October 10, 2023

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

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (File Number S7-12-23); 88 Fed. Reg. 53960 (Aug. 9, 2023)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal" or "Release")[2] that would require broker-dealers and investment advisers to eliminate, or neutralize the effects of, certain conflicts of interest associated with their use of technology in their interactions with investors. The increasing use of artificial intelligence and other technologies in securities recommendations and investment advice may lead firms to interact with investors in a way that prioritizes the firms' interests over investors' interests. The Proposal is a necessary measure to ensure that the securities laws keep pace with technological innovations.

Conflicts of interest lie at the heart of many types of investor abuse in the financial markets. Advisers have long promoted investments or trading strategies that maximize their profits at the expense of their clients. Goldman Sachs infamously designed a complex derivative investment keyed to residential mortgages, off-loaded it to unsuspecting investors, and then bet against it, pocketing hundreds of millions of dollars. And today, many broker-dealers receive huge "payments for order flow" by routing investor orders to wholesalers who in turn obtain inferior execution prices for the broker-dealers' clients. A new species of conflict of interest has evolved through the increasingly prevalent use of advanced technology in the retail investment arena. The use of that technology may benefit retail investors in some ways, but it also threatens to create complex and hidden conflicts of interest. These increasingly sophisticated technologies can be touted as offering state of the art financial advice, yet they can harm investors on a broad scale by influencing investors to trade in ways that enrich the firm but lead to inferior results. And the technology is evolving rapidly. The Proposal represents a vitally important step to address the specific risks that these technologies pose to investors, now and in the future.

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 88 Fed. Reg. 53,960 (Aug. 9, 2023).

OVERVIEW

Artificial intelligence has the potential to transform finance. The last few decades have witnessed significant advances in financial technology made possible in part by artificial intelligence.[3] Many of these advances have been beneficial for society.[4] They have lowered the costs of capital, expanded the types of financial resources available to a broader and more diverse population of investors, and made it easier for individuals to bank and invest.[5] But regulators must guard against the risks that these technological innovations will also cause investors harm.[6]

The Proposal recognizes that one way in which firms' use of artificial intelligence may harm investors is through conflicts of interest that arise from predictive data analytics ("PDA"). PDA draws inferences from large datasets to make predictions about future outcomes.[7] For example, algorithmic trading is a widely used application of artificial intelligence and machine learning in finance.[8] In those applications, machine-learning models analyze large datasets and identify patterns and signals to optimize, predict, guide, forecast, or direct investment-related behaviors.[9] Although the use of PDA and similar technologies ("PDA-like technologies") has the potential to benefit investors, it may also harm investors if the technologies lead to advice or recommendations that allow firms to benefit at the expense of investors.[10]

These conflicts of interest may arise from the use of PDA-like technologies in several ways. For example, conflicts of interest may arise from the data the PDA-like technology uses and from the inferences the PDA-like technology makes.[11] The dataset underlying the PDA-like technology may be biased towards investments that are more profitable for the firm than other investments.[12] Or the algorithm that uses the dataset may produce advice or recommendations that prioritize investments that are more profitable for the firm than other investments.[13] The ease with which conflicted advice or recommendations may be transmitted to investors through chatbots, push notifications, and robo-advisory platforms means that it could spread rapidly to many investors.[14] The Proposal attempts to redress these problems by requiring that firms eliminate, or neutralize the effects of, the conflicts associated with their use of PDA-like technologies in investor interactions that place the firm's interests ahead of investors' interests.[15]

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3 Tom C.W. Lin, *Artificial Intelligence, Finance, and the Law*, 88 FORDHAM L. REV. 531, 532 (2019).
4 *Id.*
5 *Id.*
6 *See id.* at 533 (noting that the use of artificial intelligence presents both benefits and risks).
7 Release at 53,962 n.9.
8 *Id.* at 53,963.
9 *Id.*
10 *Id*. at 53,961.
11 *Id.* at 53,962.
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id*.

The Commission must reject industry's attempts to cast the Proposal as unnecessary and unduly burdensome. Critics assert that the Proposal is too costly to implement because it would require firms to test "tens of thousands of covered technologies" to identify potential conflicts.[16] But those same critics recognize that the "vast" majority of such technologies raise no issues.[17] That is because the Proposal is narrowly tailored to address only those technologies that, through their use of artificial intelligence and machine learning, could lead to interactions with investors that would cause firms to prioritize their own interests over the interests of investors. The industry cannot dispute that such conflicts have no place in the securities markets, and all the Proposal does is ensure that firms cannot use technology to avoid this fundamental precept of investor protection.

Indeed, not only must the Commission resist industry calls to withdraw or dilute the Proposal, but it must also recognize that the Proposal is only the first step in regulating the use of artificial intelligence in the securities markets. Conflicts of interest are not the only threat that investors face from the increasing use of PDA-like technologies in their interactions with securities professionals. For example, artificial intelligence could produce advice or recommendations that steer investors into unsuitable investments. Blind reliance by securities professionals on the technology underlying such advice or recommendations could cause significant harm. The Commission must ensure that as technology advances the rules and regulations protecting investors respond to the challenges those technological innovations pose.

