September 11, 2023

VIA ELECTRONIC SUBMISSION

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

RE: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (SEC Rel. Nos. 34-97990; IA-6353; File No. S7-12-23, July 26, 2023)

Dear Ms. Countryman:

We the undersigned write to comment on, and express our concerns with, the Securities and Exchange Commission's (the "Commission") proposed rule regarding Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment

Advisers.[1] This letter represents the consensus view of the undersigned, and it is not necessarily true that each of the undersigned endorses each of the positions taken in this letter.[2] On behalf of our members who represent investors, market participants, and other stakeholders across the U.S. capital markets, we request the Commission withdraw the Proposal. While we support appropriate regulatory frameworks that protect investors, we find this Proposal unnecessary, inadequately reasoned and fatally flawed.[3] We are also concerned that the Commission lacks statutory authority to adopt these rules. This concern is especially heightened when the same authority relied upon in the Proposal is currently pending court review.[4]

The Proposal Illustrates the Commission's Continued War on Technology

Broker-dealers and investment advisers, regardless of their size, rely on technology to deliver better outcomes and innovative, cost-efficient products and services to their customers or clients, to the benefit of investors who now have greater access to more products at lower costs. Technological advances in auditing, reporting, recordkeeping, trading and surveillance have left investors better protected. Our capital markets are at the forefront of the global economy due to technological innovation and competition.

The Commission only superficially recognizes these benefits in the Proposal.[5] Despite claims of being technology neutral and "not seeking to identify which technologies a firm should or should

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1 Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, SEC Release Nos. 34-97990; IA-6353 (July 26, 2023), 88 FR 53960 (Aug. 9, 2023) (the "Proposal"); *see also* Comment Letter from Trade Associations (Aug. 15, 2023) (requesting extension of the comment period for an additional 60 days).

2 Given the breadth and diversity of our respective memberships, each of undersigned may have different views on specific points addressed in this letter. Many of the undersigned intend to submit individual comment letters addressing more fully various aspects of the Proposal.

3 Comment Letter from Eric J. Pan, President and CEO, and Susan Olson, General Counsel, Investment Company Institute (Aug. 17, 2023) (stating that the Commission cannot seek to cure any Administrative Procedure Act deficiencies pertaining to the Interconnected Rules by just reopening comment files for a few more weeks because the Commission has failed to provide appropriate notice and comment) ("ICI Letter"); Comment Letter from Rebekah Goshorn Jurata, General Counsel, American Investment Council (Aug. 8, 2023) (requesting that the Commission publish an analysis of the cumulative effects of interconnected rules and reopen the comment periods before finalizing) ("AIC Letter).

4 *See* discussion, *infra* at 3-6. Pending the outcome of this review, this SEC should not enact any further rules using this statutory authority. *See* Petition for Review, *Nat'l Ass'n of Priv. Fund Managers*, v. *Sec. Exch. Comm'n*, No. 23-60471 (5th Cir. Sept. 1, 2023).

5 *See* Proposal, *supra* n.1 at 9 & nn.11, 16 (stating that, due to technological advances, there is increased retail investor participation, more efficient development of investment strategies and lower expenses for investors). This conclusory recognition ignores that the Commission specifically requested information on the use of technology by broker-dealers and investment advisers with respect to retail investors. *See* Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser use of Technology to Develop and Provide Investment Advice, SEC Release Nos: 34-92766; IA-5833 (Aug. 27, 2021), 86 FR 49067 (Sept. 1, 2021) ("With the advent and growth of digital platforms for investing . . . broker-dealers and investment advisers . . . have multiplied opportunities for retail investors to invest and trade in securities. This increased accessibility has

not use,"[6] the Proposal is outright hostile to the use of technology. The onerous, and in some cases operationally unfeasible,[7] requirements in the Proposal would likely make firms opt out of deploying technological innovations to avoid the prohibitive costs of compliance. The lack of discernible boundaries on what is a "covered technology" is likely to operate as a *de facto* ban on the use of technology. This will harm competition in the markets and the investors the Commission seeks to protect.

