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Robo-Advisers Jumping on the Bandwagon: Yet Another Cry for a Uniform Standard

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INTRODUCTION

Robo-advisers[1] have become an increasingly prominent source of investment advice in the financial services industry.[2] These robo-advisers, synonymous with terms such as "digital advisers" and "digital advice," represent a relatively small market share in comparison with more traditional investment advisers.[3] However, the recent proliferation of robo-advisers[4] has caught the attention of regulatory agencies such as the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA").[5] The continuing growth of this technology leads the world of legal academia to question the regulatory regime currently in place by scrutinizing current law and calling for newly renovated

1. Robo-advisers are "registered investment advisers that use computer algorithms to provide investment advisory services online with often limited human interaction." Press Release, SEC, SEC Staff Issues Guidance Update and Investor Bulletin on Robo-Advisers (Feb. 23, 2017), https://www.sec.gov/news/pressrelease/2017-52.html [https://perma.cc/4QXY-T99A]. Beyond a digital platform and proprietary algorithms, there is substantial variation in business models, resulting in a less-than-concrete definition of "robo-adviser." BlackRock, a large financial services firm, points to four distinct differences in levels of sophistication across robo-advisers: (1) customization, (2) tax management, (3) human intervention/oversight, and (4) type of entity providing digital advice. BLACKROCK, DIGITAL INVESTMENT ADVICE: ROBO ADVISORS COME OF AGE 4–5 (2016), https://www.blackrock.com/corporate/en-at/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf [https://perma.cc/TZN6-SZ57].

2. *See* Mary Jo White, Chair, SEC, Opening Remarks at the Fintech Forum (Nov. 14, 2016), https://www.sec.gov/news/statement/white-opening-remarks-fintech-forum.html [https://perma.cc/PYR8-Z8DT] ("The last few years have seen rapid growth in the availability and popularity of automated investment advisory programs.").

3. BLACKROCK, *supra* note 1, at 1 ("While digital advisors represent a very small segment relative to more traditional financial advice providers, their recent rapid growth suggests a need for a focused analysis of the business and activities of these advisors.").

4. One report predicted that robo-advisers will have $2.2 trillion in assets under management ("AUM") by 2020. TERESA EPPERSON ET AL., A.T. KEARNEY, HYPE VS. REALITY: THE COMING WAVES OF "ROBO" ADOPTION 26 (2015), http://www.atkearney.com/documents/10192/7132014/Hype+vs.+Reality_The+Coming+Waves+of+Robo+Adoption.pdf [https://perma.cc/ZF7M-MKHF].

5. *See* DIV. OF INV. MGMT., SEC, NO. 2017-02, GUIDANCE UPDATE: ROBO-ADVISERS 1 (2017) [hereinafter SEC GUIDANCE UPDATE], https://www.sec.gov/investment/im-guidance-2017-02.pdf [https://perma.cc/RU3S-N5CM]; FIN. INDUS. REGULATORY AUTH., REPORT ON DIGITAL INVESTMENT ADVICE 1 (2016), http://www.finra.org/sites/default/files/digital-investment-advice-report.pdf [http://perma.cc/9M88-7QVC]; *Investor Alert: Automated Investment Tools*, SEC (May 8, 2015), http://www.sec.gov/oiea/investor-alerts-bulletins/autolistingtoolshtm.html [https://perma.cc/GJ95-FCK5]; *Investor Bulletin: Robo-Advisers*, SEC (Feb. 23, 2017), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_robo-advisers.html [http://perma.cc/8476-AKMQ]. State securities agencies have also opined on the topic. *See* MASS. SEC. DIV., POLICY STATEMENT: ROBO-ADVISERS AND STATE INVESTMENT ADVISER REGISTRATION 1 (2016), http://www.sec.state.ma.us/sct/sctpdf/PolicyStatement–Robo-Advisers-and-State-Investment-Adviser-Registration.pdf [https://perma.cc/E6FP-D4L7].

methodology. The conversation in legal academia surrounding robo-advisers currently pertains to the legal obligations that robo-advisers owe their clients[6]: whether robo-advisers can or cannot fulfill their duties as fiduciaries under the Investment Advisers Act of 1940 ("Advisers Act").[7] As it currently stands, pursuant to SEC guidance, robo-advisers are regulated as investment advisers under the Advisers Act, thus sparking debate over whether robots can adequately perform the fiduciary duties owed to their clients.[8]

Notwithstanding the question of whether robots can be fiduciaries, there is another discussion of equal importance worth considering: the debate as to whether the legal standards governing investment advice should be harmonized. In fact, now is an excellent time to have that discussion. The SEC has renewed its interest in the differing standards of conduct that govern investment advisers and broker-dealers.[9]

The difference between being regulated as an investment adviser or as a broker-dealer is important because the two are held to different legal standards in connection with the investment advice given. However, the actual differences in their functions are negligible. The difference is that investment advisers are held to a fiduciary standard, whereas broker-dealers are held to a lower

6. *See generally* Megan Ji, Note, *Are Robots Good Fiduciaries? Regulating Robo-Advisors Under the Investment Advisers Act of 1940*, 117 COLUM. L. REV. 1543 (2017) (arguing that robo-advisers are "structurally capable" of meeting duty of care standards required under the Investment Advisers Act of 1940 if regulated properly); John Lightbourne, Note, *Algorithms & Fiduciaries: Existing and Proposed Regulatory Approaches to Artificially Intelligent Financial Planners*, 67 DUKE L.J. 651 (2017) (arguing that robo-advisers can meet a fiduciary standard as currently modeled).

7. Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1 to -21 (2012)).

8. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 1–2.

9. *See* Jay Clayton, Chairman, SEC, Public Statement: Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers (June 1, 2017), https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31 [https://perma.cc/38CT-E8JT]. In fact, Chairman Clayton specifically asked for public input on the matter:

> Market developments and advances in technology continue to transform the ways in which retail investors obtain advice (e.g., robo-advisers, fintech). How do retail investors perceive the duties that apply when investment advice is provided in new ways, or by new market entrants? Is this perception out of step with the actual obligations of these entities and, if so, in what ways? How should these market developments and advances in technology affect the Commission's consideration of potential future actions? What steps should the Commission take, if any, to address potential confusion or lack of information in these emerging areas?

Id.

standard of advice deemed suitable to the client in the specific circumstances.[10] Furthermore, investment advisers have continuing obligations pertaining to being a fiduciary, while broker-dealers are able to insulate themselves from liability by pointing to the suitability of the singular trade at that given point in time.[11]

The logic for promoting what many have termed a "harmonized" or "uniform" standard is straightforward: investment advisers and broker-dealers generally perform the same functions and thus should be held to the same standards under the law. On the other side of the coin is the argument that a uniform standard should not be implemented. A prominent line of reasoning against the need for a uniform standard is that holding broker-dealers to a lesser standard provides more affordable investment services for those who cannot afford a registered investment adviser.[12] This argument certainly has teeth, as it takes into account the economic reality that the availability of a lesser degree of personalized investment advice by broker-dealers may allow a larger number of market participants to receive advice.[13] However, because robo-advisers have filled the gap for cost-effective advice—and the SEC has confirmed they are held to the higher fiduciary standard[14]—there is no longer a persuasive need for the lower standard given to broker-dealers. Regardless, the discussion of whether to have a uniform standard has pervaded the industry for well over a decade, resulting in two congressionally mandated studies[15] and calls for public comment by the SEC.[16]

10. *See infra* Part I.

11. *See id.*

12. *See* Michael Finke & Thomas P. Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice*, J. FIN. PLAN., July 2012, at 28, 29 ("These less wealthy clients may be less able to receive much-needed financial advice incidental to the sale of commission products if brokers incur increased liability under a fiduciary standard.").

13. This argument necessarily depends on the idea that investment advice professionals, if held to higher standards, would likely not take on low-to-mid-wealth clients because the time spent on the accounts would not be worth the income produced, or the income produced is not worth the legal liability from a general standpoint.

14. SEC GUIDANCE UPDATE, *supra* note 5, at 2 ("Robo-advisers, like all registered investment advisers, are subject to the substantive and fiduciary obligations of the Advisers Act."); *see also* 15 U.S.C. § 80b-2(a)(11)(C) (2012) (excluding "any broker or dealer" whose advising services are "incidental" to his or her business).

15. *See generally* ANGELA A. HUNG ET AL., LRN-RAND CENTER FOR CORPORATE ETHICS, LAW, AND GOVERNANCE, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS (2008), http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf [http://perma.cc/G67N-QQ7V] (reporting the results of one congressionally mandated study of uniform standards); SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS (2011) [hereinafter SECTION 913 STUDY],

The wide variety of business models in which robo-advisers and their human teammates interact with their clients further exacerbates the need for discussion on the matter.[17] This portion of the equation has not garnered any attention up to this point; however, it should be at the forefront. While the SEC has proclaimed robo-advisers as investment advisers under the Advisers Act's regime, the gray area when factoring in different business models is striking. Hybrid models of robo-advisers[18] are increasingly becoming the norm.[19] If the differing legal standards between investment advisers and broker-dealers remain, the SEC will likely encounter the enormous obstacle of defining certain business models calling for various degrees of interaction between robo-adviser and human teammates as either investment advisers or broker-dealers. This Comment argues that a uniform fiduciary standard is warranted because the accelerated proliferation of robo-advisers—specifically, the myriad of potential hybrid business models involving these robo-advisers—will provide even greater uncertainty to the current regulatory regime. This uncertainty will not only frustrate market participants but also generate even greater issues for the SEC down the road.

This Comment proceeds in four parts. Part I provides an overview of the legal standards to which investment advisers and broker-dealers are held when they give investment advice to clients.

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https://www.sec.gov/news/studies/2011/913studyfinal.pdf [http://perma.cc/9PF2-4CLY] (reporting the results of another congressionally mandated study of uniform standards).

16. *See* Clayton, *supra* note 9. Even more recently, the SEC issued a proposed rule on its interpretation regarding the standard of conduct for investment advisers. *See* Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, 83 Fed. Reg. 21,203 (proposed May 9, 2018) (to be codified at 17 C.F.R. pt. 275).

17. *See* BLACKROCK, *supra* note 1, at 6 (listing the primary business models for advisers working together with digital advisers or digital advising platforms). *See generally* DELOITTE & AVALOQ, EMERGING MODELS OF DIGITAL WEALTH ADVISORY, https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/lu-emerging-models-digital-wealth-advisory-04102017.pdf [https://perma.cc/H2UC-RB9R] (discussing digitization trends and evolving business models).

18. Discussion of "hybrid models" or "hybrid robo-advisers" throughout this Comment is meant to differentiate between what may be called a "pure" robo-adviser, consisting of just the algorithm and web-based platform with little to no human interaction. By contrast, the hybrid model refers to a commingling of the algorithm and human interaction, resulting in a hybrid experience for the end consumer.

