988).

[138] GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS & TRUSTEES § 543, Westlaw (database updated June 2017).

[139] Diana Novak Jones, *Morningstar, Prudential Face Class Action Over Robo-Advisor*, LAW360 (Aug. 4, 2017), https://www.law360.com/articles/951428/21orningstar-prudential-face-class-action-over-robo-adviser.

[140] Complaint at 7, Green v. Morningstar, Inc., No. 1:17–cv–05652 (N.D. Ill. filed Aug. 8, 2017) (alteration in original).

[141] *Report on Digital Investment Advice*, *supra* note 122, at 7 (discussing current disclosure practices for brokers that favor self-benefitting accounts).

[142] *See, e.g.*, Yoon, *supra* note 105, at 231 (outlining the different standard broker dealers operate under and their ability to recommend products that benefit them more than clients).

[143] Archondakis, *supra* note 112, at 21.

[144] *Id.* at 21–22.

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More broadly, robo-advisers by their very nature may not be able to meet the fiduciary standard. Massachusetts Secretary of State William Gavin said, "fully-automated robo advisers, as they are typically structured, may be inherently unable to act as fiduciaries" and are ways for businesses to circumvent compliance obligations that come with being defined as a fiduciary.[145] In fact, because robo-advisers give investment advice without personal interaction or personal interaction with the client, they should not, under ERISA, be considered a fiduciary.[146] The fundamental purpose and the original intention of holding a person to the standard of a fiduciary is not a legal concept, but one of morals and ethics.[147] There must be targeted regulation, clearly expressed standards to which robo-advisers can adhere, and consequences for those firms utilizing robo-adviser platforms to the detriment of the retail investor.

IV. CONCLUSION

The Fiduciary Rule is clear about which human beings now fall into the category of fiduciary.[148] This broadened definition aimed to close the loophole that allowed different standards of conduct in the retirement investment industry.[149] By bringing all investment advisers under the definition of fiduciary, businesses and consumers alike have clarity and consistency.[150] The irony is that where the issue of inconsistency is solved for human advisers, a new question arises for the robo-advisers appearing in response to this Rule.[151] Though the function and goal is the same for humans and robo-advisers, to provide investment services in order to grow individual retirement funds, the same type of loophole is created anew. To what standard of care is this technology to be held? Is it even possible to hold a technology platform to the same fiduciary standard as a human being?[152]

These questions demonstrate the need for clearer guidance and regulation of these robo-advisers.[153] Even prior to the new Fiduciary

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[145] Powell, *supra* note 101.

[146] Fein, *supra* note 77, at 28.

[147] Jay Youngdahl, *Investment Consultants And Institutional Corruption* 25 (Harv. Univ. Edmond J. Safra Ctr. For Ethics, Working Paper No. 7, 2013), http://www.investingforme.com/pdfs/reports-studies/InvestmentConsultsCrisis.pdf ("The [fiduciary] duty, while legal in nature, is built on a firm ethical/moral foundation.").

[148] Butterfield, *supra* note 67.

[149] *See id.*

[150] *Id.*

[151] *See* Powell, *supra* note 101.

[152] MacKillop, *supra* note 113.

[153] *See generally* FINRA Comment Letter, *supra* note 120, at 11 ("[F]inancial

continued . . .

Rule, the SEC considered how robo-advisers might meet their fiduciary and other obligations under the IAA.[154] As SEC-registered investment advisers, robo-advisers are subject to all of the requirements of the IAA, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients.[155] But now that the DOL's new Rule changes those registered advisers, it necessarily must change the requirements to which robo-advisers are subject as well.

Doing nothing and assuming that current regulation will easily apply to a new technology, where the regulation would hold an algorithm to the highest standard of loyalty in law and expect the result to conform to a "punctilio of an honor the most sensitive"[156] is unrealistic.[157] The current advice from bodies like the DOL and the SEC misplaces some of the more fundamental risks presented by these robo-advisers.[158] Pushing firms to disclose to clients that the robo-adviser is not a fiduciary does not alleviate risks to vulnerable investors,[159] and allowing these digital investment platforms to contract around their fiduciary obligations undermines the entire purpose of expanding the fiduciary standard.[160]

Investing for retirement is "an emotional process" and human involvement provides investors with the "comfort and encouragement" necessary to embark upon and maintain a financial plan that meets important life events.[161] Because this Comment argues in favor of preserving the human element of fiduciary duties, a potential solution is a hybrid automated investment adviser model.[162] The hybrid model

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institutions are best able to develop successful compliance procedures in response to new standards when regulatory expectations are clear and the standards are derived from existing requirements that they understand."). There is even less guidance from the DOL, or really any regulatory body, with regard to these robo-advisers. *See id.*

[154] *Id.* at 13.

[155] Robo-Advisers Guidance Update, *supra* note 80, at 3–4 ("Information a robo-adviser should consider providing includes . . . [a] description of the particular risks inherent in the use of an algorithm to manage client accounts . . . .").

[156] Meinhard v. Salmon, 249 N.Y. 458, 464 (1928).

[157] MacKillop, *supra* note 113.

[158] *See generally supra* text accompanying notes 70–78 (outlining actual and expected consequences of the Rule).

[159] *See, e.g.*, Robo-Advisers Guidance Update, *supra* note 80, at 3–4.

[160] Jennifer Klass & Eric Perelman, *The Evolution Of Advice: Digital Investment Advisers As Fiduciaries*, MORGAN, LEWIS & BOCKIUS LLP 6 (Oct. 2016), https://www.morganlewis.com/-/media/files/publication/report/im-the-evolution-of-advice-digital-investment-advisers-as-fiduciaries-october-2016.ashx?la=en&hash=7A28D9586FD8ACADC9731733BFE4281F4E6FEB49.

[161] Onnig H. Dombalagian, *Preserving Human Agency in Automated Compliance*, 11 BROOK. J. CORP. FIN. & COM. L. 71, 85 (2016).

[162] Baker & Dellaert, *supra* note 93, at 721.

continued . . .

places a human interface over the automated algorithm, allowing human interaction and assessment of risk while the maintenance of the investment portfolio is done through the digital platform.[163] Not only will this allow investors who want to speak to a human being during their decision making process to do so, but it is likely the services come at a lower cost than traditional services.[164] Firms, too, can benefit from this hybrid model. If human advisers can outsource some of the decision making and portfolio maintenance to the robo-adviser, the human advisers can more efficiently allocate their time to tasks that bring more revenue and diversify the firm's services.[165] While this does not remove the need for clearer regulatory guidelines, it ensures that, for now, the human duty of loyalty and care are not totally stripped away and replaced with an algorithm.

[163] Clint Boulton, *Roboadvisors Stand at the Vanguard of Human-Machine Collaboration*, CIO (Mar. 25, 2016, 12:02 PM), http://www.cio.com/article/3048318/vertical-industries/roboadvisors-stand-at-the-vanguard-of-human-machinecollaboration.html.

[164] *2016 Regulatory Impact Analysis*, *supra* note 38, at 323–24.

[165] *Id.* at 320–21.