As with the areas of digital assets, electronic communications, distributed ledger technology and e-delivery, with the Proposal, the Commission continues its resistance to technological innovation, not just by enforcing existing, outdated laws, but also by adding regulation that makes it more difficult for regulated institutions to enhance their systems and to find efficiencies for their customers and clients. Institutions that fall under the Commission's regulatory authority lag behind other financial institutions in providing efficient, cost-effective technological solutions to customers and clients.[8] And now, in the area of predictive data analytics, the Commission is using the mere promise of technology to override existing regulation without appropriate notice and comment.[9]

The Commission Lacks Statutory Authority to Adopt these Rules

The Commission points to Sections 211(h) of the Investment Advisers Act of 1940 (the "Advisers Act") and 15(l) of the Securities Exchange Act of 1934 (the "Exchange Act") as sources of authority for the extraordinarily broad Proposal.[10] The expansiveness of the Proposal,

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been one of the many factors associated with the increase of retail investor participation in the U.S. securities markets in recent years."). The Proposal lacks an adequate discussion of the numerous benefits that have accrued to investors from the expanded use of technology by broker-dealers and investment advisers.

6 *See* Proposal, *supra* at n.1 at 42.

7 *See* discussion, *infra* at 11-13.

8 *See*, *e.g.*, SIFMA, E-Deliver: Modernizing the Regulatory Communications Framework To Meet Investor Needs for the 21st Century (Sept. 2020), *available at* https://www.sifma.org/wp-content/uploads/2020/09/E-Delivery-Paper.pdf ("[T]he Commission's framework no longer reflects prevailing consumer practices."); *see also* Default Electronic Disclosure by Employee Pension Benefit Plans Under ERISA, 85 FR 31884 (May 27, 2020) (Department of Labor final rule on e-delivery); BDO, Digital Transformation in Financial Services: Top Findings from BDO's 2019 Middle Market Digital Transformation Survey (Apr. 12, 2019), *available at* https://www.bdo.com/insights/industries/financial-services/digital-transformation-in-financial-services.

9 *See* discussion, *infra* at 8-11.

10 The full text of Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act is as follows: (h) Other matters The Commission shall -- *(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest; and (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.* 15 U.S.C. § 80b-11(h)(2) (emphasis added). Moreover, the Proposal does not adequately cite the statutory authority. While the Proposal refers to Advisers Act Sections 211(a) and (h), it merely refers to section 15 of the Exchange Act (with an incorrect statutory citation) and does not cite a specific provision

and the breadth of activities it would seek to prohibit, raise serious questions about whether these statutory provisions support the weight that has been placed upon them. The Commission does not provide any analysis of the basis on which the proposed rules are supported by Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act. The Proposal lacks a discussion of both the Commission's understanding of the scope of its authority under these statutory provisions and the specific findings of the Commission, as they relate to covered technologies, that would support the link between each of the proposed prohibitions and its statutory authority. Without any such explanations, those affected by the proposed rules are left without meaningful opportunity to comment.

Relying on Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act for the expansive proposed rules suggests that the Commission thinks Congress granted it *carte blanche* to prohibit any sales practice, conflict of interest, or compensation scheme. This cannot be the case with a section titled "Other Matters."

The context in which these sections were enacted by Congress informs the statutory authority granted to the Commission. The sections must be read in the full context of Section 913 of the Dodd-Frank Act,[11] which was an effort to harmonize standards of conduct between broker-dealers and investment advisers when giving investment advice to retail customers.[12] The core provisions are Sections 211(g) of the Advisers Act and 15(k) of the Exchange Act, which grant the Commission authority to adopt a harmonized standard of conduct. Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act, which the Commission is relying upon for this rulemaking, are simply an authorization for the Commission to engage in *additional*, *related* rulemaking in furtherance of this standard of conduct—that is, rulemaking to address conduct incompatible with the standard of conduct adopted under Sections 211(g) of the Advisers Act and 15(k) of the Exchange Act.

If Congress had intended to grant the Commission authority to regulate *any activity of a broker-dealer or adviser*, outside of the standards of conduct when providing recommendations or investment advice to investors, it would have explicitly granted this authority.[13] Therefore, the

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within that section. We presume that the Commission is relying on section 15(l) of the Exchange Act, as it is the analogous provision to section 211(h) of the Advisers Act.

[11] Dodd-Frank Wall Street Reform and Consumer Protection Act, Conf. Rept. 111-517, 111th Cong., 2d Sess. (2010) ("Conference Report on Dodd-Frank").

[12] The Conference Report on Dodd-Frank describes the purpose of Subtitle A of Title IX, which included Section 913, as follows:

"Subtitle A [of Title IX] directs the SEC to study the standards of care applicable to broker-dealers and investment advisers giving investment advice to retail customers, and it authorizes the SEC to promulgate rules imposing a fiduciary duty on broker-dealers and investment advisers to protect retail customers. . . . Subtitle A also clarifies the authority of the SEC to require investor disclosures before purchase of investment products and services. Finally, the subtitle requires studies on the enhancement of investment adviser examinations, financial literacy, mutual fund advertising, conflicts of interest, improved investor access to information on investment advisers and broker-dealers, and financial planners and the use of financial designations." *Id.* at 870.

