

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

January 8, 2024

Supplemental comment letter from Prof. James Tierney, Chicago-Kent College of Law

Re: File No. S7-12-23

Dear Ms. Countryman:

I appreciate the opportunity to provide further comment on the Commission's proposed rules governing conflicts of interest in the use of data analytics and other covered technologies in investor interactions. On October 10, 2023, I submitted a comment letter joined by two collaborators. I wrote then and now in my capacity as a scholar with an interest in promoting the development of federal securities law.

Since submitting the Oct. 2023 comment letter, I have developed a legal-scholarship working paper on the rule proposal. This working paper draft supersedes previous, shorter versions of the argument. I attach it here, with future updates available on SSRN at <https://ssrn.com/abstract=4524766>, for inclusion in the rulemaking file. Thank you for your consideration and engagement with this work.

Sincerely,

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I disclose institutional affiliation for identification purposes only. The views expressed in this letter are my own and not those of my institution.

The SEC's data analytics rule and the "Netflix problem" in securities regulation

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This version: December 19, 2023

First version: August 5, 2023

Just as Netflix uses recommendation algorithms to shape viewer behavior, investment advisers and broker-dealers are increasingly using sophisticated algorithmic and data analysis tools to provide "better" and more tailored financial advice. From roboadvice, digital nudges, gamification and digital engagement practices, to less visible uses of data analytics to inform or shape investment outcomes and operational behavior, these technologies are transforming the financial advisory industry. But because technology can shape information environments, choice sets, and investor behavior in ways that are not typically captured by broker-dealer and investment adviser regulation, they raise new questions about whether legacy regulatory frameworks are up to the task.

In July 2023, the SEC issued a proposed rule on conflicts of interest in the use of predictive data analytics by broker-dealers and investment advisers. The most important feature of the proposed rule is its seismic shift in regulatory strategy away from allowing advisers to disclose their way out of conflicts, and instead toward conflict elimination or neutralization. Opaque subject matter, behavioral constraints, and an informationally inefficient market mean retail investors are unlikely to be protected by market or reputational forces here. The SEC's shift in recognizing this problem, and in moving away from disclosure as a result, marks a fundamental change in how securities law addresses adviser conflicts. This article argues that this is the right course, as embracing the securities laws' investor-protective mission calls for focusing on eradicating conflicts in these relationships.

This timely article situates the SEC's proposed rule in historical and regulatory context, examines the SEC's proposal and statutory authority, and considers the desirability of intervention in light of the baseline and potential economic impacts. The proposed rule would fill a major regulatory gap, extending investor-protection principles to client interactions shaped by data analytics technologies and requiring something more than disclosure be done. The article ends by examining the rule's compliance approach, implications for federalism and fiduciary duty reform, and statutory interpretation in an era of increased judicial scrutiny.

¹ Assistant professor of law, Chicago-Kent College of Law. Thanks to Ben Edwards, Andrew Jennings, Kyle Langvardt, Alex Platt, and Rory Van Loo for comments and helpful discussions. I authored a comment letter to the SEC on the data analytics proposal (see *infra* note 55) a small amount from which was adapted into this article.

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Introduction

The popular streaming service Netflix uses an algorithm to recommend content to its users. By analyzing vast amounts of data—think viewing history, ratings, similar users’ viewing history—the algorithm provides personalized recommendations designed to keep users engaged and watching content on the platform.² The algorithm can shape behavior by guiding or nudging users toward certain content, engaging them for longer on the platform, and optimizing these interactions to get more efficient over time.³

As in the Netflix model, these sorts of data analytics technologies also shape our information environment in other domains. In the last decade, the increasing integration of advanced and predictive technologies like artificial intelligence (AI) and machine learning into the financial industry has transformed the way financial advisory firms operate.⁴

These technologies allow broker-dealers and investment advisers to offer a broader range of services, make predictions with greater accuracy, and enhance their efficiency. They enable customized investment recommendations based on investor behavior, risk tolerance, financial goals, and market trends.⁵ These often-opaque technologies are pervasive in the financial advisory industry.⁶

A natural concern is that financial advisers will use these technologies in ways that prioritize the interests of the firm over the client. This principal-agent problem arises because brokers and advisers have incentives and interests that differ from their clients’. Conflicts of interest are in some sense natural, and can arise when the use of data analytics technologies by broker-dealers (who recommend or execute buy or sell transactions, typically for commissions) and investment advisers (who advise about investments, typically as fiduciaries for fees) puts the adviser’s

² See, e.g., MATTIAS FREY, *NETFLIX RECOMMENDS: ALGORITHMS, FILM CHOICE, AND THE HISTORY OF TASTE* (2021); Blake Hallinan & Ted Striphas, *Recommended for You: The Netflix Prize and the Production of Algorithmic Culture*, 18 *NEW MEDIA SOC.* 117 (2016).

³ See, e.g., Kyle Langvardt, *Regulating Habit-Forming Technology*, 88 *FORDHAM L. REV.* 129, 154-60 (2020); Elana Zeide, *The Silicon Ceiling: How Artificial Intelligence Constructs an Invisible Barrier to Opportunity*, 91 *UMKC L. REV.* 403 (2023).

⁴ See, e.g., Wolfgang Breuer & Andreas Knetsch, *Recent trends in the digitalization of finance and accounting*, 93 *J. BUS. ECON.* 1451 (Oct. 2023); Dirk A. Zetzsche, William A. Birdthistle, Douglas W. Arner, & Ross P. Buckley, *Digital Finance Platforms: Toward A New Regulatory Paradigm*, 23 *U. PA. J. BUS. L.* 273, 275 (2020) (describing among “the most consequential ... developments in finance is the recent evolution of large financial technology platforms”).

⁵ See, e.g., Nicole G. Iannarone, *Fintech’s Promises and Perils Computer as Confidant: Digital Investment Advice and the Fiduciary Standard*, 93 *CHI.-KENT L. REV.* 141 (2018); Deloitte, *Artificial intelligence: The next frontier for investment management firms* (Feb. 5, 2019), <https://www.deloitte.com/global/en/Industries/financial-services/perspectives/ai-next-frontier-in-investment-management.html> (noting the “opportunit[ies],” “efficiencies,” and “value-added services” from “robo-advice technology,” especially for “small accounts”).

⁶ See *infra* Part I.B.

interest ahead of the client's. Financial advisers' intermediary position gives them an opportunity to shape a client's behavior in ways that promote these conflicts, intentionally or unintentionally. These technologies introduce new conflict-of-interest related challenges that, this article argues, are not adequately addressed under the existing regulatory framework.⁷

The Securities and Exchange Commission (SEC) this summer found itself grappling with how to reconcile existing regulatory frameworks with these new challenges.⁸ On July 26, 2023, the Commission approved a proposed rulemaking titled "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers" (the "proposed rule" or the "data analytics rule").⁹ This was the successor to its request for information on gamification and "digital engagement practices" for broker-dealers and investment advisers.¹⁰ The new rule would require financial advisers to determine whether, in using certain "covered technology" in "interactions" with retail investors, they have a conflict that puts their interests ahead of the investor's. If the use of technology does present this kind of conflict, the adviser would be required to eliminate or neutralize it. The rule also requires firms to have compliance policies and procedures.¹¹

The data analytics rule comes at an inflection point in how securities regulation treats artificial intelligence, machine learning, and other predictive data analytics technologies. It reflects that the nature of how financial advisers interact with clients has changed dramatically in recent decades—yet financial regulation largely has not kept up. As one state court recently explained in a case involving stock trading app Robinhood, the "once-clear dichotomy between the services offered by broker-dealers, on the one hand, and investment advisers, on the other, has 'blurred,'" and as a result "Federal and State authorities have questioned whether adhering to [that] traditional dichotomy . . . continues to make sense in this evolving marketplace."¹²

Issues related to these technologies—in particular, robo advice and digital engagement

⁷ See *infra* Part II.A.

⁸ See Jessica Corso, *SEC Announces Planned Crackdown on AI Advising*, LAW360 (July 26, 2023).

⁹ Proposed Rule, Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Exchange Act Release No. 97990, Advisers Act Release No. 6353, File No. S7-12-23 (July 26, 2023) ("Data Analytics Proposal").

¹⁰ See *infra* Part I.C.

¹¹ See *infra* Part II.C.

¹² See *Robinhood Fin. LLC v. Sec. of Commonwealth*, — N.E.3d —, 2023 WL 5490571, at *3-4 (Mass. Aug. 25, 2023) (*Robinhood II*) (quoting *XY Planning Network, LLC v. SEC*, 963 F.3d 244, 247 (2d Cir. 2020)).

practices—have caught the attention of domestic¹³ and foreign regulators,¹⁴ as well as powerful business interests,¹⁵ consumer groups, and other observers.¹⁶ The conflict of interest issues that arise from use of data analytics technology have also been the subject of a wide array of scholarship exploring digital engagement practices,¹⁷ robo advice,¹⁸ fintech,¹⁹ and retail investors in capital markets.²⁰ For the most part, however, securities law scholarship has focused on slices of

¹³ See, e.g., Department of the Treasury, et al., *Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, Including Machine Learning*, 86 Fed. Reg. 16837 (Mar. 31, 2021); Financial Industry Regulatory Authority, *Artificial Intelligence (AI) in the Securities Industry* 5 (June 2020), <https://www.finra.org/sites/default/files/2020-06/ai-report-061020.pdf>.

¹⁴ See, e.g., Eur. Secs. & Mkts. Auth., *Discussion paper on MiFID II investor protection topics linked to digitalisation*, ESMA35-43-3682 (14 December 2023), https://www.esma.europa.eu/sites/default/files/2023-12/ESMA35-43-3682_Discussion_Paper_on_MiFID_II_investor_protection_topics_linked_to_digitalisation.pdf; Jeffrey P. Gebert & William Burke, *OSC Signals Concerns about Gamification of Investing*, CANADIAN SEC. L. NEWS (Jan. 2023) (discussing Ontario Secs. Comm'n Staff Notice 11-796, *Digital Engagement Practices in Retail Investing: Gamification and Other Behavioural Techniques* (Nov. 7, 2022)).

¹⁵ See, e.g., William P. Barr, *Gary Gensler's Plan to Control Information*, WALL ST. J. (Sept. 10, 2023) (op-ed).

¹⁶ See, e.g., Sivananth Ramachandran, *Fun and Games: Investment Gamification and Implications for Capital Markets*, CFA Institute (2022), <https://cfas.org.au/wp-content/uploads/2023/03/Fun-and-Games-Investment-gamification-implications.pdf>.

¹⁷ See, e.g., Melanie Cherdack, *Pushes, Tweets, Emojis and FinTok: Emerging Tech Meets Old School Securities Regulation*, 30 No. 3 PIABA B.J. 319 (October 31, 2023); James Fallows Tierney, *Investment Games*, 72 DUKE L.J. 353 (2022); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The wrong way to regulate gamified investing*, 131 YALE L.J. FORUM 717 (2022); Doug Sarro et al, *Future of Law Lab*, University of Toronto Faculty of Law, Report: Regulating Gamification (Apr. 5, 2022); see also, e.g., Colleen Baker & Christopher Odinet, *The Gamification of Banking*, U. ILL. L. REV. — (forthcoming 2024). For examples of student notes, see Rayaan Hossain, Note, *Regulating Best Interest: Sec Confronts the Brave New Markets*, 31 U. MIAMI BUS. L. REV. 92 (2023).

¹⁸ See, e.g., Iris H-Y Chiu & Gudula Deipenbrock, eds., ROUTLEDGE HANDBOOK OF FINANCIAL TECHNOLOGY AND LAW (2021) ("HANDBOOK"); Nicole G. Iannarone, *Rethinking Automated Investment Adviser Disclosure*, 50 U. TOL. L. REV. 433 (2019) ("Rethinking"); Jill Fisch, Marion Laboure, & John A. Turnet, *The Emergence of the Robo-Advisor*, in Julie Agnew & Olivia S. Mitchell, eds., THE DISRUPTIVE IMPACT OF FINTECH ON RETIREMENT SYSTEMS 13 (2019); Nicole G. Iannarone, *Computer as Confidant: Digital Investment Advice and the Fiduciary Standard*, 93 CHI.-KENT L. REV. 141 (2018) ("Computer"); Benjamin P. Edwards, *The Rise of Automated Investment Advice: Can Robo-Advisors Rescue the Retail Market*, 93 CHI.-KENT L. REV. 97 (2018); John Lightbourne, *Algorithms & Fiduciaries: Existing and Proposed Regulatory Approaches to Artificially Intelligent Financial Planners*, 67 DUKE L.J. 651 (2017); Tom C.W. Lin, *The New Financial Industry*, 65 ALA. L. REV. 567 (2014); see also, e.g., Marika Salo-Lahti, *Good or Bad Robots? Responsible Robo-Advising*, 33 EUR. BUS. L. REV. 671 (2022); Kan Jie Marcus Ho & Ma Chao Jun, *Robo-Advisors: A Comparative Analysis in the Context of Fiduciary Law*, 5 DE LEGE FERENDA 20 (2022); Jeannie Marie Paterson, *Making robo-advisors careful? Duties of care in providing automated financial advice to consumers*, 15 L. & FIN. MKTS. REV. 278 (2021); Saule T. Omarova, *Fintech and the limits of financial regulation*, in HANDBOOK, supra; Wolf-Georg Ringe and Christopher Ruof, *Robo advice—legal and regulatory challenges*, in HANDBOOK, supra; Lee Reiners, *Regulation of Robo-Advisory Services*, in Jelena Madir, ed., FINTECH: LAW & REGULATION 353 (2019).

¹⁹ See, e.g., Dan Awrey & Joshua Macey, *The Promise & Perils of Open Finance*, 40 YALE J. ON REG. 1 (2023); Carla L. Reyes, *Autonomous Business Reality*, 21 NEV. L.J. 437 (2021); Tom C.W. Lin, *Artificial Intelligence, Finance, and the Law*, 88 FORDHAM L. REV. 531 (2019); Christopher G. Bradley, *The Consumer Protection Ecosystem: Law, Norms, and Technology*, 97 DENVER L. REV. 35 (2019); Dirk A. Zetsche, Ross P. Buckley, Douglas W. Arner, & Janos N. Barberis, *The Regulatory Challenges of Data-Driven Finance*, 14 N.Y.U. J. L. & BUS. 393 (2018).

²⁰ See, e.g., Nizan Geslevich Packin, *Financial Inclusion Gone Wrong: Securities Trading For Children*, 74 HASTINGS L.J. 349 (2023); Jill E. Fisch, *GameStop and the Reemergence of the Retail Investor*, 102 B.U.L. REV. 1799 (2022); Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782 (2022); Abraham J. B. Cable, *Regulating Democratized Investing*, 83 OHIO ST. L.J. 671 (2022); Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Collective Power of Retail Investors*, 22 NEV. L.J. 51 (2021); Gaia Balp, *The Corporate Governance Risk of Retail Investors*, 31 LOY. CONSUMER L. REV. 47, 71-88 (2018); Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55 (2016); Violet Victoria, *False*

the problem. This article offers a novel, fresh, and full scholarly treatment of the SEC’s proposed data analytics rule.²¹ In it I situate the rule within scholarly debates about the purposes of securities regulation, and articulates and defends an argument that the proposed rule would likely serve desirable policy ends.

This article argues that the SEC’s data analytics rule would fill a major regulatory gap, extending important components of the Reg BI framework to non-recommendation interactions with investors. And it would do so using two primary regulatory intervention techniques: principles-based rulemaking geared toward the particular risks a broker or adviser faces, and conflict elimination in the retail brokerage relationship. The proposal would push the frontier of the securities laws’ investor-protection mission beyond the traditional categories of human advice and recommendation. If adopted, *awareness and management of conflicts of interest* would now extend to the many ways algorithm-driven advice shapes investor behaviors and market outcomes on a broad scale. It is hard to understate the importance of the proposed rule for the regulation of financial advice. Biglaw asset management lawyers have noted that the proposal “could very well be one of Chair [Gary] Gensler’s most significant initiatives for broker-dealers and investment advisers in a crowded field of SEC proposals.”²²

This article proceeds like this. Part I starts us off with historical and regulatory context, explaining how data analytics are used in financial markets, the increasing regulatory attention to them, and the policy concerns they raise about conflicts of interest. Part II addresses the regulatory baseline and gap in legal protections, toolkits for regulating technology and securities markets, and the specifics of the SEC’s rule proposal. Part III assesses the rule proposal, including its treatment of disclosure, its desirability, and alternative approaches. Part IV ends with implications for governance and compliance, the role of states in supplying stricter investor protection rules, and judicial review of arguments about agency statutory authority in a time of rising judicial anti-administrativism.

I. Financial advisory technology in regulatory context

This Part begins by situating the problem of data analytics within modern financial markets. After discussing the policy concerns these markets raise and how we regulate them, this Part

Idols: The Perils of ‘Democratizing’ Financial Markets (2021) (MA thesis, University of Oklahoma); cf. Alon Brav, Matthew Cain, and Jonathon Zytnick, *Retail shareholder participation in the proxy process: Monitoring, engagement, and voting*, 144 J. FIN. ECON. 492 (2022).

²¹ For student notes discussing the issue of predictive data analytics, see Juliana Wendt, *Regulation Fix? Recommendations for the SEC regarding Digital Engagement Practices & PDA*, 42 REV. BANKING & FIN. L. 1009 (2023).

²² See Ethan Corey et al, *SEC takes on AI use by investment advisers and broker-dealers - Some big questions about where we are headed* (July 26, 2023), <https://www.jdsupra.com/legalnews/sec-takes-on-ai-use-by-investment-3426079/>.

illustrates several categories of ways data analytics are used in ways that shape brokers' and advisers' interactions with retail investors. It then turns to securities law's approach to regulating conflicts of interest and agency cost in this relationship, as well as special concerns related to the scalability of digitally mediated financial advice.

A. Financial advisory markets and their regulation

People often need help planning their financial lives.²³ For lack of sophistication, time, or knowledge, they management to professional advisers. The two main models involve “broker-dealers” and “investment advisers.” These regulatory regimes are focused on protecting investors, as well as promoting the “public interest”—broadly defined to include promoting fair, orderly, and efficient markets, capital formation, and competition.²⁴ In this canonical vision, the regulatory framework for financial advisers promotes a trustworthy market where investors can make informed decisions with the guidance of competent and ethical financial advisers.

The regulatory framework for financial advisers arises from various federal and state statutes, including the Investment Advisers Act of 1940 (“Advisers Act”) and the Securities Exchange Act of 1934 (“Exchange Act”). Aside from the SEC, self-regulatory organizations like the stock exchanges and the Financial Industry Regulatory Authority (FINRA) also oversee the conduct of financial advisers, examine for compliance, and pursue enforcement against their own members.

Broker-dealers are primarily involved in the buying and selling of securities on behalf of their clients, and are regulated under the Exchange Act and FINRA rules. On the other hand, registered investment advisers (RIAs), who provide more comprehensive financial planning and investment advice, are regulated under the Advisers Act. Broker-dealers and RIAs traditionally were treated differently in terms of their customer duties. Broker-dealers were traditionally engaged in the effecting of securities transactions, buying and selling—and thus were more like salesmen than fiduciaries.²⁵ For the most part, broker-dealers were not held to a fiduciary

²³ In this article, I focus on retail customers. See, e.g., Harry Mamaysky & Yiqi Zhang, *Investment Advisors to Individual Investors* (Dec. 2023); Pedro Gurrola-Perez, Kaitao Lin, Bill Speth, *Retail trading: an analysis of global trends and drivers*, World Federation of Exchanges (Sept. 2022); see also *supra* note 20 and *infra* Parts II.A & II.B.3.

²⁴ See *infra* notes Part II.B.2.

²⁵ Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 726–36 (2012); Benjamin P. Edwards, *Fiduciary Duty and Investment Advice: Will a Uniform Fiduciary Duty Make a Material Difference*, 14 J. BUS. & SEC. L. 105, 108–16 (2014); see, e.g., Brumberg, Mackey & Wall, P.L.C., 2010 WL 1976174 (May 17, 2010) (denial of no-action relief where firm proposed to not register as a broker-dealer, where it would “pre-screen potential investors” and “pre-sell ... securities to gauge the investors’ interest,” and had a “salesman’s stake” in transaction-based compensation that “would create heightened

standard except in specific situations where a greater degree of trust and reliance was placed upon them by their clients.²⁶

But the traditionally distinct business models have also become less defined over time.²⁷ Broker-dealers have been able to avoid treatment as fiduciaries under the Advisers Act if their provision of investment advice is “incidental” to their provision of broker-dealer services. Yet broker-dealers increasingly offering advisory services that are not meaningfully “incidental,” as required to prevent registering as RIAs.²⁸

B. How data analytics are used

The financial industry’s adoption of artificial intelligence and predictive data analytics has brought about significant changes in how investments are managed, how advice is given, and ultimately how capital is allocated in the broader economy.²⁹ From simple spreadsheets to Monte Carlo simulations and more complex algorithms, a key feature in this transformation has been the shift from human-led analysis and advice to algorithm-driven insights.³⁰ Computer algorithms consume and analyze data, make predictions, and guide investment decisions at scale and speed. As a result, the influence of these technologies extends far beyond individual transactions to impact broader market behaviors and outcomes.³¹

What I call the “Netflix problem” reflects what our use of technology says about our preferences and how we interact with firms in the world. In other domains of our increasingly technologically mediated lives, we find ourselves in information environments—or facing choice

incentive ... to engage in sales efforts”); James S. Tagliaferri, Exchange Act Release No. 80047, 2017 WL 632134, at *4 (SEC Feb. 15, 2017); *see also* United States v. Szur, 289 F.3d 200, 211 (2d Cir. 2002).

