



# VCU

Chair Gensler:

I write to express my concerns regarding the Securities and Exchange Commission's (SEC) recent predictive data analytics rule proposal (Proposal or PDA Proposal).<sup>1</sup> The PDA proposal's extraordinarily broad scope and prescriptive compliance requirements to eliminate so-called conflicts of interest associated with the use of technology to interact with investors is not backed by adequate economic analysis. I am concerned that the PDA proposal will harm many investors by making it more difficult, if not impossible, for broker-dealers and investment advisers to provide the innovative technology that has already driven and will continue to drive increasing rates of retail investor participation in our capital markets.

I currently serve as Dean of the Virginia Commonwealth University (VCU) School of Business. Prior to joining VCU, I spent 13 years at West Virginia University as associate dean for innovation, outreach, and engagement, as department chair of finance, and the Fred T. Tattersall Chair of Finance in the John Chambers College of Business and Economics Department of Finance. My research has included significant work on various market structure matters, including market making, price discovery, and the benefits of innovative experiential learning. I also served as a Financial Analyst and Consultant to the Office of the Chief Economist at the Commodity Futures Trading Commission (CFTC), where I gained extensive experience with the Administrative Procedure Act rulemaking process.

With my background in academia, government, and industry, I am passionate about building programs that connect these worlds and create meaningful, synergistic relationships between them. I have spent almost two decades teaching and promoting financial literacy, and I believe that finding ways to bring more retail investors into the stock market – with appropriate guardrails and quality financial education – should be a shared goal among the private sector, regulators, and the academic community.

Since 1975, the stock market has evolved from a slower, more concentrated, higher-cost market to become highly efficient, competitive, accessible, and low-cost. Technology and innovation in the financial markets have helped drive a boom in retail investor participation. I teach and work with young investors from all backgrounds who value and *want* the ability to conduct their finances using the flexible, intuitive, and powerful technological tools that modern financial service platforms now provide, often at low or no cost. Data around the low costs of investing, high availability of quality investment options, and increases in retail investor participation support the notion that our markets have never worked better for individual Americans. As

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<sup>1</sup> Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers, <https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf>.

Chair Gensler has noted, “retail investors have greater access to markets than any time in the past.”<sup>2</sup>

I believe policymakers and regulators have a duty to regularly and carefully study and assess the rules governing our capital markets to ensure that they remain the most liquid, fair, and efficient markets in the world. This duty includes the rigorous study and analysis of recent advances in financial technology to ensure that innovation flourishes and investors are provided with appropriate protections. Unfortunately, as discussed below, the PDA Proposal falls far short of this standard.

### **I. The PDA Proposal Is Biased Against Innovation and Will Harm Investors**

The SEC attempts to characterize the Proposal as both “technology-neutral” and narrowly tailored to address conflicts of interest associated with the use of more advanced technologies like predictive data analytics and artificial intelligence. The PDA Proposal’s definitions and prescriptive compliance requirements, however, show that it is neither technology-neutral nor specifically tailored to certain advanced technologies:

- “Covered technology” is defined as “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.”<sup>3</sup> This definition is so broad that it would encompass nearly every form of technology used by broker-dealers and investment advisers, from the most basic spreadsheet, email, or website design feature to more advanced programs and tools, such as large language models.
- “Investor interaction” is defined 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.”<sup>4</sup> This definition is so broad that it would effectively cover almost every communication/interaction with a customer, from a phone call, email, or text to the smallest details of designing websites and mobile application interfaces with which investors interact.
- “Conflict of interest” is defined as existing “when a firm uses a covered technology that takes into consideration an interest of the firm or its associated persons.”<sup>5</sup> By broadly defining conflict of interest in this manner, it is difficult to imagine any use of technology by for-profit financial services companies that would not be “conflicted” – in other words, the SEC’s default assumption appears to be that all technology is inherently conflicted and systematically harmful to investors.

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<sup>2</sup> SEC Chair Gary Gensler, Market Structure and the Retail Investor: Remarks Before the Piper Sandler Global Exchange Conference (June 2022), <https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822>.

<sup>3</sup> PDA Proposal at 42

<sup>4</sup> PDA Proposal at 50

<sup>5</sup> PDA Proposal at 80

If a broker-dealers or investment adviser's use of "conflicted" technology results in the firm placing its interests ahead of its customer's interests, the PDA Proposal would require firms to "eliminate or neutralize" the conflict, rather than address the matter through disclosure and customer consent as has historically been permitted under the federal securities laws. Given the PDA Proposal's extraordinarily broad definitions – covering nearly every technology that is currently in use or could be used in the future in almost any communication with a customer – it is easy to see why it would be extremely difficult, if not in many cases impossible, for firms to comply. The result, which the SEC acknowledges in the PDA Proposal, is likely to be that firms pass higher compliance and operational costs onto customers and stop using many technologies that are currently benefiting investors,<sup>6</sup> including basic products like market news and investor education. The PDA Proposal will likely also stifle future innovations in the financial services industry. Many investors may respond by simply exiting the markets. This outcome would severely hinder innovation and jeopardize the financial well-being of Americans.

