AMERICAN FREE ENTERPRISE
CHAMBER OF COMMERCE

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. 53,960 (Aug. 9, 2023)

Dear Ms. Countryman:

The American Free Enterprise Chamber of Commerce ("AmFree") writes regarding the U.S. Securities and Exchange Commission's ("SEC" or "Commission") proposed rule, *Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, 88 Fed. Reg. 53,960 (Aug. 9, 2023) ("Proposed Rule" or "Rule"). AmFree is an organization dedicated to representing the interests of hard-working entrepreneurs and businesses across America. As part of its mission, AmFree seeks to promote pro-business, free-market values and to oppose overly burdensome, ill-considered, and unlawful regulations. AmFree therefore appreciates the opportunity to comment on the SEC's Proposed Rule, which suffers from deep and pervasive flaws.

As Chairman Gensler has recognized, "[t]he SEC's mission is to protect investors, facilitate capital formation, and maintain that which sits in the middle: fair, orderly, and efficient markets."[1] Unfortunately, the Proposed Rule does precisely the opposite. As discussed in more detail below, the Rule is both bad policy and legally unsound. It adopts a paternalistic approach to so-called conflicts of interest that is at odds with decades of settled practice under the securities laws. It thoughtlessly throttles

[1] *See* Chair Gary Gensler, *"Competition and the Two SECs", Remarks Before the SIFMA Annual Meeting* (Oct. 24, 2022) (hereafter, "Gensler SIFMA Speech"), https://www.sec.gov/news/speech/gensler-sifma-speech-102422.

the most promising technological innovation. It would have the paradoxical effect of harming the retail investors it purports to protect by depriving them of information and affordable investment services. It violates the core First Amendment guarantee of the Freedom of Speech. It exceeds the SEC's statutory authority by asserting never-before claimed powers on behalf of the Commission. It needlessly layers yet another complicated "conflict of interest" rule—with a novel and expanded definition of the term—on top of existing regulatory regimes for both broker-dealers and investment advisers, which themselves are more than adequate to address conflicts of interest associated with brokers' and advisers' use of technology. Far from offering rigorous economic analysis, it barely acknowledges the massive negative effect it will have on new technologies, with only the most cursory acknowledgment of the costs that will follow. At bottom, the Rule is unconstitutional, contrary to statute, and premised on flawed, arbitrary, and incomplete reasoning.

Indeed, the Proposed Rule is so broad and disconnected from its purported concerns about developing technology, such as artificial intelligence ("AI"), that it does not appear to really be a "technology" rule at all. Rather, it seems the SEC is using "technology" as a convenient pretext for imposing entirely novel, far-reaching, and invasive standards for all broker and adviser interactions with the public at large. It is a way to do away with existing rules like Regulation Best Interest ("Regulation BI") without coming clean and simply explaining the Commission's change of position.

These problems doom the Proposed Rule. Its flaws are so pervasive that the Commission must withdraw the Rule entirely or, in the alternative, start over and propose a drastically narrower rule with a new opportunity for the public to comment.

I. The Proposed Rule Would Stymie Technological Innovation and Harm Retail Investors.

The Proposed Rule threatens to undermine the tremendous benefits that technology has brought to the markets—and to retail investors in particular—in recent years. In the age of the Internet, the use of technology has become essential to nearly every public communication of diligent brokers and advisers, enabling them to provide better information more efficiently to customers and the general public alike. Yet the Proposed Rule outlaws *all* use of covered technology in communications unless a firm can first affirmatively demonstrate it does not involve a "conflict of interest" under the SEC's novel, overbroad definition of that term. This is likely impossible to do for the emerging technologies with the greatest potential to democratize access to capital markets, meaning the Rule, if adopted, would strangle them in the cradle. Remarkably, the Rule even *acknowledges* this likely effect, 88 Fed. Reg. at 53,977, yet the SEC appears blithely unconcerned. Apparently, if technological stagnation is the price of shielding

the public from truthful information the SEC believes in its own paternalistic, judgment they cannot be trusted to handle, then so be it.

It gets worse. The Proposed Rule promotes not just technological *stagnation*, but outright *regression* by imposing needless and burdensome costs on well-established technologies. If the Commission adopts the Rule, the use of simple algorithms, basic retirement calculators, and even spreadsheets and emails will be presumptively unlawful. Firms will have to spend time and money every year certifying and re-recertifying that these mundane tools are not dangerous to the public before they can use them in connection with investor communications. Even a simple abacus would not be above suspicion.[2] The rational response for many firms will be simply to avoid the use of these basic and established tools, which will in turn reduce the amount of information they are able to provide the public.

The Proposed Rule's vague and ambiguous terminology (e.g., "analytical," "takes into consideration an interest", "predicts", "guides", "forecasts") will also make compliance difficult, if not impossible, for firms. Most egregiously, the Rule's central obligation—to eliminate or "neutralize" identified conflicts—employs a term ("neutralize") that has never before been used in this context in securities law and does not try to define it. In light of this uncertainty and lack of fair notice, rational, risk-averse firms will simply avoid using technology in communications wherever they can, rather than risk liability trying to make sense of the Rule and its open-ended terms. Again, the ultimate losers here will be retail investors, who will see their costs to invest and trade increase, and who will be deprived of useful information firms would otherwise provide through technology at low or no cost.

The Proposed Rule will also have the effect of concentrating market power in the largest, most-established firms—also to the detriment of investors. If the Proposed Rule is adopted, only the largest firms, which enjoy significant resources and economies of scale, will have any chance at absorbing its enormous compliance costs. They may even benefit as smaller competitors are driven out of the market entirely by the Rule's onerous requirements. Retail investors, in turn, will suffer higher costs and will lose the ability to make meaningful choices about financial services. Although Chairman Gensler has praised the Internet's role in democratizing access to capital markets, it is hard to see how the SEC could do a better job of reversing that trend than this Rule.

