Betterment

October 9, 2023

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Via Electronic Filing

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (File Number S7-12-23)

Dear Ms. Countryman,

Betterment LLC ("Betterment") appreciates the opportunity to respond to the Securities and Exchange Commission ("Commission") proposed regulation, *Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, File Number S7-12-23 (the "Proposed Rule").

This rulemaking addresses two of the more powerful forces that shape investor outcomes: (1) conflicts of interest, and (2) technological innovation. While we share many of the Proposed Rule's concerns about industry conflicts–and have long been vocal on this issue–we disagree with the Proposed Rule's broad mistrust of technology. We have seen firsthand the positive impact of technology in expanding investor access, improving outcomes, and driving down costs. In this comment, we hope to call the Commission's attention to positive uses of technology, so that they are not lumped in with conflicted practices. We fear that the Proposed Rule paints with such a broad brush that it would roll back decades of progress and severely harm retail investors.

To summarize our concerns:

1. The definitions of "covered technology" and "investor interactions" are extremely broad, capturing many processes and interactions that unquestionably benefit investors;

2. The scope of conflict of interest is also overbroad and would include circumstances where the relevant "conflict" is a firm's financial interest in growing an investor's portfolio; and

3. The compliance burden of addressing such "conflicts" for every covered technology–including the requirement to "mitigate or neutralize" the conflict–would be so great as to deter the use of technology altogether, which would negatively impact investors.

I. Background

Betterment was launched in 2010 and pioneered the use of technology to provide investment advisory services primarily over the internet. This service model lowered costs and expanded access to sophisticated advisory services that were previously only available to affluent investors. Betterment's offering is focused on long-term goals and building wealth. We use technology to create engaging and clear digital experiences that help clients identify savings goals (such as retirement or education), select managed portfolios, and track their progress towards those goals. We also use technology to provide automated rebalancing and tax management strategies. Our portfolios are composed primarily of globally diversified, low-fee exchange-traded funds ("ETFs"). We serve individual investors (including through partnerships with third-party advisers), as well as employer-sponsored retirement plans through our Betterment at Work platform. As of August 30, 2023, Betterment managed over $40 billion on behalf of over 800,000 clients, with a median age of around 40.

A. Our Advisory Model

Our business is designed to be fundamentally aligned with our clients' interests. Betterment clients pay a level fee for the advisory services that we provide, which is typically 0.25% of assets under management, or $4 per month. Our straightforward fee structure is easy for clients to understand. Our compensation does not vary based on the particular securities we recommend, such that our portfolio construction is unconflicted, unlike firms that recommend proprietary products or otherwise receive revenue from particular fund providers. Additionally, because we are not compensated based on our clients' trading volumes, we have no incentive to engage in frequent trading or to encourage our clients to do so. We believe that our fee structure fundamentally aligns Betterment's interests with our clients: our fees grow when our clients' portfolios grow.

Betterment agrees with some of the concerns regarding conflicts that were articulated in the Proposed Rule. We believe that there are too many conflicts in the investment industry and that these conflicts can negatively impact investor outcomes. Accordingly, we have actively engaged in prior rulemaking initatives to improve conflicts disclosure, in particular supporting the Commission's efforts to improve investor disclosure through Regulation Best Interest ("Reg. BI") and Form CRS Relationship Summary. For example, we advocated that the Commission revise Form CRS to more clearly distinguish between firms with financial incentives to recommend particular investments, and firms, like Betterment, that do not.[1] We suggested that the Commission add a new section to Form CRS titled "Alignment of Interests" that would more clearly highlight when firms have financial incentives to recommend particular products. We have also publicly advocated for clients' interests with other regulators, including in connection with the Department of Labor's 2016 fiduciary rule.[2]

We do not, however, agree with the definition of "conflict" that is articulated in the Proposed Rule. It is so broad as to capture any use of technology to grow an investor's portfolio if a firm stands to earn additional revenue as a result. Even a visually pleasing user interface that results in a satisfied client deciding to deposit additional funds could be swept up by the Proposed Rule.[3] We do not believe that the firm's interest in these scenarios should be classified as a conflict akin to circumstances where a firm and an investor are truly at odds.