²⁶ *See, e.g.*, Patsos v. First Albany Corp., 741 N.E.2d. 841, 851 (Mass. 2001); *see also* Angela H. Magary, *Theories of Involuntary Fiduciary Liability*, 12-FALL PIABA BAR. J. 29 (2005); *cf.* Benjamin P. Edwards, *Fiduciary Duty and Investment Advice: Will a Uniform Fiduciary Duty Make a Material Difference*, 14 J. BUS. & SEC. L. 105 (2014); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 704 (2010).

²⁷ *See infra* Part IV.

²⁸ Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C); Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, 84 Fed. Reg. 33,681, 33,685 (July 12, 2019).

²⁹ *See* Daniel Broby, *The Use of Predictive Analytics in Finance*, 8 J. FIN. & DATA SCI. 145 (Nov. 2022); IOSCO, *The use of artificial intelligence and machine learning by market intermediaries and asset managers*, at 1 (Sept. 2021); Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461, 497 (2015).

³⁰ *See, e.g.*, Hugh Son, *JPMorgan is developing a ChatGPT-like A.I. service that gives investment advice*, CNBC (May 25, 2023).

³¹ *See* Dimitris Andriopoulos et al., *Computational Approaches and Data Analytics in Financial Services: A Literature Review*, 70 J. OPERATIONAL RSCH. SOC. 1581 (2019).

sets—that have been curated for us by people who want to sell us things.³² Data analytics technology is shaping the content for us. And it does so in ways that firms have every natural incentive to optimize to keep us coming back.

This might be unobjectionable, as the Netflix analogy illustrates. A well-trained recommendation algorithm may help us discover our next favorite show. We may also justifiably prefer services that offer more over less personally tailored content. Rather than having an algorithm think we’re just into BBC content, we might prefer it really “understand” us—that there be an element of trust.³³ We *might* want it to understand that the BBC content we like involves documentaries about British miners’ strikes, not police procedurals set in seaside British towns.³⁴

Just as firms like Netflix use technology to optimize their operations or sales practices, so too have firms in the financial services industry begun to adopt them, meaning financial markets are full of “technologies that were unavailable even a few years ago.”³⁵ Scholarly debates about robo advisers, at least before the adoption of the “best interest” package of rules in 2019, focused narrowly on the role of data analytics in providing low-cost advice to the masses.³⁶

As a general matter, we can think of data analytics technologies as a category that helps financial market participants make better predictions; tailor advice to prior behavior, risk tolerance, market trends, and financial goals; and the like. The following discussion illustrates the range of uses to which data analytics technologies are put in modern financial advice.³⁷

1. *Investment purposes.* Financial advisers use all sorts of tools, ranging from calculators or spreadsheets to complex algorithms or models, to formulate and provide advice.³⁸ In a world of big data and relatively cheap computational power, it’s easier than ever to use computational methods like machine learning to analyze financial or trade

³² See, e.g., Van Loo, *infra* note 61, at 1272-73 (describing role of “digital intermediaries” that tailor algorithms “without disclosing their bias”).

³³ To this end, scholars of data analytics technology have focused on the role of “trust” in both willingness to adopt. See, e.g., Nizan Geslevich Packin, *Consumer Finance and AI: The Death of Second Opinions?*, 22 N.Y.U.J. LEGIS. & PUB. POL’Y 319 (2020).

³⁴ Spoiler alert for the police procedural: it was the vicar.

³⁵ Gary Gensler, Speech, Testimony at Hearing before the Subcommittee on Financial Services and General Government (Mar. 29, 2023).

³⁶ See *infra* part II.A.2; FINRA, Report on Digital Investment Advice (March 2016), <https://www.finra.org/sites/default/files/digital-investment-advice-report.pdf>.

³⁷ I’ve tried to define the technologies here capaciously, tracking the definition in the data analytics rule, discussed below. See *infra* Part II.C.1.

³⁸ Surely this is a joke; what kind of conflict of interest would exist in using Excel (or, as SEC Commissioner Mark Uyeda has suggested, an abacus)? See *infra* note 155 and accompanying text.

data, like financial statements to determine fair market value.³⁹ In addition, data analytics technology has enabled the provision of “robo advice,” or automated, low-cost planning services.⁴⁰ Monte Carlo simulations are used to model probabilities of outcomes in an uncertain market.⁴¹ Algorithms are used widely by both large block traders and high-frequency arbitrageurs to trade around the effects of price impact.⁴² And market participants seek to take advantage of *other* algorithms, such as social media, that can direct investor attention and thus behavior.⁴³

2. *Client experience purposes.* Financial advisers must compete in the market for client attention and money, so they have an incentive to offer attractive client experience. Notably, this can include “gamification” or “digital engagement practices,” or user experience design features that are thought to promote engagement with the adviser’s digital app. Companies may design their information environments using A/B testing, or the comparison of two alternative communications with a target audience, to see which performs better. In addition, informational algorithms or platform microstructure filter and prioritize financial news, market data, and investment opportunities based on the client’s profile and preferences. This can materially influence investor behavior by highlighting certain information while omitting others, potentially skewing perception of market conditions or investment opportunities. Framing the information environment or choice set can make options more salient, subtly influencing even self-directed investor behavior.⁴⁴

³⁹ See, e.g., William Magnuson, *A Unified Theory of Data*, 58 HARV. J. ON LEGIS. 23 (2021).

⁴⁰ See *supra* note 18; Christine Lazaro & Teresa Verges, *The Obligations and Regulatory Challenges of Online Broker-Dealers and Trading Platforms*, 29 NO. 1 PIABA B.J. 25 (2021); Christine Lazaro, *The Regulation of Digital Investment Advice* (Nov. 2019); Bernd Scherer & Sebastian Lehner, *Trust me, I am a Robo-advisor*, 24 J. ASSET MGMT. 85 (Oct. 29, 2022); Lukas Brenner & Tobias Meyll, *Robo-advisors: A substitute for human financial advice?*, 25 J. BEHAV. & EXPER. FIN. 100275 (Mar. 2020).

⁴¹ They run a range of scenarios to help clients understand the potential risks and rewards of their investment strategies. This can influence investor behavior by providing a more nuanced view of potential financial futures.

⁴² See DONALD MACKENZIE, *TRADING AT THE SPEED OF LIGHT: HOW ULTRAFAST ALGORITHMS ARE TRANSFORMING FINANCIAL MARKETS* (2021); Gina-Gail S. Fletcher, *Deterring Algorithmic Manipulation*, 74 VAND. L. REV. 259 (2021); Lin, *supra* note 29, at 496.

⁴³ Note that someone acting as an investment adviser and using an “algorithm” giving rise to a “conflict of interest” might not realize that they can be subject to the duties of a registered entity even if unregistered. See *infra* note 88. On influencers and copy trading, see Sue Guan, *The Rise of the Finfluencer*, 19 N.Y.U. J. L. & BUS. 489 (2023); Nikita Aggarwal, D. Bondy Valdovinos Kaye, Christopher Odet, *#FinTok and Financial Regulation*, 54 ARIZ. ST. L.J. 333 (2023). For experimental evidence that people subjected to a social comparison manipulation trade more and riskier, see Dániel Kaszás, *We’re Living in a Society: Four Studies on Social Information and Decisions Under Uncertainty* (2021) (dissertation, ETH Zurich).

⁴⁴ See Stephanie M. Grant, Jessen L. Hobson & Roshan K. Sinha, *Digital Engagement Practices in Mobile Trading: The Impact of Color and Swiping to Trade on Investor Decisions*, MGMT. SCI. (forthcoming, 2023); Xiao Cen, *Smartphone Trading Technology, Investor Behavior, and Mutual Fund Performance*, MGMT. SCI. (forthcoming, 2023); Brad M. Barber, Xing Huang, Terrance Odean & Christopher

3. *Operations efficiency and administrative purposes.* Data analytics technology can be deployed for compliance, supervision, and quality control, all important functions in securities law. It can be used for trade execution, clearance, and the like. Additional uses of data analytics include making sense of unstructured textual data that would be difficult to assess and model through more labor-intensive means,⁴⁵ “regtech,”⁴⁶ and the aggregation of heterogeneous preferences.⁴⁷
4. *Power-relations, transactional, and regulatory purposes.* The expansion of data analytics technology meant to optimize revenue in every domain of our lives reflects the relations of power and dominance inherent in residual claimants’ pursuit of return on investment, potentially not in the interest of other stakeholders.⁴⁸

One thing we immediately see from this recitation of different categories of data analytics use cases is how different they all are, and the different kinds of conflicts that may be more or less amenable to disclosure- or market-based solutions. I return in Part III.C.1 to the problem of trying to categorize these data analytics practices into more fine-grained regulatory categories.

C. Regulatory attention to digital engagement practices and predictive data analytics

The Commission’s proposal comes after several years of attention to the principal-agent

Schwarz, *Attention-Induced Trading and Returns: Evidence from Robinhood Users*, 77 J. FIN. 3141 (Dec. 2022); Gregory W. Eaton, T. Clifton Green, Brian S. Roseman & Yanbin Wu, *Retail trader sophistication and stock market quality: Evidence from brokerage outages*, 146 J. FIN. ECON. 502 (Nov. 2022); Terrence Hendershott, Xiaoquan (Michael) Zhang, J. Leon Zhao & Zhiqiang (Eric) Zheng, *FinTech as a game changer: Overview of research frontiers*, 32 INFO. SYS. RES. 1 (2021); Shana M. Clor-Proell, Ryan D. Guggenmos, & Kristina Rennekamp, *Mobile devices and investment news apps: The effects of information release, push notification, and the fear of missing out*, 95 ACCOUNTING REV. 95 (2020).

⁴⁵ Cf. Andrew C. Call, Ben Wang, Liwei Weng, Qiang Wu, *Human Readability of Disclosures in a Machine-Readable World* (Sept. 2023); Yonathan A. Arbel & Shmuel I. Becher, *Contracts in the Age of Smart Readers*, 90 GEO. WASH. L. REV. 83 (2022).

⁴⁶ See, e.g., Tom C. W. Lin, *Compliance, Technology, and Modern Finance*, 11 BROOK. J. CORP. FIN. & COM. L. 159 (2016).

⁴⁷ The financial advisory relationship is an agency one involving delegation and planning, and typically we want the agent to faithfully represent their principals’ interests and preferences. There are imperfectly contractible solutions to align agents’ incentives with managers’. But this supposes a single incentive is ascertainable; what of managers to pooled investment vehicles, like pension funds, representing a wide array of heterogeneous investors? Data analytics tools might be used to elicit and order the preferences of pension plan fiduciaries so the overall distribution of their preferences is represented. Gosse A.G. Slderda, Benedict G.C. Dellaert, Laurens Swinkels, Fieke S.G. van der Lecq, *Individual pension risk preference elicitation and collective asset allocation with heterogeneity*, 101 J. BANK. & FIN. 206 (2019). On broader questions, see Przemyslaw Palka, *Algorithmic Central Planning: Between Efficiency and Freedom*, 83 LAW & CONTEMP. PROBS. 125 (2020).

⁴⁸ See, e.g., McKinsey & Co., *Marketing & Sales: Big Data, Analytics, and the Future of Marketing & Sales* (Mar. 2015); see also, e.g., Pieter Verdegem, *Critical AI studies meets critical political economy*, in Simon Lindgren, ed., *HANDBOOK OF CRITICAL STUDIES OF ARTIFICIAL INTELLIGENCE* 302 (2023); James Bessen, *THE NEW GOLIATHS: HOW CORPORATIONS USE SOFTWARE TO DOMINATE INDUSTRIES, KILL INNOVATION, AND UNDERMINE REGULATION* (2022).

problems arising from the use of technology in shaping investor behavior. In some sense this reflects an evolution of the SEC’s thinking and top-level framing of the problem, but Gensler’s attention to data analytics has signaled for some time the direction of the SEC’s thinking on digital engagement practices.⁴⁹ From the beginning, that thinking has not been simply about “gamification” but also about how data analytics and algorithms shape behavior.

Concerns about conflicts of interest and agency costs in the financial adviser relationship are age-old, and these legacy concerns and legal doctrines do not disappear simply because new technology is in use.⁵⁰ The SEC’s concern are traceable to a longstanding project about harmonizing the standards of conduct applicable to broker-dealers and investment advisers. But the “data analytics” subplot begins in earnest in early 2021 with the “meme stock” craze.⁵¹ Afterward there was a growing recognition that free-and-easy trading apps, combined with splashy and engaging user interfaces, could affect markets more broadly based on how they shape retail customer behavior. To that end, the House Financial Services Committee held at least four hearings in 2021 that addressed the problems of what would later be called digital engagement practices and predictive data analytics.⁵² In May 2021, for instance, Chair Gensler highlighted the use of “features that have come to be familiar in our increasingly online world — features such as gamification, behavioral prompts, predictive analytics, and differential marketing.”⁵³

In connection with this attention to data analytics, the SEC in late 2021 issued a request for information related to potential rulemaking about “digital engagement practices” for broker-dealers and investment advisers.⁵⁴ It raised questions about DEPs as a user-experience design problem that were salient to market observers in an age of frothy markets, Robinhood crypto trading, and meme stocks. But it also focused on the role that algorithms play in shaping investor

⁴⁹ *Examining Facebook’s Proposed Cryptocurrency and Its Impact on Consumers, Investors, and the American Financial System, Hearing before the H. Comm. on Fin. Servs.*, 116th Cong. (2019) (statement of Gary Gensler); see also Betsy Vereckey, *SEC’s Gary Gensler on how artificial intelligence is changing finance*, MIT Sloan School of Management, IDEAS MADE TO MATTER (Oct. 12, 2022).

⁵⁰ See *infra* notes 172-173, 177-180, and accompanying text; Barbara Novick, et al., *Artificial intelligence and machine learning in asset management*, BlackRock Public Policy Viewpoint (Oct. 2019), <https://www.icmagroup.org/assets/documents/AI.pdf>.

⁵¹ See, e.g., Dhruv Aggarwal, Albert H. Choi & Y.H.A. Lee, *Meme Corporate Governance* (2023).

⁵² See Tierney, *supra* note 17, at 359 n. 18 (collecting citations); *Oversight of the U.S. Securities and Exchange Commission: Wall Street’s Top Cop is Finally Back on the Beat, Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. (2021).

⁵³ *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong., at 5-6 (2021) (statement of Gary Gensler, Chairman, Sec. & Exch. Comm’n); see also, e.g., Gary Gensler, *Speech, Prepared Remarks at SEC Speaks* (Oct. 12, 2021), <https://www.sec.gov/news/speech/gensler-sec-speaks-2021-10-12>.

⁵⁴ *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*, Exchange Act Release 92766, 86 Fed. Reg. 49,067 (Sept. 1, 2021).

behavior and outcomes, and how “predictive data analytics and artificial intelligence/machine learning” can be used “to analyze the success of specific features and practices at influencing retail investor behavior.”⁵⁵

D. How data analytics present conflicts of interest

Investor interactions involving data analytics can introduce unique conflicts of interest that are harder to discern and have the potential to result in investor harm.⁵⁶ Algorithms are typically developed and optimized to maximize certain parameters such as returns or risk reduction, and in doing so, they may inadvertently overlook or undermine investor interests.⁵⁷ As discussed more below, for instance, a broker might use computational or algorithmic tools to present customers with a list of possible investments, including those that provide more or less commission revenue or other transaction-based compensation to the broker. This can lead to conflicts of interest, where the technology might serve the firm’s interests over those of the investor—such as by prioritizing the higher-revenue investments.⁵⁸ The solution, then, would be to target the conflict.⁵⁹ This subpart addresses these conflicts, as well as complications from “scalability.”

1. Data analytics, agency costs, and externalities

In other domains of our increasingly technologically mediated lives, we find ourselves being promoted things from people who want to sell us things. Sometimes we might be worried we’re being led astray, innocently or not. Suppose you are looking for a night where you can watch a little Netflix, and chill. If you get a bad recommendation from the Netflix algorithm, it could be

⁵⁵ *Id.* at 49,068. In response to that RFI, I wrote a comment letter arguing that the problem with gamification was not “flashy app design” like digital confetti. Rather, it was in the use of technology that “learns what kinds of [push notifications or other] prompts are likely to be more effective at encouraging me to place a trade—and then responds by serving more of these prompts to get me to trade more,” putting its own interests ahead of the client’s. James Fallows Tierney, Comment Letter on Digital Engagement Practices (Oct. 1, 2021), <https://perma.cc/AS7G-TXKX>.

⁵⁶ Algorithms, despite their objectivity and speed, can introduce biases, inaccuracies, or even systemic risks. *See* Langvardt, *supra* note 3; Zeide, *supra* note 3; cf. Talia B. Gillis, *The Input Fallacy*, 106 MINN. L. REV. 1175 (2022).

⁵⁷ *See* Data Analytics Proposal, *supra* note 9, at *21 (noting that “a firm may use these technologies to optimize for the firm’s revenue or to generate behavioral prompts or social engineering to change investor behavior in a manner that benefits the firm but is to the detriment of the investor”).

⁵⁸ *Id.* at *83 (noting that this kind of conflict can occur where “[r]evenue or profits can be take into account directly, such as if a firm populates an asset allocation algorithm on its website to prioritize investments that it is trying to promote because it benefits the firm (e.g., by over-weighting funds that make revenue sharing payments or proprietary funds”).

⁵⁹ *See, e.g.*, Arthur B. Laby, *Advisors as Fiduciaries*, 72 FLA. L. REV. 953 (2020); Megan Ji, Note, *Are Robots Good Fiduciaries? Regulating RoboAdvisors Under the Investment Advisers Act of 1940*, 117 COLUM. L. REV. 1543, 1545 (2017) (prioritizing regulatory “focus on policing robo-advisor conflicts of interest” rather than “quality of robo-advisor advice,” because the problem is in hard coding the conflict of interest).

because of a problem with the algorithm. Maybe the training data was bad — people *like* you liked this documentary, but didn't capture that you prefer BBC whodunnits over documentaries. Or maybe there was some conflict that led the provider (here, Netflix) to steer you toward that recommended item, perhaps because of a particular financial interest in having more consumers of that particular offering.

Whatever the reason, the bad recommendation might sour the evening, but the stakes seem low. The stakes are considerably higher in the realm of algorithmically driven financial advice. Data analytics technologies may allow firms to offer broader ranges of services, make predictions with greater accuracy, and enhance their efficiency.⁶⁰

But conflicts of interest can easily arise from direct uses of these technologies, such as the presentation of investment choices that make more salient to clients the options that put the adviser's economic interest first.⁶¹ For example, an algorithm might be programmed to suggest financial products that yield higher commissions or fees for the adviser or their firm, rather than those that best serve the client's financial goals.⁶² Securities law is deeply committed to investor protection, and in particular the reduction of agency costs.⁶³ Take the financial adviser relationship, which is well known to give rise to conflicts of interest and associated agency costs.⁶⁴ Advisers can steal, shirk, pursue conflicts of interest, and violating rules intended to promote the integrity of capital markets.⁶⁵

⁶⁰ Iannarone, *Computer*, *supra* note 18.

⁶¹ Rory Van Loo, *Rise of the Digital Regulator*, 66 DUKE L.J. 1267, 1272 (2017) (explaining that just how other firms can “profit from consumer misperceptions, ... digital intermediaries can do the same through their search engines and web interfaces”).

⁶² See *infra* Part II.C.3.

⁶³ See, e.g., Abraham J.B. Cable, *Mad Money: Rethinking Private Placements*, 71 WASH. & LEE L. REV. 2253, 2268-73 (2014); Patrick Corrigan, *Do the Securities Laws Actually Protect Investors (and How)? Lessons from SPACs*, WASH. U. L. REV. (forthcoming 2024); cf. Yoon-Ho Alex Lee, *Beyond Agency Core Mission*, 68 ADMIN. L. REV. 551, 565 (2016) (“Although no one doubts that protection of investors was the most important driver behind the creation of the SEC, in some ways, it is somewhat curious that this historical consideration should play such a sticky role for the SEC's core mission for eighty years to follow.”).

⁶⁴ See, e.g., Deborah A. DeMott, *Rogue Brokers and the Limits of Agency Law*, in CAMBRIDGE HANDBOOK OF INVESTOR PROTECTION (Arthur B. Laby ed., 2022); Quinn Curtis, *The Fiduciary Rule Controversy and the Future of Investment Advice*, 9 HARV. BUS. L. REV. 53, 61 (2019); Daniel Bergstresser, John M.R. Chalmers & Peter Tufano, *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry*, 22 REV. FIN. STUD. 4129, 4153-54 (2019); Benjamin P. Edwards, *The Professional Prospectus: A Call for Effective Professional Disclosure*, 74 WASH. & LEE L. REV. 1457, 1469 (2017); Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025 (2009); Peter Bolton, Xavier Freixas, and Joel Shapiro, *Conflicts of interest, information provision, and competition in the financial services industry*, 85 J. FIN. ECON. 297 (2007); see also, e.g., SEC. & EXCH. COMM'N, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H. DOC. NO. 95, 88th Cong., 1st Sess. Ch. 3, 254 (1964).

⁶⁵ Cheating imposes costs on third parties and thus results in gains to customers. William A. Birdthistle & M. Todd Henderson, *Becoming the Fifth Branch*, 99 CORNELL L. REV. 1, 10 (2012).