BACKGROUND

The artificial intelligence and machine learning underlying the PDA-like technologies that financial firms use to interact with investors are complex.[18] But the problems that may arise from the use of such technologies are simple to understand. The algorithms that underly these technologies are just formulas for making choices. For example, robo-advisors employ key algorithms that rank the financial products for investors to select. Each algorithm is embedded in software code that is based on a model of how to optimize the fit between the attributes of the financial products available to the investor and the attributes of the investor using the robo-advisor. The algorithm then matches investors with products.[19] The problem is that the firms using these technologies may employ a biased matching or ranking algorithm.[20]

PDA-like technologies are not immune from the misalignment of incentives that has historically affected financial product intermediaries.[21] Humans still develop, run, and maintain

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16 American Benefits Counsel et al., Comment Letter re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (Sept. 19, 2023), https://www.sec.gov/comments/s7-12-23/s71223-262739-624502.pdf.

17 *Id.*

18 William Magnuson, *Artificial Financial Intelligence*, 10 HARV. BUS. L. REV. 337, 377 (2020).

19 Tom Baker and Benedict Dellaert, *Regulating Robo Advice Across the Financial Services Industry*, 103 IOWA L. REV. 713, 734 (2018).

20 Lindsay Sain Jones and Goldburn P. Maynard, Jr., *Unfulfilled Promises of the Fintech Revolution*, 111 CALIF. L. REV. 801, 835 (2023).

21 Baker and Dellaert, 103 IOWA L. REV. at 732.

the algorithms that provide financial advice.[22] These algorithms can be programmed to prioritize what is best for the firm, rather than what is best for the client.[23] For example, the algorithm may prioritize investments that lead the firm to receive more compensation than it would have had the algorithm prioritized other investments.[24] But it would be a conflict of interest for a matching algorithm to take into account either the size of the commissions or the fees paid to the firm using the PDA-like technology.[25] The firm personnel who design the algorithm may also be influenced by firm incentives, which could lead them to subconsciously bias algorithms to favor the firm over the firm's clients.[26] So the firms that use these technologies remain subject to the usual incentives that could cause them to place their interests ahead of the interests of their clients, and regulators cannot assume that the firms will always choose the algorithms and choice architecture that are best for investors rather than the firms.[27] As a result, regulators must require that the firms that use PDA-like technologies ensure that the algorithms that underlie the PDA-like technologies do not incorporate biases that affect outcomes in a way that harms investors.[28]

Indeed, the need to guard against biases in the algorithms that underlie PDA-like technologies is more pronounced than in the case of traditional investment advice. In the case of advice provided through PDA-like technologies, investors "have no choice but to rely on the accuracy of the software as the algorithm behind it is opaque."[29] This "open[s] the door" to "biased advice" since investors may have no apparent reason to suspect bias or, if they do, "may find it difficult to formulate specific questions to clarify issues."[30]

These concerns are not theoretical. In 2022, Charles Schwab agreed to pay a $135 million penalty in response to allegations that it marketed its robo-adviser portfolios as charging investors no fees despite the fact that they were pre-set to hold a certain percentage of assets in cash and its affiliate would earn income on customers' cash held in deposit accounts.[31] This compensation structure created a conflict of interest, as it could drive the company to allocate more of a customer's portfolio to cash even if that strategy would not maximize customer returns.[32]

Similarly, in 2017, investors filed a class action lawsuit alleging that Morningstar, a robo-adviser designer, and Prudential, the investment management company, colluded 'to design a robo-

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22 Jones and Maynard, 111 CALIF. L. REV. at 836.
23 Megan Ji, Note, *Are Robots Good Fiduciaries? Regulating Robo-Advisors Under the Investment Advisers Act of 1940*, 117 COLUM. L. REV. 1543, 1573 (2017).
24 *Id.*
25 Baker and Dellart, 103 IOWA L. REV. at 736.
26 Ji, 117 COLUM. L. REV. at 1573.
27 Baker and Dellart, 103 IOWA L. REV. at 732.
28 *Id.* at 736.
29 Philipp Maume, *Regulating Robo-Advisory*, 55 TEX. INT'L L.J. 49, 70 (2019).
30 *Id*.
31 *Charles Schwab & Co., Inc.*, Exchange Act Rel. No. 95087, 2022 WL 2128612 (June 13, 2022).
32 Jones and Maynard, 111 CALIF. L. REV. at 835.

adviser program to steer [users] toward investments that paid Prudential high fees.'"[33] The complaint alleged that Morningstar and Prudential "modified their adviser technology 'to generate "revenue sharing fees" . . . by limiting the investment options available to [the plaintiffs].'"[34]