## II. The PDA's Economic Analysis

The PDA Proposal's economic analysis has at least three flaws/shortcomings. *First*, while the Proposal recognizes that technology "brings benefits in market access, efficiency, and returns,"<sup>7</sup> the economic analysis fails to meaningfully analyze and, where possible, quantify the *existing* benefits for investors.<sup>8</sup> For example, for brokerage customers, technology has helped pave the

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<sup>6</sup> PDA Proposal at 102 ("In certain cases, it may be impossible to comply with the applicable standard of conduct without stopping use of the covered technology before the conflict of interest can be adequately addressed."); 188 ("The overall costs, including recordkeeping costs, of the proposed conflicts rules and proposed recordkeeping amendments could also cause some firms to avoid using certain covered technologies in investor interactions, even if the technologies did not create any conflicts of interest. This might happen if the costs of complying with the proposed rules and amendments exceed the revenue that can be gained and/or costs that can be saved by using the technology. For example, a firm might opt not to use an automated investment advice technology because of the costs associated with complying with the proposed rules and amendments. In these types of situations, firms would lose the potential revenues that these technologies could have generated, and investors would lose the potential benefits of the use of these technologies. In addition, in the absence of these technologies, firms might raise the costs of their services, thus increasing the costs to investors."); 189 ("Similarly, there may be technologies that do create conflicts that must be eliminated or their effect neutralized, but that also benefit investors if firms address those conflicts. Investors would lose the benefit of such technologies if firms determine that the process of eliminating, or neutralizing the effect of, conflicts is too difficult, costly, or uncertain to succeed."); 190 ("The time needed to review and document changes to the technology could incentivize firms to reduce the frequency of technological updates, or slow the overall rate of updates, which could harm both the firm and investors. These delays and associated monetary costs could reduce the quality or increase the cost of the technology or service for investors, and could reduce the revenues of the firms.").

<sup>7</sup> PDA Proposal at 6.

<sup>8</sup> Innovation and technology in the financial services industry have driven down costs and brought many retail investors from diverse backgrounds into our capital markets. In fact, a study by the Financial Industry Regulatory Authority and NORC at the University of Chicago found that 4.2% of the U.S. adult population opened new brokerage accounts in 2022 compared to 3.6% in 2020. The study goes on to state that "New Account Investors at that time were more frequently Black (16 percent) and Hispanic/Latino (15 percent) compared to investors who had been in the market prior to 2020 (7 percent and 13 percent, respectively). That trend continued in 2022: 15 percent of 2022 New Account Investors were Black, and 19 percent were Hispanic/Latino." See <https://www.finrafoundation.org/sites/finrafoundation/files/New-Investors-2022-Entering-The-Market-In-Novel-and-Traditional-Ways.pdf>; <https://www.schwabmoneywise.com/tools-resources/ariel-schwab-survey-2022>.

way for products such as, among other things, commission-free trading, no account minimums, fractional share trading, and automated saving/dollar cost averaging tools that have driven down costs and expanded market access for millions. For advisory customers, technology has helped provide investors with, among other things, low-cost robo advisory services, low-cost diversification, and automated portfolio rebalancing tools, as well as direct indexing and tax loss harvesting. The many benefits technology currently provides to investors do not appear to be adequately reflected in the economic analysis baseline.

*Second*, the economic analysis significantly underestimates the costs of complying for broker-dealers and investment advisers. For example, despite the broad scope and application of the PDA Proposal, the economic analysis estimates it will cost firms only:

- \$11,150 for initial compliance, and \$5,575 for annual compliance per firm for “simple” covered technologies; and
- \$156,100 for initial compliance, and \$78,050 for annual compliance per firm for “complex” covered technologies.

Although the distinction between “simple” and “complex” covered technologies is not entirely clear, these estimates appear to be far too low given that most firms use hundreds, if not thousands of covered technologies in myriad different customer interactions and make a large number of adjustments to these technologies during the normal course of business to ensure that they are functioning properly and serving investors’ evolving needs. The PDA Proposal even admits: “In certain cases, it may be difficult or impossible to evaluate a particular covered technology or identify any conflict of interest associated with its use or potential use within the meaning of the proposed rules.”<sup>9</sup> This uncertainty underlines how difficult and expensive it would likely be in order for broker-dealers and investment advisers to remain in compliance with this extraordinarily broad and prescriptive Proposal. Ultimately, increased compliance costs are likely to be passed along to investors in the form of higher trading costs or other fees, which work to disenfranchise lower-income investors.

*Third*, the economic analysis fails to attempt to quantify at least some of the costs to investors in the likely event that the Proposal causes firms to reduce or eliminate technologies that otherwise benefit investors. The PDA Proposal clearly recognizes this risk: “a firm might opt not to use an automated investment advice technology because of the costs associated with complying with the proposed rules and amendments. In these types of situations, firms would lose the potential revenues that these technologies could have generated, and investors would lose the potential benefits of the use of these technologies. In addition, in the absence of these technologies, firms might raise the costs of their services, thus increasing the costs to investors.”<sup>10</sup> The Proposal further states, “Investors would lose the benefit of [conflicted but beneficial] technologies if firms determine that the process of eliminating, or neutralizing the effect of, conflicts is too difficult, costly, or uncertain to succeed.”<sup>11</sup> It is unclear why the SEC is unable to estimate at least some of these costs including, for example, the potential elimination of commission-free

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<sup>9</sup> PDA Proposal at 65.

<sup>10</sup> PDA Proposal at 188. For additional examples of potential harms to investors, see footnote 6 above.

<sup>11</sup> PDA Proposal at 189.

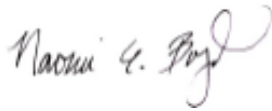
trading or technologies that help customers save through automated reinvesting strategies that take advantage of dividends and compound interest, as well as portfolio rebalancing, direct indexing, and tax loss harvesting capabilities.

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The SEC's PDA Proposal is far too broad to achieve its goals of investor protection while also allowing innovation to continue in the financial services sector. The SEC should withdraw the Proposal and take additional time to carefully study what technologies are actually being used by broker-dealers and investment advisers; how and why investors are using or interacting with these technologies; whether there is any systematic harm from technology that requires additional regulation beyond the many SEC and FINRA rules that already govern the financial services industry; and what the actual costs and benefits of additional regulation would be.

Thank you for your consideration.

Warmly,

A handwritten signature in cursive script that reads "Naomi G. Boyd".

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