The integration of data analytics technologies in retail financial advice raises significant concerns regarding conflicts of interest, a topic well-explored within the law-and-economics scholarly literature. There is a significant body of empirical literature substantiating policy concerns that conflicts of interests, such as commissions and other transaction-based compensation structures, may result in steering clients to products that are not in their best interest.⁶⁶ There may be other consequences of data analytics and conflict of interest as well; people also suffer from algorithm aversion, and may be more wary of investment advice that is both algorithmically generated and subject to conflicts of interest.⁶⁷

Conflicts are in some sense inevitable under imperfect information, high transaction costs, and intermediation. What to do about it heavily contested.⁶⁸ As tools for enforcing the alignment of incentives and reducing agency costs, the modern approach to *corporate* law focuses on disclosure and private ordering coupled with ex post liability for misrepresentation or breaches of loyalty. As we'll see in Part III.A, the data analytics rule reflects a judgment that disclosure is unlikely to be effective here. The proposed rule thus imposes conflict of interest duties, but also raise broader questions about how these technologies impact market dynamics and individual investor behavior.⁶⁹

2. Data analytics and the problem of scalability

In this subsection, I consider the SEC's expressed concern in this area for "scalability." The proposed rule notes the "potential for firms" to expand the use of "these technologies and . . . reach a broad audience at rapid speed," such that "any resulting conflicts of interest could cause harm to investors in a more pronounced fashion and on a broader scale than previously possible."⁷⁰

Some costs to investors from conflicts of interest are at the individual scale. Where a financial adviser elicits investment decisions or outcomes based on suboptimal inputs, or inputs that are tainted by factors or considerations other than the investor's best interest, investors will

⁶⁶ See, e.g., Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 OHIO ST. L.J. 181, 184 (2017); Bergstresser et al., *supra* note 64; Panle Jia Barwick, Parag A. Pathak & Maisy Wong, *Conflicts of Interest and Steering in Residential Brokerage*, 9 AM. ECON. J.: APPL. ECON. 191 (2017); *see also, e.g.*, Executive Office of the President, *The Effects of Conflicted Investment Advice on Retirement Savings* (Feb. 2015).

⁶⁷ Carlos J.S. Lourenco, Benedict G.C. Dellaert & Bas Donkers, *Whose Algorithm Says So: The Relationships Between Type of Firm, Perceptions of Trust and Expertise, and the Acceptance of Financial Robo-Advice*, 49 J. INTERACTIVE MKTG. 107 (2020).

⁶⁸ See, e.g., Hamid Mehran & Rene M. Stulz, *The economics of conflict of interest in financial institutions*, 85 J. FIN. ECON. 267 (2007).

⁶⁹ Cf. Alan Kluegel, *The Ties That Bind: The Relationship Between Law Firm Growth and Law Firm Survival*, 53 SETON HALL L. REV. 201, 209 (2022).

⁷⁰ Data Analytics Proposal, *supra* note 9, at 53,961.

receive advice or product recommendations that aren't in their best interest. Unsuitable recommendations driven by underlying conflicts can lead to financial losses. Idiosyncratic, individual-level losses may be socially wasteful.⁷¹

One of the primary supposed benefits of scalability in technology-mediated financial advice is the “democratization” of financial services.⁷² Technologies like robo-advisers allow for widespread, cost-effective financial advice, making it accessible to a broader segment of the population. Yet scalability of processes (and so of conflicts) also introduces significant risks, including of widespread misallocative decisions and market distortions.⁷³ This aligns with Magnuson's (2020) observation that nominally small distortions introduced from financial data analytics may have unexpectedly broad effects because the whole endeavor is designed around Keynesian beauty contests—guessing what others think about future states of the world.⁷⁴

As use of data analytics becomes more widespread, conflicts can ripple across a larger number of investor interactions.⁷⁵ Duffy and Parrish (2021) have thus characterized firm-technology-mediated conflicts as “arguably more detrimental than personal conflicts between an advisor and client because the number of clients impacted by the firm[-level] conflict is potentially exponentially higher.”⁷⁶ In addition to being a response to incentives, scalability also bears on the feasibility of timely and full disclosure.⁷⁷ From a perspective inflected with the modern law and political economy approaches, moreover, scalability may also make it easier to extract, to oppress, to depredate.⁷⁸

The effect of scalability might indeed vary based on the nature of the investor interaction and the technology in question. Direct use of a covered technology by an investor can be

⁷¹ See *infra* Part III.B.1.

⁷² See Cable, *supra* note 20; compare Tierney, *supra* note 17, at 406-12.

⁷³ See, e.g., Hilary J. Allen, *Driverless Finance*, 10 HARV. BUS. L. REV. 157 (2020).

⁷⁴ William Magnuson, *Artificial Financial Intelligence*, 10 HARV. BUS. L. REV. 337 (2020). On the construction of these expectations in capitalism, see generally JENS BECKERT, *IMAGINED FUTURES: FICTIONAL EXPECTATIONS AND CAPITALIST DYNAMICS* (2016).

⁷⁵ See Tom Baker & Benedict Dellaert, *Regulating Robo Advice Across the Financial Services Industry*, 103 IOWA L. REV. 713, 742 (2018) (explaining how scalability affects “three factors” bearing on scope of harm, including “number of consumers affected,” “probability of the harmful action occurring,” and “severity of the consequence”); see also, e.g., Murad A. Mithani, *Scaling digital and non-digital business models in foreign markets: The case of financial advice industry in the United States*, 58 J. WORLD BUS. 101457 (June 2023); Roberto Moro-Visconti, Salvador Cruz Rambaud, and Joaquín López Pascual, *Sustainability in Fintechs: An explanation through business model scalability and market valuation*, 12 SUSTAINABILITY 10316 (2020).

⁷⁶ Sophia Duffy and Steve Parrish, *You Say Fiduciary, I Say Binary: A Review and Recommendation of Robo-Advisors and the Fiduciary and Best Interest Standards*, 17 HASTINGS BUS. L.J. 3, 26 (2021).

⁷⁷ See *infra* Part III.A.

⁷⁸ For discussion, see *infra* Part III.B.2 and IV.C.

susceptible to rapid scalability, making conflicts harder to manage. In contrast, when an associated person provides recommendations based on technology, there's a human layer of interpretation and judgment that might serve as a buffer, reducing the immediate scalability of any potential conflict.⁷⁹

II. Conflicts of interest in data analytics for retail investors

This part addresses the regulatory baseline and gap, design and assessment approaches to regulatory intervention, and the specifics of the SEC's rule proposal.

A. The regulatory gap and the SEC's statutory authority to fill it

Let's begin by situating the statutory authority that gave rise to the regulatory gap here, but also gives the SEC the power to fix it. Section 913 of the Dodd-Frank Act jumps off from the common-law distinction and aims to harmonize the standards of conduct for broker-dealers and investment advisers.⁸⁰ In particular, Section 913 of the Dodd-Frank Act directed the SEC to undertake a study of existing regulatory baselines with respect to "personalized investment advice and recommendations" to retail customers.⁸¹ The study was to consider, among other things, "whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care ... for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute."⁸² Congress also directed the SEC to submit a report, highlighted considerations to be addressed, authorized rulemaking consistent with the report, and authorized the SEC to establish a fiduciary duty for broker-dealers.⁸³

Dodd-Frank Act § 913 amended both the Exchange Act and the Advisers Act to make clear that the SEC may adopt rules providing that broker-dealers and investment advisers must "act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser."⁸⁴ Congress directed the Commission to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships" with

⁷⁹ For discussion of the role of human oversight and intervention in technology-driven systems, see Rebecca Crootof, Margot E. Kaminski & W. Nicholson Price II, *Humans in the Loop*, 76 VAND. L. REV. 429 (2023); Aziz Huq, *A Right to a Human Decision*, 106 VA. L. REV. 611 (2020).

⁸⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(b), 124 Stat. 1376, 1824 (2010).

⁸¹ *Id.* § 913(b)(1), 124 Stat. at 1824.

⁸² *Id.* § 913(b)(2), 124 Stat. at 1825.

⁸³ *Id.* § 913(c)(1)-(14), (d), (f), (g), 124 Stat. at 1825-29.

⁸⁴ *Id.* § 913(g)(1)-(2), 125 Stat. at 1828-29, codified at Exchange Act § 15(k) and Advisers Act § 211(g).

advisers, “including any material conflicts of interest.”⁸⁵

Most important for our purposes, however, is the authority Congress conferred outside what we just discussed. Recognizing that the SEC’s study may also find that disclosure may be inadequate, Congress directed the Commission in Exchange Act § 15(l)(2) and Advisers Act § 211(h)(2) to “examine, and where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes ... that the Commission deems contrary to the public interest and the protection of investors.”⁸⁶

These Dodd-Frank amendments reflect how the law of financial adviser regulation has traditionally, and also increasingly, been concerned with reducing conflicts of interest in the adviser-client relationship.⁸⁷ To that end, over the last few years the SEC has taken an increasingly proactive stance toward investor protection and market integrity issues arising from conflicts of interest and principal-agent problems in the financial advisory relationship.⁸⁸ Existing regulatory frameworks are now aimed at reducing these agency costs.⁸⁹ This subpart looks at the best-interest concept in Reg BI and in state and federal fiduciary duties.⁹⁰

1. Regulation Best Interest

The SEC’s first major effort to harmonize the standards of conduct for broker-dealers and investment advisers came in 2019, when the agency adopted the “best interest” package of rules

⁸⁵ *Id.*, codified at Exchange Act § 15(l)(1) and Advisers Act § 211(h)(1).

⁸⁶ *Id.*, codified at Exchange Act § 15(l)(2) and Advisers Act § 211(h)(2).

⁸⁷ See *supra* note 64.

⁸⁸ So far we’ve discussed broker-dealers and investment advisers as SEC-regulated entities. But there are other firms participating in financial advisory markets who may not be SEC-regulated entities, such as vendors and service providers. Even though these firms may not be directly regulated today, the SEC’s regulatory jurisdiction is relevant to their role as indirect suppliers or participants in markets for retail financial advice. Cf. Saule T. Omarova, *Dealing with Disruption: Emerging Approaches to Fintech Regulation*, 61 WASH. U. J. L. & POL’Y 25, 33-34 (2020) (noting that “many recent innovations in finance are designed specifically to overcome traditional regulatory boundaries”). For instance, the Exchange Act authorizes the SEC to pursue administrative enforcement proceedings (including civil penalties) against “any person” who is engaging in primary violations, or certain secondary “causing liability” violations, of the securities laws. Securities Act Section 8A, 15 U.S.C. § 77h-1(a); Moshe Marc Cohen, Exchange Act Release No. 78797, 2016 WL 4727517, at *9 (Sept. 9, 2016) (describing secondary liability for causing a violation of the securities laws). As the SEC has explained, “a person or entity not registered with the Commission may be deemed to be subject to ... heightened duties by virtue of their conduct,” such as by acting as an unregistered investment adviser. Equity Trust Co., Securities Act Release No. 10420, at *2 n.7 (Sept. 28, 2017); compare Conrad P. Seghers, Advisers Act Release No. 2656, 2007 WL 2790633, at *1, 7 (Sept. 26, 2007) (conduct gave rise to “fiduciary role” even though not registered as an investment adviser).

⁸⁹ See James Fallows Tierney & Benjamin P. Edwards, *Stockbroker Secrets*, U. PA. J. BUS. LAW —, at *10–11 (forthcoming 2024) (“Recent regulatory initiatives ... explicitly identify [reduction of agency costs] as a regulatory goal.”); see also *supra* Part I.D.1 and *infra* note 172.

⁹⁰ For discussion of the recent executive order on artificial intelligence, see Part II.B.3 below.

aiming to enhance the quality and transparency of retail investors' relationships with investment advisers and broker-dealers.

With respect to broker-dealers, the centerpiece of that rulemaking was Regulation Best Interest ("Reg BI").⁹¹ Broker-dealers are subject to Reg BI in making "recommendations" to "retail customers."⁹² In making such a recommendation, broker-dealers are to act in their customers' best interests, meaning duties with respect to disclosure about conflicts of interest and the provision of detailed information regarding the costs and risks associated with their recommendations.⁹³

Note that Reg BI was intended to raise the standard of conduct for broker-dealers closer to the fiduciary standard applicable to RIAs.⁹⁴ Though hoped to mark a significant development in the regulation of financial advice, aiming to increase transparency and trust in the interactions between broker-dealers and their clients, the evidence about enforcement and the effects of Reg BI has been mixed.⁹⁵

The baseline leaves broad categories of brokerage conduct largely unregulated with respect to conflicts of interest. For example, Reg BI does not apply to interactions that do not meet the test for a "recommendation" or to self-directed investors who don't receive a "recommendation."⁹⁶ In addition, broker-dealers face a number of obligations "[w]here recommendations are involved, ... relating to care, disclosure, compliance, and conflicts."⁹⁷ As SEC Investor Advocate Rick Fleming has explained, "when a retail customer independently directs their broker to make a trade without any related recommendation, the broker does not have to consider any of the[se]

⁹¹ See Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) ("Reg BI Adopting Release").

⁹² *Id.* at 33,329.

⁹³ See Christine Lazaro & Michael S. Demiston, *Pleading and Advocating a Negligence Claim Through the Regulation Best Interest Lens*, 29 PIABA Bar J. 297, 299-301, 303-306, 310-13, 314 (2022).

⁹⁴ See Ed McCarthy, *How Thoughts About the SEC's Regulation Best Interest Have Evolved*, PLANADVISER (Apr. 8, 2022), <https://www.planadviser.com/exclusives/thoughts-secs-regulation-best-interest-evolved/>.

⁹⁵ See *id.*

⁹⁶ Reg BI Adopting Release, *supra* note 91, at 33,334-35 (defining a "recommendation" under a facts-and-circumstances standard that asks, among other things, "whether the communication 'reasonably could be viewed as a call to action' and 'reasonably would influence an investor to trade a particular security or group of securities'"); NAT'L ASS'N OF SEC. DEALERS REGUL., INC., NOTICE TO MEMBERS 01-23: SUITABILITY RULE AND ONLINE COMMUNICATIONS (2001), <https://www.finra.org/rules-guidance/notices/01-23> [<https://perma.cc/P7L5-5K6G>]; Rick Fleming, *Inv. Advoc., Sec. & Exch. Comm'n, Remarks at SEC Speaks: Investor Protection in the Age of Gamification: Game Over for Regulation Best Interest?* (Oct. 13, 2021), <https://www.sec.gov/news/speech/fleming-sec-speaks-101321> [<https://perma.cc/3CKA-8UQF>].

⁹⁷ Tierney, *supra* note 17, at 435.

component obligations in carrying out the trade.”⁹⁸

2. Fiduciary law and the regulation of investment advisers

In addition to sales practices regulation like Reg BI, securities law relies on fiduciary duties to police the financial advisory relationship. Federal- and state-level fiduciary duties can apply to advisers and broker-dealers, and present opportunities and challenges.

The regulation of RIAs focuses on adherence to the fiduciary standard—inferred from the structure of the Advisers Act—and the duty to provide advice that is in the best interest of the client. As the Supreme Court has explained, the Advisers Act was meant, in part, “to eliminate conflicts of interest between the investment adviser and the clients as safeguards both to ‘unsophisticated investors’ and to ‘bona fide investment counsel.’”⁹⁹ Though Advisers Act § 206 imposes on RIAs fiduciary duties of care and loyalty, it mostly seeks to eliminate conflicts through disclosure and market mechanisms rather than through “merit regulation.”¹⁰⁰

The 2019 best interest rulemaking included a “Fiduciary Interpretation” clarifying the standards of conduct for investment advisers under the Advisers Act.¹⁰¹ In that release, the SEC said that RIAs can satisfy this duty either by “eliminat[ing] or at least expos[ing] through full and fair disclosure all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.” While the Fiduciary Interpretation clarifies the standards of conduct for RIAs, it leaves open important questions of how to regulate in this space.

In recent years, the emergence of “robo-advice” has introduced regulatory challenges, and the pace of change in this space has been particularly striking.¹⁰² Just a few short years ago, before the 2019 fiduciary interpretation, scholars debated the nature of “plain vanilla” robo advisers and whether the existing regulatory baseline was up to the task of regulating them.¹⁰³ At that

⁹⁸ Fleming, *supra* note 96.

⁹⁹ SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180, 191 (1963).

¹⁰⁰ See Arthur B. Laby, *Models of Securities Regulation in the United States*, 23 *FORDHAM INT’L L.J.* S20, S21 (2000); see also Thomas P. Lemke & Gerald T. Lins, *REGULATION OF INVESTMENT ADVISERS* § 2:33 (Feb. 2023).

¹⁰¹ See Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019), 84 Fed. Reg. 33,681.

¹⁰² See, e.g., Justin L. Mack, Regulators turn up the volume on calls for AI guardrails as the technology spreads across wealth management, *Financial Planning* (Aug. 7, 2023);

¹⁰³ Plain vanilla robo advice, in this sense, refers to the use of data analytics tools for “customer profiling, asset allocation, portfolio selection, trade execution, portfolio rebalancing, and tax-loss harvesting.” Melanie L. Fein, *FINRA’s Report on Robo-Advisors: Fiduciary Implications* 3 (Apr. 2016) (unpublished manuscript); see also Commissioner Kara Stein, Speech, *Surfing the Wave:*

time, one concern was that roboadvice was simply too rote, too cookie cutter, and too reliant on disclosure to satisfy duties of care under the Advisers Act (or ERISA for retirement accounts).¹⁰⁴ Strzelczyk (2017), for instance, argued that robo-advisors could not fit within the fiduciary framework because they could not provide appropriate advice.¹⁰⁵ Emphasizing the disclosure or reputational mechanism, Ji (2017) argued that regulators should focus on the duty of loyalty, as algorithms can be programmed to reflect a firm's conflicts of interest.¹⁰⁶ Iannarone (2018, 2019) has argued, by contrast, that traditional disclosure frameworks in the Advisers Act might not adequately address robo-advisers' unique challenges.¹⁰⁷ Others, like Baker and Dellaert (2019), contended that existing doctrines were sufficient.¹⁰⁸

B. Toolkits for regulation

This subpart collects some of the scholarly literature on regulatory interventions with respect to behavioral and algorithmic harms, situates these harms within the SEC's rulemaking authority and economically grounded approach, and discuss the agency's statutory authority to regulate conflicts of interest in this space.

1. Tech regulation toolkits

Scholars of regulatory design have considered a range of interventions, including with respect to both securities markets and innovative technology. Securities law has a typology of regulatory interventions for addressing conflicts of interest in retail intermediation, some of which will be discussed below.¹⁰⁹ These canonical interventions include enhanced disclosure, stronger fiduciary duty, occupational gatekeeping, and sales practices prohibitions.¹¹⁰ To the extent we're worried about behavioral exploitation, additional tools include "(1) default rules; (2)

Technology, Innovation, and Competition—Remarks at Harvard Law School's Fidelity Guest Lecture Series (Nov. 15, 2015) (expressing skepticism about the fiduciary role of "a robotic entity that automatically generates investment advice").

¹⁰⁴ See, e.g., Melanie L. Fein, *Robo-Advisors: A Closer Look* (June 30, 2015) (unpublished manuscript) (review of roboadvisor account agreements suggested they "are not free from conflicts of interest and do not minimize investment costs to the extent the DOL assumes," for purposes of ERISA fiduciary duties).

¹⁰⁵ See Bret E. Strzelczyk, *Rise of the Machines: The Legal Implications for Investor Protection with the Rise of Robo-Advisors*, 16 DEPAUL BUS. & COMM. L.J. 54 (2017)

¹⁰⁶ Ji, *supra* note 59, at 1545.

¹⁰⁷ See, e.g., Iannarone, *Rethinking*, *supra* note 18; Iannarone, *Computer*, *supra* note 18.

¹⁰⁸ See, e.g., Tom Baker & Benedict Dellaert, *Behavioral Finance, Decumulation, and the Regulatory Strategy for Robo-Advice*, in *THE DISRUPTIVE IMPACT OF FINTECH ON RETIREMENT SYSTEMS* (Julie Agnew & Olivia S. Mitchell eds., Oxford 2019); see also, e.g., Lightbourne, *supra* note 18, at 665-66.

¹⁰⁹ See *infra* Parts II.C.3, III.A, and III.C.

¹¹⁰ See, e.g., James Fallows Tierney, *Retail Investors and Capital Markets Intermediation*, forthcoming in Deborah DeMott & Tan Cheng-Han, eds., *RESEARCH HANDBOOK ON AGENCY AND INTERMEDIATION* (Edward Elgar 2025).

provision or re-framing of information; (3) cooling-off periods; and (4) limiting consumer choices.”¹¹¹

Scholars have also examined the regulation of algorithmic harms in consumer markets.¹¹² It is contested the extent to which these conflicts should be handled through disclosure as compared to elimination, a topic discussed more below. Bar-Gill, Sunstein, and Talgam-Cohen (2023), for example, argue for disclosure as a response to algorithmic harm to consumers in markets where we are concerned about behavioral exploitation under information asymmetry.¹¹³

We might also be attuned to how regulation can be used to promote certain kinds of pro-social intermediation, even though this may well create new conflicts. For instance, Van Loo (2017) has argued that digital intermediaries can play an important role in protecting buyers by promoting better choice in markets with information asymmetry and ineffective disclosure.¹¹⁴ One tool, then, might be to think of data analytics vendors or contract counterparties as a new subject of regulatory concern in securities markets.¹¹⁵

There may also be existing toolkits that can be repurposed to meet challenges posed by new technologies.¹¹⁶ For instance, in parallel with rulemaking efforts, SEC has begun to look to existing fiduciary duty frameworks that might capture some conflicts of interest in the use of data analytics technology.¹¹⁷

After discussing the SEC’s rule proposal, we’ll revisit some of these toolkits in Part III.