The risks of PDA-like technologies are not limited to algorithms that produce advice or recommendations that steer investors to favored products. Firms may use PDA-like technologies to gather customer-specific information and then use that information to exploit vulnerabilities.[35] A brokerage app may collect information on a customer's trading patterns, predict what types of securities the customer is likely to buy, and target that customer with recommendations for more of those types of securities.[36] Or the app may target investors who are likely to purchase securities on margin.[37] This targeting may allow a broker to pursue investors that are receptive to a particular pitch or trading strategy, which may generate additional revenue for the broker but run counter to the investor's best interest.[38] The use of these technologies can generate conflicts of interest if firms use them to nudge users to trade more frequently on their platforms, or to invest in products that are more profitable for the firm but expose investors to higher costs or risks.[39]

SUMMARY OF THE PROPOSAL

The Proposal requires that firms eliminate, or neutralize the effect of, the conflicts of interest associated with their use of PDA-like technologies in certain investor interactions.[40]

- The Proposal would require a firm to (i) evaluate any use or reasonably foreseeable potential use by the firm or its associated person of a covered technology in any investor interaction to identify any conflict of interest associated with that use or potential use; (ii) determine whether any such conflict of interest places or results in placing the firm's or its associated person's interest ahead of the interest of investors; and (iii) eliminate, or neutralize the effect of, those conflicts of interest that place the firm's or its associated person's interest ahead of the interest of investors.[41]

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33 *Id*. at 835-36 (quoting Diana Novak Jones, Morningstar, Prudential Face Class Action over Robo-Adviser, LAW360 (Aug. 4, 2017), https://www.law360.com/articles/951428/morningstar-prudential-face-class-action-over-robo-adviser).

34 *Id.* at 836 (quoting *Green v. Morningstar Inv. Mgmt. LLC*, No. 1:17-cv-05652, 2019 WL 216538, at *1 (N.D. Ill. Jan. 16, 2019)).

35 Jill E. Fisch, *GameStop and the Reemergence of the Retail Investor*, 102 B.U. L. REV. 1799, 1855 (2022).

36 *Id*.

37 *Id.* at 1856.

38 *Id*. at 1856.

39 Release at 54,002.

40 *Id.* at 53,970.

41 *Id.* at 53,971. A "covered technology" is an analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes in an investor interaction. *Id.* at 53,970.

- The Proposal would require a firm that has any investor interaction using covered technology to adopt and implement written policies and procedures reasonably designed to achieve compliance with the proposed rules, including:
    - a written description of the process for evaluating any use (or reasonably foreseeable potential use) of a covered technology in any investor interaction;
    - a written description of any material features of any covered technology used in any investor interaction and of any conflicts of interest associated with that use;
    - a written description of the process for determining whether any conflict of interest results in an investor interaction that places the interest of the firm or person associated with the firm ahead of the interests of investors;
    - a written description of the process for determining how to eliminate, or neutralize the effect of, any conflict of interest that results in an investor interaction that places the interest of the firm or associated person ahead of the interests of investors; and
    - a review that occurs at least annually of the adequacy of the established policies and procedures and the effectiveness of their implementation.[42]
- The Proposal would require firms to make and keep books and records related to the requirements of the proposed conflict rules. The books and records requirements are designed to help facilitate the Commission's examination and enforcement capabilities, including assessing compliances with the requirements of the proposed conflict rules.[43]

COMMENTS

I. The Commission should adopt the Proposal to prevent broker-dealers and investment advisers from using PDA-like technologies to place their interests ahead of investors' interests.

A. The Proposal is an appropriate response to the risks retail investors face from the conflicts of interest that may arise when broker-dealers and investment advisers use PDA-like technologies in investor interactions.

The Proposal is an appropriate first step to address the risks that the use of artificial intelligence poses to investors. Although the exact nature of all of those risks may yet be unclear, there is no question that the use of PDA-like technologies poses some clear and substantial risks of conflicts of interest. In the case of automated information platforms or automated advice, conflicts of interest may emerge if the underlying algorithm is programmed to direct investors

42 *Id.* at 53,971-53,972.
43 *Id.* at 53,972.

towards a specific range of preferred investment alternatives or intermediaries for which the platform or its affiliates receive higher commissions or other forms of compensation.[44] As a result, the Proposal is tailored to address these and related risks arising from the use of PDA-like technologies. The Proposal in no way prevents broker-dealers and investment advisers from using these technologies in their interactions with investors; it simply requires that they eliminate or neutralize the conflicts of interest that could arise from the use of these technologies. Broker-dealers and investment advisers should be able comply with these sensible requirements since they are in control of the PDA-like technologies that they use. To the extent their technologies are so complex or impenetrable that identifying the potential conflicts of interest they pose is impossible, then firms should not be permitted to deploy them and place their clients at risk.