19. *See* Barbara A. Friedberg, *Growth of Hybrid Robo-Advisors to Outpace Pure Robos*, INVESTOPEDIA, https://www.investopedia.com/articles/financial-advisor/100616/growth-hybrid-roboadvisors-outpace-pure-robos.asp [http://perma.cc/L8ND-W3MR] (last updated Feb. 23, 2017) ("A recent study projected that the growth of hybrid human and robo-advisors will outpace stand-alone robo-advisors in terms of assets under management in the next several years.").

Part II synthesizes years of debate regarding whether the same legal standard should govern the two types of investment professionals. Part III discusses the recent regulatory activity surrounding robo-advisers and the legal conversation regarding whether they can be fiduciaries under the law. Finally, Part IV analyzes how robo-advisers add to the conversation of a uniform standard and concludes that regulators would be well advised to harmonize the two standards by creating a uniform standard.

I. OVERVIEW OF DIFFERENT OBLIGATIONS OWED BY INVESTMENT ADVISERS AND BROKER-DEALERS

The two primary types of professionals that provide investors with investment advice and guidance are investment advisers and broker-dealers.[20] Many investors are unaware that both the substance of the work performed and the standards of care owed to clients differ between investment advisers and broker-dealers.[21] Furthermore, the SEC itself has recognized that the boundary separating the two groups has been blurred throughout the years.[22] The discussion for harmonization—as opposed to the status quo—is well storied and oft argued in academia and industry alike.[23] The SEC recently asked for public comments from interested parties pertaining to the harmonization, or lack thereof, of the standards of conduct for investment advisers and broker-dealers.[24]

20. *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 701 (2010) [hereinafter Laby, *Fiduciary Obligations*].

21. *See Enhancing Investor Protection and the Regulation of Securities Markets: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 76 (2009) (statement of Mary L. Schapiro, Chairman, SEC) ("We are studying whether to recommend legislation to break down the statutory barriers that require a different regulatory regime for investment advisers and broker-dealers, even though the services they provide often are virtually identical from the investor's perspective."); HUNG ET AL., *supra* note 15, at 112–13 (observing that many investors do not understand "key distinctions" between the two investment professionals, including their duties, titles, and services offered).

22. *See* Laby, *Fiduciary Obligations*, *supra* note 20, at 702; *see also* JAMES HAMILTON, SEC REGULATION OF INVESTMENT ADVISERS AND BROKERS IN THE BRAVE NEW WORLD 7 (2008), http://business.cch.com/securitieslaw/news/03-26-08a.pdf [https://perma.cc/M7TY-D3UT] ("Some investment advisers, for example, may offer services that employ computerized trading programs and may take an active, discretionary management role over customer accounts. From the retail investor's prospective [sic], these activities may not be obviously distinct from those in which brokers typically engage.").

23. *See, e.g.*, Laby, *Fiduciary Obligations*, *supra* note 20, at 703 n.10 (citing calls for harmonization).

24. SEC Chairman Jay Clayton issued a public statement on June 1, 2017, asking for public comments pertaining to the two different standards. Chairman Clayton credits the "Fiduciary Rule" promulgated by the Department of Labor ("DOL") and the DOL's

This part first introduces the fiduciary standard to which investment advisers are held, along with the standard's duty of care and duty of loyalty components. It then introduces the various standards to which broker-dealers are held. It concludes by briefly summarizing the differences.

A. Investment Adviser Fiduciary Duty

Investment advisers are regulated under the Advisers Act, which imposes a fiduciary duty standard on all advisers registered with the SEC.[25] The Advisers Act defines an "investment adviser" as

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . .[26]

The definition goes on to specifically exclude "any broker or dealer whose performance of such services is solely *incidental* to the conduct of his business as a broker or dealer and who receives no special compensation therefor."[27]

The Advisers Act was one of six federal statutes enacted in the 1930s that were designed to address mischievous conduct in the securities industry, which was broadly believed to have caused the Great Depression.[28] The Advisers Act itself was "the last of the New Deal securities laws" and "was probably the least considered and the least important."[29] The Advisers Act was passed as a companion to

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Secretary Acosta for urging the SEC and DOL to "engage constructively as we each pursue our ongoing analyses of the standards of conduct applicable to investment advisers and broker-dealers when they provide investment advice to retail investors." Clayton, *supra* note 9.

25. 15 U.S.C. § 80b-2(a)(11) (2012).

26. *Id.* In lay terms, "[i]nvestment advisers are financial service professionals or firms in the business of providing discretionary advice to client investors on how to allocate investment assets." Ji, *supra* note 6, at 1546 n.14.

27. 15 U.S.C. § 80b-2(a)(11)(C) (2012) (emphasis added); *see also* Thomas Lee Hazen, *Stock Broker Fiduciary Duties and the Impact of the Dodd-Frank Act*, 15 N.C. BANKING INST. 47, 51 (2011).

28. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963). The other five statutes were the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. *Id.*

29. Roberta S. Karmel, *The Challenge of Fiduciary Regulation: The Investment Advisers Act After Seventy-Five Years*, 10 BROOK. J. CORP. FIN. & COM. L. 405, 406 (2016).

the Investment Company Act,[30] the latter initially taking the lion's share of import.[31]

Despite the rather innocuous beginning of the Advisers Act, courts and the SEC have since expanded the breadth of investment advice law.[32] Perhaps the single most important case was *SEC v. Capital Gains Research Bureau, Inc.*,[33] in which the Supreme Court read the investment adviser fiduciary duty into the Advisers Act.[34] The Court observed:

> The Investment Advisers Act of 1940 thus reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship," as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.[35]

Thus, the investment adviser fiduciary duty was born.[36] Although there is no explicit mention of a fiduciary duty within the Advisers Act,[37] the SEC has said, "There is no doubt . . . that an investment

30. Investment Company Act of 1940, ch. 686, 54 Stat. 789. The Investment Company Act regulates companies that invest and trade in securities, as well as companies that offer their own proprietary investment products for sale to the public. Ji, *supra* note 6, at 1547.

31. Both statutes stemmed from a congressional mandate, through the Public Utility Company Act of 1935, directing the SEC to conduct a study on investment companies and trusts. *Id.* at 1546–47. This study encouraged the Senate to introduce both the Investment Company Act and the Advisers Act. *Id.* The SEC study itself did not focus on investment adviser functions, and, after grueling negotiations pertaining to the Investment Company Act, the study's chief counsel prodded Congress to expedite passage of basic legislation. *See id.*

32. *See id.* at 1548. "Mechanisms used to develop Advisers Act law include, but are not limited to, federal court cases, interpretive releases, the SEC's bully pulpit, no-action letters, and enforcement actions." *Id.* (citations omitted). The wide-ranging direction of where the law can be promulgated results in a lack of clarity where "[t]he law is scattered and standards are unclear." *Id.* at 1549.

33. 375 U.S. 180 (1963). The case dealt with a registered investment adviser engaging in conduct called "scalping." *See id.* at 181–83. Most importantly, the Court found that the practice of scalping violated the antifraud provision, which is found in section 206 of the Advisers Act. *Id.* at 195.

34. *See id.* at 194–95.

35. *Id.* at 191–92.

36. *See, e.g.*, Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979) ("[T]he [Advisers] Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.").

37. Furthermore, apart from references that investment advisers owe their clients fiduciary obligations in general, the SEC has promulgated no regulations that substantively define the standards of care owed by investment advisers to their clients. 17 C.F.R. §§ 275.0–2 to .222–2 (2018).

adviser is subject to the federal fiduciary duty . . . ."[38] Furthermore, the SEC has stated:

> Under the Advisers Act, an adviser is a fiduciary. This fiduciary standard applies to the investment adviser's entire relationship with its clients and prospective clients, imposes upon investment advisers the "affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation to 'employ reasonable care to avoid misleading'" their clients and prospective clients.[39]

The SEC has also stated:

> The duty is not specifically set forth in the [Advisers] Act, established by SEC rules, or a result of a contract between the adviser and the client (and thus it cannot be negotiated away). Rather, fiduciary duties are imposed on an adviser by operation of law because of the nature of the relationship between the two parties.[40]

Ultimately, however, the SEC has taken the position that clients bear the burden of evaluating an adviser's competence.[41] The fiduciary duty further encapsulates two broader notions—the duty of care and the duty of loyalty—both of which must be adhered to by an investment adviser.[42]

38. Memorandum from the Inv'r as Purchaser Subcomm. to the Inv'r Advisory Comm. 4 (Feb. 15, 2010), https://www.sec.gov/spotlight/invadvcomm/iacmemofiduciaryduty.pdf [https://perma.cc/XL5G-AF3T]. For a high-level discussion of the absence of a clear definition of "fiduciary," see Hazen, *supra* note 27, at 59–60.

39. SECTION 913 STUDY, *supra* note 15, at 36 (quoting *Capital Gains Research Bureau*, 375 U.S. at 191–92); *see also* Memorandum from the Inv'r as Purchaser Subcomm. to the Inv'r Advisory Comm., *supra* note 38, at 4.

40. DIV. OF INV. MGMT., SEC, REGULATION OF INVESTMENT ADVISERS BY THE U.S. SECURITIES AND EXCHANGE COMMISSION 23 (2013) [hereinafter SEC STAFF REPORT], https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf [https://perma.cc/B4PC-E2B7].

41. Ji, *supra* note 6, at 1552; *see also Investment Advisers: What You Need to Know Before Choosing One*, SEC (Aug. 7, 2012), https://www.sec.gov/reportspubs/investor-publications/investorpubsinvadvisershtm.html [https://perma.cc/G826-L6SP] ("While some investment advisers and financial planners have credentials . . . no state or federal law requires these credentials. . . . Before you hire a financial professional, be sure to ask about their background. If they have a credential, ask them what it means and what they had to do to earn it. Also, find out what organization issued the credential, and then contact the organization [to independently verify it].").

42. *See, e.g.*, TAMAR FRANKEL, FIDUCIARY LAW 106–07 (2011); *see also* SECTION 913 STUDY, *supra* note 15, at 22.

1. Duty of Care

The duty of care, which stems from section 206 of the Advisers Act,[43] encompasses two specific obligations—suitability and best execution.[44] Some believe that neither are enforced to a rigorous standard.[45] The SEC explains the suitability requirement as follows:

> As fiduciaries, investment advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an investment adviser to determine that the investment advice it gives to a client is suitable for the client, taking into consideration the client's financial situation, investment experience, and investment objectives.[46]

Interestingly, this "suitability" obligation relies on a rule proposed by the SEC in 1994 that was never adopted.[47] Although recognizing the rule was never implemented, the SEC has stated that the suitability obligation does indeed "reflect[] the current obligation of advisers under the Act."[48] The inquiry is ultimately based on what is "reasonable under the circumstances."[49] Enforcement actions based upon suitability grounds are somewhat rare and are seemingly utilized only for the most egregious of violations.[50]

The second duty of care recognized in the Advisers Act is the duty of best execution in selecting a broker-dealer.[51] Once again, there is no express duty of best execution in the Advisers Act or SEC regulations, but the SEC has expressly noted its applicability.[52] "Put simply, when an investment adviser selects a broker-dealer to execute

43. *See* 15 U.S.C. § 80b-6 (2012).