¹¹¹ Colin Camerer, Samuel Issacharoff, George Loewenstein, Ted O’Donoghue & Matthew Rabin, *Regulation for Conservatives: Behavioral Economics and the Case for “Asymmetric Paternalism,”* 151 U. PA. L. REV. 1211, 1224 (2003).

¹¹² See, e.g., Matthew R. Gaske, *Regulation Priorities for Artificial Intelligence Foundation Models*, 26 VAND. J. ENT. & TECH. L. 1 (2023); Gerhard Wagner & Horst Eidenmuller, *Down by Algorithms: Siphoning Rents, Exploiting Biases, and Shaping Preferences: Regulating the Dark Side of Personalized Transactions*, 86 U. CHI. L. REV. 581 (2019); Ryan Calo, *Artificial Intelligence Policy: A Primer and Roadmap*, 51 U.C. DAVIS L. REV. 399 (2017).

¹¹³ See Oren Bar-Gill, Cass R. Sunstein, and Inbal Talgam-Cohen, *Algorithmic Harm in Consumer Markets* (2023); see *infra* Part III.A.

¹¹⁴ Van Loo, *supra* note 61.

¹¹⁵ Cf., e.g., Kristin N. Johnson, *Automating the Risk of Bias*, 87 GEO. WASH. L. REV. 1214, 1261 (2019).

¹¹⁶ See, e.g., Iris H-Y Chiu & Ernest WK Lim, *Technology vs Ideology: How Far Will Artificial Intelligence and Distributed Ledger Technology Transform Corporate Governance and Business?*, 18 BERKELEY BUS. L.J. 1, 50 (2021) (suggesting why the conflicts of interest that arise from corporate use of AI reflect human inputs and needs, and thus center “the human-centeredness of ... liability regime[s]”).

¹¹⁷ See *infra* note 269; Richard Vanderford, *SEC Probes Investment Advisers’ Use of AI*, WALL ST. J. (Dec. 10, 2023).

2. Background on SEC rulemaking approaches

The SEC pursues its mission mainly under the authority of enabling statutes like the Exchange Act and Advisers Act, which provide the foundational legal frameworks within which the SEC operates. Its rulemaking process reflects the authority granted in these statutes, which typically are framed in terms of authorizing the agency to promulgate rules that are appropriate for protecting investors and serving the public interest. In doing so, the SEC must “consider, in addition to the protection of investors, whether the action will promote” other statutory policies sought to be served in the public interest, such as “efficiency, competition, and capital formation.”¹¹⁸ Securities law thus has a multipolar orientation toward a number of potentially incommensurable goals to be traded off in regulating financial advice.¹¹⁹

Courts have interpreted this mandate as compelling the SEC to evaluate the broader economic implications of its rules and to strive for regulations that optimize among this multipolar set of policies.¹²⁰ In cases like *Chamber of Commerce v. SEC* (2005) and *Business Roundtable v. SEC* (2011), the D.C. Circuit has required the SEC to engage in cost-benefit analysis in its rulemaking, underscoring the need for rigorous analysis of economic impacts of its rules, including a detailed assessment of the potential costs and benefits. Though really a matter of judicial gloss rather than statutory text, according to the D.C. Circuit the SEC has a “statutory obligation to determine as best it can the economic implications of the rule it has proposed.”¹²¹

This requirement has significantly shaped the direction of SEC rulemaking, embedding an economic efficiency criterion in the evaluation of proposed regulations.¹²² The current vision and practice of cost-benefit analysis provides a structured framework for evaluating regulatory impact. It also introduces limitations.¹²³ For instance, it may constrain the SEC’s ability to

¹¹⁸ Securities Act of 1933, § 2(b), 15 U.S.C. § 77b; Exchange Act § 3(f), 15 U.S.C. § 78c(f); see also *id.* § 23(a)(2); *id.* § 15(n)(2), 15 U.S.C. § 78o(n)(2); David S. Ruder, *Balancing Investor Protection with Capital Formation Needs after the SEC Chamber of Commerce Case*, 26 PACE L. REV. 39, 71 (2005).

¹¹⁹ Cf. Victoria, *supra* note 19.

¹²⁰ See, e.g., *Am. Equity Inv. Life Ins. Co. v. SEC*, 572 F.3d 923, 923, 935 (D.C. Cir. 2009).

¹²¹ *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005); *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); compare Dennis Kelleher, et al., *Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC: A Report from Better Markets, Inc.* *19 (Jul. 30, 2012).

¹²² See, e.g., Jerry Ellig, *Improvements in SEC Economic Analysis after Business Roundtable: A Structured Assessment*, 19 FLA. ST. U. BUS. REV. 51 (2020).

¹²³ See, e.g., Dan Awrey & Kathryn Judge, *Why Financial Regulation Keeps Falling Short*, 61 B.C. L. REV. 2295, 2318 (2020); Donna Nagy, *The Costs of Mandatory Cost-Benefit Analysis in SEC Rulemaking*, 57 ARIZ. L. REV. 129 (2015); Robert J. Jackson, Jr., *Comment: Cost-Benefit Analysis and the Courts*, 78 LAW & CONTEMP. PROBS. 55 (2015); Jill E. Fisch, *The Long Road Back: Business Roundtable and the Future of SEC Rulemaking*, 36 SEATTLE U. L. REV. 695 (2013); Bruce Kraus & Connor Raso, *Rational Boundaries for SEC Cost-Benefit Analysis*, 30 YALE

implement regulations that are more qualitative in nature or whose benefits, such as improved confidence or market integrity, are difficult to quantify.

The emphasis on cost-benefit analysis can also be seen as placing a “thumb on the scale” in favor of policies that align with a particular vision of economic efficiency, potentially in tension with investor protection or market fairness.¹²⁴ Problems with this approach are well known, to the extent they promote a narrow framing of the “public interest” that prioritizes measurable economic factors over less tangible, but equally important, benefits.¹²⁵ Gordon (2014) notes financial regulation affects the design of the system that generates costs and benefits to be assessed, complicating the analysis. The better solution, he says, is to think of it as a problem of navigating tradeoffs informed by normative priors.¹²⁶

After *Business Roundtable*, the formalized economic analysis in-house by creating a Division of Economic Risk and Analysis staffed with economists, often on loan from academia. Its rule-makings now typically include extensive discussion of the economic effects of rules.¹²⁷ Among other things, the SEC has to “compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule.”¹²⁸ In addition, the SEC has also adopted a framework for economic analysis in rulemakings that prioritizes the *Business Roundtable* mandate.

This is the neoclassical vision that is hegemonic in securities market regulation, and I suggest it easily permits intervention here. The SEC is concerned with classic market failures like unpriced externalities, agency costs, conflicts of interest, and the like. Under this framework, the SEC defended its Reg BI rulemaking on economic grounds, which the Second Circuit largely accepted.¹²⁹ That financial advisers have embraced data analytics tools is not an excuse, the SEC is

J. ON REG. 289 (2013); James D. Cox & Benjamin J.C. Baucom, *The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority*, 90 TEX. L. REV. 1811 (2012).

¹²⁴ See, e.g., Steven L. Schwarcz & Theodore L. Leonhardt, *Lawmaking Without Law: How Overreliance on Economics Fails Financial Regulation (and What to Do About It)*, 71 AM. U. L. REV. 2111 (2022).

¹²⁵ See, e.g., Luke Herrine, *Reporting Live! At the Nexus of Antitrust & Consumer Protection*, 2023 UTAH L. REV. 849, 853 (2023).

¹²⁶ See Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEG. STUD. S2 (2014); cf. Carliss Chatman & Tammi S. Etheridge, *Federalizing Caremark*, 70 UCLA L. REV. 908, 920–21 (2023).

¹²⁷ See, e.g., Ellig, *supra* note 122. Though Commissioners and industry participants have recently complained both that economic analysis is looking increasingly speculative, and that it is making many interventions in market structure at once, making it hard to disentangle the economic effects of these rules.

¹²⁸ Memorandum from the SEC's Division of Risk, Strategy, and Financial Innovation and the Office of General Counsel to the Staff of the Rulemaking Divisions and Offices (Mar. 16, 2012).

¹²⁹ Reg BI Adopting Release, *supra* note 91, at 33,373–96; XY Planning Network, LLC v. SEC, 963 F.3d 244, 256 (2d Cir. 2020); see Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations-Laying the Groundwork for the Next Financial Crisis*, 13 DREXEL L. REV. 377, 425–26 (2021) (faulting the SEC and XY Planning Network for this analysis).

now suggesting with this rulemaking, to ignore conflicts of interest that intentionally or unintentionally arise in the provision of technologically mediated financial advice. The SEC’s justification for doing so here is a classic agency cost story:

“These conflicts of interest are exacerbated by firms’ use of certain covered technologies because the technologies that firms use may be complex and opaque to investors, who may not have the knowledge or time to understand how firms’ use of these technologies may generate conflicts of interest in their interactions with investors. If these conflicts of interest were left unaddressed, investors could be harmed by less efficient investment strategies and incur agency costs. This could also adversely affect the formation of capital, as investors might choose to invest less or might lose confidence in capital markets.”¹³⁰

Regulatory intervention may well be needed, the SEC concluded, to address the “negative externalities” from the use of covered technologies for “markets more broadly.”¹³¹

3. The specific question of statutory authority

This subsection argues that Congress has sufficiently clearly authorized the SEC to adopt the proposed analytics rules as a method of reducing agency costs in retail investor markets. Contrary to the claims of some commentators, Congress contemplated that something beyond the regulatory baseline might be needed, and that the SEC’s study of retail financial markets might uncover other targeted conflicts of interest that might need to be addressed through rulemaking; that is what the PDA rules would do. Though this is the best reading of the relevant statutes, the critics may be right that a court will not buy it—to which I return in Part IV.C.

Before setting out the primary doctrinal criticisms, recall that Exchange Act § 15 and Advisers Act § 211 direct the SEC undertake a study and rulemaking about harmonizing standards of conduct.¹³² Congress also authorized the SEC to examine—and regulate through prohibition or restriction—“certain” other conflicts of interest.¹³³ With this background, let’s turn to the *three* primary arguments about the statute, relating to scope, disclosure, and subsection title.

¹³⁰ Data Analytics Proposal, *supra* note 9, at *148-49.

¹³¹ *Id.* at *153, 181.

¹³² See *supra* note 81-83.

¹³³ In this section, for brevity and to match the analysis, I’m going to use Advisers Act § 211(h)(2) to refer to both itself and to Exchange Act § 15(l)(2), which is substantively identical. See *supra* notes 84-86; Comment Letter of Andrew Vollmer (Sept. 29, 2023) (noting the “identical text” and that he’d refer to both as § 211(h)(2) “for simplicity”).

First, consider the scope criticism as articulated by Vollmer (2023), a former SEC general counsel, in a position paper for conservative think tank the Mercatus Center.¹³⁴ Like other commentators, Vollmer faults the SEC for “ignor[ing] the statutory limitations and treat[ing] the subsection as free-standing authority” to remake the retail financial advisory industry.¹³⁵ Citing a structural distinction between the “harmonization” or “best interest” authority in § 211(g) and the “other matters” authority in § 211(h)(2), Vollmer says this means “the SEC was first to address the major issues of the standards of conduct of BDs and IAs under section 211(g) and then ‘examine’ [certain] other conflicts, ... [which] naturally means less than” what they were authorized to do in the “best interest” rulemaking. In this view, Congress was worried about standards of conduct for “recommendations” and “advice” to “retail customers”; anything more would be impermissible.¹³⁶

There’s no doubt that the regulatory baseline should inform how we understand the grant of authority in § 211(h)(2). But I draw the opposite conclusion, and Vollmer himself even seems to give the game away to the extent he concedes that Act § 211(h)(2) authorizes the SEC to “prohibit or restrict” conflicts of interest giving rise to harms to investors if they were “not already addressed and could not be addressed through disclosure.”¹³⁷

If this is correct, then it is unclear why § 211(h)(2)’s scope would not extend to conflicts in the use of covered technologies in investor interactions. The SEC’s approach here concludes categorically that disclosure is inappropriate in this context, and that prohibitions or restrictions of conflicts of interest not already captured by a “recommendation” rule were necessary for investor protection. The main difference is how we read “certain” in § 211(h)(2)’s authorization to regulate “certain” conflicts of interest. Vollmer argues the “natural[.]” implication is to limit the scope of the conflicts the SEC can target to “exceptional” harms not already addressed.¹³⁸ This argument assumes that the PDA rule’s subject matter can’t fit within the word “certain,” which seems dubious given the expansive scope the term can include. It can refer both to the process by which knowledge about the world becomes more fixed or definite (such as through notice and comment), and also mean fewer than all conflicts.¹³⁹ In this respect, the SEC’s recent

¹³⁴ See, e.g., Vollmer, *supra* note 133. A large number of other comment letters repeat this claim. See, e.g., Comment Letter of Jay Knight for the ABA Business Law Section Federal Regulation of Securities Committee (Oct. 10, 2023); Comment Letter of Robinhood Financial (Oct. 2023).

¹³⁵ Vollmer, *supra* note 133.

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ See Oxford English Dictionary (“certain”); see, e.g., *El Al Israel Airlines, Ltd. v. Tsui Yan Tseng*, 525 U.S. 155, 173 (1999) (“Inclusion of the word ‘certain’ in the [Warsaw] Convention’s title . . . accurately indicated that the [C]onvention is concerned with

private fund advisers rule contemplated that “certain” in § 211(h)(2) means not all conflicts “but rather only those that, after examination, the Commission deems contrary to the public interest and the protection of investors.”¹⁴⁰

What’s more, the argument appears grounded in the conviction that Congress in Dodd-Frank didn’t have in mind that the SEC would pursue data analytics conflicts of interest this way, and wouldn’t have authorized it had they known what was coming down the pike.¹⁴¹ This speculation about a past coalition’s supposedly deregulatory purposes isn’t particularly convincing, given the statutory text. Who’s to say whether we’re still “all textualists now”?¹⁴²

Second, there’s the argument that the SEC is constrained not to pursue any regulatory approach other than disclosure here. Though it’s incorrect, it’s easy to see the superficial allure of this argument. Disclosure is the canonical intervention in the securities laws.¹⁴³ Commentators have come up with several candidate justifications for this argument that are more or less plausible.¹⁴⁴ But the answer is no; agencies can change their minds, if done right and if not constrained by statutory text (as it is not here).¹⁴⁵

It is worth looking closely at the pair of sentences, § 211(h)(1) and (2), as together they falsify claims that Congress has mandated a pure disclosure approach with respect to retail financial advice. Advisers Act § 211(h)(1) directs the SEC to “facilitate the provision of simple and clear disclosures,” including with respect to “material conflicts of interest.” But that doesn’t mean

certain rules only, not with all the rules relating to international carriage by air”); *In re Min. Lac. Paint*, 17 F. Supp. 1, 2 (E.D. Pa. 1936), *aff’d sub nom. Salkind v. Dubois*, 105 F.2d 640 (3d Cir. 1937).

¹⁴⁰ Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63,206, 63,216 (Sept. 14, 2023). Contrary to claims that the proposed rule would ban all conflicts, it’s only those associated with investor interactions using covered technology.

¹⁴¹ Vollmer, *supra* note 134, at 2.

¹⁴² Cf. Kevin Tobia, *We’re Not All Textualists Now*, — NYU Ann. Surv. Am. L. —, at *1 (2023) (describing Justice Elena Kagan’s announcement and later rescission of the notion that “we’re all textualists now,” and assessing the textualist tradition’s fair-weather friends); cf. Vollmer, *supra* note 134, at 3 (looking to “history, structure, and context”).

¹⁴³ See *infra* note 188.

¹⁴⁴ See, e.g., WilmerHale Comment Letter for Broker-Dealer Clients, at *8-10 (Oct. 10, 2023) (implying that Sarbanes-Oxley’s statutory directives about disclosure with respect to research-related conflicts somehow limit later-enacted statutory authority); AIMA Comment Letter, at *8 (Oct. 10, 2023) (complaining that “the proposal overrides existing rules”); Investment Adviser Association Comment Letter at *7-11 (Oct. 10, 2023) (“IAA Comment Letter”).

¹⁴⁵ See *Nat’l Cable & Telecommunications Ass’n v. F.C.C.*, 567 F.3d 659, 667 (D.C. Cir. 2009) (“an agency is free to change its mind so long as it supplies ‘a reasoned analysis,’ showing that ‘prior policies and standards are being deliberately changed, not casually ignored”); *Everytown for Gun Safety Support Fund v. Bureau of Alcohol, Tobacco, Firearms & Explosives*, 984 F.3d 30, 34 (2d Cir. 2020) (“An earlier-enacted statutory requirement cannot prevent the ‘plain import’ or ‘fair implication’ of a later-enacted statute from taking effect.”).

the SEC can *only* use disclosure; nothing in the securities laws requires it to adopt a disclosure-only approach here. In fact, the very next sentence, Advisers Act § 211(h)(2), provides that after promoting disclosure, the SEC may also (“and”) “promulgate rules prohibiting or restricting certain ... conflicts of interest.”

The SEC took this approach in its best-interest regulations, in small measure. Reg BI largely adopts a “disclose or eliminate” regime, but requires firms to “identify and eliminate” certain conflicts related to “sales contests, sales quotas, bonuses, and non-cash compensation” based on transactions in securities “within a limited period of time.” The SEC deemed these conflicts to be “in direct opposition to our goal of reducing the effect of conflicts of interest,” unable to be mitigated, and thus “should be eliminated.”¹⁴⁶

Third, and finally, there’s the objection that the Commission cannot exercise its explicit statutory authority because it is enumerated in a section called “other matters.” Besides Vollmer, other special-interest group commenters have urged that this should constrain the scope of Advisers Act § 211(h)(2).¹⁴⁷ In this view, the enabling authority should be viewed as subordinate to the scope of the “best interest” rulemaking. The relevant doctrinal rule is that “the title of a statute and the heading of a section are tools available for the resolution of a doubt about the meaning of a statute,” but that “a title will not ... override the plain words of a statute.”¹⁴⁸

C. The SEC’s rule proposal

The SEC adopted the data analytics rule proposal on July 26, 2023.¹⁴⁹ Chair Gensler and Democratic Commissioners Caroline Crenshaw and Jaime Lizárraga voted for the proposal, with Republican Commissioners Hester Peirce and Mark Uyeda voting against it.

Reaction from the financial industry has been widely negative.¹⁵⁰ From a regulatory perspective it is light touch—neither banning nor prescribing the use of these technologies, but drawing firms’ awareness to potential conflicts of interest with respect to their use.¹⁵¹ The rule centers on interrelated concepts that are worth discussing at the outset: recognizing that financial advisers’ use or potential use of (1) “covered technologies” in (2) “investor interactions” can (3)

¹⁴⁶ Reg BI Adopting Release, *supra* note 91, at 33,396.

¹⁴⁷ See, e.g., IAA Comment Letter, *supra* note 144.

¹⁴⁸ *Dubin v. United States*, 599 U.S. 110, 120-21 (2023).

¹⁴⁹ See Data Analytics Proposal, *supra* note 9.

¹⁵⁰ See, e.g., Jennifer Hughes, *SEC faces fierce pushback on plan to police AI investment advice*, FIN. TIMES (Nov. 8, 2023); “*This Will Be a Bashing.*” At *D.C. Gathering, Traders Unload on Gensler’s SEC*, CAPITOL ACCOUNT (Oct. 12, 2023).

¹⁵¹ See Data Analytics Proposal, *supra* note 9, at 175-76, 181-85; see also *infra* Part III.A.

give rise to conflicts of interest, the rule proposal would require broker-dealers and investment advisers (4) to adopt and implement compliance policies that “eliminate or neutralize the effect” of these conflicts of interest. By framing this around certain categories of technology that might pose conflicts of interest, the proposed rule acknowledges that these technologies can have a profound influence on investor behavior and market outcomes.¹⁵² This part addresses these four components of the rule.

1. Covered technologies

Let’s begin with the term “covered technologies.”¹⁵³ The rule proposal defines it broadly to mean 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” from investors.¹⁵⁴

In voting against the proposed rule, Commissioner Uyeda expressed concern about the scope of “covered technology.” He raised the specter that a “simple electronic calculator” or even an “abacus” could be considered a covered technology.¹⁵⁵ This feels like a joke until you remember that conflicts can arise from the tools themselves, how they are used, or the surrounding social context and circumstances. The fallacy that technological innovation will avoid conflicts of interest overlooks (or aims to insulate) conflicts at the level of the humans controlling the design, input, and implementation of these systems.¹⁵⁶

Understood this way, of course using an abacus might have human-level conflicts. Consider a vendor gift of a fancy artisanal Koa wood abacus as expensive art for a conference room; “*and where are the clients’ abacuses?*”¹⁵⁷ Less implausibly, a financial product vendor might offer “soft dollar”-like calculation tools that might make an adviser feel more obligated to favor a vendor’s products in advice due to perceived relationship or benefit received.¹⁵⁸

Returning to covered technologies, user interface and experience design also has an

¹⁵² Data Analytics Proposal, *supra* note 9, at *176-81.

¹⁵³ *Id.* at *43-50.

¹⁵⁴ *Id.* at 38, 44 (explaining proposal “encompasses design elements, features, or communications that nudge, prompt, cue, solicit, or influence investment-related behaviors or outcomes from investors”).