We are also concerned that the Proposed Rule lacks clarity for firms who seek to comply with its requirements. The Proposed Rule provides a vague standard for firms to quantify the relative benefits of a covered technology to determine whether it places the interests of the firm "ahead" of investors.[4] And, even if firms conduct a good faith analysis and conclude the advice or service continues to be in the best interests of clients, firms can be subject to regulatory scrutiny and second-guessing–deterring the beneficial use of technology altogether.

---

[1] Jon Stein, Benjamin T. Alden, Seth Rosenbloom, "Betterment Comment Letter Re: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation; Regulation Best Interest; and Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles" (August 7, 2018) at 4-5, *available at* https://www.sec.gov/comments/s7-09-18/s70918-4185842-172707.pdf. Betterment also provided the Commission with the results of its own investor testing on Form CRS to demonstrate that Betterment's proposed changes to Form CRS improved the form's overall effectiveness.

[2] Krysia Lenzo, "Fiduciary Rule Is Good For Investors: Betterment CEO" (April 6, 2016), *available at* https://www.cnbc.com/2016/04/06/fiduciary-rule-is-good-for-investors-betterment-ceo.html.

[3] Proposed Rule, § 240.15l-2(b)(3) requires firms "eliminate, or neutralize the effect of, any conflict of interest (other than conflicts of interest that exist solely because the broker or dealer seeks to open a new investor account)." The Proposed Rule treats any potential incremental revenue, other than account opening, as a conflict, even in circumstances where investors benefit. See "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers," SEC Release No. 34-97990 (July 26, 2023) at 231, *available at* https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf.

[4] Proposed Rule, § 240.15l-2(b)(1) requires firms "evaluate any use or reasonably foreseeable potential use of a covered technology…in any investor interaction…prior to its implementation or material modification, and periodically thereafter." See. id. at 230.

B. Our Approach to Technology

The Proposed Rule will seriously jeopardize our ability to effectively serve clients. At Betterment, technology plays a significant role in creating the operational efficiencies that allow us to provide advanced advisory services to retail investors at a low cost. Without automation, it is not economical for advisers like Betterment to serve lower balance retail investors, and offerings that serve this population will simply cease to exist. Almost any use of technology would be covered by the Proposed Rule's burdensome and unworkable compliance requirements, effectively chilling all uses of technology, including beneficial uses.

It is our hope that the Commission will consider the many ways in which we currently use technology to advance our clients' interests. All of the technologies described below are included in the bundle of services provided to Bettement clients, with no additional costs. The Proposed Rule endangers these services.

1. Discretionary Management Technologies

Betterment uses technology to optimize portfolio construction and management in ways that benefit clients. Even though these uses of technology do not involve a specific investor interaction, and are thus far removed from the specific practices that are the focus of the Proposed Rule, they would fall within its scope because these technologies are "analytical models and processes that optimize for investment-related behaviors or outcomes"[5] that are presented in various investor interactions where Betterment is "exercising discretion with respect to investors accounts"[6], and involve a potential conflict of interest because Betterment and its affiliates also benefit from the growth of investor assets (in the form of higher asset-based fees on such assets).

- Portfolio construction: Betterment employs technology to construct and manage its globally diversified investing portfolios. We select asset classes and optimize allocations that seek to maximize expected returns and minimize expected risk, which requires a complex set of calculations. We also run Monte Carlo simulations to test our portfolio

