

September 30, 2021

Chairman Gary Gensler
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549
Re: File Number S7-10-21

Dear Chair Gensler,

The growing use of digital engagement practices (DEPs) by broker-dealers and investment advisers offers great promise for investors, accompanied by the need for new investor protections. We applaud the Commission for calling attention to, and seeking input about, the ramifications of DEPs in the published Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches (“Request”).¹

DEP providers benefit from enhanced abilities to attract, engage, and retain customers (especially a younger, tech-savvy clientele) while potentially reducing business costs and increasing the scale, efficiency, reliability, and profitability of services provided. Those advantages to providers produce cost, access, and service quality benefits to consumers as well.

By design, DEPs empower investors to be responsible for their activities and decisions. DEPs are generally disconnected from direct professional assistance and, while DEP users may be tech-savvy, they may also be inexperienced investors with limited capabilities (financial literacy and capacity to take risk and independently make sound financial decisions).

If this is the reality of DEPs, is a reframing of investor protections required? Can we do more to assure that investors are competent to use tools that may pose substantial risks to their immediate and long-term financial well-being? We believe the answer to both questions is yes. Society has long recognized the importance of placing guardrails around activities that require competency to minimize risks to oneself and others. For example, driving a car requires licensure and a demonstration of proficiency and our most impactful medicines are prescribed, filled, and overseen under a framework of medical supervision.

DEPs represent a disruptive technology designed to influence investor behavior. There must be a regulatory framework and business responsibility to place guardrails that limit the risk to investors when they approach the limits of their financial capability. DEPs must be designed to meet regulatory obligations that are consistent with the influence they exert on human behavior and manage the risks to investors associated with the products and services they offer. Moreover, DEP providers should alert investors to potential risks, suggest they seek (or directly provide) human assistance, and prevent further action unless and until the investor acknowledges understanding the risks involved and accepts responsibility for their actions.

In your statement announcing publication of the Request,² you expressed your particular interest in the following two policy questions:

1. “How might we protect investors in light of the potential conflicts of interest that may exist when DEPs’ optimization practices have a statistically significant impact on platform revenues, data collection, or investor behavior?”
2. “To the extent that DEPs’ underlying predictive data analytics use ‘optimization functions’ that, at least in part, optimize on revenues, data collection, or investor engagement – and to the extent that optimization leads to statistically significant changes in investor behavior – how does that affect the determination of whether DEPs are making a recommendation or providing advice?”

As senior executives who have each worked for several decades providing fiduciary education, technology, and support services to advisors,³ we are commenting in direct response to these questions. Our input on these questions is relevant to related, more specific questions in the Request document. We comment briefly in response to questions 1.8, 1.10, 3.11 and 4.16.

In our view, the answer to your second policy question informs the answer to the first. As the second question suggests, DEPs that lead to statistically significant changes in investment behavior are rendering either recommendations or advice. They provoke specific, predictable investor actions orchestrated by the DEP provider. Direction of the investor’s behavior is precipitated by the decision architecture of the DEP.

Regulatory issues associated with DEPs are addressed in Section III of the Request. In describing the standard of conduct required for broker-dealers (page 31), the Request states: “Regulation Best Interest (Reg BI) requires broker-dealers that make recommendations of securities transactions or investment strategies involving securities (including account recommendations) to retail customers to act in their best interest, and not place the broker-dealer’s interests ahead of the retail customer’s interest.

Request Section III, C, 2, Existing Investment Advisor Obligations states: “The Investment Advisers Act of 1940 (“Advisers Act”) establishes a federal fiduciary duty for investment advisers, whether or not registered with the Commission, which is made enforceable by the anti-fraud provisions of the Advisers Act.” Footnote 61, page 39 explains that “... to the extent that an adviser provides investment advice to a client through or in connection with a DEP, then all such investment advice must be consistent with the adviser’s fiduciary duty.”

The distinction between advice provided with fiduciary accountability versus a recommendation subject to Reg BI is significant. However, under either standard, the investment adviser or broker-dealer would not be permitted to place their own interests ahead of the client or customer. Consequently, in response to your first question, the notion of “optimization” on revenues, data collection, or investor engagement seems incompatible with both standards. The client’s or customer’s interests must be “optimized”, not subordinated to benefits to the investment advisor or broker-dealer.

Reg BI entails four obligations: Disclosure, Care, Conflicts of Interest, and Compliance. Fiduciary obligations are the highest known to law, requiring the highest degree of devotion to the beneficiary (i.e., the client or person(s) to whom fiduciary obligations are due). Fiduciary duties include disclosure, care, conflicts of interest, and compliance obligations that meet or exceed those of Reg BI.

For ease of discussion, we treat the obligations of Reg BI as minimum regulatory requirements for DEPs that statistically impact customer or client behavior. However, we note that full fiduciary accountability flows from advisory relationships, elevating the responsibilities of parties dispensing advice, including DEP providers.

