
RISK, REWARD, ROBO-ADVISERS:
ARE AUTOMATED INVESTMENT PLATFORMS ACTING IN YOUR BEST
INTEREST?

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I. Introduction

Robots are not taking over the world, but they are becoming more prevalent in everyday life, making daily chores simpler and even eliminating jobs altogether.¹ One industry that is heavily influenced by trends in technology is investment management.² Traditionally, an individual will seek the advice and services of a financial

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¹ See Kathleen Elkins, *The 20 Jobs that Robots Are Most Likely to Take Over*, BUSINESS INSIDER (May 29, 2015), archived at <https://perma.cc/2R9K-VFSM> (analyzing 20 jobs that robots are likely to replace humans with in the near future); Bob Tedeschi, *This Year in Robots: 10 Home Robots to Lighten Your Domestic Chores*, N.Y. TIMES (Dec. 24, 2014), archived at <https://perma.cc/ER5V-9VQZ> (listing ten new helpful home robots and discussing how tech optimists believe that it will become more common for robots to complete household chores).

² See Leslie Kramer, *How Technology Helps Financial Advisors*, INVESTOPEDIA (Jan. 13, 2016), archived at <https://perma.cc/PC8Z-RCBR> (explaining how investment advisers have a need for technology to best serve their clients by educating them, processing investment information, and making smart and profitable decisions); see also Avadhut Nigudkar, *What You Should Know About Asset Management Jobs*, FINANCEWALK (Feb. 9, 2017), archived at <https://perma.cc/5ECP-Z377>

planner or an investment adviser to manage their money to save for retirement, increase their personal wealth, or diversify their personal assets.³ Robo-advisers, an emerging form of investing, manage a client's funds on an automated investing platform, usually by way of investing in Exchange Traded Funds ("ETFs").⁴ A traditional human adviser may substantially profit from a commission-based or transaction-based fee, which differs from robo-advisers that operate on algorithmic investing and typically profit from flat fees.⁵

Robo-advisers have been on the rise in recent years, as small independent automated investment platforms seeking to attract a younger generation of investors.⁶ Robo-advisers initially made their way into the market by targeting the "millennial" generation given their attraction to the technology based platforms, low fee structure, and a hands off approach to investing and saving for retirement or growing personal wealth.⁷ Robo-adviser accounts are easy to set up

(explaining how asset management firms invest money on behalf of their clients, along with the specific skills and characteristics of asset managers).

³ See United States Securities and Exchange Commission ("SEC"), INVESTMENT ADVISERS: WHAT YOU NEED TO KNOW BEFORE CHOOSING ONE (Aug. 7, 2012) (providing investors with information on how to choose an investment advisor, specifically differentiating the typical roles of investment advisors and financial planners).

⁴ See *Exchange-Traded Fund (ETF)*, INVESTOPEDIA (Feb. 9, 2017), archived at <https://perma.cc/B5VD-6N3A> (defining an exchange-traded fund as "a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund . . . trade[d] like a common stock on a stock exchange . . ."); see also Chance Barnett, *FinTech Trends: Wealth Management and the Rise of Robo Advisors*, FORBES (Sept. 1, 2015), archived at <https://perma.cc/C9EN-Z4MW> (describing how "robo advisor platforms" lower costs, simplify trading, and even make investing "fun").

⁵ See *Algorithmic Trading*, INVESTOPEDIA (Feb. 9, 2017), archived at <https://perma.cc/9CHD-AHJ2> (defining algorithmic trading as a method of trading based on mathematical formulas and models that aim to optimize returns through high-speed decisions); see also Jason Van Bergen, *Paying Your Investment Advisor - Fees or Commissions?*, INVESTOPEDIA (Feb. 9, 2017), archived at <https://perma.cc/Z3UR-C5KZ> (explaining how fee-based advisers charge a flat hourly rate, whereas commission-based advisers are paid a percentage of each trade they make).

⁶ See Barnett, *supra* note 4 (analyzing the history of robo-advisers and how they have been targeting millennials, particularly because of their ease of usage and low fees).

⁷ See Frank J. Cavaliere, *Finances on the Web: Robo-Advisors*, A.L.I. 62 No. 5 Prac. L. 11, (Oct. 2016) (defining robo-adviser and also discussing how firms like

and begin investing with: there is a short questionnaire to calculate an investor's risk tolerance, the investor deposits money, and the algorithm creates and maintains an individualized diversified portfolio, usually consisting of ETF, for the client.⁸ Similar to the expectations of traditional investment advisers, clients may expect their robo-advisers to be regulated by a governmental or regulating agency and held under a strict fiduciary duty, so their assets and investments are invested in a way that is in their best interest.⁹

It is no surprise that technology plays a key role for investment firms, considering it has become a major facet in basic, everyday life.¹⁰ In order to protect investors and provide transparency, the Department of Labor ("DOL") recently released a new rule, the Conflict of Interest Rule (the "Final Rule" or "Rule"), that will create a more stringent fiduciary standard, which seeks to eliminate all conflicts of interest between a client's best interest and an advisers desire to maximize their compensation.¹¹ The Final Rule's proposed implementation was originally April 2017, but with the new administration, the DOL has proposed a sixty-day delay from the phased implementation and continually delayed full implementation.¹² Shortly

Betterment and Wealthfront have entered the investment market, while large firms have created their own automated investment platforms); *see also* Barnett, *supra* note 4 (noting that robo-advisers target tech-driven millennials, but nevertheless, these young investors sometimes still desire a trusted human adviser).

⁸ *See* Matt Egan, *Robo Advisors: The Next Big Thing in Investing*, CNN MONEY (June 18, 2015), *archived at* <https://perma.cc/BJY4-XP3Y> (explaining how robo-advisers work and the way an account is set up and managed).

⁹ *See* U.S.SEC, REGULATION OF INVESTMENT ADVISERS 1 (Mar. 2013) (explaining that "[m]oney managers, investment consultants, and financial planners are regulated in the United States as 'investment advisers' under the U.S. Investment Advisers Act of 1940 ... [and] by the U.S. Securities and Exchange Commission.").

¹⁰ *See* INVESTOPEDIA & FINANCIAL PLANNING ASSOCIATION, HIGH-TECH AND HIGH-TOUCH: INVESTORS MAKE THE CASE FOR CONVERGING AUTOMATED INVESTING PLATFORMS AND FINANCIAL PLANNING 1 (2018) (explaining how investment professionals use technology to not only better advise existing clients, but also to find new clients through automated platforms).

¹¹ *See Fact Sheet: Department of Labor. Finalizes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle Class Families Billions of Dollars Every Year*, U.S. DEP'T OF LABOR (Oct. 22, 2016), *archived at* <https://perma.cc/KFP2-Z24P> [hereinafter *Fact Sheet*] (outlining what the Department of Labor's new ruling is set out to accomplish).

¹² *See* Greg Iacurci, *DOL Sends Final Fiduciary Rule Delay to Office of Management and Budget*, INVESTMENTNEWS.COM (March 29, 2017), *archived at*

after the delay, the DOL has begun to implement this standard, requiring all investment advisers to act in their clients best interests.¹³ Notwithstanding the delay, there is still confusion on how this standard will apply to robo-advisers and what their clients need to understand.¹⁴ The Final Rule focuses on documenting recommendations and communications between advisers and clients; however, robo-advisers have little to no interaction with their clients past the initial account set-up.¹⁵ Since more robo-adviser start-ups are increasing their assets under management (“AUM”) and large investment firms are acquiring their own robo-advisers, there will likely be a hike in fees and costs to invest in these types of platforms as well as some regulation.¹⁶ In anticipation of a shift towards lower cost investment advice, robo-advisers are hopeful the DOL’s Final Rule will drive more

<https://perma.cc/67KB-VUVW> (explaining how the DOL delayed the implementation of their Final Rule by 60)). President Trump’s Administration instructed the DOL to reevaluate the Final Rule regarding, specifically, retirement accounts. *Id.*¹³ See *Need Help Understanding the DOL Fiduciary Rule?*, TD AMERITRADE (Jan. 7, 2018), *archived at* <https://perma.cc/HGW9-H5DC> (addressing when the DOL’s fiduciary standard will go into effect); see also Liz Skinner, *Figuring Out Fiduciary: Now Comes the Hard Part*, INVESTMENTNEWS (May 9, 2016), *archived at* <https://perma.cc/Y8Q3-RBN4> (stating the Labor Department’s new rule would stop advisers from putting their own interests before those of their clients’).