44. *See* Ji, *supra* note 6, at 1552.

45. *See id.*

46. *General Information on the Regulation of Investment Advisers*, SEC (Mar. 11, 2011), https://www.sec.gov/divisions/investment/iaregulation/memoia.htm [https://perma.cc/8BR8-NYXA]; *see also* Suitability of Investment Advice Provided by Investment Advisers, 59 Fed. Reg. 13,464 (proposed Mar. 22, 1994) (to be codified at 17 C.F.R. pt. 275 (2018)) (offering a new rule that would "expressly prohibit investment advisers from making unsuitable recommendations to clients").

47. *See* Suitability of Investment Advice Provided by Investment Advisers, 59 Fed. Reg. at 13,464; *see also* SEC STAFF REPORT, *supra* note 40, at 24.

48. SEC STAFF REPORT, *supra* note 40, at 24 n.134 (noting that enforcement actions against advisers have been initiated in the past for those providing unsuitable investment advice).

49. Suitability of Investment Advice Provided by Investment Advisers, 59 Fed. Reg. at 13,465.

50. *See* Ji, *supra* note 6, at 1553 n.68 (listing a handful of SEC enforcement actions that have utilized the suitability requirement).

51. *See* SECTION 913 STUDY, *supra* note 15, at 28–29.

52. *See id.*

the transactions she recommends, she must seek to ensure that the client's total costs are 'the most favorable under the circumstances.'"[53] Factors to be considered by the investment adviser when choosing a broker-dealer include execution capacity, commissions, financial responsibility, responsiveness, and value of that firm's research.[54] Similar to suitability, the SEC does not aggressively pursue enforcement actions based on an adviser's failure to comply with the best execution obligation.[55]

2. Duty of Loyalty

The SEC has also recognized that the fiduciary duty owed to clients requires investment advisers to place the interests of their clients ahead of their own, which necessitates disclosure or elimination of material conflicts of interest.[56] Compared to the duty of care, the SEC "is far more rigorous in its governance of the investment adviser duty of loyalty."[57] In *Capital Gains*, the Court tacitly recognized the unique importance of the duty of loyalty within the Advisers Act.[58]

Indeed, in enacting the Advisers Act, Congress was "deeply concerned about conflicts of interest in the advisory relationship."[59] Thus, "under Section 206, advisers have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them."[60]

The SEC strictly enforces the disclosure requirement by disallowing any waiver for conflicted investment advisers in certain circumstances.[61] The SEC has promulgated specific rules pertaining to

53. Ji, *supra* note 6, at 1553.

54. *See* SECTION 913 STUDY, *supra* note 15, at 28–29.

55. Ji, *supra* note 6, at 1553. For examples of enforcement actions by the SEC regarding best execution issues, see *id.* at 1553 n.72.

56. *See* SECTION 913 STUDY, *supra* note 15, at 22.

57. Ji, *supra* note 6, at 1554.

58. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191–92 (1963) (stating that Congress enacted the Advisers Act with the intention of addressing conflicted investment advisers that could render advice "which was not disinterested"); *see also The Supreme Court, 1963 Term*, 78 HARV. L. REV. 177, 294 (1964) (providing that the Court interpreted the Advisers Act "to require full disclosure in any situation in which there is a possibility of bias").

59. Laby, *Fiduciary Obligations*, *supra* note 20, at 729.

60. *General Information on the Regulation of Investment Advisers*, *supra* note 46.

61. *See* Ji, *supra* note 6, at 1554–55 ("There is no waiver for conflicted investment advisers who believe in good faith that, despite the conflict, they still put their clients' interests first; for advisers who take adequate internal precautions to address conflicts; or for advisers who never acted upon a conflict." (footnotes omitted)).

disclosures. For instance, upon registering with the SEC, investment advisers must file a Form ADV.[62]

B. Broker-Dealer Standard

Broker-dealers are regulated under the Securities Exchange Act of 1934 ("Exchange Act").[63] A "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others."[64] Likewise, a "dealer" is defined as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[65] Although the SEC has authority over broker-dealers and regulates them through the Exchange Act, FINRA promulgates and enforces specific rules regarding the obligations owed to investors.[66]

Broker-dealers are generally excluded from regulation under the Advisers Act;[67] thus, "they are not subject to a federal 'fiduciary' standard of care."[68] The exclusion of broker-dealers from the Advisers Act was "a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act" solely because

62. *See* 17 C.F.R. § 275.203-1 (2018); *see also* Ji, *supra* note 6, at 1555.

> They must update the form annually and more frequently if significant changes occur. Part 1 of the Form ADV is primarily for SEC use and is formatted as a check-the-box, fill-in-the-blank form. It asks questions regarding an adviser's business, ownership, clients, employees, business practices, and disciplinary past. Part 2 of the Form ADV is divided into a brochure (Part 2A) and brochure supplement (Part 2B). The brochure has nineteen items. In it, advisers must describe, in plain English, much of the information they disclosed in Part 1. Finally, the brochure supplement provides information about the professionals working with a client's account. Investment advisers must deliver both the brochure and brochure supplement to clients before or at the time investment advisers and clients begin their contractual relationship. Afterward, advisers must update the documents and provide clients with a summary of material changes every year. Including untrue statements in or omitting material facts from any of these documents breaches the Section 206 duty of good faith and violates Section 207 of the Advisers Act.

Id. at 1555–56.

63. *See* 15 U.S.C. §§ 78a–78pp (2012).

64. *See id.* § 78c(a)(4)(A).

65. *See id.* § 78c(a)(5)(A).

66. *See* Ryan K. Bakhtiari, Katrina Boice & Jeffrey S. Majors, *The Time for a Uniform Fiduciary Duty is Now*, 87 ST. JOHN'S L. REV. 313, 317 (2013).

67. *See* 15 U.S.C. § 80b-2(a)(11) (2012) (excluding any broker or dealer that satisfies two conditions: (1) investment advice is solely incidental to the conduct of business as a broker-dealer, and (2) the broker-dealer does not receive any special compensation).

68. Bakhtiari et al., *supra* note 66, at 317.

it is part of their business.[69] Likewise, investment advisers are excluded from the Exchange Act because they do not engage in "effecting" securities transactions.[70] Thus, they need not register as broker-dealers merely because they have discretionary authority to place orders and execute transactions.[71]

Broker-dealers have other various duties owed to their clients, such as a duty of fair dealing, a duty of best execution, suitability requirements, and various disclosure requirements.[72] The combination of SEC and FINRA rules has been said to impose "fiduciary-like" rules that are designed to protect customers of broker-dealers.[73]

Most notably, investment advice given by broker-dealers—if incidental and devoid of any special compensation thereof—is held to a "suitability" standard of care under FINRA Rule 2111.[74] The broker-dealer suitability requirement, in contrast to the suitability requirement of investment advisers, is expressly set forth via regulations.[75] FINRA Rule 2111 requires "reasonable diligence" when creating a client's investment profile, including all relevant factors to obtain "sufficient information" to make an investment recommendation that is suitable for that specific client.[76] Any recommendations are analyzed for suitability on a case-by-case basis.[77] Recommendations are not deemed suitable merely because a

69. Investment Advisers Act Release No. 2, 11 Fed. Reg. 10,996 (Sept. 27, 1946) (to be codified at 17 C.F.R. pt. 276).

70. Investment Advisers; Uniform Registration, Disclosure, and Reporting Requirements; Staff Interpretation, 50 Fed. Reg. 49,835, 49,839 (Dec. 5, 1985) (to be codified at 17 C.F.R. pt. 276).

71. *Id.*

72. MORRISON & FOERSTER LLP, NEWS BULLETIN: A FIDUCIARY DUTY FOR BROKER-DEALERS? HOW DODD-FRANK MAY CHANGE THE WAY BROKER-DEALERS CONDUCT BUSINESS 1 (2010), http://www.mofo.com/files/Uploads/Images/100719 DoddFrank. pdf [https://perma.cc/3NCM-BGV3].

73. Melanie L. Fein, How Are Robo-Advisors Regulated? 17–18 (Sept. 12, 2017) (unpublished manuscript), https://ssrn.com/abstract=3028232 [https://perma.cc/F9U2-WNGN] [hereinafter Fein, How Are Robo-Advisors Regulated?].

74. *See Rule 2111: Suitability*, FINRA (May 1, 2014), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 [https://perma.cc/HT5X-GK3T].

75. Fein, How Are Robo-Advisors Regulated?, *supra* note 73, at 18.

76. *Rule 2111.04: Customer's Investment Profile*, FINRA (May 1, 2014), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 [https://perma.cc/HT5X-GK3T].

77. *See Rule 2111.05: Components of Suitability Obligations*, FINRA (May 1, 2014), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859 [https://perma.cc/HT5X-GK3T].

client consents to or agrees with them.[78] Importantly, recommendations governed by the suitability rule do not give rise to an "ongoing duty to monitor and make subsequent recommendations."[79]

Additionally, broker-dealers should only make recommendations that are consistent with the customer's best interests.[80] This so-called "best interests" standard is built into FINRA's suitability rule. In effect, the directive that a broker-dealer only make recommendations that are in the client's best interests serves as a prohibition on a broker "placing his or her interests ahead of the customer's interests."[81]

Unfortunately, this implies "that FINRA's concept of the best interest standard is simply another iteration of the duty of loyalty requiring brokers to refrain from self-dealing and unauthorized conflicts of interest."[82] Further, the best interests duty does not necessarily require the broker-dealer to recommend the least expensive investment, so long as the recommendation is suitable and the broker-dealer is not placing his or her interests ahead of the client's.[83] Cost is simply one of many factors that FINRA deems important in the suitability evaluation.[84]

Within the best interests duty also lies a best execution duty similar to that of an investment adviser.[85] Broker-dealers are required

78. *See* FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 12-25 SUITABILITY: ADDITIONAL GUIDANCE ON FINRA'S NEW SUITABILITY RULE 19 n.15 (2012) [hereinafter FINRA, REGULATORY NOTICE 12-25], https://www.finra.org/sites/default/files/NoticeDocument/p126431.pdf [https://perma.cc/J63G-KP9F].

79. FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 12-55 SUITABILITY: GUIDANCE ON FINRA'S SUITABILITY RULE 3 (2012), http://www.finra.org/sites/default/files/NoticeDocument/p197435.pdf [https://perma.cc/GQ9F-5QLP]. This is in direct contrast to an investment adviser.

80. *See* FINRA, REGULATORY NOTICE 12-25, *supra* note 78, at 3.

81. *Id.*

82. Fein, How Are Robo-Advisors Regulated?, *supra* note 73, at 26.

83. *See* FINRA, REGULATORY NOTICE 12-25, *supra* note 78, at 4.