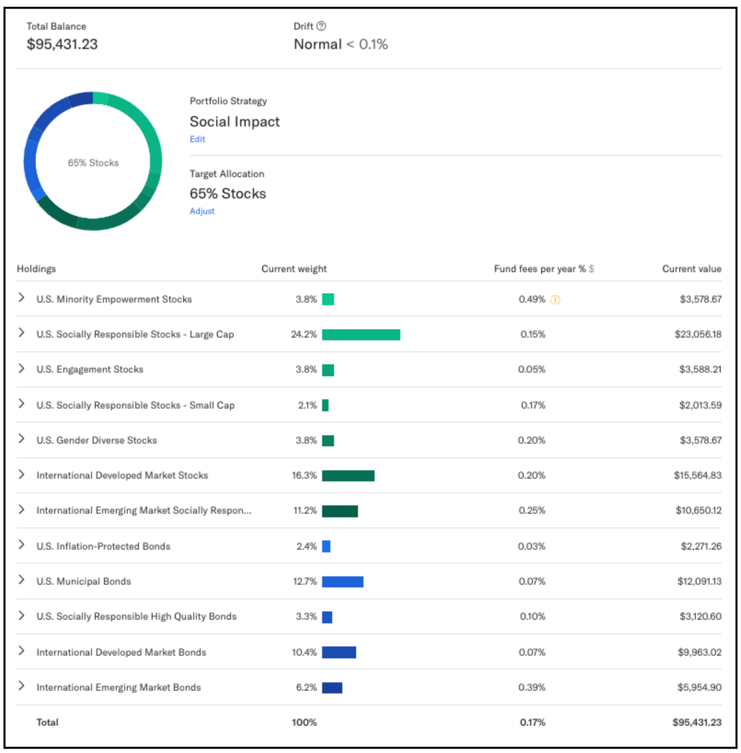
---

[5] Proposed Rule, § 240.15l-2(a) defines "covered technology" as "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 id. at 230.

[6] Proposed Rule, § 240.15l-2(a) defines any "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; except that the term does not apply to interactions solely for purposes of meeting legal or regulatory obligations or providing clerical, ministerial, or general administrative support." **(emphasis added)** See id. at 230.

strategies under various market scenarios.[7] Our sophisticated method of portfolio construction is only possible because of technology.

- Asset Selection: We build our investing portfolios primarily with low-cost ETFs designed to provide exposure to a diversified set of global assets. Betterment turns to technology to help inform selection of ETFs from the broad range of available options. The total annual cost of ownership ("TACO") is Betterment's scoring method used to rate funds for inclusion in Betterment portfolios, which balances the annual expense of a security (expense ratio) with its transactional cost (bid-ask spread).[8] Betterment uses technology to compute TACO for each asset it considers for one of its portfolio strategies. This quantitative asset selection methodology is only possible because of technology, and we believe that the use of technology provides important standardization and avoids subjective biases.



Holdings	Current weight	Fund fees per year % $	Current value
U.S. Minority Empowerment Stocks	3.8%	0.49%	$3,578.67
U.S. Socially Responsible Stocks - Large Cap	24.2%	0.15%	$23,056.18
U.S. Engagement Stocks	3.8%	0.05%	$3,588.21
U.S. Socially Responsible Stocks - Small Cap	2.1%	0.17%	$2,013.59
U.S. Gender Diverse Stocks	3.8%	0.20%	$3,578.67
International Developed Market Stocks	16.3%	0.20%	$15,564.83
International Emerging Market Socially Respon...	11.2%	0.25%	$10,650.12
U.S. Inflation-Protected Bonds	2.4%	0.03%	$2,271.26
U.S. Municipal Bonds	12.7%	0.07%	$12,091.13
U.S. Socially Responsible High Quality Bonds	3.3%	0.10%	$3,120.60
International Developed Market Bonds	10.4%	0.07%	$9,963.02
International Emerging Market Bonds	6.2%	0.39%	$5,954.90
Total	100%	0.17%	$95,431.23

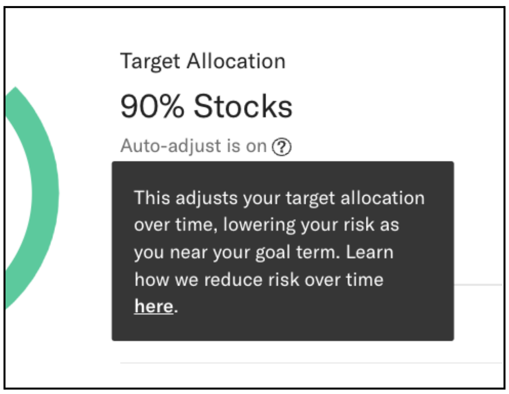
- Portfolio Management: We also use technology to provide ongoing management of client investment portfolios. In particular, our technology works to manage investors' risk in a variety of ways, including auto-adjust, rebalancing, and dividend reinvestment.

---

[7] "The Betterment Portfolio Strategy" (October 19, 2022), *available at* https://www.betterment.com/resources/betterment-portfolio-strategy.

[8] "ETF Selection For Portfolio Construction" (October 13, 2022), *available at* https://www.betterment.com/resources/etf-portfolio-selection-methodology.