The Proposed Rule also adopts an unusually paternalistic approach, assuming that investors cannot even be trusted to *hear* or *see* communications involving

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[2] *See* Comm'r Mark T. Uyeda, *Statement on the Proposals re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers* (July 26, 2023) ("Uyeda Dissent"), https://www.sec.gov/news/statement/uyeda-statement-predictive-data-analytics-072623.

technology unless the speaker can first affirmatively demonstrate the absence of a "conflict." This departs radically from the securities laws' decades-long practice of relying principally on disclosure and informed consent to address conflicts. More fundamentally, it is at odds with the value judgment enshrined in the First Amendment that truth is best discovered through the open flow of information, and that the answer to potentially bad (*i.e.*, conflicted) speech is more speech (*i.e.*, disclosure), not censorship.

Finally, the Proposed Rule is needlessly duplicative and surreptitiously hides policy disagreement with earlier Commission rules. Just four years ago, the Commission issued extensive regulations requiring brokers and advisers to address conflicts of interest, most notably Regulation BI, 84 Fed. Reg. 33,318 (July 12, 2019), and the Fiduciary Interpretation, 84 Fed. Reg. 33,669 (July 12, 2019). If the Commission believes those regulations do not go far enough, it should honestly announce that view and propose amending them.[3] But instead, the Commission has chosen to layer on an additional, substantially duplicative—yet much more extensive —scheme of regulation under the guise of addressing "technology," without seriously engaging with how this new scheme interacts with the requirements already on the books. Nothing prevents the Commission from revisiting these regulations if it believes they have shortcomings. But rather than do that—and honestly announce it has changed its mind on how to approach conflicts—the Commission has issued the Proposed Rule, which would impose burdensome and duplicative requirements on conflicts under the guise of addressing emerging technology, all without adequately addressing how the Proposed Rule's new requirements interact with those already on the books. That is no way for the government to operate.

II. The Proposed Rule Imposes an Unconstitutional Prior Restraint on Protected Speech.

In addition to being bad policy, the Proposed Rule also violates the letter and spirit of the First Amendment. The First Amendment embodies a judgment that, in a free society, there ought to be an uninhibited flow of ideas and information. Even in the so-called "commercial" realm, the "remedy" for bad speech generally "is more speech, not enforced silence." *Linmark Assocs., Inc. v. Willingboro Township*, 431 U.S. 85, 97 (1977). The government must not indulge the "paternalistic assumption" that "truthful, nonmisleading commercial information" should be "suppress[ed]" simply

[3] *See* Letter of Ann Wagner, Chairman, House Subcommittee on Capital Markets, et al., to Gary Gensler, Chair, SEC (Sept. 22, 2023) ("While it is promoted as an investor protection measure, the Proposal's true intention seems to be rewriting existing and well-functioning SEC regulations, such as [Reg BI] and the fiduciary standard.").

because some members of the public will use it "unwisely." *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 497 (1996).

The Proposed Rule stands in stark contrast to the philosophy of the First Amendment. It treats speech involving technology—which, in today's era and under the Proposed Rule's expansive scope, means practically all speech by brokers and advisers—as suspect until proven legitimate. And it asserts a broad-ranging power to alter the content of truthful speech so that it does not, in the Commission's view, pose a risk of harm to the public. All this is justified on the basis of conclusory statements that advances in technology make conflicted communications too dangerous for the public to so much as hear them. This is precisely the line of reasoning—that "modern forms of communications" have made obsolete the values of the First Amendment—the Supreme Court has previously rejected as "frivolous" and contrary to how "[w]e … interpret constitutional rights." *District of Columbia v. Heller*, 554 U.S. 570, 582 (2008).

More concretely, the Proposed Rule contravenes the First Amendment in at least three ways.

First, the Rule imposes an unjustified and unconstitutional prior restraint on speech. The most fundamental guarantee of the Free Speech Clause is its prohibition on prior restraints—regimes where speakers must establish the lawfulness of their speech before they have permission to speak. *Near v. Minnesota ex rel. Olson*, 283 U.S. 697, 732–35 (1931). Yet that is precisely how the Proposed Rule operates. The Rule flatly prohibits firms from communicating with the public using covered technology unless they have (1) determined whether any uses or potential uses of the technology involve a conflict of interest, (2) determined whether any conflict results in the firm's interests being placed ahead of investors', and (3) if so, neutralized or eliminated the conflict. 88 Fed. Reg. at 53,971.

As a result, the Rule is straightforwardly unconstitutional. Prior restraints are "acceptable only in 'exceptional cases,'" such as matters of "urgent national security." *CBS, Inc. v. Davis*, 510 U.S. 1315, 1317 (1994). No such need could justify restraints on purely informational communications with the public regarding financial matters – communications which have been carried out by brokers and advisers for decades. And even where genuine conflicts exist, disclosure—not a prohibition on speech—has long been understood to be an adequate and appropriate remedy.

Further, even in cases of exceptional need, a regime of prior restraints must include certain procedural safeguards to be lawful. "[T]he censor" must bear the burden of establishing the speech's unlawfulness, *Freedman v. Maryland*, 380 U.S. 51, 58 (1965), and the prospective speaker must be "assured an almost immediate judicial determination of the validity of the restraint," *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58,

70 (1963). But here, the Proposed Rule turns the First Amendment on its head, putting the burden on firms to establish the absence of unlawful conflicts based on ambiguous terms, rather than on the SEC to establish their existence.

Second, the Proposed Rule censors fully protected speech. Even if the issue of prior restraints could be set aside, the Proposed Rule could only survive First Amendment scrutiny if the Commission could show it restricts only commercial speech—that is, "speech proposing a commercial transaction." *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n*, 447 U.S. 557, 562 (1980). Otherwise, the Rule is subject to strict scrutiny, the most demanding test in constitutional law. *Reed v. Town of Gilbert*, 576 U.S. 155, 163 (2015).