At the highest level, responsible delivery of recommendations or advice require the provider to acquire, consider, and act upon information that is material to the wants, needs, and capabilities of the recipient customer or client. This “know thy customer/client” imperative is specific to the customer/client and the financial objective to be achieved or the need to be addressed. The more complex and atypical the relevant information is, the broader and more specialized the solution set becomes.

DEPs that provide narrow or rudimentary courses of action may be suitable for a homogenous clientele with a common set of wants and needs. Similarly, if the product and service set offered entails low risk, commonly understood solutions, and appropriately thorough disclosures, the required financial capability (financial literacy, capacity, and experience) may be relatively low. These DEPs may also be able to provide reasonable solutions that rely upon digital help functions rather than human customer support.

However, as the complexity and heterogeneity of wants, needs, and capabilities of the clientele rises, the sophistication and artificial intelligence and machine learning (AI/ML) of the DEPs must increase dramatically. Commensurately, the internal oversight and regulatory guardrails required to assure that customer/client best interests are served must also increase.

Question 1.8 asks, in part: “Are firms seeking to use DEPs specifically to increase investor education?”

While we are strong advocates of investor education, it is important to note that general efforts to increase financial literacy have not proven to be particularly effective. Knowledge that is acquired through broad financial education programs for the investing public tends to decay. However, “just-in-time” education on a financial subject of immediate concern to the individual seems to be much more effective, probably because the learner is motivated and the subject matter can be immediately applied.^{4,5}

We believe it would be useful for DEP providers to provide targeted investor education resources (either directly or through relationships with third-party providers) on topics relevant to the products and services they include on their platform and to which their customer/clients

are directed. Mastery of content pertaining to complex or higher risk products and services may be a prerequisite for access.

Question 1.10 asks, in part, “Do firms that utilize DEPs offer live, phone-based customer support or customer support through live, human-directed online support (i.e., online conversations that are not through an automated chatbot)? Does the availability of this type of support depend on the type of account or investments held (e.g., investors holding riskier products) or on account balances or asset thresholds?”

As we addressed above, as the complexity and risks of products and services provided by firms that utilize DEPs increase, so too does the need for more sophisticated and accessible customer support, including the ability to access live, human-directed online support or direct human interaction. Customer/client best interests are not served if decisions are required or actions are to be taken without customer/clients having access to well-trained support personnel and the ability to opt out of outcomes orchestrated by the decision-architecture of DEPs.

Question 3.11 asks “How do firms using DEPs obtain sufficient retail investor information and provide sufficient oversight to satisfy their regulatory obligations, including, for example, applicable anti-fraud provisions and account opening or approval requirements?”

The compliance obligation of Reg BI “requires the broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI.” (Request footnote 35, page 32) The compliance obligation requires fulfillment of the other Reg BI obligations: disclosure, care, and conflict of interest. Thus, policies and procedures are necessarily required to assure that material information is disclosed, that the broker-dealer exercises reasonable diligence, care, and skill in making recommendations, and that the broker-dealer addresses conflicts of interest associated with recommendations rendered.

The fiduciary responsibilities of investment advisers require procedural prudence – applying generally accepted investment theories and practices designed to fulfil the fundamental fiduciary duties of loyalty and care. The “trustee/trustor” nature of the advisor client relationship requires adherence to heightened obligations of care, disclosure, avoidance or mitigation of conflicts, and compliance with laws, regulations, governing documents, and professional standards.

Written policies and procedures should be thorough, specific to products and services provided, and consistent with applicable regulatory requirements. They must be regularly reviewed to keep them up to date and formally monitored to ensure they are followed in practice.

Machine-level monitoring of business outcomes of the DEP should also verify alignment to the provider’s best interest or fiduciary obligations to customers/clients. Moreover, internal audits or third-party reviews can and should be periodically conducted to assess conformity to regulatory obligations and efficacy in serving the best interests of customers/clients.

Question 4.16 asks, in part, “In what ways do investment advisers assess whether using these types of technology to develop and provide investment advice enables them to satisfy their fiduciary duty to their clients? How do investment advisers assess their ability to satisfy their duty of care and duty of loyalty when using these types of technology? How does an investment adviser determine whether the advice produced by its automated algorithm is in the best interest of a particular client?”

Our comments in response to question 3.11 focus upon demonstrating conformity to Reg BI and Advisers Act regulatory obligations to serve the best interests of customers or clients. However, we believe this question, relating to how an investment adviser determines if an algorithm is in the best interest of a particular client, transcends investment regulations. Specifically, the financial best interests of clients should be evaluated in a financial planning context.