[13] *See West Virginia* v. *E.P.A.*, 142 S.Ct. 2587 (2022).

Proposal exceeds the statutory authority granted by Congress because it extends beyond investment recommendations or advice to investors, to every aspect of the broker's or adviser's business that has a touch (however remote) to an investor.[14]

The rule would apply "when a firm uses covered technology in an investor interaction." The Commission purposefully crafted a "broad [definition of covered technology] to encompass a wide variety of methods, using current and future technologies, that firms could use to interact with investors" and would capture the most sophisticated technologies to simple spreadsheets.[15] The Commission likewise broadly defined "investor interaction" so that the Proposal would apply even when a firm is not communicating with an investor.[16] As a result, no reasonable line can be drawn by a broker-dealer or an investment adviser on when they are using a "covered technology" for an "investor interaction." The Commission does not have authority under Sections 211(h) and 15(l) to regulate the entirety of the business of broker-dealers and investment advisers.

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[14] With respect to investment advisers, the Commission yet again exceeds its statutory authority by extending coverage of the Proposal beyond retail investors. The Commission has no authority under Section 211(h) to adopt any rule applicable to private funds. *See* Comment Letter of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association (Apr. 28, 2022) on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, SEC Release No. IA-5955 (Feb. 9, 2023) (the "Private Funds Proposal"); Comment Letter of Alternative Investment Management Association and Alternative Credit Council (Apr. 25, 2022) on the Private Funds Proposal; Comment Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association (Apr. 25, 2022) on the Private Funds Proposal; Comment Letter from Drew Maloney, President and CEO, American Investment Council (Apr. 25, 2022) on the Private Funds Proposal ("AIC Private Funds Letter"); Comment Letter of Kristen Malinconico, Director, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (Apr. 25, 2022) on the Private Funds Proposal; Comment Letter of Elliot Ganz, General Counsel, Co-Head Public Policy, Loan Syndications and Trading Associations ("LSTA Letter") on the Private Funds Proposal. The comment letters on the Private Funds Proposal (File No. S7-03-22) are available at https://www.sec.gov/comments/s7-03-22/s70322.htm.

[15] *See* Proposal, *supra* n.1 at 43, 51. The Proposal defines "covered technology" to cover "an analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes." *See* Proposed Rule 211(h)(2)-4(a). The SEC notes that the proposed definition of "covered technology" is designed to capture predictive data analytics-like technologies such as "AI, machine learning, or deep learning algorithms, neural networks, [natural language processing], or large language models, as well as other technologies that make use of historical or real-time data, lookup tables, or correlation matrices among others." *See* Proposal, *supra* n.1, at 82. *See also* Commissioner Hester M. Peirce, Through the Looking Glass: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers Proposal (July 26, 2023) (stating "commonly used software, math formulas, statistical tools, and AI trained on all manner of datasets, could fall within the ambit of this rulemaking" and citing question 36 in the release that discusses "whether technologies 'trained on all books in the English language' should be excluded from the [Proposal's] coverage").

[16] The Proposal defines "investor interaction" as "engaging or communicating with an investor including by exercising discretion with respect to an investor's account; providing information to an investor; or soliciting an investor . . . ." *See* Proposed Rule 211(h)(2)-4(a). The definition "would include engagement between a firm and an investor's account" and would capture "any advertisements . . . that promote or offer services or that seek to obtain or retain one or more investors." *See* Proposal, *supra* n.1 at 50-51.

Further, the Commission created a new definition of conflict of interest that does not exist anywhere else in the federal securities laws and conflicts with existing definitions of the term. The definition is vague; it is not clear what it means for a technology (rather than the firm itself) to "take into consideration" the adviser's or broker-dealer's interest.[17] In fact, the Proposal takes the definition of conflict one step too far in suggesting that, just because a manner of investor interaction may increase investor engagement and transactions (and therefore fees), there is a conflict. This view cannot stand, not only because it suggests that anything making a broker-dealer or an adviser more user friendly or effective presents a conflict, but also because it reads out of the statutory requirement that there be a *conflict* between the interest of the investor and the firm (*i.e.*, an interest that causes the firm to be not disinterested).

