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October 10, 2023

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1091

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

Dear Ms. Countryman:

The Investment Company Institute[1] is writing to provide comments on the Securities and Exchange Commission's (the "Commission" or "SEC") proposal on investment advisers' and broker-dealers' conflicts of interest ("Proposal").[2] The Commission has proposed sweeping new regulatory requirements to address potential risks to investors from conflicts of interest associated with the use of "covered technologies" by investment advisers and broker-dealers (collectively, "firms"). Proposed Rules 15l-2 under the Securities Exchange Act of 1934 ("Exchange Act") applicable to broker-dealers and 211(h)(2)-4 under the Investment Advisers Act of 1940 ("Advisers Act") applicable to registered investment advisers ("Proposed Rules") would require firms to evaluate their use of predictive data analytics (PDA) and other covered technologies in connection with investor interactions and to eliminate or "neutralize" certain conflicts of interest associated with such use. The Commission also proposes amendments to

[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage $31.5 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional $8.8 trillion in regulated fund assets managed outside the United States. ICI also represents its members in their capacity as investment advisers to certain collective investment trusts (CITs) and retail separately managed accounts (SMAs). ICI has offices in Washington DC, Brussels, and London and carries out its international work through ICI Global.

[2] *See Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, 88 Fed. Reg. 53960 (Aug. 9, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-08-09/pdf/2023-16377.pdf ("Proposing Release"). On September 11, 2023, ICI, along with 13 other trade associations, filed a letter with the SEC raising serious concerns regarding the Proposal. The letter requests that the Commission withdraw the Proposal because it is unnecessary, inadequately reasoned, and fatally flawed. *See* Comment Letter to Ms. Vanessa A. Countryman, Secretary, SEC, from Trade Associations (September 11, 2023), *available at* https://www.sec.gov/comments/s7-12-23/s71223-258279-605062.pdf ("Joint Trades Letter"). *See also* Comment Letter to Ms. Vanessa A. Countryman, Secretary, SEC, from Trade Associations (Aug. 15, 2023) (requesting extension of the comment period for an additional 60 days), *available at* https://www.sec.gov/comments/s7-12-23/s71223-245299-541662.pdf.

rules under the Exchange Act and Advisers Act that would require firms to make and maintain certain records in accordance with the Proposed Rules.

We urge the SEC to withdraw the Proposed Rules. They are unnecessary and would have detrimental consequences for the very investors the SEC seeks to protect. While focusing on the purportedly unique risks raised by investment advisers' and broker-dealers' use of certain technologies, the Proposed Rules would fundamentally change well-established legal principles that govern how firms and their representatives address conflicts of interest in compliance with the federal securities laws. The Proposed Rules raise constitutional issues by unduly restricting firms' ability to communicate with investors. The Commission neither has adequately demonstrated the existence of a problem that would justify such a radical change in regulation, nor has it provided sufficient public notice of its intent to do so. Furthermore, the Proposal exceeds the Commission's statutory authority and violates the Administrative Procedure Act (APA) and the Commission's rulemaking obligations under the securities laws. The Commission has failed to adequately analyze the tremendous costs of this vague, flawed, and wide-ranging proposal for market participants, including investors, which would outweigh any potential benefits. We further note that members of Congress recently raised similar concerns regarding the Commission's basis and authority for issuing the Proposed Rules.[3]

Executive Summary

The SEC should withdraw the Proposed Rules for the following reasons:

- The Commission has provided no basis or evidence that the Proposed Rules are needed. The Proposed Rules are confusing, unworkable, and overreaching and would harm the very investors the Commission seeks to protect by stifling innovation, restricting financial education, and effectively limiting investors' ability to access, through technology, affordable advice and investment products (Section 1);

- Existing Standards of Conduct[4] for advisers and broker-dealers fully and appropriately address any concerns the SEC may have regarding conflicts of interest raised by new technologies (Section 2, Appendices A, B);

- The Proposed Rules violate the First Amendment by unduly limiting, without adequate justification, how firms can communicate with investors and potential investors (Section 3);

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[3] *See* Comment Letter to the Honorable Gary Gensler, Chair, SEC, from Members of Congress (September 22, 2023), *available at* https://www.sec.gov/comments/s7-12-23/s71223-263559-629942.pdf.

[4] Regulation Best Interest ("Reg BI") and the fiduciary duty applicable to investment advisers ("IA Fiduciary Standard," collectively, the "Standards of Conduct"). The SEC adopted Reg BI in 2019 and confirmed the IA Fiduciary Standard in a Commission interpretation that same year. *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019) ("Reg BI Adopting Release"); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, SEC Release No. IA-5248 (June 5, 2019), 84 FR 33669 (July 12, 2019) (the "Fiduciary Release").

- The Proposed Rules exceed the Commission's statutory authority (Section 4);

- The Proposal violates the APA and the Commission's statutory duty to consider effects on efficiency, competition, and capital formation in rulemaking.[5] While the Proposal focuses on potential concerns raised by new technologies, the Proposed Rules would broadly change existing regulation without adequate explanation or appropriate notice and comment, and therefore are arbitrary and capricious. The Commission's economic analysis is fundamentally flawed, as it does not identify or analyze the costs and benefits of such a radical change to existing legal standards. By not identifying and analyzing the extensive implications of the Proposed Rules for existing regulations applicable to firms and, more broadly, for how firms use technology in their day-to-day businesses and to interact with investors, and the impact of categorically eliminating or neutralizing essentially all conflicts of interest, the Commission fails to adequately identify or consider the Proposal's costs and burdens, which overwhelmingly outweigh any potential benefits (Section 5); and

- ICI's own economic analysis finds that the Proposal fails to demonstrate any potential benefits to outweigh the Proposed Rules' tremendous costs. Based on the SEC's own cost estimates, the Proposed Rules, if adopted, would impose costs of over $10 billion over the first 10 years alone. We believe, however, that this analysis significantly understates costs due to errors of omission and implausible assumptions in the Commission's analysis. Our analysis instead finds that the potential costs are likely to be several times higher than the Proposal estimates. The actual costs of the Proposed Rules, if adopted, are expected to be at least $30 billion in the first ten years (Appendix C).

Existing Standards of Conduct include well-developed principles for addressing conflicts of interest that can be readily tailored to new technologies and other market developments. The Commission should seek to promote a regulatory environment that encourages technological innovation that benefits investors and markets, rather than proposing rules that would have a severely chilling effect on technological innovation and are harmful to investors and markets. The Commission therefore should first obtain additional industry feedback through roundtables and other opportunities for public input, carefully identify any existing problems specific to the use of technology that may need to be addressed, and tailor a solution proportionate to any specific concerns it identifies.[6] Further, the Commission should consider holistically the implications of the Proposal in combination with those of its other proposed and existing rules.[7]

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[5] 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).

[6] In 2021, the SEC did request public comment on "digital engagement practices" by broker-dealers and investment advisers. As discussed further below, however, that request was much more narrowly focused than the scope of the Proposed Rules. *See infra* note 22 and accompanying text.

[7] Letter to Chair Gary Gensler, SEC, from Eric J. Pan, President and CEO, and Susan Olson, General Counsel, Investment Company Institute (August 17, 2023) (explaining why the SEC must account for the aggregated impact of its rulemaking), *available at* https://www.sec.gov/comments/s7-04-22/s70422-246959-547222.pdf ("ICI Letter").

Our comments below focus on the Proposed Rules' implications for (i) registered investment advisers, in their capacity as advisers to registered investment companies and separately managed accounts; (ii) registered investment companies, including mutual funds, exchange-traded funds, and closed-end funds (together, "funds") and their investors; and (iii) registered broker-dealers that sell fund shares. Our perspective reflects the important role each of these entities plays in helping retail investors achieve their investment goals.

1. The Proposed Rules Are Unnecessary

The Commission has provided no evidence in the Proposal that the Proposed Rules, which are exceedingly broad in scope, are needed and has failed to demonstrate that there is a problem that the current regulatory framework is unable to address. At the same time, the Commission's incomplete understanding of industry's use of technology has caused it to dramatically understate the costs of the Proposed Rules. The Proposed Rules therefore impose extreme burdens without solving a real, identified problem, in violation of basic requirements of reasoned decision-making.

1.1 The Commission Has Not Explained Why "Covered Technologies" Warrant a New Conflict of Interest Regime

As discussed further below, the Proposal does not offer a single example of a new conflict of interest associated with "covered technologies" that would require a different approach than that taken by the Standards of Conduct. Instead, the Proposal describes common conflicts such as revenue sharing, recommendation of proprietary products, and dually registered broker-dealers and investment advisers that may have an incentive to steer investors toward the account type that is most profitable for the firm, and offers no support that these conflicts are inadequately addressed by current regulation.[8] Rather than identifying actual harms to investors from the use of broadly defined "covered technologies," the Commission cites possible risks from theoretical or potential uses of PDA and other technologies as the basis for its rulemaking.[9] The Commission, however, fails to explain why these risks are unique or why existing standards of conduct are inadequate to address them.[10]

The Commission's primary assertion why a new approach to conflicts is needed for "covered technologies" is "scalability."[11] It is unclear why scalability, which the Commission mentions repeatedly throughout the Proposal, is relevant in this context, or why reaching a broad audience

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[8] *See* Proposing Release at 53961.

[9] *Id.* at 53962 nn.15-18.

[10] *Id.* at 53961–62.

[11] *Id.* at 53961 (the Commission asserts that "due to the scalability of these technologies and the potential for firms to reach a broad audience at a rapid speed . . . any resulting conflicts of interest could cause harm to investors in a more pronounced fashion and on a broader scale than previously possible.").

at a rapid speed would necessitate a different approach to conflicts of interest.[12] Accompanying disclosures could be communicated just as rapidly. The Commission offers no logical connection between changing the Standards of Conduct and preventing any harmful use of technology. Fundamentally, the Commission has failed to demonstrate what is unique about conflicts arising from the use of "covered technologies" and why the current regulatory framework is insufficient to protect investors and markets from any such concerns.

The Proposal also fails to establish that there is any actual harm associated with covered technology in need of redress. The Commission has not provided examples of investor harm it was unable to address under current law with its existing tools, including its examinations and enforcement authority and its ability to issue targeted guidance on issues of concern. Rather than referencing concrete examples of unaddressed harms resulting from firms' conflicts in their use of technology, the Commission instead relies heavily on theoretical academic papers to attempt to substantiate its views.[13]

Other than a single example of a disclosure-based enforcement action[14] and reference to recent exams the SEC has conducted of robo-advisers,[15] the Proposal does not include relevant findings

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[12] Moreover, the Commission neglects to consider the positive aspects of scalability, such as lower costs and accessibility. For example, scalability may allow firms to utilize technology to inclusively reach a wider universe of investors at a more cost-effective price point. In addition, it is not clear how investment advisers' use of covered technologies in interactions with investors in discretionary advisory accounts would raise scalability concerns.

[13] *See, e.g.,* Proposing Release at 53968, nn. 83, 87, 53999 n. 240. These theoretical academic papers often miss the mark, citing basic economic principles but not acknowledging the extensive regulatory framework in place to address investor harm.

[14] *In re Charles Schwab & Co., Inc., et al*., Exchange Act Release No. 95087 at 2, 3, 4 (June 13, 2022) (settled order) (enforcement action involved allegations that an adviser marketed that its "no fee" robo-adviser portfolios were determined through a "disciplined portfolio construction methodology" when they allegedly were pre-set to hold a certain percent of assets in cash because the adviser's affiliate was guaranteed a certain amount of revenue at these levels. The adviser allegedly did not disclose its conflict of interest in setting the cash allocations; that this conflict resulted in higher cash allocations, which could negatively impact performance in a rising market; and that the cash allocations were higher than other services because clients did not pay a fee.).

Since the Proposing Release was issued, the Commission brough a settled enforcement action against another registered investment adviser that agreed to pay more than $18 million related to alleged undisclosed conflicts of interest involving a cash sweep program operated by its affiliated custodian and its receipt of millions of dollars in revenue sharing payments from third-party custodians. *See In re AssetMark, Inc*., Investment Advisers Act Release No. 6434 (September 26, 2023) (settled order) (as with the *Schwab* action, the SEC was able to address the alleged violation of undisclosed conflict of interest with its existing authority under Section 206 of the Advisers Act).

[15] *See* Proposing Release at 53966–67 (discussing enforcement actions); s*ee also* SEC Division of Examinations Risk Alert, Observations from Examinations of Advisers that Provide Electronic Investment Advice (Nov. 9, 2021) ("Robo-Adviser Risk Alert"), *available at* https://www.sec.gov/files/exams-eia-risk-alert.pdf (SEC examinations staff observed that nearly all of the examined advisers received a deficiency letter, with observations most often noted in the areas of: (1) compliance programs, including policies, procedures, and testing; (2) portfolio management, including, but not limited to, an adviser's fiduciary obligation to provide advice that is in each client's best interest; and (3) marketing/performance advertising, including misleading statements and missing or inadequate disclosure.) The staff's observations in the Robo-Adviser Risk Alert identified deficiencies under existing law and rules. The staff did not suggest that the Fiduciary Duty Standard was in any way inadequate. Similarly, the

or other information from the Divisions of Enforcement, Examinations, Investment Management, or Trading and Markets, to support the Proposed Rules. In the disclosure-based enforcement action, the adviser allegedly did not disclose its conflict of interest in setting the cash allocations for its "no fee" robo-adviser portfolios. The SEC charged the alleged violation, however, under its *existing authority* under Section 206 of the Advisers Act. Thus, this case does not support the Commission's theory that conflicts associated with the use of covered technology are unique; rather, it appears to support the sufficiency of the existing Standards of Conduct as a basis to charge an adviser's alleged failure to appropriately address conflicts of interest.

Similarly, the Proposal notes the size and scope of the investment advisory and brokerage industries which, by all indications, are operating efficiently and effectively. The Commission fails to provide examples of market disruption or widespread failures suggesting the need for dramatic changes to the current regulatory framework. The Commission also acknowledges that it cannot quantify or estimate either the benefits of the Proposed Rules or their impact and burden on market participants, including investors. This does not provide a basis for sound rulemaking that is consistent with the requirements of the APA, as discussed below. If the Commission cannot clearly identify a problem and demonstrate that the benefits of the Proposed Rules would outweigh their costs, it should not be proposing these rules.

1.2 The Proposed Rules Would Harm Investors, Not Benefit Them

Because of their incredibly broad scope, the Proposed Rules raise a multitude of issues and are more likely to harm markets, funds, and long-term investors than to protect them. If the Proposed Rules were adopted, they likely would result in limiting access to financial advice and information for ordinary American investors, including those who historically have had less access to investment advice.[16] These are the investors that have benefited most from the

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Proposing Release does not suggest that the SEC lacks the enforcement authority under existing law that is needed to sanction firms for exploiting conflicts of interest associated with their use of technology.

[16] For example, households using robo-advisers tend to be younger (78 percent are headed by someone younger than 55, including 29 percent who are younger than 35) and tend to have more modest household financial assets (69 percent have less than $250,000, including 28 percent with less than $50,000). While households with ongoing advisory relationships come from all ages and wealth levels, they tend to be older (45 percent are 65 or older) and tend to have more household financial assets (61 percent have $250,000 or more). *See infra* Figure C.1 in Appendix C for additional detail. The Proposed Rules may impact investors more widely, perhaps even those who are self-directed or saving through retirement accounts. With regard to mutual fund-, ETF-, and closed-end fund-owning households, 71.7 million households representing 120.5 million individual investors in 2022 could be impacted. *See* Sarah Holden, Daniel Schrass & Michael Bogdan, *Ownership of Mutual Funds and Shareholder Sentiment*, ICI Research Perspective 28, no. 9 (Oct. 2022), *available at* https://ssrn.com/abstract=4293324 and https://www.ici.org/system/files/2022-10/per28-09.pdf. The bulk of these households own mutual funds, and mutual fund−owning households come from all age, income, and wealth groups. In 2022, almost half (48 percent) of households owning mutual funds held funds purchased through an investment professional, and 28 percent owned funds purchased through the direct market channel. *See* Sarah Holden, Daniel Schrass & Michael Bogdan, *Characteristics of Mutual Fund Investors, 2022*, ICI Research Perspective 28, no. 10 (Oct. 2022), *available at* SSRN: https://ssrn.com/abstract=4293327 and https://www.ici.org/system/files/2022-10/per28-10.pdf. Finally, more broadly, though in large part supported by indirect access through funds, stock ownership in the United States has expanded and reached more deeply across more income groups over time. *See* Sarah Holden & Michael Bogdan,

technological advancements that have democratized financial services. Innovation has allowed these investors to gain access to personalized financial information and advice that historically was limited to the very wealthy. The popularity of robo-advice and online accounts is a testament to how technology has been key to inclusivity in investing.[17]

By imposing costly and burdensome compliance and documentation obligations on every conceivable use of technology, the Proposed Rules would deter firms from engaging with investors in the manner they prefer. An example of this is a beneficial "nudge" or reminder to maximize retirement savings. An electronic nudge can remind an investor that there are steps that might be taken to improve his or her financial outcome and help the investor meet his or her investment goals.[18] But given the costs the Proposed Rules would impose on initiating these nudges, some firms would likely opt to forego them altogether. Similarly, by applying the Proposed Rules to financial education that firms create using, or provide to investors by means of, covered technologies, the Proposed Rules would deter firms from making available financial education to investors—a practice the Commission has endorsed and strongly encouraged.[19] The Proposed Rules would not only cause firms to reassess the use of existing technologies to offer services and products to investors, but they would also have a severe chilling effect on firms' willingness to engage in technological innovation with respect to investor services and products.

By radically changing the well-established Standards of Conduct and day-to-day business practices of investment advisers and broker-dealers, the Proposed Rules would place onerous, confusing new responsibilities on firms, based on scant evidence that the proposed changes will better protect investors—the rules are a solution in search of a problem. We believe changing the Standards of Conduct is unnecessary and would instead create a host of practical difficulties that we outline in this letter.

Main Street Owns Wall Street, ICI Viewpoints (Feb. 10, 2021), *available at* https://www.ici.org/viewpoints/21_view_equityownership.

[17] *See* Rhodri Preece et al., *Future State of the Investment Industry,* CFA Institute Research & Policy Center at 11 (Sept. 2023) *available at* https://rpc.cfainstitute.org/-/media/documents/article/industry-research/future-state-of-the-investment-industry.pdf (stating that global assets in robo-advisers are expected to reach $2.8 trillion by year-end and $4.7 trillion by 2027).