¹⁴ See Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions, 82 Fed. Reg. 31,278 (Proposed July 6, 2016) [hereinafter Request for Information] (addressing the changes that will be implemented to whoever is considered a fiduciary under this Final Rule, while addressing mechanisms which may allow robo-advisers to be considered fiduciaries or how this Final Rule will affect them).

¹⁵ See Fact Sheet *supra* note 11 (summarizing the DOL’s Final Rule and how the main focus of the requirement for advisers is to document communications between clients and advisers); S.E.C., DIVISION OF INVESTMENT MANAGEMENT, No. 2017-02, GUIDANCE UPDATE: ROBO-ADVISERS (Feb. 2017) (discussing the limited interaction clients have with robo-advisers when setting up an account); Office of Investor Education & Advocacy, *Investor Bulletin: Robo-Advisers*, INVESTOR.GOV (Feb. 23, 2017), *archived at* <https://perma.cc/Y5EH-ANPQ> (explaining what a robo-adviser is and how they have grown in recent years).

¹⁶ See Melanie L. Fein, *Robo-Advisors: A Closer Look*, at 27-28 (June 30, 2015) (on file with author) (explaining how robo-advisers will not meet the disclosure requirements of the DOL’s Final Rule and would be in violation of the Conflict of Best Interest aspect of the DOL’s Final Rule).

customers to utilize their platforms, increasing an already growing business for them.¹⁷

This Note analyzes the DOL's Final Rule and its definition of fiduciaries and how under this Final Rule, robo-advisers may be considered fiduciaries, but fall short of meeting this strict standard. Part II of this note begins with background of the fiduciary standard, the DOL's Rule and certain exceptions to the Rule, and conflicts which could arise from a breach of these duties.¹⁸ Part II will discuss robo-adviser's emergence into the investment market. Additionally, it will also discuss how new technologies may aide advisers with specific documentation requirements.¹⁹ Part III of this note will breakdown the DOL's exemptions and how advisers, including robo-advisers, can utilize them in compliance with the DOL's new Rule.²⁰ Finally, Part IV of this Note will get to the nuts and bolts of conflicts of interest and how under the DOL's new definition of fiduciary, even with the use of the exemptions, robo-advisers should not be considered a fiduciary.²¹

¹⁷ See Liz Skinner, *Betterment Presses Trump to Keep DOL Rule*, INVESTMENTNEWS (Dec. 5, 2016), archived at <https://perma.cc/JG59-8LMX> (quoting Craig Iskowitz, founder of Ezra Group, a technology consulting firm in the financial advice industry, saying, "[t]he robo-advisers see the DOL Final Rule as being a disadvantage for broker-dealers, and they think [robo-advisers] could be getting business from broker-dealers dropping small accounts.").

¹⁸ See *infra* section II.

¹⁹ See *infra* section II.

²⁰ See *infra* section III.

²¹ See *infra* section IV.

II. History

A. *Fiduciaries and Fiduciary Standards*

A fiduciary is a person who is held to one of the highest ethical standards, in which an agent must act in the principal's best interest regardless of their own interests.²² An investment adviser is a common example of someone who is held to a fiduciary standard, because they are entrusted to advise a client on the movement of their financial assets.²³ Furthermore, traditional investment advisers are required to act in their client's best interest and disclose any conflict of interest that may arise, even if the financial compensation is not advantageous to themselves.²⁴ In terms of regulating Registered Investment Advisers ("RIA") and firms, the Investment Advisers Act of 1940 ("40 Act") was created, which sets forth standards of disclosure, policies regarding a change in investment plans, causes of action and remedies for breach of fiduciary duties, and general standards all RIA's must meet.²⁵ The Final Rule recently approved by the

²² See *Investment Company Act of 1940*, INVESTOPEDIA.COM (Mar. 5, 2017), archived at <https://perma.cc/LRJ2-X6XR> (outlining features of the act which dictate fiduciary duties owed by fund companies); Tyler Kirk, *A Federal Fiduciary Standard Under the Investment Advisers Act of 1940: A Refinement for the Protection of Private Funds*, 7 HARV. BUS. L. REV. ONLINE 23-24 (2016) (summarizing a fiduciary as one who owes their client duties of care and loyalty, which exceed the typical business relationship standard of conduct); *Fiduciary Definition*, BLACK'S LAW DICTIONARY (2nd ed.) (defining a fiduciary [relationship] as one where a person is "invested with rights and powers to be exercised for the benefit of another").

²³ See U.S. SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT iii-124 (Jan. 2011) [hereinafter SEC STUDY] (explaining that investment advisers are fiduciaries and their duties include acting in their client's best interest).

²⁴ See Ethan S. Braid, *Is My Financial Advisor A Fiduciary or a Stock Broker?*, HIGH PASS ASSET MANAGEMENT (Mar. 2013), archived at <https://perma.cc/M6US-UGM3> (defining what makes an investment advisor a fiduciary, and stating that the investment advisor must act in the client's best interest even if it adverse to his/her compensation).

²⁵ See 15 U.S.C. § 80a-1 (1940) (outlining the regulation and policies set forth in the 1940 Act and how it will apply to RIA's); REGULATION OF INVESTMENT ADVISERS, *supra* note 9, at 1 (explaining how the SEC regulates advisers under the 1940 Act); *Registered Investment Advisor – RIA*, INVESTOPEDIA (Jan. 22, 2018), archived at <https://perma.cc/7DZN-6WVC> (defining an RIA as "an advisor or firm

DOL is an attempt to reduce conflicts of interest and breaches of fiduciary duty between clients and investment advisers.²⁶

B. Overview of Department of Labor's Conflict of Interest Rule and Exceptions

In April of 2016, after many hearings, petitions, and comments, the DOL adopted the Conflict of Interest Final Rule, which includes different fee exemptions for investment advisers.²⁷ The Final Rule defines who is considered a fiduciary investment adviser and describes what investment advice gives rise to fiduciary responsibilities.²⁸ Furthermore, the Final Rule provides exemptions to advisers which could allow them to maintain current fee structures, which normally be prohibited, so long as their advice is in the best interest of the client and meets certain exemption requirements.²⁹ The exemptions, the Best Interest Contract Exemption ("BIC Exemption") and Principal Transactions Exemption ("PT Exemption") are two of the

engaged in the investment advisory business and registered either with the Securities Exchange Commission (SEC) or state securities authorities). RIAs have a fiduciary duty to their clients, which means they have a fundamental obligation to provide suitable investment advice and always act in their client's best interest." *Id.* See also *Investment Advisors Act of 1940*, INVESTOPEDIA (Jan. 22, 2018), archived at <https://perma.cc/5BW7-EXYH> (defining the 1940 Act as "[a] piece of legislation passed in 1940 that . . . defined the role and responsibilities of an investment advisor:").

²⁶ See Fact Sheet, *supra* note 11 (summarizing the DOL's Final Rule, how it seeks to eliminate conflict of interest and ensure that investment advisers, regardless of investor classification, are all being held to the same fiduciary standard and are acting in their client's best interest).

²⁷ See Iacurci, *supra* note 11 (explaining that the Office of Management and Budget will evaluate the final rule prior to sending it back to the Department of Labor); see also Ashlea Ebeling, *The DOL Fiduciary Rule: A Timeline*, FORBES (Mar. 23, 2017), archived at <https://perma.cc/4HXZ-84QJ> (outlining that in April 2016, the DOL's Final Rule became "effective" up until April 2017 which was the proposed implementation date). The DOL's final rule in its current status under the new administration put a 180-day delay on the proposed phased implementation date. *Id.*

²⁸ See Fact Sheet, *supra* note 11 (generalizing who will be classified as an advisor based on their recommendations under the DOL's Final Rule).