The time to address the risks that these conflicts of interest pose is now. The use of PDA-like technologies in the financial sector has become increasingly prevalent in recent years. For example, the initial robo-advisers were independent, venture-backed start-up companies.[45] But traditional money managers have now overtaken independent robo-advisers. The growth rates of independent robo-advisers have been falling since mid-2015, and traditional money managers are now the primary driver of robo-adviser asset growth.[46] The use of PDA-like technologies by large broker-dealers and investment advisers has serious consequences for retail investors, because these firms use the technology in tandem with the other products and services that they offer.[47] The increased prevalence of the use of this technology by these firms increases the need for a comprehensive regulatory system for the conflicts of interest that result, since large broker-dealers and investment advisers have a greater potential to be conflicted as a result of their incentive to place clients into products that benefit their affiliated lines of business.[48]

The need to eliminate or neutralize these conflicts of interest is also essential in light of the potential for the conflicts of interest to impact such a large swath of investors. The conflicts that arise from the use of PDA-like technologies have larger and more certain effects than the conflicts that tempt individual employees of broker-dealers and investment advisers.[49] Individual employees may be influenced differently by outside incentives, as some may be easily tempted to take advantage of compensation structures that would benefit themselves at the expense of their clients, but others may not be.[50] In addition, broker-dealer and investment adviser employees traditionally interact on a client-by-client basis. If a conflict biases a financial firm's algorithm, however, that conflict "will without a doubt impact all clients and their investment returns."[51] Thus, conflicts in the use of PDA-like technologies have a larger and more certain impact.[52]

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44 INT'L ORG. OF SEC. COMM'NS, RESEARCH REPORT ON FINANCIAL TECHNOLOGIES (FINTECH) 24-26, 29-36 (2017), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf.
45 Ji, 117 COLUM. L. REV. at 1560.
46 *Id*. at 1562.
47 *Id*. at 1561-62.
48 *Id*. at 1579.
49 *Id*. at 1578.
50 *Id*.
51 *Id.*
52 *Id.*

The ability of PDA-like technologies to influence investor behavior also presents a "distinct concern."[53] The technology used by a brokerage platform may allow a firm to collect substantial information on customer preferences, trading patterns, and responses to nudges and cues.[54] The platform can then use artificial intelligence to respond to that information.[55] It may do so by prompting investors to trade certain stocks or engage in certain trading strategies.[56] These prompts may yield conflicts of interest if they encourage behavior that benefits the firm financially but is inconsistent with the best interests of the firm's customers.[57]

Demographic shifts in the market make eliminating or neutralizing these conflicts all the more important. Young investors inherently trust technology and prefer their services to be delivered at a faster pace.[58] They interact with the market primarily via apps on their phones.[59] This makes them particularly susceptible to PDA-like technologies that deliver electronic nudges to prompt certain investing behaviors. Effective regulation is necessary to prevent broker-dealers and investment advisers from taking advantage of the faith younger investors place in technology.

In short, PDA-like technologies present new, complex, and rapidly evolving threats to investors on an unprecedented scale, along with their potential benefits. While Reg BI and the Investment Advisers Act already address conflicts of interest as a general matter, the unique nature of the conflicts presented by PDA-like technologies calls for more. A targeted regulatory response in the form of the Proposal is appropriate and necessary.

B. The Proposal is right to require that broker-dealers and investment advisers eliminate or neutralize conflicts of interest when they use PDA-like technologies to interact with investors and not simply disclose conflicts.

The Proposal is right to take the position that disclosure is not sufficient to cure the conflicts of interest that may arise when financial firms use PDA-like technologies. For example, many firms use robo-advisers that disclose that they may invest in products sponsored by affiliates or from which they or their affiliates may receive fees.[60] But investors may ignore or discount the risks raised by these disclosures because they cling to an overarching belief that robo-advisers and similar PDA-like technologies are options that offer them quality professional securities

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53 Fisch, 102 B.U. L. REV. at 1855.
54 *Id*. at 1856.
55 *Id.*
56 *Id*. at 1854-55.
57 *Id.* at 1856.
58 Ji, 117 COLUM. L. REV. at 1579.
59 Sergio Alberto Gramitto Ricci and Christina M. Sautter, *The Corporate Forum*, 102 B.U. L. REV. 1861, 1865 (2022).
60 Melanie L. Fein, *Robo-Advisers: A Closer Look*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2658701.

recommendations and investment advice at low cost.[61] And disclosures are not effective if investors cannot understand them.[62] Disclosures of dense and complex information concerning the use of advanced technology to deliver recommendations and advice are unlikely to enable investors to understand the potential conflicts that may arise from the use of such technology.[63]

The problem with relying on disclosure to redress conflicts of interest is especially acute with respect to the use of PDA-like technologies in investor interactions. Investors that rely on automated investment advice tend to be less sophisticated than other investors.[64] Indeed, financial firms usually market their use of technology to provide recommendations and advice to younger and less financially sophisticated investors.[65] These investors will therefore have greater difficulty understanding the consequences of conflicts, even if disclosed.[66] An additional problem is that younger investors are less likely than other investors to examine text disclosures.[67]

The Commission must not make the same mistakes that it made with Reg BI. There, the Commission ignored or downplayed evidence of real, concrete harm that retail investors suffer as a result of widespread conflicts of interest in the brokerage industry.[68] It chose to rely largely on disclosures to protect retail investors from those conflicts. Yet the obligation to disclose conflicts of interest in Reg BI was an insufficient regulatory response. It is well-established that disclosure without substantive safeguards is an inadequate shield against conflicts of interest and other threats to investors. They are often poorly designed, incomprehensible, delivered too late in relation to an investor's investment decision, and even discounted by other assurances that financial professionals use to win investors' confidence. Recent analysis confirms that retail investors may fail to read disclosures about such conflicts, and if they do they may fail to understand them.[69] Regardless, disclosure does not prevent conflicted advice.[70] The use of PDA-like technologies poses conflicts of interest that threaten retail investors, and the Commission must respond to those threats by requiring firms that use these technologies eliminate or neutralize the conflicts.

