The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

October 10, 2023

VIA ELECTRONIC SUBMISSION: RULE-COMMENTS@SEC.GOV

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

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers
Release No. 34-97990; File Number S7-12-23

Dear Ms. Countryman:

I write in my capacity as the chief securities regulator for Massachusetts. The Office of the Secretary of the Commonwealth administers and enforces the Massachusetts Uniform Securities Act, M.G.L. c.110A (the "Act"), through the Massachusetts Securities Division. We welcome this opportunity to comment on the Securities and Exchange Commission's (the "SEC" or the "Commission") proposed rules addressing Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (the "Proposed Rules").

While innovation in the financial marketplace is desirable, innovation that touches upon main street investors comes with great responsibility. We support the Commission's efforts to craft principled rules to meet the challenges posed by artificial intelligence[1] and more specifically predictive data analytics and similar technologies ("PDA-like technologies"). Because these often novel technologies have the power to influence the behavior of investors, firms must be held accountable to address accompanying risks. In particular, we are concerned about investor harm resulting from the use of these technologies without guardrails to ensure proper disclosure and consideration of conflicts. While commending the Commission, we urge

[1] Including machine learning, deep learning, neural networks, large language models, generative artificial intelligence, and other similar technologies, processes, or tools.

the Commission to broaden its approach to these challenges—including a recognition of the role state securities regulators play in regulating financial service firms.

I. Refining the Definition of Covered Technology and Acknowledgement of Engagements as Recommendations or Investment Advice

The definition of covered technology should include technologies that are used to optimize for, predict, guide, forecast, *influence*, or direct investment-related behaviors or outcomes. The addition of the word influence reflects the power of new technologies to impact investors, especially inexperienced investors, in ways that are reckless and place the interests of the firm above the customer. The proposed definition focuses on the intentions behind the implementation of a given PDA-like technology, i.e. to guide or direct. However, PDA-like technologies may result in outcomes that are unpredictable, unfold over an extended period of time, and may cause investor harm. The word influence is necessary because it will require firms to consider a broader range of investment behaviors or outcomes when evaluating these technologies. For example, certain gamification strategies based on digital engagement practices might have cumulative effects not apparent at the time of implementation.[2]

We likewise encourage the Commission to explicitly broaden the universe of engagement practices that constitute a recommendation or investment advice. In particular, a firm's PDA-like technologies, which by design or effect have the result of encouraging investors to engage in risky trading, should be deemed recommendations by the SEC. As the Commission has noted, such interactions can be in the form of nudges or prompts that promote investment-related actions by customers, including decisions to buy or sell. The Commission's principles-based approach goes far in addressing this concern, but it could benefit from a more direct statement that engagement practices that influence an investor's trading can constitute recommendations or investment advice. This framework has been a focus of my office's recent enforcement actions and will remain a focus of my Securities Division's efforts to protect investors.

The definition of covered technology should also address both direct and *indirect* uses of technologies. Indirect uses are prone to the same conflicts of interest as direct, investor-facing tools. In fact, indirect uses may pose an increased risk where an interaction appears to be the work of a trusted professional. A definition that accounts for the impact of both direct and indirect uses of technology is thus necessary to address conflicts of interest and protect investors.

II. Investor Interactions

We support the Commission's efforts to cover investor interactions that may fall short of advice or recommendations. While many investor interactions may rise to the level of a recommendation, the rule appropriately addresses those interactions which do not arise to the

[2] *See e.g.*, James Fallow Tierney, Investment Games, 72 *Duke Law Journal* 353-446 (2022) (For support of the notion that gamification strategies that might be profitable for financial firms can cause investors to act against their own interests or in a manner wholly separate from the value of a security.).

level of a recommendation. In these instances, it is equally important for firm to evaluate conflicts of interest and ensure that the investor's interest comes first.

III. Oversight of Covered Technologies

PDA-like technologies often are based upon computer and behavioral sciences not typically subject to a regulatory regime designed to protect investors. Without insight into the technical operations of these tools, firms cannot meaningfully address the conflicts of interest they create. This is particularly true where the technology is complex or development is undertaken by third-parties.