[18] By way of example, plan participants who are either not contributing to their retirement plan or are not contributing at a level to receive the full benefit of their employer match may receive a communication or "nudge" reminding them of the benefits of contributing more to their plan. While such nudges are highly beneficial to participants, firms that provide recordkeeping services also stand to benefit from fees earned on greater assets in the plans. Additionally, where the recordkeeper's proprietary funds are available through the plans, the recordkeeper can also benefit from the increased revenue received from higher plan balances invested in those funds. In this example, the covered technology used to create and send the nudges might look to only a single data point – the contribution levels of participants – to determine who should receive the nudges without in any way factoring in firm revenues. This is illustrative of the illogical nature of the Proposal's sweeping scope.

[19] The Commission has made investor education a cornerstone of its mission to protect investors, establishing an Office of Investor Education and Advocacy, and hosting a website, https://www.investor.gov/, the purpose of which is to serve as an online resource to help retail investors make sound investment decisions and avoid fraud.

1.3 The Proposed Rules Understate the Burdens They Would Impose Because They Do Not Reflect How Firms Operate and Utilize Technology

The Proposed Rules do not reflect how firms operate or utilize technology for the benefit of investors—and therefore fail to fully appreciate the costs they would impose by burdening firms' use of technology. Firms rely on technology for all aspects of their day-to-day operations, including to manage portfolios, trade, perform back-office functions, conduct compliance, engage in regulatory reporting, and keep records.[20] Technology has revolutionized firms' ability to offer investors innovative, cost-efficient products and services, as well as critically important investment education and tools. These technological advancements have democratized investing and made the financial markets accessible to ordinary retail investors for the first time in history. Furthermore, technology allows firms to effectively engage with investors to help them personalize their investments and make better informed decisions regarding their portfolios at an affordable cost.

While the Commission notes the benefits technology has brought to the industry and investors,[21] the overreaching scope of the Proposed Rules reflects a lack of acknowledgement of the extensive benefits technology brings to investors and a failure to weigh these benefits appropriately. The Proposed Rules would likely strongly disincentivize firms' use of technology, diminishing the many benefits of technology for investors.

Prior to issuing the Proposed Rules, the Commission should have engaged in more industry and investor outreach to better understand how firms use technology, identify specific problems that need to be addressed, and understand the exact nature and scope of any problems and then, only if appropriate, developed potential solutions based on an accurate understanding of industry practice tailored to address the particular concerns identified. While the Commission, in 2021, did request public comment on "digital engagement practices" by broker-dealers and investment advisers,[22] that request was aimed at the use of "behavioral prompts, differential marketing, [and] game-like features."[23] Unlike the Proposed Rules, the Commission's request did not extend to

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[20] Overall, the benefits of technology generally include increased productivity, lower costs, and more efficient and affordable investor access to accurate, automated information, data, and services. If the Commission adopts the Proposed Rules, the anticipated pullback on the use of such technology could result in a decrease in the flow of information to clients from advisers and brokers, and investors no longer having access to previously provided beneficial technologies.

[21] *See* Proposing Release at 53962 nn.11, 16 (stating that, due to technological advances, there is increased retail investor participation, more efficient development of investment strategies, and lower expenses for investors).

[22] *See* 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, Release Nos. 34-92766; IA-5833 (Aug. 27, 2021), 86 Fed. Reg. 49067 (Sept. 1, 2021) (RFI), *available at* https://www.govinfo.gov/content/pkg/FR-2021-09-01/pdf/2021-18901.pdf.

[23] *Id.* at 49067.

the use of technology in virtually every aspect of an investment adviser's and broker-dealer's day-to-day business.[24]

2. The Proposed Rules Needlessly Abandon Well-Established Standards of Conduct, Including the Commission's Recently Adopted Reg BI

Not only does the Proposal fail to establish that covered technology presents any unique conflicts, but it also fails to adequately explain why the current regulatory regime is insufficient to address any conflicts that may be raised by investment advisers' and broker-dealers' use of covered technology. The Proposed Rules would largely replace the well-established framework under the IA Fiduciary Standard for addressing conflicts of interest, as well as the provisions for addressing conflicts under the SEC's own recently adopted Reg BI. We believe that existing Standards of Conduct fully and appropriately address any concerns regarding conflicts of interest raised by advisers' and broker-dealers' use of technology in investor interactions. The Commission has not demonstrated that the conflicts of interest raised by the use of AI and other covered technologies are unique or that advisers' and broker-dealers' application of the existing Standards of Conduct are insufficient to address such conflicts. We summarize our views below and provide more detail in Appendices A and B regarding existing Standards of Conduct and how the Proposed Rules dramatically depart from them, as well as other regulatory obligations applicable to investment advisers and broker-dealers that address conflicts of interest.

Under the IA Fiduciary Standard, it is well established that an adviser is subject to both the duty of care and the duty of loyalty and may not subordinate its clients' interests to its own. To satisfy this fiduciary duty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship. An adviser must eliminate, or at least expose through full and fair disclosure, all conflicts of interest which might incline the adviser—consciously or unconsciously—to render advice which is not disinterested.[25] Just a few years ago, the Commission confirmed this standard in an interpretation of an adviser's fiduciary duty, including the ability of an adviser to address conflicts using disclosure and informed consent.[26] The Commission clearly contemplated that an adviser may be required to address complex conflicts, noting its view that, in order for disclosure to be full and fair, it should be sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision regarding whether to provide consent. The Commission further explained its belief that some "conflicts may be of a nature and extent that it would be difficult for an adviser to provide

[24] To the extent the SEC believes that the further regulation may be necessary to address concerns around gamification, it must: (i) identify those concerns with particularity, (ii) propose tailored regulation intended to address those concerns, (ii) explain specifically how any proposed regulation would address the particular harms identified by the SEC related to gamification, (iv) analyze why existing law and regulation are inadequate to address those harms, and (v) adopt rules, reflecting public comments, that would address any specific gaps in existing law or regulation. The SEC does not do this with respect to the Proposed Rules, which are much broader than necessary to address any concerns related to gamification. *See Nat'l Fuel Gas Supply Corp. v. FERC,* 468 F.3d 831, 841 (D.C. Cir. 2006) (Kavanaugh, J.).

[25] *SEC v. Capital Gains Research Bureau, Inc.*, 375 US 180 (1963).

[26] *See* Fiduciary Interpretation.

disclosure, particularly to retail clients, that adequately conveys the material facts or the nature, magnitude, and potential effect of the conflict sufficient for a client"[27] to provide informed consent and that, in these situations, the adviser should eliminate the conflict or adequately mitigate it so that full and fair disclosure and informed consent are possible.[28] The SEC has not discussed why its 2019 interpretation is inadequate to address conflicts raised by an adviser's use of technology.

Reg BI, adopted by the SEC in 2019, imposes an enhanced standard of conduct on broker-dealers and their associated persons when they provide recommendations to retail customers regarding a securities transaction or an investment strategy involving securities.[29] Under Reg BI, a broker-dealer and its associated persons must act in the retail customer's best interest and cannot place their own interests ahead of the retail customer's interests. This best interest obligation is satisfied through compliance with four component obligations including, among others, a conflict of interest obligation that requires the broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to: (i) identify and, at a minimum, disclose or eliminate conflicts of interest; (ii) identify and mitigate any conflicts of interest associated with recommendations that create an incentive for associated persons of the broker-dealer to place their interest or the interest of the broker-dealer ahead of the customer's interest; (iii) identify and disclose any material limitations placed on the securities or investment strategies recommended to the customer and any conflicts of interest associated with such limitations;[30] and (iv) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. Although the Commission implicitly acknowledges that Proposed Rule 15l-2 is broader in scope than Reg BI, it does not explain why Reg BI's conflict of interest obligation is inadequate to address conflicts raised by a broker-dealer's use of technology in making a recommendation, or if a more narrowly tailored approach to any perceived gaps in Reg BI would be more appropriate.

The Proposed Rules depart dramatically from Reg BI and the IA Fiduciary Standard.[31] They would effectively prohibit the use of disclosure and informed consent as a means to address

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[27] *Id.* at 33677.

[28] *Id.*

[29] *See* Reg BI Adopting Release.

[30] This includes preventing any such limitations and associated conflicts of interest from causing the broker-dealer or its associated persons to make recommendations that place their interest, or that of the broker-dealer, ahead of the customer's interest.

[31] When the Commission considered these Proposed Rules at its open meeting, Commissioner Peirce observed that:

> In addition to rejecting disclosure, this proposal continues the Commission's layering on of obligations. While some covered technologies may create unique challenges, advisers are bound by their obligations as fiduciaries, and broker-dealers are bound by Regulation Best Interest and FINRA rules. The Commission describes this proposed rulemaking as a "supplement . . . to existing regulatory obligations related to conflicts." As we make clear in the release, "[b]roker-dealers and investment advisers are currently subject to extensive obligations under Federal

conflicts, based on the Commission's unsupported assertion that, when an investment adviser or broker-dealer uses a covered technology in an investor interaction, "a conflict can replicate to a much greater magnitude and at a much greater speed than would be possible to address through timely disclosure."[32] It is unclear what the SEC is even addressing with this statement or why the replication of a conflict could not be addressed by clear and timely disclosure.

The Commission's wholesale departure from disclosure and informed consent as a method for addressing and mitigating many conflicts of interest is contrary to decades of well-established law regarding the IA Fiduciary Standard and is in direct conflict with the SEC's recently adopted Reg BI. The Standards of Conduct are effective, in part, because of their flexibility—they are designed to address the varying nature and magnitude of conflicts firms may face, today or in the future, and offer a framework to address conflicts and protect investors in pragmatic ways designed to ensure the availability of a variety of business models and products to meet different investor preferences and goals.[33]

Under the Proposal, however, it is far from clear exactly what new regime is taking the place of disclosure and informed consent. The Proposed Rules' requirement to "neutralize" conflicts of interest is a concept found nowhere else in the federal securities laws, including the Standards of Conduct. It is unclear how the proposed requirement to "neutralize" differs from "eliminate." The Proposal fails to articulate how neutralization would work in practice. It appears that the Commission would effectively require *elimination* of conflicts. Dismissing disclosure and informed consent as an effective means to address conflicts of interests suggests that an investor is unable to make reasonable decisions for him or herself with adequate information from the

> securities laws and regulations . . . that are designed to promote conduct that, among other things, protects investors . . . from conflicts of interest." Under these overarching standards, firms using covered technologies have to identify and mitigate conflicts of interest. We already have the ability to pursue bad actors. We should be considering issuing guidance or conducting a roundtable to discuss topics such as adaptive AI, but we do not need standalone rules. Today's proposal joins a growing list of Commission rulemakings that are unnecessary.

Commissioner Peirce's statement is available at https://www.sec.gov/news/statement/peirce-statement-predictive-data-analytics-072623?utm_medium=email&utm_source=govdelivery.

[32] Proposing Release at 53988.

[33] For example, under Reg BI, a broker-dealer may offer only proprietary or other limited range of products if it has policies and procedures reasonably designed to disclose the limitations and associated conflicts and to prevent the limitations from causing broker-dealer or its associated persons from placing their interests ahead of the customer's interest. Reg BI also does not require a broker-dealer to recommend the lowest cost product and instead permits a broker-dealer to recommend higher-cost or higher-risk products, or those that result in greater compensation to the broker-dealer, or that are more expensive, than other products, provided that the broker-dealer complies with Reg BI's component obligations. *See* Reg BI Adopting Release at 33321; 33334. Similarly, the Commission has confirmed that, to satisfy its fiduciary duty, an investment adviser that is dually registered as a broker-dealer "should disclose any circumstances under which its advice will be limited to a menu of certain products offered through its affiliated broker-dealer or affiliated investment adviser." Fiduciary Interpretation at 33676.

firm—a principle that is antithetical to Congress's and the Commission's historical approach to regulation under the federal securities laws.[34]

3. Proposed Rules Would Violate the First Amendment

The Proposed Rules, if adopted, would violate the First Amendment because they would, without adequate justification, unduly restrict information firms can communicate to investors or potential investors. The Proposed Rules would apply broadly, even to any purely informational or educational interactions with current or prospective investors, if the "investor interaction" involves a covered technology that "takes into consideration" a firm's interests. The SEC would effectively prohibit a firm from communicating this information, even in a one-on-one setting, until it first assesses whether the interest of the firm is placed ahead of the investor and, if so, only if the firm has "eliminated" or "neutralized" the interest. Requiring this exercise for almost every communication involving a covered technology by a firm with an investor or potential investor is not only subjective but is likely unfeasible as a practical matter.

Such sweeping restrictions—which extend well beyond speech that "propose[s] a transaction"—warrant strict constitutional scrutiny, under which restrictions on speech are "presumptively unconstitutional" and can stand only if the government can show "that the restriction[s] further[ ] a compelling interest and [are] narrowly tailored to achieve that interest."[35] The Commission can satisfy neither requirement: there is no "compelling interest" because there is no indication that covered technologies currently present any unique harms that cannot be adequately addressed by existing regulations. And the Proposed Rules are certainly not "narrowly tailored" to achieve the SEC's interest. Requiring elimination or "neutralization" of effectively all conflicts goes beyond the requirements of fiduciary duty or Reg BI, which generally permit disclosure and informed consent. The SEC has not demonstrated why its new, sweeping approach is necessary. The Commission could pursue any number of less restrictive and more effective means than the Proposal here, such as issuing targeted guidance on the use of specific PDA-type technologies that may raise concerns or providing investor education about conflicts of interest that may be raised by firms' use of such technologies.

Even under the more deferential constitutional scrutiny given to commercial speech, the Proposed Rules do not pass muster.[36] Under that standard, the government's restrictions must directly advance the governmental interest asserted and not be more extensive than is necessary

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[34] *See* Harvey L. Pitt, Chairman, U.S. SEC, *Testimony Concerning Financial Literacy* (Feb. 5, 2002), *available at* https://www.sec.gov/news/testimony/020502tshlp.htm ("Ours is a disclosure-based system. And it is our job to promote clear, accurate, and timely disclosures—proactively."); Statement of David Schenker, Chief Counsel, SEC, Investment Trusts and Investment Companies: Hearings Before the Subcomm. on Sec. & Exch. of the S. Comm. on Banking & Currency, 76th Cong. 266 (1940) ("If [a fund is] going to be a speculative investment trust, and they disclose that fact to their investors, and the investors want to invest in that type of investment company, who are we to say, 'No, you shall not invest in that type of company?'").

[35] *Reed v. Town of Gilbert*, 576 U.S. 155, 163 (2015).

[36] *Friedman v. Rogers*, 440 U.S. 1, 9 (1979) (commercial speech is protected by the First Amendment unless it is "false, deceptive, [or] misleading."); s*ee Edenfield v. Fane*, 507 U.S. 761, 770 (1993) (the government bears the burden of showing that the targeted speech is sufficiently misleading to forfeit the First Amendment's protection.).

to serve that interest.[37] Yet, the Commission offers only "mere speculation or conjecture" that the Proposed Rules would advance investor protection.[38] And the Proposed Rules are far more extensive than necessary to achieve this purported interest, reaching countless communications that have not been shown to cause any of the harms the SEC alleges.[39]

4. Proposed Rules Exceed the Commission's Authority

The Commission lacks authority under Section 211(h) of the Advisers Act and Section 15(l) of the Exchange Act to promulgate the Proposed Rules. This concern is particularly acute because the same authority relied upon in the Proposed Rules is currently pending court review.[40] More generally, Congress has not granted the Commission the authority to regulate any activity of a firm or to redefine terms that have a well-accepted meaning under the federal securities laws or in ordinary speech. It exceeds the Commission's statutory authority to: (i) define a "covered technology" to include a wide variety of commonly-used tools that do not use technology; (ii) define "investor interaction" so broadly as to not require an interaction with an investor; and (iii) remove the requirement that a "conflict of interest" include a conflict.[41]

4.1 The Commission Lacks Authority Under Sections 211(h) and 15(l)

The Proposed Rules rely on a strained reading of the Dodd-Frank Act to establish a basis for this rulemaking. The Commission cites Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act, both of which were enacted under Section 913(g) of the Dodd-Frank Act,[42] as authority for its proposed rulemaking.[43] Dodd-Frank Act Section 913 addressed the differing duties of broker-dealers and investment advisers and authorized the Commission to engage in rulemaking to adopt a harmonized standard of conduct for broker-dealers and investment advisers when providing investment advice to retail investors. It did not give the Commission the

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[37] See *Byrum*, *v. Landreth*, 566 F.3d 442, 445 (5th Cir. 2009); *see Central Hudson Gas & Elec. Corp. v. Pub. Serv. Com'n of N.Y.*, 447 U.S. 557, 566 (1980).

[38] *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 555 (2001).

[39] *See 44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 518 (1996) (Thomas, J., concurring in part) (stating that commercial speech should be protected to the same extent as noncommercial speech.).

[40] *See* Petition for Review, *Nat'l Ass'n of Priv. Fund Managers*, v. *Sec. Exch. Comm'n*, No. 23-60471 (5th Cir., Sept. 1, 2023). The Commission should delay moving forward on the Proposed Rules until the court rules on this critical issue.

[41] As discussed below, in Section 5.5, defining the terms in this manner also violates the notice and comment requirements of the APA, and is arbitrary and capricious.

[42] Dodd-Frank Wall Street Reform and Consumer Protection Act, Conf. Rept. 111-517, 111th Cong., 2d Sess. (2010).

[43] The full text of Sections 211(h) of the Advisers Act and 15(l) of the Exchange Act is as follows: "Other matters The Commission shall -- (1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest; and (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors." 15 U.S.C. § 80b-11(h)(1)–(2); 15 U.S. Code § 78o(l)(1)–(2).

authority to adopt new rules broadly governing the conduct of broker-dealers and investment advisers.

The broad scope of the Proposed Rules and the expansiveness of the activities they seek to prohibit are not supported by the statutory provisions the Commission relies on for its authority. The Commission provides no analysis of its authority to promulgate the Proposed Rules under Sections 211(h) and 15(l). These provisions do not provide the Commission with limitless rulemaking authority. Rather, they must be viewed in the context in which they were enacted.[44]

Dodd-Frank Section 913 focuses on standards of care applicable to broker-dealers and investment advisers when providing advice to retail customers. Section 913(g), which is entitled "Authority to Establish a Fiduciary Duty for Brokers and Dealers," has two parts. First, it amended the Advisers Act and Exchange Act to add Section 211(g) and Section 15(k), respectively, both of which provide the Commission authority to establish a harmonized standard of conduct for broker-dealers and investment advisers.[45] Concurrently, Section 913(g) amended the Advisers Act and the Exchange Act to add, respectively, Section 211(h) and Section 15(l), which grant the Commission authority to "promulgate rules prohibiting or restricting certain sales practices, conflicts of interests, and compensation schemes." The Commission is relying on this latter provision as authority to promulgate the Proposed Rules.[46]

The connected nature of Section 913's subsections makes clear that Sections 211(h) and 15(l) are not independent grants of rulemaking authority, but were enacted as part of the Commission's "Authority to Establish a Fiduciary Duty for Brokers and Dealers." As such, they are simply an authorization for the Commission to engage in *additional*, *related* rulemaking in furtherance of a

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[44] *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.").