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61 *See* Christine Sgarlata Chung, *The Devil You Know: A Survey Examining How Retail Investors Seek out & Use Financial Information and Investment Advice*, 37 REV. BANKING & FIN. L. 653, 739 (2018) (explaining the many reasons that investors may ignore disclosures of the risks of investing).

62 Nicole G. Iannarone, *Rethinking Automated Investment Advice*, 50 U. TOL. L. REV. 433, 441 (2019).

63 *See generally* Nicole G. Iannarone, *Computer as Confidant: Digital Investment Advice and the Fiduciary Standard*, 93 CHI.-KENT L. REV. 141, 160-61 (2018) (noting that commentators have long suggested that disclosure may not be an effective device and stating that disclosure is not a "miracle cure" for the problems associated with the use of PDA-like technologies in interactions with retail investors).

64 Ji, 117 COLUM. L. REV. at 1578.

65 *Id*.

66 *Id*.

67 Jacob Freund, Note, *Investors Take Note: Complexity and Disclosure Efficacy Concerns Amid a Structured Notes Renaissance*, 123 COLUM. L. REV. 139, 178 (2023).

68 Dennis M. Kelleher, Jason Grimes, and Andres Chovil, *Securities-Democratizing Equity Markets with and Without Exploitation: Robinhood, GameStop, Hedge Funds, Gamification, High Frequency Trading, and More*, 44 W. NEW ENGL. L. REV. 51, 107 (2002).

69 Douglas J. Plume, Note, *Finding a Better Disinfectant: Shortcomings of Modern Public-Disclosure Regulations as a Tool for Directing Corporate Behavior and Protecting Consumers*, 40 REV. BANKING & FIN. L. 865, 916-17 (2021).

70 *Id*.

In addition to disclosure being an inadequate remedy for conflicts of interest, existing regulations such as Reg BI are not sufficient to address the risks that the use of PDA-like technologies pose. PDA-like technologies may nudge investors to invest in ways that benefit brokers rather than investors, but Reg BI may not address these uses of PDA-like technologies if they did not rise to the level of a recommendation.[71] The Proposal is a necessary measure to force firms to eliminate conflicts of interest not covered by Reg BI or other rules or regulations.[72]

Indeed, the Commission cannot rely on any other laws, rules, or regulations that prohibit conflicts of interest to regulate the conflicts of interest associated with the use of PDA-like technologies in investor interactions. The nature of these technologies—such as the fact that they are inherently complex and that they have the potential to infect a firm's entire client base with conflicted advice and recommendations—means that firms must take additional steps to address conflicts associated with their use in investors interactions.[73] The Proposal thus requires that broker-dealers and investment advisers first evaluate whether a use of covered technology in an investor interaction involves a conflict of interest, then determine whether any conflict of interest results in an investor interaction that places the interest of the firm or associated person ahead of investors' interests, and finally take steps to eliminate or neutralize any such conflict of interest.[74] The requirement to eliminate or neutralize any such conflict of interest applies only to conflicts that the firm determines actually place the interests of the firm ahead of the interests of investors, as opposed to potential conflicts, which continue to be covered by other authorities such as an investment adviser's fiduciary duty and Reg BI.[75] Thus, the Proposal appropriately supplements, rather than supplants, existing regulatory obligations regarding conflicts of interest, and it is necessary in light of the unique risks that PDA-like technologies pose.[76]

II. The Commission should reject unjustified criticisms of the Proposal.

The Commission must reject industry attempts to characterize the Proposal as overly broad and burdensome. It is not. The Proposal is narrowly tailored to address the specific risks that conflicts of interest arising from the use of PDA-like technologies pose to investors.

A. The Proposal is narrowly tailored to address specific conflicts of interest.

Critics assert that the Proposal is overly broad because it would govern "any analytical or computational tool whereby information potentially relevant to investments is presented to the

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71 James Fallows Tierney, *Investment Games*, 72 DUKE L.J. 353, 435 (2022).

72 *See* Release at 54,002; Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations—Laying the Groundwork for the Next Financial Crisis*, 13 DREXEL L. REV. 377, 414 (2021).

73 *Id.* at 53,977.

74 *Id.* at 53,976.

75 *Id.* at 53,976-53,977 n.142.