By the SEC's own admission, the Proposed Rule sweeps well beyond speech proposing a commercial transaction. The Rule applies to "both prospective and current retail investors." 88 Fed. Reg. at 53,974. And it covers "firm communications" that do "not rise to the level of a recommendation, yet" nonetheless "have the *effect* of[] guiding or directing investors to take an investment-related action." *Id.* at 53,975 (emphasis added). The Proposed Rule thus restricts, for instance, the ability of firms to post on their websites purely educational articles on the state of the stock market that include content that draws, at least in part, on a covered technology, because a member of the public may come across it and find it insightful when making investment decisions. This is fully protected speech. The SEC does not have license to engage in censorship simply because a speaker may have an economic motive for speaking. *303 Creative LLC v. Elenis*, 143 S. Ct. 2298, 2320 (2023); *Lowe v. SEC*, 472 U.S. 181, 234 (1985) (White, J., concurring in the result).

Nor does the Proposed Rule present the extremely rare case where a restriction on fully protected speech can survive strict scrutiny. Among other reasons, far from being "narrowly tailored to serve compelling state interests," *Reed*, 576 U.S. at 163, it is astonishingly overbroad. The Commission claims the Proposed Rule is warranted because of the supposed dangers posed by "new technologies such as AI, machine learning, NLP, and chatbot technologies." 88 Fed. Reg. at 54,001–02. This appears to be less of a rationale to impose additional regulations and more a marketing tactic to distract from the breadth and burdens of the Rule Proposal. Indeed, it applies to *any* technology a firm may use to forecast market outcomes or that could influence investor behavior in any way, no matter how established, like a Black Scholes calculator, or simple, such as a spreadsheet or element of graphic design. *Id.* at 53,792.

Third, the Proposed Rule cannot even survive the lesser scrutiny applicable to restrictions on purely commercial speech. The First Amendment does not tolerate "broad prophylactic rules" limiting commercial speech. *Zauderer v. Off. of Disciplinary Couns.*, 471 U.S. 626, 649 (1985). Restrictions are permissible only if the government

can show that the restriction "directly advance[s]" a substantial "state interest" and that the interest could not "be served as well by a more limited restriction." *Central Hudson*, 447 U.S. at 564. By restricting *all* speech involving covered technology until the speaker proves it to be permissible, the Proposed Rule establishes precisely the sort of prophylactic regime the First Amendment condemns. And by sweeping well beyond the SEC's stated concerns about "new technologies," 88 Fed. Reg. at 54,001, it is, as discussed, hopelessly overbroad. Further, the Commission cannot explain why the "remedy" for any serious conflicts it identifies should not be "more speech" in the form of the disclosures the securities laws have long relied upon, rather than outright suppression. *See Linmark*, 431 U.S. at 97.

III. The Proposed Rule Exceeds the SEC's Statutory Authority.

At every turn, the Proposed Rule makes novel and far-reaching assertions of authority on behalf of the SEC. But the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 provide no basis for these assertions. Still less is there the sort of *clear statement* needed to justify a nearly ninety-year-old agency's claims to newly discovered powers to regulate vast swaths of new economic activity and push the boundaries of the First Amendment.

A. The SEC's Outright Prohibition on Conflicts Violates Its Organic Statutes.

Rather than require disclosure or identify specific contexts where conflicts must be eliminated, the Proposed Rule categorically mandates that all so-called conflicts be eliminated or neutralized. The SEC is not authorized to issue a blanket ban of this kind. At minimum, the Commission could only do so after giving a more rigorous explanation and making more detailed findings than the Proposed Rule provides.

1. *The SEC is not authorized to promulgate a blanket ban on conflicts in this context.*

The Exchange Act and Advisers Act establish a strong presumption that the remedy for conflicts of interest is disclosure and consent, not mandatory elimination. They provide that, under the SEC's rules, "any material conflicts of interest shall be disclosed and may be consented to by the customer." 15 U.S.C. § 80b-11(g)(1) (governing advisers); *see id.* § 78*o*(k)(1) (permitting the SEC to subject brokers to "the same … standard of conduct" as advisers "when providing personalized investment advice").[4] In other words, brokers and dealers not only have a general duty to disclose

[4] Section 78*o* has two subsection (k)'s and two subsection (*l*)'s. Here and throughout this letter, we refer to the second such subsection.

conflicts; customers also have a corresponding *right* to give informed consent to any conflict. Further, the provisions of the Acts on which the Proposed Rule is based, *see* 88 Fed. Reg. at 54,021, *require* the SEC to "facilitate the provision of … disclosures to investors regarding … material conflicts of interest." 15 U.S.C. §§ 78*o*(*l*)(1), 80b-11(h)(1).

This presumption harmonizes the Acts with the First Amendment. As discussed, the First Amendment rejects the "paternalistic assumption" that "truthful, nonmisleading commercial information" can be suppressed because the public will use it "unwisely." *44 Liquormart*, 517 U.S. at 497. By calling for disclosure rather than elimination, the presumption makes the default remedy for conflicts "more speech," not censorship. *See Linmark*, 431 U.S. at 97.

Consistent with the presumption of disclosure, the SEC's power to prohibit conflicted communications outright is narrow and context specific. The SEC bases its authority for the Proposed Rule on a provision of the Dodd-Frank Act titled "Other matters." 15 U.S.C. §§ 78*o*(*l*), 80b-11(h). It states that the Commission may "*where appropriate*, promulgate rules prohibiting … *certain* … conflicts of interest … *that the Commission deems contrary* to the public interest and the protection of investors." *Id.* §§ 78*o*(*l*)(2), 80b-11(h)(2) (emphases added). These qualifiers make clear that any outright prohibition on conflicts has to be the product of a context-specific determination about a particular subset of conflicts. Moreover, the "Other Matters" provision is part of section 913 of the Dodd Frank Act which principally concerns the provision of personalized investment advice. It must therefore similarly be read as applying only to personalized advice in a client relationship. It does not confer the power to prohibit conflicts broadly and generally, and particularly with respect to members of the public who are not actually investors.