In addition to investments, clients must devote time, attention, and resources to a full range of issues with financial implications: budgeting, debt management, risk management (e.g., insurance needs), college funding, saving for retirement and assuring lifetime income, estate planning, etc. Investment advice rendered without careful consideration of other financial planning priorities is not in a client’s best interest.

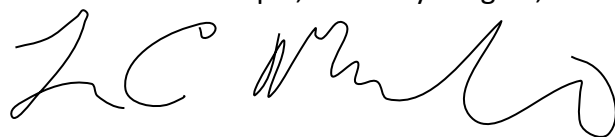
We urge the SEC to consider expanding the context of a client’s “best interest” by taking a more holistic view of financial goals and priorities. In our view, a “scorecard” approach to assess financial priorities and progress is needed as part of the process of gathering material client information.

That does not mean that every financial services firm should be prepared to provide holistic financial planning advice. It does mean that there should be a process for gathering information about overall financial capacity by considering other aspects of a client’s financial wellness. Firms utilizing DEPs should disclose the importance of considering financial priorities beyond their own services and (ideally) provide access to education to promote awareness of other needs that may require attention.

Sincerely,



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Founder and Principal, Fiduciary Insights,



Frank C. Mindicino, CFP®, APMA®
Founder and Managing Partner, Practice Growth Partners

Notes

1 SEC Release Nos. 34-92766; IA-5833; File No. S7-10-21 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

<https://www.sec.gov/rules/other/2021/34-92766.pdf>

2 Statement on Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches, Chair Gary Gensler, August 27, 2021 <https://www.sec.gov/news/public-statement/gensler-dep-request-comment>

3 Brief biographical summaries for Blaine Aikin and Frank Mindicino are provided below.

4 See Financial Literacy, Financial Education and Downstream Financial Behaviors by Daniel Fernandes, John G. Lynch, Jr., and Richard G. Netemeyer. January 6, 2014

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333898

5 See also PISA 2021 Financial Literacy Analytical and Assessment Framework, April 2019

<https://www.oecd.org/pisa/sitedocument/PISA-2021-Financial-Literacy-Framework.pdf>

Brief biographical Information about the authors

Blaine F. Aikin, AIFA[®], CFA, CFP[®]

Fiduciary Subject Matter Expert, Fi360, Inc.

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Blaine Aikin is the Founder and Principal of Fiduciary Insights, an independent provider of fiduciary subject matter expertise for organizations that employ or provide services to investment advisors.

During the 15 years prior to founding Fiduciary Insights in 2019, Blaine served in the executive leadership of Fi360, Inc. He progressed from Chief Knowledge Officer to CEO in 2007, became Executive Chairman of Fi360 and CEFEX in 2016, and continues to serve as fiduciary subject matter expert for Fi360.

He served as a Director of the CFP Board of Standards from 2013 through 2016 and Chair of CFP Board in 2017. Additionally, from 2018 through 2020, he chaired CFP Board's Standards Resources Commission that is tasked with providing guidance on the Boards Code and Standards to CFP[®] professionals. In 2021, he was appointed to the Professional Standards Committee of the international Financial Planning Standards Board (FPSB).

Blaine is a public speaker and author of numerous articles on fiduciary responsibility and investment management. He has been named to Investment Advisor magazine's IA25 list of the most influential people in the investment advisory community and one of the ten most influential individuals in the 401(k) industry by RIABiz.

Blaine holds a bachelor's degree in economics and political science from Allegheny College and Master of Public Management and Policy from the Heinz School of Carnegie-Mellon University. He is a Certified Financial Planner[®] (CFP[®]) professional, Chartered Financial Analyst (CFA) charterholder, and Accredited Investment Fiduciary Analyst[®] (AIFA[®]) Designee.

Frank C. Mindicino, CFP®, APMA®

Enterprise Financial Services Subject Matter Expert.
Founder and Managing Partner of Practice Growth Partners.
Complex Team Franchise Consultant for Ameriprise Franchise owners.

Frank C. Mindicino founded Practice Growth Partners in 2007. It is one of the only firms in the industry that specializes in helping independent financial services professionals evolve from a sole practitioner to an Enterprise business. The Enterprise model provides clients an integrated care model that is rooted in the Fiduciary Duty of Care responsibilities because clients require a team of specialists to deliver the care they need in today's complex financial services world.

Exams passed, series 6, 7, 9, 10, 22, 24, 63, SIE.

Frank's 40-year professional experiences include compliance services, integration of the financial services industry firms including accounting, banking, financial planning and wealth management, guest speaker and panelists for industry related events, leadership services for teams identified in Barron's 2021 top 100 independent advisors.

Frank holds a bachelor's degree in Music Education from the Dana School of Music affiliated with Youngstown State University. He is a Certified Financial Planner® (CFP®) professional, Accredited Portfolio Management Advisor (APMA®) Designee.