[45] The Commission did not recommend a harmonized standard of conduct in the study that Congress directed under Section 913 of the Dodd-Frank Act. Instead, the Commission recommended an enhanced standard of conduct for broker-dealers. The Commission therefore relied primarily on Section 913(f) of the Dodd-Frank Act for its authority when it promulgated Reg BI:

> The Commission is utilizing its authority under 913(f) in order to adopt an enhanced investor-protection standard for broker-dealers that maintains the availability of both the broker-dealer model and the investment adviser model. The Commission has chosen not to apply the existing fiduciary standard under the Advisers Act to broker-dealers in part because of concerns that such a shift would result in fewer broker-dealers offering transaction-based services to retail customers, which would in turn reduce choice and may raise costs for certain retail customers.

See Reg BI Adopting Release at 33330; *see also* Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011) ("913 Study") at 8-12, *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf (discussing the range of brokerage and dealer services provided by broker-dealers).

[46] Sections 211(h) and 15(l) provide that the Commission shall "examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors." 15 U.S.C. § 80b-11(h)(2); 15 U.S.C. § 78o(l)(2).

harmonized standard of conduct when providing investment advice to investors (which the Commission never adopted)—that is, rulemaking to address conduct incompatible with the standard of conduct adopted under Sections 211(g) and 15(k). The Proposed Rules in no way do that, but instead broadly regulate the conduct of investment advisers and broker-dealers.

4.1.1 Definition of Investor Should Not Include Fund Investors

Under the Proposed Rule 211(h)(2)-4, the definition of "investor" would include a prospective or current investor in a registered or private fund advised by the adviser, as defined in Rule 206(4)-8.[47] The Commission lacks the authority under Section 211(h) to promulgate a rule regulating conflicts of interest raised by investment advisers' interactions with fund investors.[48] An investment adviser's client is the fund, not the fund shareholders.[49] As discussed above, the Commission lacks the authority under Section 211(h) to promulgate Proposed Rule 211(h)(2)-4. The Commission would be stretching its authority beyond the breaking point to claim that, under Section 211(h), it can extend Proposed Rule 211(h)(2)-4 to regulate an adviser's conduct with respect to fund shareholders, looking past the adviser's actual client.

Nor can the Commission justify the breadth of its rule by pointing to Section 206 of the Advisers Act.[50] That is an antifraud provision, under which the Commission promulgated Rule 206(4)-8. Rule 206(4)-8 prohibits advisers to pooled investment vehicles, including registered and private funds, from (i) making false or misleading statements to investors or prospective investors in those pools or (ii) otherwise defrauding those investors or prospective investors. The scope of the Commission's authority under the antifraud provisions of the federal securities laws, however,

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[47] Proposing Release at 53973–74.

[48] In the Proposing Release, the Commission does not analyze or consider the implications of applying Proposed Rule 211(h) to registered investment companies or their shareholders. Registered funds are subject to comprehensive regulation under the Investment Company Act and are subject to independent oversight by boards of directors. Independent directors have a fiduciary duty, comprised of a duty of loyalty and a duty of care, to protect the interests of the fund and its shareholders, and have both specific and general oversight responsibilities for the operations and management of the fund. For example, among other things, fund boards oversee the fund's compliance program pursuant to Rule 38a-1 under the Investment Company Act, which requires that funds have policies and procedures reasonably designed to prevent violations of the federal securities laws, including the conflict-of-interest provisions of the Investment Company Act.

[49] *See Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) (discussing *Lowe v. SEC*, a Supreme Court case which held that publishers of certain financial newsletters were not "investment advisers" under the Advisers Act and noting that "[a]fter an extensive discussion of the legislative history of the Advisers Act, the Court held that existence of an advisory relationship depended largely on the character of the advice rendered. Persons engaged in the investment advisory profession 'provide personalized advice attuned to a client's concerns.' . . . '[F]iduciary, person-to-person relationships' were 'characteristic' of the 'investment adviser-client relationship.' The Court thought it 'significant' that the Advisers Act 'repeatedly' referred to 'clients,' which signified to the Court 'the kind of fiduciary relationship the Act was designed to regulate.' *This type of direct relationship exists between the adviser and the fund, but not between the adviser and the investors in the fund. The adviser is concerned with the fund's performance, not with each investor's financial condition.*") (internal citations omitted and emphasis added).

[50] Proposed Rule 211(h)(2)-4 defines "investor" to mean "any prospective or current client of an investment adviser or any prospective or current investor in a pooled investment vehicle (as defined in §275.206(4)-8) advised by the investment adviser."

historically is broad, consistent with the overarching policy of the securities laws to protect the markets and investors against fraud.[51] As the Commission stated when it adopted Rule 206(4)-8, "Congress expected that we would use the authority provided by Section 206(4) to 'promulgate general antifraud rules capable of flexibility.'"[52] The legislative history of Section 211(h) offers no similar basis for treating fund shareholders as "investors," for purposes of Proposed Rule 211(h)(2)-4.

4.2 Congress Has Not Clearly Granted the Authority to Broadly Regulate Any Activity of a Firm

If Congress had intended to grant the Commission authority to regulate *any and all activities* of a firm, it would have clearly granted this authority.[53] There is no basis under Section 211(h) or 15(1) for extending the Commission's authority to regulate virtually every aspect of a firm's business that involves an investor interaction, as the Proposed Rules would do. Under the Supreme Court's major questions doctrine, the statute must be construed not to reach matters of such "vast" significance.[54] Principals of constitutional avoidance also strongly reject a reading of the statute that would permit the First Amendment intrusions the Proposed Rules threaten.[55]

The Proposed Rules define "covered technology" and "investor interaction" so broadly that they cover the entire scope of an investment adviser's or broker-dealer's business. The Proposed Rules are applicable "when a firm uses covered technology in an investor interaction." As discussed below, in Section 5.5, the Proposed Rules' definition of "covered technology" is limitless and the lack of discernible boundaries on what is a "covered technology" applies not just with respect to technologies used in direct interactions, but to those used for portfolio management and trading. Further, the definition extends beyond the actual technology to encompass methods and processes as well. Similarly, the definition of "investor interaction" is so

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[51] *See, e.g.*, *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, 72 Fed. Reg. 44756 (Aug. 9, 2007) *available at* https://www.govinfo.gov/content/pkg/FR-2007-08-09/pdf/E7-15531.pdf ("Rule 206(4)-8 Adopting Release")("The terms material false statements or omissions and 'acts, practices, and courses of business as are fraudulent, deceptive, or manipulative' encompass the well-developed body of law under the antifraud provisions of the federal securities laws. The legal authorities identifying the types of acts, practices, and courses of business that are fraudulent, deceptive, or manipulative under the federal securities laws are numerous . . ."); *c.f.*, 3 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation*, § 12:16 (2023) (internal citations omitted) ("The general antifraud provision of the 1934 Act is contained in section 10(b), which provides that it is unlawful 'to use or employ [utilizing any means or instrumentality of interstate commerce], in connection with the purchase or sale of any security … any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." The Commission has utilized this rulemaking power in a number of instances with regard to a wide variety of manipulative and deceptive acts and practices . . .").

[52] *See* Rule 206(4)-8 Adopting Release.

[53] *See West Virginia* v. *E.P.A.*, 142 S.Ct. 2587 (2022).

[54] *Alabama Ass'n of Realtors v. Dep't of Health & Human Services*, 141 S. Ct. 2485, 2489 (2021).

[55] *Zadvydas v. Davis*, 533 U.S. 678, 689 (2001) ("[W]hen an Act of Congress raises 'a serious doubt' as to its constitutionality, 'this Court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided.'" (quoting Crowell v. Benson, 285 U.S. 22, 62 (1932)).

far-reaching that it applies not only to a firm's investors, but when a firm is communicating with prospective investors as well. Accordingly, these sweeping definitions of "covered technology" and "investor interaction" effectively regulate the entirety of a firm's activities. Congress did not grant the Commission authority under Sections 211(h) and 15(l) to broadly regulate a firm's activities—especially not in provisions entitled "Other Matters."

4.2.1 Commission Lacks the Authority to Redefine "Conflict of Interest"

Further, Congress did not authorize the Commission to redefine the well-understood definition of "conflict of interest" to eliminate the requirement of a "conflict." In the Proposed Rules, the Commission mischaracterizes a firm having *any* interest as inherently creating a *conflict* of interest. The Commission asserts that a "[c]onflict of interest exists when a firm uses a covered technology that *takes into consideration* an interest of the firm, or a natural person who is an associated person of a firm."[56]

The Proposed Rules' expansive definition of "conflict of interest," however, radically departs from decades of settled law and Commission regulation, and is antithetical to the plain meaning of the word "conflict"—which requires opposing interests.[57] The legal definition of conflict of interest, which the Commission recently confirmed in the adopting release for the final private fund adviser rules, issued *after* the Proposed Rules were issued, is "an interest that might incline an adviser, consciously or unconsciously, to render advice that is not disinterested."[58] By requiring firms to create written policies and procedures for *any interest* of the firm implicated by covered technology, the Proposed Rules exceed whatever authority the Commission has to regulate "conflicts of interest" under Sections 211(h) and 15(l).

Moreover, by proposing this new definition of a conflict of interest, the Commission would introduce a new standard that would fundamentally alter the relationship between firms and the investors they serve. Further, adopting the SEC's proposed definition of "conflict of interest" would result in two competing and inconsistent definitions of the same term—one that applies when a "covered technology" is used and another for interactions that do not involve technology. The Proposed Rules would impose a highly prescriptive approach requiring elimination or neutralization of conflicts when an adviser or broker-dealer uses a covered technology that places the adviser's or broker-dealer's interests ahead of investors' interests, but a different standard would apply if the same information were provided or conveyed without the use of a covered technology, although the "conflict" may be the same. The Commission does not address the confusion and inconsistency its new conflicts regime would create and provides no explanation

[56] *See* Proposing Release at 54021–22, 54023 (emphasis added).

[57] *Conflict*, Merriam-Webster (2023) ("competitive or opposing action of incompatibles**:** antagonistic state or action (as of divergent ideas, interests, or persons)").

[58] *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA–6383, 88 Fed. Reg. at 63213 (Sept. 14, 2023) *available at* https://www.govinfo.gov/content/pkg/FR-2023-09-14/pdf/2023-18660.pdf. *See* Reg BI Adopting Release at 33325 (defining a conflict of interest as "an interest that might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested . . .").

for why introducing such a radically different definition is necessary. Further, as explained in Appendix C, the Proposal's economic analysis fails to take into account the costs associated with a new definition of "conflict of interest."

5. Proposed Rules Have Not Been Issued in Conformity With the APA

An agency's action is arbitrary and capricious if the agency "has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or [has offered an explanation] so implausible that it could not be ascribed to a difference in view or product of agency expertise."[59] Here, the Commission violated the requirements for agency rulemaking by: (i) not providing adequate notice to the public or evidence of a "real problem;"[60] (ii) not acknowledging that adoption of the Proposed Rules would result in a change in the Standards of Conduct beyond the authority granted to the Commission by Congress; (iii) issuing Proposed Rules that would conflict with other existing and proposed SEC rules without consideration of the interconnectedness and interdependencies among these rules and proposals;[61] (iv) not acknowledging that the Proposed Rules would impact the entirety of a firm's businesses, thereby providing an inadequate analysis of the costs and benefits of the Proposed Rules; and (v) drafting the Proposed Rules using sweepingly broad language and vague definitions that make it challenging, if not impossible, for market participants to understand their legal obligations.

5.1 Commission Has Not Provided Adequate Notice or Evidence of a Real Problem

The APA requires an agency to provide the public with sufficient notice of a proposed rule and the agency's supporting rationale, as well as a meaningful opportunity for interested parties to provide comments.[62] In this case, the public notice of the Proposed Rules is deficient. The Proposed Rules would fundamentally change the Standards of Conduct for investment advisers and broker-dealers, yet the Commission nowhere acknowledges or addresses this disruption of the existing legal framework. Instead, the Commission presents the Proposed Rules as "supplement[ing], rather than supplant[ing], existing regulatory obligations related to conflicts of interest . . ."[63] Not identifying and analyzing the full scope of the regulatory changes inherent in

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[59] *See George v. Bay Area Rapid Transit*, 577 F.3d 1005, 1010 (9th Cir. 2009) (internal quotation and citations omitted) (*citing United States v. Snoring Relief Labs, Inc.* 210 F.3d 1081, 1085 (9th Cir. 2000)).

[60] *Nat'l Fuel Gas Supply Corp.,* 468 F.3d at 841.

[61] *See* ICI Letter.

[62] 5 U.S.C. § 553.

[63] *See* Proposing Release at 53976. *See CSX Transp., Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1081 (D.C. Cir. 2009) (stating that under well-settled principles of administrative law, a proposed rule must "ma[ke] clear that the agency was contemplating" the "particular change" adopted in the final rule. The Commission has not made its intentions clear with these Proposed Rules.).

the Proposed Rules is inadequate under the APA, as it fails to provide the public with appropriate notice, analysis, and opportunity to comment on this fundamental change in the law.[64]

The APA also requires that agency rulemaking be backed by "evidence of a real problem."[65] Here the Commission does not present such evidence—as explained above, the Commission has not presented any reason why covered technology presents any unique conflict-of-interest problems, and no evidence beyond its assertion that there is a problem in need of solving. But "[p]rofessing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking."[66]

5.2 Commission Does Not Acknowledge That the Proposed Rules Would Fundamentally Alter Existing Standards of Conduct

Despite the Proposal's purported focus on addressing conflicts raised by using Covered Technologies, the Proposed Rules would, in fact, fundamentally alter existing Standards of Conduct, departing without adequate explanation from the SEC's 2019 rulemakings.[67] The Proposed Rules create inconsistencies between how conflicts must be addressed under the Standards of Conduct and how they must be addressed under the Proposed Rules. Under the Proposed Rules, if an investment adviser or broker-dealer uses a covered technology in an investor interaction that results in a conflict of interest that places the firm's (or its representatives') interests above investors' interests, the firm must eliminate or neutralize that conflict. This approach would not "supplement" the Standards of Conduct, as the SEC claims, but instead would result in outcomes that are directly in conflict with the results under the Standards of Conduct.

As discussed further in Appendix A, examples of how the Proposed Rules are inconsistent with the Standards of Conduct include that the Proposed Rules: (i) would require firms to "eliminate" or "neutralize" conflicts, whereas the Standards of Conduct generally rely on disclosure and consent; (ii) would redefine "conflict of interest" to eliminate the requirement that there be a "conflict," resulting in different/conflicting outcomes compared to the Standards of Conduct; (iii) would apply to a broader scope of activities, especially for broker-dealers, whereas Reg BI applies at the point of recommendation; (iv) would apply to prospective clients and customers, unlike the Standards of Conduct; and (v) would include, within the definition of "investor," self-directed investors, unlike Reg BI.

By presenting the Proposed Rules as supplementing rather than overriding the existing regulations governing conflicts of interest, the Commission has failed its fundamental

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[64] As a result, the Commission is departing from past policy without adequate explanation. *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

[65] *Nat'l Fuel Gas Supply Corp.,* 468 F.3d at 841.

[66] *Id.* at 843 (vacating order where agency "cited *no* complaints and provided *zero* evidence of [an] actual [problem]").

[67] *FCC v. Fox Television Stations, Inc.*, 556 U.S. at 515 (an agency must "display awareness that it *is* changing position" and "show that there are good reasons for the new policy").

rulemaking obligation to "display awareness that it *is* changing position."[68] Because it does not recognize the change in position, it also fails to give any "good reason" for changing its position. Indeed, Reg BI was promulgated just four years ago, and the Commission has not explained how conflicts of interest have changed in that time such that the "original reasons" for adopting Reg BI—with its modest scope and disclosure-based regime—"are no longer dispositive."[69]

5.3 Proposed Rules Conflict with Other Existing Rules and Proposed Rules

The contradictions created by the Proposed Rules run deeper still. The Proposal violates the APA because the requirements it puts forward significantly conflict with, and potentially override without appropriate notice and comment, certain of the Commission's other current regulations (some of which were recently adopted after extensive and costly implementation periods for firms) including the marketing rule under the Advisers Act (the "Marketing Rule"),[70] the Advisers Act compliance rule[71] and the regulatory framework around soft dollars and securities lending.

Proposed Rule 211(h)(2)-4 conflicts with the Marketing Rule. Under the Marketing Rule, an advertisement is defined as "any direct or indirect communication an investment adviser makes to more than one person . . . that offers the investment adviser's investment advisory services [.]"[72] That definition is limited to advice. Rule 211(h)(2)-4, however, would include, within the broad definition of "investor interaction," "any advertisements . . . that offer or promote services or that seek to obtain or retain one or more investors,"[73] thereby including communications by an adviser that do not offer the adviser's services, as well as one-on-one communications. Further, the recently adopted Marketing Rule permits disclosures to address conflicts of interests with respect to the use of promoters, which would not be permitted under the Proposed Rules.[74]

The Proposed Rules also potentially conflict with statutory exemptions that cannot be overturned with a rule, as Congress must grant the Commission explicit authority to override the statutes it has enacted. For example, Section 28(e) of the Exchange Act creates a safe harbor for investment advisers, under certain circumstances, to use "soft dollars" in the form of client commission payments to purchase eligible brokerage and research services. The Proposed Rules' broad definitions of "covered technologies" and "investor interaction" would result in prohibiting the use of technologies that facilitate soft dollar practices that are consistent with Section 28(e).

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[68] *Id.*

[69] *Id.*

[70] 17 C.F.R. § 275.206(4)-1.

[71] 17 C.F.R. § 275.206(4)-7 requires advisers to adopt compliance policies and procedures to ensure reasonable compliance with federal securities laws, which include fiduciary obligations to clients.

[72] 17 C.F.R. § 275.206(4)-1.

[73] *See* Proposing Release at 53974.

[74] 17 C.F.R. § 275.206(4)-1. The Marketing Rule requires prominent disclosure regarding of any material conflicts of interest on the part of the person giving a testimonial or endorsement resulting from the adviser's relationship with such person and also requires disclosures regarding any compensation arrangement.

The Proposed Rules similarly appear to conflict with common SEC-regulated practices, such as securities lending. Firms use technology for all aspects of securities lending which, in some cases can present a conflict with an investor. The SEC and its staff are aware of potential conflicts raised by securities lending and have addressed them explicitly through a series of exemptive orders, no-action letters, and guidance. A key element of the SEC's regulatory framework with respect to conflicts raised by securities lending is disclosure. Would a broker-dealer or investment adviser be required to eliminate any use of technology to be able to continue engaging in securities lending? It is unclear whether that would even be possible in the modern securities lending market.