¹⁵⁵ See Uyeda, *infra* note 192; cf. *supra* note 38.

¹⁵⁶ Luca Enriques & Dirk A. Zetzsche, *Corporate Technologies and the Tech Nirvana Fallacy*, 72 *Hastings L.J.* 55 (2020).

¹⁵⁷ Cf. Robert F. Ferguson, *Where Are the Customers’ Yachts?*, 35 *FIN. ANAL. J.* 56, 56 (Mar.–Apr. 1979).

¹⁵⁸ One regulatory concern with “soft-dollar arrangements,” or the receipt of cross-subsidized research benefits, is that advisers may put their own interests ahead of clients’ because they are receiving some tangible research benefit the clients are paying for. See Thomas P. Lemke and Gerald T. Lins, *SOFT DOLLARS AND OTHER TRADING ACTIVITIES* § 1:4 (2023 update).

important role in shaping investor behavior, as well, such as by influencing the information environment or playing on behavioral biases. Recent studies have shown subtle but significant effects of design feature choices like color (red vs. green, associated with loss and profit), swipe vs. prompt, and the like on investor behavior.¹⁵⁹

There are other questions about scope, such as how covered technology is used in an investor interaction. The SEC's rule proposal tees up a distinction between direct and indirect uses of covered technologies, as well as between the firm's uses and its associated persons' uses.¹⁶⁰ To begin, indirect influences can be as impactful as direct ones. For instance, an AI tool might not provide explicit recommendations but might make more salient certain news articles or sentiment analysis, shaping an information environment, skewing a choice set, and altering investment decisions. Or a brokerage firm might use algorithmically generated push notifications to inform clients about market events, like greater than average volatility in one of the stocks in their portfolio.¹⁶¹

Although a more comprehensive regulatory framework would include both indirect and direct use of covered technologies, the SEC could explicitly define "indirect" uses. It might want to clarify that the concern is with the conflicts arising from use, whether direct or indirect; a conflict is no less if mediated through Google or an abacus. The concern, then, is with implementing this so as not to impede the development of tools that provide valuable information to the public about how to finance projects in the real economy and, through mechanisms of shareholder governance, "democratize" the economy.¹⁶²

2. Investor interactions

Second, "investor interactions." The proposal has an investor-protection framing that is focused on retail investors, defining the investors at issue as those who are using financial services "primarily for personal, family, or household purposes."¹⁶³ And it proposes to define an 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

¹⁵⁹ See *supra* note 44.

¹⁶⁰ Data Analytics Proposal, *supra* note 9, at § II.A.2.c.-e.

¹⁶¹ See, e.g., Langvardt & Tierney, *supra* note 17, at 727.

¹⁶² The most optimistic scholarly views in this respect hold "that dispersed retail trading, mediated by digital brokerage apps, will help overcome typical barriers to retail participation in shareholder voting and corporate governance." Tierney, *supra* note 17, at 409 (collecting literature).

¹⁶³ Data Analytics Proposal, *supra* note 9, at 53,973-76.

investor.”¹⁶⁴

The proposed rules’ definition is broader than the “retail customer” definition in Reg BI.¹⁶⁵ As the proposal explains, this “would capture firm communications that may not rise to the level of a recommendation” under Reg BI, “yet are nonetheless designed to, or have the effect of, guiding or directing investors to take an investment-related action.”¹⁶⁶ There are open and contested questions about whether the rules would apply only to the “retail customers” at issue in Reg BI, or even more broadly to include other institutional clients of investment advisers and broker-dealers.¹⁶⁷

3. Eliminating or neutralizing conflicts

One hallmark of the proposed rule is a shift from Reg BI’s eliminate-or-disclose regime to an eliminate-or-neutralize regime.¹⁶⁸ Under the proposed rule, a conflict of interest would generally exist when a firm uses a covered technology that considers the firm’s or its associated persons’ interests. Firms would be required to identify such conflicts of interest and determine if these place the firm’s interest ahead of the investors’.¹⁶⁹

The regulatory inquiry does not end when a firm evaluates its uses of covered technology to identify conflicts associated with those uses. The proposed conflicts rules would also require the firm to determine whether the conflict places (or results in placing) their interests ahead of the investor’s. The proposal contemplates that this would be a facts-and-circumstances inquiry. The outcome of this determination process would then direct the firm to eliminate the conflict or neutralize its effect if it lacks a reasonable belief that the conflict won’t put the firm’s (or its associated persons’) interests first.¹⁷⁰

The generality of the requirement, as phrased, is intended to help promote a future-resistant

¹⁶⁴ *Id.* at *51.

¹⁶⁵ Compare Reg BI Adopting Release, *supra* note 91, at 33,341-45 (July 12, 2019).

¹⁶⁶ The proposal also clarifies that it would not extend to covered “technologies that are not used in [investor] interactions.” Data Analytics Proposal, *supra* note 9, at *52. The SEC cited several examples for which there is a lower risk in the firm’s use of covered technology, such as “to identify trends and make predictions related to the firm’s intra-day liquidity needs, peak liquidity demands, and working capital requirements.” *Id.*

¹⁶⁷ Because I focus on retail customers, I do not consider the SEC’s request for comment on whether the definition should cover all types of investors, including institutional clients of registered investment advisers.

¹⁶⁸ See Reg BI Adopting Release, *supra* note 91, at *61-97. Cf. Aaron A. Dhir, Sarah Kaplan & Maria Arabella Robles, *Corporate Governance and Gender Equality: A Study of Comply-or-Explain Disclosure Regulation*, 46 SEATTLE U. L. REV. 523 (2023) (discussing adjacent framework of comply-or-explain disclosures).

¹⁶⁹ Data Analytics Proposal, *supra* note 9, at 53,982.

¹⁷⁰ *Id.* at 53,983.

(if not future-proof) regulatory framework.¹⁷¹ The principle that financial advisers should not prioritize their interests over investors is timeless.¹⁷² To the extent that principle ought to apply, it ought to do so regardless of technological advancements, some of which may enhance and others inhibit the principal-agent conflicts that will inevitably emerge in the relationship.¹⁷³ However, as new technologies emerge, there may be nuanced ways in which conflicts arise. It would be prudent for the SEC to periodically review and refine its definitions and guidance in response to these evolutions.

As it stands, Reg BI's care and conflict obligations require advisers to be aware of and manage their conflicts of interest with respect to advice and recommendations.¹⁷⁴ But the data analytics rule extends this requirement to be aware of and manage one's conflicts of interests, so as to eliminate or neutralize their effect, to the *processes* behind investor interactions. The people who run broker-dealer and investment adviser firms are imperfectly rational and may not be able to see their own conflicts here without a regulatory push.¹⁷⁵ This new regime puts firms to the choice of getting rid of a practice of using covered technology that gives rise to a conflict of interest that puts its interest ahead of the client's—or to take steps to address it, such as by “prevent[ing] it from biasing the output towards the interest of the firm or its associated persons,” such that the output does not place the firm's interest first.¹⁷⁶

Securities law *already* deems broker-dealers and investment advisers as having a conflict of

¹⁷¹ Cf. Lyria Bennett Moses, *Recurring Dilemmas: The Law's Race to Keep Up with Technological Change*, 2007 U. ILL. J.L. TECH. & POL'Y 239, 274 (developing a theory of a “future-proof” regulatory approach has to go beyond “ensuring nondiscrimination” between technologies but also “to draft rules that are unlikely to become uncertain or obsolete in new contexts”).

¹⁷² See, e.g., Laby, *Fiduciary Obligations*, *supra* note 25, at 720-23; Gregory A. Hicks, *Defining the Scope of Broker and Dealer Duties—Some Problems in Adjudicating the Responsibilities of Securities and Commodities Professionals*, 39 DEPAUL L. REV. 709, 716 n.16 (1990) (explaining that conflicts of interest “has affected federal securities regulation and generated adverse comment from its earliest days,” serving as “a major engine for reforming the practices of dealers”).

¹⁷³ See Iris H-Y Chiu, *Fintech and Disruptive Business Models in Financial Products, Intermediation and Markets - Policy Implications for Financial Regulators*, 21 J. TECH. L. & POL'Y 55, 91-92 (2016).

¹⁷⁴ See Reg BI Adopting Release, *supra* note 91, at 33,321 (describing the Compliance and Conflict of Interest Obligations).

¹⁷⁵ Cf. Roger P. Alford & James Fallows Tierney, *Moral Reasoning in International Law*, in *THE ROLE OF ETHICS IN INTERNATIONAL LAW* 1, 33-34 (Donald Earl Childress III ed., 2012) (explaining that those “that make actual decisions” for corporate entities “are people whose rational behavior is bounded by human psychology”).

¹⁷⁶ As an example of a conflict of interest arising from the use of covered technology, the SEC noted that an adviser would have to determine that its own interests were “being placed ahead of investors” if it used an algorithmic “model ... designed to screen out an investment if it would not result in a sufficient performance-based fee for the adviser despite acceptable returns for investors.” Data Analytics Proposal, *supra* note 9, at 53,984. In contrast, the SEC gave an example of an algorithm that presented “investment ideas” to a client and “does not give more prominence to the investments that provide revenue to the firm than those that do not and no one investment is being recommended.” Under those circumstances, the SEC concluded, a firm “could reasonably determine that the conflict of interest created by the algorithm considering the revenue does not require elimination or neutralization under the proposed conflicts rules.” *Id.*

interest with an investor if the firm takes into consideration its profits and revenues in providing “advice” or a “recommendation.”¹⁷⁷ As part of the regulatory baseline under Reg BI, and “[g]enerally consistent with the fiduciary duty under the Advisers Act,” the Commission has defined a conflict of interest as one that might incline a relevant person, “consciously or unconsciously[,] to make a recommendation that is not disinterested.”¹⁷⁸ Longstanding SEC precedent in enforcement proceedings likewise recognizes that a conflict can exist where a broker [or adviser] considers “economic self-interest.”¹⁷⁹ As an empirical matter, the existence of a conflict may shift advisory behavior, though its disclosure may not.¹⁸⁰

How do you neutralize a conflict that would otherwise put your own interest ahead of the customer’s?¹⁸¹ One approach might come from the European Commission, which as part of the 2023 Retail Investment Strategy plans to get rid of the existing “quality enhancement” test under MiFID II and replace it with a mandate to recommend a suitable range and the least cost option within it, as well as one at least one other option to permit comparison.¹⁸²

The Commission should not treat lightly the distinction between direct and indirect action here. A data analytics rule that applies the conflicts rules to these indirect outcomes and consequences would be essential for ensuring fair play and investor protection. In both direct and indirect scenarios, there may be a misalignment between the adviser’s interest and the client’s best interest. An expanded determination requirement that encompasses a wider range of legal and ethical considerations would strengthen the rule’s overall impact.

One final matter. There may be some inherent difficulty in identifying an investor’s “interests,” which creates some slack for a test that is measured by mis-alignment of the investor’s and adviser’s interests.¹⁸³ In related contexts, agencies like the Department of Labor have been

¹⁷⁷ Compare *id.* at 53,982.

¹⁷⁸ Reg BI Adopting Release, *supra* note 91, at 33,347; see also *id.* at 33,327 at n.74.

¹⁷⁹ *RichMark Capital Corp.*, Exchange Act Release No. 48758, 2003 WL 22570712, at *3 (Nov. 7, 2003) (requiring that a broker-dealer in making a recommendation “must disclose material adverse facts of which it is aware,” including any “economic self-interest that could have influenced its recommendation”).

¹⁸⁰ See *infra* note 201.

¹⁸¹ See also *infra* notes 300-301.

¹⁸² Giovanni Campi & Edoardo Crosetto, *European Commission Adopts Retail Investment Strategy Package With The Aim To Enhance Investor Protection*, K&L Gates (June 16, 2023), <https://www.klgates.com/European-Commission-Adopts-Retail-Investment-Strategy-Package-with-the-Aim-to-Enhance-Investor-Protection-6-16-2023>.

¹⁸³ See, e.g., Tierney, *supra* note 17, at 410 n.226 (explaining that each person’s “individual utility function reflects ... preferences with respect to stakeholder issues” other than strict wealth maximization). For additional perspectives on defining shareholders’ range of acceptable interests here, see Quinn Curtis, Jill Fisch & Adriana Z. Robertson, *Do ESG Mutual Funds Deliver on Their Promises?*, 120 MICH. L. REV. 393 (2022); Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience:*

the site of contestation about whether to hardwire a definition of investor interest, such as meaning strict wealth maximization.¹⁸⁴ Revealed preferences among investors suggest that they may value and have an interest in factors or considerations that go beyond wealth maximization in a narrow sense.

4. Compliance obligations and regulatory technique

In addition to these conflicts rules, the proposal also would require firms to “adopt, implement, and, in the case of broker-dealers, maintain, written policies and procedures reasonably designed to achieve compliance with the proposed conflicts rules.”¹⁸⁵ This would include a description of the process for evaluating any use of a covered technology and for determining how to eliminate or neutralize any conflicts of interest.¹⁸⁶ Finally, firms would be required to maintain records related to the requirements of the proposed rules.¹⁸⁷

Broker-dealers and investment advisers are already required to have policies and procedures in place to ensure compliance with various regulations. Firms’ compliance with these regulatory requirements is likely to contribute to compliance with the proposed conflicts rules, and vice versa. Firms have incentives to have robust mechanisms in place already to identify and manage conflicts of interest. Part IV.A returns to discuss other implications of regulatory technique and to situate it within the New Governance literature.

III. Assessing the Data Analytics Rule Proposal

This Part addresses three important theoretical matters in how to regulate conflicts of interest in retail adviser markets. First, the proposal reflects a shift away from disclosure as the main regulatory intervention in this space. Second, one view of the problem sees a social-welfare and justification for regulatory intervention to tamp down on these conflicts of interest. Third, contrary to suggestions that the SEC should scrap the rule, this Part offers suggestions on how to better tailor the proposal to the categories of regulatory risk posed by different kinds of data analytics functions.

The Law and Economics of ESG Investing by a Trustee, 72 STAN. L. REV. 381 (2020); Ann M. Lipton, *What We Talk about When We Talk about Shareholder Primacy*, 69 CASE W. RES. L. REV. 863 (2019); LYNN STOUT, *THE SHAREHOLDER VALUE MYTH* 11 (2012).

¹⁸⁴ Contrast U.S. Dep’t of Labor, *Financial Factors in Selecting Plan Investments*, 85 Fed. Reg. 72,846, 72,846 (Nov. 13, 2020) (“A fiduciary’s evaluation of an investment or investment course of action must be based solely on pecuniary factors . . .”).

¹⁸⁵ Data Analytics Proposal, *supra* note 9, at 114.

¹⁸⁶ *Id.* at 114-36.

¹⁸⁷ *Id.* at 137-44.

A. The regulatory turn away from disclosure

The most notable features of the proposed rule is its turn away from disclosure. Disclosure is a fundamental technique in securities regulation and often a first-choice solution.¹⁸⁸ Many doctrines in this area reflect policy judgments favoring disclosure, thought to act through “market” solutions by shaping participant behavior. For instance, the best interest rulemaking package included a disclosure mandate under which broker-dealers and advisers must deliver Form CRS (Customer Relationship Summary), a supposedly plain-English description meant to be a “conversation starter” about how advisers get paid.¹⁸⁹ This disclosure mandate was based on the supposition that disclosure might reduce information asymmetries between advisers and clients, allowing them to “make more informed investment decisions, or ... to critically evaluate any investment advice they receive.”¹⁹⁰ To this end, the disclosure obligation requires timely delivery of Form CRS as well as the disclosure of any other conflicts of interest material to the transaction.¹⁹¹ Several Commissioners and many commenters have urged that disclosure might be a more appropriate alternative here, too.¹⁹²

The rule proposal suggests full and fair disclosure is tricky in markets for retail financial advice, and market- or reputation-based mechanisms may well be ineffective. This is a marked shift from Form CRS, as to which the SEC said it did “not share the view” of commenters who “questioned the general efficacy of disclosure in the context of investment advice to retail investors.”¹⁹³ Here, by contrast, the SEC has largely rejected calls to deal with the problem using disclosure, finding the disclosure mechanism unlikely to be effective.¹⁹⁴ This seems right: as we’ll

¹⁸⁸ See, e.g., Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1043 (2009); see also, e.g., Comment Letter of Professors Sergio Alberto Gramitto Ricci and Christina M. Sautter, at Appendix B (Oct. 9, 2023) (Ricci and Sautter Letter) (enumerating disclosure mandates throughout the securities laws); *supra* note 144 and accompanying text.

¹⁸⁹ Final Rule, *Form CRS Relationship Summary; Amendments to Form ADV*, Exchange Act Rel. No. 86032, 84 Fed. Reg. 33,492 (July 12, 2019) (Form CRS Adopting Release).

¹⁹⁰ *Id.* at 33,596.

¹⁹¹ Reg BI Adopting Release, *supra* note 91, at 33,321.

¹⁹² See, e.g., Commissioner Hester M. Peirce, Speech, *Through the Looking Glass: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers Proposal* (July 26, 2023) (noting that the proposed rule “rejects one of [the SEC’s] primary regulatory tools—disclosure”); Commissioner Mark T. Uyeda, Speech, *Statement on the Proposals re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers* (July 26, 2023); see also, e.g., Comment Letter of the Managed Funds Association 3-5 (Oct. 10, 2023); compare Data Analytics Proposal, *supra* note 9, at 53,967 (describing difficulties with disclosure in this context).

¹⁹³ Form CRS Adopting Release, *supra* note 189, at 33,579; Tierney & Edwards, *supra* note 89, at *9-10.

¹⁹⁴ See, e.g., Data Analytics Proposal, *supra* note 9, at 54,014 (tentatively concluding that “it is not clear that prescribing a standardized disclosure would be sufficient to enable investors to provide informed consent or otherwise achieve the investor

see in a moment the idea is that disclosure will not inform individual retail investors (obstructing self-help). Meanwhile, these investors cannot rely on an informationally efficient market to protect them, as they might elsewhere in capital markets.

Both the SEC's direction here, and the view of disclosure I describe, are heavily contested; securities law has long debated whether disclosure is sufficient, or whether other regulatory interventions may be needed to promote the securities laws' policy goals.¹⁹⁵ And you could even see how prior-or-just-in-time disclosure *might* make sense in the context of Reg BI, in which the trigger of a "recommendation" might be sufficiently salient to get a retail customer to sit up and take notice. But disclosure-based solutions are likely to be inadequate *here*, and regulators may well be justified in rejecting disclosure-based regulatory solutions, for several reasons.

It is worth beginning with the reasons individual retail investors aren't effective consumers of disclosures about retail financial advice, and so are unlikely to be able to engage in protective self-help.¹⁹⁶ In reality, only a small subset of investors are likely to read and comprehend these disclosures.¹⁹⁷ And that is to say nothing of firms' tendency to underproduce full and fair disclosure even when mandatory, as recent state examination sweeps of firms' Form CRS disclosure

protection goals of the proposed rules"); Yoon-Young Lee et al., *Broker-Dealers and Advisers Beware: The SEC's "PDA" Proposal Could Upend Firms' Interactions With Customers, Clients and Investors*, WilmerHale Client Alert (Aug. 17, 2023).

¹⁹⁵ See, e.g., Andrew K. Jennings, *Disclosure Procedure*, 82 MD. L. REV. 920, 922 (2023); Anita I. Krug, *Investors' Paradox*, 43 J. CORP. L. 245, 268–69 (2018) (collecting scholarship "tak[ing] the SEC's current disclosure regime to task for being a singularly inadequate mechanism for protecting investors"); Michael D. Guttentag, *Evolutionary Analysis in Law: On Disclosure Regulation*, 48 ARIZ. ST. L.J. 963, 971–81 (2016); Jeremy Burke, Angela A. Hung, Jack Clift, Steven Garber, and Joanne K. Yoong, *Impacts of Conflicts of Interest in the Financial Services Industry*, RAND Working Paper Series WR-1076 (2015); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward A More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 149–184 (2006); cf. ANDREW CROCKETT, TREVOR HARRIS, FREDERIC S. MISHKIN & EUGENE N. WHITE, *CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY: WHAT SHOULD WE DO ABOUT THEM?* 71–79 (2003).

¹⁹⁶ The volume of information that retail investors face can lead to information overload, making it difficult for them to discern the essentials. See Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003). Like consumers in other contexts, retail investors may focus on what is highly salient to them, even if it is not the most important consideration. See, e.g., John Beshears, James J. Choi, David Laibson & Brigitte C. Madrian, *Behavioral Household Finance*, in 1 HANDBOOK OF BEHAVIORAL ECONOMICS: APPLICATIONS AND FOUNDATIONS 177, 225 (B. Douglas Bernheim, Stefano DellaVigna & David Laibson eds., 2018) (collecting literature on "situations in which households have been shown to overweight salient attributes and underweight shrouded attributes"); Brad M. Barber, Terrance Odean & Lu Zheng, *Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows*, 78 J. BUS. 2095, 2098 (2005).