We encourage the Commission to require firms to designate a responsible individual who must affirmatively demonstrate his or her competence to supervise each covered technology. The responsible individual should be familiar enough with the underlying technologies to facilitate oversight, modification, and testing. This structure is also necessary to help to avoid conflicts that might be obscured by technical complexity or the use of third-party developers. Tasking a specific person with responsibility for explaining the use of new technologies will benefit investors and also improve communications within firms and with regulators.

IV. Evaluation and Testing

We support the Commission's proposed requirements for firms to evaluate and test covered technologies. These requirements provide sufficient flexibility for firms to create a review structure necessary to evaluate the use of covered technology and its impact on investors. In particular, the requirement that a firm address conflicts of interest prior to implementation of these technologies as well as periodic testing will provide necessary safeguards to protect against these technologies getting out of control. We encourage the Commission to include as part of this testing, an evaluation of the likelihood that such deployment may constitute a recommendation or investment advice.

V. Existing State Frameworks

State securities regulators are on the front lines when it comes to the impact of new technologies on main street investors. This is particularly so, given our frequent interaction with retail investors in addressing their complaints and concerns. We urge the Commission to act along Massachusetts and other states in addressing these important issues.

a. Avoidance and Elimination of Conflicts of Interest

The complexity of PDA-like technologies, both from a technological and behavior perspective, makes it clear that certain conflicts cannot be adequately addressed through disclosure. In particular, these new technologies are likely to blur the line between machine-

generated outputs and personalized contacts. Further, many underlying technologies are impossible to evaluate without technical expertise.

In Massachusetts, broker-dealers and investment advisers are subject to a uniform fiduciary standard. This duty mandates that firms avoid, eliminate, or mitigate conflicts of interest when providing advice or making a recommendation.[3] These duties also require that recommendations and investment advice be provided without regard to the financial or other interest of any party other than the client-investor. The interest of the investor must come first. We encourage the Commission to consider an approach to PDA-like technologies which incorporates the concepts set forth in the Massachusetts fiduciary rule as it concerns conflicts—in particular, the duty to avoid, eliminate, or mitigate conflicts.

b. Addressing Investor Confusion

PDA-like technologies that replace human interactions also risk increasing investor confusion. Investors may not be able to distinguish between digital engagement practices aimed at influencing their behavior and investment advice tailored to their financial circumstances. Investors may also have difficulty discerning whether communications have been prepared by a machine or a trusted adviser. Investors must be able to readily determine the purpose of an investor interaction. The fiduciary duty standard compels firms to take steps to avoid investor confusion, particularly where a firm might stand to benefit from said confusion.

c. Problems Stemming from Explainability

PDA-like technologies raise serious issues of explainability and visibility because they can operate as a so-called "black box," where it is difficult to know what information was used to reach a given result and because the processes these programs use are not observable. A black box can be difficult to understand, even for experts. We agree with the Commission that financial services firms may not avoid responsibility for the results created through new technologies because they lack visibility into how a covered technology functions.

Firms should not be allowed to avoid responsibility because the results created through new technologies are "not explainable." An absence of explainability could result from reliance on a third-party developer or a so-called black box algorithm or from a program's consideration of vast amounts of information. We agree with the Commission that financial services firms may not avoid responsibility for outcomes because they cannot explain how a covered technology functions. Explainability will pose increasing challenges as technologies grow more complex.

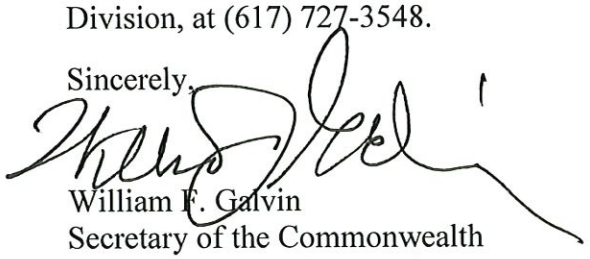
[3] 950 C.M.R. 12.207 (Making a broker-dealer or agent subject to a fiduciary duty to a customer when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security).

Financial services firms must meet these challenges by taking steps to assure that the interests of investors always come first.

VI. Conclusion

We support the Commission's proposal, which would take important steps to address the growing risks posed by unchecked use of PDA-like technologies, and we thank you for the opportunity to comment on this important proposal. If you have questions or I can assist in any way, please contact me or Anthony R. Leone, Deputy Secretary of the Massachusetts Securities Division, at (617) 727-3548.

Sincerely,



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