Thus, for instance, Regulation BI primarily addresses conflicts by requiring brokers to adopt "policies and procedures reasonably designed to identify fully and fairly disclose material facts about conflicts of interest." 84 Fed. Reg. at 33,318. It requires the outright elimination or mitigation of conflicts only when the SEC has "determined that disclosure is insufficient to reasonably address the conflict." *Id.*

The Proposed Rule's ban on conflicted statements involving the use of covered technology effectively supplants Regulation BI and cannot be squared with this narrow grant of authority. In the Internet age, any competent broker or adviser is likely to make use of covered technology in interactions with investors and potential investors.[5] The

[5] In fact, FINRA Rule 1013, describing the requirements for broker-dealer new member applications. presumes that broker-dealers will use the Internet to develop a customer base and to offer and sell products and services to customers. *See* FINRA Rule 1013(a)(1)(e)(vi)). FINRA's

Proposed Rule and its attendant ban on conflicts thus will apply to all—or almost all—interactions with investors. It is therefore a ban on conflicted statements period, not on "certain" conflicts "where appropriate."

If Congress had meant to grant the SEC blanket authority to ban conflicts and conflicted communications generally, it would have spoken more clearly. This is so for at least four reasons. *First*, Congress "does not … hide elephants in mouseholes." *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 468 (2001). If Congress had meant to grant the novel and transformative power to ban conflicts generally in Dodd-Frank, it would not have done so in a provision with the modest title "Other matters." *Second*, in the almost 90 years of the SEC's existence, it has never claimed such sweeping authority to ban all conflicts of interest outright. "This lack of historical precedent, coupled with the breadth of authority that the [SEC] now claims, is a telling indication that the [Proposed Rule] extends beyond the agency's legitimate reach." *NFIB v. DOL*, 595 U.S. 109, 119 (2022). *Third*, the SEC's interpretation would give it the power to prohibit communication of a large swath of truthful, non-misleading information, creating serious First Amendment concerns. *See supra* Part II. The statute should not lightly be read to create such grave constitutional issues. *Jennings v. Rodriguez*, 138 S. Ct. 830, 836 (2018). *Finally*, the economic effects of this power are incalculably large, since the SEC asserts the power to throttle the development of new technology in investing across the economy. Congress should not lightly be presumed to have assigned to the SEC powers of such "vast economic and political significance." *West Virginia v. EPA*, 142 S. Ct. 2587, 2605 (2022).

At the very least, this approach of mandatory elimination or neutralization, rather than disclosure whenever feasible, marks a serious departure from Regulation BI. Yet the Commission has not explained why it now believes that Regulation BI's presumption in favor of disclosure—itself of recent vintage—is no longer tenable.

2. *At minimum, the SEC's organic statutes require a more rigorous explanation why an outright prohibition is necessary.*

At minimum, the statutory presumption in favor of disclosure as a potential remedy requires a heightened showing before the SEC can impose a broad prohibition on conflicts. A "rule is arbitrary and capricious if [the] agency fails to consider factors it must consider under its organic statute." *Chamber of Com. of U.S. v. SEC*, 412 F.3d 133, 140 (D.C. Cir. 2005). And the SEC cannot issue rules on conflicts without taking into account investors' general right to consent to disclosures, 15 U.S.C. § 80b-11(g)(1); *see*

Communications Rule similarly contemplates that a broker-dealer will link its website to FINRA's home page for the purpose of enabling a customer to obtain information about the broker-dealer from FINRA's BrokerCheck system. *See* FINRA Rule 2210(d)(8) and (e).

also id. § 78*o*(k)(1), or its duty to facilitate disclosures addressing conflicts, *id.* §§ 78*o*(*l*)(1), 80b-11(h)(1). Given this entrenched policy in favor of disclosure, a reasoned rule that does not allow for disclosure must contain a rigorous, detailed explanation why the presumption in favor of disclosure has been overcome.

The SEC's attempted explanation for why disclosures are inadequate is both perverse and perfunctory. Its sole explanation is the conclusory assertion that the "complexity" and "scalability" of new technologies makes reliance on disclosure infeasible. 88 Fed. Reg. at 53,961, 53,988. At most, this could potentially justify prohibiting conflicts for new, more advanced technologies such as complex artificial intelligence programs. However, it does not explain why disclosures are inadequate for established technologies like spreadsheets or other valuation calculators, charts, emails, electronic notifications or alerts, or graphic design. Further, this explanation simply takes for granted that scalability undermines disclosure. But scalability works both ways -- if advisers and brokers can communicate directly with more investors more rapidly than ever before, they also can get disclosures front and center more easily than ever before.

More fundamentally, this reasoning is alien to both the Constitution and the SEC's organic statutes. These sources of law enshrine the timeless principle that the free flow of information, not paternalism, should be the governing rule. The SEC may not abandon these principles simply because new "forms of communication" have emerged. *See Heller*, 554 U.S. at 582.

3. *The SEC has not made the findings required by statute.*

The SEC further has not made the findings that are by statute a necessary precondition to any prohibition on conflicts of interest. The SEC can only prohibit conflicts of interest if it "deems" those conflicts "contrary to the public interest and the protection of investors." 15 U.S.C. §§ 78*o*(*l*)(2), 80b-11(h)(2). But the Commission purports to make this finding only for new "PDA-like" technologies. 88 Fed. Reg. at 53,967, 54,021. It has not found that conflicts in the use of established technologies, like spreadsheets, are contrary to the public interest and the protection of investors, yet they are still included in the definition of "covered technologies" and thereby subjected to a high compliance burden. Even as to newer technologies, the SEC's findings are conclusory and unreasoned. The Proposed Rule does not define the vague category of "PDA-like" technologies, leaving unknown what emerging technologies actually fall within it. And the Rule provides no explanation for why the statutory standard has been met for this category.