Moreover, the mere fact that, for example, a particular activity of a broker-dealer or an investment adviser may entail a "conflict of interest" is not, by itself, sufficient under sections 211(h) of the Advisers Act and 15(l) of the Exchange Act to support its prohibition as the proposed rules would do. Rather, these sections should not be invoked unless the activity in question involves not only a conflict of interest but also a "sales practice" and "compensation scheme."[18] This is a basic canon of statutory construction.[19] Congress grouped these three items together and any rule under these sections should clearly be tied to activities that involve all three.[20]

The broad nature of the Proposal goes well beyond the plain meaning of these terms individually and collectively. The plain meaning of "sales practice" is a mode or method of making sales. The word "sales" refers to "operations and activities involved in promoting and selling goods or services."[21] And "practice" means "the usual mode or method of doing something."[22] Taken together, those terms refer to promotional methods in making sales of a good or service. In the context of broker-dealer and investment advisory services, this would refer to recommendation or advice with respect to securities. This informs the meaning of the next two phrases in Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act's list: "conflicts of interest" and "compensation schemes." These terms refer to incentives that may encourage a broker-dealer or investment adviser to push an investor into an unsuitable transaction. Finally, the word "certain" preceding "sales practices, conflicts of interest, and compensation schemes" reinforces the limited nature of Congress's grant of rulemaking authority. The "certain" modifier "applies to

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17 The Proposal defines "conflict of interest" as "when a firm uses a covered technology that takes into consideration an interest" of the firm or certain associated persons. *See* Proposed Rule 211(h)(2)-4(a).

18 *See* Comment Letter from Michael S. Hong, Chair, Private Investment Funds Committee, and John Fitzgerald, Chair, Investment Management Regulation Committee, New York City Bar Association Committee on Private Investment Funds and Committee on Investment Management Regulation (Apr. 25, 2022) ("NYC Bar Letter") on the Private Funds Proposal.

19 *Dole* v. *United Steelworkers of Am.*, 494 U.S. 26, 36 (1990).

20 *See* AIC Private Funds Letter, *supra* n.14; NYC Bar Letter, *supra* n.18 ("Section 211(h) should not be involved unless the activity in question involves not only a 'conflict of interest,' but also a 'sales practice' and 'compensation scheme'"); *see also Dole*, 494 U.S. at 36.

21 Webster's Third New International Dictionary 2003 (1961) ("Webster's Third")

22 *Id.*

the entire series."[23] And it demonstrates that Congress carefully delineated the Commission's rulemaking authority to proscribe discrete promotional practices, tactics, and compensation schemes that misalign the incentives of the regulated entities and the retail investors whom they advise.[24]

Interconnectedness—yet Another Rule that Does not Account for Implications of Interconnections and Dependencies

The Proposal is yet another example of a rule that does not account for interconnectedness and interdependencies with other pending proposals.[25] In a rush to finalize an aggressive agenda to inexplicably reshape the markets, the Commission is eschewing its obligations under the Administrative Procedure Act (the "APA"). The Commission's separation of interconnected rules proposals in time and analysis renders the comment process deficient and may cause harm to investors and the markets. It is the Commission's obligation at the proposing stage to come forward with well-informed analyses of how markets operate, the likely effect of the changes it is proposing, and why such changes are necessary and appropriate. Instead, as is evident in the onslaught of proposed rules over the past couple of years, the Commission, yet again, simply ignores the substantive work required to publish a thoughtful proposal that shows an understanding of the markets, the implications of the proposed changes and why such changes are necessary or appropriate.

For example, in the Commission's proposal, Outsourcing by Investment Advisers,[26] the Commission would prohibit investment advisers from outsourcing "covered functions" without conducting due diligence and monitoring of the service providers. These include functions that would be covered by the Proposal.[27] In a footnote in the Proposal, the Commission "encourage[s] commenters to review that proposal to determine whether it might affect comments on this

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23 *Facebook*, *Inc.* v. *Duguid*, 141 S. Ct. 1163, 1169 (2021).

24 *See El Al Israel Airlines, Ltd*. v. *Tsui Yan Tseng*, 525 U.S. 155, 173 (1999) ("Inclusion of the word 'certain' in the [Warsaw] Convention's title . . . accurately indicated that the [C]onvention is concerned with certain rules only, not with all the rules relating to international carriage by air" (second alteration in original) (internal quotation marks omitted)). Additionally, Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act received no legislative debate whatsoever—a strong indication that members of Congress understood the provision to confer a limited rulemaking power to supplement standards of conduct rules under Sections 211(g) and 15(k). Through this ancillary provision, Congress did not grant the Commission unfettered authority to reshape the business model of broker-dealers and investment advisers from soup to nuts. *See Whitman* v. *American Truckers*, 531 U.S. 457, 468 (2001) ("Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.").