²⁹ See Request for Information, *supra* note 14 (detailing the 'final rule' and what exemptions can be used by advisors to maintain certain commission structures). The final rule details who is a "fiduciary" for the Internal Revenue Code and taxation purposes. *Id.*

major exemptions of the Final Rule.³⁰ The BIC Exemptions have two major subsections, BICE Lite and BICE, for advisers to maintain their compensation structure, so long as they adhere to specific standards.³¹

Advisers “must either avoid payments that create conflicts of interest or comply with the protective terms of an exemption issued by the Department.”³² The Final Rule places a substantial amount of emphasis on “recommendations” made by advisers and whether the advice given by the fiduciary is considered a recommendation as defined in the Final Rule.³³ Certain communications and advice will not constitute a recommendation if it involves information pertaining to education, general communications, and platform providers.³⁴

³⁰ See *Understand Benefits of BICE vs. BICE Lite*, THE AMERICAN COLLEGE OF FINANCIAL SERVICES (Sept. 28, 2016), archived at <https://perma.cc/363N-T3TW> (explaining that “BICE is a special type of prohibited transaction exemption (PTE) that allows financial advisors to receive variable forms of compensation without assessing penalties, as long as financial advisors and institutions follow specific requirements”). BICE Lite, in contrast, exposes the advisors to less risk because they are not bound to a fiduciary standard. *Id.*

³¹ See *id.* (describing that compensation structure for advisors is subject to a new fiduciary standard); see also Shearman & Sterling LLP, *The US Department of Labor’s Final “Fiduciary” Rule Incorporates Concessions to Financial Service Industry but Still Poses Key Challenges*, COMPENSATION, GOVERNANCE & ERISA, Apr. 14, 2016, at 8, 9 (addressing the compensation structure some advisors will be allowed to follow as conditions of the BIC Exemption).

³² *Department of Labor Issues Rules on Retirement Conflicts of Interest*, DELEON & STANG (May 13, 2016), archived at <https://perma.cc/T3GP-ZAMZ> (addressing part of the exemptions under the ‘final rule’ and the necessity for some advisers to restructure their compensation schedules to avoid conflicts of interest, unless fitting into the terms of an exemption).

³³ See FTC Credit Practices Rule, 29 C.F.R. § 2510.3-21 (b)(1) (defining “recommendation” as “a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.”); see also Shearman & Sterling LLP, *supra* note 31, at 2 (proffering that for the advice to constitute a recommendation, the advice must be given for a “fee or other compensation.”).

³⁴ See Shearman & Sterling LLP, *supra* note 31 at 2-7 (listing some of the exemptions to the “recommendation” threshold). Educating investors does not rise to the level of a recommendation because not only is it beneficial, but also allows for alternative investment options to be considered when deciding on the best plan. *Id.* Communicating in a general fashion in which a reasonable person would not consider investment recommendation does not rise to the level of recommendation laid

With a looming full implementation date, advisers and firms are searching for ways in which they will comply with this more stringent fiduciary standard.³⁵ In anticipation of the tightening standards and with the hope of maintaining certain fee structures, investment advisers have begun integrating technology to help them comply with the Rule's requirements and maintain their fee structure.³⁶

C. Breach of Fiduciary Duty and Conflict of Interest Controversies

Generally, an adviser generates their profits through commissions and fees, which has the potential to lead to conflicts with clients.³⁷ A client may file a claim for breach of fiduciary duty under the '40 Act if an adviser does not act in the client's best interest or the adviser's compensation is disproportionate to the services provided.³⁸ The Supreme Court, as decided in *Gartenberg v. Merrill*

out in the 'final rule'. *Id.* Marketing different platform providers, similar to educating, allows investors to view different plans to best fit their needs. *Id.*

³⁵ See Carlo V. di Florio, Dir., Office of Compliance Inspections and Examinations, Speech at National Society of Compliance Professionals: Conflicts of Interest and Risk Governance (Oct. 22, 2012) (suggesting appropriate transitions for firms and advisors to comply with the 'final rule'). Di Florio lists three considerations; effective process, broad consideration, and firm's risk governance structure. *Id.*

³⁶ See Kevin Poe, *Complying with the Labor Department's Fiduciary Standards: What Financial Firms Should Know*, 22 WESTLAW J. DERIVATIVES 1, 1-5 (Sept. 22, 2016) (evaluating different ways investment advisers and financial firms will need to change their compensation and plan structure to comply with the DOL's Final Rule and suggesting robo-advisers as one way to integrate more technology into the processes and procedures of financial advising).

³⁷ See Van Bergen, *supra* note 5 (mentioning that commission-based compensation can encourage advisors to engage in an investing style that is not suitable for his client). The article further explains that fee-based advisers collect a flat fee or a percentage of assets under management and commission-based advisers receive payment upon opening an account for a client or on the sale of a financial product by the company offering that financial product. *Id.*

³⁸ See *Jones et al. v. Harris Assoc. L.P.*, 559 U.S. 335, 345-46 (2010) (affirming and adopting the ruling from the *Gartenberg* court). The Court, in *Jones* held that "to face liability under § 36(b), an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." *Id.* See also *Gartenberg v. Merrill Lynch Asset Mgmt., Inc. et al.*, 694 F.2d 923, 930 (2d Cir. 1982) (establishing that a claim for breach of fiduciary duty under §36(b) of the '40 Act must prove that fees charged by advisers are so excessive or unfair as to

Lynch Asset Management Inc.,³⁹ recently affirmed that the plaintiff has the burden of proving advisers' fees are so excessive or unfair to constitute a breach of fiduciary duty as set forth by statute governing compensation.⁴⁰

The DOL aims to reduce conflicts of interest for clients by increasing the scrutiny for advice being given by advisers, assuring that such advice is in fact in the best interest of the client.⁴¹ Conflicts of interests between advisers and clients is another controversial area, often prone to regulatory action.⁴² Some experts believe this is more prevalent in the financial services industry, stating, "[c]onflicts of interest arise in any fiduciary relationship, and perhaps no more so than in the financial service industry."⁴³ Investment advisers often run into ethical dilemmas when deciding between a transaction that is in the best interest of the client or an investment that is financially beneficial to themselves or the firm.⁴⁴ Regulating agencies are wary to the temptation an adviser has to be deceitful when a decision is more

constitute a breach of fiduciary duty as set forth by statute governing compensation).

³⁹ 694 F.2d 923 (2d Cir. 1982).

⁴⁰ See *Jones et al.*, 559 U.S. at 347 (stating that a plaintiff has the burden of proving that the fees the adviser is charging are excessively disproportionate to the services rendered).

⁴¹ See *Fact Sheet*, *supra* note 11 (examining how the DOL's Final Rule will define what it means to be a fiduciary, the threshold requirement for "recommendations," and the disclosure of fees and advice that will be monitored).

⁴² See *di Florio*, *supra* note 35 (explaining conflicts of interest and why the SEC and other agencies are diligent in monitoring them); see also Jon Eisenberg, *SEC Actions Against Investment Advisers In 2016: Part 1*, LAW360 (Dec. 16, 2016), archived at <https://perma.cc/GXW5-XWFC> (providing cases to illustrate scenarios where investment advisers can be held liable for conflicts of interest and subject to regulatory action).

⁴³ Joshua Horn & Amit Shah, *Guidance on Conflicts of Interest for Investment Advisers*, PRACTICAL COMPLIANCE AND RISK MGMT. FOR THE SEC. INDUS., Jan.-Feb. 2015, at 21 (introducing that in a fiduciary relationship, conflicts of interest are prevalent in the financial services industry).

⁴⁴ See *id.* at 23 (highlighting the difficulties advisers face when tasked with acting in their client's best interest); see also Peter Clarke, *Business of Conflicts of Interest*, LEGAL MATCH (June 19, 2014), archived at <https://perma.cc/L9EQ-XJWK> (explaining conflicts of interests which may arise in business law).

financially beneficial to themselves and not in their client's best interest.⁴⁵ Furthermore, the *Vernazza v. SEC*⁴⁶ case held that conflicts of interest, resulting in the misrepresentation of reporting information and financially benefiting without disclosure could warrant fines and sanctions.⁴⁷

Additionally, clients need to be aware of whether they are dealing with an investment adviser, who are held to a fiduciary standard and avoid conflicts of interest, or if they are dealing with a broker-dealer, who might not be held to the same standard and thus can avoid conflict of interest regulations.⁴⁸ There are several differences between investment advisers and broker-dealers, primarily that not all broker-dealers are held to a fiduciary standard like investment advisers.⁴⁹ Broker-dealers operate on a transaction-based commission schedule, because they directly buy and sell securities, therefore are more likely driven by profit and not always their client's best interest.⁵⁰ Broker-dealers are typically held to a suitability standard,

⁴⁵ See Press Release, SEC, Blackstone Charged with Disclosure Failures: Private Equity Advisers to Pay Nearly \$39 Million Settlement (Oct. 7, 2015), *archived at* <https://perma.cc/D3D8-FHDT> (using The Blackstone Group as an example of how the SEC Enforcement Division's Asset Management Unit is monitoring whether advisers are disclosing fees or conflicts of interest which could benefit themselves).

⁴⁶ 327 F.3d 851 (9th Cir. 2003).

⁴⁷ See *Vernazza*, 327 F.3d 851, 858-59, 863 (holding that a conflict of interest is created when the best interest of the advisor is put before the client).