¹⁹⁷ See, e.g., 84 Fed. Reg. at 33,579 n. 1016 (citing pre-Form CRS "evidence suggesting investors are not reading current disclosures"); Zev T. Chabus, *Form CRS in Practice: How the SEC Fails to Protect Retail Investors*, 29 PIABA B.J. 187 (2022); Robert A. Prentice, *Moral Equilibrium: Stock Brokers and the Limits of Disclosure*, 2011 WISC. L. REV. 1059, 1070.

practices have found.¹⁹⁸

The literature on disclosure in financial advice supply additional reasons to doubt its effectiveness as a market-disciplinary mechanism.¹⁹⁹ Aside from the problem of underproduction of disclosure, several studies have shown that disclosure may counterintuitively “promote undesirable behavior by the disclosing party.”²⁰⁰ A recent experimental study involving an adviser with a conflict (transaction-based compensation for selling a vertically integrated financial product) found that disclosure did not affect the client’s behavior, such as acting on the disclosure by rejecting the recommendation.²⁰¹ In addition, some digital engagement practices are meant to act behaviorally, in ways that may not be amenable to disclosure solutions.²⁰² If most don’t read, and don’t do anything with it even if they do, the primary purpose of providing them—to inform and protect the investor—gets undermined.²⁰³

If achievable at all, full and fair disclosure and informed consent will be more difficult for retail financial advice relative to other areas of securities regulation. As I argue next, retail markets for financial markets are “inefficient.”²⁰⁴ They’re subject to different information-impoundment mechanisms than semi-strong-form efficient capital markets. Informational inefficiency here means that retail investors who don’t read disclosures aren’t going to be protected by the market mechanisms that securities regulation supposes exist to protect them in capital markets more broadly.

Those mechanisms exist in deeply liquid capital markets, not markets for financial advice.²⁰⁵ In general, securities law’s assumptions about the market mechanisms of disclosure focus on

¹⁹⁸ See, e.g., Patrick Medeo & Ronak Patel, *Regulation BI: Key Perspectives from Recent Report by State Regulators*, JDSUPRA (Sept. 22, 2023).

¹⁹⁹ See, e.g., 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 (2018); Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197 (2008).

²⁰⁰ Reg BI Adopting Release, *supra* note 86, at 33,433-34 (collecting literature); see also, e.g., Sunita Sah & Daniel Feiler, *Conflict of Interest Disclosure with High-Quality Advice: The Disclosure Penalty and the Altruistic Signal*, 26 PSYCHOL. PUB. POL’Y & L. 88 (2020).

²⁰¹ See Paul Chen & Martin Richardson, *Conflict of Interest, Disclosure and Vertical Relationships: An Experimental Analysis*, 38 ECON. PAPERS 167 (2019); see also, e.g., Stephanie Bornstein, *The Enforcement Value of Disclosure*, 72 DUKE L.J. 1771 (2023); Christopher Tarver Robertson, *Biased Advice*, 60 EMORY L.J. 653 (2011).

²⁰² Data Analytics Proposal, *supra* note 9, at 54,007.

²⁰³ This suggests some role for digital intermediaries to help process disclosures and do better by the end consumers of this information. See Van Loo, *supra* note 61; Riccardo Calcagno, Maela Giofre, & Maria Cesira Urzi-Brancati, *To Trust is Good, but to Control is Better: How Investors Discipline Financial Advisors’ Activity*, 140 J. ECON. BEHAV. & ORG. 287 (2017).

²⁰⁴ Cf. Patrick Corrigan, *Footloose with Green Shoes: Can Underwriters Profit from IPO Underpricing?*, 38 YALE J. REG. 908, 921 (2021) (identifying another example of a market “frequently derided by academics and courts alike as [informationally] ‘inefficient’”).

²⁰⁵ See, e.g., George S. Georgiev, *The SEC’s Climate Disclosure Rule: Critiquing the Critics*, 50 RUTGERS L. REC. 101, 114-20 (2022).

informationally efficient markets. There, the integrity of the price formation process is thought to protect even those who don't read the disclosures of corporate securities issuers, who "benefit" from the workings of an informationally efficient price formation process.²⁰⁶

Informational efficiency in this sense contemplates markets with sufficient liquidity and activity by informed traders to allow price discovery and the impoundment of new information.²⁰⁷ Such capital markets are characterized by their efficiency in quickly integrating publicly available information into asset prices.²⁰⁸ In such markets, discerning consumers of corporate disclosures drive price formation processes, and the logic of informationally efficient markets means non-consuming investors are protected by relying on the market price. The process of price discovery provides incentives for market participants to learn nonpublic information that has not been priced into those securities to earn profits by buying securities that are undervalued and selling those that are overvalued relative to this private information.²⁰⁹ As Lin (2015) has noted, the rise of data analytics technologies in capital markets has permitted more efficient processing of information by sophisticated investors.²¹⁰

In markets for consumer services contracts, scholars suggest that the non-reading problem can be solved if there are others on the margin who do pay attention.²¹¹ These marginal consumers might be able to exert sufficient pressure to drive bad practices out of the market. Yet if here there are too few discerning consumers on the margin who select for the disclosure—the non-

²⁰⁶ In this process, speculative traders buy or sell financial assets when their price diverges from their own private estimations of value. If the market thinks some stock is worth \$20 a share, but the market doesn't yet know important information suggesting the stock is really worth \$30, that information asymmetry can be valuable. Non-insider traders who believe they have information relevant to a price difference can try to speculate—buy low, sell high, pocket the difference—updating the price as a result to reflect the new information. *See, e.g.,* Caleb N. Griffin, *Extrinsic Value*, 75 ALABAMA L. REV. 1 (2023); *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 989 (1988).

²⁰⁷ Cf. *West v. Prudential Secs., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002) (Easterbrook, J.) (explaining that *Basic's* concept of market efficiency does not include a theory of how "prices would respond" to information that "do[es] not come to the attention of professional investors or money managers").

²⁰⁸ *See, e.g.,* Patrick M. Corrigan, *Does an initial public offering (IPO) issuer's Securities and Exchange Commission registration fee calculation method predict pricing revisions and IPO underpricing?*, 19 J. EMPIR. LEG. STUD. 1114, 1115 (Dec. 2022).

²⁰⁹ *See, e.g.,* LASSE HEJE PEDERSEN, EFFICIENTLY INEFFICIENT 40-42 (2015).

²¹⁰ Lin, *supra* note 29, at 511.

²¹¹ In the classic formulation, this is the debate about whether an informed minority will be able to police bad quality out of the market. Compare Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 638-39 (1979) (yes), with Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 22-23 (2008) (no); cf. Restatement of the Law Consumer Contracts, Reporters' Introduction, at 3 (Am. Law Inst. Discussion Draft No. 4, 2017) (explaining that for the similar non-reading problem in consumer contracting, "mandating more disclosures might 'backfire' by creating a false presumption of meaningful assent, thus undercutting the second policing technique—the ex post scrutiny of contract terms").

salient attribute of the good or service—“the market” will be ineffective at protecting the unaware consumers through disclosure.²¹²

Even if effective disclosure were achievable in the retail investor *context*, and I’d want to see the evidence,²¹³ there might be justifiable concerns about the effectiveness of disclosure about these *topics*. The traditional financial adviser interaction contemplates easy-to-understand disclosures. Modern financial instruments and strategies can be intricate, and explaining them in a simple, comprehensible manner is challenging. This complexity can reduce the efficacy of disclosures that are too technical for the average investor to understand. Some conflicts can be articulated clearly, but others will arise from within algorithmic processes that might be inherently difficult to explain. Data analytics technologies primarily relying on statistical processes might be relatively easier to explain than neural networks or other “black box” technologies.²¹⁴ Unexplainable models may have heterogeneous effects among retail investors depending on their domain experience with how automated financial advice might be constructed.²¹⁵

Iannarone (2019) argues for the deployment of data analytics technologies so “the robo-adviser learns about the investor’s baseline understanding, and provides bespoke disclosure tailored to the investor.”²¹⁶ In principle, if disclosure were effective, this would appear to be a sensible solution—though there may still be limits to the ability of even bespoke disclosure to fully and fairly inform investors of more opaque conflicts. Firms could be required to use data analytics this way as part of a disclosure regime, or there may yet be a role for digital intermediaries to offer this kind of service if disclosure is valuable to the market and not merely an escape hatch for nonsaliently capturing consumer surplus.

Finally, as discussed in Part III.C.1 below, there might be benefits to trying to categorize technologies and their related conflicts of interest into distinct classes. The Commission in adopting a final rule could remain attuned to the different susceptibility of different kinds of technology uses or interactions, and the respective conflicts of interest they implicate. For instance, straightforward conflicts where the benefit to the firm or associated person is direct and quantifiable might be effectively addressable through clear disclosure. Conflicts that are easy for laypeople to understand have traditionally been the sort of thing the securities laws have permitted

²¹² See Tierney, *supra* note 17, at 427 (“If disclosures are not salient and there are too few disclosure-reading consumers on the margin selecting on the disclosures, those consumers are unlikely to move the market.”).

²¹³ Cf. Talia B. Gillis, *Putting Disclosure to the Test: Toward Better Evidence-Based Policy*, 28 LOYOLA CONSUMER L. REV. 31 (2015).

²¹⁴ Cf. Data Analytics Proposal, *supra* note 9, at 53,977; Simon Chesterman, *Through a Glass, Darkly: Artificial Intelligence and the Problem of Opacity*, 69 AM. J. COMPAR. L. 271 (June 2021).

²¹⁵ Cf. Hui Zhu, Eva-Lotta Sallnäs Pysander & Inga-Lill Söderberg, *Not transparent and incomprehensible: A qualitative user study of an AI-empowered financial advisory system*, 7 DATA & INFO. MGMT. 100041 (Sept. 2023).

²¹⁶ Iannarone, *Rethinking*, *supra* note 18, at 443.

to be handled through disclosure. Complex, intertwined conflicts that arise from multifaceted algorithmic decisions might not be as easily understandable through disclosure alone.

B. Social welfare analysis of the SEC’s data analytics rule proposal

The SEC’s approach reflects an understanding that the potential for *unseen* and *unmanaged* conflicts of interest can be just as great, if not greater, from algorithm-driven advice as it is from human advice. This subpart argues that the proposed rule may provide an effective framework for minimizing conflicts of interest, ensuring fair treatment of retail investors, and promoting a reasonable normative vision of the good to be promoted through financial advice. The SEC is constrained in the kind of social welfare analysis that the D.C. Circuit will let it get away with.²¹⁷ In that spirit, I consider some benefits and costs of the proposed rule, recognizing that for lack of fine-grained data some of the discussion here is speculative. First, there are well-understood investor-protection and public-interest justifications for intervening here to prohibit or restrict conflicts of interest. Though many of the benefits and costs remain to be identified and quantified in the SEC’s economic analysis, in principle the rule proposal could generate significant social benefits. The proposed rule’s toughest critics have identified compliance costs as potentially significant, and these claims should be seriously addressed and distinguished from the “costs” of forgone conflicts. I consider the proposed rule’s impact on industrial policy and technological innovation.

1. Public interest justifications for market intervention

The proposed rule invokes a contested vision about the scope of permissible regulation in this space. Debates about whether relevant uses should extend to “indirect” ones, that “result in placing” the firm’s interest first, are about how far out into the chain of private ordering we wish to extend the reach of securities laws. In my view, the question is whether we are expanding out the scope of the securities laws—or protecting opportunities for advisers to hide their heads to their extended conflicts, and continue to eke out agency costs as a result.

Current practices under the regulatory baseline suggest that, contrary to the concerns of Commissioners Peirce and Uyeda,²¹⁸ the proposed rule would fill an important regulatory gap and would serve the public interest and investor protection.²¹⁹ The proposed rule extends Reg

²¹⁷ See *supra* notes 118-131 and accompanying text.

²¹⁸ See Peirce, *supra* note 192; Uyeda, *supra* note 192.

²¹⁹ Data Analytics Proposal, *supra* note 9, at 54,005 (arguing that the rule is “beneficial because [it] would apply to a broader set of investor interactions and impose express requirements to evaluate and document certain conflicts of interest and to eliminate them or neutralize their effect”).

BI's conflict and compliance obligations beyond the recommendation context, to include all sorts of ways that advisers and brokers interact with their clients and use technology to shape behavior. And likewise it mandates the adoption and implementation of written policies and procedures designed to prevent violations or achieve compliance.²²⁰

There are harms to be avoided here, at first-person and societal levels. Let's begin with first-person harms. Securities law is a kind of consumer protection for capital, and in this way reflects a distributional preference for "investor protection"—for minimizing agency costs in retail investors' relationships with their financial advisers.²²¹

The adoption of practices that encourage this kind of conflict-laden transaction should be seen presumptively as breaches of a duty of loyalty or a duty of care related to quantitative suitability. It is hard to generalize, but consider first the problem of digital engagement practices, which give rise to potential conflicts of interest about behavioral manipulation or encouraging attention-induced noise trading.²²² Some retail investors become active but uninformed "noise" traders for consumption reasons, such as because they like the rush of the trade.²²³ Others do so because they believe, falsely, that they are going to get rich through trading.²²⁴

Zooming out from that example, conflicts of interests have widely varying costly manifestations. Some of these may be conceived of as purely distributional harms that may be objectionable. In this vein, Commissioner Lizárraga said that "technology has the potential to influence investing behavior in ways that can be designed to benefit firms at the expense of investors' interests, which can raise critical investor protection issues."²²⁵ The data analytics rule may in part be a roundabout way of attacking a problem, suboptimal investment choice by or for retail investors in an information environment that may be leading them astray, in a way that Tierney

²²⁰ See generally *id.*

²²¹ James Fallows Tierney, *Reconsidering Securities Industry Bars*, 28 STAN. J. L. BUS. & FIN. — at *29-31 (forthcoming 2024).

²²² See, e.g., Alex Nekrasov, Siew Hong Teoh, & Shijia Wu, *Limited Attention and Financial Decision Making*, forthcoming in HANDBOOK OF FINANCIAL DECISION MAKING (2023); Marie-Hélène Broihanne, *Gamification and Copy Trading in Finance: An Experiment* (Nov. 2023); Taha Havakhor, Mohammad Saifur Rahman, Tianjian Zhang, & Chenqi Zhu, *Tech-Enabled Financial Data Access, Retail Investors, and Gambling-like Behavior in the Stock Market* (Oct. 2023).

²²³ See, e.g., Tierney, *supra* note 17, at 387-89 (collecting literature on how "[s]ome people indeed trade rationally because they are trying to satisfy nonpecuniary preferences for entertainment or consumption").

²²⁴ See *id.* at 399 (identifying regulatory basis for intervening with respect to retail investors' "unreflective decisions to trade too much—and to confuse 'trading' with 'investing' as the way to build wealth"). On heterogeneity among investors' and how behavior may relate to sorting into types of advisory engagement experience, see Philipp Chapkovski, Mariana Khapko & Marius Zoican, *Trading Gamification and Investor Behavior*, MGMT. SCI (forthcoming, Oct. 2, 2023).

²²⁵ Commissioner Jaime Lizárraga, Speech, *Expanding Investor Protection* (July 26, 2023), <https://www.sec.gov/news/statement/lizarraga-statement-predictive-data-analytics-072623>.

(2022) says securities law has traditionally “shown little ambition to address.”²²⁶

There are also second-order effects from conflicts of interest in the use of technology with retail investors. Conflict-shaped investor behavior can worsen market quality, as vividly illustrated by evidence that some metrics of market quality improve during shocks when retail traders unexpectedly leave the market because of outages in popular stock trading apps.²²⁷

The use of data analytics in financial advice can lead to externalities and other market failures if conflicts of interest are not properly mitigated. Edwards (2017) has shown that conflicts of interest like this “drive[] capital misallocation, causing significant macroeconomic and other harms.”²²⁸ In addition, as to digital engagement practices, Tierney (2022) has argued that “[e]ncouraging unreflective consumption of goods and services tends to distort individual decisionmaking in ways that can produce systemic harms,” including to “price discovery and capital-allocation functions.”²²⁹

Finally, distortions introduced by conflicts of interest (and redistribution of consumer surplus) can have significant long-term impacts on society more broadly, particularly given deepening retirement insecurity and persistent wealth gaps across racial, ethnic, gender, and generational lines. In a capitalist economy the effective consumption and use of financial advice is often a precondition to wealth creation, and its effective take-up may require “predictability of income and wealth, baseline financial literacy, and access to financial products with legible risk and return.”²³⁰ To say nothing of lack of wealth, those lacking financial literacy are more susceptible to the detrimental impacts of conflicted advice under a disclosure regime.²³¹ This is troubling as the long-term effects of such advice may be imperceptible to the retail investor, subtly eroding financial stability overtime. There are also issues of intersectionality, as women and minorities traditionally face higher barriers to financial literacy and wealth accumulation, and thus may be disproportionately affected. The problem of conflicted investor interactions is not just a technical concern of securities regulation but a matter of broad social equity. Effective consumer protection policy might therefore be attuned to the effects of conflicts on the

²²⁶ Tierney, *supra* note 17, at 389.

²²⁷ See, e.g., Eaton et al, *supra* note 44.

²²⁸ Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 OHIO ST. L.J. 181 (2017).

²²⁹ Tierney, *supra* note 17, at 416-17; see also Saule T. Omarova, *New Tech v. New Deal: Fintech as a Systemic Phenomenon*, 36 YALE J. ON REG. 735, 787-92 (2019).

²³⁰ Tierney, *supra* note 17, at 411-12.

²³¹ See, e.g., Lisa Fairfax, *The Securities Law Implications of Financial Literacy*, 104 VA. L. REV. 1065, 1089 (2018).

perpetuation or deepening of socioeconomic inequality.²³²

In short, prohibiting financial advisers from putting their interests first in the use of covered technology can help promote the regulatory goal that the outcomes of investor interactions are in clients' best interest.

2. Costs from forgone innovation and compliance

Regulating technology in this space may obstruct innovation or even eliminate access to low-cost financial advisory platforms on the internet.²³³ Securities regulations necessarily impose constraints on business, raising their input costs and potentially impeding the processes of innovation. The economic logic of "cost pass-through" suggests that in some circumstances the costs will be borne by end users in higher up front prices, worse service, less choice in the market, etc.²³⁴ So the more we regulate in ways that impede innovation, in this view, the worse off everyone'll be.

In this respect, Ricci and Sautter (2023) have predicted that the proposed rule "will *eliminate* the ability of retail investors to use mobile investing platforms for the purchase or sale of securities" or for other purposes related to investor "education."²³⁵ That may be undesirable if true, to the extent that retail investors face fewer transaction costs and coordination problems over the internet; their collective power in shareholder "democracy" might be harnessed in ways that have usually been hampered through collective action problems and rational apathy.²³⁶

At any rate, all sorts of regulations are opposed on grounds that they'll reduce choice and make us worse off.²³⁷ These claims are partly empirical and partly normative in the sense of weighting certain tradeoffs in policy choice; while grounded in some theoretical predictions,

²³² See *infra* note 251; see also Daniel Markovits, Barak D. Richman & Rory Van Loo, *Consumer Law as an Axis of Economic Inequality*, 102 B.U. L. REV. 1169 (2022).

²³³ Data Analytics Proposal, *supra* note 9, at 54,011 (noting that "[t]he proposed conflicts rules could negatively affect efficiency by impeding the use of technology in several ways," including "dissuad[ing] some firms from using covered technologies in investor interactions" because of "compliance costs," and reducing the rate of change in technological innovation).

²³⁴ See, e.g., Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1991).

²³⁵ Ricci and Sautter Letter, *supra* note 188, at 3 (emphasis added).

²³⁶ See, e.g., Ricci & Sautter, *supra* note 20, at 83-88; Fisch, *GameStop*, *supra* note 20, at 27-28.

²³⁷ See, e.g., Benjamin Powell, *A Case against Child Labor Prohibitions*, Cato Institute Econ. Develop. Bulletin No. 21 (July 29, 2014). For discussion of why society ought to be allowed to experiment with regulation, see Hillary Allen, *Permission to Fail*, 19 N.Y.U. J. L. & Bus. 237 (2023).

the empirical evidence remains to be shown here.²³⁸ There is no obvious reason to accept a claim that the proposed rule would “eliminate” retail access to online investing; it just as well may be offered by the market participants who are best able to offer those services having eliminated or neutralized their conflicts with respect to online investing.²³⁹

These matters also bear on whether the rule is cost justified. Implementing a data science rule would unquestionably come with costly compliance obligations, and these costs should not be understated. Commenters have criticized the proposed rule for under-counting potential costs.²⁴⁰ Still, the compliance costs we are talking about may have economies of scale with respect to the risk and complexity of a firm’s exposure to conflicts arising from data analytics, giving firms an opportunity to sort into the amount of complexity they like.

Several sources of costs are readily identifiable, as outlined in both the proposed rule as well as in several comment letters. First, there are the costs of complying with the conflicts rules’ requirement to identify and determine conflicts, such as through “code review” or “develop[ing] a testing system or engag[ing] with an independent third party.” There are also direct costs of eliminating or neutralizing conflicts, which could be simple or require “a more substantial and thus costly testing regime.” Finally, there are direct costs associated with the policies and procedures requirement and recordkeeping requirement, mainly related to recurring costs as firms conduct regular audits and ensure compliance. The SEC also identified several categories of indirect costs, which it acknowledged might or might not be passed on to retail investors. Notably, it recognized that the effect of the rule may well be to “cause firms to lose the revenue that might have been generated by conflicts” under a “disclosure” regime.²⁴¹

It remains to be seen in the final economic analysis whether the SEC can quantify benefits of the proposed rules that outweigh credible compliance costs. As Verret (2023) has explained, the analysis contemplated by *Business Roundtable* is “focused on the market broadly and require[s] consideration of market wide consumer and producer surplus.”²⁴² The SEC has been faulted in comment letters for its estimates of per-firm burdens.²⁴³ But agency commenters have incentives to overstate the downsides of a new rule and understate its benefits. The agency’s

²³⁸ Cf. Reg BI Adopting Release, *supra* note 91, at 33,421-22 (describing mixed evidence about the effect of the DOL Fiduciary Rule on consumer choice).