The Proposed Rules also would conflict with other SEC proposed rules such as the proposed rule under the Advisers Act that would prohibit investment advisers from outsourcing "covered functions," including functions that would be covered by the Proposed Rules, without conducting due diligence and monitoring of the service providers ("Outsourcing Rule")[75] and the Commission's proposed rule on investment advisers' safeguarding of client assets ("Safeguarding Rule").[76]

A federal agency may not change its position without at least acknowledging the change and giving good reasons for it.[77] The Commission has not done so here. The APA does not permit an agency to advance "unexplained and inconsistent positions,"[78] and the Commission's failure to acknowledge and explain its about-face is fatal to the Proposed Rules.

5.4 Commission's Economic Analysis Is Deficient

By not explaining how broadly the Proposed Rules would apply and how they would deviate from existing law, the Commission, in violation of the APA, and its heightened cost-benefit obligations under the securities laws, does not adequately identify or consider the benefits, costs and burdens of the Proposed Rules, which overwhelmingly outweigh any potential benefits. The Commission has failed to consider the public interest in the Proposed Rules beyond noting speculative benefits to investors. It does not consider the consequences of the Proposed Rules for the markets, investment advisers, and broker-dealers, in costs and jobs, and further does not address the negative consequences to investors, including the likely reduction in investment options, diminished access to investment advice and financial education, and the higher

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[75] *See Outsourcing by Investment Advisers*, Release Nos. IA–6176, 87 Fed. Reg. 68816 (Nov. 16, 2022), *available at* https://www.sec.gov/files/rules/proposed/2022/ia-6176.pdf.

[76] *See Safeguarding Advisory Client Assets*, Release No. IA–6240, 88 Fed. Reg. 14672 (Mar. 9, 2023) *available at* https://www.govinfo.gov/content/pkg/FR-2023-03-09/pdf/2023-03681.pdf.

[77] *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016).

[78] *R.J. Reynolds Vapor Co. v. FDA*, 65 F.4th 182, 191 (5th Cir. 2023).

management fees that would lead to lower investment returns. The APA and the securities laws require that the Commission's cost-benefit analysis address these considerations.[79]

As Appendix C details, the Proposed Rules' benefits, costs and burdens are not adequately identified or considered by the SEC. The Proposed Rules would stifle technology, have a chilling effect on innovation, limit access to affordable advice, disincentivize firms to provide financial education, and impose significant costs on advisers and broker-dealers that ultimately will be passed on to investors. The Commission acknowledges that the Standards of Conduct, as well as other regulatory obligations, regulate conflicts of interest of advisers and broker-dealers, but does not make the case why existing law and regulation have been ineffective or what the benefit of the Proposed Rules would be to the markets, advisers, broker-dealers, and investors.

5.4.1 Compliance Burdens

If adopted, the Proposed Rules would require substantial effort and cost by advisers and broker-dealers in order to comply, although it is unclear that, as proposed, compliance is even operationally feasible. Compliance would require significant buildout of firms' existing compliance infrastructures to handle the tremendous burden that would be created by the development and implementation of the policies and procedures required by the Proposed Rules. Recordkeeping obligations would increase exponentially. The Proposed Rules requirement to eliminate or "neutralize" certain conflicts would require modifications to, or elimination of, technologies and/or changes to business models and functions.

By redefining a "conflict of interest" to mean *any* interest of an investment adviser or broker-dealer and broadly defining "covered technology" to mean almost *any* technology, method, or process, the Commission would require firms to undergo an arduous conflict identification process that potentially would be operationally impractical to implement. Just the process of identifying the universe of "covered technologies" for each firm would be an overwhelming task.

If a firm plans to use any sort of "covered technology," the Proposed Rules' compliance obligations would be triggered and the firm would need to conduct assessment, analysis, conflict elimination, annual reviews, testing, and recordkeeping. Each technology and every modification to the technology utilized by the firm would have to be assessed continuously to see if it is in scope of the Proposed Rules. The firm would be required to document this assessment (initially and periodically). After this step, the firm would have to assess whether there is a conflict of interest, which is defined broadly as any interest of the firm or its associated persons, which is likely to exist for most, if not all, technologies used by a firm, solely by virtue of operating as a for-profit enterprise.

[79] *Bus. Roundtable v. SEC*, 647 F.3d at 1148–49 (stating that the rules were arbitrary and capricious because "the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.").

The Proposal does not provide guidance on who should be conducting the compliance assessment and assumes that firms will have personnel with "sufficient knowledge of both the applicable programming language and the firm's regulatory obligations to review the source code of the technology, review documentation regarding how the technology works, and review the data considered by the covered technology (as well as how it is weighted)."[80] Thus, every firm would either need to hire individuals with the requisite expertise, use third-party service providers to conduct this function, or eliminate its use of the covered technology. It also is unclear what documentation the SEC would consider sufficient to satisfy the Proposed Rules' requirements. The Commission does not identify or analyze these likely costs, which may be considerable, in its economic analysis.

These compliance requirements will likely be particularly difficult for smaller firms. Smaller investment advisers may be disproportionately impacted by the cost and compliance burdens flowing from the Proposed Rules, as they do not benefit from economies of scale in the same way as larger complexes. These smaller firms, like all firms, will be expected to effectively have written descriptions for processes that identify each covered technology, review each technology for use and "reasonably foreseeable use" in an investor interaction to determine whether it involves a conflict of interest, then determine whether that conflict places the firm's interests ahead of investors' interests and, if it does, eliminate or neutralize the conflict. Firms would have to go through and document this exercise even when they know that an investor interaction involving a covered technology does not place the firm's interest ahead of investors' interests. The policies and procedures requirements of the Proposed Rules would further require firms to undertake a review (and written documentation of such review) of the adequacy of such policies and procedures to be conducted at least annually. While all firms will be challenged on how to allocate their compliance resources and ensure that they are not taking away from areas of potentially greater risk, smaller firms will bear this burden most heavily, hindering their ability to compete.

Relatedly, the Proposed Rules would include a specific requirement for testing. We are generally supportive of testing.[81] However, based on the Proposed Rules' broad application to an overly wide range of "covered technologies," we are concerned that the Proposed Rules' testing requirements would be unreasonable and onerous. Firms would be expected to test each covered technology periodically to determine whether the use of such covered technology is associated with a conflict of interest. The Proposed Rules do not specify any particular method or frequency of testing that the firm must conduct, although testing would be required (i) prior to implementing the covered technology and (ii) before deploying any "material modification" of the technology. Firms, especially smaller firms, will likely face challenges with the testing requirement.

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[80] *See* Proposing Release at 53977.

[81] *See, e.g.,* Robo-Advisory IM Guidance Update (Feb. 2017), *available at* https://www.sec.gov/investment/im-guidance-2017-02.pdf.

The Proposed Rules would significantly raise compliance costs, even for the many uses of covered technologies that benefit investors,[82] because a firm must complete the Proposed Rules' assessment regardless. Firms would likely consider compliance costs in two ways. First, for each current technology or new technology, firms will engage in a cost-benefit analysis regarding whether to continue to use or develop the technology, given the heightened costs of deployment. Second, on a global scale, firms' total technology and transformation budgets would have to cover the compliance costs for implementing and monitoring new technologies, which would result in limiting technological innovation. The Proposed Rules would likely require that all process changes, from back-office operations to product development, be reported and reviewed by compliance to ensure that no conflict exists. This would have a chilling effect on technological innovation and the implementation of technological enhancements that benefit investors.

Finally, the policies, procedures, evaluations, and reviews required by the Proposed Rules would be extremely burdensome, particularly given the broad scope of the rules, and would stretch firms' compliance resources and budgets if these rules are adopted in their current form. This is significant as firms' compliance departments have already been stretched thin due to the Commission's isolated and piecemeal approach to its heavy rulemaking agenda, which fails to consider the cumulative impact of its interconnected rules.[83]

As the discussion above demonstrates, and is discussed in more depth in Appendix C, the compliance costs and burdens of the Proposed Rules are estimated to be tremendous, and are much higher than described in the Proposal's economic analysis. Members have characterized the infrastructure that would be needed to comply with the rules as "unprecedented" and expect that the extraordinarily high costs of complying with the Proposed Rules, if it is even operationally feasible to do so (which is questionable), would result in firms re-evaluating their use of covered technologies and being significantly less likely to utilize covered technologies that benefit investors moving forward. For smaller firms, especially those seeking to offer robo-advice or other investment management services largely via technological means, these costs will serve as a barrier to entry. Ultimately, it is ordinary investors that rely on covered technologies for access to investment information, advice, and access to the financial markets who will be harmed by the exorbitant compliance costs of the Proposed Rules. While it is speculative, at best, whether the Proposed Rules would prevent potential future harms, the Proposed Rules will most certainly greatly increase compliance costs and burdens, limit use of technology, and make the markets less inclusive.

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[82] Examples of covered technologies that benefit investors would include electronic: (i) planning tools such as a simple retirement, savings or lifetime income calculator designed to help investors determine how much in total they need to save by retirement and how much money they can afford to spend once they are in retirement; (ii) educational tools such as financial education regarding different asset classes and investment products, newsletters, and news alerts that investors affirmatively elect to receive; (iii) asset allocation tools and investment models that are based on information provided by an investor regarding his or her risk tolerance and goals; and (iv) technologies that provide access to the securities markets, products, and advice, such as direct indexing and robo-advice are other popular investment services that make investing available to a wider universe of investors that historically did not have asset levels high enough to afford such services.

[83] *See* ICI Letter.

5.5 Proposed Rules Are Exceedingly Broad in Scope, Include Vague Terms That Are Not Used Under the Federal Securities Laws, and Would Provide Industry Participants with Insufficient Notice of When and How the Rules Would Apply

The Proposed Rules are exceedingly expansive in scope. Rather than concisely identifying an actual, rather than theoretical, problem, demonstrating a gap in the current regulatory framework, and then tailoring a specific solution to address the problem, the Commission proposes broadly defined terms that are confusing and would be infeasible to comply with because they bring almost everything into scope. The definitions of "covered technology" and "investor interaction" would encompass virtually every aspect of a firm's day-to-day business activities and would make it nearly impossible for well-intended market participants to know how to comply with the Proposed Rules. Furthermore, the ambiguity of these Proposed Rules would make it highly likely that the rules would be implemented inconsistently across firms as firms, in good faith, likely would evaluate the same conflicts differently.

5.5.1 Definition of Covered Technology Is Limitless

The Commission's definition of "covered technology" is excessively broad and ambiguous. Under the Proposed Rules, a "covered technology" means 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."[84] It applies to such technology when used by firms to engage directly with investors, as well as technology used indirectly, including exercising discretion with respect to an investor's account, providing information to an investor, or soliciting new investors. The proposed definition is so expansive that SEC Commissioner Uyeda said that a myriad of commonly-used tools could qualify as covered technology—"a simple electronic calculator or even non-electronic calculators like an abacus might be legally subject to its scope."[85] More importantly, the term "technology" is a misnomer. As proposed, the definition would encompass not only technologies, but functions, algorithms, models, or a "similar method or process that optimizes for . . ." Moreover, it is unclear what the terms "optimizes for" and "forecasts" really mean, within the proposed definition. The Commission does not address these points.

The Commission also intends for "covered technologies" to include technologies used by investment advisers and broker-dealers indirectly. The Proposed Rules provide that the Commission would view technologies associated with order routing, accounting, and trade settlement as out-of-scope for purposes of the Proposed Rules so long as those processes do not involve an investor interaction.[86] *This suggests, however, that all other trading and portfolio*

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[84] *See* Proposing Release at 53970.

[85] Commissioner Uyeda's statement is available at https://www.sec.gov/news/statement/uyeda-statement-predictive-data-analytics-072623?utm_medium=email&utm_source=govdelivery.

[86] *See* Proposing Release at 53974 (". . . [A] firm could implement covered technology for automation of, for example, 'back office' processes like the routing of customers' orders and accounting and trade settlement. In each

management technologies are likely within scope. For example, any portfolio management technology could be considered an "analytical, technological, or computational function, algorithm, model . . . or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes," as could most trading technology. Examples of portfolio management technologies include, among many others, advisers' forecasting and modeling platforms that are used to create research, support investment and advice methodologies, support investment management teams, and inform product development and portfolio decisions. Quantitative portfolio management technology is another example. Including these "behind the scenes" technologies in the definition of "covered technology" would be highly problematic. It likely would be unworkable, as a practical matter, and could impact firms' abilities to effectively engage in portfolio management and trading activities on behalf of their clients—their day-to-day business. Focusing significant compliance resources on these technologies is not an efficient use of a firm's limited resources.

5.5.2 Definitions of Investor Interaction and Investor Are Exceptionally Broad

The Proposed Rules would generally define "investor interaction" as engaging or communicating with an investor, including by exercising discretion with respect to an investor's account; providing information to an investor; or soliciting an investor. Importantly, "investor interaction" would encompass activity far beyond recommendations and advice *and is not limited to when an investor interacts with the firm or its representatives by means of a covered technology*. This overly broad definition would capture a firm's correspondence, dissemination, or conveyance of information to or solicitation of investors, in any form, including communications that take place in-person, on websites; via smartphones, computer applications, chatbots, email messages, and text messages; and other online or digital tools or platforms. This definition would also include a firm's discretionary or non-discretionary management of an investor's account. The definition would further include any advertisements, disseminated by or on behalf of a firm, that offer or promote services or that seek to obtain or retain one or more investors.

5.5.2.1 Definition of Investor Should Not Include Prospective Investors

The Standards of Conduct are not unlimited in scope—they are limited to current investors, recognizing that a firm cannot satisfy a fiduciary duty or best interest standard of conduct to an unknown investor. Generally, both the fiduciary duty for investment advisers and Reg BI do not apply to prospective investors. Similarly, the Proposed Rules should not include prospective investors. Instead, FINRA advertising rules and the Marketing Rule more appropriately apply to communications to prospective investors. Furthermore, the SEC has antifraud authority under the Advisers Act and the Exchange Act that it historically has used to address fraudulent marketing. Marketing, by its nature, is a self-interested practice—applying the Proposed Rules to communications to prospective investors would mean that any marketing communication would

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of these examples, the use of covered technology for these processes does not involve an investor interaction, and therefore would not be subject to the proposed conflicts rules.") (internal citations omitted).

potentially be enough to implicate the conflict neutralization and elimination duties under the Proposed Rules. This result would make advertising impractical.

5.5.2.2 No Distinction for Institutional Investors

Additionally, Proposed Rule 202(h)(2)-4 is overly broad, as it fails to distinguish between retail and institutional advisory clients.[87] It is unclear what public policy purpose would be served by applying the Proposed Rule 211(h)(2)-4 to interactions with institutional advisory clients. The Proposal does not address why the Commission proposes to define "investor," for purposes of Proposed Rule 211(h)(2)-4, differently from the Commission's definition of "retail investor" in Form CRS, which the Commission adopted just a few years ago. If the Commission's concern is that retail investors are vulnerable to risks raised by conflicts in firms' use of covered technology, then why should Proposed Rule 211(h)(2)-4 be applicable to sophisticated institutional investors? Significantly, this is inconsistent with the Commission's 2019 guidance in connection with an investment adviser's fiduciary obligations, which acknowledges that an investment adviser may, consistent with its fiduciary duty, tailor its obligations differently to its retail and institutional clients.[88]

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For the reasons discussed in this letter, the ICI strongly opposes the Commission adopting the Proposed Rules. The Commission has not demonstrated the need for the Proposed Rules or explained why existing Standards of Conduct are inadequate to address conflicts raised by technology. The Proposed Rules raise Constitutional issues, exceed the SEC's authority, and violate the APA. We urge the Commission to withdraw the Proposed Rules, which would hurt the very investors the Commission intends to help.

If you have any questions or require further information regarding our comments, please do not hesitate to contact us at solson@ici.org or sarah.bessin@ici.org, or Mitra Surrell, Associate General Counsel, at mitra.surrell@ici.org.

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel

/s/ Sarah A. Bessin

Sarah A. Bessin
Deputy General Counsel

[87] This is also inconsistent with the Commission's approach under Rule 15l-2, which is limited to retail investors and defines an investor as "a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or household purposes." The Proposing Release does not provide an explanation as to why it uses different definitions of the term "investor" for broker-dealers and investment advisers or why it includes institutional investors in the definition of "investor" for purposes of Proposed Rule 211(h)(2)-4.

[88] *See* Fiduciary Interpretation.

cc: Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizárraga, Commissioner
William A. Birdthistle, Director, Division of Investment Management
Erik Gerding, Director, Division of Corporation Finance
Jessica Wachter, Director, Division of Economic and Risk Analysis
Haoxiang Zhu, Director, Division of Trading and Markets
Megan Barbero, General Counsel
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Robert W. Cook, Chief Executive Officer
Robert L.D. Colby, Chief Legal Officer
FINRA

Appendix A –Standards of Conduct

The existing regulatory regimes for broker-dealers and investment advisers fully and appropriately address any concerns the SEC may have regarding conflicts of interest raised by advisers' and broker-dealers' use of technology in investor interactions. The Proposed Rules would supplant Regulation Best Interest ("Reg BI") and the Commission Interpretation Regarding Standard of Conduct for Investment Advisers ("IA Fiduciary Standard;" together with Reg BI, "Standards of Conduct") to require the categorical elimination or neutralization of conflicts of interest. As discussed below, the Proposed Rules would deviate significantly from existing Standards of Conduct in ways that would materially harm investors, including by limiting access to products and services, notwithstanding that the SEC, less than five years ago, settled on an approach that is carefully designed to avoid that outcome.

A.1 Proposed Rules Are Not Narrowly Tailored to "Predictive Data Analytics" – the Purported Focus of the Proposed Rules – and Instead Would Apply to Nearly All Interactions that Broker-Dealers and Investment Advisers Have with Investors

The SEC states in the Proposal that the definition of "covered technology" is intentionally broad and would capture even the use of a simple "spreadsheet that implements financial modeling tools or calculations."[1] In effect, any technology that a broker-dealer or investment adviser uses in a broadly defined "investor interaction" would be a covered technology subject to the Proposed Rules. For example, technology that firms use to monitor asset allocation and determine how to reallocate accounts would be a covered technology. The Proposed Rules would go well beyond the use of AI and algorithms to cover nearly all technology that broker-dealers and investment advisers use in their day-to-day businesses. In addition, the Proposed Rules would apply whether the use of a covered technology in an investor interaction occurs directly through the use of a covered technology itself or indirectly by firm personnel using the covered technology to produce information that is then communicated to an investor, or to manage an account for an investor.

