November 14, 2023

SENT VIA EMAIL

rule-comments@sec.gov

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

Re: File Number S7-12-23 - Request for Information and Comments on Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers

Dear Ms. Countryman:

Wealthfront Corporation ("Wealthfront") appreciates the opportunity to engage with the U.S. Securities and Exchange Commission ("SEC") regarding its proposed new rules ("proposed rules") covering the use of predictive analytics by broker-dealers and investment advisers (collectively, "firms") and related potential conflicts of interest. As interactions between financial services companies and clients increasingly shift online and depend on technology, we appreciate the SEC's open communication with market participants, particularly when the proposed rules are poised to have potentially harmful and costly impacts on investors and the firms that serve them.

Wealthfront respectfully requests that the SEC withdraw the proposed rules and, instead, utilize the current, well-established,, and understood, principles-based legal and regulatory framework to govern the use of current and new technology as well as any associated conflicts that arise. As we have done in the past, Wealthfront would welcome the opportunity to work

constructively with the SEC toward a practical solution that is less likely to harm consumers and chill innovation. To summarize, our positions are:

1. The proposed rules fail the SEC's own stated goal of being technology-neutral. Instead, the proposed rules establish highly onerous and impractical requirements that *target* technology in general rather than focusing on the manner in which technology is used. The proposed rules are also overbroad in scope, covering not only emerging technologies but nearly any technology, including technology as simplistic or utilitarian as a spreadsheet. Such a limitless approach to regulating technology will not only increase costs, but will likely undermine the ability of firms to offer low cost solutions to investors.

2. The current legal and regulatory framework adequately serves the SEC's mission to protect investors. The SEC's proposal would unnecessarily upset decades of common law jurisprudence establishing an adviser's fiduciary responsibility to its clients as well as comprehensive regulatory requirements for investment advisers and broker-dealers, including, but not limited to, applicable anti-fraud and compliance program provisions established under Section 206 of the Investment Advisers Act of 1940 (the "Advisers Act"), and applicable anti-fraud and compliance program provisions established under Section 206 of the Investment Advisers Act of 1940 (the "Advisers Act"), and Regulation BI.

<u>Wealthfront</u>

Wealthfront's mission is to build a financial system that favors people, not institutions. To that end, we provide a suite of online, software-based financial services to our clients. We believe that technology is the most powerful means to accomplish this mission. Our platform has attracted over 700,000 clients who have entrusted Wealthfront Advisers LLC ("Wealthfront Advisers") and Wealthfront Brokerage LLC ("Wealthfront Brokerage") with the management of nearly $50 billion in assets. Wealthfront utilizes technology to reach an important demographic

that has historically been underserved by the traditional financial sector: young professionals who are in the early stages of wealth accumulation.

Investment Management

Wealthfront Advisers pioneered the delivery of globally diversified and regularly rebalanced portfolios of low-cost index funds that, through technology, could be managed automatically for a quarter of the average advisory fee charged by traditional advisers. Wealthfront Advisers was also one of the first to offer to a broad audience investment features that were previously only available through advisers that generally required large account minimums (sometimes as much as $10 million). These features include ETF-based tax-loss harvesting, tax-loss harvesting within an index, multi-factor smart beta, risk parity, and tax-minimized transitions to more optimized portfolios.

Wealthfront Advisers neither uses proprietary trading algorithms nor attempts to outperform the market by picking individual securities. We do not engage in these practices because academic research has shown that it is almost impossible to outperform the market over the long term. Instead, we pursue passive investment strategies based on "Modern Portfolio Theory" (personalized to the risk tolerance of each of our clients) and deliver value by minimizing fees and taxes through the use of software.

Cash Management

Wealthfront Brokerage offers a cash sweep program that allows clients to earn interest on cash balances awaiting investment. Wealthfront Brokerage also offers a margin lending product that provides clients with fast and flexible access to capital at a low rate.

Free Financial Planning

Wealthfront also offers a free, interactive, software-based financial planning tool directly to consumers ("Path"). Path allows users to set financial goals such as purchasing a home, funding college tuition, and retiring. Then, with users' consent, using data linked from users'

financial accounts (including banks, brokerage firms, 401(k) accounts, credit card accounts, and mortgages), third-party sources like Redfin and Zillow for home pricing estimates,, and the Department of Education for college tuition costs, Path allows users to visualize how their spending and saving patterns affect their financial goals.

Technology neutral approach

We believe that any rules proposed by the SEC should be technology neutral to continue fostering a regulatory environment that promotes, rather than hinders, the use of technology (and its related benefits) in the financial sector. The SEC's own press release announcing the proposed rules seemed to reflect this notion, with Chair Gensler stating that the proposed rulemaking "is intended to be technology neutral. We are not seeking to identify which technologies a firm should or should not use."

