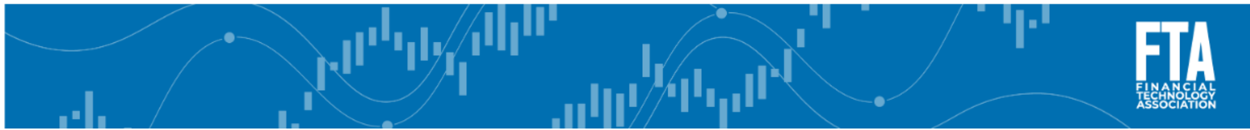


Submitted via electronic mail

October 10, 2023

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

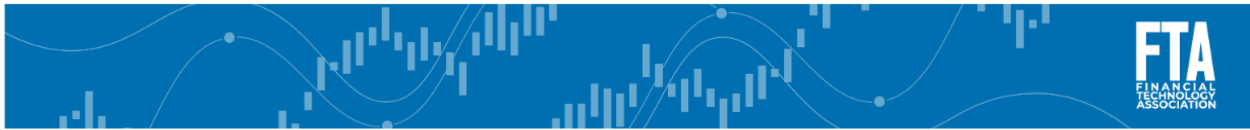
Re: FTA Comment on the SEC's Proposed Rulemaking regarding Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

(File Number S7-12-23)

The Financial Technology Association ("FTA") appreciates the opportunity to provide feedback on the Securities and Exchange Commission's (the "Commission" or "SEC") proposed rulemaking regarding conflicts of interest associated with the use of so-called predictive data analytics by broker-dealers and investment advisers (the "Proposal"). FTA represents industry leaders shaping the future of finance, champions the power of technology-centered financial services, and advocates for the modernization of financial regulation to support inclusion and responsible innovation.

FTA members include fintech innovators that have made significant contributions to the financial industry by lowering costs of investment advisory services and trading services, increasing market participation and retail investor access to investment advice, improving compliance, introducing competition with legacy business models, and promoting capital formation. Much of this investor-centric innovation is predicated on responsible development and adoption of technology, which permits enhanced investor access to information and investor engagement, including with respect to financial education and advice. In line with the Biden Administration's call for increased competition in financial services and ensuring that all Americans have access to responsible wealth creation advice and opportunities, sound policy and regulation should *foster* investor-centric innovation and technology adoption, not deter it.

Unfortunately, the Commission's Proposal moves in the opposite direction. Rather than regulating conduct, the Proposal regulates innovation and penalizes firms adopting modern technologies as compared to those using outdated, inefficient, legacy models. This type of blanket technology-targeted regulation fails to solve clearly identifiable harms and will serve to limit, steer, and even preclude further innovation. The Proposal is overbroad, duplicative and unnecessary given existing



regulations, and unfairly and unequally targets technology-based business models to the harm of investors. FTA accordingly offers the following feedback and recommendations regarding the Proposal:

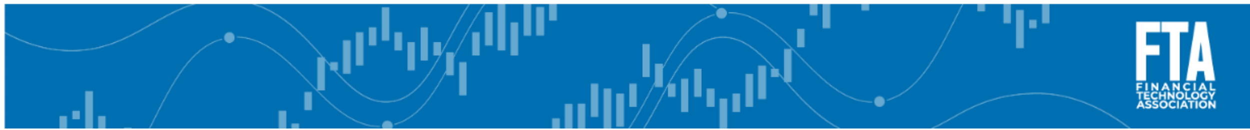
A. The definitions of covered technologies and conflicts of interest are overbroad and would impose unequal treatment of technology-driven business models.
B. The rulemaking is predicated on an unfounded belief that technology-driven business models are more likely than legacy models to harm investors and go undetected, despite clear evidence that many models are more transparent and improve investor choice and outcomes.
C. Existing rules and frameworks are capable of addressing conflicts and other harms that may arise in the context of new technologies, including so-called "PDA-like" technologies.
D. The SEC's proposed rules will sharply curb innovation, reduce investor choice and opportunity, and steer activity towards opaque and inferior business models relying on legacy tools and communications approaches.

