October 10, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (88 Fed. Reg. 53960; File No. S7-12-23)

Dear Ms. Countryman,

The American Securities Association (ASA)[1] submits these comments in response to the July 2023 proposed rulemaking from the Securities and Exchange Commission (SEC or Commission) regarding the use of "predictive data analytics" by broker-dealers and investment advisers (Proposal).

We previously submitted testimony to the U.S. House Committee on Financial Services calling on the SEC to apply the current customer protection rules, including Regulation Best Interest (Reg BI), to algorithms that simulate human interactions with customers and lead to the purchase or sale of security.[2] Unfortunately, this Proposal does not do that. As a result, the ASA calls on the SEC to end any further consideration of the Proposal.

The scope of the Proposal and the activities of regulated entities it would cover is breathtaking and at complete odds with current SEC regulation. In fact, the Proposal reads more like a concept release in which a regulator surveys the industry to learn more about a topic and to better inform itself as to any unintended consequences.

The SEC lacks the depth of expertise in the evolving area of artificial intelligence (AI) and should not be crafting an overarching proposal like this. Further, the ASA is concerned the SEC is relying on the views of special interest groups and activist state regulators to inform this rulemaking effort and has not even attempted to fully understand how the industry operates, let alone how the industry uses the technology the agency seeks to "neutralize or eliminate".

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

[2] https://d1d329da-dbb0-4cc9-b461-d7bd4ad09b4e.usrfiles.com/ugd/d1d329_3f2f86ce78804cb7b6feb79104d17412.pdf

The ASA does not believe the Proposal has many redeemable qualities and, contrary to an informed proposal, cannot be amended to make it workable and effective for financial firms without harming those same firms and their clients. Adopting this Proposal or any derivation of it would harm millions of investors because it prevents broker-dealers and investment advisers from providing investment advice or even basic educational materials to their clients.

The Proposal should be abandoned in its entirety and reproposed with a clear description of the problem it is seeking to fix, an educated explanation of the policy goals the SEC seeks to achieve, and demonstrable evidence of the harm it seeks to mitigate. Policymaking by groupthink is not enough.

Our views on the Proposal and its implications are discussed in further detail below.

I. The Proposal Guts the Regulation Best Interest Standard of Care and Unlawfully Imposes a Fiduciary Standard.

In June 2019, the SEC adopted Reg BI after a multi-year examination of broker-dealer and investment adviser practices and calls for the SEC to heighten the standard of care that applies to retail investor recommendations.

As part of that process, the industry was given ample opportunity to comment on the Reg BI proposal and meet with SEC staff. This iterative process delivered a measured approach to balancing the SEC's goals of investor protection against the various business models used by financial services firms.

When the SEC adopted Reg BI, it also issued a Commission interpretation regarding the fiduciary duty of investment advisers when making recommendations to retail investors. These actions established strong, national standards and heightened protections for investors. They were also necessary to blunt persistent efforts by the Department of Labor (DOL) to regulate the investment advice market, notwithstanding the DOL's unlawful efforts in 2016 when its fiduciary advice rule was struck down by the courts.[3]

Unfortunately, since Reg BI was finalized, well-funded special interest groups and certain state regulators have sought to undermine Reg BI's effectiveness by attempting to impose new rules on BDs that would cut off access to financial advice for low-income investors and increase legal liability for all broker-dealers.[4]

After accepting the view of politically connected special interest groups, the Commission issued a Proposal that would mandate broker-dealers and investment advisers "eliminate or neutralize"

[3] *U.S. Chamber of Commerce v. U.S. Department of Labor* (5th Cir. Mar. 15, 2018)
[4] https://www.americansecurities.org/post/asa-questions-premise-of-nasaa-reg-bi-survey

conflicts of interest that may exist or be used in connection with any "covered technology". If adopted, this would force broker-dealers (BDs) and investment advisors (IAs) to abstain from using certain technologies and/or limit or eliminate communication with a substantial portion of their client base. It is also a direct attack on a registered representative's ability to take payment in exchange for providing investment recommendations.

The "eliminate or neutralize" mandate stands in contrast to Reg BI's provisions which focuses on disclosures of certain conflicts of interest, a well understood concept that brings the client into the discussion. We also note that the word "neutralize" is not a legal term of art and depending on the context, it can have many different meanings (i.e. Merriam-webster notes it means "kill, destroy" or "to make neutral by blending with the complementary color").[5]

This Proposal fails to acknowledge that Reg BI's conflict requirements already apply to covered technologies, and it does not explain why those technologies should be treated any differently than other activities Reg BI already covers. The SEC has also failed to explain why today's Reg BI disclosure regime is failing, other than to posit the unsupported political assertion that disclosure doesn't work.[6]

In fact, industry firms are still undergoing examinations on the effectiveness of Reg BI, and they have not had the benefit of hearing directly from the SEC as to whether and why it believes Reg BI is does not achieve the SEC's policy goals. Without that sort of basic communication, the SEC removes valuable tools its needs to inform its view on Reg BI.