⁴⁸ See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (stating that a disclosure philosophy may be misleading and investors should follow the "caveat emptor" philosophy); SEC Study, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, (Jan. 2011) (acknowledging the different responsibilities and obligations of investment advisers and broker-dealers under Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act); see *Broker-Dealer*, INVESTOPEDIA, *archived at* <https://perma.cc/5FQX-4QR5> (defining a broker-dealer as a person or firm who buys and sells securities, as well as fulfills many other roles in facilitating the flow of securities for individuals, firms, banks, and the market).

⁴⁹ See Kenneth G. Williams, *6 Pointed Questions To Ask Before Hiring A Financial Advisor*, FORBES.COM (Sept. 20, 2013), *archived at* <https://perma.cc/6JXZ-DFXW> (addressing the difference between broker-dealers and investment advisers that investors need to be aware of before trusting someone with their money or when accepting investment advice).

⁵⁰ See *id.* (highlighting that broker-dealers are not necessarily fiduciaries and do not have to act in their client's best interest); see also *Dept. of Labor, Federal Register Part III*, Vol. 80, No. 75, 21928 (Proposed April 20, 2015) [hereinafter Final Rule]

which is much less stringent than the standard the DOL will be imposing on financial advisers under the Final Rule.⁵¹ The DOL's new Rule is more stringent and broadens who is classified as a fiduciary, prioritizing their client's best interest in avoidance of any chance for conflict of interest.⁵²

(explaining how "non-fiduciaries may give imprudent and disloyal advice..." because they can operate outside of the DOL's fiduciary standard).

⁵¹ See Ross David Carmel, *The DOL Fiduciary Rule's Effect on Small Broker-Dealers*, INVESTMENT NEWS (May 4, 2016), archived at <https://perma.cc/NSA8-WDDF> (discussing the standard that broker-dealers were held to prior to and the new standard they will be held to after the new DOL Final Rule).

⁵² See Fact Sheet, *supra* note 11 (outlining the DOL's Final Rule and what the documentation requirements are under this new rule).

D. Robo-Advisers Emerging into the Investment Market

Within the past six years, there has been a shift away from traditional investment advisers towards technology-based platforms, such as robo-advisers.⁵³ A wave of start-up companies such as Wealthfront and Betterment have developed algorithm-based software that allows a client to invest easily.⁵⁴ Not only has there been a rise in smaller robo-advisers, who continue to grow their AUM, but also established investment firms such as Charles Schwab, Eaton Vance, and Blackrock have either created or acquired their own automated investment platforms.⁵⁵

The new DOL Final Rule has laid out certain exemptions which robo-advisers can utilize to meet the fiduciary standards they may be held to.⁵⁶ However, there has been industry commentary surrounding robo-advisers and their place in the market as a new platform for investing.⁵⁷ Specifically, DOL Secretary Thomas I. Perez

⁵³ See Barnett, *supra* note 4 (explaining how robo-advisers have become a popular way to invest in money markets over the past six years due to their software based technology).

⁵⁴ See Barnett, *supra* note 4 (discussing the ways in which robo-advisers use a human free, algorithm based theme to invest their clients' money, keeping fees to a minimum).

⁵⁵ See Barnett, *supra* note 4 (finding that large investment firms have begun to utilize robo-advisers as another low-cost option for their clients, also to offer more options which will comply with the DOL ruling); see also Falguni Desai, *The Great FinTech Robo Advisor Race*, FORBES (July 31, 2016), archived at <https://perma.cc/GKK3-BDBT> (analyzing how robo-advisers are making their way into the market for both small and large firms).

⁵⁶ See *Federal Register Part III*, *supra* note 50 (detailing that the Final Rule "treat[s] persons who provide investment advice or recommendations [for a fee]" with respect to assets of a plan or the IRA and the exemptions that robo-advisers can utilize in meeting higher fiduciary standards).

⁵⁷ See Mark Schoeff, *DOL Secretary Perez Touts Wealthfront as Paragon of Low-Cost, Fiduciary Advice*, INVESTMENT NEWS (June 19, 2015), archived at <https://perma.cc/S8U2-Y8SX> (explaining how DOL Secretary Thomas I. Perez has been advocating for robo-advisers, specifically complimenting their low-cost advantage for middle-income investors). Secretary Perez is challenged by opponents of the rule who say "it will significantly increase liability risk and regulatory costs for brokers and force them to abandon accounts for middle-income savers." *Id.*

has commended robo-advisers for the ability to maintain low-cost accounts.⁵⁸ Some commentators are projecting that should the Rule be fully implemented that robo-advisers will benefit from it due to their low cost, level fee base commission schedule.⁵⁹

E. How FinTech Could Help Advisers

Investment advisers are utilizing Financial Technology (“FinTech”), such as robo-advisers, to modify their current practice and comply with the new DOL Rule.⁶⁰ Due to FinTech becoming more common in the financial services industry, the shift towards utilizing automated investment platforms or documentation tracking tools, is becoming more common for large investment firms, as well as start-ups are exploiting this type of technology.⁶¹ Technology is growing so rapidly in the financial services industry that a subsection

⁵⁸ See *id.* (detailing Secretary Perez’s claim that technology provides Americans with access to investment advice). See also Connie Chen, *Betterment v. Wealthfront: How 2 of The Most Popular Robo-advisors Stack Up*, BUSINESS INSIDER (Jan. 3, 2018), archived at <https://perma.cc/3U9X-KG83> (identifying Betterment and Wealthfront as two of the most cost beneficial of robo-advisor companies). Specifically, Wealthfront platforms allows customers to select securities based on their own investment preferences. *Id.*

⁵⁹ See Michael Kitces, *How DoL Fiduciary Will Disrupt the Blackrock and Schwab Robo-Advisors*, KITCHES (May 12, 2016), archived at <https://perma.cc/R7RX-5V67> (explaining that when robo-advisers operate on a fee-based platform, the fiduciary standard is lowered to the client’s “best interests”). By lowering the fiduciary duty standard for robo-advisers, costs are minimized and reflected in lowered prices for investors. *Id.* This is important for major investment companies who face potential conflicts of interest as a result of their robo-advisers selling in-house products. *Id.*

⁶⁰ See *FinTech*, INVESTOPEDIA (Jan. 29, 2018), archived at <https://perma.cc/RC52-GGUY> (defining “FinTech” as financial technology which has been steadily emerging in the financial services sector in the 21st Century); see also Liz Skinner, *How FinTech Aims to Make DOL Fiduciary Rule Manageable*, INVESTMENT NEWS (Oct. 21, 2016), archived at <https://perma.cc/QR7D-AFEY> [hereinafter Skinner 1] (discussing how financial firms use FinTech to comply with a dynamic regulatory environment). FinTech companies are developing software like RiXtrema, which guides advisers through rollover retirement plans. *Id.*

⁶¹ See Angela Walch, *The Path of the Blockchain Lexicon (and the Law)*, 36 REV. BANKING & FIN. 713, 718-20 (arguing that “blockchain” is the backbone of FinTech, given its use in the overwhelming majority of financial transactions, both domestic and international); see also *FinTech*, *supra* note 60 (noting that while large banks are a primary user of FinTech, smaller startups received a total of \$17.4 billion in funds in 2016).

of FinTech has emerged called RegTech, which specifically helps firms and advisers comply with regulations imposed by government agencies.⁶²

With regard to one of the more rigorous requirements of the Final Rule exemptions, which calls for the disclosure of certain documents showing the transactions have been in the best interest of the client, advisers are looking to software such as fi360 that will generate risk tolerance and transaction documents to show clients they are acting in their best interest.⁶³ However, even FinTech companies understand that advisers will not be protected from litigation just because they implement new software.⁶⁴ Financial services technology consultant Susan Glover stated, “[t]echnology is going to help with DOL, but there still needs to be due diligence...[r]isk assessments and modeling tools contain assumptions and variables, so advisers

⁶² See Gregory Roberts, *FinTech Spawns RegTech to Automate Compliance With Regulations*, BLOOMBERG BNA (June 28, 2016), archived at <https://perma.cc/RLG6-AVXD> (analyzing how RegTech is a new, specified area of FinTech which help financial services firms comply with ever changing regulations); see also *Regtech*, INVESTOPEDIA (Jan. 29, 2018), archived at <https://perma.cc/4MPQ-NHYJ> (defining RegTech as a group of businesses that use technology to help comply with regulations efficiently and inexpensively).