I. The Proposal is overbroad, duplicative and unnecessary given existing regulations, and unfairly and unequally targets technology-based business models to the harm of investors.

A. The definitions of covered technologies and conflicts of interest are overbroad and would impose unequal treatment of technology-driven business models.

The Proposal defines a "covered technology" to be 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 in an investor interaction."[1] Such a broad definition is inherently not technology neutral – it is intended to capture a limitlessly broad set of technologies, including "lookup tables" in a spreadsheet,[2] and then subject them to stricter scrutiny and possible preclusion under an entirely new conflicts of interest regime. This definition would appear to exclude only legacy communications and related tools, such as a telephone and postal mail,[3] and sweep in any computer-based system capable of

[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)
[2] *Id.*
[3] Alternatively, if the Commission intends for telephones and other legacy communications and analytics tools to be covered by the definition, then the proposed rules would completely subsume all prior conflict rules – this becomes an end-around of a proper rulemaking process and further evidence of violation of the Administrative Procedures Act (APA). *See Joint Trades Comment Letter, Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers (Sept. 11, 2023),* available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2023/09/Trade-Associations-PDA-Comment-Letter-Final.pdf?#.



automating decisions, increasing efficiencies that reduce costs, improving analytics, tailoring and enhancing investor experiences, and modernizing operations.

While the Proposal briefly notes potential benefits of covered technologies, it makes clear that it views such technologies with at best skepticism and at worst disfavor by creating a new conflicts framework that does not permit the use of time-tested mitigation tools, including the bedrock concept of disclosure and informed consent. Put directly, the Proposal is predicated on the notion that covered technologies will cause broad and undetected harm to investors such that only complete preclusion is appropriate—this unfounded conception is not technology neutral, but rather seeks to roll back the clock and incentivize broker-dealers and investment advisors to return to the days of analog computations and telephone-based sales and communications efforts with investors.

Compounding the overly broad definition of covered technologies, the Proposal applies an overbroad and novel definition of conflict of interest that conflicts with its common definition in other SEC rules.[4] The Proposal can be read to suggest that any covered technology capable of reaching many investors through scalable platforms poses a conflict of interest if the broker-dealer or investment advisor has any conceivable financial interest or revenue interest in the communication or interaction (with only a narrow set of the most bare advertising content apparently excluded). The proposed definition appears to apply even if the investor's best interest is aligned with the firm's interest—this outcome is at odds with precedent and will result in harm to investors who will not be presented with tools and opportunities that are clearly to their benefit.

The Proposal goes on to note that informational tools for investors, including daily price and volatility alerts for certain investments, would be covered by the proposed rule and pose a conflict given the *possibility* such alerts *could* drive increased trading activity.[5] Based on the Proposal's examples, it is likely that a broad range of informational and educational communications and helpful behavioral nudges (for example, to round up savings or increase retirement account contributions) would be deemed a conflict if the firm might benefit financially from the engagement—this outcome would result even if the investor and firm's interests are aligned with such an offering or activity. Because the Proposal eliminates disclosure and informed consent as appropriate risk mitigation measures, this means that such informational, educational, and behavioral engagements would be precluded, even if desired and demanded by investors, or in their best interest.

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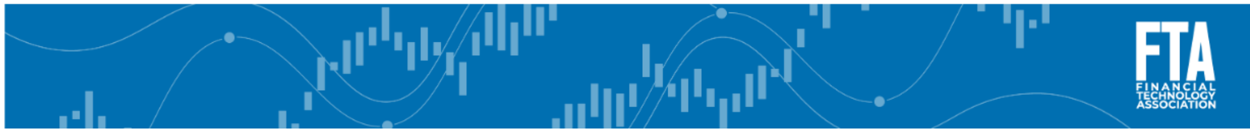
[4] *See* Joint Trades Letter, n.4.
[5] *See* Proposal at p.53, n.81.