The proposed definition of "investor interaction" is similarly broad and would cover all interactions that a broker-dealer or investment adviser has with investors. It would cover in-person and telephonic communications, and any correspondence or communication through any medium. As the SEC acknowledges in the Proposal, the definition would include interactions that have generally been viewed as outside the scope of "recommendations" for broker-dealers, including research pages and email subscriptions. It would also extend to all marketing materials generated from or using a covered technology. As a result of the sweeping overbreadth of the Proposed Rules, the SEC effectively would require the removal of conflicts of interest from any interaction a broker-dealer or investment adviser has with investors. This is a significant departure from the underpinnings of the federal securities laws – under which conflicts of interest of interest are generally addressed through full and fair disclosure and investor consent.

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[1] *See* Proposing Release at 53972.

A.2 Existing Regulatory Regimes for Investment Advisers and Broker-Dealers Fully and Appropriately Address the Regulation of Broker-Dealers and Investment Advisers and Any Concerns the Commission May Have Regarding Conflicts of Interest Raised by Using Technology in Investor Interactions

As discussed below, investment advisers are subject to a fiduciary duty codified under Section 206(1) and (2) of the Advisers Act and restrictions on agency and principal trading under Section 206(3). Broker-dealers generally are not fiduciaries but are subject to Reg BI when making recommendations to retail customers, as well as various SEC and FINRA rules addressing sales practices and conflicts of interest.[2] Broker-dealers and investment advisers are also subject to comprehensive rules relating to their marketing activities.

Investment Adviser Regulatory Regime. Investment advisers are subject to a fiduciary duty codified under Section 206(1) and (2) of the Advisers Act. The SEC has long recognized that the scope of an adviser's fiduciary relationship may be shaped by agreement with the client, provided there is full and fair disclosure and informed consent.[3] In the Fiduciary Interpretation, the SEC stated that "where an investment adviser cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent, the adviser should either *eliminate* the conflict or adequately *mitigate* (*i.e.,* modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible."[4]

Under the Advisers Act, even trading with a client as principal, a practice that Congress recognized presents a risk that investment advisers might use their investment authority to dump unwanted securities in client accounts, is addressed through disclosure and consent. Section 206(3) requires that an investment adviser engaging in principal trades and agency cross trades provide disclosure of its capacity and conflicts of interest, and obtain client consent, prior to completion of the transaction. Under Section 206(3), however, unlike for other conflicts for which one time disclosure and consent might be sufficient, investment advisers must obtain client consent to agency cross and principal trades on a trade-by-trade basis and cannot obtain blanket consent.[5]

The SEC has generally addressed particular conflicts of interest through enforcement actions, alleging that investment advisers violated Section 206(1) and/or (2) by failing to disclose all material facts about the conflicts of interest. For example, the SEC has successfully used its authority under Section 206(1) and (2) to address concerns with respect to particular conflicts of

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[2] *See* Appendix B.

[3] *Commission Interpretation Regarding the Standard of Conduct for Investment Advisers*, 84 Fed. Reg. 33669 (July 12, 2019) ("Fiduciary Interpretation").

[4] *Id.* at 33677.

[5] Rule 206(3)-2 provides an exception from Section 206(3)'s requirement of trade-by-trade consent for prospective client consent to agency cross trades, if certain conditions are met.

interest, including double dipping,[6] selection of proprietary products,[7] share class selection,[8] allocation of investment opportunities,[9] and cherry picking.[10]

Broker-Dealer Regulatory Regime. Broker-dealers are subject to a fundamental obligation under the antifraud provisions of the federal securities laws and FINRA rules to deal fairly with their customers – an obligation that cannot be satisfied through disclosure. Sections 10(b) and 15(c) of the Exchange Act broadly prohibit broker-dealers from making misstatements or misleading omissions of material facts, or from engaging in fraudulent or manipulative acts or practices, in connection with the purchase or sale of securities. Broker-dealers generally are not subject to a fiduciary duty but have been found by some courts to owe customers a fiduciary duty when exercising discretion or control over customer assets or having a relationship of trust and confidence with their customers. The federal securities laws address broker-dealers' conflicts of interest through a combination of disclosure and restricted or prohibited conduct.

Notwithstanding the expansive regulatory regime to which broker-dealers are subject, less than five years ago, the SEC adopted Reg BI, which requires broker-dealers, when making recommendations of securities or investment strategies involving securities to a retail customer, to act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer or its associated persons ahead of the interest of the retail customer.[11] The SEC undertook a lengthy, thoughtful process prior to proposing and adopting Reg BI, beginning with a 2011 SEC staff study mandated by Congress that recommended the SEC consider adopting a uniform standard of conduct for investment advisers and broker-dealers; continuing with a 2013 request for information on the standards of conduct for investment advisers and broker-dealers;[12] and culminating in 2019 with the adoption of Reg BI. The SEC ultimately decided not to adopt a uniform standard of conduct for investment advisers and broker-dealers, and instead adopted Reg BI under Section 913(f) of the Dodd-Frank Act.

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[6] Dean Patrick McDermott, McDermott Investment Advisors, LLC, and McDermott Investment Services: Court Enters Final Judgments Against Investment Adviser and Its Principal for Defrauding Clients Through Their Selection of Higher-Cost Unit Investment Trusts, Litigation Release No. 25570 (Nov. 3, 2022).

[7] *In re JPMorgan Chase Bank, N.A. & J.P. Morgan Secs. LLC*, Investment Advisers Act Release No. 4295 (Dec. 18, 2015); *In re Banc of America Investment Services, Inc. & Columbia Mgmt. Advisors, LLC*, Investment Advisers Act Release No. 2733 (May 1, 2008).

[8] SEC Press Release, SEC Share Class Initiative Returning More than $125 Million to Investors (Mar. 11, 2019).

[9] Fiduciary Interpretation at 33677 n.64.

[10] *In re GlennCap LLC & Glenn*, Investment Advisers Act Release No. 6422 (Sept. 14, 2023).

[11] Reg BI Adopting Release at 33332 ("The 'without placing the financial or other interest . . . ahead of the interest of the retail customer' phrasing recognizes that while a broker-dealer will inevitably have some financial interest in a recommendation—the nature and magnitude of which will vary—the broker-dealer's interests cannot be placed ahead of the retail customer's interest.").

[12] *Duties of Brokers, Dealers, and Investment Advisers*, Securities Exchange Act Release No. 69013 (Mar. 1, 2013).

Under Reg BI, a broker-dealer's best interest obligation is satisfied through compliance with four component obligations: disclosure, care, conflict of interest, and compliance. Reg BI addresses conflicts of interest in several ways:

1. Disclosure Obligation: A broker-dealer must provide the retail customer in writing, prior to or at the time of the recommendation, full and fair disclosure of all material facts relating to conflicts of interest that are associated with the recommendation.

2. Care Obligation: A broker-dealer is required to exercise reasonable diligence, care and skill to have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker-dealer or its associated person ahead of the interest of the retail customer.

3. Conflict of Interest Obligation: The conflict of interest obligation addresses conflicts at both the firm and representative levels. At the firm level, a broker-dealer is required to identify and disclose or eliminate all conflicts of interest associated with recommendations. In addition, if the broker-dealer places material limitations on the securities or investment strategies involving securities it makes available to retail customers, it must identify and disclose those material limitations and prevent the limitations and associated conflicts from causing the broker-dealer or its associated persons to place their interests ahead of the retail customer's interests. At the representative level, a broker-dealer must identify and mitigate any conflicts of interest associated with recommendations that create an incentive for a representative to place the interest of the broker-dealer or representative ahead of the interest of the retail customer. Further, Reg BI requires a broker-dealer to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.

In adopting Reg BI, the SEC was clear that it did "not intend for our standard to require a broker-dealer to provide conflict-free recommendations"[13] and that Reg BI "will not per se prohibit a broker-dealer from making recommendations where conflicts of interest are present."[14] Moreover, the SEC "confirm[ed] that Regulation Best Interest is not intended to limit or eliminate recommendations that encourage diversity in a retail customer's portfolio through investment in a wide range of products, including, when appropriate, products that may involve higher risks or cost to the retail customer, as these products may be in the best interest of certain retail customers at certain times or in certain circumstances."[15]

In addition to Reg BI, various SEC, FINRA, and MSRB rules address broker-dealers' conflicts of interest through disclosure, mitigation, or elimination of the conflicts. The SEC does not

[13] *Id.* at 33331.

[14] *Id.* at 33334.

[15] *Id.*

address this existing regulatory framework and fails to make any qualitative evaluation as to whether additional regulation of conflicts is necessary beyond the existing regulatory framework or whether, or under what circumstances, compliance with existing rules would satisfy the Proposed Rules' requirements to eliminate or neutralize broker-dealers' conflicts of interest.[16]

FINRA and the MSRB have also adopted various rules and issued guidance to address concerns, including conflicts, related to particular products, including bonds and bond funds;[17] collateralized mortgage obligations;[18] direct participation programs;[19] investment company securities;[20] municipal securities;[21] non-traded REITs;[22] options;[23] penny stocks;[24] private placements;[25] security futures;[26] structured products;[27] variable products;[28] and warrants.[29]

Broker-Dealer and Investment Adviser Marketing. The antifraud provisions of the federal securities laws and various rules adopted by the SEC and FINRA protect investors, including prospective clients/customers, in ways that are not specifically addressed by the Standards of Conduct. One significant area relates to advertising, which would also be significantly impacted by the Proposed Rules. Under FINRA Rule 2210 and Advisers Act Rule 206(4)-1, broker-dealers and investment advisers are subject to comprehensive rules that prohibit materially misleading advertisements. The rules generally require that advertisements be fair and balanced and prohibit the making of any untrue statement of a material fact, or omission of a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading. They also generally prohibit advertisements that include material statements of fact that cannot be substantiated.

A.3 Proposed Rules Would Deviate Significantly from Existing Standards of Conduct

As noted in our letter, the Proposed Rules are inconsistent with the Standards of Conduct in several ways. For example, they would require firms to "eliminate" or "neutralize" conflicts,

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[16] *See* Appendix B.

[17] FINRA Regulatory Notice 08-81; NASD Notice to Members 04-30; MSRB Rule G-31.

[18] FINRA Rule 2216.

[19] FINRA Rule 2310; FINRA Rule 5123; NASD Rule 2340.

[20] FINRA Rule 2122; FINRA Rule 2213; FINRA Rule 2341; FINRA Rule 2342.

[21] MSRB Rule G-19.

[22] NASD Rule 2340; FINRA Regulatory Notice 13-18.

[23] FINRA Rule 2220; FINRA Rule 2360.

[24] Exchange Act Rules 15g-1 through 15g-9; FINRA Rule 2114.

[25] FINRA Rule 5122.

[26] FINRA Rule 2215; FINRA Rule 2370.

[27] FINRA Regulatory Notice 09-73; NASD Notice to Members 05-59.

[28] FINRA Rule 2211; FINRA Rule 2320; FINRA Rule 2330.

[29] FINRA Rules 2351 through 2359.

whereas the Standards of Conduct generally rely on disclosure and consent. The Proposed Rules would introduce a new definition of "conflict of interest" to focus only on whether there is an "interest" of the firm involved and eliminate the requirement that there be a "conflict," resulting in different and, potentially, conflicting outcomes compared to the Standards of Conduct. In addition, the Proposed Rules would apply to a broader scope of activities, including marketing and self-directed investments, whereas the Standards of Conduct only when firms provide advice or make recommendations. The SEC fails to justify why the Proposed Rules are appropriate and necessary for the protection of investors, particularly when the SEC adopted the Standards of Conduct less than five years ago.

The Standards of Conduct amounted to a generational shift in the way that broker-dealers and investment advisers are regulated.[30] The Standards of Conduct were adopted after the SEC was given a clear Congressional directive and benefitted from nearly a decade of public comment and SEC staff analysis.[31] In adopting the Standards of Conduct, the SEC made a conscious choice not to require the elimination or mitigation of all conflicts of interest (consistent with longstanding common law fiduciary principles) so as not to inadvertently harm investors by limiting access to products and services.[32] Rather, investment advisers and broker-dealers were generally permitted to address firm-level conflicts through full and fair disclosure and informed consent.[33] Notwithstanding this backdrop and the SEC's reasoned approach in adopting the Standards of Conduct, the SEC now proposes – without adequate justification – to require substantially all conflicts of interest to be either eliminated or "neutralized" because the Proposed Rules would apply any time a broker-dealer or investment adviser uses a "covered technology" in an "investor interaction."

A.4 Proposed Rules Would Abandon the Concept of Disclosure and Consent to Conflicts and instead Require Substantially All Conflicts of Interest to be Either Eliminated or "Neutralized"

[30] Commissioner Elad L. Roisman, Statement at the Open Meeting on Regulation Best Interest, the Interpretation of the Standard of Conduct for Investment Advisers, the Form CRS Relationship Summary, and the Interpretation of "Solely Incidental" (June 5, 2019) ("One area of total agreement among all Commissioners is the importance of the matters on which we are voting today. Collectively, they are of generational significance. The comment files for the proposals make this clear—they literally include thousands of letters from registrants, trade and policy groups, as well as private citizens. Each provided broad, focused, and often passionate views on the SEC's 2018 proposals, including views about things we got right, things we got wrong, areas in which we went too far, and areas in which we did not go far enough. Many of those commenters followed up with meetings and phone calls with the Divisions' staffs, the Chairman's staff, and my and my fellow Commissioners' staffs. Since joining the Commission, I have had more meetings and discussions on these rulemakings than on any other topic.").

[31] Dodd-Frank Wall Street Reform and Consumer Protection Act § 913; Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers (Jan. 2011).

[32] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33318, 33390 n.739 (July 12, 2019) ("Reg BI Adopting Release") ("We are persuaded by commenters regarding the competitive issues for broker-dealers that could arise if we require mitigation of firm-level financial incentives, which is not required by an investment adviser's fiduciary duty, and could further encourage migration from the broker-dealer to investment adviser model and result in a loss of choice for retail customers.").

[33] *Id.* at 33390.

This is a radical departure from the historical approach to investment adviser and broker-dealer conflicts under the federal securities laws, which recognize that conflicts are inherent in all principal-agent relationships. For example, in adopting Reg BI, the SEC stated:

> Like many principal-agent relationships—including the investment adviser-client relationship—the relationship between a broker-dealer and a customer has inherent conflicts of interest, including those resulting from a transaction-based (*e.g.,* commission) compensation structure and other broker-dealer compensation. These and other conflicts of interest may provide an incentive to a broker-dealer to seek to increase its own compensation or other financial interests at the expense of the customer to whom it is making investment recommendations.[34]

Reg BI represents a delicate balancing of competing interests in a principal-agent relationship that combines disclosure, a standard of care, and tailored requirements to mitigate (and in the case of sales contests, eliminate) certain conflicts of interest. Similarly, the SEC has long recognized disclosure and informed consent as an appropriate way to address an investment adviser's conflicts while facilitating client choice:

> To allow clients and prospective clients to evaluate the risks associated with a particular investment adviser, its business practices, and its investment strategies, it is essential that clients and prospective clients have clear disclosure that they are likely to read and understand. For example, such disclosure could enable a prospective client to screen advisers based on disciplinary history, financial industry affiliations or compensation methods. Such screening would allow clients to avoid advisers with a disciplinary history, should they wish to do so. Clients also would be able to choose advisers based on affiliations and compensation methods; in some cases, the client may not be comfortable with the conflicts of interest that those affiliations and compensation methods create, while other clients may value an advisory relationship that allows for broader access to other financial services and may seek an adviser with financial industry affiliates. A prospective client may seek modifications to an investment advisory agreement to better protect the client against an investment adviser's potential conflict of interest, either by better aligning the adviser's interest with that of the client or by prohibiting a particular practice in the client's account. If an adviser is unwilling to make such modifications, a prospective client may select a different adviser.[35]

The SEC now proposes to abandon these principles in favor of a paternalistic view that conflicts of interest should not exist or that investment advisers and broker-dealers should be able to provide conflict-free advice through the elimination or neutralization of conflicts. We do not believe such an approach ultimately benefits investors and believe that the existing standards of conduct are flexible enough to apply to a wide range of conflicts of interest, including those involving new and highly complex technologies.

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[34] Reg BI Adopting Release at 33319.

[35] *Amendments to Form ADV*, 75 Fed. Reg. 49234 (Aug. 12, 2010).

Requiring the elimination or neutralization of conflicts of interest would harm investors by limiting access to products and services. Under the Proposed Rules, investment advisers and broker-dealers would be subject to second-guessing by the SEC as to whether any particular conflict of interest was actually eliminated or appropriately neutralized. For firms that offer open or semi-open architecture, the Proposed Rules might leave them subject to constant second-guessing by the SEC and its staff as to whether the firms violated the Proposed Rules any time a proprietary product was purchased or recommended to an investor. To address this risk and potential liability, firms may decide to limit the range of products made available. As the SEC recognized less than five years ago in adopting Reg BI, reducing the range of options available could harm retail investors.[36] Similarly, some firms make available tools that allow investors to determine whether to roll over their assets from a retirement plan, transfer their assets from an IRA, or select the type of account that would be appropriate for their needs. If the Proposed Rules are adopted, firms are likely to limit the availability of these tools because of the high compliance costs the rules will impose[37] and to avoid the risk of the SEC, in hindsight, finding that they have conflicts of interest that were not eliminated or neutralized.

Requiring the elimination or neutralization of conflicts of interest would significantly curtail the ability of investment advisers and broker-dealers to advertise their services. In today's digital world, the vast majority of advertising is done online.[38] It is hard to conceive of an online advertisement by a broker-dealer or investment adviser that would not be viewed as an investor interaction using a covered technology. Moreover, a firm advertising its products or services inherently involves conflicts of interest because the advertiser is ultimately seeking to profit from the sale of its products and services. While the Proposed Rules include a narrow carve-out for conflicts of interest that exist solely because a broker-dealer or investment adviser seeks to open a new investor account, many advertisements might not be viewed as *only* relating to opening new accounts. Further, firms may engage in marketing directed at existing clients and customers. For example, advertisements might also describe the services that are provided in an account or describe the types of products, including proprietary products, that might be purchased through the accounts. FINRA Rule 2210 and the Marketing Rule implicitly recognize the conflicted nature of advertising and do not require the elimination or neutralization of conflicts of interest associated with the advertisements. Rather, they apply principles-based requirements designed to ensure that advertisements do not include untrue statements of material facts, can be substantiated, are not materially misleading, and are fair and balanced. We are concerned that requiring that broker-dealers and investment advisers eliminate or neutralize conflicts of interest related to marketing will ultimately result in preventing firms from marketing their products and services.

[36] Reg BI Adopting Release at 33321 ("In designing Regulation Best Interest, we considered a number of options to enhance investor protection, while preserving, to the extent possible, retail investor access (in terms of choice and cost) to differing types of investment services and products.").

[37] *See* Section 5.4.1 Compliance Burdens of main letter.

[38] Sara Lebow, *Digital Will Account for 71.8% of US Media Ad Spend this Year, Up 16 Percentage Points from 2019—and Growing*, INSIDER INTELLIGENCE (Nov. 7, 2022), *available at* https://www.insiderintelligence.com/content/digital-us-media-ad-spend.