B. The SEC Cannot Prohibit Conflicts with Non-Customers.

The SEC can define conflict-of-interest standards for firms' dealings with customers and non-customers that they are actively soliciting. But it has no authority to impose conflict-of-interest standards on otherwise accurate communications involving the public at large that do not rise to the level of a recommendation or an active solicitation to enter into a commercial relationship. Yet the Proposed Rule does precisely that, purporting to regulate *all* "investor interactions," including communications that simply may have an *effect* on a *prospective* investor. It thus sweeps well beyond this statutory limit, as well.

The provisions on which the Proposed Rule is purportedly based authorize the Commission to "promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers." 15 U.S.C. §§ 78*o*(*l*)(2), 80b-11(h)(2). "Conflict of interest" is an established term of art concerning a professional's duties toward his clients. *See Conflict of Interest*, *Black's Law Dictionary* (11th ed. 2019); Fiduciary Interpretation, 84 Fed. Reg. at 33,671. The term "conflicts of interest" also sits between the terms "sales practices" and "compensation schemes," which clearly apply only to a client relationship. Under the *noscitur a sociis* canon, "conflicts of interest" must as well.

Two neighboring provisions confirm this limit.

First, the provisions delegating power to the SEC to establish standards of conduct for conflicts of interest apply only when investors or advisers are "providing personalized investment advice about securities." 15 U.S.C. §§ 78*o*(k)(1), 80b-11(g)(1). But firms do not "provid[e] *personalized* investment advice" to individuals who are not current customers, such as members of the general public who merely visit the firm's website as they search the web. Indeed, in many circumstances—such as self-directed broker-dealers—they do not even provide "personalized investment advice" in communications with people who are their current customers.

Second, the Commission's duty to "facilitate the provisions of simple and clear disclosures to investors" concerns only disclosures "regarding the terms of their relationships with brokers, dealers, and investment advisers, *including* any material conflicts of interest." *Id.* §§ 78o(*l*)(1), 80b-11(h)(1). In other words, the provisions identify "conflicts of interest" solely as part of a client relationship.

In violation of this limit, the Proposed Rule applies well beyond interactions with existing and solicited clients. The Rule covers interactions with even "*prospective* investors." 88 Fed. Reg. at 53,974 (emphasis added). The SEC does not define that vague and expansive term, but it indicates it may sweep as broadly as "any person or entity that …visits the firm's website." *Id.* at 53,796. And covered "interaction" sweeps

well beyond active solicitation or recommending of a security to cover "firm communications" that merely "have the *effect* of guiding or directing investors to take an investment-related action." *Id.* at 53,795 (emphasis added). Thus, for instance, a firm would owe a fiduciary duty to a member of the public who simply reads an article on its website containing analysis or investor education from the use of covered technology, finds it insightful, and entirely on her own accord, changes her investing behavior. This complete untethering of fiduciary duty from an existing or solicited client relationship exceeds the SEC's statutory authority.

Here again, Congress would speak more clearly if it meant to delegate this power to the Commission. The Commission has never before asserted the power to so broadly regulate the truthful speech of brokers and advisers to non-customers. To the contrary, the disclosure regime of Regulation BI, for instance, applies only to *recommendations* to retail investors, not persons visiting a firm's website to use a retirement calculator. *See* 17 C.F.R. § 240.15*l*-1(a)(1). Further, the power to regulate communications outside of a client relationship is the power to censor fully protected, non-commercial speech. *Supra* Part II. In promulgating the Proposed Rule, the SEC cannot assume Congress would have so lightly conferred such a constitutionally dubious power.

C. The SEC Cannot Aggrandize its Authority by Expanding the Established Meaning of "Conflicts of Interest."

The Proposed Rule purports to rely on the SEC's power to address "conflicts of interests." *See* 15 U.S.C. §§ 78*o*(*l*)(2), 80b-11(h)(2). But the Rule radically re-defines the term to include consideration of "*any* firm-favorable information in an investor interaction." 88 Fed. Reg. at 53,982. This goes far beyond the ordinary historical meaning of the term "conflicts of interest." The SEC has no authority to redefine statutory terms with long-established meanings to aggrandize its own power.

As "creatures of statute," administrative agencies "possess only the authority that Congress has provided." *NFIB*, 595 U.S. at 117. And statutory terms must be interpreted in line with their "ordinary meaning." *Wis. Cent. Ltd. v. United States*, 138 S. Ct. 2067, 2070 (2018). In particular, "a common-law term of art should be given its established common-law meaning," at least absent a clear indication to the contrary. *United States v. Castleman*, 572 U.S. 157, 163 (2014). If agencies can simply redefine established terms in their organic statutes, then they would have the power to enlarge their jurisdiction at will, without accountability to the legislative branch.

"Conflict of interest" is a term of art with a substantially narrower definition than the one the Proposed Rule uses. A conflict does not exist when a fiduciary—let alone a professional communicating to the public outside the context of a client relationship—merely considers his own interest to some extent. Rather, there must be

an actual *conflict*, *i.e.*, an "incompatibility between one's private interests and one's … fiduciary duties." *Conflict of Interest*, *Black's Law Dictionary*, *supra*. Indeed, the Proposed Rule even acknowledges that its definition of conflict does not comport with ordinary meaning, noting that it is "broader than how economists usually define" the term. 88 Fed. Reg. at 53,998 n.232. It is also broader than how Congress and the securities laws have understood the term for many decades. Again, if Congress had meant to depart from the long-established meaning of "conflict of interest" to confer on the SEC the broad power it claims here, it would have done so clearly. But using the term in a short provision titled "Other matters," and saying nothing about the SEC's ability to redefine it, is about as far from a clear statement as it gets.

The SEC's redefinition of "conflict" also conflicts with the safe harbor established by the Exchange Act. The Act provides that "[t]he receipt of compensation based on commission or other standard compensation for the sale of securities *shall not*, in and of itself, be considered a violation" of the "standard of conduct" the Commission establishes for broker-dealers. 15 U.S.C. § 78*o*(k)(1) (emphasis added). Yet the Proposed Rule provides that a conflict exists if the offered covered technology "takes into consideration" *any* interest of the broker-dealer, including these expressly permitted forms of compensation.