Unfortunately, the proposed rules, rather than being neutral towards the use and application of technology, are specifically and inherently focused on regulating technology. As drafted, the proposed rules target the use of emerging, predictive technologies, including artificial intelligence, and not the misconduct of the parties utilizing such technologies. Simply put, the proposed rules fail to be technology neutral because they are directly focused on the use of "covered technology," apparently based on the perception that certain technologies, and not their use, give rise to conflicts of interest. The proposed rules seek to combat such theoretical conflicts by imposing a more onerous standard of conduct that requires firms to eliminate or neutralize technology-related conflicts. Such an approach creates what is effectively a de facto ban on technology, upsetting long-standing standards of fiduciary conduct that allow for the full and fair disclosure of conflicts of interest. As described more fully below, the proposed rules will necessarily increase costs, diminish investor choice, and chill innovation.

In addition to increasing the required standard of care for technology-specific conflicts, the proposed rules further target technology by imposing a nearly limitless definition of "covered technology." The proposed rules set no appreciable boundary on what technologies might, in

fact, be covered by the rule. "Covered technology," means any "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." Although the phrase "*covered* technology" (emphasis added) implies a theoretical boundary or limit to the types of technology subject to the rule's requirements, no such practical boundary or limit exists. For all practical purposes, the rule covers *any* technology and, therefore, *all* technology. "Covered technology" would ostensibly cover an advisor's use of a slide rule, pen, and paper to craft and communicate advice to an investor. Which is to say, that the proposed rules place an unnecessary, costly,, and most crucially, innovation stifling set of requirements on the shoulders of an industry that increasingly *requires* this same technology to communicate with and advise their clients.

Impact

The proposed rules' targeted focus on technology and overbroad coverage of what very well may be any technology will cause significant and harmful impacts to investors and the firms that serve them. In the short term, firms will invest in internal and external resources to develop and implement policies and procedures to identify covered technologies, identify and assess related conflicts of interest, and take action to either neutralize or eliminate such conflicts. The cost associated with complying with the proposed rules will meaningfully hinder the industry's ability to deliver value to investors by deterring the continued adoption and use of technologies that have been leveraged to provide a growing number of previously underserved individuals with access to reliable and low cost financial solutions. More specifically, implementing the compliance regime necessary to adhere to the proposed rules will dramatically diminish Wealthfront's (and the industry's) ongoing ability to provide access to high-quality investment solutions at exceedingly low costs to investors.

In the long term, the ambiguity and nearly unlimited breadth of the proposed rules' scope will inevitably lead to inconsistent methods of compliance that will take decades of guidance and enforcement to refine into a practical and workable regulatory regime. This means that even after

short-term efforts to come into compliance, market participants will be forced to bear the cost of ongoing enhancements necessary to stay in compliance with a vague and ambiguous rule, as enforcement evolves over time.

These short and long term costs will ultimately be borne by the investor. Naturally, the value market participants deliver to clients is fundamentally and inherently constrained by the cost of compliance. Technologies that might otherwise streamline operations, if implemented, may then be subject to the proposed rules' onerous standards. This decreases the value market participants deliver to investors, both in terms of the quality of service enabled by potentially covered technologies and by the increase in the client's direct cost to obtain such services.

As a result, the proposed rules will dramatically diminish Wealthfront'sWealthfront's opportunity to build a system that favors people, rather than institutions, by limiting the ability to embrace and leverage technology for the purposes of delivering value to investors. In addition to increasing costs for market participants and investors, the proposed rules' targeting of technology will inherently chill innovation that has proven to be instrumental in providing financial services to so many individuals. Requiring firms to address the "eliminate" requirement will likely block firms from investing in new technologies or using technology to formulate investment advice or interact with investors. Worst of all, the proposal upsets the current principles-based legal and regulatory framework that we believe can more than adequately address the SEC's concerns regarding the use of technology and any related conflicts of interest.

The current framework adequately serves investor protection

Wealthfront urges the SEC to withdraw the proposed rules because, as noted above, they are not only extremely burdensome, but they are also unnecessary. Chair Gensler acknowledges that investment advisers and broker-dealers—today—operate under legal and regulatory requirements that, for all practical purposes, serve the same well-intended purpose as the proposed rules. As Chair Gensler noted in the above-referenced press release, when serving investors, "firms are obligated to eliminate or otherwise address any conflicts of interest and not

put their own interests ahead of their investors' interests." Naturally, firms that fail to do so run the costly risk of noncompliance, reputational harm, and loss of investor confidence. Taken together, the regulatory regime described below, can and should be used to regulate any conflicts that arise from the use of current and novel technologies.

Fiduciary duty

An investment adviser's fiduciary duty traces its roots to decades of well-established, well-understood, and well-enforced standards of professional conduct. In defining the duties of a fiduciary, Justice Cardozo's landmark 1928 opinion *Meinhard v. Salmon* notes that:

> "Many forms of conduct permissible in the workaday world for those acting at arm's length are forbidden by those bound by fiduciary ties. A fiduciary is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)."