⁶³ See Skinner 1, *supra* note 60 (noting that fi360 announced its “software would help a home office keep its advisers on a fiduciary track when they’re creating investment policy statements for clients and investment watch-list criteria, and in documenting and monitoring client accounts.”). Fi360 helps automate the workflow process by reducing an organization’s liability related to fiduciary requirements. *Id.* See also *About Fi360*, Fi360 (Jan. 29, 2018), archived at <https://perma.cc/K7WP-FHHD> (highlighting how the Fi360 company helps advisers comply with fiduciary standards through different means of technology, such as the “AIF and AFIA designation programs and the Fi360 Toolkit software”).

⁶⁴ See Skinner 1, *supra* note 60 (stating that “[e]ven technology companies agree their wares can’t protect advisers 100% from litigation.”). The technology is not foolproof because advisers need to act in the best interest of their clients. *Id.*

need to dig as much as they can into how the end result gets calculated.”⁶⁵ While technology will aide investment advisers in complying with certain requirements, they cannot guarantee FinTech is a final solution to the Rule’s requirements.⁶⁶

One of the major shifts advisers and financial firms may need to make in the future is restructuring of their compensation plans, unless they are relying on one of the exemptions and complying with the Best Interest Standard.⁶⁷ Advisers might shift their compensation structures, from compensation-based to fee-based, to comply with the fiduciary standards, but advisers and firms will need to individualize each recommendation and investment plan to document how the adviser is acting in the client’s best interest.⁶⁸ Firms such as Fidelity Investments Inc., have begun to implement FinTech, which will help advisers and firms comply with the Final Rule.⁶⁹ To enhance certain sponsored plans, advisers may begin to offer services or plan options

⁶⁵ See Skinner 1, *supra* note 60 (articulating Susan Glover’s opinion on how FinTech will help firms, but recognizes that there still needs to be due diligence by financial advisors when assessing risk assumptions and variables produced by the Fintech software); see also Fein, *supra* note 16 at 4 (discussing the limited information robo-advisers can obtain in a short risk tolerance questionnaire, which may lead to a “one-size-fits-all rebalancing algorithm.”).

⁶⁶ See Skinner 1, *supra* note 60 (explaining how FinTech will help advisers, but ultimately there will have to be certain due diligence done to calculate substantial end results).

⁶⁷ See *DOL Fiduciary Rule Explained as of Aug. 31, 2017*, INVESTOPEDIA (Aug. 31, 2017), archived at <https://perma.cc/C7D2-6NQ8> [hereinafter *DOL Fiduciary Rule*] (noting that the new DOL rule could eliminate many commission structures and that advisors will need to provide clients with a disclosure agreement in order to continue working on commission).

⁶⁸ See *id.* (expanding the definition of fiduciary to include any professional making a recommendation or solicitation while also changing commission structures); REGULATION OF INVESTMENT ADVISERS, *supra* note 9, at 23-24 (outlining a fiduciary’s duty to avoid any conflicts of interest and to disclose to the client all material facts regarding any conflict).

⁶⁹ See Roberts, *supra* note 62 (quoting Bart van Liebergen of the Institute for International Finance, who suggests that the use of technologies to help address issues of compliance and regulatory reporting); Liz Skinner, *Fidelity’s eMoney Introducing DOL Fiduciary Compliance Functions For Advisers*, INVESTMENT NEWS (Sept. 22, 2016), archived at <https://perma.cc/L7WK-WMV7> [hereinafter Skinner 2] (showing how investment firms are utilizing fintech to prepare for the DOL’s full implementation, such as using technology companies to monitor and archive interactions between clients and advisers to document the fact that advisers acted in the best interest of clients when giving recommendations).

involving robo-advisers, which would decrease a commission-based fee schedule and increase lower cost compensation plans, yet still allowing for individualized plans.⁷⁰

III. Facts/Premise

The DOL's Final Rule has adopted a phased implementation approach for the BIC Exemption and PT Exemption.⁷¹ Since the BIC Exemption is going to be a key aspect of the Final Rule, potentially having the most significant change for clients and advisers, the DOL is using a phased implementation for advisers to adjust to the new standards and be prepared for full implementation in 2018.⁷² These requirements encompass the overarching policies of the Final Rule in which the "investment advice", along with other information must be disclosed to the client as well as the DOL.⁷³

For the BIC Exemption, the primary contractual disclosures require advisers to disclose certain information like "the Best Interest standard of care," provide email and telephone number for a specific

⁷⁰ See Ronald E. Hagan, 32 THE EXCELLENT FIDUCIARY; NEW FIDUCIARY RULE CHANGES THE GAME FOR RETIREMENT PLAN MANAGEMENT, J. OF COMPENSATION AND BENEFITS 4, 14 (2016) (offering different ways investment advisers and firms can comply with the DOL's Final Rule through robo-advisers and switching their plans to be more individualized).

⁷¹ See Sara Pikofsky, *The DOL's Final "Fiduciary" Rule-Countdown to Implementation Begins in Earnest*, JONES DAY (Apr. 2016), archived at <https://perma.cc/9XE3-UM6Y> (explaining the "phased" implementation process of the BIC Exemption aspect of the Final Rule and how it will fully become effective in January of 2018, however, aspects of it will be implemented with the help of the DOL April 10, 2017). One of the most stringent aspects of the BIC Exemption will be the disclosure requirement which will not be implemented until 2018. *Id.*

⁷² See *id.* (describing how the DOL will work with advisers, plan advisers and small firms to implement BIC Exemption policies and procedures to maintain or adjust profit structures while adhering to Final Rule regulations).

⁷³ See Marcia S. Wagner, et al., *Best Practices Arising from the DOL Fiduciary Rule*, INVESTMENTS & WEALTH INSTITUTE, Oct. 2017, at 40, 42 (explaining how the BIC Exemption and the disclosure requirement must be in the client's best interest, the fees being charged must be reasonable, and the firms must maintain a website with their investment information, all being available at the request of the client).

adviser, monitoring by either the adviser or firm.⁷⁴ The disclosures for specific transactions include, that the adviser must again state the “Best Interest standard of care” and inform the investor in writing of policies and procedures to ensure compliance with “Impartial Conduct Standard[s]” and specific disclosure of costs fees and other compensation.⁷⁵

Utilizing the BIC Exemption, advisers can keep fee structures otherwise prohibited under the Final Rule, however they must comply with specific standards.⁷⁶ There are two specific subsections of the BIC Exemption advisers can rely on: (1) BICE Lite and (2) BICE.⁷⁷ Analysts believe that the more “streamlined” BICE lite is more advantageous to advisers, firms, and clients because there are

⁷⁴ See SHEARMAN & STERLING LLP, THE DOL’S NEW FIDUCIARY RULE: THE DETAILS ON DISCLOSURE 1, 4 (May 5, 2016) (detailing the requirements under the primary contractual disclosures).

⁷⁵ See Sara Pikofsky, *The DOL’s Final “Fiduciary” Rule-Countdown to Implementation Begins in Earnest*, JONES DAY (Apr. 2016) (detailing the requirements under the specific transaction disclosures).

⁷⁶ See Greg Iacurci, *Two Sides of the DOL Fiduciary Rule’s ‘Best Interest Contract Exemption’ Advisers Must Understand*, INVESTMENTNEWS (May 27, 2016), archived at <https://perma.cc/5745-PEMQ> (detailing how advisers need to be aware of complying with BIC Exemption requirements) [hereinafter *Two Sides*]. See also *Fact Sheet*, *supra* note at 11 (outlining how advisers can maintain compensation structures while abiding by the new fiduciary standards).

Specifically . . . to align the adviser's interests with those of the plan or IRA customer, the exemption requires the financial institution to acknowledge fiduciary status for itself and its advisers. The financial institution and advisers must adhere to basic standards of impartial conduct, including giving prudent advice that is in the customer's best interest, [and] avoiding making misleading statements . . . The financial institution also must have policies and procedures designed to mitigate harmful impacts of conflicts of interest and must disclose basic information about their conflicts of interest and the cost of their advice. Importantly, the financial institution may not give its advisers financial incentives to make recommendations that are not in the customer's best interest.

Id.