A.5 Proposed Rules Would Likely Require Elimination of All Conflicts of Interest as There Does Not Appear to be a Meaningful Difference Between Eliminating and Neutralizing a Conflict of Interest

The definitions of eliminating and neutralizing are effectively the same—the SEC's examples of how firms could neutralize a conflict of interest in the Proposal would result in the elimination of the conflict. Based on the definitions of these words in Webster's dictionary, it is difficult to identify the difference between the two terms, particularly as they relate to the elimination or neutralization of conflicts of interest.

Webster's Definition of "Eliminate"	Webster's Definition of "Neutralize"
• "to put an end to or get rid of"	• "to counteract the activity or effect of"
• "to remove from consideration"	• "to render (something) ineffective or harmless by applying an opposite force or effect"
• "to remove from further competition by defeating"	• "to kill, destroy"

Each term effectively contemplates the removal of the conflict of interest from consideration in an investor interaction.

Similarly, in the Proposal, the SEC's examples of ways to neutralize a conflict of interest would result in the elimination of the conflict.[39]

Under either approach – elimination or neutralization – the ultimate effect can be expected to result in broker-dealers and investment advisers being prohibited from engaging in any investor interaction that involves a conflict of interest because the firm would ultimately need to remove or render ineffective or harmless the conflict of interest.

A.6 Proposed Rules Would Inappropriately Extend to Self-Directed Brokerage Relationships

As discussed above, the obligations that broker-dealers owe to self-directed brokerage customers are limited – as a reflection of the limited nature of the relationship and lack of reliance that a self-directed customer places on a broker-dealer. Broker-dealers are required to deal fairly with

[39] *See, e.g.,* Proposing Release at 53986 (footnotes omitted and emphasis added) ("[T]he firm could eliminate this conflict of interest by removing any data that would allow the robo-adviser to determine which funds are sponsored or advised by the firm, thus eliminating any bias in favor of the firm's interest . . . [or] neutralize the conflict of interest by sufficiently increasing the weights given to factors, such as cost to the investor or risk-adjusted returns . . . to provide a counterweight that *prevents any consideration of the firm's own interests* from resulting in an investor interaction that places the firm's interests ahead of investor's interests.").

their customers[40] and disclose information related to the consummation of the transaction,[41] including information required under rules adopted by the Commission or FINRA.

The Commission has considered whether to impose, but never adopted, additional obligations on broker-dealers with respect to the purchase of certain "complex" products in self-directed brokerage accounts, such as leveraged ETFs.[42] The Proposed Rules would go beyond adopting rules to address perceived concerns about particular products and instead broadly restrict all conflicts of interest related to the sale of securities resulting from the use of a covered technology, even where no recommendation was made or where the risk of loss to a self-directed investor is low relative to other products.

This approach is contrary to the longstanding approach under the federal securities laws and can be expected result in broker-dealers significantly curtailing the products and services that are made available to investors. Broker-dealers make available various tools and investor education through their websites that would likely be viewed as covered technologies but that might ultimately be viewed as involving conflicts of interest for which elimination or neutralization might be required under the Proposed Rules. For example, broker-dealers make available fund supermarkets that include both proprietary and third-party funds and that might highlight proprietary products, while not making a recommendation of any security or investment strategy involving securities. Under the Proposed Rules, broker-dealers offering fund supermarkets might need to consider how to eliminate or neutralize any conflicts of interest related to making available proprietary products. Similarly, the Proposed Rules would extend to investment analysis tools that have traditionally not been subject to FINRA Rule 2111 or Reg BI because they do not include a recommendation of a security or investment strategy involving securities. Our understanding is that these tools are designed to assist self-directed investors – and address gaps in financial literacy – by allowing investors to analyze the potential impacts of different investment strategies. We are concerned that broker-dealers might reduce the number and type of investment analysis tools that they make available to ensure that they have eliminated or neutralized any conflicts of interest. The elimination of these tools would harm investors by impacting their ability to analyze the impact of various investment decisions and determine appropriate investment strategies based on the investment products available through their broker-dealer.

[40] *See Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943).

[41] *See Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 536 (29 Cir. 1999).

[42] *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, 85 Fed. Reg. 83162 (Dec. 21, 2020) (declining to adopt sale practices rules for broker-dealers and investment advisers in the sale of leverage ETFs).

Appendix B – SEC and SRO Rules Addressing Conflicts of Interest

Conflict of Interest	Rule(s)	Description
1. Advertising	• Advisers Act Rule 206(4)-1 • FINRA Rules 2210, 2211, 2212, 2213, 2214, 2215, 2216	• Establishes requirements for advertisements and investment analysis tools designed to prevent misleading statements and address conflicts of interest.
2. Pay to Play	• Advisers Act Rule 206(4)-5 • FINRA Rule 2030 • MSRB Rule G-37	• Places limitations on the ability of firms to engage in business with government entities within 2 years of having made a covered political contribution.
3. Proxy Voting	• Advisers Act Rule 206(4)-6	• Requires investment advisers to adopt and implement policies and procedures reasonably designed to vote proxies in the best interest of clients and disclose to clients their proxy voting policies.
4. Custody	• Advisers Act Rule 206(4)-2 • Exchange Act Rule 15c3-3	• Establishes requirements designed to ensure the safekeeping of customer funds and securities.
5. Compliance Policies and Procedures	• Advisers Act Rule 206(4)-7 • FINRA Rule s3110, 3120, 3130	• Requires firms to adopt and implement policies and procedures reasonably designed to comply with applicable securities laws and rules.
6. Accounts at Other Broker-Dealers	• FINRA Rule 3210 • MSRB Rule G-28	• Prohibits associated persons of a broker-dealer from opening an account at another firm in which securities transactions can be effected and in which the associated person has a beneficial interest without the broker-dealer's written consent.
7. Fixed Price Offerings	• FINRA Rule 5141	• Prohibits a broker-dealer or associated person of a broker-dealer participating in a selling syndicate or selling group or acting as sole

Conflict of Interest	Rule(s)	Description
		underwriter in connection with a fixed price offering from offering or granting, directly or indirectly, to any person or account that is not a member of the selling syndicate or selling group or that is a person or account other than the single underwriter any securities in the offering at a price below the stated public offering price.
8. Front Running of Block Transactions	• FINRA Rule 5270	• Prohibits a broker-dealer or associated person of a broker-dealer from causing to be executed an order to buy or sell a security or a related financial instrument when the broker-dealer or associated person has material, non-public market information concerning an imminent block transaction in that security, a related financial instrument or a security underlying the related financial instrument prior to the time information concerning the block transaction has been made publicly available or has otherwise become stale or obsolete.
9. Gifts and Gratuities	• FINRA Rule 3220 • MSRB Rule G-20	• Prohibits a broker-dealer or associated person of a broker-dealer from, directly or indirectly, giving or permitting to be given anything of value, including gratuities (i.e., a gift of any type), in excess of one hundred dollars per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity.
10. Guarantees	• FINRA Rule 2150 • MSRB Rule G-25	• Prohibits a broker-dealer or associated person of a broker-dealer from guaranteeing a customer against loss in connection with any securities transaction or in any securities account of the customer.
11. Loans with Customers	• FINRA Rule 3240	• Prohibits associated person of a broker-dealer from borrowing money from or lending money to a customer unless certain requirements are met.
12. Market Making	• FINRA Rule 5250	• Prohibits a broker-dealer or associated person of a broker-dealer from accepting any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter

Conflict of Interest	Rule(s)	Description
		thereof, for publishing a quotation, acting as market maker in a security, or submitting an application in connection therewith.
13. New Issues –Equity Securities	• FINRA Rule 5130	• Prohibits a broker-dealer or associated person of a broker-dealer from (a) selling or causing to be sold a new issue to any account in which a restricted person has a beneficial interest; (b) purchasing a new issue in any account in which such member or person associated with a member has a beneficial interest; or (c) continuing to hold new issues acquired by the member as an underwriter, selling group member or otherwise; except as otherwise permitted under the rule.
14. New Issues –Flipping	• FINRA Rule 5131(c)	• Prohibits a broker-dealer or associated person of a broker-dealer from directly or indirectly recouping, or attempting to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate.
15. New Issues – Quid Pro Quo Allocations	• FINRA Rule 5131(a)	• Prohibits a broker-dealer or associated person of a broker-dealer from offering or threatening to withhold shares it allocates of a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.
16. New Issues – Spinning	• FINRA Rule 5131(b)	• Prohibits a broker-dealer or associated person of a broker-dealer, under certain circumstances, from allocating shares of a new issue to any account in which an executive officer or director of a public company or a covered non-public company, or a person materially supported by such executive officer or director, has a beneficial interest.
17. Non-Cash Compensation	• FINRA Rule 2310(c) • FINRA Rule 2320(g)(4)(D) • FINRA Rule 2341	• Prohibits a broker-dealer or associated person of a broker-dealer from directly or indirectly accepting or making payments or offers of payments of any non-cash compensation unless consistent with Reg BI and limitations under the listed rules.

Conflict of Interest	Rule(s)	Description
	• FINRA Rule 5110(h) • MSRB Rule G-20	
18. Outside Business Activities	• FINRA Rule 3270	• Prohibits any registered person from being an employee, independent contractor, sole proprietor, officer, director or partner of another person, or being compensated, or having the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member.
19. Payment for Order Flow	• FINRA Rule 5310 • Rules 606 and 607 of Regulation NMS	• FINRA Rule 5310 requires a broker-dealer to use reasonable diligence to determine the best market for a security and execute an order at a price that is as favorable as possible under prevailing market conditions. • Regulation NMS Rule 606 requires a broker-dealer to provide quarterly, aggregated public disclosure of their practices in the routing and handling of held orders and provide customer-specific disclosure upon request. • Regulation NMS Rule 607 requires a broker-dealer, upon opening a new customer's account, to provide annual descriptions of the terms of any payment for order flow and any profit-sharing arrangements that may influence a broker-dealer's order routing decision.
20. Private Securities Transactions	• FINRA Rule 3280	• Prohibits an associated person of a broker-dealer from participating in any manner in a private securities transaction except in accordance with the requirements of the rule.
21. Selling Agreements	• FINRA Rule 5160	• Requires that selling syndicate agreements or selling group agreements set forth the price at which the securities are to be sold to the public or the formula by which such price can be ascertained, and state clearly to whom and under what circumstances concessions, if any, may be allowed.

Conflict of Interest	Rule(s)	Description
22. Sharing in Customer Accounts	• FINRA Rule 2150 • MSRB Rule G-25	• Prohibits a broker-dealer or associated person of a broker-dealer from making improper use of a customer's securities or funds.
23. Splitting Orders	• FINRA Rule 5290	• Prohibits a broker-dealer or associated person of a broker-dealer from engaging in conduct that has the intent or effect of splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind amount to be received by the broker-dealer or associated person as a result of the execution of such orders or the transaction reporting of such executions.
24. Trading Ahead	• FINRA Rule 5320	• Prohibits a broker-dealer that accepts and holds an order in an equity security from its own customer or a customer of another broker-dealer without immediately executing the order from trading that security on the same side of the market for its own account at a price that would satisfy the customer order, unless it immediately thereafter executes the customer order up to the size and at the same or better price at which it traded for its own account.
25. Fair Prices and Commissions	• FINRA Rule 2121 • MSRB Rule G-30	• Requires a broker-dealer buying from or selling to a customer from its own account to buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit. • Prohibits a broker-dealer acting as agent from charging his customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor.

Conflict of Interest	Rule(s)	Description
26. Charges for Services Performed	• FINRA Rule 2122	• Requires that charges, if any, for services performed, including, but not limited to, miscellaneous services such as collection of monies due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safe-keeping or custody of securities, and other services be reasonable and not unfairly discriminatory among customers.
27. Control Relationships with Issuers	• Exchange Act Rule 15c1-5 • FINRA Rule 2262 • MSRB Rule G-22	• Requires a broker-dealer controlled by, controlling, or under common control with, the issuer of any security, shall, before entering into any contract with or for a customer for the purchase or sale of such security, to disclose to the customer the existence of such control, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction.
28. Interest in Distribution	• Exchange Act Rule 15c1-6 • FINRA Rule 2269	• Requires a broker-dealer who is acting as a broker for a customer or for both the customer and some other person, or as a dealer and who receives or has promise of receiving a fee from a customer for advising the customer with respect to securities, to give the customer written notification of the existence of the broker-dealer's participation or interest in the primary or secondary distribution at or before the completion of any transaction.
29. Public Offerings of Securities with Conflicts of Interest	• FINRA Rule 5121	• Prohibits a broker-dealer that has a conflict of interest from participating in a public offering unless the offering complies with the requirements of the rule.
30. Net Transactions	• FINRA Rule 2124	• Requires a broker-dealer to provide disclosure and obtain consent from the customer as provided under the rule before executing a transaction for or with the customer on a net basis.

Appendix C – ICI's Economic Analysis of Commission's Proposed Rulemaking on Predictive Data Analytics

The Securities and Exchange Commission (the "Commission") has issued a proposal on investment advisers' and broker-dealers' conflicts of interest ("Proposal")[1] that is intended to address potential risks to investors from conflicts of interest associated with the use of "covered technologies" by investment advisers and broker-dealers. Proposed rules 15l-2 under the Securities Exchange Act of 1934 applicable to broker-dealers and 211(h)(2)-4 under the Investment Advisers Act of 1940 applicable to registered investment advisers ("Proposed Rules") would require firms to evaluate their use of predictive data analytics (PDA) and other covered technologies in connection with investor interactions and to eliminate or "neutralize" certain conflicts of interest associated with such use, as well as imposing extensive recordkeeping requirements.

The Commission must provide compelling evidence of the need to adopt the rule, including that any potential benefits outweigh costs.[2] The Proposal's economic analysis does not meet this test. As discussed in this Appendix C, the economic analysis fails to document any salient benefits. The Proposal's economic analysis calculates that costs of the Proposal over the first ten years would accumulate to more than $10 billion; our analysis shows that actual costs would likely be multiples higher than that.

- The Commission argues that the Proposal is necessary because investors could be harmed by use of existing or potential future technology tools. As Appendix C discusses, Americans understand and appreciate the benefits of investing. Many of these benefits are linked directly with the ability to access technology-based tools, such as when saving for retirement or education. Moreover, considerable evidence shows that investors already value, and are comfortable using, a range of technologies.

- As noted in the body of ICI's comment letter, the Proposal seeks to redefine and broaden the meaning of a "conflict of interest" to "an interest." [3] But economic activity is driven fundamentally by interests, whether those of businesses and consumers, or savers and investors. Those interests are channeled by competition to benefit consumers. The proposed redefinition thus potentially captures any and all economic activities. As a result, the Proposal is likely to undermine, not enhance, competitive forces that support investors' interests.

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[1] *See Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, 88 Fed. Reg. 53960 (Aug. 9, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-08-09/pdf/2023-16377.pdf ("Proposing Release").

[2] The Commission's Current Guidance on Economic Analysis lists identifying a clear justification for regulatory action and how the Proposed Rules will meet that need as the first substantive requirement for conducting economic analysis in rulemakings. *See Current Guidance on Economic Analysis in SEC Rulemakings*, *available at* https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[3] *See* Proposing Release at 54023.

- Regarding benefits, the Commission's economic analysis lacks any quantitative estimate of benefits and does not provide any qualitative or theoretical economic analysis indicating clear potential benefits.

- The Proposal's consideration of costs is deficient in three important ways: (1) nowhere are total costs aggregated; (2) in certain instances, hours of burden are omitted ("omissions") from dollar-cost estimates; and (3) normal levels of detail present in other Commission analyses are absent. Related to each of these: (1) The Commission's recurring costs total over $1 billion a year; (2) initial costs jump 45 percent to over $2 billion after adding in costs of the omissions, and (3) as a result of the lack of detail in the Commission's analysis, it is not possible for a reader to determine precisely how broader understatements of hours of burden translate to dollars. But even good-faith analysis indicates the understatements are meaningful; we estimate that the potential costs would be several times as large as the Commission estimates — at a minimum more than $30 billion over a ten-year horizon.

- In addition, the Commission's cost analysis is "static" in that it assumes the number of technologies affected will remain constant in the future. This is hard to justify. If anything, the number of "covered technologies" will increase over time (albeit at a slower pace due to the Proposed Rules' stifling effect on technological development). We do not try to quantify this effect, but it clearly would add further to expected costs of the Proposed Rules. These added costs would of course be avoided if firms stop developing new technologies because of the Proposed Rules.

Taken at face value, the Proposal's economic analysis provides no evidence of benefits while providing evidence of very high costs. Beyond this, as discussed below, we find the methods, cost estimates, and level of detail provided by the economic analysis to be insufficient to meet the Commission's own guidance on conducting economic analyses in rulemakings.

C.1 Investors Already Benefit from Technology and Competition and the Proposal Provides No Evidence of a Problem

As discussed in the body of ICI's comment letter, the Proposal will limit investors' access to technologies through which they access investment advice and financial products. This would harm investors because, as we show in this section, the benefits of investing for financial and overall well-being are well established.

C.1.1 Americans' Engagement with Capital Markets Has Expanded over Time to the Benefit of Investors and Markets; Technology Is Constructive and Facilitates Main Street Investors' Access in Engagement and Returns

Americans understand and appreciate the benefits of investing. For example, recent research shows that experience with investing is linked to improved financial and overall well-being (such

as through observed differences in longevity).[4] These benefits are supported critically by, and raise the demand for and development of, technology.

For example, more than half of US households invest in stocks, either directly or indirectly through registered investment companies ("funds").[5] Americans' propensity to invest in stocks is especially strong among younger and lower-income households. These developments would have been impossible without widespread and increased use of technology by asset managers and investors, such as web-based tools to buy, sell, and monitor investments.

Investor welfare depends importantly on retirement saving, and retirement saving in turn depends critically on technology. Technology is emerging as a driver initiating investment experience. In 2022, for example, 65 percent of mutual fund–owning households indicated that they first purchased a mutual fund through an employer-sponsored retirement plan, transactions that in today's world mostly occur online.[6] Workers exposed to defined contribution (DC) plan features — such as the opportunity to select investments, which typically occurs online — save and invest more outside of their DC plans, both through tax-deferred vehicles (such as individual retirement accounts [IRAs]) and holdings of assets in nonretirement savings vehicles.[7] DC plans rely heavily on technology to establish plans, maintain records, and provide web-based services to plan participants.