Auto-adjust is a feature Betterment offers investors that, if enabled, will automatically modify client allocations towards more conservative levels as clients approach their goal time horizon. In general, the longer an investing goal's time horizon, the more aggressive our initial recommended allocation (characterized by a greater proportion of stocks as compared to bonds). As time progresses, we use automation to automatically adjust clients' portfolios to more conservative allocations (characterized by a greater proportion of bonds as compared to stocks). We also use automation to make those adjustments as tax efficiently as possible, using cash-flows, deposits, withdrawals, and dividends to guide a client's portfolio toward the target allocation, without having to sell any assets. This technology helps investors reduce risk and increase the long-term expected returns of their account.[9]



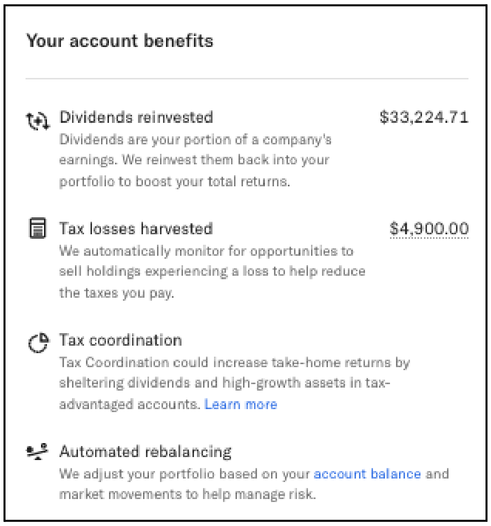
We offer automatic portfolio rebalancing for all investing portfolios. Over time, assets in a portfolio will move up and down in value, causing the portfolio to drift away from the target allocation weights that achieve optimal diversification (described above in portfolio construction). Our technology automatically monitors client accounts for portfolio drift and looks for opportunities to reduce drift (i.e., rebalancing). For example, our technology will use a new deposit or dividend reinvestment to purchase asset classes that are underweight, reducing the need to sell securities, which also reduces capital gains taxes.[10]

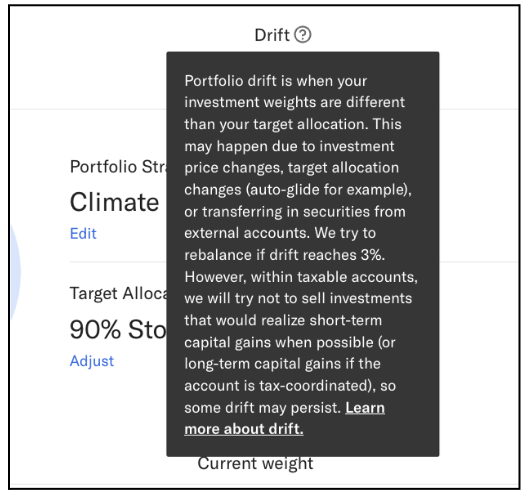
We also use technology to automatically reinvest dividends earned in client portfolios, which increases the potential for compounding returns. Auto-adjust, rebalancing, and dividend reinvestment are each designed to reduce risk and increase clients' long-term investment returns, thereby growing client assets invested with Betterment. The Proposed Rule jeopardizes these services by considering any incremental revenue earned on growing assets as a conflict. Automated technology allows Betterment to provide these beneficial strategies to investors and should not be discouraged.

---

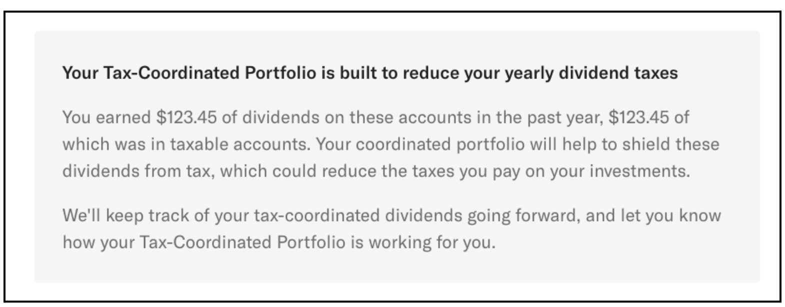
[9] "Auto-Adjust Disclosure" (September 7, 2023), *available at* https://www.betterment.com/legal/auto-adjust-disclosure.

[10] "How Betterment Manages Risk In Your Portfolio" (September 9, 2022), *available at* https://www.betterment.com/resources/how-betterment-manages-risk.