D. The SEC Lacks Authority to Prohibit Immaterial Conflicts.

Finally, the Proposed Rule ignores the bedrock requirement of materiality. As with many of its other powers, the SEC's authority to regulate conflicts is limited to "*material* conflicts of interest." 15 U.S.C. §§ 78*o*(*l*)(1) and 80b-11(h)(1) (emphases added). Yet the Proposed Rule does not have a materiality threshold. It applies to *any* consideration of the firm's own interests in the use of covered technology. This reads the word "material" out of the statutes, in violation of the presumption against surplusage.

Indeed, the Rule does not just ignore materiality; it also sweeps plainly immaterial "conflicts" into its reach. Materiality has an established meaning in securities law: information a "reasonable investor" would "consider significant." *Basic Inc. v. Levinson*, 485 U.S. 224, 234 (1988). In a free-enterprise system, it is obvious that for-profit firms will always be motivated to some extent by their own interests. Reasonable investors would not find that fact, without more, significant. Indeed, as noted above, Congress recognized this in enacting Exchange Act section 15(k)(1) when it found that the receipt of standard compensation for the sale of securities "shall not", without more, be considered a violation of a broker-dealer's standard of conduct.

At minimum, the SEC cannot issue broad restrictions on the use of technology where *any* consideration of self-interest comes into play without explaining how that is

consistent with the materiality requirement. Yet the Rule does not even attempt to do this.

IV. The Proposed Rule Is Arbitrary and Capricious

The SEC "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation.'" 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c). *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011). This requires the Commission "to determine as best it can the economic implications of the rule," including a rigorous assessment of the rule's costs and benefits. *Id.* But although the SEC is held to a higher standard than the typical agency, its analysis of the Proposed Rule falls well short of the mark. Indeed, the Commission appears blithely unconcerned with the monumental consequences the Rule will have on the future use of new technology in investing should it ever go into effect.

A. The SEC Has Failed to Quantify the Rule's Costs and Benefits.

To the extent it can, the SEC must "adequately quantify" the Proposed Rule's costs and benefits. *Bus. Roundtable*, 647 F.3d at 1149. Even if that is infeasible, it must still estimate their scale "as best it can." *Id.* at 1148. But the Proposed Rule largely fails to do this. It contains no attempt to quantify or otherwise measure the scale of the Rule's benefits, *see* 88 Fed. Reg. at 54,006–08, nor of its indirect costs, which vastly outweigh its direct compliance costs, *see id.*at 54,010–11.

B. The SEC Has Failed to Account for the Existing Regime as Its Baseline.

The Proposed Rule does not sufficiently take into account the SEC's existing regulations on conflicts established by the recently promulgated Regulation BI and Fiduciary Interpretation, and by the Advisers Act. To justify a new rule, the SEC must first "determine whether, under the existing regime, sufficient protections existed to enable investors to make informed investment decisions and sellers to make suitable recommendations to investors." *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 179 (D.C. Cir. 2010). And it must analyze costs and benefits "at the margin" in light of existing regulations. *Bus. Roundtable*, 647 F.3d at 1151.

The Proposed Rule briefly mentions these existing protections and claims to be "consistent" with them. 88 Fed. Reg. at 53,988. Yet the Proposed Rule's reach is far broader. Specifically:

- Regulation BI protects "retail customers" of a broker-dealer. 17 C.F.R. § 240.15*l*-1(b)(1). In contrast, the Proposed Rule concerns "investors", which includes both current and *prospective* customers—*i.e.*, any member of the public whose investment choices may somehow be *affected* by a firm's communications,

regardless of the firm's intent or the individual's reasonable understanding of its intent.

- Regulation BI applies "when making a *recommendation* of any securities transaction." *Id.* § 240.15*l*-1(a)(1) (emphasis added). The Proposed Rule covers any "investor interaction" generally, which includes any act of "engaging or communicating with an investor", whether or not the person is a customer and whether or not a recommendation is actually provided. 88 Fed. Reg. at 54,022.

- Regulation BI defines a "conflict of interest" as an interest "that might incline a broker" or "dealer … to make a *recommendation* that is not disinterested." 17 C.F.R. § 240.15*l*-1(b)(3) (emphasis added). The Proposed Rule defines a conflict differently to include consideration of "*any* firm-favorable information in an investor interaction." 88 Fed. Reg. at 53,982. No actual recommendation is required.

- Regulation BI largely allows brokers and dealers to address conflicts by disclosure. 17 CFR § 240.15*l*-1(a)(2)(iii). The Proposed Rule, by contrast, requires that conflicts be eliminated or neutralized, not simply disclosed. 88 Fed. Reg. at 53,972.

The Fiduciary Interpretation for investment advisers is similar to Regulation BI in these respects. It identifies the duty to address conflicts as arising from a client relationship and applying in the course of making recommendations. 84 Fed. Reg. at 33,670–71. And it recognizes disclosure as a generally acceptable way of addressing conflicts. *Id.* at 33,671.

Reasoned decision-making requires that the SEC consider to what extent this extensive preexisting regulatory regime already addresses the issues it hopes the Proposed Rule will solve. *Am. Equity*, 613 F.3d at 179. And before radically expanding the scope of regulation in this area, the Commission must revisit the careful and extensive balancing of costs and benefits it previously made when issuing Regulation BI and the Fiduciary Interpretation, and explain why a different balance is now warranted. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983). It is disingenuous of the Commission to propose a rule departing so substantially from its previous regulations on conflicts while breezily asserting it is "consistent" with what came before.

Further, the SEC has failed to consider cost "at the margin" by taking into account the combined costs of compliance with the Proposed Rule *and* all the other rules it has promulgated on conflicts of interest over the past several years. *Bus. Roundtable*, 647 F.3d at 1151. These costs easily add up to many, many millions of

dollars. By adopting so many new and expanded rules with overlapping and inconsistent requirements over a relatively short period of time, the SEC fails to take seriously its responsibility to foster capital formation.