Technology has been found to reduce the cost of advice and to improve returns for investors. For instance, D'Hondt et al. test artificial intelligence (AI) methods embedded in robo-advice models against individual investors' actual returns and find that the median low-income investor gains roughly two-thirds more from the use of AI than the median high-income investor in their sample.[8]

Technology also encourages investment by those with lower levels of income or education or who are minorities. For example, many investors start small. A recent FINRA study found that

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[4] *See* Table A4 in Holden, S., and Seligman J., "Do People Successfully Manage Their Nest Eggs Through Retirement? Evidence from the Evolution of US Household Balance Sheets" *SSRN WP* (June 2023) *available at* https://ssrn.com/abstract=4470865.

[5] *See* Holden, S., and Bogdan, M., "Main Street Owns Wall Street," *ICI Viewpoints* (February 10, 2021) *available at* https://www.ici.org/viewpoints/21_view_equityownership.

[6] *See* Holden, S., Schrass, D, and Bogdan, M., "Characteristics of Mutual Fund Investors, 2022" *ICI Research Perspective* 28, no. 10 (October 2022) *available at* https://www.ici.org/system/files/2022-10/per28-10.pdf.

[7] *See* Seligman, J., and Bose, R., "Learning by doing: Active employer sponsored retirement savings plan participation and household wealth accumulation," *The Quarterly Review of Economics and Finance* 52(2) (2012): 162-172, *available at* https://doi.org/10.1016/j.qref.2012.02.002.

[8] *See* D'Hondt, *et al*., "Artificial Intelligence Alter Egos: Who might benefit from robo-investing?" *Journal of Empirical Finance* 59 (2020): 278-299, *available at* https://www.sciencedirect.com/science/article/pii/S0927539820300633. Further, when testing passive investment schemes against AI algorithms, the authors write, "*...we find that investors displaying certain characteristics – in particular low education and low income – stand to gain significantly.*"

many started investing primarily because they learned that they could invest small amounts,[9] a development supported by technology. While "the ability to invest with a small amount of money" was important across all the racial/ethnicity groups in the survey, it was especially prominent among Hispanic/Latino investors (43 percent) and African American investors (35 percent).[10]

Digital resources are particularly valuable in helping younger investors save for education. For example, the number of 529 savings plan accounts has grown from 8.3 million in 2007 to 15.1 million in 2022.[11] Households saving for education tend to be younger (in 2022, just over half were under age 45), and to have lower incomes (in 2022, 43 percent of households saving for college had household income of less than $100,000).[12]

In short, there is strong evidence that American savers depend on technology to help them begin investing and to meet important goals, such as saving for education and retirement.

C.1.2 Many Investors Are Comfortable with and Benefit from Engaging Electronically

As part of its motivation for the Proposed Rules, the Commission writes, "*…investors may have to undertake costly efforts to understand how firms are using technology and to be comfortable with newer technologies used by firms.*"[13] However, many investors already choose to engage electronically in several areas of their financial lives.

Evidence shows that investors broadly value and benefit from automated and digital resources.[14] For example, many households value digital resources when considering IRA rollovers,

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[9] *See* Lush, M., Fontes, A., Zhu, M., Valdes, O., and Mottola, G., "Investing 2020: New Accounts and the People Who Opened Them," *FINRA Investor Education Foundation and NORC at the University of Chicago: Consumer Insights: Money & Investing* (February 2021), *available at* https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

[10] *Id.*

[11] *See* Investment Company Institute, 529 Plan Program Statistics, *available at* https://www.ici.org/research/stats/529s.

[12] *See* Investment Company Institute, *2023 Investment Company Fact Book* at 114, *available at* https://www.ici.org/fact-book.

[13] *See* Proposing Release at 54002. Here, the speculative concern ("may have to") imposes costs without any documented harm, or any defined benefit to be derived from remedy of said harm.

[14] *See* Swire and Kennedy-Mayo. "2018 Update to Delivering ERISA Disclosure for Defined Contribution Plans: Why the Time Has Come to Prefer Electronic Delivery" (April 2018), *available at* https://peterswire.net/wp-content/uploads/2018-Update-to-Delivering-ERISA-Disclosure-for-DC-Plans-002.pdf. Regarding use and outcomes, these authors find that DC plan participants that are more digitally or electronically engaged with their plans achieve better outcomes in terms of savings rates. *See* Collins, J. M., and Urban, C. "Understanding Financial Well-being Over the Lifecourse: An Exploration of Measures." (2018) working paper, *available at* https://www.montana.edu/urban/Draft_FWB_2018%20Anonymous.pdf. Regarding benefits, these authors find

reviewing online materials from their employers and financial services firms.[15] Recent FINRA Investor Education Foundation research reports that 65 percent of new investors find digital engagement features helpful to learn more about investing.[16]

Younger and less wealthy investors depend on digital engagement more when seeking advice. For instance, households that use robo-advice tend to be younger and have lower wealth. Of the roughly 130 million households in America, 7.9 million use robo-advisers. Of these, 29 percent were younger than 35 (see Figure C.1). Forty-two percent of robo-advice using households had less than $100,000 in financial assets.

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automating savings, both in retirement savings plans, and outside of them, to be strongly associated with improved financial well-being (Table 4).

[15] *See* Table A8: Holden, S., and Schrass, D. The Role of IRAs in US Households' Saving for Retirement, 2022. *ICI Research Perspective* 29(1) (February 2023). *available at* http://www.ici.org/files/per29-01-data.xls; full publication available at: The Role of IRAs in US Households' Saving for Retirement, 2022 (ici.org). Households headed by a person younger than 50 were even more likely to review online, rather than printed materials.

[16] *See* Fontes, A., Meagher, K., Mulford, B., Bloomfield, A., Ganem, R., Valdes, O., and Mottola, G., "New Investors 2022: Entering the Market in Novel and Traditional Ways," *FINRA Investor Education Foundation and NORC at the University of Chicago: Consumer Insights: Money & Investing* (April 2023), *available at* https://www.finrafoundation.org/sites/finrafoundation/files/New-Investors-2022-Entering-The-Market-In-Novel-and-Traditional-Ways.pdf.

Figure C.1
US Households Engagement with Robo- and Traditional Investment Advisers
Percentage distributions for US households using adviser services by type of service, 2023

By:	Households that use a roboadviser		Households that have ongoing relationship with an adviser	
	Percentage of	*Cumulative*	*Percentage of*	*Cumulative*
Age:				
Younger than 35	29	29	10	10
35 to 54	49	78	25	35
55 to 64	13	91	20	55
65 or older	9	*100*	45	*100*
Household income:				
Less than $50,000	16	16	18	18
$50,000 to $99,999	29	45	29	47
$100,000 to $149,999	26	71	20	67
$150,000 or more	29	*100*	33	*100*
Household financial assets:				
Less than $50,000	28	28	11	11
$50,000 to $99,999	14	42	10	21
$100,000 to $249,999	27	69	18	39
$250,000 or more	31	*100*	61	*100*

Source: ICI tabulations from the 2023 ICI Annual Mutual Fund Shareholder Tracking Survey

These data all point to a concern unaddressed in the Proposal. Regulations that burden digital engagement technologies like robo-advice, will disproportionately affect households with lower financial wealth – including households that are less educated, younger, or are minorities—hampering their opportunities and ability to invest. The Proposal's economic analysis does not consider distributional effects.

C.1.3 Proposal's Concern over Technology and Fees Overlooks Role of Competition and Robust Regulatory Framework Already in Place

The Commission's emphasis on conflicts of interest regarding fees ignores the important role of competition in the financial services industry. The Proposal asserts that investment advisers and broker-dealers may be using technology to manipulate investors into selecting higher fee investments.[17]

Mutual fund data provide no evidence of this. On the contrary, expense ratios for long-term mutual funds have on average declined substantially over the past 26 years: from 1996 to 2022, average equity mutual fund expense ratios dropped by 58 percent and average bond mutual fund

[17] *See* Proposing Release at 53982.

expense ratios dropped by 56 percent.[18] This drop reflects both index and actively managed funds; for instance, the average expense ratio for actively managed equity mutual funds declined 39 percent over the same period. The average expense ratio for target date mutual fund expense ratio fell 52 percent from 2008 to 2022.[19] In 2022, the most recent year available, expense ratios for equity, bond, and target date funds continued to fall.[20] Average expense ratios for ETFs also have declined over time.[21] When mutual fund–owning households are asked what factors they consider when selecting mutual funds, more than 90 percent say they consider fund fees and expenses.[22] ETF-owning households also consider fees and cost-effectiveness.[23]

The Commission states that "[t]he proposal is intended to be technology neutral . . ."[24] If that is the Commission's intent, then it should track investors' experiences in the marketplace, rather than proposing rules that seek to track particular innovations that advisers and broker-dealers may employ to offer investors more tailored products at lower costs. Generally, firms make investments in technology to be, and to stay, competitive.

The Proposed Rules seek to protect investors through costly documentation of process checks, but this is unnecessary. The beneficial competition in an already robust regulatory framework has arisen without the compliance burdens the Proposed Rules would require. Firms may conduct product testing for reputational and reliability reasons, without any Commission requirements.[25] The expansion of market participation in a declining fee environment demonstrates that production is expanding such that the market clears with higher quantities being sold at lower prices as the supply curve shifts outwards. That is evidence enough.

Legacy technologies have already demonstrated their worth and value to investors. Investors choose to use, and benefit from, well-established legacy technologies like spreadsheets, calculators, correlation matrices, decision trees, and other tools.[26] All of these tools have been developed, offered, and used by investors in a highly competitive market. The same competition

[18] *See* Duvall, J., and Ryback, C., "Trends in the Expenses and Fees of Funds, 2022" *ICI Research* Perspective 29(3) (March 2023), *available at* https://www.ici.org/system/files/2023-03/per29-03.pdf.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *See* Holden, S., Bogdan, M., and Schrass, D., "What US Households Consider When They Select Mutual Funds, 2022," *ICI Research* Perspective 29(4) (April 2023), *available at* https://www.ici.org/system/files/2023-04/per29-04.pdf.

[23] *See* Holden, S., and Schrass, D., "How Do ETF and Mutual Fund Investors Differ?" *ICI Viewpoints* (September 22, 2023), *available at* https://www.ici.org/viewpoints/23-view-etf-investors.

[24] *See* Proposing Release at 53971.

[25] *See* Section 5.4.1 Compliance Burdens of main letter.

[26] Regarding benefits, see earlier cites on investing, financial tools, use of electronic resources, and well-being.

has driven fund expenses down. These facts counter the Proposal's broad suggestions that a market failure is created by principal-agent issues related to technology.

C.1.4 Proposed Rules Are Vague and Wide-Ranging

The Proposed Rules will disincentivize firms from continuing to offer and develop tools and models that investors find valuable because of the costs (or impracticality) of demonstrating and documenting a lack of conflicts. The Proposal itself acknowledges this concern.[27] ICI member firms have strong concerns that costs of documenting technologies will rise even for technologies where conflicts of interest do not arise.[28] These concerns are especially pronounced among small investment management firms that have more limited resources to devote to building tools internally.

C.1.5 Proposed Rule Discusses, but Provides No Evidence of, Principal-Agent Problems

The economic analysis relies on the concept of a principle-agent problem in an effort to provide support for the Proposal. The Proposal asserts that principle-agent problems arise "when one party, known as the principal, hires an agent to perform a task on the principal's behalf, but the interests of the principal and the agent are not aligned."[29]

Principal-agent problems are a well-studied area of finance and, when they arise, could indicate the need for regulation. However, the Proposal does not argue that new technologies raise principal-agent concerns, only conjecturally that they *can potentially* do so.[30] Consistent with this conjecturing, the Proposal provides no evidence that technologies are creating principal-agent problems requiring sweeping new regulation. In contrast, the strong evidence of decreasing financial market costs (e.g., fund fees) indicates that, to the extent there are principal-agent problems, they are being mitigated by competitive market forces.

The Proposal argues that hypothetical principal-agent problems, if unaddressed, "could adversely affect the formation of capital."[31] Although that is a theoretical possibility, in reality it is more

[27] *See* Proposing Release at 54011. The Commission recognizes that investors might lose benefits from technologies firms decide not to employ, or that they stop employing, because "firms might have no practical or financially viable way to demonstrate that there was not a conflict of interest."

[28] Many ICI members have expressed similar sentiments to this quote from one, *"I'm most concerned about tech that we know does not have a conflict of interest. That it does NOT put the firm's interest above investors' interests, but still takes so many resources to validate, that we cease offering it, or now seek not to develop it. That is a case where we can demonstrate a lack of harm, but the costs of doing so change the cost-benefit analysis enough such that it is now not worth offering."*

[29] *See* Proposing Release at 53998.

[30] *See* Proposing Release at 53998 arguing that "[f]irms usually have more information about the investments they are recommending, pricing, and market dynamics than the investors that they serve, and *can potentially* place their interests ahead of investors' interests" [emphasis added].

[31] *See* Proposing Release at 53998-53999.

likely that the Proposal will stifle capital formation. As we discuss below, the Commission's economic analysis documents high initial and ongoing costs that firms would incur under the Proposal to provide technologies that investors value. It is well-accepted in economics that high fixed costs impose barriers to entry. It follows that the Proposal is likely to raise barriers of entry, making it harder for smaller firms to remain or enter the advice market, leading to industry consolidation, which will weaken competition. That cannot be good for capital formation.

C.1.6 Proposal Defines "Conflict of Interest" to Capture Virtually Any Economic Activity, to the Detriment of Competition

A fundamental problem for the Proposal's economic analysis is the wide-ranging scope of the Proposal itself. The Commission proposes that a "*conflict of interest exists when an investment adviser uses a covered technology that takes into consideration an interest of the investment adviser, or a natural person who is a person associated with the investment adviser."*[32] As the Proposal acknowledges, this definition is at odds with the standard definition tied to economic analysis.[33] However, other than being acknowledged, this fundamental problem is ignored throughout the Proposal's economic analysis.

The problem with seeking to redefine "conflict of interest" to mean any "interest" is that it is so broad that it can sweep in virtually any type of economic activity. "Interests" are fundamental to creating competitive pressures in markets, whether financial markets or otherwise. These are the normal features of competitive markets: economic actors work to meet their own interests by meeting the interests of others.

The Proposal's economic analysis is careful on this point. It suggests that some economists define a 'conflict of interest as a "situation in which a party to a transaction can potentially gain by taking actions that *adversely* affect its counterparty" [emphasis added]. In other words, in economics, a "conflict of interest" necessarily relates to the potential for one party to gain by harming another. In contrast, in a competitive market, one party may have an "interest" that it meets while *enhancing* the interests of others.

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[32] *See* Proposing Release at 54023**.** *Also see* Testimony of Chair Gensler at the September 13, 2023, Senate oversight hearing, when describing the Proposal*, available at* https://www.banking.senate.gov/hearings/09/06/2023/oversight-of-the-us-securities-and-exchange-commission.

- With Senator Menendez at 00:58 hours, "*We put out a rule for comment and proposal around conflicts in the market, when a robo-advisor or brokerage app is taking into consideration their interest and may be putting that ahead of their investors.*"
- With Senator Rounds at 1:06 hours, "*it's like if an investment advisor, think about a robo-advisor, is giving you advise and it is only based on your family or well-being – great, thumbs up. But if they are also taking into account their own interests their profits their revenues and the like, therein lies a potential conflict.*" (emphasis added).

[33] *See* Proposing Release at 53998, footnote 232, which states that "The proposed conflicts rules' definition of 'conflict of interest' is broader than how economists usually define 'conflicts of interest' such as in the context of the principal-agent problem. One economist's definition of 'conflict of interest' is 'a situation in which a party to a transaction can potentially gain by taking actions that adversely affect its counterparty.'"

Thus, by seeking to regulate "interests" rather than "conflicts of interest," the Proposal would undermine normal competition in the financial markets, contrary to the Commission's obligations to the public. The Commission is required to demonstrate a benefit from the Proposal. While mitigating a harm would constitute a benefit, demonstrating an "interest" is not sufficient to demonstrate a harm. Since no harm has been shown by the Proposal with respect to either current "covered technologies" or for emerging ones, the significant costs the Proposed Rules would impose, even where use of a covered technology does not put the interest of the firm or its representatives ahead of investors' interests, are in the "interest" of no one. Firms profit by their activity, just as those who buy their products benefit. A market failure occurs when the benefits from trade are upset by a persistent and identifiable imbalance, i.e., market power. The Proposal's economic analysis has not demonstrated that any such imbalance exists.

Current evidence from the market suggests beneficial competition. The Proposed Rules, however, are expected to lead to a decline in beneficial competition. It does not follow then that the Proposed Rules would protect investors, work to maintain fair, orderly, and efficient markets, or facilitate capital formation.

We next consider the Proposal's benefit-cost analysis.

C.2 Benefits of Proposal: The Economic Analysis Offers No Salient Benefits

The Proposal's economic analysis provides no quantitative estimates of benefits. Indeed, the Commission notes that doing so is impractical:

> *Some of the benefits and costs discussed below are impracticable to quantify because quantification would necessitate general assumptions about behavioral responses that would be difficult to quantify.*[34]

To the extent that the Proposal does attempt to discuss potential benefits, the discussion is descriptive, speculative, and conjectural, such as repeatedly asserting that the Proposed Rules "might," "could," or "can potentially" convey benefits "to the extent" that a particular assumption holds or that a particular event occurs.[35]

While we are sympathetic to the Commission's view that quantifying benefits can be difficult, the Commission should nevertheless attempt it. This is important because, as shown in the next section, the estimated costs of complying with the Proposal are very large, even by the Commission's own analysis.

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[34] *See* Proposing Release at 53998.

[35] *See, e.g.,* Proposing Release at 54006, suggesting that "By requiring firms to eliminate, or neutralize, the effect of conflicts of interest that place the firm's or an associated person's interest ahead of investors' interest, the proposed conflicts rules *could* enhance investor protection" [emphasis added]. *See also* Proposing Release at 54007 arguing that "Elimination, or neutralization of the effect of, a conflict of interest *could* have greater investor protection benefits than disclosure *to the extent that it could* be difficult for a firm to accurately determine whether it has designed a disclosure that puts investors in a position to be able to understand the conflict of interest" [emphasis added].

C.3 Costs of Proposal: Commission's Estimates Are Large and Understated

The Commission requests comment on whether the Proposal's cost estimates are reasonable.[36] We find them to be unreasonable.

In aggregate, the Commission's cost estimates are very large, more than $10 billion over the first decade. We note, however, that the Commission's analysis comprises meaningful errors by omission. Moreover, we believe the analysis significantly understates costs by way of the number of entities affected, the hours of burden per firm, and the number and/or types of technologies that would be implicated. In addition, there are obvious and significant inconsistencies in costs implied by the Proposal's assumptions.

As we demonstrate using simple frameworks, the potential costs are likely to be several times higher than the Proposal posits. The actual costs of the Proposed Rules, if adopted, would total well over $30 billion in the first 10 years. Direct costs would be lower if the Proposed Rules cause firms to curtail the provision and development of technologies that investors value. But because investors value such technologies, such curtailment would offset any potential benefits of the Proposal.