84. *See id.*

85. *See* FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 15-46, GUIDANCE ON BEST EXECUTION OBLIGATIONS IN EQUITY, OPTIONS AND FIXED INCOME MARKETS 2 (2015), https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf [https://perma.cc/C4W9-VTSA]. The regulatory notice asserts,

> [A] broker-dealer's obligation to obtain best execution of a customer's order in any security is based, in part, on the common law agency duty of loyalty, which obligates an agent to act exclusively in the principal's best interest, and also has been incorporated explicitly in FINRA rules. As such, any broker-dealer, when acting as agent on behalf of a customer in a transaction, is under a duty to exercise reasonable care to obtain the most advantageous terms for the customer.

to "use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions."[86] Factors used to determine "reasonable diligence" include the "character of the market for the security," "the size and type of transaction," and "the number of markets checked."[87]

Despite the protection to customers provided by FINRA, some commentators believe that the duties of broker-dealers fall short of the fiduciary duty that applies to investment advisers.[88]

C. *Summation of Differences*

Simply put, broker-dealers are held to a standard of suitability, while investment advisers are held to a higher fiduciary standard. Although not immediately obvious, the standards are significantly different in terms of legal obligation and liability. Associate Professor Arthur Laby of Rutgers Law School notes,

> The suitability rule requires that a broker-dealer have a reasonable basis to believe a recommendation or investment strategy is *suitable* for a customer based on information the broker must obtain through reasonable diligence. A fiduciary standard is far more exacting. A fiduciary standard is a "best interest" standard. Under a fiduciary standard it is not sufficient to determine whether advice is suitable, rather the adviser must act *in the client's best interest*. Fiduciaries are subject to a distinctive duty of loyalty, which, absent disclosure, prohibits conflicts of interest when the fiduciary's personal interest conflicts with the principal's interest, and conflicts of duty when the interests of two or more principals conflict with one another.[89]

Id.

86. *Rule 5310(a)(1): Best Execution and Interpositioning*, FINRA (May 9, 2014), http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10455 [https://perma.cc/7DQ2-BNGB].

87. *Id.*

88. *See, e.g.*, MORRISON & FOERSTER LLP, *supra* note 72, at 1 ("While such duties and requirements provide some degree of investor protection, they fall short of the 'fiduciary' standards described by the SEC."); *see also* Bakhtiari et al., *supra* note 66, at 317–18.

89. Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 725 (2012) [hereinafter Laby, *Selling Advice and Creating Expectations*] (emphasis added).

II. THE DEBATE SURROUNDING A UNIFORM STANDARD

Scholars and industry alike have oft written and debated on the differences between the standards governing investment advisers and broker-dealers. Many recommend a unification, or harmonization, of those standards into a so-called uniform, or "unitary," fiduciary standard that all providers of investment advice must follow.[90]

This part first introduces a congressionally mandated study, spurred by section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), on whether to promulgate a uniform fiduciary standard. Next, it briefly mentions the SEC's recent request for comment on the matter. Finally, this part analyzes the arguments presented on the topic.

A. *Section 913 of the Dodd-Frank Act*

Following the 2008 financial crisis, Congress passed the Dodd-Frank Act, directing the SEC to perform a study on the different standards investment advisers and broker-dealers owe their respective clients.[91] Effectively, Congress punted on the issue and "handed the baton to the SEC."[92] Section 913 not only required the performance of a study but also gave the SEC explicit rulemaking authority in connection with that study.[93] Quite simply, Congress gave the SEC the authority to rectify any concerns that it had at the end of the study regarding the differences in the standards of care to which investment advisers and broker-dealers are held concerning securities-related investment advice. Therefore, under section 913,

90. *See* Barbara Black, *How to Improve Retail Investor Protection After the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 13 U. PA. J. BUS. L. 59, 59 (2010) (arguing for harmonization of the standard of conduct between broker-dealers and investment advisers by basing the standards of care and competence on professionalism rather than fiduciary standard); Steven D. Irwin, Scott A. Lane & Carolyn W. Mendelson, *Wasn't My Broker Always Looking Out for my Best Interests? The Road to Become a Fiduciary*, 12 DUQ. BUS. L.J. 41, 61 (2009) ("A consistent fiduciary duty standard would likely help to increase investor trust."); Laby, *Fiduciary Obligations*, *supra* note 20, at 701–02 (describing differences between broker-dealer and investment adviser regulation and application of fiduciary standard).

91. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 7, 12, 15, 18, 22, 31, and 41 U.S.C.). This massive legislation exceeds eight hundred pages and constitutes "the most comprehensive financial regulation ever adopted by Congress" when considering the breadth of subjects, activities, and financial institutions to which it extends its reach. Hazen, *supra* note 27, at 47–48.

92. Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 735.

93. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(f), 124 Stat. 1376, 1827–28 (2010) (codified at 15 U.S.C. § 78o (2012)); *see also* Hazen, *supra* note 27, at 48.

the SEC has the power to require a uniform fiduciary standard for both types of investment professionals.

Complying with the mandate, the SEC issued its findings from the study in January 2011.[94] The findings contained two principal recommendations. First, the SEC recommended consideration of a uniform fiduciary standard for both investment advisers and broker-dealers when providing investment advice to retail customers.[95] The second recommendation was that all investors should be given the same protections regardless of which type of investment professional provides them with advice.[96] Despite these recommendations, the SEC has yet to act definitively, issuing no new rules or regulations on this topic.[97]

B. *The SEC's Request for Notice and Comment on the Differing Standards*

The gravity of this debate, and the more important notion of protection for retail investors when it comes to investment advice, is not lost on the SEC as a whole. At the behest of the Secretary of Labor,[98] and in the wake of extreme uncertainty regarding the Department of Labor's ("DOL") so-called Fiduciary Rule,[99] the SEC

94. *See generally* SECTION 913 STUDY, *supra* note 15 (describing the SEC's findings and recommendations based on the study).

95. *See id.* at ii. Notably, this recommendation explicitly states that the standard should be consistent with the current regime applied to investment advisers, which would mean a fiduciary standard. *See id.*

96. *See id.* at 129.

97. The overall recommendations of the study were supported by only three of the five SEC commissioners, which may help explain why no new rules or regulations have been promulgated on this topic. *See* Kathleen L. Casey & Troy A. Paredes, Comm'rs, SEC, Statement Regarding Study on Investment Advisers and Broker-Dealers (Jan. 21, 2011), http://www.sec.gov/news/speech/2011/spch012211klctap.htm [https://perma.cc/48MS-NC2N]. Two of the commissioners dissented from the study, proclaiming insufficiencies in the analytical and empirical basis in the recommendations made. *See id.* ("The Study should be viewed as a starting point for further research and consideration, rather than as forming the primary basis for rulemaking. Before the Commission proposes rules in this area, more rigorous analysis - rooted in economics and data - is needed to avoid unintended consequences."). The two dissenting commissioners argued that the study does not "fulfill[] the statutory mandate of Section 913 . . . to evaluate the 'effectiveness of existing legal or regulatory standards of care.'" *Id.*

98. Alexander Acosta, *Deregulators Must Follow the Law, So Regulators Will Too*, WALL ST. J., May 23, 2017, at A19. For more information on the current Secretary of Labor, R. Alexander Acosta, see *Secretary of Labor Alexander Acosta*, U.S. DEP'T LAB., https://www.dol.gov/agencies/osec [https://perma.cc/W36R-2VNF].

99. The Fiduciary Rule comprises both a final rule and various prohibited transaction exemptions that were newly adopted or amended at the same time. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, and 2550). On May 22,

issued a statement asking for public comments. The SEC's goal was to "engage constructively" as both the DOL and SEC "pursue [their] ongoing analyses of the standards of conduct applicable to investment advisers and broker-dealers when they provide investment advice to retail investors."[100] While noting that the SEC has been reviewing this area for quite some time,[101] Chairman Clayton expressed that the time spent on this review "illustrate[s] the complexity of the issues as well as the fast-changing nature of our markets, including the evolving manner in which investment advice is delivered."[102] Chairman Clayton specifically recognized robo-advisers and other forms of fintech[103] as areas to which those responding with comments should lend significant focus.[104] Comments have been passionate and wide-ranging.[105]

2017, the Department of Labor and the Department of the Treasury issued formal non-enforcement policy statements regarding the Fiduciary Rule. U.S. DEP'T OF LABOR, FIELD ASSISTANCE BULL. NO. 2017-02, TEMPORARY ENFORCEMENT POLICY ON FIDUCIARY DUTY RULE (2017), https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02.pdf [https://perma.cc/WQ72-BFJF]; *see also* I.R.S. Announcement 2017-04, 2017-16 C.B. 1106 (Apr. 17, 2017). The Department of Labor also issued a guidance document to provide compliance assistance to affected parties. *See* U.S. DEP'T OF LABOR, CONFLICT OF INTEREST FAQS (TRANSITION PERIOD) (2017), https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-1.pdf [https://perma.cc/EC4S-LMJQ].

For a detailed discussion on the DOL's Fiduciary Rule and its embattled existence, or lack thereof, see Karmel, *supra* note 29, at 423–25.

Furthermore, a Presidential Memorandum issued by President Trump directed the DOL "to examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice." Memorandum on the Fiduciary Duty Rule, 2017 DAILY COMP. PRES. DOC. 95, at 1 (Feb. 3, 2017). This resulted in yet another delay for the embattled DOL rule.

As of June 21, 2018, the Fiduciary Rule was put to rest for the time being, as the Fifth Circuit issued a mandate vacating the Fiduciary Rule in total. Chamber of Commerce v. U.S. Dep't of Labor, 885 F.3d 360, 388 (5th Cir. 2018). In striking down the Fiduciary Rule for overstepping the DOL's authority, the Fifth Circuit reasoned that "[t]he Fiduciary Rule . . . bears hallmarks of 'unreasonableness' under *Chevron* Step Two and arbitrary and capricious exercises of administrative power." *Id.*

100. Clayton, *supra* note 9.

101. *See id.* (referencing the Section 913 Study, the RAND Institute study published in 2008, and a solicitation of data and other information by the SEC in 2013).

102. *Id.*

103. Fintech is a portmanteau which combines the words "financial" and "technology" to reference innovative and disruptive technology in the financial sector. *See Fintech*, INVESTOPEDIA, https://www.investopedia.com/terms/f/fintech.asp [https://perma.cc/FMC7-4XZ2].