25 *See* AIC Letter *supra* n.3; ICI Letter *supra* n.3; Comment Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, Managed Funds Association (Jul. 21, 2023) on the Private Funds Proposal, among others.

26 Outsourcing by Investment Advisers, SEC Release No. IA-6176 (Oct. 26, 2022), 87 FR 68816 (Nov. 16, 2022).

27 *See* Proposal, *supra* n.1, at n.124 and accompanying text.

proposal."[28] Rather than doing the necessary analysis mandated by the APA and presenting such analysis for public comment, the Commission is shifting the burden of analyzing costs and benefits to commenters. Apparently, the American public works for the regulator rather than the regulator working for the American public.

Further, the Proposal does not account for the myriad of rules and regulations (other than the Standards of Conduct) that already require broker-dealers and investment advisers to identify and evaluate the covered conflicts of interest. Both broker-dealers and investment advisers have rules in place that require the conduct of annual risk assessments around conflicts of interest. For example, FINRA Rule 3120 requires broker-dealers to identify supervisory controls in the areas of trading and sales practices, among others. For investment advisers, Rule 206(4)-7 requires advisers to adopt compliance policies and procedures to ensure reasonable compliance with the Advisers Act and the rules thereunder, including fiduciary obligations to clients. The Commission has not done its diligence in studying the current regulatory landscape and outlining for commenters why further regulation is necessary or appropriate.[29]

The Proposal Overrides Existing Rules without Notice and Comment as Required by the APA

The Proposal conflicts with, and potentially overrides without appropriate notice and comment under the APA, certain of the Commission's current regulations (some of which were recently adopted) including Regulation Best Interest ("Reg BI") and the Commission's Final Interpretation of the Investment Advisers Fiduciary Duty (collectively, the "Standards of Conduct"),[30] the Investment Adviser Marketing Rule (the "Marketing Rule"),[31] and the regulatory framework around soft dollars and securities lending.

First, the Proposal seeks to override the Standards of Conduct by applying a different definition of conflict of interest.[32] In a footnote, the Commission notes that "the elimination or neutralization requirement of the proposed rules applies only to a narrower, defined subset of the broader universe of conflicts—those conflicts, that a firm determines actually place the interests of the firm or certain associated persons, ahead of the interests of investors. This is in contrast to, for example, an investment adviser's fiduciary duty, which encompasses any interest that might incline the adviser, consciously or unconsciously, to provide advice that is not disinterested, or similarly in contrast to the broader universe covered by Reg BI.[33] Other conflicts of interest that

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28 *Id.*

29 We note that the statutory authority the Commission is relying upon for this rulemaking requires demonstration that the rules are appropriate. *See supra* n.10.

30 Regulation Best Interest, 17 C.F.R. § 15l-1; Commission Interpretation Regarding Standard of Conduct for Investment Advisers, SEC Release No. IA-5248 (June 5, 2019), 84 FR 33669 (July 12, 2019).

31 Investment Adviser Marketing, 17 C.F.R. § 275.206(4)-1.

32 *See supra* n.17 and accompanying text.

33 Regulation Best Interest similarly defines a "conflict of interest" as "an interest that might incline a broker, dealer, or a natural person who is an associated person of a broker or dealer – consciously or unconsciously – to make a recommendation that is not disinterested." 17 C.F.R. § 15l-1(b)(3).

only might affect the firm's investor interactions would continue to be subject to these other obligations, as applicable."

The release does not explain why the Standards of Conduct do not apply to conflicts of interest presented in the use of covered technologies and why such a standard is not sufficient to address the concerns noted in the Proposal.[34] There is nothing in the Standards of Conduct that limits their application to conflicts that *might*, rather than conflicts that *actually*, exist. Additionally, the Commission fails to provide adequate lines between when a conflict *might* and when a conflict *actually* exists. For example, the Proposal covers any use or *reasonably foreseeable future use* of a covered technology. How would a firm *actually* know whether a conflict of interest would exist in future use? By its own admission, the Commission recognizes the rapidly evolving nature of technology. The Commission explicitly states that the Proposal, while limited to covered technologies, is intended to cover a broad range of actions from providing advice and recommendations, to design elements, features or communications to nudge, prompt, cue, solicit or influence investment-related behaviors or outcomes. How would a firm know whether it should be looking to the Standards of Conduct or this Proposal, when both cover recommendations and investment advice? What conduct is covered under the Proposal that is not covered by the Standards of Conduct? The Proposal appears to generally cover the same conduct covered by the Standards of Conduct apart from fund investors and retail customers of a broker-dealer engaged in self-directed trades. If the Commission intends to extend the Standards of Conduct to fund investors and self-directed trades, the Commission should explicitly state as such. Without this clarity, the public cannot meaningfully comment on the Proposal.