²³⁹ Data Analytics Proposal, *supra* note 9, at 54,010 (noting that “which entities will bear the ultimate cost of the proposed rules” is a matter of the “relative elasticity of the demand and supply curves for the service provided by the technology”).

²⁴⁰ See, e.g., Comment Letter of David Burton, Heritage Foundation (Oct. 10, 2023).

²⁴¹ Id. at 54,010.

²⁴² J.W. Verret, *Efforts to Sue the SEC Over Broker-Inducement Regulation Unlikely to Succeed*, 17 OHIO STATE BUS. L.J. 180, 202-03 (2022) (noting, with respect to PFOF reform, that “[d]riving conflicts out of firms provides the benefit intended by the rule”).

²⁴³ See, e.g., Comment letter of Investment Company Institute (Oct. 2023); Comment letter of Robinhood Financial (Oct. 2023)..

ability to defend a rule stamping out conflicts of interest in this space may well depend on the quality of the evidence it can marshal in favor of these findings.

3. Industrial policy, technological innovation, and the goals of financial advisory regulation

There are also important questions of what securities law is trying to accomplish with tinkering in the structure of the market this way. The traditional role of (non-securities) industrial policy in securities law has often be peripheral rather than of central focus. It historically hasn't been directly engaged with the promotion or shaping of industrial sectors outside the financial industry, and in many respects has kept processes of technological innovation at arm's length.²⁴⁴ But it's hard not to engage with the problem of industrial policy in considering broader impacts of regulatory choice on economic development and innovation.

The balance between protecting investors and promoting other public interest goals often involves complex trade-offs. Some approaches aim to minimize regulatory impacts on innovation in finance.²⁴⁵ In explaining her support for the SEC's proposed rule, Commissioner Crenshaw invoked efforts at the federal level to address the "considerable promise and great risk offered by artificial intelligence."²⁴⁶ What's more, the October 2023 executive order on the development and use of artificial intelligence signals the importance, if also perhaps the lack of a unifying theory, around an approach to balancing innovation and other social welfare goals.²⁴⁷

This balancing problem means it's contested the extent to which securities regulation ought

²⁴⁴ Cf. Juan Pablo Pardo-Guerra, *where Are The Market Devices? Exploring the Links Among Regulation, Markets, and Technology at the Securities and Exchange Commission, 1935-2010*, 49 *THEORY & Soc'Y* 245, 246, 271 (2020).

²⁴⁵ See, e.g., Sofia Ranchordás, *Innovation-Friendly Regulation: The Sunset of Regulation, the Sunrise of Innovation*, 55 *JURIMETRICS* 201 (2015).

²⁴⁶ Commissioner Caroline A. Crenshaw, Speech, *Statement on Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers Proposal* (July 26, 2023), <https://www.sec.gov/news/statement/crenshaw-statement-predictive-data-analytics-072623>.

²⁴⁷ In October 2023, President Joe Biden issued Executive Order 14110 on the development and use of artificial intelligence. Among other priorities, EO 14110 identified the need to protect "interests of Americans who increasingly use, interact with, or purchase AI and AI-enabled products in their daily lives." It also noted that "hard-won consumer protections are more important than ever in moments of technological change." Executive Order 14110, *The Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence* (Oct. 30, 2023). For discussion of the order, see John Mark Newman, Veena Dubal, Salomé Viljoen, Ifeoma Ajunwa, Nikolas Guggenberger, Elettra Bietti, Jason Jackson, & JS Tan, *Seven Reactions to Biden's Executive Order on Artificial Intelligence*, *LPE BLOG* (Dec. 4, 2023), <https://lpeproject.org/blog/seven-reactions-to-bidens-executive-order-on-artificial-intelligence/> (especially contributions by Bietti and Guggenberger describing industrial policy and approach to "industrial organization" that contemplates "simultaneous support for permissionless innovation and for strong government intervention").

to be promoting innovation as an inherent good.²⁴⁸ Innovation is a driving force in economic growth and development. Ford (2013) has warned against a too-light approach to private sector innovation based on unchallenged assumption that it is beneficial: there is no “magical step change in regulatory technique that will harness private sector innovation without tradeoffs.”²⁴⁹ Chiu (2020), meanwhile, has suggested that “the de-personalization of the investment paradigm [has] caused lasting structural impact on the investment management industry, now characterized as short-termist and riddled with principal-agent problems.”²⁵⁰ Innovation may fit uneasily with the other policies that society might try to pursue, such as a more equitable or “democratic” distribution of resources in society.²⁵¹

How securities law mediates power relations should be an important design choice. To the extent that securities law is industrial policy, it is with respect to the workings of finance capitalism. The contestation of securities law is thus, in part, over whether it serves a function for disciplining capital in the institutional sense, ensuring it operates in a manner beneficial in “the public interest” and not just to select market participants.²⁵² Technology law scholar Frank Pasquale has suggested, consistent with this way of thinking, that finance and technology are not acoustically separated, and that “legal rules ... are in fact a prime driver of technological developments in finance.”²⁵³ Legal rules’ influence on technological innovation could be salutary.

Other sectorial efforts illustrate how to promote regulation of data analytics technologies in the common good. As Omarova (2020) has observed, “the fintech disruption invites a potentially

²⁴⁸ See, e.g., Saule T. Omarova, *Technology v Technocracy: Fintech as a Regulatory Challenge*, 6 J. FIN. REG. 75 (2020); William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167 (2018); Chris Brummer, *Disruptive Technology and Securities Regulation*, 84 Fordham Law Review 977 (2015); Zachary J. Gubler, *The Financial Innovation Process: Theory and Application*, 36 DEL. J. CORP. L. 55 (2011); Paul G. Mahoney, *Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U. L. Q. 815 (1997).

²⁴⁹ Cristie Ford, *Financial Innovation and Flexible Regulation: Destabilizing the Regulatory State*, 18 N.C. BANKING INST. 27, 31-33, 38 (Nov. 2013) (“the regulation of financial sector innovation in recent years in no way counts as successful if what we care about is transparency, accountability, or the bending of the arc of private innovation toward greater social benefit than the market can produce on its own”); see also, e.g., Chiu, *supra* note 173, at 60. For additional perspective on this point, see Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235 (2019); Christopher G. Bradley, *FinTech’s Double Edges*, 93 CHI.-KENT L. REV. 61 (2018).

²⁵⁰ Chiu, *supra* note 173.

²⁵¹ Firms in a capitalist economy pursue projects that increase return on invested capital, and have an incentive to tie development of innovative projects to that drive for return. If these returns exceed the growth rate of the economy, securities law regulations designed to expand “opportunity” for investment may actually reinforce existing distributional inequalities. Emily Winston, *Unequal Investment: A Regulatory Case Study*, 107 CORNELL L. REV. 781, 831-44 (2022).

²⁵² See *infra* notes 317-318.

²⁵³ Frank Pasquale, *Law’s Acceleration of Finance: Redefining the Problem of High-Frequency Trading*, 36 CARDOZO L. REV. 2085, 2086 (2015).

decisive shift in the inherently unstable public-private balance in modern finance.”²⁵⁴ This offers a framework for thinking about fintech regulatory interventions: the data analytics approach may look like Omarova’s “accommodative” approach, responding to market-led interventions to address concrete harms without necessarily impeding innovation itself.²⁵⁵

Technology-regulation scholars have warned against subject matter specific attempts to intervene in ways that may be less flexible or impede cross-sectorial innovation and economic opportunity.²⁵⁶ If there were ever a context, however, in which regulatory intervention were appropriate on a subject-matter-specific and cohesive area of law, “fintech” regulation might well be it.²⁵⁷ Securities law ought not be oblivious to effects on innovation. But it also need not prioritize innovation at the expense of other core objectives, especially if regulation is to serve the goals of the real economy and not simply the financialized economy.²⁵⁸

C. Alternative approaches

The SEC is certain to tinker with the proposed rule, and so further doctrinal modifications to the regulatory framework are likely. Although I have taken the position in this article that it is in the public interest to adopt robust and effective regulation of conflicts of interest in the use of technology by financial advisers, there may be adjustments in the regulatory framework that could better accommodate countervailing concerns while still promoting the underlying policy goals. In this section, I first identify a number of doctrinal tweaks that might be made to the existing proposed framework, then consider several alternative approaches to the problem that I suggest are inferior to the SEC’s proposed approach.

1. Tailoring rules to categories of technology and their agency-cost risk

In this subsection, I suggest the SEC consider adopting different regulatory techniques for different categories of covered technology, based on their impact and function in the advisory

²⁵⁴ Omarova, *supra* note 88, at 31.

²⁵⁵ *See id.* (warning “this approach is likely to solidify private market actors’ control over both technology and finance”).

²⁵⁶ *See, e.g.*, Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 255-69 (2018) (describing impediments to effectively regulating fintech from the wide distribution of tech-relevant competition authority across multiple regulators).

²⁵⁷ *See, e.g.*, Magnuson, *supra* note 74, at 341 (“Financial regulators are well-placed to deal with artificial financial intelligence because they have a wide array of laws and regulations covering the relevant behaviors—ensuring fairness, promoting efficiency, and protecting stability.”); *cf.* Omarova, *supra* note 88, at 53 (urging “the importance of developing a normatively unified and coherent strategy of fintech regulation, which would seek—explicitly and systematically—to support and harness the power of technology in the public’s interest”).

²⁵⁸ *Cf.* Aaron Benanav, *A Dissipating Glut?* NEW LEFT REVIEW (Mar/June 2023).

process: direct advisory technologies, indirect influence tools, and support technologies.²⁵⁹ Each category necessitates a tailored regulatory approach to ensure compliance and manage conflicts of interest while being practical and adaptable to the evolving nature of financial technologies.

Consider *direct advisory technologies* first. These provide explicit investment advice or recommendations, manage portfolios, or otherwise are directly provided to or consumed by end users. Examples might include robo-advisers, algorithmic trading platforms, and advanced portfolio management software. These technologies directly influence investment decisions and outcomes, and potentially may do so in ways that are scalable. The direct impact of these technologies on investment decisions makes them highly susceptible to conflicts of interest, particularly when they are programmed to favor certain investments that may benefit the advisory firm financially.

By the same token, direct advisory technologies are potentially most susceptible to effective disclosure of any of the categories discussed here. To the extent the SEC were to contemplate disclosure regulation, it might require detailed disclosure about how these technologies operate, the criteria they use for building models, the existence of conflicts of interest, and any potential biases built into their algorithms. Where the SEC concludes—as it seems to have here, as a programmatic matter—that disclosure is unlikely to be effective, prohibitions or restrictions might well be necessary and appropriate for certain types of data analytics technologies that could lead to the provision of conflicted advice.

Second, *indirect influence tools* might be understood as those technologies that subtly shape investment behaviors in ways that are less transparent and less subject to disclosure- or market-based mechanisms of control. It could include digital engagement practices, like push notifications or user interface design features, that shape the information environment available to retail customers in making self-guided investment decisions. To this point, Langevoort (1985) asked why pure “transmission of solely historical or factual data,” *without* any “judgments about the value of particular securities or types of securities[,] should ever qualify as an investment advisory activity,” given the Adviser’s Act’s concern for “a conflict of interest that could lead the supplier to arrange the information in a manner calculated to serve an objective other than the client’s welfare.”²⁶⁰ The inverse implication, to my reading, is that indirect-influence data analytics technologies may well arrange information environments in this way, triggering

²⁵⁹ See also, e.g., Novick et al., *supra* note 50 (distinguishing user experience, operational efficiency, and investment process uses of these technologies).

²⁶⁰ Donald C. Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747, 797-98 (1985) (suggesting a framework for thinking about when information environment design might be “advice”).

fiduciary duties under federal and state law, as well as other best-interest obligations.

Regulation of these tools might address both the existence of conflicts as well as the integrity of the data used in shaping investor behavior. Consider, in this regard, the concern that digital engagement practices are used to promote the amount of time a user spends engaging with a stock trading app, or are used to steer customers into trading noisily in the stock of some security for reasons other than fundamentals. The traditional concern is that a broker-dealer offering zero-commission trades must be cross-subsidizing from some other revenue source, which may include payment for order flow—a kind of kickback from other market participants who want the opportunity to take the other side of a retail investor’s order.

Intervening against indirect influence tools might take the form of restricting or prohibiting these conflicts of interest. This is both more politically salable as well as presents less litigation risk than alternative approaches, such as “confetti regulation,” or the command-and-control regulation by the SEC or FINRA of the user-interface and -experience design features that investment products for retail customers must or must not have.²⁶¹ As a practical matter, however, the SEC historically has not shown much appetite for prohibiting entirely practices such as payment for order flow, though in recent equity market structure reform proposals it has taken some steps in that direction.²⁶² Understood broadly as a category, however, you could see how the Commission could determine that this kind of thing is not really susceptible to effective disclosure- or market-based solutions.²⁶³

Finally, with respect to *support technologies*, the Commission might begin by taking a relatively hands-off approach. Support technologies refer to tools used for administrative tasks with more attenuated effects on investment decisions or outcomes. Examples could include customer relationship management (CRM) software, compliance management systems, and automated reporting tools.²⁶⁴ While these technologies do not directly influence investment advice, they can impact the efficiency and effectiveness of advisory services. They may also include primarily administrative or ministerial functions, which the proposed rule contemplates could be subject to an exemption.²⁶⁵ Regulation in this sphere could be less stringent, focusing on data security, privacy, and accuracy. Compliance rules might include ensuring the secure handling of client

²⁶¹ See Langvardt & Tierney, *supra* note 17.

²⁶² See Proposed Rule, *Regulation Best Execution*, 88 Fed. Reg. 5,440, 5,469 (2023).

²⁶³ In addition, with respect to indirect influence tools the SEC might focus on the integrity and source of the data they use. Rules might require disclosures regarding the sources of data, the methodologies used for analysis, and any inherent limitations or biases in these tools.

²⁶⁴ Nizan Geslevich Packin, *RegTech, Compliance and Technology Judgment Rule*, 93 CHI.-KENT L. REV. 193 (2018).

²⁶⁵ Data Analytics Proposal, *supra* note 9, at 53,974–76.

data, maintaining accurate records, and transparent reporting practices.

This is just to sketch out a framework for thinking about buckets of regulatory risk. Conflicts of interest are not all alike, and the conflicts in uses of support technologies may manifest in very different ways—or not at all—with respect to investor behavior compared to conflicts in direct or indirect technologies.

2. Additional regulatory alternatives

There are a number of plausible alternative regulatory approaches. We looked at disclosure above. subpart addresses alternative approaches, in particular from the SEC Investor Advisory Committee (IAC).

Among other things, the Dodd-Frank Act created the IAC to provide targeted, high-level input from a range of public perspectives on matters before the Commission. In 2023, the IAC issued a report on the data analytics proposal, recommending that the SEC narrow its scope to conflicts in direct technology use by retail investors.²⁶⁶ The IAC raised concerns about the definitions of “covered technologies”²⁶⁷ and “conflict of interest.”²⁶⁸ Notably, the IAC argued that Reg BI’s framework is sufficient to deal with the problem of “digital engagement practices.” The IAC encouraged the SEC and FINRA to enforce existing regulations with respect to digital engagement practices that are abusive, misleading, or manipulative.²⁶⁹ They particularly suggest clarifying what constitutes a recommendation within DEPs, such as trading encouragements and margin account defaults, to ensure investor protection and compliance with Reg BI.

The IAC’s comments are well-considered, but ultimately I disagree that tinkering with the definition of “recommendation” is the most desirable solution. The point of the rulemaking to fill a regulatory gap left by a focus on “recommendations” and “advice.”²⁷⁰ These concepts are boundary markers for a familiar regulatory framework. But linking the data analytics rule to

²⁶⁶ Recommendation of the SEC Investor Advisory Committee’s Disclosure Subcommittee Regarding Digital Engagement Practices (Dec. 7, 2023) (IAC Report).

²⁶⁷ According to the IAC, “covered technologies” is defined too broadly, and compliance costs are likely to be passed on to investors, limiting access and choice. The IAC thus suggested the SEC focus on technologies like machine learning, neural networks, and the like, and incorporate well-accepted definitions of AI and predictive data analytics into the rules.

²⁶⁸ The IAC also advocated for focusing on inherently opaque and complex PDA and AI technologies, for which disclosure alone may not be sufficient. They also recommend a context-driven approach to conflicts, emphasizing instances where disclosure is insufficient and conflicts must be eliminated or mitigated.

²⁶⁹ See *id.*

²⁷⁰ See Data Analytics Proposal, *supra* note 9, at 53,975 (“The proposed definition of investor interaction would include interactions that have generally been viewed as outside the scope of ‘recommendations’ for broker-dealers.”).

these concepts leaves unremediated a wide range of conflicts arising from the use of technology that alters investor behavior. There might also be unintended consequences in tinkering with the definition of a “recommendation,” a legacy doctrinal category.²⁷¹ After all, “[i]t may not be appropriate trigger all these duties with respect to every kind of gamification feature or DEP.”²⁷² Concerns about compliance burdens thus might be no materially weaker under this scenario, for firms would still have the various Reg BI obligations (care, disclosure, compliance) with respect to any use of digital analytics technology that constitutes a recommendation.²⁷³

A second potential approach is informed by securities law’s self-regulatory tradition, which is replete with stock exchanges, clearing agencies, and other quasi-public organizations that set and enforce rules. In work on digital regulators, Van Loo (2017) likened the public-interest-inflected public-utility role of digital regulators as akin to the New York Stock Exchange.²⁷⁴ The idea is not that an SRO should govern data analytics firms,²⁷⁵ but that digital regulators can sometimes have natural monopoly-like qualities that mediate access to the financial sector. In this respect, and perhaps akin to the postal banking analogy, we might think with open texture about the potential role of a digital regulator in retail finance.²⁷⁶

IV. Implications

In this last Part, I situate the data analytics rule within the SEC’s regulatory thinking, identifying some implications for “principles-based regulation” as a tool that securities law uses to implement investor protection policy. I then address some open questions raised in the SEC’s proposal.

A. New Governance approaches to regulatory intervention

The proposed rule aligns in important respects with recent scholarly moves in the institutional design of regulation that aim for self-regulatory approaches to governance. Briefly put,

²⁷¹ Stretching the category of “recommendation” might be undesirable if we try to glom on categorical definitions, like lists of DEPs, to a category that has traditionally been “facts-and-circumstances” and evaded enumeration. Reg BI Adopting Release, *supra* note 91, at 33,335. For what would it mean to have a concept of a “recommendation” that is triggered by any kind of DEP “designed to affect investor behavior or that [has] the effect of doing so,” but with a carveout for “educational or informational DEPs”? IAC Report, *supra* note 266, at 14. Is the dopamine hit from a shower of digital confetti not “informational”?

²⁷² Tierney, *supra* note 17, at 435.

²⁷³ See *supra* note 98.

²⁷⁴ Van Loo, *supra* note 61, at 1319–21.

²⁷⁵ But *cf.* *supra* note 88.

²⁷⁶ Cf. Saule Omarova, *The National Investment Authority: A Blueprint*, Berggruen Institute (Mar. 23, 2022); K. Sabeel Rahman, *Regulating Information Infrastructure: Internet Platform as the New Public Utilities*, 2 GEO. L. TECH. REV. 234 (2018).

the “New Governance” label refers to flexible, participatory, and decentralized approaches rather than top-down regulatory interventions. New Governance-style approaches are commonplace in securities law, a field that emphasizes the role of self-regulation. This literature suggests that participatory models can lead to better compliance, elicit and leverage specialized knowledge, and promote more effective regulation.²⁷⁷ But then there are the typical concerns about self regulation: that without sufficient oversight, firms should be expected to prioritize their interests over regulatory compliance.²⁷⁸

Requirements for firms to maintain accurate books and records, develop comprehensive written supervisory procedures, and implement effective supervision systems is a manifestation of this New Governance approach. These requirements encourage firms to engage in self-monitoring and self-regulation, thereby internalizing compliance norms.²⁷⁹ This approach shifts part of the regulatory burden onto the firms themselves, making them active participants in the regulatory process. It reflects a belief that firms, when properly incentivized and guided, can effectively monitor their own behavior and take corrective actions more efficiently than external regulators alone.

Though I have characterized the proposed rule’s as consistent with the New Governance approach, critics of the rule might disagree. Many observers have faulted the proposed rule as too prescriptive; too top-heavy. Commissioner Uyeda, for instance, objected that the proposal uses “a highly prescriptive process for evaluating, testing, and documenting a firm’s use of the covered technology with respect to conflicts of interest.”²⁸⁰

I contend this objection is incorrect. The data analytics rule can best be described as taking a “principles based” and “risk based” approach, focusing on the role of supervisory procedures in shaping a firm’s awareness and management of its legal compliance obligations. The securities laws often try to shape firm behavior through books-and-records, written supervisory procedures, supervision, and similar mechanisms of promoting self-monitoring and trust-building

²⁷⁷ See, e.g., Iris H-Y Chiu, *An Institutional Theory of Corporate Regulation*, 39 *Nw. J. Int’l L. & Bus.* 85 (2019); Dan Awrey, *Regulating Financial Innovation: A More Principles-Based Proposal?*, 5 *BROOK J. CORP. FIN. & COM. L.* 273 (2011); Cristie Ford, *New Governance in the Teeth of Human Frailty: Lessons from Financial Regulation*, 2010 *WIS. L. REV.* 441 (2010).