The Proposal frequently cites a recent Commission enforcement action to support the need for this rulemaking and as support for its triggering definitions. A closer look at the referenced matter, however, demonstrates that this rulemaking is ill-conceived and unnecessary. More specifically, the matter involved a scenario where a firm offered a digital investment advisory service that would make automated investment allocations based on financial information and investment objectives provided by the investor. The firm was found to have "pre-set" and allocated large portions of each investor's portfolio to "cash" since such cash holdings generated significant revenue for the firm (especially since the firm did not charge any other fees for the service). The Commission alleged that the firm failed to properly disclose that such large cash balances might harm investor performance and were not in the investor's best interest. The Commission ultimately settled with the firm, resulting in financial fines and remediation.[6]

Despite the fact that the Commission prevailed in securing such fines and other remedies from the firm under *existing* regulations, the Proposal inexplicably cites the matter as highlighting "the potential for PDA-like technologies to be used in ways that advance a firm's interests at the expense of its investors' interests."

As a threshold matter, it is hard to understand how a firm that has a "pre-set" allocation of investments to cash would be deemed to be using predictive data analytics (PDA)-like technologies. There is nothing advanced, technological, or digital about pre-setting cash holdings. Second, even if a firm were using an algorithm to set larger cash balances as a revenue-generation approach, with proper disclosure, an investor may prefer this model that comes with no other fees as compared to a model that charges a set fee for services. With sound disclosure and informed consent, the market should provide investors with choice. Finally, the very example the Commission cites in support of a new rule actually supports an opposite conclusion—the Commission was able to identify the firm's disclosure deficiency and bring an enforcement action under existing regulation, which demonstrates that the current Proposal is unnecessary.

B. The rulemaking is predicated on an unfounded belief that technology-driven business models are more likely than legacy models to harm investors and go undetected, despite clear evidence that many models are more transparent and improve investor choice and outcomes.

The Proposal offers sweeping changes to established conflict of interest requirements based on a number of highly speculative and unfounded assertions.

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[6] *See* SEC, *Schwab Subsidiaries Misled Robo-Adviser Clients about Absence of Hidden Fees* (June 13, 2022), available at https://www.sec.gov/news/press-release/2022-104.

First, the Proposal implies that the potential use of complex PDA-like technologies is novel conduct that necessitates a novel regulatory response. In providing specific examples, however, the SEC points to basic and longstanding conduct and activities, including price alerts, "pre-set" cash allocations as noted in the enforcement matter above, the use of statistical regression analyses, lookup tables, and other common practices that were in existence when past conflicts rules were developed or amended. Beyond innuendo, there is little in the Proposal to substantiate the need for new frameworks based on actual developments in the market.

As discussed further below in the next section, to the extent that particular practices are specifically identified that are not aligned with and may cause harm to investors, including, for example, broker sales contests, the Commission has proven that it has the tools to preclude such activity. Restrictions and prohibitions are only appropriate, however, once the Commission has identified actual risk of harm based on specific conduct—blanket scrutiny of covered technologies is inappropriate.

Second, the need for the Proposal is based on the notion that PDA-like technologies are different from current engagement and legacy analytical approaches given their ability to scale across a platform to many users; the Proposal also broadly claims that such conflicts are more likely to go unidentified. These foundations and justifications for the rule require closer scrutiny.

As a threshold matter, broker-dealers and investment advisors have been using scalable internet and mobile-based platforms for decades to provide consistent, efficient, and lower-cost services to investors. This is not new. Additionally, as the cited enforcement action above involving a robo-advisory product makes clear, the fact that many thousands of investors receive the same treatment from a firm based on scalable engagement activities would logically *increase* the odds of detection, especially as compared to legacy approaches where a broker might use a telephone and hold idiosyncratic conversations with investors or potential clients—the risk of undetected harm in this latter scenario is significantly higher than in the context of a transparent, consistent, and documented approach across a mobile or internet platform.