⁷⁷ See *Understand Benefits of BICE vs. BICE Lite*, *supra* note 30 (discussing the differences between BICE and BICE Lite and how they may impact advisers).

less contracts required between advisers and clients.⁷⁸ The more robust BICE requires disclosure contracts between clients and advisers, but there is more flexibility to accommodate compensation plans.⁷⁹ The disclosures required by advisers under BICE will include, among other things, disclosing things such as point-of-sale transaction, contact information and website information.⁸⁰

Some experts believe both subsections of the BIC Exemption could increase litigation because clients will now have judicial remedies for breach of contract, which can be viewed as more subjective, and not just breach of fiduciary duties.⁸¹ With the expanded definition of what a fiduciary is and the detailed definition of “investment advice”, the DOL is seeking to maintain fair policies and regulations for both advisers and clients.⁸² However, without these exceptions, advisers might be deterred from the profession because it would be much less profitable.⁸³

⁷⁸ See *Understand Benefits of BICE vs. BICE Lite*, *supra* note 30 (discussing the inflexibility of BICE Lite compared to the more flexible full BICE). BICE Lite is the more streamlined approach to the DOL exemption rules because it does not require contracts with their clients and it has limited disclosure requirements. *Id.*

⁷⁹ See *Understand Benefits of BICE vs. BICE Lite*, *supra* note 30 (explaining the differences and more expansive requirements for advisers under BIC Exemptions); see also *Understanding the DOL Rule: BICE*, THE AMERICAN COLLEGE OF FINANCIAL SERVICES (Aug. 12, 2016), archived at <https://perma.cc/87MM-VB3R> (stating that there are disclosure requirements an insurer, broker or RIA must include to enter into a contract with clients).

⁸⁰ See *Understanding the DOL Rule: BICE*, *supra* note 79 (listing the disclosure requirements that BICE requires before entering into a contract with clients).

⁸¹ See *Understand Benefits of BICE vs. BICE Lite*, *supra* note 30 (suggesting the potential exposure for increased litigation if there is a breach of a written contract under the BIC Exemption).

⁸² See *DOL Fiduciary Rule Explained as of August 31, 2017*, INVESTOPEDIA, (Aug. 31, 2017), archived at <https://perma.cc/K8R3-JEGP> (demonstrating the broad goals of the DOL’s rule and how it will impact advisers and clients). While the rule seeks to hold advisers to a higher standard, it leaves flexibility to profit under certain exceptions while the client’s investments are held to a best interest standard opposed to a suitability standard. *Id.*

⁸³ See *Understanding the DOL Rule: BICE*, *supra* note 79 (identifying BICE as a prohibited transaction exemption that allows advisers to maintain certain commission schedules).

One of the biggest differences between BICE Lite and BICE deals with the compensation structures.⁸⁴ BICE Lite is stricter in that it only allows fiduciaries to have a level, or levelized fee structure whereas BICE is flexible in its fee structures.⁸⁵ A level fiduciary is one who has a consistent fee and does not get compensated by third parties, while a levelized fiduciary has a stated level fee, but can receive compensation from a third party.⁸⁶ BICE is more flexible for advisers and brokers because it allows for variable compensation; however, it does require more disclosures as to how an advisers actions are acting in the client's best interest.⁸⁷ Potentially, firms and advisers may implement a hybrid of BICE Lite and BICE so long as it is disclosed to the client and they are acting in their best interest.⁸⁸

The DOL has proposed a phased implementation of the entire Rule which could start in 2017, however, it may not be fully implemented until 2018.⁸⁹ Since there will be a phased implementation, the Final Rule will likely implement the "amended definition of fiduciary advice . . . [o]n that same date, the BIC Exemption and the [PT] Exemption will become available to fiduciary advisers" in 2018.⁹⁰

⁸⁴ See *Two Sides*, *supra* note 76 (explaining the differences between BICE Lite and BICE, specifically the compensation or fee structure and how they need to either be level-fees or variably based).

⁸⁵ See *Two Sides*, *supra* note 76 (illustrating the fee structures of BICE and BICE Lite and how they apply to advisors and third parties).

⁸⁶ See Fred Reish, *Three Kinds of Level Fee Fiduciaries . . . and What's a "Level Fee?"*: Interest Angles on the DOL's Fiduciary Rule #30, THE NATIONAL LAW REVIEW (Dec. 27, 2016), archived at <https://perma.cc/JS4H-UHQQ> (defining the difference between a level and levelized fiduciary and how the DOL's Final Rule impacts them).

⁸⁷ See *Two Sides*, *supra* note 76 (comparing the ways in which BICE allows for more flexibility in compensation structures but will require more due diligence to conform to the documentation requirements to act in a client's best interest to BICE Lite's narrow application and limited disclosures).

⁸⁸ See *Two Sides*, *supra* note 76 (explaining how RIA's and brokerage firms can use both BICE Lite and BICE with the same client).

⁸⁹ See Request for Information, *supra* note 14 (stating the dates at which the adopted Final Rule is set to be implemented).

⁹⁰ Shearman & Sterling LLP, *supra* note 31 at 7 (explaining how the BIC Exemption is at the "heart" of the Final Rule in that it allows advisers to receive forms of compensation otherwise prohibited). Furthermore, without the BIC Exemption, advisers would be prohibited from soliciting 12b-1 fees. *Id.* For advisers and firms to receive otherwise prohibited fees and compensation, they must adhere to require-

Due to the Final Rule being complicated and the need for advisers and firms to restructure parts of their business, this phased-implementation will aide in both protecting the interests of investors and allowing advisers time to prepare for full implementation.⁹¹

The BICE and the PT Exemption are; the main exemptions advisers would rely on to avoid prohibited transactions.⁹² Advisers will use the BICE to maintain fee structures, such as receiving 12b-1 fees, while advisers use the PT Exemption when they are the principal in the purchase or sale of certain securities.⁹³ Both exemptions, like most of the exemptions in the Final Rule, have strict disclosure requirements such as: primary contact disclosures, specific transaction disclosures, annual disclosures and more.⁹⁴

While the regulation of robo-advisers is ever changing from both the SEC and DOL's standpoint, SEC Chairwoman Mary Jo White has accurately stated that they should be treated and held to the

ments such as adhering to Impartial Conduct Standards, they must adopt and comply with policies designed to ensure adherence to Impartial Conduct Standards, and must comply with certain disclosure and recordkeeping requirements. *Id.* Explaining what that the PT Exemption “allows financial institutions to purchase or sell certain assets in ‘principal transactions’ or ‘riskless principal transactions’ with plans . . . to receive similar payments as a result of the advice.” *Id.* Principal transactions occur when institutions purchase or sell assets to a plan for its own account. *Id.* A riskless principal transaction is when an institution purchases or sells a principal traded asset to offset the contemporaneous transaction. *Id.* See also *Conflict of Interest FAQs (Part I – Exemptions)*, U.S. DEPARTMENT OF LABOR (Oct. 27, 2016), archived at <https://perma.cc/7BQS-GEV4> (explaining the phased-implementation of the Final Rule and what will be implemented on the initial date).

⁹¹ See *CONFLICT OF INTEREST FAQs (Part I – Exemptions)*, *supra* note 90 (justifying the phased-implementation aspect of the Final Rule).

⁹² See *CONFLICT OF INTEREST FAQs (Part I – Exemptions)*, *supra* note 90 (explaining how the BIC Exemption and Principal Transaction Exemption will be used by advisers to comply with the new regulations).

⁹³ See *Shearman & Sterling LLP*, *supra* note 31 at 6 (illustrating that the BICE exemption can be used for things such as commission and revenue while the PT exemption can be used in the purchase and sale of certain securities); see also *12b-1 Fee*, IVESTOPEDIA (Feb. 5, 2018), archived at <https://perma.cc/QNQ8-BALG> (defining a 12b-1 fee as an annual “marketing or distribution fee on a mutual fund”).

⁹⁴ See *The DOL's New Fiduciary Rule: The Details on Disclosure*, *supra* note 74 at 1 (providing where situations where financial institutions may take advantage of the BICE and PT exemptions); see also *Understanding the DOL Rule: BICE*, *supra* note 79 (listing that BICE requires an insurer or broker to disclose specifics such as transaction disclosures, contact disclosures and website disclosures).

same fiduciary standards as human investment advisers.⁹⁵ Chairwoman White believes that FinTech will beneficially influence the ability for robo-advisers to be held and maintain the requirements of a human adviser being held to the fiduciary standard.⁹⁶ An opponent of Chairwoman White's stance on robo-advisers, argues that robo-advisers could be unregistered investment advisers and would illegally be giving advice under the '40 Act and other SEC regulations.⁹⁷ Contrary, a study done by a Pennsylvania based law firm, maintains that robo-advisers can meet the DOL requirements being classified as a fiduciary regardless of the amount of "human" interaction these platforms have with clients compared to human advisers.⁹⁸

In April of 2016, Securities Regulator William Galvin issued a policy in Massachusetts which states that robo-advisers that wished to register in the state of Massachusetts will be evaluated on a case-by-case basis if they will be held to the fiduciary standards.⁹⁹ This policy clearly defines what it means to be a robo-adviser registered in

⁹⁵ See Suleman Din, *SEC's White: Robo Advice Has Broad Potential* (Nov. 14, 2016), archived at <https://perma.cc/WJ44-BZXQ> (describing how robo-advisers should be held to the same standard as human investors because they ultimately act with the same purpose; giving investment advice to clients to make investment actions); see also Robert Powell, *Robo advisers can be Fiduciaries – if Standards are Met* (May 8, 2017), archived at <https://perma.cc/8EYH-3D6A> (explaining that robo-advisers are regulated by the Investment Advisers Act of 1940 because investment advisers want to ensure that robo-advisers are meeting disclosure, suitability and compliance obligations).