76 *Id.* at 53,976.

public."[77] But this is not the case. The Proposal does not apply to all the technology that a firm uses. Rather, it applies only to an "analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes in an investor interaction."[78] Thus, it is not sufficient that the technology involves a computational function, algorithm, or model. The technology must predict, guide, forecast, or direct investment-related behaviors or outcomes.

The Proposal does not even apply to all of a firm's uses of a covered technology. A firm must eliminate, or neutralize the effect of, conflicts of interest only with respect to its use of covered technology in *investor interactions*.[79] So the Proposal does not implicate a firm's use of a covered technology to analyze historical data and current market data to identify trends and make predictions about its own liquidity needs, capital requirements, or investment decisions.[80]

The Proposal also does not adopt "an expansive conception of 'conflict' that departs radically from decades of settled law and existing conflict rules."[81] The Supreme Court has long described conflicts of interest as arrangements that would cause securities professionals to render advice that is not "disinterested."[82] The Proposal requires only that broker-dealers and investment advisers eliminate (or neutralize the effect of) conflicts of interest that result in investor interactions that place the interest of the broker-dealer or investment adviser ahead of the interest of investors.[83] This is squarely in line with the settled meaning of conflicts of interest.

B. The Commission has the authority to adopt the Proposal.

No more persuasive is the argument that the Commission lacks the authority to regulate the use of PDA-like technologies in this manner.[84] The Proposal relies on the authority in Section 15(l) of the Exchange Act and Section 211(h) of the Advisers Act, which authorize the Commission to "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."[85] Critics maintain that this plain language does not support a rule addressing conflicts of interest because the title of Section 15(1) and Section 211(h) is "Other Matters."[86] According to them, because

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77 William P. Barr and Barbara Comstock, *Gary Gensler's Plan to Control Information*, The Wall Street Journal (Sept. 10, 2023), https://www.wsj.com/articles/gary-genslers-plan-to-control-information-sec-financial-regulation-firms-investors-technology-market-927579dc?mod=opinion_lead_pos5.

78 Release at 53,970.

79 *Id.* at 53,974.

80 *Id.* at 53,974.

81 Barr and Comstock, *supra* note 77.

82 *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92 (1963).

83 *See* Release at 54,021-54,022.

84 *See* Barr and Comstock, *supra* note 77.

85 Release at 53,971 (quoting Section 913 of the Dodd-Frank Act) (emphasis added).

86 Comment Letter from Chamber of Commerce et al. re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (Sept. 11, 2023), https://www.sec.gov/comments/s7-12-23/s71223-258279-605062.pdf.; Comment Letter from Andrew N.

Section 15(k) of the Exchange Act and Section 211(g) of the Advisers Act first gave the Commission rulemaking authority to harmonize the standards of conduct applicable to broker-dealers and investment advisers, the authority in Section 15(l) and Section 211(h) only allows the Commission to engage in additional rulemaking related to this harmonized standard.[87] This argument ignores the plain language of the statute, which in no way limits the Commission's rulemaking authority to prohibit conflicts of interest for brokers, dealers, and investment advisers.

The Supreme Court has long held that "the title of a statute and the heading of a section cannot limit the plain meaning of the text."[88] Headings and titles "are not meant to take the place of the detailed provisions of the text."[89] Nor are they "necessarily designed to be a reference guide or synopsis."[90] That is because "headings and titles can do no more than indicate the provisions in a most general manner; to attempt to refer to each specific provision would often be ungainly as well as useless."[91] So headings and titles "are of use only when they shed light on some ambiguous word or phrase."[92] But they "cannot undo or limit that which the text makes plain."[93] Here, the text makes plain that Congress gave the Commission the authority to promulgate rules addressing conflicts of interest with respect to brokers, dealers, and investment advisers.

The Commission must reject industry complaints that mischaracterize the nature of the Proposal. The Proposal does not invoke Section 15(l) and Section 211(h) to "regulate the entirety of the business of broker-dealers and investment advisers."[94] Rather, the Proposal invokes those sections to do precisely what they authorize the Commission to do—address conflicts of interest.[95]

C. The economic analysis adequately justifies the need for the Proposal.

The argument that the economic analysis underlying the Proposal is inadequate also misses the mark. Critics argue that the economic analysis does not address the ways in which technology benefits investors and recognizes that requiring firms to eliminate conflicts of interest associated

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Vollmer re: Conflicts of Interest Associated with the Use of Predictive Data Analytics (Sept. 29, 2023), https://www.sec.gov/comments/s7-12-23/s71223-266060-638562.pdf.

87 *Id.*

88 *Brotherhood of R.R. Trainmen v. Baltimore & O.R. Co.*, 331 U.S. 519, 528-29 (1947). The Court reiterated this longstanding principle of statutory construction just last term. *Dubin v. United States*, 599 U.S. 110, 121 (2023) ("A title will not, of course, 'override the plain words' of a statute.") (internal citation omitted).

89 *Id.* at 528.

90 *Id.*

91 *Id.*

92 *Id.* at 529.