C. The SEC Has Failed to Justify the Rule's Breadth.

Although the scope of the Proposed Rule is dramatically broader than previous regulations governing conflicts among brokers and advisers and their customers, the SEC has not even attempted to justify much of the new territory it seeks to claim.

Specifically, although the Proposed Rule admits it is adopting a novel, more expansive definition of "conflict", 88 Fed. Reg. at 53,998 n.232, it does not offer a reasoned explanation for this departure from settled practice. Indeed, the only concrete "principal-agent problems" the SEC identifies as calling for more regulation, such as encouraging gambling-like behavior, involve traditional conflicts—alleged practices where advisers encourage investors to engage in harmful behavior. *Id.* at 53,998–99.[6]

Likewise, the Rule does not justify why the definition of "covered technology" must include spreadsheets, simple algorithms, and other well-established technologies that have been used for years without issue. The Rule—whose title, after all, is Conflicts of Interest Associated With the Use of *Predictive Data Analytics*—is suffused with concerns about predictive-data analytics and AI-based technology. Indeed, the SEC claims the Rule must cast a broad net to capture these rapidly evolving and subtly operating technologies. *Id.* at 53,963–66, 53,972. This does not explain, however, why the Rule needs to apply to *all* technologies used to analyze future investment outcomes—including technologies that have existed for years under the existing regulatory regime without apparent incident. The Rule does not identify any existing problem with these everyday technologies, or the rules that currently govern them, that justifies the invasiveness of its prohibitions and obligations.

D. The SEC Grossly Underestimates the Rule's Compliance Costs.

The SEC recognizes that the Proposed Rule would impose ongoing direct costs related to the annual review of every covered technology offered by the firm, even if analyzed previously, and certification that no conflict of interest, as that term would be expanded in the Proposal, is present. And it purports to quantify those costs, estimating

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[6] To the extent that the SEC is concerned with and seeks to address, through this Proposal, "gamification" in the securities industry, it seems to assume that investors are creatures of suggestion, like Pavlov's dog, incapable of exercising rational thought and analysis when receiving information and entering into securities transactions, and therefore need to be protected from themselves through a prohibition on even receiving such information. But, such a focus is really an attack on the means of presentation of information and not the substance, since "gamification" is, in effect, shorthand for information attractively presented. If the same information were presented in a dry and dull manner, the SEC would be unlikely to be concerned.

it would take 350 total firm hours per year to evaluate the use of covered technology, determine which uses require elimination of a conflict, and to eliminate the conflict. 88 Fed. Reg. at 54,009. But given what the Proposed Rule demands of firms, this estimate is entirely unrealistic. Indeed, many brokers and advisers make use of literally thousands of covered technologies that would need to be assessed by an initial review and then annually evaluated. And because the relevant code for investment technologies can change several times throughout the year, brokers and advisers may have to reexamine their technologies even more frequently than once a year.

As the Proposed Rule acknowledges, the source material for technologies relying on AI and machine learning is often opaque or very broad (*e.g.*, the entire Internet), making it very difficult, if not impossible, to determine how the relevant data are weighted at any point in time. *Id.* at 53,977. As a result, the Proposed Rule asserts that just the first step of evaluating potential uses may involve *reengineering the technology* to give it "explainability" features that make it easier to analyze. *Id.* To the extent this—not to mention imposing new constraints on the technology to address any identified conflict—would be possible at all, it would likely require nothing short of a *team* of highly specialized and sophisticated software engineers who are well-versed in both computer science and finance (and whom firms are not likely to already have on staff) to dedicate substantial time and resources to the effort. This is doubly true for technologies provided by third party vendors, which firms may not have the ability to reverse-engineer or alter to suit the Proposed Rule's purposes and whose vendor agreements may even prohibit users from reengineering their intellectual property. It is not the sort of task that can be accomplished by a single employee working alone for less than 9 weeks.

E. The SEC Fails to Adequately Consider the Rule's Indirect Costs.

The Proposed Rule also fails to appreciate the monumental indirect costs it imposes on efficiency, competition, and capital formation. It ignores certain critical costs and glosses over those it does mention, without taking seriously their immense scale. This is flawed in at least four respects.

First, the Proposed Rule's consideration of indirect costs is entirely perfunctory. The Rule devotes less than a full page to indirect costs. *See* 88 Fed. Reg. at 54,010–11. The agency simply rattles off different costs without any discussion of their seriousness or scale, without any citation to any studies or authority considering them, and without addressing any arguments that may be so severe as to make the Rule unjustified. The APA demands more than this.

Second, the Proposed Rule fails to consider the harm to consumers of prohibiting so-called "conflicted" communications with investors. The SEC does acknowledge that compliance costs may cause firms to forgo even those communications that do not involve "any conflicts of interest." *Id.* at 54,010. But it simply assumes that no benefits

are lost by preventing communications that the Rule does label as "conflicted." But under the Proposed Rule's unconventionally broad definition of the term, a communication can be "conflicted" even when it gives investors access to genuinely beneficial information, so long as the communication also accounts for the speaker's interests. Indeed, in our system of free enterprise, this "conflict" is what incentivizes firms to discover and disseminate useful information to investors. By removing any incentive for firms to do this, the Proposed Rule will in many cases leave the public less informed of beneficial investment opportunities. Yet the SEC does not consider this cost.

Third, the Proposed Rule does not take seriously its cost of throttling emerging investment technologies. Although it candidly acknowledges that the Rule may have the effect of prohibiting the use of AI and other emerging technologies relying on machine learning in the financial services industry, it does not meaningfully grapple with the seismic harms this would impose on investors.