The mandate to "neutralize" conflicts related to covered technologies is also troubling given that the word "neutralize" does not appear anywhere in the federal securities laws and it is not a term that is typically understood as part of a legal obligation. There would appear to be no distinction between a requirement to "neutralize" a conflict of interest and a requirement to "eliminate" a conflict of interest. This would be an impossible standard for BDs and IAs to meet and, as noted above, would cause these entities to refrain from using even basic technologies, like email, text messages, Excel spreadsheets, and PowerPoint presentations when interacting with customers.

Even more concerning, the term "neutralize" appears in the North American Securities Administrators Association's (NASAA) recently proposed revisions to NASAA's model rule regarding dishonest or unethical business practices.[7] The language in the NASAA proposal is strikingly similar to the language in the SEC Proposal. This unfortunately suggests direct

[5] https://www.merriam-webster.com/dictionary/neutralize
[6] https://wagner.house.gov/sites/evo-subsites/wagner.house.gov/files/evo-media-document/letter-to-chairman-gensler-re-data-analytics-proposal-9.22.23.pdf (see FN 6 See Letter from Barbara Roper and Micah Hauptman to the Department of Labor. (Aug. 7, 2017), at 43-44. https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/rules-and-regulations/public- comments/1210-AB82/00529.pdf)
[7] https://www.nasaa.org/wp-content/uploads/2023/09/Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf

nonpublic coordination between the SEC and favored stakeholders may have taken place to bypass the standard practice of the Commission issuing a request for comment from the public.

Rather than follow the law and past practice, it appears the SEC confined its outreach to only those stakeholders whose interests are aligned with some in the Commission to create a new legal obligation for broker-dealers without any authorization from Congress. *We remind the SEC that its obligation to fulfill its national mandate is to the public, not special interest groups.*

II. The Definition of "Covered Technology" is Unlawful because it is Overly Broad, Vague and Ambiguous.

Under the Proposal, a "covered technology" is defined 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."[8] These criteria are extremely vague, overly broad, and extend well beyond the AI-type technologies the Proposal is purportedly intended to address. This leads one to worry whether the SEC is being purposefully broad that the public thinks the Commission listened when it tailors the final rule, only to find out later the SEC's will apply a fiduciary standard to all methods of recommendation, including those with a human component, through its enforcement and examination divisions.

Commissioner Peirce warned about the implications of this definition in her dissenting statement at the open meeting on July 26th:

> "Despite protestations that "[t]he proposal is intended to be technology neutral" and does "not seek to identify which technologies a firm should or should not use," the proposal reflects a hostility toward technology… spreadsheets, commonly used software, math formulas, statistical tools, and AI trained on all manner of datasets, could fall within the ambit of this rulemaking."[9]

During recent appearances before Congress, Chairman Gensler and Division of Investment Management Director William Birdthistle were both asked about technologies that would be covered under the Proposal. Both declined to name any technologies that the Proposal would *not* cover, indicating that the SEC does intend to apply these new rules well beyond AI or similar technologies.

This Proposal would effectively make it impossible for firms to communicate with their clients in certain circumstances or even to provide basic information about markets or a customer's

[8] Proposal at 42
[9] Through the Looking Glass: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Commissioner Hester Peirce. (July 26th, 2023)

portfolio holdings. To highlight an example included in a recent joint trade letter signed by the ASA,[10] a firm which provides market news and alerts to customers – a presumably proactive thing to do - could be deemed to have a "conflict of interest" if those news and alerts induce some customers to enter trades and generate commissions for the broker-dealer or investment adviser. The firm would therefore have to eliminate that service for clients, depriving them of critical information regarding their portfolio. Such an outcome would be completely at odds with the SEC's mandate to protect investors, but the Proposal fails to consider any of these scenarios.

While we discuss this in depth below, let us be crystal clear on this point: the SEC does not have the legal authority to regulate in this area. Congress did not provide the SEC with a mandate to regulate and approve the proprietary technology and intellectual property of its regulated entities. The SEC is not a science and technology regulator and to suggest that every technology used by a regulated entity needs the blessing of an unelected SEC bureaucrat who will subjectively determine whether that technology falls within a vague and ambiguous regulation is the very definition of "arbitrary and capricious".

III. The SEC Does Not Have Legal Authority to Adopt this Proposal.

The Proposal takes a circuitous path in trying to find the legal authority the SEC needs to promulgate new requirements for broker-dealer and investment adviser conflicts of interest. The SEC is relying on Section 913 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act – specifically the additions of Section 211(h) of the Investment Advisers Act and Section 15(l) of the Securities Exchange Act – as justification for regulating conflicts related to covered technologies. Either the Commission was given direct authority to regulate specific conduct, or it was not. In this case, citing multiple sections of differing statutes illustrates the SEC's unconditional desire to create legal authority Congress never provided.