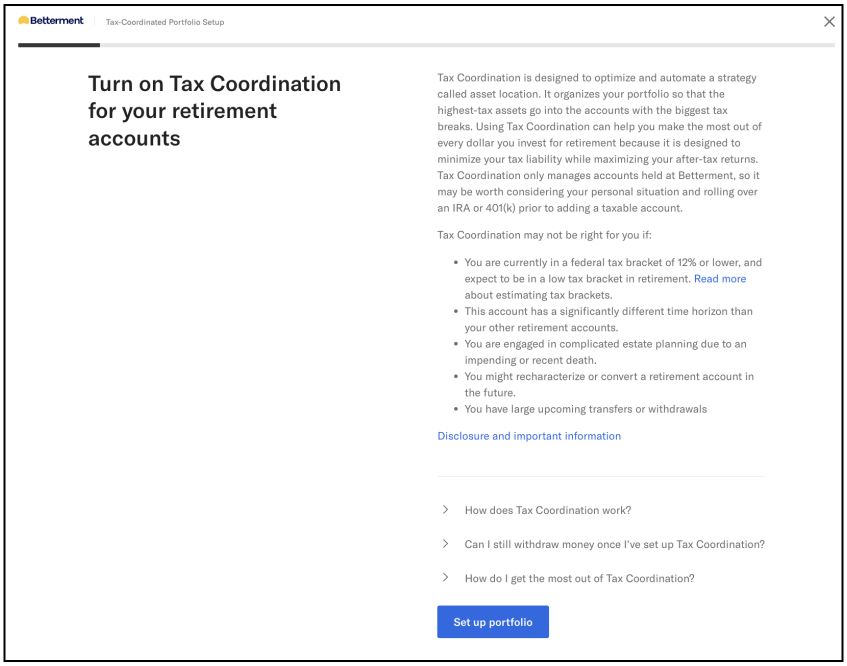




- Tax Coordinated Portfolios: Betterment also offers tax coordination to clients saving for retirement. Tax coordination is an asset location service that helps those who have more than one account type (tax-deferred, tax-exempt, or taxable) to optimize their after-tax returns by strategically holding investments in each account type.[11] Sophisticated tax management strategies like tax coordination would not be possible without technology.



[11] "How Our Tax Coordination Feature Can Boost Your Returns" (October 20, 2022), *available at* https://www.betterment.com/resources/tax-coordination.

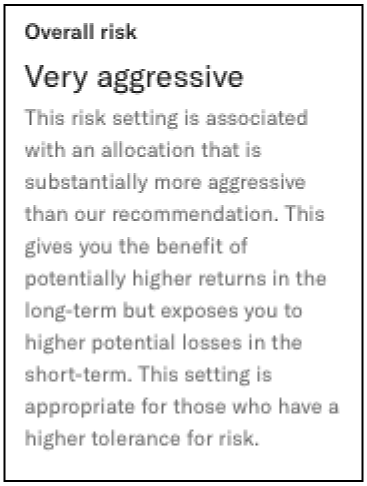


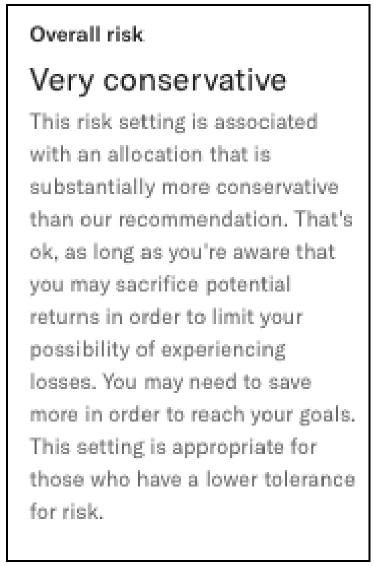
2. Client Communication Technologies

Technology also allows Betterment to engage and communicate with investors in a variety of positive ways. These include interactive experiences that surface key information to clients at the most relevant time and otherwise encourage positive, long-term investing. To the extent that Bettermente might receive incremental revenue as a result–whether as the result of a particular client decision to save more for retirement or even greater affinity for our services–these experiences could be swept within the broad scope of the Proposed Rule. As a result, these beneficial technologies would be imperiled by the Proposed Rule. For example:

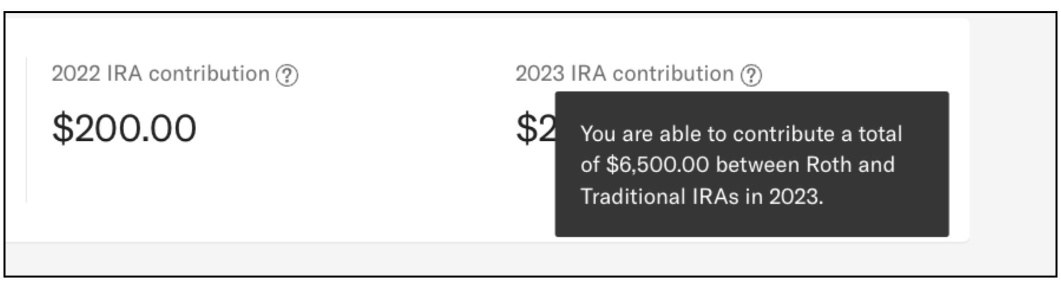
- Risk Notifications: When clients open an investing goal and select a portfolio strategy, Betterment recommends an allocation that is based on the goal type and the time horizon.[12] Clients can follow the recommendation or modify the allocation to be more aggressive or conservative. When a client makes modifications, Betterment's interface provides warnings to the client if their allocation is too risky or too conservative relative to their stated goal or time horizon. These risk notifications nudge investors to review their investment choices and consider making changes.

[12] For example, Emergency Fund goals generally have a more conservative allocation recommendation than Retirement goals with a long time horizon, which generally start with a more aggressive recommendation and adjust to a more conservative recommendation as the client's retirement age approaches. See "Betterment's Recommended Allocation Methodology" (October 25, 2022), *available at* https://www.betterment.com/resources/recommended-allocation-methodology.





- Tool-tips: Tool-tips are another way that Betterment employs technology to surface relevant information to clients in an efficient and engaging manner. A tool-tip is an interactive information call-out in our client account interface. Tool-tips put investment information in locations where it is relevant and proximate for investors. These features help increase investor understanding and can also play a role in providing layered disclosure about a particular investment product or service.[13] In some instances, tooltips may result in investors making additional deposits (such as a reminder of the relevant contribution limits for an IRA) or otherwise modifying their behavior in ways that improve their investment outcomes.



- Tax Impact Preview: Betterment displays a tax impact preview to investors before they confirm an account withdrawal or allocation adjustment. This feature shows investors the

---

[13] The Commission recognized the benefits of tool-tips in its 2017 Investment Management Guidance on Robo-Advisers ("2017 Guidance"). In the 2017 Guidance, the Division took a thoughtful and principled approach to investment advisers' use of technology and left room for advisers to develop future innovations that serve the best interest of clients. See "Investment Management Guidance Update on Robo-Advisers" (Feb. 2017), *available at* https://www.sec.gov/investment/im-guidance-2017-02.pdf.

potential taxes and costs associated with their action. Our research on tax impact preview, as published in an academic paper, demonstrated that tax reminders can reduce user bias towards excessive trading (an established investor bias that is correlated with statistically significant lower returns compared to the overall market).[14] The data showed that investors presented with a tax impact preview before finalizing allocation changes (i.e. buying and selling stock and bond securities in their portfolios) were more likely to reduce short-term trading behavior, thereby benefiting their long-term investment outcomes.[15]

[14] Abigail Sussman, Daniel Egan, and Sam Swift (2018) ,"Increasing Tax Salience Alters Investment Behavior", in NA - Advances in Consumer Research Volume 46, eds. Andrew Gershoff, Robert Kozinets, and Tiffany White, Duluth, MN : Association for Consumer Research, at 26-27, *available at* https://www.acrwebsite.org/volumes/2412356.

[15] The allocation change treatment group made 14.5% fewer allocation changes as compared to the control group. See id. at 26-27.

Betterment

Estimated Tax Impact

Selling shares, which can be triggered by a withdrawal, transfer, or allocation change, may be a taxable event. Betterment always tries to lower the tax impact of any transaction by prioritizing shares with lower tax costs.

Things to consider

If you're making an allocation change or transferring money to another goal, we may have to sell shares to reach your new risk level.

If you're making changes due to market concerns, consider a more conservative allocation or a Betterment Cash Reserve account.

If you're withdrawing this money for its intended use, carry on.