The SEC acknowledges that emerging technologies relying on AI and machine learning are the most likely to have an opaque process for the recommendations and conclusions they make. 88 Fed. Reg. at 54,009. It further recognizes that, as a result, it may be practically impossible to determine whether such technologies are "conflicted" under its definition. *Id.* at 53,978. And the agency also acknowledges that, in such cases, the Rule will outright *prohibit* using these technologies. *Id.*

It simply cannot be justified for the Proposed Rule to have this effect. The opacity of AI and machine learning is directly linked to their massive potential. They do not rely on human beings to define their inputs, instead using computing abilities orders of magnitude above what simple algorithms directly produced by humans can do. This gives them the potential to unlock untold benefits for investors that are unable to be obtained by other means. The Rule would shut the door to these benefits, all because the SEC believes investors cannot be trusted to make reasonable judgments if there exists the mere *possibility* that a broker or adviser's self-interest might play *some* role in the use of the technology. It cannot promote efficiency or capital formation to prohibit innovative technologies by assuming they are harmful until proven innocent.

Fourth, the SEC fails to consider that the Proposed Rule will undermine competition by imposing costs that are prohibitive for all but the largest, most-profitable firms. Smaller firms that cannot benefit from economies of scale are likely to find the Rule's initial and ongoing compliance costs to be prohibitive, forcing them to avoid the use of technology altogether or reduce the ways in which they communicate with the investing public. For instance, even something as simple as hosting a retirement calculator on a firm website would trigger the Proposed Rule's costly review, potential elimination , and annual certification requirements. The hassle and cost of doing this is much less likely to be worth the benefit for smaller firms. Still less are smaller firms

in a position to reengineer AI and machine-learning technology to make them acceptable to use under the Proposed Rule. As a result, the Rule may drive smaller firms out of the market, concentrating market share in the largest, most profitable firms best able to shoulder the costs of compliance (or pass them on to retail investors). For instance, the Proposed Rule is likely to severely negatively impact the robo-advisory industry, as compliance with the Proposed Rule would assuredly increase the costs to such firms so that they would no longer be able to offer a low-cost alternative to a full-service investment adviser, making investment advice less accessible to the average investor without a large investment portfolio. The Commission does not consider these burdens on competition, let alone whether they are necessary or appropriate under its organic statutes.

F. The SEC Has Not Meaningfully Weighed Costs and Benefits in the Aggregate.

Although the Proposed Rule rattles off (some of) the Rule's costs as well as its purported benefits in isolation and in a perfunctory manner, the SEC has not adequately weighed them together to reasonably predict the Rule's overall effect. To be sure, the SEC does assert in conclusory fashion that the Proposed Rule will, on net, promote efficiency, competition, and capital formation. *Id.* at 54,011–12. But since it never attempts to measure, even in purely qualitative terms, the degree of the benefits and costs it identified—let alone compare them—this conclusion is unreasoned *ipse dixit*.

Further, nowhere does the SEC attempt to address the aggregate costs of all of the many new proposed and adopted rules, and amendments to existing rules, that it has adopted in recent years. The sheer magnitude of the SEC's recent rule-making agenda is staggering in its size, frequency, and complexity—particularly for broker-dealers, investment advisers, and retail investors. Yet nowhere does the SEC address the impact of the combined costs of all of these new and amended rules. For example, the Commission fails to explain the potential impacts of the Proposed Rule when combined with the SEC's equity market structure proposals, which also purport to address so-called conflicts in the handling of retail investors' stock trades and competition among market centers, all of which will affect the costs and accessibility of investing (likely for the worse).[7] Any cost/benefit analysis that does not take the combined impact of the Commission's aggressive regulatory agenda over the past several years falls well short of the reasoned decision-making required by the Administrative Procedure Act.

[7] *See Regulation Best Execution*, 88 Fed. Reg. 5440 (Jan. 27, 2023); *Disclosure of Order Execution Information*, 88 Fed. Reg. 3786 (Jan. 20, 2023); *Order Competition Rule*, 88 Fed. Reg. 128 (Jan. 3, 2023); *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better*, 87 Fed. Reg. 80,266 (Dec. 29, 2022).

V. The Proposed Rule Cannot Be Cured by Adopting a Narrower or Different Proposal.

The SEC's release setting forth the Proposed Rule and its reasoning in support of the Rule takes up a little more than 64 pages of the Federal Register and includes 106 separately numbered requests for comment, almost all of which include multi-part questions on the Rule and its constituent parts, including possible alternatives to the Rule or various aspects of it. The Proposed Rule is so absurdly overbroad, and the relatively narrow justifications for it are so clearly out of proportion with its sweeping breadth, that it seems likely the SEC has no intention of promulgating the Rule as proposed. Instead, the Proposed Rule's numerous flaws strongly suggest that the Commission intends—as it has done in several recent rulemakings—to issue a Final Rule that is materially and substantially different from the one it has proposed. Indeed, as Commissioner Uyeda has noted, it has become a "pattern" in "recent Commission proposals" to include "outlandish components" to "dr[a]w the attention and focus of commenters," only to adopt a different approach buried in "a request for comment or a glancing discussion in the economic analysis."[8]

The APA does not allow the SEC to hide the ball in this manner and thereby insulate its rules from public comment and criticism. The Commission must give the public "notice" of the "substance of the proposed rule" so that it has a meaningful "opportunity to participate in the rule making" through comments before the rule is finalized. 5 U.S.C. § 553(b), (c). Further, the SEC "has a unique obligation … to apprise … the public … of the economic consequences of a proposed regulation" during the rulemaking process. *Bus. Roundtable*, 647 F.3d at 1148. But the SEC has not rigorously analyzed the economic effects of any alternatives to the Proposed Rule, and the Proposed Rule is so sweeping and overbroad it is not immediately apparent what narrowing fixes the SEC could adopt. Simply put, there is no way for the public to discern what narrower approach there is that would be "a 'logical outgrowth' of the rule proposed." *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 174 (2007).

Consequently, no narrower alternative Rule would satisfy the APA's requirements of notice and a meaningful opportunity to comment. The only proper course before the agency is to either withdraw the Proposed Rule entirely or issue a new, narrower proposal with a renewed opportunity for public comment.

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[8] Uyeda Dissent, *supra* note 2.

Sincerely,

Gentry Collins

Chief Executive Officer
American Free Enterprise Chamber of Commerce