⁹⁶ See Suleman Din, *supra* note 95 (quoting SEC Chairwoman White: "[f]intech is well on its way to playing a role in the future of the securities industry"). Chairwoman White further went on to opine that "[r]egulators have an obligation to understand, monitor, and where appropriate, encourage such development." *Id.*

⁹⁷ See Suleman Din, *supra* note 95 (noting how Attorney Melanie Fein's conflicting views on robo-advisers were included in an April policy established by Massachusetts' securities regulator William Galvin).

⁹⁸ See Suleman Din, *supra* note 95 (describing a study done by Morgan, Lewis & Bockius, LLP, a Pennsylvania based law firm, who conducted a study which goes into great on how robo-advisers could meet Final Rule requirements); see also Barbara Novick et al., *DIGITAL INVESTMENT ADVICE: Robo Advisors Come of Age* (Blackrock 2015) (explaining that digital advisory services have the potential to provide "affordable and accessible services" by providing greater channels of communications for clients).

⁹⁹ See SECRETARY OF THE COMMONWEALTH OF MASSACHUSETTS, POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION (2016) (detailing the typical actions of a fully automated robo-adviser).

the Commonwealth of Massachusetts and the requirements they must abide by to fulfil their fiduciary obligations.¹⁰⁰ Massachusetts policy regulations is one of the first to directly address robo-advisers and while it does state that it will consider each adviser on a case-by-case basis, the requirements seem to align in a similar manner to the DOL's Final Rule standards, which begs the question, will this hybrid system be the most beneficial for advisers, clients, or both?

IV. Analysis:

As robo-advisers gain traction and popularity as investment platforms, the question remains whether or not they can be trusted to act in a client's best interest when dealing with inherently risky investments?¹⁰¹ The DOL's Final Rule seeks to create more transparency between the client and the adviser, by eliminating the possibility of conflicts of interest through strict disclosure requirements, while giving the adviser protection from sanctions, fines, or potential legal action because of their fee structure by advisers utilizing the exemptions.¹⁰² Although, the DOL has offered certain exemptions that advisers can use, it seems unreasonable to conclude that automated algorithms can be fiduciaries acting in ones best interest.¹⁰³

Robo-advisers should not be considered fiduciaries because there is no concrete standard under which they should be evaluated,

¹⁰⁰ See *id.* (outlining the specific state requirements that robo-advisers must abide by to meet their fiduciary obligations and how they are defined compared to traditional advisers). The policy further goes on to explain the due diligence, the disclaimers and disclosures, as well as the registration requirements. *Id.*

¹⁰¹ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99 (addressing the particular concerns that individuals may have when investing their monies with a robo-advisor); see REGULATION OF INVESTMENT ADVISERS, *supra* note 9, at 1 (describing how securities regulation aims to protect individual investors from greedy advisers who mismanage funds through risky account); see also Final Rule, *supra* note 50 (reaffirming how customers may choose alternative investment strategies according to their own risk tolerance).

¹⁰² See Fact Sheet, *supra* note 11 (summarizing the DOL's Final Rule and highlighting that the purpose is to "protect, educate, and empower" retirement investors).

¹⁰³ See Fact Sheet, *supra* note 11 (noting that the DOL has given exemptions that will apply to all advisers, but can be utilized by robo-advisers to meet the fiduciary standard).

unlike the way Massachusetts is considering them on a case-by-case base.¹⁰⁴ While robo-advisers do not meet the DOL's fiduciary standard, State and Federal regulators must establish standards by which they can operate, even if they are not fiduciaries.¹⁰⁵ The Massachusetts Securities Division articulated that robo-advisers "may be inherently unable to carry out the fiduciary obligations of a state-registered investment adviser."¹⁰⁶ Their concern surrounding robo-advisers focuses on the lack of due diligence and gathering client information before recommending plan and investing.¹⁰⁷ The lack of due diligence concern would indicate that Massachusetts believes robo-advisers will not be able to act in their client's best interest which is a crucial aspect, and the overarching goal of the DOL's Rule.¹⁰⁸

Considering what some robo-advisers require as an initial investment, clients expect the investing platforms to understand their goals, similar to how a traditional adviser would after an initial consultation, not strictly based off a questionnaire.¹⁰⁹ Once robo-advisers set the initial investment plan for clients, that specific plan at that time is in the clients best interest; however, due to the absence of interactions with the client, future changes by the algorithm might not

¹⁰⁴ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99 (illustrating how Massachusetts has defined robo-advisers and whether or not they will be regarded as fiduciaries under state law).

¹⁰⁵ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99 (asserting that robo-advisers, if they wish to register in Massachusetts, will be evaluated on a case-by-case basis to determine if they meet fiduciary requirements laid out in the Policy Statement).

¹⁰⁶ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99 (asserting that, at least by the standards set out in the Policy Statement, the Massachusetts Securities Division does not believe robo-advisers can meet the requirements to be a fiduciary).

¹⁰⁷ See Skinner 1, *supra* note 60 (explaining how technology, such as robo-advisers, will lack the ability to conduct due diligence so human advisers will need to use due diligence to ensure that the calculations are producing the best results for their clients).

¹⁰⁸ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99, at 5 (providing examples of areas in which robo-advisers lack the ability to conduct due diligence, such as inquiring about assets held outside of a client's account).

¹⁰⁹ See Barnett, *supra* note 4 (focusing on the preference of millennials and their desire to have trusted advisers to ask questions, to express financial goals and to learn how to manage money).

be best for the client.¹¹⁰ The premise and attractiveness of using a robo-adviser is to avoid in depth human interactions and utilize a hands-off platform; while some large investment firms who utilize human interaction are now acquiring their own automated platforms, which could lead to a mix of automated investing after human due diligence.¹¹¹

Understanding how robo-advisers operate is the first step the DOL and other regulatory agencies must do to realize that robo-advisers cannot be held to the same fiduciary standard as human advisers as defined under the Final Rule.¹¹² Robo-advisers should not be classified as fiduciaries because, while they do offer investment advice, albeit packaged and automated advice, they are only interacting with clients based on a risk tolerance survey which cannot take into consideration the entirety of their client's ever changing needs.¹¹³ It is unlikely that a simple risk tolerance survey can fully comprehend a client's key interests and goals which ultimately guides an algorithm to invest and adjust investments accordingly.¹¹⁴

Furthermore, robo-advisers cannot be classified as fiduciaries under the DOL Final Rule, because they would not be able to fulfil the disclosure and documenting requirements, but rather they are simply an automated system offering advice and recommendations.¹¹⁵ Since the advice and recommendations given by robo-advisers would fall under the definitions of recommendations defined in the Final Rule because they are offering advice for a fee or compensation,

¹¹⁰ See Barnett, *supra* note 4 (emphasizing how the lack of human qualities in robo-advisers may prevent future changes in the best interest of the client).

¹¹¹ See Barnett, *supra* note 4 (discussing the target clients for robo-advisers as being those who utilize technology and want to avoid traditional human advisers, typically millennials, and explaining how larger investment firms have been acquiring and forming their own automated-platforms for investing).

¹¹² See Cavaliere, *supra* note 7 (explaining how robo-advisers work and how they have come into the market).

¹¹³ See Egan, *supra* note 8 (clarifying how robo-advisers use ETF bundles which are suggested based on a client's risk tolerance survey and account size).

¹¹⁴ See Fein, *supra* note 16 (discussing how robo-advisers cannot act in their client's best interest because they are unable to obtain all information relevant to making investments to best serve their clients interest).