Detailed breakdown

Net long-term gain or (loss) ⓘ	($100.00)
Long-term gain	$100.00
Long-term loss	($100.00)
Washed loss ⓘ	($100.00)
Permanently washed loss	($100.00)
Net short-term gain or (loss) ⓘ	$100.00
Short-term gain	$100.00
Short-term loss	($100.00)
Washed loss ⓘ	($100.00)
Permanently washed loss	($100.00)
Estimated tax impact	$300.00

Your pending transactions may significantly impact this number.

Estimated tax for this transaction only, based on estimated gains and losses and assuming the highest tax rates of 37% federal tax for short-term capital gains, 20% federal tax for long-term capital gains, 13.3% state capital gains tax, and 3.8% medicare surtax.

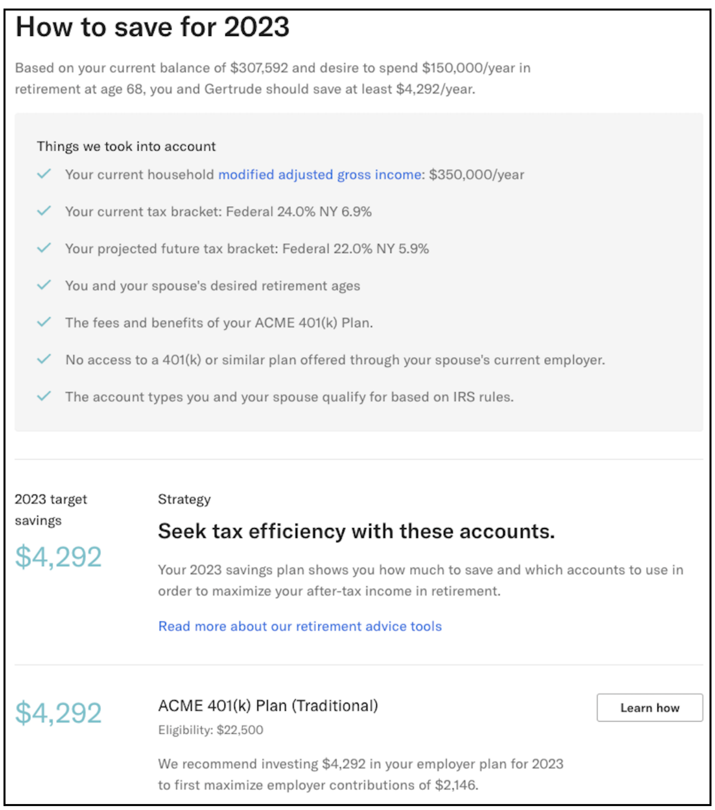
Actual tax results are likely to be different depending on specific circumstances, including, but not limited to, the marginal tax rate applicable to you, any subsequent trading activity, the presence of other capital gains or losses for the year, and securities prices at the moment you execute the trade. Furthermore, transactions made at brokerages other than Betterment cannot be taken into account, and could affect these estimates. This is not tax advice.

- Savings Advice: Betterment clients are able to receive tailored savings advice and track their progress towards their identified savings and investing goals in the client application through the use of Betterment's "goal forecaster" and "how to save" modules.

Goal forecaster shows investors their progress towards a particular financial goal and whether the goal is "on-track" or "off-track." The tool incorporates the investor's actual performance to date, balance, goal time horizon, expected deposits, and asset allocation. Goal forecaster also includes customizable inputs that allow investors to visualize the impact of scheduling recurring or one-time deposits, edit their planned contributions (with respect to retirement accounts), or edit their goal time horizon.

How to save advice takes into account the investor's household gross income, tax bracket, current age and desired retirement age, account type and fees, and recommends how a client can maximize their retirement savings in any given year, for example, by taking advantage of a 401(k) match or Roth IRA eligibility (among other things).

This individualized advice is enabled by the use of technology. Rather than spending time and money to call a human investment adviser over the phone, clients can use "how to save" and "goal forecaster"' as on-demand financial check-ins.



These examples demonstrate that technology can be used to more effectively advise, engage, and serve clients. Yet the breadth of the Proposed Rule threatens our ability to make these services available to investors. Each use of technology contributes to client satisfaction or growth in client assets, both of which are beneficial to Betterment's revenues. The Proposed Rule treats this as a conflict and would thus subject the underlying technology to a host of vague and burdensome requirements. This approach would deter beneficial uses of technology and thereby harm investors and reduce choice, contrary to the Commission's mission of expanding access to capital markets and facilitating wealth creation.