104. Clayton, *supra* note 9. Clayton explains:

> Market developments and advances in technology continue to transform the ways in which retail investors obtain advice (e.g., robo-advisers, fintech). How do retail investors perceive the duties that apply when investment advice is provided in new ways, or by new market entrants? Is this perception out of step with the actual

C. Arguments For and Against a Uniform Standard

Efforts to unify the standard, and efforts to the contrary, have been ongoing for well over a decade. Interested parties to the conversation include academics, interest groups, policymakers, and industry, all of which have presented several justifications for a change.[106]

1. Investor Confusion

Perhaps the most common justification in support of a uniform standard is that investors are simply confused as to the difference in roles between investment advisers and broker-dealers.[107] This confusion was further highlighted in the RAND Institute for Civil Justice report from 2008,[108] which was commissioned by the SEC in order to research the different protections afforded to retail investors under the Advisers Act and the Exchange Act.[109] Indeed, this report became a rallying cry from academia to the Treasury Department for

> obligations of these entities and, if so, in what ways? *How should these market developments and advances in technology affect the Commission's consideration of potential future actions?* What steps should the Commission take, if any, to address potential confusion or lack of information in these emerging areas?

Id. (emphasis added).

105. Examples of those who have submitted comments are: Senator Elizabeth Warren; the Director of Policy Research from Morningstar, Inc.; the Chairman and CEO of The Vanguard Group, Inc.; and the Managing Director and Associate General Counsel of the Securities Industry and Financial Markets Association. *See Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisors and Broker-Dealers*, SEC, https://www.sec.gov/comments/ia-bd-conduct-standards/iabdconductstandards.htm [https://perma.cc/K477-B7BQ] (last modified July 24, 2018). In addition, the comments include someone named Spencer Gould who simply wished to say, "Hands off my 401(k) Wall St!" Spencer Gould, Comment to *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisors and Broker-Dealers*, SEC (July 21, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-156542.htm [https://perma.cc/ULL6-4TBT].

106. *See* Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 736.

107. *See* Irwin et al., *supra* note 90, at 53 (explaining that recent surveys indicated what they called "understandable confusion"); Knut Rostad, *Strengthen Disclosures by Limiting Their Role in the Delivery of Investment and Financial Advice*, 30 REV. BANKING & FIN. L. 141, 144–46 (2011) (reviewing studies regarding investor confusion about the difference between investment advisers and broker-dealers); Gary A. Varnavides, Note, *The Flawed State of Broker-Dealer Regulation and the Case for an Authentic Federal Fiduciary Standard for Broker-Dealers*, 16 FORDHAM J. CORP. & FIN. L. 203, 204 (2011) ("[B]roker-dealers and investment advisers offer virtually identical services to investors, resulting in considerable confusion for both investors and regulators.").

108. *See* HUNG ET AL., *supra* note 15, at 31.

109. For more information about the rule the SEC adopted with regard to the Adviser's Act, see generally Certain Broker-Dealers Deemed Not to Be Investment Advisers, 70 Fed. Reg. 20,424 (Apr. 19, 2005) (to be codified at 17 C.F.R. pt. 275).

a uniform standard.[110] The SEC warned of the same in the Section 913 Study, showing that retail customers are plainly confused by the differing roles.[111]

It is important to note that there is inherent risk in investing, regardless of who is advising an investor.[112] Indeed, all investments have risks associated with them. However, that argument is certainly not sufficient to combat the shortcomings of holding investment professionals to differing standards.

2. Investor Expectations

Investors may expect that their brokers are held to the same standard as investment advisers or any other person in the profession of giving investment advice. This expectation may be addressed in the fine print of the contract, stating that broker-dealers are not held to a fiduciary standard.[113] Ultimately, this places the burden upon the investors to "parse through legal distinctions to determine whether the advice they receive was provided in accordance with their expectations."[114] The RAND Report introduced empirical evidence to this end, highlighting a TD Ameritrade survey which found that sixty percent of respondents believe broker-dealers owe a fiduciary duty to their clients.[115]

3. Reasonable Expectations

Another possible justification is that of reasonable expectations. A proponent of this justification, Professor Laby does not believe the aforementioned arguments are compelling and do not, in themselves, justify a uniform standard.[116] However, he puts forth a compelling argument that centers around broker-dealers holding themselves out to be the same as investment advisers.[117] As Laby explains, the

110. *See* U.S. DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 125–26 (2008), https://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf [https://perma.cc/AP27-JKZS] (arguing that brokers who provide investment advice to retail customers should be held to the same fiduciary standard as investment advisers).

111. *See* SECTION 913 STUDY, *supra* note 15, at 101.

112. *See Risk Disclosures*, INV. CTR., INC., https://www.investmentctr.com/client/disclosures/risk-disclosures [https://perma.cc/WB25-F7AS].

113. *See* HUNG ET AL., *supra* note 15, at 10 ("Unlike the case of investment advisers . . . broker-dealers are not categorically bound—by statute, regulation, or precedent—to a per se rule imposing fiduciary obligations toward clients.").

114. SECTION 913 STUDY, *supra* note 15, at 101.

115. HUNG ET AL., *supra* note 15, at 31.

116. *See* Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 753.

117. *See id.* at 753–54.

implications of heavy advertising and use of titles to connote an advisory relationship lead to the creation of reasonable expectations that the broker-dealer is the client's fiduciary.[118] This results in common law consequences that generally justify broker-dealers being held to a fiduciary standard alongside investment advisers.[119] The argument concludes that, overall, broker-dealers' "use of advertisements and titles, which induce[] customers to obtain advice from brokerage firms[,] . . . creates a reasonable expectation that brokers providing advice are fiduciaries and must act in customers' best interest."[120]

4. Functional Similarities Despite Inconsistent Standards

This argument centers around the fact that brokers have functionally become investment advisers and, yet, are held to a different standard. The most explicit mention of this argument came in a 2009 Treasury Department White Paper, which stated that "investment advisers and broker-dealers are regulated under different statutory and regulatory frameworks, even though the services they provide often are virtually identical from a retail investor's perspective."[121] The argument is that "[u]nder a functional approach to regulation, two groups of people performing the same function should be regulated by the same standard."[122] Critics point out that disparate regulatory treatment does not, in itself, qualify as a compelling argument for regulatory change.[123]

This functional approach argument encapsulates the issue presented by robo-advisers. While it is settled that the pure robo-adviser model is a fiduciary under the Advisers Act, it is the hybrid model that is left with uncertainty. Consider the scenario of two hybrid business models. Each hybrid model gives partial responsibility to the algorithm and partial responsibility to a human investment professional. Model 1 has an algorithm churn out investment advice adequate for the specific client in question, then has a human broker-dealer make the call to the client regarding the new investment or strategy. Model 2 is the exact same but utilizes a

118. *See id.*
119. *See id.* at 773.
120. *Id.*
121. U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 71, https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf [https://perma.cc/98J6-K5CX].
122. Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 742.
123. *See id.* at 742–43.

human registered investment adviser to make the phone call. The distinction between whether the human is an investment adviser or a broker-dealer is important. If the exact same conversation takes place with a client in both Model 1 and Model 2, the investment advice from each conversation is held to a different legal standard. Currently, the advice given by Model 1—utilizing a human broker-dealer—is held to the lower suitability standard. In contrast, the advice given by Model 2—utilizing a human investment adviser—is held to the higher fiduciary standard. In both scenarios—whether a broker-dealer or investment adviser—a human makes a phone call and little else. However, the investment advice, rooted only in the algorithm's genius, is held to a more stringent legal standard.

5. Ineffective Standards

Some commentators believe that the suitability standard imposed on broker-dealers is simply too weak to protect retail investors and that the standard needs strengthening.[124] Most, if not all, advocates of this approach believe that the fiduciary standard imposed upon investment advisers would provide investors with a higher standard of protection than the existing suitability standard.[125]

While arguable, most would agree that regulation of broker-dealers under the suitability standard is less demanding than the fiduciary standard imposed upon investment advisers. It is a matter of degree and circumstance. Ultimately, advocates of a fiduciary standard argue the obvious: broker-dealers may recommend an investment that is simply suitable and need not be in the client's best interest.[126]

Critics of this argument point out what the advocates may be overlooking: broker-dealers may be "already subject to significant fiduciary-like obligations when acting as more than mere order takers for their customers."[127] The argument proceeds that existing broker-dealer law already accounts for those broker-dealers who are acting in the same capacity as an investment adviser.[128] However, whether the SEC enforces the situation in that way is another ballgame altogether. Ultimately, the fact that the standard of care may be lower does not in itself prove that the investment advice rendered is of a

124. *See, e.g.*, *id.* at 744.
125. *See id.* at 743–44.
126. *Id.* at 744.
127. Hazen, *supra* note 27, at 49; *see also* Fein, How Are Robo-Advisors Regulated?, *supra* note 73, at 17.
128. *See* Hazen, *supra* note 27, at 48–49.

lower quality or not regulated to a sufficient extent. Another critique of this argument is simple, yet eloquent: "a higher standard is not necessarily a better standard."[129]

6. Theoretical Economic Benefits

The sixth argument tracks the economic proposition that a fiduciary standard will "benefit investors more than it will cost them."[130] Evaluation of that claim necessitates a utilitarian cost-benefit analysis of gigantic theoretical proportions.[131] The Obama administration used this theory.[132]

The main critique of the investor benefits argument is that the claim is simply theoretical and unsubstantiated.[133] Due to this inherent limitation, it is presumed that a proper "justification will have to be based largely on non-economic grounds."[134] Since this Comment is not economic in nature, the theory behind the claim is beyond its scope.

III. ROBO-ADVISERS AND THE CURRENT MAINSTREAM NARRATIVE

This part introduces the overall atmosphere surrounding robo-advisers, including what they are, recent developments, and the current regulatory scheme. This part first provides a background regarding what exactly a robo-adviser is and briefly describes certain attributes about robo-adviser business models. Next, this part presents the latest regulatory scrutiny surrounding robo-advisers. Finally, this part synthesizes the current legal discussions about robo-advisers and their ability to meet the fiduciary standard under the Advisers Act.

129. Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 746 ("If higher were always better, then one ought to raise the standard of conduct applicable to brokers and advisers to the highest possible level. This makes little sense.").

130. *Id.* at 746.

131. *See id.* at 746–47.

132. This argument was used by the Obama administration to back the DOL's now-deceased Fiduciary Rule. "The Obama administration, which proposed the [fiduciary] rule, claimed it would save Americans $17 billion a year from conflicted [investment] advice." Alessandra Malito, *The Fiduciary Rule Is Officially Dead. What Its Fate Means to You*, MARKETWATCH (June 25, 2018, 1:55 PM), https://www.marketwatch.com/story/is-the-fiduciary-rule-dead-or-alive-what-its-fate-means-to-you-2018-03-16 [https://perma.cc/MZ9Q-U3U8].

133. *See* Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 748.

134. *See id.* at 749–50.