Second, the Proposal would eliminate the ability of firms to meet their best interest obligations, under the Standards of Conduct, to investors by disclosing or mitigating conflicts, as appropriate. The Commission eliminated disclosure to address the covered conflicts of interests in the Proposal "because a conflict can replicate to a much greater magnitude and at a much greater speed than would be possible to address through timely disclosure." The Commission also noted, without explanation, that investment advisers cannot fully and fairly disclose such conflicts and obtain informed consent. Given, by way of one example, that the Proposal covers conflicts of interest associated with reasonable future use of covered technology, why would disclosure not be timely? It is not clear how the replication of the conflict in and of itself could not be explained by clear and timely disclosure.[35]

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[34] Commissioner Mark T. Uyeda, Statement on the Proposals re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (July 26, 2023) ("To the extent this proposal addresses investor interactions that are not recommendations by broker-dealers and thus not covered by Regulation Best Interest or other rules or guidance, the proposal should have been narrowed to address that perceived gap. Instead, this proposal layers on duplicative requirements and an overly prescriptive approach to policies and procedures, all of which can lead to a 'check the box' mentality at firms.").

[35] The lack of ability to disclose is not consistent with other Commission and FINRA rules that prescribe for disclosure when there is a conflict of interest. *See*, *e.g.*, 17 C.F.R. § 240.15c1-5 (requiring disclosure of control); 17 C.F.R. § 240.15c1-6 (requiring disclosure of interest in a distribution); 17 C.F.R. § 240.15c2-5 (requiring disclosure when extending or arranging credit in certain transactions); FINRA Rules 2241 and 2242 (requiring disclosure of conflicts in research reports); FINRA Rule 2262 (disclosure of control

Instead, the Commission would require elimination or neutralization of the conflict. Neutralization is a word that has no history in federal securities laws and overrides the current Standards of Conduct. Relying on its plain English meaning, "neutralization" is "to counteract the activity or effect of," "to render (something) ineffective or harmless by applying an opposite force or effect," or "to kill, destroy."[36] It is unclear how this is substantively different in effect from eliminate, which means "to put an end to or get rid of;" to the extent the standard is substantively different, the release fails to articulate how it would work in practice. Therefore, with respect to all conflicts of interests associated with the use of covered technologies that place the firm's interest above investors' interests, the Commission would require elimination. This is a standard that is not achievable and would send broker-dealers and investment advisers decades into the past, because they would have to dust off typewriters and fax machines to service their customers and clients.

Finally, Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act explicitly direct the Commission to facilitate the provision of "simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers" including *any* material conflicts. Rather than facilitate simple and clear disclosures, the Commission decides to totally abandon this disclosure framework and propose a regime that would prohibit actions inconsistent with the statutory text, legislative intent and prior Commission positions in the Standards of Conduct. If Congress had intended for the Commission to prohibit the use of disclosure, it would have clearly, explicitly and affirmatively granted the Commission such statutory authority.[37] Congress did not under these sections.

The Proposal also conflicts with, and potentially overrides, the Marketing Rule.[38] The Commission states that the Proposal captures "any advertisements . . . that offer or promote services or that seek to obtain or retain one or more investors."[39] Notably, the Marketing Rule defines an advertisement as "any direct or indirect communication an investment adviser makes to *more than one* person . . . ."[40] Is the Commission revising the definition of advertisement via this Proposal? If the Commission is not intending to revise the definition—which should be the

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relationship with issuer); FINRA Rule 2269 (disclosure of participation or interest in primary or secondary distribution).

36 Webster's Third, *supra* n.20.

37 In fact, Congress is explicit when it intends to prohibit disclosure. For example, Section 27B of the Securities Act of 1933 (enacted as Section 621 of the Dodd-Frank Act) states: "[a]n underwriter, placement agent, initial purchase, or sponsor, or any affiliate or subsidiary of any such entity, of an asset-backed security . . . *shall not*, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security, engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity. Sec. 621, Public Law 111-203, 124 Stat. 1376, 1632 (codified as amended as 15 U.S.C. § 77z-2a). (emphasis added).