93 *Id.*

94 *See* Comment Letter from Chamber of Commerce, *supra* note 86.

95 The same commenter argues that the Commission cannot invoke its authority under Section 15(l) and Section 211(h) to prohibit conduct that qualifies as a conflict of interest unless that conduct also qualifies as a "sales practice" and "compensation scheme." *Id.* That cannot be. The statutory language allows the Commission to prohibit certain sales practices, conflicts of interest, and compensation schemes; it does not limit the Commission to prohibiting only conduct that would qualify as all three of those things.

with the use of PDA-like technologies may dissuade them from using certain technologies.[96] But the Proposal acknowledges that PDA-like technologies "can bring benefits in market access, efficiency, and returns."[97] The Proposal simply aims to ensure that the harm to investors that could result from receiving conflicted recommendations or advice through the use of PDA-like technologies do not outweigh the benefits of the use of those technologies. And the recognition that some firms may choose not to use certain technologies if doing so could give rise to a conflict of interest is not a flaw in either the economic analysis or the Proposal itself. The Commission must be able to recognize that requiring firms to eliminate conflicts of interest in the use of their PDA-like technologies imposes a "cost" yet determine that the benefits of eliminating conflicts of interest outweigh any costs to the firms. Firms cannot argue that they should be allowed to provide conflicted recommendations and advice because it would be too costly to do otherwise.

In addition to arguing that the Proposal does not acknowledge the ways that technology benefits investors, critics argue that the economic analysis does not establish that investors will benefit from the Proposal. They contend that "there is no analysis of any benefits" in the economic analysis.[98] But the economic analysis states specifically that the "primary benefit of the proposed conflict rules . . . would stem from the requirement to eliminate, or neutralize the effect of, conflicts of interest that place the firm or associated person's interest ahead of investors' interests."[99] "This requirement could enhance investor protection by eliminating or neutralizing the effects of certain conflicts of interest, particularly in the context of the increasing scope and scale of investor interactions made possible by new technologies and by firms' increased ability to influence investor behavior" by using PDA-like technologies in their interactions with investors.[100] The industry cannot dispute that eliminating conflicts of interest furthers investor protection.[101]

The fact that these benefits are more qualitative than quantitative does not matter. Many rules "have benefits or costs that cannot be quantified or monetized in light of existing information."[102] Agencies "must often act in the face of substantial uncertainty about the likely consequences" of a regulation and recognize that, in some cases, "quantification of various effects is highly speculative."[103] These uncertainties apply with special force in financial market regulation, where the costs and benefits are often contingent, unpredictable, and difficult to quantify. For example, the costs of compliance will vary greatly depending on how a market participant adapts to a new regulation. Assessing the rule's benefits is often even more difficult.

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96 Letter from Members of Congress to Chair Gary Gensler (Sept. 22, 2023), https://www.sec.gov/comments/s7-12-23/s71223-263559-629942.pdf.

97 Release at 53,961.

98 American Benefits Counsel, *supra* note 16.

99 Release at 54,006.

100 *Id.*

101 *See generally* Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should be Fiduciaries*, 87 WASH. L. REV. 707, 747 n.219 (2012) (noting that "several studies and reports suggest that conflicts of interest harm investors" and providing examples of such studies and reports).

102 OMB, 2011 REPORT TO CONG. ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES, at 4 (2011).

103 *Id.*

The benefits of financial regulation are typically crucial yet amorphous, such as market integrity, investor protection, and reducing informational asymmetries. Thus, under a cost-benefit analysis, many advantages of financial regulation, no matter how important to investors and properly functioning markets, may be sorely undervalued or entirely disregarded.[104]

For this reason, the Commission must reject attacks on the Proposal as unduly burdensome. History has shown time and time again that claims that regulation will overburden the financial services industry, stifle innovation, and even harm consumers by reducing their choices are false. For example, a century ago, when securities regulation first emerged at the state level, Wall Street railed against it as an "unwarranted" and "revolutionary" attack upon legitimate business that would cause nothing but harm. However, in the years following this early appearance of financial regulation, banks and their profits grew handsomely. Similarly bold yet false claims were launched against a long list of important financial reforms, including the federal securities laws, deposit insurance, the Glass-Steagall Act, mutual fund reform, and the national market initiatives of the mid-1970s. On the other hand, de-regulation has famously led to financial disaster, from the stock market crash of 1929 to the financial crisis of 2008.[105] The Commission must not let similar attacks deter it from implementing the important reforms set forth in the Proposal.

Indeed, critics invoke the usual argument that the Proposal "stifles innovation."[106] They assert that the "prudent approach" is to "allow time for the technology to gain traction and for its benefits and risks to take shape before weighing in, and then doing so only as necessary to address a discrete harm."[107] But that is exactly the approach the Commission took in the Proposal. As discussed above, as financial firms have incorporated PDA-like technologies into their investor interactions the risks of conflicts of interest have become apparent. The Proposal's only impact on the ability of those firms to use PDA-like technologies is to require that they eliminate any conflicts of interest that result from such use. Firms should not be able to deploy technology that creates conflicts of interest under the guise that preventing such conflicts stifles innovation. Broker-dealers and investment advisers should be no more able to provide conflicted recommendations and advice using PDA-like technologies than they can through other means. In both cases, the Commission has the authority and the duty to protect investors from such conflicts.