Notably, support for this conclusion comes from one of the very sources the Commission relies upon to assert that PDA-like technologies require a stricter and more preclusive conflicts framework. Indeed, while the SEC cites a law review article by Professors Duffy and Parrish for the idea that a scalable platform may propagate "unaddressed" and "pernicious" conflicts across a firm's customer base, the very same article goes on to state that:

> *There is a counter argument to this challenge. While conflicts can occur within a robo-advisor environment,* ***these conflicts of interest are more readily detected*** *because the conflict of interest in a robo-advisor originates from inappropriate program design. Whether innocently or nefariously created, the conflict is "hard wired" into the robo-advisor's recommendation. To the extent this violates the fiduciary duty of loyalty, it violates it for all clients in the same circumstances.* ***Once discovered, it can be exposed and stopped. Robo-advising doesn't prevent negligent or fraudulent design, but it makes it easier to detect.*** (emphasis added).[7]

The SEC's selective use of sources like the one outlined above are concerning and reveal the clear anti-technology lens of the proposed rulemaking. The notion that disclosure and informed consent are insufficient to cure even small conflicts related to PDA-like technologies reveals a biased view that such technologies are never in the investors' best interest or capable of providing helpful content and information. To this end, the same article cited by the SEC to support its rulemaking further states that "[a]s we have shown, robo-advisors meet the best interest standard, and in specific contexts, **robo-advisors can meet the fiduciary standard to an even greater extent than human advisors**. (emphasis added)"[8]

This latter point highlights how covered financial technologies are benefitting investors as compared to legacy approaches and should be *encouraged* by the Commission, not deterred. Financial technologies have had a substantial positive impact on financial markets and introduced new categories of financial services,[9] increased competition and efficiency, lowered investor costs, and expanded market participation.[10] The growth of fintech has helped to facilitate wealth creation for millions of Americans over the last decade, and future innovation holds substantial promise in helping to close the wealth gap in the United States.[11]

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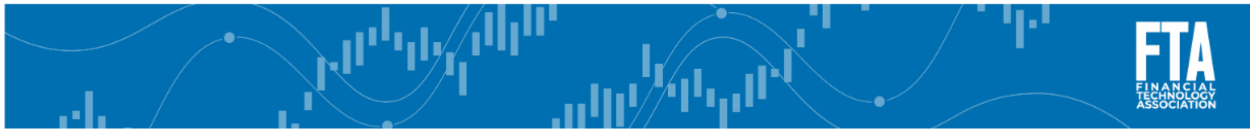
[7] Sophia Duffy and Steve Parrish, *You Say Fiduciary, I Say Binary: A Review and Recommendation of Robo-Advisors and the Fiduciary and Best Interest Standards*, 17 Hastings Bus. L.J. 3 (2021), available at: https://repository.uchastings.edu/hastings_business_law_journal/vol17/iss1/3.

[8] *Id.*

[9] For example, digital investment advisers, also known as "robo-advisors," pioneered the use of technology to provide investment advisory services over the Internet, services previously available only to affluent investors. Focused on long-term investment and wealth creation strategies, digital investment advisers use technology to help investors identify savings goals, such as retirement or education, and track their progress towards their financial goals.

[10] Other investor-centric fintech companies include those focused on micro-investing, those that allow customers to round up on purchases and invest the difference, those focused on expanding access to company equity ownership opportunities, and those pioneering investment opportunities in new asset classes and fractional shares.

[11] Increased participation in equity investments has been shown to help build generational wealth and close the racial wealth gap. *See* McKinsey, *The economic impact of closing the racial wealth gap* (Aug. 13, 2019), available at https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-economic-impact-of-closing-the-racial-wealth-gap.



Additionally, many of the tools and approaches likely to fall under the Commission's covered technologies definition are merely better ways to pursue customer engagement and education. Digital design features can be used to shape investor behavior and outcomes in a variety of ways, and can be a powerful force for good. Investor-centric fintechs design such tools to incentivize long term thinking and positive outcomes for clients.

For example, "On-track / Off-track", a practice employed by digital investment advisers, shows an investor their progress towards a particular financial goal, helping them focus on long-term savings as opposed to short-term market movements. These progress reports are based on the investor's goal time horizon, expected deposits, and asset allocation. Tools designed with the clients' best interest in focus, like "On-track / Off-Track," do not drive investors to take action in response to stock prices and short-run market volatility, but may lead an investor to increase savings—which under the rule could create a nonwaivable conflict since the provider may also experience increased revenues from higher account balances.