The Congressional intent behind Section 913 is widely understood to cover broker-dealer and investment adviser recommendations made to retail investors and does not grant the SEC unfettered authority to regulate any aspect of broker-dealer or investment adviser activities.

Since the Proposal would include all possible current or future communication or interaction involving a covered technology – not just investment recommendations – it defies any kind of sound legal reasoning to use Adviser Act Section 211(h) and Exchange Act Section 15(l) as the legal basis for these new requirements.

Equally concerning, the Proposal would apply to investment adviser communications with investors in private funds who, by definition, are typically either institutional or accredited

[10] https://www.americansecurities.org/post/trade-associations-send-letters-to-sec-on-negative-impacts-of-predictive-data-analytics-proposal

investors, (i.e. not retail investors). Sophisticated investors typically do not require the same level of protection as retail investors.

If Congress had intended for Section 913 to apply to private funds, it would have written that into the statute. The legal basis underpinning the entire Proposal is therefore based upon statutory authority that does not exist.

A basic review of statutory construction and agency interpretation should have informed the SEC about the limits of its authority in this instance. That review should have prevented a proposal that is so clearly outside the scope of the Commission's legal authority from being forced into the public sphere.

IV. The SEC Failed to Adequately Consider the Economic Costs of this Proposal.

1. **Flawed Compliance Cost Estimates**. The ASA has previously expressed concern about the SEC's costs of compliance estimates for certain proposed rulemakings – in particular estimated costs of hiring outside legal counsel.[11] Until the Fall of 2022, the SEC estimated a $400 hourly rate for regulated entities to hire outside counsel for assistance in complying with SEC rules – a completely unrealistic number that is far below what most companies pay law firms for legal counsel.

Last Fall, the SEC quietly revised the $400 estimate to $600/hour, still well below going rates for outside counsel. Unsurprisingly, the economic analysis accompanying the Proposal (or lack thereof) does not consider the high likelihood that many broker-dealers and investment advisers will seek outside counsel to help comply with the new mandates and does not incorporate more accurate estimates of what hiring outside counsel would cost, which the Commission has been told in numerous rulemakings is well above $1,000 per hour. We reiterate to the SEC that $1,000 is the average cost of engaging outside counsel to assist with compliance matters, not the exception.

The consistent and pervasive use of the wrong cost of compliance estimates throughout the Chairman's regulatory agenda intentionally masks the true amount of monetary resources regulated entities are forced to redirect to lawyers and consultants in the professional class. It also intentionally slants the cost-benefit analysis in favor of whatever ideological policy the Chair wants the Commission to adopt. This begs the question: Why is the SEC adopting a regulatory agenda that enriches a politically connected professional class at the expense of America's retail investors, small businesses, and market participants?

[11] ASA Opinion: The True Cost of the SEC's Regulatory Overreach published in The Washington Times; March 23, 2023; https://www.americansecurities.org/post/asa-opinion-the-true-cost-of-the-sec-s-regulatory-overreach

2. **General Cost Benefit Concerns**. Given all of the different business lines within a broker-dealer or investment adviser that would be involved in compliance with the Proposal – legal, IT, marketing, and other business units – the ASA believes the initial and ongoing cost estimates contained in the economic analysis significantly underestimate reality.

The SEC should not propose rules that do not reflect the true costs of the rulemaking. It is required to put forth a legitimate economic analysis that can survive legal muster, not one that cannot pass a reasonableness test and tries to make up for it by asking: "did we get this right?". This process sidesteps a basic premise of "notice and comment" rulemaking, which demands the public have due process to opine on current data that support the Commission's assumptions. Furthermore, it is not the job of the public to do the economic analysis related to a proposed rule, that job was *mandated by Congress to the SEC*.

To underpin the SEC's flawed economic analysis, the ASA joined several other industry associations to argue that this flawed economic analysis raises the probability that a court would find the SEC rule to be 'arbitrary and capricious'[12]. In that letter, the Associations wrote in part, "We believe that a more substantive and complete economic analysis would demonstrate that the proposed rule would have a devastating effect on low and middle-income investors."

V. Conclusion.

For all the reasons outlined above, the SEC must abandon the Proposal and instead focus its finite resources on other efforts that are in line with the SEC's mission and statutory authority. While we see no reasonable path forward for this ill-advised regulatory effort, the ASA will continue to serve as a resource for Commissioners and staff on these critical issues.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
President & Chief Executive Officer
American Securities Association

[12] https://www.americansecurities.org/post/trade-associations-send-letters-to-sec-on-negative-impacts-of-predictive-data-analytics-proposal