A. *Background on Robo-Advisers*

Industry professionals are beginning to recognize that robo-advice technology has a good chance of "revolutionizing how individuals receive investment advice."[135] These "sophisticated machine learning algorithms [are utilized] to provide personalized investment advice and monitoring 24-7."[136] Simply put, robo-advisers are "online services that use algorithms to generate investment recommendations for clients."[137]

Due to the absence of human oversight and cost of human advice, robo-advisers generally charge significantly lower fees than other investment professionals.[138] In addition, the robo-adviser business model realizes efficiencies beyond just lower fees. Robo-advisers can actively and accurately perform common advisory functions, such as rebalancing and tax-loss harvesting.[139] As of the beginning of 2017, the total assets under management ("AUM") of the six largest robo-advisers ranged from $1 billion (Future Advisor, a subsidiary of BlackRock) to $60 billion (Vanguard Personal Advisor).[140] A report from 2015 speculates that robo-advice platforms

135. Ji, *supra* note 6, at 1544.

136. Lightbourne, *supra* note 6, at 652.

137. Ji, *supra* note 6, at 1543. FINRA uses the terminology "digital investment advice tools" to refer to what are generally considered robo-advisers. *See* FIN. INDUS. REGULATORY AUTH., REPORT ON DIGITAL INVESTMENT ADVICE 2, 9 (2016) [hereinafter FINRA, REPORT ON DIGITAL INVESTMENT ADVICE], http://www.finra.org/sites/default/files/digital-investment-advice-report.pdf [https://perma.cc/L6N8-RW42]. Generally speaking, FINRA is concerned more with broker-dealers utilizing robo-advice in conjunction with a broker. *See id.* at 2. The 2016 report does recognize, however, that FINRA is concerned with what it calls "client-facing digital advice tools." *Id.* at 9. The SEC has recently described robo-advisers as "innovative technologies to provide discretionary asset management services to their clients through online algorithmic-based programs." SEC GUIDANCE UPDATE, *supra* note 5, at 1. The Massachusetts Securities Division defines fully automated robo-advisers as meeting the following criteria:

> (1) do not meet with or conduct significant (or any) due diligence on a client, (2) provide investment advice that is minimally personalized, (3) may fail to meet the high standard of care that is imposed on the appropriateness of investment advisers' investment decision-making, and (4) specifically decline the obligation to act in a client's best interests.

MASS. SEC. DIV., *supra* note 5, at 3.

138. *See Does Not Compute*, ECONOMIST, Oct. 31–Nov. 6, 2015, at 69, 69–70 (stating that robo-advisers typically charge 0.25% or so of a client's portfolio rather than the 1% to 3% typically charged by human advisers).

139. *See, e.g.*, *Rebalancing and Tax-Loss Harvesting in Schwab Intelligent Portfolios*, CHARLES SCHWAB, http://intelligent.schwab.com/public/intelligent/insights/whitepapers/tax-loss-harvesting-rebalancing.html [https://perma.cc/KK9E-BKHG].

140. Tom Baker & Benedict Dellaert, *Regulating Robo Advice Across the Financial Services Industry*, 103 IOWA L. REV. 713, 717 n.11 (2018).

will reach $489 billion in AUM by the year 2020.[141] An even more bullish speculation puts the number at approximately $2 trillion by 2020.[142] While there may be uncertainty as to projection, it is universally accepted that the market for robo-advice will continue to rise steadily.

Robo-advisers employ a sizeable range of business models. For example, "[s]ome robo-advisers provide investment advice directly to the client with limited, if any, direct human interaction . . . ."[143] Others provide investment advice after parameters are set with human advisory personnel.[144] Furthermore, the methods of collecting client information upon which to base the investment advice differs as well.[145] These differences in business models create a gray area that the SEC has yet to clarify and will confuse clients even more with respect to the differences between legal standards owed to them.

B. *Recent Regulatory Activity Impacting Robo-Advisers*

Regulatory scrutiny has increased over the past few years, most likely due to the rising sentiment in favor of greater protection of consumers in the financial services arena. Despite a significant lack of clarity surrounding the regulation of robo-advisers, one important detail has been definitively settled: robo-advisers are subject to the Advisers Act, as is any other registered investment adviser.[146]

Robo-advisers have come under regulatory scrutiny at times. The debate surrounding the DOL's Fiduciary Rule contained significant mentions of robo-advisers.[147] Worried that the DOL's Fiduciary Rule

141. Damian Fantano, *Large Retail Entrants to Boost Digital Advice: Cerulli*, FIN. TIMES: FIN. ADVISER (Nov. 12, 2015), https://www.ftadviser.com/2015/11/12/ifa-industry/large-retail-direct-entrants-to-boost-digital-advice-cerulli-jTEYXeJa6c0pt51VG974EM/article.html [https://perma.cc/PHJ4-RLLH].

142. EPPERSON ET AL., *supra* note 4, at 26.

143. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 1.

144. *See id.*

145. *See id.* (describing how some robo-advisers utilize questionnaires of varying lengths to obtain information, while others may use a human adviser to obtain information or passively await client input).

146. *See id.* at 2; MASS. SEC. DIV., *supra* note 5, at 4 ("[R]obo-advisers and traditional advisers shoulder the same fiduciary duty."). For regulatory duties owed under the Advisers Act for registered investment advisers, see *supra* Section I.A.

147. *See, e.g.*, Fin. Indus. Regulatory Auth., Comment Letter on Proposed Conflict of Interest Rule and Related Proposals, RIN-1210-AB32 (July 17, 2015), http://www.finra.org/sites/default/files/FINRACommentLetter_DOL_07-17-15.pdf [https://perma.cc/4LGT-EXF2]. The Fiduciary Rule would have required all persons providing investment advice to qualified retirement accounts to adhere to a fiduciary standard. 29 C.F.R. § 2510.3–21 (2018). The hotly contested rule was adopted after a significant time period. *See, e.g.*, Karmel, *supra* note 29, at 424–25.

would tend to push its broker-dealers toward abandoning accounts that do not meet a fairly low minimum investment, FINRA commented that robo-advisers may not be able to act as a savior in that respect because "robo-advice is a poor substitute for a financial adviser who understands the customer's needs and guides the customer through market turbulence or life events."[148] Notwithstanding the prior statement, DOL Secretary Thomas Perez has praised robo-advisers as low-cost tools for those who may be ignored by business models that require high minimums.[149] The Fiduciary Rule was put on hold in 2017 when President Trump issued a Presidential Memorandum directing the DOL "to examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice."[150] The Fiduciary Rule is now laid to rest for the time being: the Fifth Circuit declared that the DOL overstepped its congressional mandate.[151]

Following the decision by the Fifth Circuit to vacate the DOL's attempt at imposing stricter standards on broker-dealers, the spotlight quickly turned to the states and whether they would attempt to do what the DOL could not accomplish. New Jersey was at the forefront of this push, becoming the first state to take action after the DOL's failed attempt.[152] Governor Phil Murphy stated that he was pushing

148. Fin. Indus. Regulatory Auth., *supra* note 147.

149. *See* Mark Schoeff Jr., *DOL Secretary Perez Touts Wealthfront as Paragon of Low-Cost, Fiduciary Advice*, INVESTMENTNEWS: FIDUCIARY FOCUS (June 19, 2015, 1:24 PM), http://www.investmentnews.com/article/20150619/FREE/150619892/dol-secretary-perez-touts-wealthfront-as-paragon-of-low-cost [https://perma.cc/7U34-XZ23].

150. Memorandum on the Fiduciary Duty Rule, *supra* note 99, at 1. Governor Cuomo of New York recently said that New York is considering implementing its own "best interest" standard in the absence of the passage of the federal Fiduciary Rule. Press Release, N.Y. State Dep't of Fin. Servs., Governor Cuomo Announces New Consumer Prots. for Life Ins. Sales (Dec. 27, 2017), https://www.dfs.ny.gov/about/press/pr1712271.htm [https://perma.cc/P8L6-9N7R]. Cuomo notes that "[a]s Washington continues to ignore and roll back efforts to protect Americans, New York will continue to use its role as a strong regulator of the financial services and insurance industries to fight for consumers and help ensure a level playing field." *Id.*

151. *See* Chamber of Commerce v. U.S. Dep't of Labor, 885 F.3d 360, 388 (5th Cir. 2018) ("[The] DOL impermissibly bootstrapped what should have been safe harbor criteria into 'backdoor regulation.'" (quoting Hearth, Patio & Barbecue Ass'n v. U.S. Dep't of Energy, 706 F.3d 499, 507–08 (D.C. Cir. 2013))).

152. *See* Greg Iacurci, *New Jersey Fiduciary Rule Could Be First of Many Among States Post-DOL*, INVESTMENTNEWS: FIDUCIARYFOCUS (Sept. 26, 2018, 3:03 PM), https://www.investmentnews.com/article/20180926/FREE/180929933/new-jersey-fiduciary-rule-could-be-first-of-many-among-states-post [https://perma.cc/S229-VB5S].

for the new rule in order to protect the state's investors.[153] According to Murphy, there is a need for state regulatory action because "most consumers assume that financial professionals are required to give unbiased advice."[154] Furthermore, "most investors don't realize broker-dealers often get undisclosed financial benefits for steering clients toward particular investments."[155] The New Jersey rule is in direct response to the Fifth Circuit's quashing of the DOL's Fiduciary Rule.[156] The robo-advisor industry, however, is expected to push back against the attempt by New Jersey to institute a uniform standard of care.[157]

The various publications released by the SEC, FINRA, and the Massachusetts State Securities Division—which issue warnings and guidance for both investors who currently do business with robo-advisers and those who are thinking of doing business with robo-advisers—are more directly impactful on the robo-advice industry.[158] These publications indicate skepticism among the regulatory community that robo-advisers may not be properly equipped to comply with current law.

In 2015, the SEC and FINRA issued a joint Investor Alert cautioning investors to focus on understanding a robo-adviser's terms and conditions, among other criteria, prior to investing.[159]

153. *Murphy Unveils Fiduciary Duty for NJ's Investment Brokers*, U.S. NEWS & WORLD REP. (Sept. 17, 2018, 8:29 PM), https://www.usnews.com/news/best-states/new-jersey/articles/2018-09-17/murphy-unveils-fiduciary-duty-for-njs-investment-brokers [https://perma.cc/XVZ9-U6DL (dark archive)]. In accordance with Murphy's announcement, the New Jersey Bureau of Securities is initiating work on the rule, which will require all New Jersey investment professionals "to place their clients' interests above their own when recommending investments." John Iekel, *NJ to Follow Its Own Fiduciary Rule*, ASPPA (Sept. 25, 2018), https://www.asppa.org/news/browse-topics/nj-follow-its-own-fiduciary-rule [https://perma.cc/AB8E-LXQ8]. The state-level regulatory reforms will "enhance the integrity of [New Jersey's] financial services industry by holding every investment professional to the highest standard under the law." *Id.*

154. *See Murphy Unveils Fiduciary Duty for NJ's Investment Brokers*, *supra* note 153.

155. *Id.*

156. *See id.*

157. *See* Greg Iacurci, *New Jersey Brokers Expect Industry Will Push Back Against Fiduciary Rule Proposal*, INVESTMENTNEWS: FIDUCIARYFOCUS (Sept. 27, 2018, 5:13 PM), https://www.investmentnews.com/article/20180927/FREE/180929922/new-jersey-brokers-expect-industry-will-push-back-against-fiduciary [https://perma.cc/4FRZ-NMUS] [hereinafter Iacurci, *New Jersey Brokers*].