II. Recommendations

We believe that investors are best served by a technology-neutral regulatory approach, rather than one that views technology as inherently problematic. We respectfully submit that our own business amply demonstrates that technology can be used to better and more cost-effectively serve investors. Although the emergence of artificial intelligence and similar technologies will undoubtedly be transformative, the Commission should not introduce new regulations unless they are narrowly scoped to an identified gap in the existing regulatory framework. Absent such a gap, a principles-based, technology-neutral approach will better serve the investing public and allow beneficial innovation to flourish.

While we understand the Commission is looking to limit harmful "gamification" of investing, not all technology contributes to or causes such gamification.[16] As the Commission has recognized in the past, technological innovation has improved financial markets, fostered competition, lowered costs, and improved services. Indeed, although the Proposed Rule threatens to roll back such progress, it also acknowledges that "the advent and growth of services available on certain digital platforms, such as those offered by online brokerages and robo-advisers, have multiplied the opportunities for retail investors, in particular, to invest and trade in securities, and in small amounts through fraction shares."[17]

This access has played a key factor in increased retail investor participation in U.S. markets in recent years. In a recent speech, Commissioner Uyeda noted "from stock ticker machines, to the introduction of the fax machine in 1964, to the computerization of order flow and introduction of electronic communications networks in the early 1970s - innovation has been at the forefront and

---

[16] Some uses of technology that are arguably gamification, such as virtual confetti or badges, can also be used to reward good investor behaviors and counter frequent trading. For example, a client might receive such recognition after completing a financial profile update or opening a new retirement account.

[17] "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers," SEC Release No. 34-97990 (July 26, 2023) at 15, available at https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf.

the U.S. financial markets have benefited from these technological advances."[18] Technology has contributed to the strength of the U.S. economy and promoted wealth creation for millions of Americans. The U.S. financial technology ("fintech") market size was estimated at $4 trillion in 2022, and is expected to continue to grow.[19] One of the primary drivers of this growth is the increasing consumer demand for convenient and user-friendly digital financial services. Investors want to receive investment advice in a digital format–on their own schedule, with lower costs, and increased transparency. Future innovations hold promise to drive further investor access and choice, as well as lower costs.[20]

Indeed, in other contexts the Commission has specifically recognized that technology can improve investor outcomes or more effectively communicate complex information. For example, Rule 206(4)-1 of the Investment Advisers Act of 1940 (the new "Marketing Rule") specifically excluded interactive analysis tools from its prohibition on hypothetical performance displays. In that context, the Commission recognized that technological tools with customizable user inputs could be an effective means for investors to evaluate the potential risks and returns of an investment.[21] The Commission noted that interactive performance displays were less likely to be misleading than other presentations of performance because clients could modify the inputs and customize them to their situation. Such tools could nonetheless be swept within the overbroad scope of the Proposed Rule.

III. Conclusion

The Proposed Rule is unduly broad, overly burdensome, and would undoubtedly roll back investor-friendly innovation. Betterment believes that investors would be better served if the Commission retains a principles-based and technology-neutral approach. To that end, Betterment encourages the Commission to work with firms to understand new technologies and their use. Technological innovation has been at the forefront of U.S. markets and retail investors have

[18] Mark T. Uyeda, "Remarks to the 2023 NASAA Fall Annual Meeting – Modernizing Investor Protection for the Digital Age" (Sept. 10, 2023), *available at* https://www.sec.gov/news/speech/uyeda-remarks-nasaa-091023.

[19] Mordor Intelligence, Industry Reports, "United States Fintech Market 2022-2028" (2022), *available at* https://www.mordorintelligence.com/industry-reports/us-fintech-market/market-size.

[20] Technology, if deployed appropriately, could even be leveraged to to mitigate some of the issues identified by the Proposed Rule, such as frequent trading prompted by broker-dealer's financial incentives. For example, tools like Betterment's tax impact preview could be used to surface investors with the negative consequences of trading so that investors can better appreciate the impact of their decisions.

[21] Final Rule: Investment Adviser Marketing, Release No. IA-5653 (Dec. 22, 2020) at 214-215, *available at* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf.

benefited from these advances. Betterment is committed to the responsible use of technology to better serve investors.

Sincerely,

Seth Rosenbloom General Counsel	Joshua Rubin Vice President, Legal	Megan Fitzgerald Director, Legal