¹¹⁵ See Din, *supra* note 95 (arguing that robo-advisers could be unregistered and be giving illegal investment advice); see also SEC Study, *supra* note 23 (outlining what the requirements for giving a recommendation are under the DOL's Final Rule).

robo-advisers would need to document all of this in accordance with the Rule.¹¹⁶ The more disclosures and documented information advisers are able to produce, the more difficult it will be for clients to bring an action against them for breach of fiduciary duties.¹¹⁷ Furthermore, documenting the advice, recommendations, and transactions should aid advisers in justifying the fees they are charging and robo-advisers are typically low-cost consistent fee structures.¹¹⁸

The documentation requirements would seem to be an easy task for robo-advisers seeing as they are interacting entirely through standardized webpages and forms.¹¹⁹ However, the most difficult aspect of the documentation requirements for robo-advisers is documenting how and why investments after the initial set up are in the best interest of the client.¹²⁰ Once robo-advisers put an acceptable investment plan together, it is up to the algorithm to invest and adjust the diversification based on market conditions.¹²¹ This leaves the control out of the hands of the client, however, due to the lack of human interaction, it is up to the client to notify the robo-adviser.¹²² This is one of the main points the Massachusetts Policy Statement is making; that the robo-advisers are not fiduciaries because they leave

¹¹⁶ See *Algorithmic Trading*, *supra* note 5 (explaining the benefits of utilizing algorithmic trading to find optimal solutions).

¹¹⁷ See *Two Sides*, *supra* note 76 (suggesting that while there will be less litigation for breach of fiduciary duties, more common breach of contract claims will be brought in state court).

¹¹⁸ See *Two Sides*, *supra* note 76 (describing how BICE Lite and BICE will require more documentation for action taken by advisers and brokers, but, will also require much more research and explaining); see also Barnett, *supra* note 4 (highlighting the lower costs and simplicity offered by utilizing robo-advisors).

¹¹⁹ See Egan, *supra* note 8 (portraying the risk tolerance survey as one in which robo-advisers put together a plan which is kept and slightly adjusted based on market conditions).

¹²⁰ See Egan, *supra* note 8 (explaining the investment plan being given to the client is catered to be in the best interest of the client); see also *Two Sides*, *supra* note 76 (examining how the DOL will require greater documentation to show that an investment adviser is acting in the best interest of their client).

¹²¹ See Egan, *supra* note 8 (describing how robo-advisers put together a proposed investment plan for potential investors to review, following a risk tolerance analysis, before allowing the computer algorithm to invest on behalf of the client).

¹²² See Egan, *supra* note 8 (summarizing how robo-advisers work and the lack of human interaction because of the algorithmic investing and adjusting).

many major decisions up to the client.¹²³ The Massachusetts Policy Statement does point to the fact that the client is doing some decision making, however, it is the algorithm which diversifies, invests, and maintains the account; therefore, the algorithm is doing the heavy lifting once the client agrees to the plan.¹²⁴

It is likely robo-advisers will not be able to maintain their identity of being efficient and a low-cost alternative to traditional investment advisers and grow their market position as a useful tool for advisers because they cannot fulfil requirements imposed by the DOL.¹²⁵ The documentation requirements imposed by the DOL decreases the risk of client's bringing an action against them for breach of fiduciary duty.¹²⁶ Furthermore, there is not likely to be a lot of changes, such as buying or selling, because the portfolios are mainly made up of ETFs which frequently follow a trend in the markets and are not traded as frequently as stocks.¹²⁷

There is still the issue of whether robo-advisers can disclaim their ability to be a fiduciary and push some accountability on the client to do their own due diligence prior to investing.¹²⁸ There have already been instances where robo-adviser agreements state that it is

¹²³ See Two Sides, *supra* note 76 (asserting that clients do not have the knowledge or access to the information they may need to make an informed decision, which would affect their investment).

¹²⁴ See Egan, *supra* note 8 (illustrating the way a robo-adviser account is set up, maintained, and operated). Clients fill out an online form about their income, goals and relative risk taking. *Id.* The computer software analyzes the inputs and suggests the best investments personalized to that particular client. *Id.* The computer constantly monitors and balances the client's portfolios. *Id.*

¹²⁵ See Skinner 1, *supra* note 60 (discussing how FinTech is rolling client assets from qualified retirement plans into individual retirement accounts monitored by an adviser so that they can comply with the DOL's new standards). Under the DOL rule, advisers need to be able to demonstrate they are acting as fiduciaries for clients when providing advice about retirement accounts. *Id.*

¹²⁶ See Fact Sheet, *supra* note 11 (summarizing the documentation requirements all advisers are going to be required to follow with the implementation of the DOL Final Rule).

¹²⁷ See Exchange-Traded Fund (ETF), *supra* note 5 (describing what an ETF is and how they are comprised of individual stocks to cover a market sector and typically find a trend in the market). An ETF is a marketable security that tracks indexes, commodities, bonds, or bundles of assets similar to an index fund. *Id.*

¹²⁸ See Two Sides, *supra* note 76 (noting how some robo-advisor agreements will try and disclaim their ability to make a recommendation in the client's best interest in order to be exempt from the DOL fiduciary requirements).

the responsibility of the client to make sure the proposed investment plan is in their best interest.¹²⁹ Although robo-advisers agreements make such claims, they still owe a duty of care to fairly represent the information they are giving the clients and to act in their best interest.¹³⁰ The duty all advisers have is to advise their clients fairly, and act in their best interest to avoid all conflicts of interest that may arise, which is a major aspect of the DOL's Final Rule.¹³¹ Therefore, the DOL has implemented the Best Interest Contract in which advisers will be required to disclose to their client that they are acting as a fiduciary and they will be acting in their best interest, as well as documenting all communications.¹³²

In sum, robo-advisers should not be classified or held to the DOL's new fiduciary standard.¹³³ Due to the lack of human interaction, robo-advisers cannot fully understand and act in a way that is best for their client's interests.¹³⁴ Since the DOL has yet to make a definite ruling on how to classify robo-advisers, it may be beneficial if they proactively determine whether or not they should be fiduciaries, as has been the case in Massachusetts.¹³⁵ Finally, the only way robo-advisers could be considered fiduciaries under the DOL's new

¹²⁹ See Fein, *supra* note 16 (citing one robo-advisor agreement, which puts the responsibility of determining whether the package is the best on the client, requiring the client do their own due diligence).

¹³⁰ See DOL *Fiduciary Rule Explained as of Aug. 31, 2017*, *supra* note 67 (explaining how robo-advisors are subject to be in compliance with the DOL fiduciary rule requirements).

¹³¹ See di Florio, *supra* note 30 (noting that all advisors need to be diligent in avoiding conflicts). They are extremely common and advisors should take precautionary measures to avoid SEC violations regarding conflicts of interest. *Id.*

¹³² See Kitces, *supra* note 59 (explaining how the BICE will be implemented and what it serves to do for investors and advisers). Advisers can give potentially conflicted advice that can still be permissible so long as it is the best interest advice "for reasonable compensation without misleading sales and communication." *Id.*

¹³³ See Egan, *supra* note 8 (explaining the ETF bundles robo-advisors put together for their clients, which is based on a risk tolerance questionnaire).

¹³⁴ See Din, *supra* note 95 (analyzing whether robo-advisors utilize interactions similar to humans). There has been no definitive ruling, but it is possible robo-advisors are no different than human-based investment advisors in their ability to give investment advice. *Id.*

¹³⁵ See POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION, *supra* note 99 (noting that Massachusetts classifies robo-advisors on a case-by-case basis).

definition of fiduciary, is if they implemented a hybrid like system to have more human interaction to act in their client's best interest.¹³⁶

V. Conclusion:

With robo-advisers becoming more popular in small start-ups as well as the large investment firms, it seems unlikely the regulating agencies can avoid addressing them; as fiduciaries or not, for too much longer. This technology will never fully take over an investment adviser's job, but it can be useful. Based on the new definition of what it means to be a fiduciary, and the requirements from the DOL's Final Rule, it will take a lot for robo-advisers to compete with the large firms just because of the costs they will incur in the long run.

With all advisers being held to this more stringent standard, robo-advisers and advisers must implement new FinTech to meet the documenting requirements of the Final Rule. The documenting requirements will likely decrease the risk of litigation for breach of fiduciary duty, however, it will likely result in an increase in the number of smaller breach of contract claims. If robo-advisers can implement their own FinTech to document their transactions and communicate more frequently with client's, they will likely be able to maintain and grow as fiduciaries. This, of course, will not come without an increase in costs to consumers.

¹³⁶ See Two Sides, *supra* note 76 (showing how hybrid robo-advisor systems utilize both human and computer interactions with clients).