158. *See generally* MASS. SEC. DIV., *supra* note 5 (providing guidance to investors regarding robo-advisors).

159. *See Investor Alert: Automated Investment Tools*, *supra* note 5. The Investor Alert cautions investors to consider five areas prior to moving forward with the relationship: (1) terms and conditions, (2) limitations and key assumptions, (3) recognition that the robo-adviser is making decisions solely based on the input that was given, (4) awareness that the

Interestingly, the Investor Alert raised the concern that "you may lose the value that human judgment and oversight, or more personalized service, may add to the process."[160] In 2016, FINRA issued a report on robo-advisers entitled "Report on Digital Investment Advice."[161] The FINRA report ultimately seemed to suggest that "absent intervention by a trained professional, the investment advice given by a robo-adviser may be deficient."[162] Following FINRA's report, the SEC issued concurrent releases in February of 2017—one in the form of Investor Guidance and the other in the form of an Investor Bulletin.[163] The Investor Guidance highlighted three specific areas that robo-advisers should pay special attention to when analyzing compliance with the Advisers Act: (1) adequate and effective disclosure, (2) collection of information to deliver suitable advice, and (3) effective compliance systems.[164] Most importantly, the SEC stated in its Guidance Update that "[r]obo-advisers, like all registered investment advisers, are subject to the substantive and fiduciary obligations of the Advisers Act."[165] Thus, robo-advisers are to be held to the fiduciary duty owed by any other investment adviser.

The Massachusetts Securities Division is the only state regulator thus far to come out strongly in the negative as to whether robo-advisers can live up to a fiduciary standard.[166] While federal regulators have proceeded rather timidly and cautiously, Massachusetts stated, "[I]t is the position of the Division that fully automated robo-advisers, as currently structured, may be inherently unable to carry out the fiduciary obligations of a state-registered investment adviser."[167]

investment guidance given may not be appropriate, and (5) safeguarding of personal information. *Id.*

160. *Id.*

161. *See generally* FINRA, REPORT ON DIGITAL INVESTMENT ADVICE, *supra* note 137 (discussing digital investment advice).

162. Fein, How Are Robo-Advisors Regulated?, *supra* note 73, at 6.

163. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 1–2; *Investor Bulletin: Robo-Advisers*, SEC (Feb. 23, 2017), https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-robo-advisers [https://perma.cc/8ZHP-YGPF].

164. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 2.

165. *Id.* For regulatory duties owed by registered investment advisers under the Advisers Act, see *supra* Section I.A.

166. *See* MASS. SEC. DIV., *supra* note 5, at 8.

167. *Id.* at 1. Smaller investment advisers are governed by state regulatory agencies. THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 20.5 (7th ed. 2017). If the adviser has less than $25 million in AUM, it must register according to the state's regulatory agency's rules. *Id.* If it has between $25 million and $100 million in AUM, the adviser must register under its state's rules, unless greater than fifteen states

C. *Current Debate Surrounding Robo-Advisers' Ability to Meet the Fiduciary Standard*

In the past few years, industry professionals, regulatory agencies, and academics have "criticized the quality of robo-advice recommendations" and have also "indicated skepticism that robo-advisers, as they currently exist, could ever meet the fiduciary standards" that the Advisers Act requires of them.[168] One commentator believes that the arguments may be synthesized into three closely related propositions: (1) limitations are inherent in using questionnaires to gather data to base investment guidance upon, (2) limitations of robo-advisers as binary creatures exist as a result of a lack of a human element, and (3) robo-advisers lack experience in anything but a bull market.[169] The combined message of these three arguments may be that humans are not ready to hand over the reins completely.

The use of electronic questionnaires is a common practice with robo-advisers.[170] Critics argue that such questionnaires have a tendency to miss vital information, which inevitably leads to an insufficiency when considering the duties owed to clients.[171] The SEC has specifically flagged possible issues, such as the client's lack of opportunity to provide context to her answers and the robo-advisers' lack of ability to follow up on a line of questioning or to clarify any inconsistencies.[172] The argument follows that these possible issues could then lead to a robo-adviser's failure to consider important criteria such as "experience, time horizon, cash needs, and financial

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would require it to register, in which case it is able to register with the SEC. *Id.* Advisers with over $100 million in AUM must always register with the SEC. *Id.*

168. Ji, *supra* note 6, at 1545.

169. *See id.* at 1565–68. A bull market is "characterized by optimism, investor confidence and expectations that strong results should continue." *Bull Market*, INVESTOPEDIA, https://www.investopedia.com/terms/b/bullmarket.asp [https://perma.cc/5V2B-4N95]. By contrast, investors and analysts colloquially use "bear market" to refer to a downtrodden or downward-moving market. *Bear Market*, INVESTOPEDIA, https://www.investopedia.com/terms/b/bearmarket.asp [https://perma.cc/3AVV-73KY].

170. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 6 ("We have observed that robo-advisers may provide investment advice based primarily, if not solely, on client responses to online questionnaires.").

171. Ji, *supra* note 6, at 1565; *see also* MASS. SEC. DIV., *supra* note 5, at 5 ("[R]obo-advisers gather some information from prospective clients, but may not gather sufficient information to enable them to discharge their fiduciary duties by providing personalized and appropriate investment advice.").

172. *See* SEC GUIDANCE UPDATE, *supra* note 5, at 6. The SEC goes on to suggest factors that should be taken into account by robo-advisers in an effort to gather information from their clients that is sufficient to meet their suitability obligation. *See id.* at 6–7.

goals."[173] The inability—or unwillingness, for that matter—to delve into the margins of an investor's current and future situations provides fodder for arguments that robo-advisers are essentially an investment brokerage service because they do not "tak[e] into consideration an investor's 360 [degree] financial picture and goals."[174]

The lack of "human perception" has also troubled critics.[175] FINRA has observed that the human capability of truly developing "a nuanced understanding of the client's needs," as opposed to "client-facing digital advice tools rely[ing] on a discrete set of questions," may be absent when investing with a robo-adviser.[176] Furthermore, the problem may increase in magnitude when the tool does not allow one to interact with an actual person, thus completely losing the value of human judgment, human oversight, or more personalized service.[177] Robo-advisers may miss crucial information in relation to the original plan, resulting in unsound investment advice.[178]

The third argument posits that robo-advisers are ill-equipped to handle market failures because they have never experienced anything but a bull market.[179] This argument centers on the physical capability of a human adviser picking up the phone to calm down a panicked investor and offer a resolution.[180] In times of economic turmoil, it is the human adviser who has the ability to talk investors through

173. Ji, *supra* note 6, at 1565.

174. Melanie Waddell, *Can Robo-Advisors Really Be Fiduciaries?*, THINKADVISOR (Nov. 30, 2015, 11:31 AM), http://www.thinkadvisor.com/2015/11/30/can-robo-advisors-really-be-fiduciaries [https://perma.cc/B2WD-ACZA].

175. *See* Ji, *supra* note 6, at 1566–67.

176. FINRA, REPORT ON DIGITAL INVESTMENT ADVICE, *supra* note 137, at 8–9.

177. *See Investor Alert: Automated Investment Tools*, *supra* note 5.

178. *See* Tara Siegel Bernard, *The Pros and Cons of Using a Robot as an Investment Adviser*, N.Y. TIMES (Apr. 29, 2016), https://www.nytimes.com/2016/04/30/your-money/the-pros-and-cons-of-using-a-robot-as-an-investment-adviser.html?_r=0 [https://perma.cc/9UBF-GUJ4 (dark archive)] (discussing Professor Laby's view that robo-advisers are not "fiduciaries in the traditional sense because of their inability to address subtleties that may arise in conversation").

179. *See* Melanie L. Fein, Robo-Advisors: A Closer Look 5 (June 30, 2015) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2658701 [https://perma.cc/WW9K-TW4L] [hereinafter Fein, Robo-Advisers] (stating that robo-advisers have been in existence "only during a bull market and are untested in how they would perform in a downturn").

180. *See* Robert Litan & Hal Singer, Opinion, *Obama's Big Idea for Small Savers: 'Robo' Financial Advice*, WALL ST. J. (July 21, 2015, 7:39 PM), http://www.wsj.com/articles/obamas-big-idea-for-small-savers-robo-financial-advice-1437521976 [https://perma.cc/2GC8-D2X2] ("An email or text message in the fall of 2008 would not have sufficed to keep millions of panicked savers from selling, with devastating consequences for their nest eggs.").

decisions to avoid the irrational investor phenomenon.[181] Indeed, cutting against the heart of this argument, Vanguard Personal Advisor Services—Vanguard's digital advice platform—markets itself as the epitome of stability for investors.[182] Critics are simply concerned that there have been no use cases to analyze how robo-advisers will perform in a declining market.[183]

One commentator has pushed back against the popular concern over whether a robo-adviser can meet its fiduciary duty of care and concludes that "the investment adviser fiduciary duty of care is more lenient than robo-advisor critics recognize and that a well-designed robo-advisor meets the standard without issue."[184] Interestingly, it is the conflicts of interest, part of an adviser's duty of loyalty, where the commentator believes that the bulk of concern should be placed.[185] Ultimately, it is recommended that regulators do not endeavor into duty of care issues but, rather, that they focus more intently on the conflicts of interest present in robo-adviser business models.[186]

While there is certain to be more debate amongst interested parties as to whether robo-advisers are truly able to meet the fiduciary standard under the Advisers Act, the cautionary words given by regulatory agencies function as mere bark rather than bite. The regulators recognize that there may be inherent issues but are not ready to act. Regardless of whether a robo-adviser is deemed to fall short of its duty of care or duty of loyalty, the regulators have the option to proclaim it as not meeting its obligations as an investment adviser fiduciary to its clients.

181. The term "irrational investor" is used here loosely to refer to investors who believe that they must sell assets when the price has gone down without any significant change in the investment's financials. For a more in-depth discussion, see Julia Hanna, *Behavioral Finance—Benefiting from Irrational Investors*, WORKING KNOWLEDGE (June 6, 2007), https://hbswk.hbs.edu/item/behavioral-financebenefiting-from-irrational-investors [https://perma.cc/HLB9-GUUT].

182. *See Advice for Real Life*, VANGUARD PERS. ADVISOR SERVS., https://investor.vanguard.com/advice/personal-advisor [https://perma.cc/7YLS-ZYTW] ("When it comes to investing, your natural reactions can get in the way. It's human nature to overthink, overreach, and, at times, be overwhelmed. With Vanguard Personal Advisor Services, an advisor serves as an emotional circuit breaker so you don't abandon a well-thought-out plan.").

183. *See* Ji, *supra* note 6, at 1567–68.

184. *Id.* at 1568.