²⁷⁸ New Governance models have been ascendant in neoliberal visions of market regulation, for they offer promising alternatives to traditional regulatory approaches. Experience teaches, however, that they require careful design and oversight so delegation doesn’t compromise the underlying public-interest regulatory goals. Saule T. Omarova, *Wall Street as a Community of Fate: Toward Financial Industry Self-Regulation*, 159 *U. PA. L. REV.* 411 (2011).

²⁷⁹ See Omarova, *supra* note 88; John Armour, Jeffrey N. Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 *YALE J. ON REG.* 1 (2020).

²⁸⁰ Uyeda, *supra* note 192.

by registrants. It calls firms' attention to the possibility of unseen conflicts of interest with respect to the use of covered technologies, and requiring them to have systems in place to neutralize or eliminate the conflicts. In this respect, the SEC seems to be betting that the proposed rules will promote a clearer understanding of conflicts on the part of registered entities and their associated persons, making it less likely that they will continue to use covered technologies in investor interactions subject to unidentified and unremediated conflicts of interest.

Far from a pedantic debate, whether the data analytics rule is "prescriptive" raises important questions about how to achieve regulatory goals while reducing compliance costs arising from unnecessary requirements unrelated to a firm's specific risks.²⁸¹ As a matter of regulatory technique, the conflicts rules combined with the policies and procedures requirement is better thought of as a kind of "principles based" or "risk based" rulemaking so often demanded by regulated industry.

This is the same approach used in other areas of law. For instance, under FINRA Rule 3310, brokerage firms must "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act ... and ... implementing regulations."²⁸² As the SEC has explained, this imposes a "risk-based approach" in which firms examine their own risks, and create an AML compliance program "appropriate for the particular broker-dealer in light of such risks."²⁸³

This is also the main framing of the recent proposed Regulation Best Execution.²⁸⁴ There is a best execution obligation, but the rubber hits the road by requiring firms to adopt and implement procedures designed to satisfy the obligation. As in the AML context and Reg Best Ex, the data analytics rule rejects a one-size-fits-all approach and requires firms to adopt and implement policies that are tailored to their specific risks. The proposal is targeted at making conflicts of interest in the use of data analytics more salient to compliance processes at firms.

To be certain, the proposed data analytics rule contemplates "minimum standards for the written descriptions and annual review that a firm's policies and procedures would need to include." But the point is to "provide firms with flexibility to determine the specific means by

²⁸¹ See Adam Fovent, *Parsing the Prescriptive Prerogative: Fiduciary and Best Interest Obligations in the Regulation of Financial Advice*, 6 BUS. & FIN. L. REV. 81 (2023); Wei Chen Lin and Dominic Saebeler, *Risk-Based v. Compliance-Based Utility Cybersecurity - A False Dichotomy*, 40 ENERGY L.J. 243 (2019).

²⁸² FINRA Rule 3310.

²⁸³ See Merrimac Corp. Secs., Exchange Act Release No. 86404, 2019 WL 3216542 (SEC July 17, 2019).

²⁸⁴ See Proposed Rule, Regulation Best Execution, Exchange Act Release No. 96496, 88 Fed. Reg. 5,440, 5455-58 (2023) (describing proposed rule 1101(a)(1)).

which they address each element, and the degree of prescriptiveness the firm includes in their policies and procedures.”²⁸⁵ They focus firms’ attention on their firm-specific risks, requiring them to take stock of where they are at and to address their own risks, rather than to fit one-size-fits-all compliance requirements as the “prescriptive” label might suggest.²⁸⁶

Principles based regulation is a mainstay of securities regulation.²⁸⁷ This approach focuses on outcomes and compliance with standards rather than with detailed, prescriptive requirements.²⁸⁸ More broadly, the choice between rules and standards (or principles-based regulation) has been a subject of extensive debate among legal scholars. It’s often framed as a trade-off between clarity and flexibility, or between ex ante precision and ex post adaptability.²⁸⁹ As seen elsewhere with the broader debate between rules and standards, principles-based regulation has an advantage of being adaptable and flexible, allowing for innovation and response in industries (like financial services) where technology is advancing rapidly.

For firms, especially smaller ones, this approach can be a double-edged sword. On one hand, it offers the freedom to design their own compliance procedures based on broad principles. On the other hand, it adds the responsibility of interpreting these principles correctly and building robust systems that can stand up to regulatory scrutiny. This is the flip side to principles-based regulation, one that becomes apparent during the compliance and enforcement process. The lack of prescriptive rules raises the possibility of ambiguity or discrepancies in enforcement, an inevitable problem with adjudicating the application of standards. Ex post adjudication of principles-based regulation “will remain subject to loud and influential, if not entirely persuasive, criticisms that the SEC is engaging in ‘regulation by enforcement.’”²⁹⁰

The benefit of doing it this way, from an enforcement perspective, is the SEC can target systematic failures of process rather than try to prove individual violations of the underlying conduct rule. It is hard for firms to know about all their un-avoided and un-neutralized conflicts, and harder yet for the SEC to prove individual violations of conflicts rules. From a policy

²⁸⁵ Data Analytics Proposal, *supra* note 9, at 53,990 & n.200 (explaining that the proposal is “intended to encourage development of risk-based best practices by firms, rather than to impose a one-size-fits-all solution”).

²⁸⁶ *Cf.* Investment Adviser Marketing, Advisers Act Release No. 5653 (Dec. 22, 2020), 86 Fed. Reg. 13,024, 13,025 (Mar. 5, 2021) (noting that the rules are “designed to accommodate the continual evolution and interplay of technology and advice”).

²⁸⁷ See Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L.J. 1 (2008); Commissioner Roel C. Campos, *Speech: Principles v. Rules* (June 14, 2007), <https://www.sec.gov/news/speech/2007/spch061407rcc.htm>.

²⁸⁸ See, e.g., James J. Park, *The Competing Paradigms of Securities Regulation*, 57 DUKE L.J. 625 (2007).

²⁸⁹ See, e.g., Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23 (2000); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

²⁹⁰ Langvardt & Tierney, *supra* note 17, at 727.

perspective, the biggest concern is not that a firm has let a conflicted interaction with a particular customer go un-neutralized; it is that the firm is not aware of the conflict—and so has taken no steps to adopt and implement a policy designed to achieve compliance with the conflict-elimination-or-neutralization rule with respect to the use of a particular technology.²⁹¹ By shifting towards a principles-based approach, the SEC opens up the possibility of focusing on the objectives of reducing conflicts of interest rather than prescribing detailed compliance procedures. This could give financial firms more flexibility in integrating AI technologies, creating an environment that encourages innovation, in a way that is future-adaptive.²⁹²

Commissioner Uyeda’s comments highlight the tension that securities regulators face in implementing principles-based regulatory interventions that are targeted at a firm’s specific risks. The optimal regulatory approach likely involves a balance of rules and standards. Here, the SEC has sought to balance outcomes-oriented, principles-based requirements to eliminate or neutralize conflicts of interest and to have appropriate compliance procedures in place, but mostly has not adopted prescriptive rules for how firms may or may not use covered technologies. The constraint is not on the use of covered technologies, but on unidentified and unmitigated conflicts arising from their use. Even acknowledging the difficulty of navigating the complexities inherent in these policy tradeoffs, in my view the proposed rule belies the label “prescriptive.”

B. Jurisdictional competition and state fiduciary rules

Capital markets scholarship recognizes the role of jurisdictional competition, including the possibility that entrepreneurial states in a federal system can raise standards above a federal floor. This dynamic is well understood in the literature, which discusses how states may engage in a form of regulatory “race to the top” by enhancing consumer protections and ethical standards.²⁹³ This contrasts with the more commonly feared “race to the bottom,” where jurisdictions lower standards to attract managers with the power to reallocate capital assets into those states.²⁹⁴ States with higher standards can influence the national market, potentially leading to

²⁹¹ One recent trade news article quoted broker-dealer industry attorneys expressing surprise that Reg BI’s requirement to be self-reflective about conflicts appeared to cause firms to examine and get rid of some conflicts they didn’t want to disclose. See McCarthy, *supra* note 94.

²⁹² See *supra* notes 171.

²⁹³ See Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135 (2004).

²⁹⁴ See, e.g., William Magnuson, *The Race to the Middle*, 95 NOTRE DAME L. REV. 1183 (2020); Eric Chaffee, *Finishing the Race to the Bottom: An Argument for the Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. 1581 (2010).

a broader adoption of these elevated standards.²⁹⁵

The SEC’s data analytics rule is only one possible solution to the problem of conflicts of interest from the use of technology in providing financial advice. Recent developments with state broker fiduciary regulation might provide roadmaps for alternative interventions. While federal regulations like Reg BI play a pivotal role in shaping investment advice, states play no less important a role.²⁹⁶ Several states, including Massachusetts, New Jersey, and Nevada, have pushed the envelope, proposing or enacting their own fiduciary standards for brokers operating within their jurisdictions.²⁹⁷ These efforts often arise from perceived gaps or insufficiencies in federal standards, with states taking the initiative to provide additional protections for their residents.²⁹⁸

Massachusetts, in particular, took a notable step by implementing a broker fiduciary duty rule.²⁹⁹ The rule addresses the statutory term “unethical or dishonest conduct or practices” in the Massachusetts Uniform Securities Act (“MUSA”).³⁰⁰ It defines that term to include a broker-dealer’s “failure to act in accordance with a fiduciary duty to a customer when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security.”³⁰¹ It defines this to include the fiduciary duties of “utmost care and loyalty.”³⁰²

The Massachusetts fiduciary rule illustrates an alternative regulatory approach for dealing with conflicts of interest arising from the use of technology in investment advice. It paints with a much broader brush. The state fiduciary rule mandates that brokers act in their clients’ best

²⁹⁵ On the role of states in this space, see Benjamin T. Seymour, *The New Fintech Federalism*, 24 YALE J.L. & TECH. 1 (2022); Andrew K. Jennings, *State Securities Enforcement*, 47 BYU L. REV. 67 (2021).

²⁹⁶ See Comment Letter of William Galvin, Secretary of State of the Commonwealth of Massachusetts (Oct. 10, 2023); *Robinhood II*, 2023 WL 5490571.

²⁹⁷ See Tracey Longo, *Will Affirmation of Mass. Fiduciary Rule Have a Ripple Effect in Other States?* FINANCIAL ADVISER MAGAZINE (Aug. 28, 2023).

²⁹⁸ *Id.* (quoting comments of Professor Benjamin P. Edwards that state-level regulatory action had “recognize[d] the reality that Regulation Best Interest sets a low floor for investor protection and that the states have the ability to demand better treatment for their retirees and savers”).

²⁹⁹ See Adopting Release, Amendments to Standard of Conduct Applicable to Broker-Dealers and Agents, 1412 Mass. Reg. 61 (Mass. Sec. Div. Feb. 21, 2020).

³⁰⁰ Mass. Gen. L. ch. 110A, § 204(a)(2)(G).

³⁰¹ See 950 Code Mass. Regs. § 12.207(1)(a) (2020); see also *id.* § 12.207(3) (defining “customer”).

³⁰² *Id.* § 12.207(2); see also *id.* § 12.207(2)(a) (defining “duty of care”); *id.* § 12.207(2)(b)(1)–(3) (defining “duty of loyalty” to include conflict avoidance, elimination, and mitigation).

interests, placing client needs ahead of their own or those of their firm.³⁰³ Under those standards, broker-dealers must make all reasonably practicable efforts to avoid conflicts of interest, eliminate conflicts of interest that cannot reasonably be avoided, and mitigate conflicts that cannot reasonably be avoided or eliminated.³⁰⁴ Unlike Reg BI, it recognizes that disclosure may be insufficient with respect to conflicts of interest; it goes a step beyond, emphasizing the need for action to avoid, eliminate, or mitigate conflicts.³⁰⁵ In essence, Massachusetts' rule mirrors the standards historically reserved for investment advisers, signaling a shift in how the state views the responsibilities of brokers.³⁰⁶

After Massachusetts adopted the fiduciary duty rule, its state securities regulator brought an administrative enforcement action against a brokerage app firm, “alleging that Robinhood targeted unsophisticated investors, luring them in with gamification features and strategies.”³⁰⁷ In response, the firm sued the regulator, challenging its authority to promulgate the rule.³⁰⁸

In August 2023, the Massachusetts Supreme Judicial Court upheld the state fiduciary rule and rejected Robinhood's initial challenges. It concluded that the rule did not exceed the regulator's statutory authority under MUSA, rejecting the argument that industry norms should control when “the industry has strayed from the traditional model for the provision of investor services.”³⁰⁹ It likewise concluded, among other things, that the rule did not abrogate the common law and was not preempted by federal law.³¹⁰ The court remanded for further proceedings, and open questions include the fate of Robinhood's administrative enforcement hearing and whether its technology-mediated investor interactions violate the fiduciary rule.

Decisions like this validate state-level efforts, of course. But they also send a broader message about the evolving landscape of securities regulation—emphasizing the need for both federal and state entities to prioritize investor protection, and making room for cautious optimism

³⁰³ See *id.* (defining “unethical or dishonest conduct or practices in the securities ... business,” in the Massachusetts Uniform Securities Act, to require broker-dealers providing investment advice to retail customers to comply with a defined fiduciary duty); see also *Robinhood Fin. LLC v. Sec. of Commonwealth*, — N.E.3d —, 2023 WL 5490571, at *5 (Mass. Aug. 25, 2023) (*Robinhood II*) (discussing the history of the rule's adoption).

³⁰⁴ See 950 Code Mass. Regs. 12.207(2)(b)(2) (2020).

³⁰⁵ See 950 Code Mass. Regs. § 12.207(2)(c) (“Disclosing conflicts alone does not meet or demonstrate the duty of loyalty.”).

³⁰⁶ See *supra* note 12.

³⁰⁷ Tierney, *supra* note 17, at 372 n.72.

³⁰⁸ Robinhood argued that adoption of a fiduciary duty through administrative regulation abrogated the Massachusetts common law, exceeded the regulator's authority, and was preempted by Reg BI. The state trial court at first concluded that the rule was invalid as “the Secretary's promulgation of the Fiduciary Duty Rule was beyond his authority.” See *Robinhood Fin., LLC v. Galvin*, 2022 WL 1720131 (Mass. Super. Ct., Suffolk Cnty. Mar. 30, 2022) (*Robinhood I*), *rev'd by Robinhood II*, 2023 WL 5490571.

³⁰⁹ *Robinhood II*, 2023 WL 5490571, at *8.

³¹⁰ See *id.* at *10, 15.

about states as laboratories for experimenting with stronger state fiduciary duties in a federalist system. State-level initiatives can pilot reforms and set high benchmarks, which could inform and shape future federal policy.

C. Returning to the statutory authority question and administrative agonism

In this final subsection, I return to the SEC’s statutory authority, situating arguments about interpretation within a spirit of administrative agonism. How ought we approach the problem of contested agency jurisdiction—of whether sticky endowments of statutory authority can be interpreted to support regulation, in a time when regulation and governance in the public interest are increasingly facing skepticism of a judiciary increasingly captured by conservative special interests?

Let me end with some comments about the “best” reading of the statute. In a world where existing statutory authorities are sticky and legislative change is hard, we have to figure out how to promote the public interest through reasonably grounded interpretations of agency enabling legislation. Part of this is about people contesting their reasonable interpretations of that legislation; after all, the difference between Vollmer’s and my readings of § 211(h)(2) are that he thinks “certain” means “exceptional,” while I think “certain” means “less than all” and so can encompass a targeted subject matter (like the use of covered technology in investor interactions).³¹¹

But there is the broader question of what we are doing when we engage with this kind of statutory reasoning, and it is not necessarily about fighting over the “best” reading. In an era marked by reactionary conservative doctrinal change in federal courts, the interpretation of agency enabling legislation faces new challenges.³¹² The rise of anti-administrativism and doctrines like the major questions doctrine signal a shift in how federal courts approach agency deference. Historically, agencies were granted considerable leeway under *Chevron* deference, allowing them to interpret enabling statutes within reasonable bounds.³¹³ However, recent trends suggest a more restrictive approach.³¹⁴ In other words, the meaning of statutes is heavily contested; what appears to be the plain words of a statute authorizing the SEC to prohibit certain conflicts of interest might well be thought to be a “major question” as to which a federal agency

³¹¹ See *supra* Part II.B.3.

³¹² See Joel Seligman, *The Judicial Assault on the Administrative State*, 100 WASH. U. L. REV. 1687 (2023).

³¹³ Eric Berger, *Constitutional Conceits in Statutory Interpretation*, 75 ADMIN L. REV. 479 (2023).

³¹⁴ See, e.g., *id.*; Jon D. Michaels & David L. Noll, *Vigilante Federalism*, 108 CORNELL L. REV. 1187, 1216–17 (2023); see also, e.g., Jedediah Britton-Purdy, David Singh Grewal, Amy Kapczynski, & K. Sabeel Rahman, *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1807 (2020).

in a Democratic presidential administration is not entitled to regulate.³¹⁵

This necessitates a strategic rethinking of how agencies (and scholars and others) interpret these enabling statutes. Even robust and meticulous statutory interpretation, grounded in textualism, may not withstand scrutiny of judges that just don't like the cut of the agency's jib. This makes administrative agencies' jobs look as if they are trying to cross an actively quaking geological fault line without knowing where a sinkhole will next open beneath them.³¹⁶

One implication is that a court's decision may not always align with the most compelling or traditionally accepted reading of the statute. This situation requires a pragmatic yet principled approach, wherein agencies engage in a rigorous interpretation of texts, even as they recognize the influence of external, including political, factors on judicial decisions. Scholars have written about contestation of statutory and regulatory meaning in an age of many overlapping crises.³¹⁷ In response to this shifting judicial attitude, agencies might adopt a stance of administrative agonism and moral economy—commitment to the public interest and being unafraid to push boundaries in regulatory actions.³¹⁸ This approach involves bold experimentation and a willingness to explore the full extent of their statutory authority, even in the face of potential judicial pushback. Agencies can use this as an opportunity to test the limits of their enabling legislation, offering innovative interpretations that serve the public good. While there is a risk of judicial rejection, especially from a judiciary inclined to skepticism of regulation and redistributive policy, the virtue lies in advocating for social needs.

Conclusion

Regulating AI in finance is uncharted territory, and the proposed SEC rule is an important step towards creating a regulatory environment that can keep pace with such technological advancements. It shows the SEC's commitment to adapting its regulatory oversight to match the

³¹⁵ See *W. Va. v. Env'tl Protection Agency*, -- S. Ct. --, 2022 WL 2347278 (June 30, 2022); see also, e.g., Todd Phillips & Beau Baumann, *The Major Questions Doctrine's Domain*, 89 BROOKLYN L. REV. (forthcoming 2024).

³¹⁶ Cf. Tierney, *supra* note 221, at *56.

³¹⁷ On whether this is enough, see Sameer Ashar, *Deep Critique and Democratic Lawyering*, 104 CALIF. L. REV. 201, 217-19 (2016) (“thinking beneath and beyond liberal legalist approaches to social problems”).

³¹⁸ See, e.g., Daniel E. Walters, *The Administrative Agon: A Democratic Theory for a Conflictual Regulatory State*, 132 YALE L.J. 1, 14 (2022); Herrine, *supra* note 125, at 853 (explaining that a moral economy approach “motivate[s] a shift ... away from correcting for discrete market failures or maximizing a monetized measure of net social benefit and toward imposing substantive standard of fairness that balance the interests of different market participants,” which may offer “a more avowedly political—and, for its left-leaning advocates, democratic—vision of administrative governance”); Cristie Ford, *Regulation as Respect*, L. & CONTEMP. PROBS. (forthcoming 2023).

rapidly evolving technological landscape of financial advisory services.

The Netflix problem calls our attention to the effects of technology-mediated conflicts of interest in financial advice when disclosure is ineffective. In a world that allows broker-dealers and investment advisers to offer conflicted recommendations or advice to clients if it is disclosed, conflicts of interest can be important sources of revenue. As a kind of consumer protection law for capital, securities law is a space of contestation about what to do about those conflicts and that revenue. In the vision of the securities laws I have sketched out here, it may well be inevitable that finance capital and society will contest the extent to which one is subordinated to the other.³¹⁹ As social movements organize to answer many overlapping crises, this vision suggests law should be designed to challenge dominant power relations in service of human flourishing.³²⁰

This vision of the good posits a role for countervailing power in contesting the design of securities regulation. If movements and coalitions can overcome collective action problems that enable regulatory capture, agencies can potentially pursue the broader public interest rather than the sectoral interests of financial advisers. If the SEC is in a pro-regulatory cycle now (and will inevitably be de-regulatory again in the future), shouldn't it have some license to try? That's a show I'd binge watch.

³¹⁹ See KARL POLANYI, *THE GREAT TRANSFORMATION* 35-58, 71-80 (2001 ed.).

³²⁰ Cf. Lindsay Sain Jones & Goldburn P. Maynard Jr., *Unfulfilled Promises of the Fintech Revolution*, 111 CAL. L. REV. 801, 848-63 (2023); GEORGES UGEUX, *WALL STREET'S ASSAULT ON DEMOCRACY: HOW FINANCIAL MARKETS EXACERBATE INEQUALITIES* (2023); Hannah Bloch-Wehba, *Algorithmic Governance from the Bottom up*, 48 BYU L. REV. 69 (2022); Kate Andrias & Benjamin I. Sachs, *Constructing Countervailing Power: Law and Organizing in an Era of Political Inequality*, 130 YALE L.J. 546 (2020).