Other investor-centric technology-driven practices incorporate behavioral nudges to allow people to invest even if they may not feel they have enough funds, time, or appetite to take a more active role, by starting small and counting on those savings to eventually add up. Behavioral nudges, like rounding up, or tax impact preview screens that cause an investor to pause and evaluate costs of a withdrawal during periods of market instability, use behavioral science to drive positive client outcomes. The potential benefits of behavioral nudges, especially in the context of increasing retirement savings rates and balances in America, is receiving significant interest from leading thinkers in the country, including Cass Sunstein, Richard Thaler, and Maya Shankar.[12]

Notwithstanding the clear benefits to investors, because a broker-dealer or investment advisor may also experience a benefit, the Proposal would inexplicably end such practices and/or deter activity that may fall into gray or ambiguous zones. Firms will accordingly be encouraged to roll back the clock and offer investors more expensive and lower-quality service in order to satisfy the Commission. The Proposal will further undermine clear public policy objectives, including increasing savings and retirement participation across key demographics.

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[12] *See* Shlomo Benartzi, *How Digital Tools and Behavioral Economics Will Save Retirement, Harvard Business Review* (Dec. 7, 2017), available at https://hbr.org/2017/12/how-digital-tools-and-behavioral-economics-will-save-retirement.

C. Existing rules and frameworks are capable of addressing conflicts and other harms that may arise in the context of new technologies, including so-called "PDA-like" technologies.

The SEC has a robust and well-established legal and regulatory framework that has proven it is fit-for-purpose and capable of adjusting to govern new practices and technologies, as evidenced by the digital investment advisory enforcement action discussed above. More specifically, anti-fraud provisions, which cover manipulative and deceptive trade practices, requirements to provide disclosures and material information to investors, Regulation Best Interest (Reg BI), existing conflicts rules, and advertising restrictions already serve as effective enforcement authorities for pursuing misconduct, both from traditional and digital broker-dealers and investment advisers.[13] Additionally, the SEC and FINRA have issued other rules and guidance related to model risk management requirements and practices that can mitigate identifiable risks related to new technologies, including with respect to advanced AI technologies.[14] The existing framework is appropriately technology-neutral, requires broker-dealers and investment advisors to develop adequate controls over their use of technology, and allows investors to make informed decisions regarding the services they seek.

With respect to Reg BI, the Proposal disingenuously appears to suggest that mere disclosure and investor consent are all that is required to cure a conflict. But, as the SEC well knows, disclosure and consent are not the end of the analysis when a conflict is identified in relation to investment advice or recommendations. To be sure, an investment advisor or broker-dealer must take further steps beyond disclosure and consent to ensure that the recommendation is in the investor's "best interest."[15] The Proposal, however, fails to acknowledge these additional elements contained within the existing conflicts framework and does not discuss why they are insufficient to address certain conflicts that might arise with PDA-like technologies.

To the contrary, existing conflicts frameworks—in addition to marketing rules and anti-fraud and deception rules—provide the SEC with ample authority to identify and enforce against problematic practices. With existing authorities, the SEC has proven that it is capable of precluding certain practices that unequivocally cause investor harm, as it did with blanket restrictions on broker-

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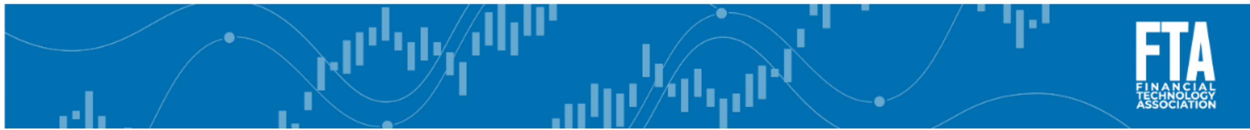
[13] Securities and Exchange Commission, *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice*, issued Aug. 27, 2021, pp. 31-37, available at https://www.sec.gov/news/press-release/2021-167.