185. *See id.* at 1579–83.

186. *See id.*

IV. ROBO-ADVISERS MUST ENTER THE CONVERSATION ON A UNIFORM STANDARD

Automated investment advice finds itself in the middle of the shuffle of the DOL's Fiduciary Rule,[187] the SEC's renewed interest in public comment on a uniform standard, and the SEC's stated willingness to promulgate uniform standards on its own. Robo-advisers received ample spotlight from advocates of the DOL's Fiduciary Rule as an "exemplary, low-cost investment advice service[] that act[s] in the best interests of clients."[188] Viewing robo-advisers in this light effectively results in the DOL's blessing as a backstop for the potential negative consequences of the fiduciary duty being applied to both investment advisers and broker-dealers alike.[189] This endorsement by the DOL has not gone unquestioned:

> During the development of the Fiduciary Rule, DOL suggested that "robo-advisers" will fill any gaps that result from constraints on commissioned advice. Robo-advisers are a relatively new and untested method of providing financial advice and are not necessarily more cost-effective than in-person advice. No rigorous studies have examined whether a robo-adviser is a good substitute for a human being, especially in troubled markets such as the 2008 market crash.[190]

Further still, the SEC, in its most recent endeavor regarding the differing standards of conduct, has explicitly asked for public

187. The importance of this conversation is even greater when considering the possible impact the DOL Fiduciary Rule could have had on low-balance retirement accounts. These accounts could have been too administratively expensive when it comes to compliance for firms, so investors would flood in large quantities to the automated advice market. One report has stated, "As firms move toward fee-based advisory, many low-balance accounts will no longer be served, shifting many assets to formats such as robo-advisory and self-directed . . . ." A.T. KEARNEY, A.T. KEARNEY STUDY: THE $20 BILLION IMPACT OF THE NEW FIDUCIARY RULE ON THE U.S. WEALTH MANAGEMENT INDUSTRY 8 (2016), https://www.atkearney.com/documents/10192/7041991/DOL+Perspective+-+August+2016.pdf/b2a2176b-c821-41d9-b12e-d3d2b0807d69 [https://perma.cc/YUY9-WQPL].

188. Ji, *supra* note 6, at 1572.

189. *See* Schoeff, *supra* note 149. The argument is that an increase in the standard that broker-dealers owe to their clients may make broker-dealers unwilling to assume the risk of giving investment advice where the potential payoff is not worth their while, effecting low-balance brokerage and retirement accounts. *Id.*

190. American Council of Life Insurers, Comment Letter on the SEC's Request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers (Oct. 3, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2640466-161282.pdf [https://perma.cc/3T5Y-ZGSS].

comments to address the rise of robo-advisers and other disruptive fintech.[191] Specifically, Chairman Clayton asked the following:

> Market developments and advances in technology continue to transform the ways in which retail investors obtain advice (e.g., robo-advisers, fintech). How do retail investors perceive the duties that apply when investment advice is provided in new ways, or by new market entrants? Is this perception out of step with the actual obligations of these entities and, if so, in what ways? *How should these market developments and advances in technology affect the Commission's consideration of potential future actions?* What steps should the Commission take, if any, to address potential confusion or lack of information in these emerging areas?[192]

Conspicuously absent from this discussion is the world of legal academia. Due to the rise of robo-advisers and the increasing prevalence of regulatory scrutiny and acceptance of robo-advisers, it is necessary to revisit the ever-salient discussion regarding a uniform standard through a lens that captures robo-advisers. The acknowledgement that a plain definition of robo-advisers is missing leads to the ultimate conclusion that rules should be either adapted or promulgated de novo in order to specifically cater to the unique characteristics of how robo-advisers are used in practice.

The following arguments highlight the need for a uniform standard and the inadequacies of the current regulatory regime in the context of robo-advisers.

A. Investor Confusion

As explained briefly above, the argument that investor confusion warrants the imposition of a uniform standard has teeth.[193] Adding yet another entity about which investors could be confused might tip the scales toward justifying a uniform standard.

Currently, it is clear that investor confusion surrounding the duties that investment advisers and broker-dealers owe them is a critical issue. Both the RAND Report and Section 913 Study recognize this point clearly.[194] Now, robo-advisers hold themselves

191. *See* Clayton, *supra* note 9.
192. *Id.* (emphasis added).
193. *See supra* Section II.C.1.
194. *See* HUNG ET AL., *supra* note 15, at 20–21; SECTION 913 STUDY, *supra* note 15, at 101; *supra* text accompanying note 108.

out to be an entity that may give investment advice, which further blurs the lines of exactly what duties are owed to their clients.

In fact, robo-advisers often aim to minimize the fiduciary duties owed to their clients through the use of customer agreements with clauses that perform this function.[195] One robo-adviser expressly disclaims that it has any relationship with the client, except as an independent contractor:

> [Robo-advisor] is and will hereafter act as an independent contractor and not as an employee of Client, and nothing in this Agreement may be interpreted or construed to create any employment, partnership, joint venture *or other relationship* between [Robo-advisor] and Client.[196]

Other customer agreements seek to limit the fiduciary duty owed or seek to disown it altogether.[197] This inevitably leads down the path of investor confusion, broadening the impact of the disparate standards altogether.

B. *Inconsistent Standards*

Examining the different business models that robo-advisers may employ adds to the inconsistent standards argument. The SEC has stated that robo-advisers are held to a fiduciary standard when giving investment advice to clients, but what about robo-advisers operating in the capacity of a broker-dealer?

This key question has been overlooked thus far. It is now settled by the SEC that robo-advisers are generally investment advisers regulated under the Advisers Act, but there has been no mention anywhere of whether automated advice algorithms utilized by broker-dealers are held to the same standard. Given the current law, it appears that robo-advisers that operate as broker-dealers—or as a supplement to broker-dealers—would, in fact, be governed under a different standard than their investment adviser brethren.

The scenario is simple. Imagine that the same exact algorithm, which operates independently of all human interaction, could be used by a broker-dealer in conjunction with a human for the clients to call. The algorithm performs the investment analysis while the human performs the interaction, effectively functioning as a salesman. The idea that the same algorithm used in two different capacities—one as

195. *See* Fein, Robo-Advisers, *supra* note 179, at 24.
196. *Id.* (quoting a provision from a robo-adviser customer agreement).
197. *See id.* at 24–25.

a standalone registered investment adviser, and the other as a supplement to a broker-dealer—could be held to different legal standards is indicative that a uniform standard is warranted. While the proposition is theoretical, it is ultimately probable.

The variance in human interaction would certainly be key when considering whether that robo-adviser is operating in the capacity of an investment adviser or a broker-dealer. This is the exact analysis that should spur the SEC to finally put the issue to bed and regulate investment advisers and broker-dealers under the same standard of conduct. The argument that human investment professionals who functionally give the same advice should be held to the same standard is well documented.[198] The natural corollary to the argument is that bits of code that are exactly the same and produce the same output, investment advice, should be held to the same standard.

C. Reasonable Expectations

The advent of robo-advisers bolsters Professor Laby's argument that it is actually the reasonable expectations broker-dealers confer upon their clients that ultimately create the fiduciary relationship.[199] As described above, a robo-adviser that acts as a broker-dealer would arguably create a reasonable expectation among clients that the digital investment advice is investment guidance that is in the client's best interest. It would likely be foreign to many investors to hear that an algorithm has been coded to actually work against their clients in promoting more expensive or less strategic investing activity so that the ultimate owner or user of the algorithm may make more money.

D. Proposal for Uniform Standard

The disparity between the standard of conduct owed by a registered investment adviser and that owed by a broker-dealer has reared its head prominently over the past two decades. Robo-advisers must now be accounted for in the discussion. This Comment proposes three potential solutions, all of which have varying degrees of difficulty with implementation, administration, and effectiveness.

First, states could begin to follow New Jersey's lead and promulgate rules applying a fiduciary standard across the board within their regulatory arms that oversee securities activity.[200] However, the cost to market participants stemming from each state's

198. *See, e.g.*, Laby, *Selling Advice and Creating Expectations*, *supra* note 89, at 742.
199. *See supra* Section II.C.3.
200. *See* Iacurci, *New Jersey Brokers*, *supra* note 157.

variance in its standard of conduct could be immense. Market participants generally have to answer to three regulatory bodies already—the SEC, FINRA, and state-level regulatory agencies. There is a cost at each level.[201] This cost further supports the salient argument that low-cost investment advice could be impossible to come by if broker-dealers are held to a fiduciary standard. In spite of the high cost, state-level regulation may be necessary if states strongly believe in protecting their citizens in this way. The SEC has had the opportunity to apply a fiduciary standard across the board, most recently in 2017, but has dropped the ball. Regulation by state agencies might be the unfortunate product of the SEC's unwillingness to step up and handle the matter itself.

Second, the SEC could promulgate a blanket rule. A broad rule, applying to all investment professionals and creating a uniform standard, is the easiest path to harmony within the industry. It would preclude states from having to do so, thus protecting firms from having to increase costs of compliance across the board. However, this option looks increasingly unlikely. The defeat of the DOL's Fiduciary Rule, the unwillingness of the SEC to move forward with a uniform standard, and the general stance of the Trump administration on matters of financial industry regulation indicate that this solution is not likely, at least in the near future.

Third, the SEC sticks with the status quo—differing standards between registered investment advisers and broker-dealers—but accounts for the different business models employed by robo-advisers. The factors of investor confusion, inconsistent standards, and reasonable expectations all point toward a uniform standard. If, however, a uniform standard is not possible, the SEC could, at the very least, account for the proliferation of robo-advisers and the plethora of differences in their business models. Although the SEC has said that robo-advisers are investment advisers, it misses the difference between algorithms used as standalone investment professionals and those used by broker-dealers in the same capacity, albeit with a twinge of human interaction. The allowance of broker-dealers to use, in theory, the same algorithm to churn out investment advice that is held to a lower legal standard is against the policy implicitly espoused by the SEC. If accounting solely for the plethora of business models, the SEC could use a sliding scale methodology that accounts for the level of human interaction and decisionmaking

201. *See id.* ("Having to answer to three masters and duplicate efforts in improving compliance becomes very challenging.").

against the interaction and decisionmaking of the algorithm. The SEC would then need to account for different levels of human interaction and decide what standard would be applied to each level. Suffice it to say, this would be an arduous task for the SEC.

CONCLUSION

Robo-advisers are still developing in many ways. The law, in turn, should develop with them. As robo-advisers become more and more ubiquitous in society, it becomes increasingly important that regulators follow along. This Comment argues that the conversation surrounding whether a uniform standard should be implemented across the two types of investment professionals should take heed of robo-advisers. The discussion should consider the impact that the growing automated advice market will have within those same parameters. In regulating robo-advice, the SEC should take into account not only the possibility of humans performing the same functions and being regulated to different degrees but also the possibility of algorithms performing those same functions and being regulated to different degrees.

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