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104 *See Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 987 (D.C. Cir. 1985) (rejecting petitioners' focus "on costs to the exclusion of the Rule's benefits" where the "non-pecuniary nature of many of the benefits [made] them difficult to measure and weigh in cost-benefit terms"); *see also* Better Markets, *The Ongoing Use and Abuse of Cost-Benefit Analysis in Financial Regulation* (Mar. 23, 2023), https://bettermarkets.org/wp-content/uploads/2023/03/BetterMarkets_Report_Cost_Benefit_Analysis_03-2023.pdf (explaining that the securities laws do not require quantitative cost-benefit analysis).

105 *See generally* Better Markets, *The SEC's Proposed Market Structure Reforms are Essential to Protect Retail Investors and Industry Cries for More Cost-Benefit Analysis Must Not Stand in the Way*, https://bettermarkets.org/wp-content/uploads/2023/06/Better-Markets-Market-Structure-Reforms-CBA-Fact-Sheet-6.21.23.pdf.

106 Barr and Comstock, *supra* note 77.

107 *Id.*

III. The Commission must treat the Proposal as only the first step toward effective regulation of the use of PDA-like technologies in the securities markets.

Conflicts of interest are not the only risk to investors from financial firms' increasing use of PDA-like technologies. Biases in the dataset used by algorithms—even biases that do not elevate a firm's financial interests—may impact the decisions made by the algorithms and produce undesirable outcomes for market participants. For example, asking questions phrased in a certain way or in a certain sequence may lead to a response that introduces implicit or explicit bias from the respondents. Such a dataset, where a bias may have been introduced by either the questioner or by the respondents, will influence the conclusions that the algorithm reaches. Any output based on such a bias will likely degrade the performance of the algorithm over time and could result in harm to investors.[108] Additionally, if an algorithm provides a recommended value for an asset, it may serve as a strong anchor, informing and biasing subsequent discussion. Even if the ultimate decisionmaker is aware of the flaws and limitations of machine learning, the very process of providing an output will affect future decisions.[109] The Commission must take steps to ensure that the algorithms that firms increasingly use to guide investor behavior do not lead to investor harm.

The Commission must use its broad rulemaking authority to "set forth clear guidelines on what sorts of artificial financial intelligence products are appropriate for investors, how those products can be marketed, and what disclosures must be made."[110] For example, the Commission should require that firms review the code underlying an advice program to ensure that it is not providing advice that could harm investors.[111] The Commission should also conduct regular reviews of artificial financial intelligence to monitor for potentially harmful effects.[112] The Commission should further study the risks from a lack of diversity with respect to the advice that PDA-like technologies produce because advisory software tends to ask standardized questions and provide standardized advice.[113] Flawed advice would affect many investors simultaneously. The risks posed by hundreds of thousands, or even millions, of investors choosing their financial products based on the same or similar models are sufficiently large and different in kind from those traditionally posed by financial firms to justify regulatory attention on those grounds alone.[114]

The absence of any prescriptive rules to guide the creation or use of artificial intelligence in the markets gives a lot of discretion to market actors.[115] Absent effective regulation, they will

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108 INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, THE USE OF ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING BY MARKET INTERMEDIARIES AND ASSET MANAGERS, at 10-11 (Sept. 2021), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD684.pdf.

109 Magnuson, 10 HARV. BUS. L. REV. at 362.

110 *Id*. at 367-68.

111 Andrew Lowenthal, *Beyond Robo-Advisers: Thinking about the Next Wave of Artificial Advisers*, 19 No. 6 Fintech L. Rep. NL 2 (2016).

112 Magnuson, 10 HARV. BUS. L. REV. at 368.

113 Maume, 55 TEX. INT'L L.J. at 69.

114 Baker and Dellaert, 103 IOWA L. REV. at 732-33.

115 Gina-Gail S. Fletcher and Michelle M. Le, *The Future of AI Accountability in the Financial Markets*, 24 VAND. J. ENT. & TECH. L. 289, 310 (2022).

use this discretion in ways that may harm investors, not just through conflicts of interest but by causing investors to invest in a manner inconsistent with their investment goals or risk tolerance.[116] The Commission must step into this breach to prevent investor harm.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

Stephen W. Hall
Legal Director and Securities Specialist

Better Markets, Inc.
2000 Pennsylvania Avenue, NW
Suite 4008
Washington, DC 20006
(202) 618-6464

shall@bettermarkets.org
http://www.bettermarkets.org

116 *See generally* Better Markets, Comment Letter re: *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* (Oct. 1, 2021), https://bettermarkets.org/sites/default/files/Better_Markets_Inc._Comment_Letter_on_Digital_Engagement_Practices_RFI.pdf.