38 *See* 17 C.F.R. § 275.206(4)-1.

39 *See* Release, *supra* n.1 at 54.

40 *See* 17 C.F.R. § 206(4)-1(e)(1)(i) (emphasis added).

case as the Commission did not provide appropriate notice and comment under the APA—how are investment advisers to resolve this conflict of law?

The Proposal also potentially conflicts with statutory sections—and Congress has yet to grant the Commission authority to override the statutes it has enacted. For example, section 28(e) of the Exchange Act creates a safe harbor that allows investment advisers, under certain circumstances, to use client commission payments to purchase eligible brokerage and research services. Given the expansive definition of "covered technologies" and "investor interactions," it is quite likely that the Proposal would capture soft dollar arrangements. Given the inherent conflict presented, a firm would be required to eliminate the use of soft dollar arrangements regardless of the fact that there is a statutory safe harbor allowing for such use. The Commission cannot, through rulemaking, override securities law statutes.

The Proposal also conflicts with regulated practices, such as securities lending. Firms use technology for all aspects of securities lending, which in some cases can present a conflict with a customer or a client. These conflicts must be disclosed and the Commission and its staff have issued exemptive orders, no-action relief, and a variety of guidance over the years regarding securities lending practices. Would a broker-dealer or investment adviser be required to forgo any use of technology to be able to continue engaging in securities lending?

Complying with this Proposal would be Challenging at Best, Impossible at Worst

The Commission has thrown a wide net over anything that could fall under the term "covered technology" and that could remotely touch on an investor's experience with a broker-dealer or an investment adviser. While the Commission states it is purportedly "limited" to technologies that "predict, guide, forecast, or direct investment-related behaviors or outcomes," there is, in fact, no limit to the breadth of this Proposal. Nor, despite the label "covered technology," is the definition even limited to technology, as it includes functions, algorithms, models, correlation matrices, or similar methods and processes that optimize for, predict, guide, forecast, or direct investment-related behaviors.

The definition of "covered technology" is without discernible limits.[41] In its own words, the Commission states: "The proposed definition would include widely used and bespoke technologies, future and existing technologies, sophisticated and relatively simple technologies,

[41] "Covered technology" could include commonly used tools such as: monte carlo simulations; retirement calculators; spreadsheets and formulas that guide investment allocation decisions and other financial planning tools; AI provided by third-parties to transcribe notes from Zoom calls with clients; internal and third-party analyses and projections of portfolio performance used in portfolio assessments and construction; identification of potential clients based on simple predictive analytics, such as area codes; research pages or electronic libraries that provide investors with the ability to obtain or request research reports, news, quotes, and charts from a firm-created website; technologies that generate email alerts to subscribing investors which provide alerts such as news affecting the securities in the investor's portfolio or on the investor's "watch list"; and technologies that provide alerts, which are used to convey various different types of information such as bankruptcy proceedings, corporate actions, and price alerts. Presumably, the conflict analysis would be different based on the type of notification. *See also*, Release, *supra* n.1 at 53.

and ones that are both developed or maintained at a firm or licensed from third parties."[42] In plain English, there is no limit in type, scope, time, source, or use.

With this breadth, would a broker-dealer or an investment adviser ever be able to service a customer or client? What form of analysis should a firm conduct on a technology that conveys vastly different types of information and that could result in different investor actions? Would this require an investor-by-investor analysis? Presumably, the conflict analysis would be different based on the type of notification, technology, alert, and nudge. By way of example, most retail brokerage websites provide financial news to their customers which are regularly refreshed as news is disseminated to the markets. As investors follow news and receive alerts—a good thing to encourage—they may choose to take actions on their portfolio holdings, and such actions could benefit the brokerage firm in the form of commissions or other transaction-based revenue. This is illustrative of the illogical nature the Proposal's sweeping scope. It is impossible for a firm to perform the analysis required by this rule on every article or alert posted on the website to discern how an investor would react to the information. Instead of promoting financial literacy, this Proposal would dissuade any firm from providing financial educational information to its customers. Notably, this would increase the market advantage of sophisticated investors over retail investors.