In 1963, the Supreme Court further refined an investment adviser's specific fiduciary duty in *SEC v. Capital Gains Research Bureau, Inc.*:

> "The Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 190-192 (1963)."

As fiduciaries, investment advisers owe their clients both a duty of care and a duty of loyalty.[1] This means that advisers must make full and fair disclosure of all material facts and

[1] *See Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, 84 FR 33669 (July 12, 2019) (Fiduciary Interpretation), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf.

eliminate or fully disclose conflicts of interest.[2] It also means that advisers have a duty to provide investment advice that is in the best interest of the client, a duty to seek best execution, and a duty to provide advice and monitoring at a frequency that is in the best interest of the client.[3] These obligations are established based on the nature of the adviser-client relationship[4] and are enforceable under Section 206 of the Advisers Act.

Taken together, these obligations are a pillar of the current regulatory framework that more than adequately enable the SEC to protect investors and regulate the industry's increasing use of technology. Should investment advisers misuse technology such that "conflicts that may arise to the extent that advisers or brokers are optimizing to place their interests ahead of their investors' interests," the SEC has the necessary legal and regulatory remedies to address such breaches.

Anti-fraud provisions

Much like the regulatory framework surrounding an investment adviser's fiduciary duty, the anti-fraud provisions currently in place are well-established and adequately enable the SEC to regulate firms that engage in manipulative and deceptive conduct, including through the use of technology. Under Rule 10b-5 of the Securities Exchange Act of 1934 it is "unlawful for any person, directly or indirectly to … make any untrue statement of a material fact or to omit to state a material fact … in connection with the purchase or sale of any security." In addition, Section 206 of the Advisers Act prohibits misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an investment advisory business. Therefore, purposefully engaging in actions that are deceptive and manipulative and to the detriment of retail clients fall squarely under the SEC's existing anti-fraud authority. Just as the SEC enforces compliance with these provisions in connection

[2] We encourage the SEC to consider modernizing the requirements for delivery of disclosures and regulatory documents by allowing firms to use technology, including digital engagement practices, to improve the distribution of that information to investors.
[3] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, *supra* Note 7.
[4] *See Hughes v. SEC,* 174 F.2d 969 (May 9, 1949).

with firms' communications with the public, the SEC can also apply anti-fraud principles to misleading or deceptive statements regarding conflicts of interest, whether or not such statements were generated, for example, by persons associated with a covered firm or by technology employed by the firm to provide automated advice or other such communications.

Reg BI and broker-dealer obligations

Broker-dealers that make recommendations of securities transactions or investment strategies involving securities to retail customers must also act in the best interests of such customers. Therefore, broker-dealers that make such recommendations may not place their interests ahead of their customers' interests. If a "covered technology" generates a recommendation, the existing regulatory framework requires that broker-dealers utilize such technology in a manner that does not place their interests ahead of their clients and meets their Reg BI obligations of disclosure, care, conflicts of interest, and compliance.[5] More broadly, even if the use of a "covered technology" does not constitute a recommendation, broker-dealers still must deal fairly with their customers and observe high standards of commercial honor and just and equitable principles of trade.[6]

Having achieved a comprehensive legal and regulatory framework through years of rulemaking, case law, and industry collaboration, the SEC already has the tools required to regulate the use of technology by firms in a manner that does not chill innovation, increase costs, or limit the adoption of financial services. Although Chair Gensler's remarks describe a practical but somewhat narrow concern with emerging technologies, the proposed rules are anything but practical or narrowly tailored to that concern. Instead, the proposed rules would upset decades of legal and regulatory jurisprudence, legislation, guidance, and enforcement in the misguided pursuit of regulating a dystopian and theoretical future of unsupervised, conflicted technology imposing itself on unsuspecting investors. Although we do not believe that such fears are

[5] 17 CFR 240.15l-1.
[6] FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade).

warranted, any concerns should be resolved by leveraging the current regulatory regime rather than adopting additional, far reaching, burdensome, and potentially conflicting regulations.

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We strongly urge the SEC to withdraw the proposed rules. The SEC should preserve the well-established, principles-based regulatory regime previously discussed and focus on conduct rather than targeting the use of technology. As proposed, the rules take square aim at tools and not the people who misuse them. This will inherently and inevitably increase investor costs and reduce access to efficient, lower-cost investment advisory and brokerage services. We firmly believe that the current framework adequately serves the industry's needs for protecting investors and that the proposed rules are unnecessary, costly, and stifle innovation.

We thank the SEC for considering our comments, and we would very much appreciate the opportunity to further discuss our views on emerging technologies. If you have any questions or would like to discuss these comments, please do not hesitate to contact me at laurenlin@wealthfront.com.

Respectfully,

Lauren Lin
Chief Legal Officer
Wealthfront Corporation