C.3.1 The Commission's Own Cost Estimates Are Very Large

First, the Commission's estimates show that the Proposed Rules will be very costly. The estimates describe initial and first-time compliance costs of $1.5 billion, and ongoing compliance costs of just over $1.0 billion per year (see Figure C.2). These costs accumulate over a ten-year period to $10.6 billion.[37]

Second, the Proposal's estimates contain meaningful errors by omission. In particular, Table 3 in the Proposal cites time burdens for initial implementation and related exercises, but it omits representing those burdens in dollar terms. Consequently, those dollar costs are never included in any dollar cost estimate reported in the Proposal. Taking the units of analysis, external costs, and labor costs as given in the Commission's analysis, these omitted costs total $664.8 million ($1,445.3 million corrected amount less $780.4 million in the Commission's Table 3; see Figure C.2). Adding in these $664.8 million raises the cumulative costs over a 10-year window to $11.2 billion.

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[36] *See* Proposing Release at Section C. *Request for Comment*. "We request comment on whether these estimates are reasonable."

[37] Assuming no new technologies are introduced over the ten-year window, such that initial costs are not repeated, in full or part, and that continuing expenses begin no earlier than year two.

Figure C.2
Correcting for Errors and Omissions Raises Proposal's First-Year Costs by 45 Percent

	Initial set-up and first time compliance costs	Estimated impact over first 10-years of compliance
Commission's Presented Estimates:	$1,472,066,225	$10,570,788,350
Corrected Estimates:	**$2,136,907,550**	**$11,235,629,675**
Percentage differences:	*45.2%*	*6.3%*
Aggregate Costs Reported in the Commission's Table 2		
For both "simple" and "complex" technology firms:	**$691,645,650**	**$2,766,582,600**
Corrections of Errors & Omissions:		
Aggregate Costs Reported in the Commission's Table 3		
For both Investment Advisers and Broker-Dealers:	$780,420,575	$7,804,205,750
Aggregate Costs Including Corrections for Initial Recordkeeping Compliance		
For both Investment Advisers and Broker-Dealers:	**$1,445,261,900**	**$8,469,047,075**

Source: ICI Tabulations Using Data in Tables 2 and 3 in Proposing Release.

Following corrections for omissions, the cost estimates offered in the Proposal are still understated, as discussed in the next subsection.

C.3.2 Alternate Frameworks Highlight the Implausibility of the Commission's Cost Estimates

Discussions with ICI members highlighted several challenges for the economic analyses. We heard concerns best characterized as, *we cannot at all confidently estimate the costs of these Proposed Rules "because the Proposed Rules are so far-reaching and vague," it is difficult to understand their intended scope,"* as summarized in a recent Ignites article.[38] However, some members that were able to attempt an estimate found meaningfully higher costs. We also performed our own estimates based on both information we gathered, and from figures offered in the economic analysis of Proposed Rules, all of which suggest much higher costs than what is presented in the Proposal.

C.3.2.1 Estimated Burdens Based on Discussions with Small Firms

Small ICI member firms we spoke with indicated that they would need to hire one or two people to comply with the Proposed Rules (assuming conflicts of interest were defined according to the existing legal definition, not as proposed). Using the Commission's estimate for the number of

[38] From August 25, 2023 Ignites - AI Proposal Would Require 'Unprecedented' Resources

hours of paid work in a year,[39] hiring one person generates a burden greater than that envisioned by the Proposal.[40]

When we look across all the estimated hours of burden offered in the Proposal's Table 2 and Table 3, both initial and ongoing, we find that for any size of firm, by either definition ("simple," "complex"), the hours of burden related to aggregate costs of the proposal offered in the Proposed Rules fail to reflect the burden of hiring just one new employee. These are three to eight times as large as the $11.2 billion cost estimate (see Figure C.3).[41]

Figure C.3
Annual Hours of Burden, as Estimated in the Proposal, Fail to Account for Any New Hiring

Number of hires	Hours of work (burden)	Ratios of burden: hiring/Proposal	
		"Simple"	"Complex"
1	1,800	8 times	3 times
2	3,600	17 times	5 times

Hours of burden listed in Proposal, for initial year:			
	Table 2		*Table 3*
	"Simple"	*"Complex"*	
	37.5	*525.0*	*177.0*
Totals:	*214.5*	*702.0*	

Source: ICI Tabulations Using Data in Tables 2 and 3 in Proposing Release.

C.3.2.2 Estimated Burdens Based on Narrower Rules

A few large members reporting an ability to offer an estimate did so on the basis of costs of complying with other narrower recent Commission rules,[42] or narrower rules proposed by other regulators. [43] The cost estimates these member firms provided to us on this basis were meaningfully higher than those suggested in the Proposal.

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[39] Hiring one person is commonly understood to add 1,820 – 2,080 hours depending on whether a 35- or a 40-hour work week is used. Though no figure is offered herein, the Commission has used a lower figure of 1,800 hours in other economic analysis. (*See Federal Register* 84(134): 33472, footnote 1398).

[40] All the firms we spoke with anticipated hiring; none believed it would be easy to hire candidates that possess the requisite skills.

[41] To generate these figures, we are using the (low) 1,800-hour estimate for paid work and comparing these to the (highest) estimate offered for hours of burden (including both initial and ongoing hours) provided by the Commission. We are also characterizing hiring for a small firm, describing themselves as having "simple" technology. We focus on hours because we cannot comment on dollar estimates given the lack of detail in the Proposal regarding composition of the "blended rate."

[42] For example, one ICI member firm mentioned using the Marketing Rule as a basis for an estimate of costs. On this basis, the firm believed its actual costs of complying with the current Proposal could be 15 times higher than the Commission's reported hour estimates for a "complex" firm in Table 2, including both initial and annual costs. When we asked this member if they could extend their estimates to cover Table 3, magnitudes were roughly similar.

[43] Specifically, based on complying with Federal Reserve SR-11-7, *available at* https://www.federalreserve.gov/supervisionreg/srletters/sr1107.htm. Firms subject to SR-11-7 regulations should be

The Commission's estimates understate the costs of complying with the Proposed Rules in another significant way. The Commission's estimates make no allowance for the fact that new technologies will be introduced in subsequent years (albeit at a slower pace due to the Proposed Rules' negative impacts for technological development). Allowance for this would add to the cost burdens of the Proposed Rules.[44]

C.3.2.3 Assumed Ratios of Simple to Complex Firms Are Inappropriate

The economic analysis is very sensitive to assumptions regarding the mix of firms. The Proposal assumes that 90 percent of firms would be simple covered technology firms ("simple") and 10 percent would be complex covered technology firms ("complex"). However, these proportions are not supported by any data in the Proposal.

Our conversations with member firms indicated that the ratio is likely to be as much as reversed. An important reason is that providing tailored financial advice to an investor is in general a complex matter. Taking all the other assumptions in the Commission's cost estimates as given, if 90 percent of firms are better characterized as "complex" and 10 percent as "simple," the cost estimates in the analysis would rise to be five and a half times what is presented (see Figure C.4). If the ratio were instead, for example, half and half, costs would be over three times as high.

Figure C.4
Proposal's Dollar Burden Estimates Hinge on Unsupported Assumptions for Firms' Technology

Percent of firms considered "complex"	Initial set-up and first time compliance costs	Estimated Impact over first 10-years of compliance
10%	***$691,645,650***	***$2,766,582,600***
25%	*$1,278,040,875*	*$5,112,163,500*
50%	***$2,255,366,250***	***$9,021,465,000***
75%	*$3,232,691,625*	*$12,930,766,500*
90%	***$3,819,086,850***	***$15,276,347,400***

Note: The Commission's Table 2 assumes 10 percent of covered firms are complex.
Source: ICI Tabulations Using Data in Table 2 in Proposing Release.

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well placed to offer estimates benefitting from experience in a related area, and with developed staff, tools, and expertise. The estimated marginal compliance costs reported to us were much higher than for the member relying on the Marketing Rule. We followed up with these members and they told us that the Proposal's definitions of "conflict of interest," "simple," and "complex," were all problematic, that their experience with other regulations gave them a strong sense of required resources, and that the definitions eliminated some hoped for economies of scale.

[44] We acknowledge that the rate at which technologies are introduced would be expected to decline if the Proposal were adopted.

To summarize, we find the economic analysis of cost estimates tied to the Proposed Rules to be unclear in terms of basis, scale, and inputs. We conclude that the design and embedded assertions within Table 2 and Table 3 are not usefully informative for those who would be subject to it. We also find that they are consistently biased downwards along several dimensions.

C.3.2.4 Data Within the Proposal Itself Suggest Much Higher Estimates of Burden

To demonstrate the extent of the Commission's underestimation of the Proposal's compliance cost, we offer a simple exercise. The Proposal provides a count of 971,758 employees of investment advisers and 701,859 FINRA-registered representatives. It suggests that these figures may undercount the number of individuals affected by the Proposal.[45] Nevertheless, taking these figures at face value and using only the smaller figure (701,859) for registered representatives, an annual one-hour compliance seminar taken by registered representatives generates 701,859 hours of burden. This alone is more than the Proposal's estimate in Table 2 of the 516,925 annual hours that simple and complex firms would be required to spend evaluating, determining, and eliminating conflicts. Put simply, the Proposal's industry employee counts and burden estimates in Table 2 appear wildly inconsistent and thus, given the breadth of employment across the industry, estimates in Table 2 are significantly understated.

As another example of striking inconsistency that could substantially raise the Commission's burden estimates, consider the firm-level estimates in Proposal Table 3. Table 3 allows five hours for *"[a]nnual review of policies and procedures and written descriptions."* Given this estimate is at the firm level and based on the number of firms as provided in the Proposal, this yields 89,875 hours annually.[46] Consider the one-hour compliance seminar example again. The one-hour seminar in our example consumes 7.8 times the burden of hours allotted.[47] Adding the entirety of annual hours of burden estimates across Tables 2 and 3 together yields 2,242,525 hours, the one-hour seminar alone would consume nearly a third of it (31.3 percent).

To be clear, an annual compliance seminar for registered representatives alone consumes over seven times the number of hours allotted for the annual review required under the Proposed

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[45] *See* Proposing Release at 54000.

[46] The overall low estimates for ongoing review, at the firm level across Tables 2 and 3 do not meet the descriptive goal of the Proposed Rules as we read it in other places within the Proposal. *See* Proposing Release at 54008: "*The periodic review element requires a firm to consider whether any changes in the business activities, any changes in the use of technology generally, any issues that arose with the technologies during the previous year, and any changes in applicable law might suggest that certain covered technologies are of a different or greater risk than the firm had previously understood.*"

[47] The proposed rule has: five hours for 17,975 firms, yielding 89,875 hours. These are proposed to include the combined efforts of the following departments: senior corporate and information technology managers and staff, assistant general counsel, and compliance attorney, and that this estimate is inclusive as well of any external costs (which are explicitly declared to additionally cost a firm nothing in Table 3, Footnote 5). Dividing across functions, the Commission's math amounts to one hour per area, per year (the set of areas being: {corporate managers and staff, information technologies managers and staff, assistant general counsel, legal compliance, external review}), or very-much less than one hour per engaged employee, per year, internal and external combined, to review all written policies and procedures for compliance and recordkeeping.

Rules. And this does not offer any burden hours for beginning the listed obligations, and none of the included labor for accomplishing that work. This highlights the serious danger of estimating burdens at the firm level. Overall, we find that the Proposal has quite seriously understated hours that would be required for compliance, including when described very narrowly.

While the tractable errors and omissions in the Proposal are notable, and the undercounting of burdens is easily demonstrated in a variety of ways, other concerns with the narrow estimates exist as well. These affect the ability to turn hours-of-burden estimates into dollar figures.

C.3.2.5 Concerns with Documentation of Methods in the Economic Analysis

Detail on adjustment mechanisms provided by the Commission in other recent economic analyses is absent from the estimates provided in this Proposal. Within categories where costs are estimated (e.g., labor costs), the economic analysis offered in this Proposal omits details on the calculation of costs present in other recent rulemakings.[48] The level of detail offered in other recent rulemakings affords the reader a chance to replicate calculations in ways one cannot here.

We are concerned by how the Proposal uses Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry in the Proposal. The use of SIFMA (2013), in this Proposal appears to differ notably from the Commission's use of these data elsewhere in recent rulemaking and Federal Register notices. In the Proposal's Table 2, the lack of tractable detail related to hourly compensation is out of character with the quality of disclosure offered for estimates in other recent Commission proposals. We would have expected a similar level of detail for compensation data as the Commission has provided in other recent rulemaking proposal.[49, 50] By this comment, we do not mean to suggest that the Commission be limited in use of methods, merely that they be disclosed. Other well-disclosed methods would afford commenters the ability to consider their merit, while remaining within the narrow

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[48] *See Federal Register* 87(95): 29977 Form 13F, and Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019) ("Reg BI Adopting Release").

[49] For example, *see Federal Register* 87(95): 29980 footnote 4, for an example of recent, more fulsome documentation in a Commission release. By contrast, Table 2 contains no description of how costs are calculated. Table 3 contains a very abbreviated note (footnote 3), which fails to disclose the specific factors commonly documented in proposed rulemaking by the Commission. If the Commission has been using the 2013 data in the 2013 SIFMA report without adjustment for bonuses, and other factors leading to total compensation, the analysis would understate costs. As well, if adjustment factors were simply copied from proposals from earlier years, those factors would not adequately represent changes over the full time period 2013 – 2023, so the Commission would again understate costs.

[50] For an example of SIFMA wage data, *available at* https://www.sifma.org/wp-content/uploads/2017/06/sample-page-for-os.pdf, which offers a sample page that serves as reference for categorical income payments in 2012 and 2013 used in this example. This example page offered the following insights: First, that salary growth of 3.1 percent in the example data was higher than inflation as measured by either the PCE deflator (1.3 percent) over the reference period of 2012Q2-2013Q2, or the CPI-U (1.4 percent) over the reference period of May 2012 – 2013. Second, that total compensation in 2012 remains higher than 2013 Salary, despite the 3.1 percent increase in wages.

requirements of the Paperwork Reduction Act (PRA), as previously interpreted by the Commission.[51]

In the past, the Commission's economic analyses have also reported methods it has employed when using the 2013 earnings data to account for wage growth, but in this release, those are omitted. For example, in Regulation Best Interest (Reg BI), at footnote 1398, the Commission employs and discloses ad hoc adjustments to account for non-salary labor costs. The Commission adds (at footnote 1398), that "[t]he SIFMA Management and Professional Earnings Report was updated in 2019," and that "[t]he numbers in the (2019) report are higher than the number we used in the (Reg BI) Proposing Release." In the Proposal, the Commission does not use the SIFMA updated report data. Nor does the Commission report any rates of adjustment to the SIFMA data. Nor does the analysis describe its apportionment across job titles in any place where it cites "blended" rates, as it has in the two prior releases cited. This obfuscates estimated dollar burdens of the Proposal, making it harder for stakeholders to assess the Commission's estimates. In March 2022, when the Commission revised down compliance burdens related to Form 13F because of technology, [52] it disclosed methods supporting its calculations.[53]

In sum, the Commission's approach in this Proposal to constructing costs estimates diverges from its past practices and, in doing so, offers too little detail for stakeholders to fully assess what it has done, thus making its analysis opaque.

Following our review, we do not think the burdens represented in the Proposal reasonably estimate average hours of burden, including an estimate solely for "simple covered technology" firms. We have additional concerns with the translation of estimated hours of burdens to dollar estimates because they are not as tractable as would be normally expected. Both broadly and in several specific places, we are concerned with the Proposal's published efforts to reasonably estimate costs, either under the relatively streamlined standard of the PRA as interpreted by the Commission, or when compared with recent prior norms of the Commission.

C.4 Summary of ICI Review

The Proposal offers no compelling benefits that would outweigh its clear costs. The Proposal's economic analysis, taken at face value, implies very significant initial and ongoing compliance

[51] Along with citing streamlined requirements under the PRA in footnote 5 of Table 3, in a recent filing, the Commission offers, "The estimate of average burden hours is made solely for the purposes of the Paperwork Reduction Act. The estimate is not derived from a comprehensive or even a representative survey or study of the costs of Commission rules."

[52] Specifically, Federal Register 87(95): 29980 at footnote 3, Table—Form 13F, the Commission notes: "We believe that this reduction adequately reflects the reduction in the time managers spend complying with Form 13F–HR as a result of advances in technology that have occurred since Form 13F was adopted." (It is unclear from this footnote what specific technologies the Commission is referencing, or whether they relate to burdens the Commission would assign firms in the current proposed rule.)

[53] By 2023, one would expect adjustments to 2013 salary data to be higher than they had been in 2018, or 2022 due to improvements in labor productivity as a result of "technology" such as the Commission might have had in mind when writing footnote 3 of Table—Form 13F, referenced above.

costs, totaling more than $10 billion over ten years. The analysis, however, comprises significant errors, omissions, and inconsistencies and is very sensitive to key assumptions. Adjusting for these factors generates compliance costs three to eight times higher than the Commission's estimates. Allowing for an increase in the number of "covered technologies" over time would result in still higher costs (albeit at a slower pace due to the Proposed Rules' stifling effect on technological development). The only way the Commission can plausibly argue that these extraordinarily costs are worth it is if the Proposal's benefits are even greater. The Proposal, however, offers no such evidence and indeed states that it cannot quantify the benefits. Our findings are summarized below.

We found that the proposed redefinition of a conflict of interest to mean solely an "interest" is irreconcilable with any well-grounded economic analysis. We further found that the analysis fails to consider facts in the public record related to research in the fields of finance, financial literacy, trust and engagement, the use of electronic disclosure, competitive pressures in the investment company space, and related facts regarding fees.

We found that the Proposed Rules would likely negatively impact firm entry, lead to firm exit, and limit the use of tools that investors like and benefit from. We believe the negative effects of the Proposed Rules will fall more heavily on smaller firms because they lack the scale to bear the increased costs.

In terms of investor protection, we found no demonstrated increase in economic benefits in this Proposal. We further found the arguments offered in terms of capital formation are similarly indeterminate. As the Commission states in its economic analysis, "*On the one hand, …, On the other hand, …*"[54]

We found that the proposed definition of "conflict of interest" is unworkable. We found that assumptions about the distribution of so called "simple" and "complex" covered technology firms were unsupported, although they were critical to presenting costs at the levels offered. Along these lines, we found documentation of methods lacking when compared to recent economic analyses by the Commission.

We found simple exercises such as hiring one person, or attending a one-hour seminar, to further demonstrate the understatement of the Proposal's cost estimates, given the numerous, complex tasks required in the Proposed Rules.

Overall, we conclude that we cannot agree with, replicate, or to any degree validate the Proposal's economic analysis.

[54] *See* Proposing Release at 54012.