Once a broker-dealer or investment adviser uses a "covered technology," whether a little or a lot, the onerous compliance burdens of the rules would apply: assessment, analysis, conflict elimination, annual reviews, testing, and recordkeeping, to name a few. Every technology will have to be assessed to see if it is in scope of the Proposal. Then the broker-dealer or investment adviser would have to determine whether it "optimizes for, predicts, guides, forecasts or directs investment-related behaviors or outcomes" and document this assessment (initially and periodically). After this step, the firm would have to assess whether there is a conflict of interest, which is defined broadly – "a covered technology that takes into consideration an interest" of the firm or certain associated persons. Taken literally, almost every technology used by a firm likely considers the interests of that firm—it is, after all, a for-profit enterprise. Thus, this assessment would require an unbounded inquiry about ways the use of a technology may take into consideration an interest of the firm. For example, investment research and analysis that is intended to improve performance or decrease portfolio risk would favor the firm's business, if successful. Marketing activity, which expands the business of the firm, favors the firm's business. These activities, while potentially self-interested, may be fully aligned with the interests of the customers or clients of the firm.

The Proposal does not provide insight on who should be conducting this assessment and assumes without a basis that a firm would have personnel with "sufficient knowledge of both the applicable programming language and the firm's regulatory obligations to review the source code of the technology, review documentation regarding how the technology works, and review the data considered by the covered technology (as well as how it is weighted)." Thus, every firm will either need to hire individuals with the requisite expertise or eliminate its use of such

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42 *Id*. at 46.

covered technology.[43] This is especially onerous for smaller firms, who will be expected, for each covered technology, to effectively identify, review, and then, for conflicts that place the firm's interest before investors' interests (a subjective determination), eliminate or neutralize that conflict. Further, because compliance resources within firms are not limitless, this massive re-allocation of resources risks misplacing attention within compliance, potentially away from areas where more serious conflicts could exist. A firm should consider conflicts of interests in its business holistically, and not elevate conflicts within one area (those arising from use of technology) over conflicts arising in any other area.

The Proposal is equally unclear on when the assessment and testing should occur. The Proposal states: "the proposed conflicts rules would include a requirement to test each covered technology prior to its implementation or material modification, and periodically thereafter, to determine whether the use of such covered technology is associated with a conflict of interest." However, any online broker does hundreds of iOS, Android and web releases every year, and hundreds of thousands of routine and other code changes every year, all of which affect the technology used to interact with retail investors. The rule would require brokers to analyze each one of those changes, which would be a massive undertaking and highly disruptive to the ability of the business to operate in regular order on a daily basis.

Even more worrisome is ignoring the unworkable. The Commission notes that "[i]n certain cases, it may be *difficult or impossible to evaluate a particular covered technology* or identify any conflict of interest associated with its use or potential use within the meaning of the proposed rules . . . [for example] there may be situations where a firm does not have full visibility into all aspects of how a covered technology functions, such as if the firm licensed it from a third party. For example, a firm may be unaware that a third-party vendor has modified the way that AI software is functioning let alone able to require assessing for conflicts before any material modification to the technology. However, a firm's *lack of visibility would not absolve it of the responsibility* to use a covered technology in investor interactions in compliance with the proposed conflicts rules."[44] How can the Commission propose rules that it acknowledges are "difficult or impossible" to comply with?

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[43] *See id.* at 64-66.

[44] *See id.* at n.151 accompanying text (emphasis added).

On behalf of our members, we have enjoyed constructive and productive dialogue with the Commission for decades and stand ready to work with the Commission and its staff on proposals that improve the experience of investors while promoting innovation and the resiliency of the U.S. capital markets. As we have outlined in this letter, the Proposal is unworkable and inadequately reasoned.

The Commission should withdraw the Proposal and engage with market participants to better understand the use of technology by firms and how firms holistically handle conflicts of interest to determine the necessity of further regulation in this area. In the guise of addressing speculative concerns relating to predictive data analytics, the Commission would dramatically change how advisers and broker-dealers interact with investors. The Commission's proposed imposition of onerous requirements on advisers' and broker-dealers' use of technology to run their day-to-day businesses and better serve investors will only serve to harm the very investors the Commission purports to help. Further, with this Proposal, the Commission has effectively determined that the adoption of any new technology will be subject to whatever regulatory conditions the Commission determines are appropriate. The Proposal has no checks on the Commission's authority to define technology, stretching the definition past its breaking point. The Commission cannot regulate (or in this case indirectly ban) technological innovation in its pursuit to drastically and unnecessarily change the regulatory infrastructure of our markets. The Commission must respect the limitations to its statutory authority and the substantive and procedural guardrails to its rulemaking authority. If you have any questions, please contact the undersigned.

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