[14] *See, e.g.,* FINRA, *AI in the Securities Industry: Key Challenges and Regulatory Considerations*, available at https://www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry/keychallenges.

[15] *See* SEC, *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest*, available at https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest.



dealer sales contests related to specific securities. In that case, the SEC determined that such conflicts are inherently in tension with the investor's best interest.

In the context of PDA-like technologies, the SEC is equally empowered to use existing conflicts, Reg BI and marketing rules to identify specific activities that cause unmitigable investor harm and then preclude such activities. It is a basic tenet of sound regulation that prescriptions—especially those that directly preclude or have the effect of precluding certain activities—be narrowly tailored to solve for specific, identifiable risks. Overbroad and speculative prohibitions will only serve to harm investors, impede competition and innovation, and improperly circumvent proper adherence to the APA.

On this latter point, the Proposal's overbroad definitions of covered technologies and conflicts of interest have the effect of expanding this rulemaking to swallow existing conflicts rules. If the rule intends to impact application of existing rules, then these changes must be subject to notice and comment.[16] If they do not so intend, then they unevenly seek to regulate the marketplace by targeting technology-based approaches and will result in investor harm and harm to the functioning of U.S. markets.

Finally, as discussed in the Proposal—but promptly rejected through thin analysis—the SEC has a number of viable and more targeted regulatory approaches it could pursue to mitigate identifiable risks to investors. One such approach would be requiring certain disclosures when a firm uses particular covered technologies in particular scenarios. For example, if an investor would like daily price alerts (something that should squarely be the investor's decision, not the Commission's), then an opt-in framework with a disclosure noting that frequent trading by a retail investor may not be an effective long-term strategy may be appropriate. This type of disclosure and informed consent would avoid the overly paternalistic approach suggested in the Proposal, whereby a daily price or price volatility alert would effectively be precluded.[17]

D. The SEC's proposed rules will sharply curb innovation, reduce investor choice and opportunity, and steer activity towards opaque and inferior business models relying on legacy tools and communications approaches.

As detailed above, the Proposal unevenly and unfairly targets broker-dealer and investment advisor use of technology and would have the effect of chilling or precluding many evolving business

[16] *See* Joint Trades Letter, n. 4. The Commission also appears to be exceeding its authority to impose blanket conflicts-related conduct limitations on broker-dealers given clear Congressional direction that such authority extends only to advice and recommendations, not broader investor interactions. *Id.*

[17] The Proposal includes a broad range of alternative approaches that would be far more appropriate to explore than this rulemaking.

practices that offer investors more choice, information and opportunity. It would further create an uneven playing field and deter technology-driven business models at a time when such models are offering investor-centric competition to opaque legacy models.

The burden of this Proposal would fall most heavily on smaller firms—a point the SEC specifically acknowledges in the rulemaking. Smaller firms may lack resources to conduct the time-consuming, ambiguous, and burdensome set of tests and compliance measures the Proposal sets out if a firm contemplates use of a covered technology. This means many firms, especially smaller ones, will be incentivized to continue use of legacy tools and approaches that do not implicate the rule. The result will be increased reliance on the most opaque forms of communications, loss of efficiency, loss of overall competitiveness, and less choice and competition that benefits investors.

We strongly urge the Commission to reconsider this misguided Proposal and base related future regulatory efforts on sound regulatory principles. To this end, the Commission should focus efforts on identifying actual risk of harm to consumers and tailoring appropriate interventions rather than engage in a speculative exercise that results in overbroad and overly-prescriptive rules that will significantly impede innovation. Additionally, the Commission should look for opportunities to *encourage* adoption of new tools and approaches that generate the positive investor outcomes detailed above, including through coordination with FINRA and development of guidance that can clarify regulatory expectations. Rather than roll back the clock to a time that included use of telephones in boiler rooms, the Commission should help the industry confidently and compliantly step into the future.

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FTA appreciates the Commission's consideration of its comments and would be happy to discuss the issues raised in this letter further. Please contact the undersigned at penny@ftassociation.org for additional information.

Sincerely,

Penny Lee
President and Chief Executive Officer
Financial Technology Association