UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
INVESTOR ADVOCATE

April 8, 2024

Submitted Electronically

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

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

Dear Ms. Countryman:

As the Commission's Investor Advocate,[1] I appreciate the opportunity to comment on the Commission's proposed new rules ("proposed conflicts rules" or "proposal") to eliminate, or neutralize the effect of, certain conflicts of interest associated with broker-dealers' or investment advisers' interactions with investors through these firms' use of technologies that optimize for, predict, guide, forecast, or direct investment-related behaviors or outcomes ("predictive data analytics" or "PDA" technologies).[2] Congress tasked the Office of the Investor Advocate with analyzing the potential impact on investors of proposed regulations of the Commission and identifying areas in which investors would benefit from changes in existing regulations or rules.[3]

On March 7, the Investor Advisory Committee ("IAC") held a quarterly meeting, during which the IAC discussed and voted on its recommendation ("IAC PDA Recommendation") regarding the SEC's proposed conflicts rule.[4] Congress has designated the Investor Advocate as a statutory

[1] These comments are provided in the author's official capacity as the Commission's Investor Advocate but do not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

[2] Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Securities Exchange Act of 1934 ("Exchange Act") Release No. 97990 (July 26, 2023), Investment Advisers Act of 1940 ("Advisers Act") Release No. 6353, 88 Fed. Reg. 53960 (Aug. 9, 2023), https://www.federalregister.gov/documents/2023/08/09/2023-16377/conflicts-of-interest-associated-with-the-use-of-predictive-data-analytics-by-broker-dealers-and. In the same release, the Commission also proposed amendments to rules under the Exchange Act and Advisers Act that would require firms to make and maintain certain records in accordance with the proposed conflicts rules.

[3] Exchange Act section 4(g)(4)(B-D).

[4] Recommendation of the SEC Investor Advisory Committee's Disclosure Committee Regarding Digital Engagement Practices (approved by the full IAC on March 7, 2024), https://www.sec.gov/files/approved-20240214-draft-recs-use-dep.pdf.

member of the IAC. I attended the meeting on March 7 and provided short remarks when voting against the IAC PDA recommendation. This letter documents and briefly expands on the extemporaneous dissenting remarks I delivered on that date.

I appreciate several points made in the IAC PDA Recommendation regarding the proposal's definition of "covered technology," and agree that the scope of the definition should be reconsidered so that it does not inadvertently reduce the benefit of some technologies for retail investors. But, if "covered technology" were appropriately scoped to focus on the use of exceptionally complex and opaque technologies (for example, artificial intelligence, predictive data analytics, neural networks, large language models, and related or emerging technologies) then firms should not be permitted to address conflicts of interest associated with those covered technologies through disclosure alone. I support the requirement in the proposed rule for firms to eliminate conflicts or their effects when the conflicts are the result of exceptionally complex and opaque technologies. It is my view that this is the most effective approach to protect investors from conflicts associated with covered technologies, for several reasons.

I question what it would look like to provide full and fair disclosure of conflicts of interest that result from exceptionally complex and opaque technologies. Research published by the Office of the Investor Advocate last year on the efficacy of disclosures for a highly complex retail investment product strongly suggests that an enormous effort is required to make those disclosures successful.[5] While research on the design of effective disclosures regarding conflicts that are generated by exceptionally complex and opaque technologies would be welcome, it seems reasonable to anticipate that creating and communicating effective disclosures regarding these conflicts will present unique and difficult challenges. It is not at all obvious that disclosures regarding conflicts that result from complex and opaque technologies will not in themselves be complex and opaque.

The serious challenges that may accompany the creation and communication of fair and full disclosures regarding conflicts of interest resulting from exceptionally complex and opaque technologies raise special concern about how self-directed investors would receive and understand such disclosures. Given the welcome growth in new retail investors,[6] many of whom are self-directed and relying on digital platforms to invest,[7] it is reasonable to give extra attention to the problem of fair and full disclosure when investors are acting without the assistance of a financial professional.

Further, due to the scalability of covered technologies and the potential for firms to reach a broad audience at a rapid speed, any conflicts of interest resulting from exceptionally complex and opaque technologies could cause harm to investors in a more pronounced fashion and on a broader scale than was previously possible. This scalability-of-harm concept is directly at the

---

[5] *See* Scholl et al., OIAD Working Paper 2023-01, Investor Testing Report on Registered Index-Linked Annuities (Sept. 2023), *available at* https://www.sec.gov/files/rila-report-092023.pdf.

[6] *See, e.g,* Federal Reserve Board Division of Research and Statistics, Changes in U.S. Family Finances from 2019 to 2022, Evidence from the Survey of Consumer Finances (Oct. 2023), *available at* https://www.federalreserve.gov/publications/files/scf23.pdf at 16 ("Direct ownership of stocks increased markedly between 2019 and 2022—from 15 percent of families to 21 percent—the largest change on record.").

[7] *See, e.g.,* FINRA Investor Education Foundation, Consumer Insights: Money & Investing, New Investors 2022: Entering the Market in Novel and Traditional Ways (Apr. 2023), *available at* https://www.finrafoundation.org/sites/finrafoundation/files/New-Investors-2022-Entering-The-Market-In-Novel-and-Traditional-Ways.pdf at 8 ("In 2020, new investors entered the market in such large numbers that mainstream media took note of the phenomenon, with many describing a moment of historic "democratization" of investing. This surge has been attributed to a combination of forces, including new mobile trading platforms, lower barriers to investing (such as the ability to get started with small amounts of money), and various pandemic-related factors. Two years later, our research suggests that the expansion of the investing population continued unabated and was supplemented by new investors entering the markets by purchasing cryptocurrency.").

heart of the Commission's rationale for its proposal.[8] I question whether reliance on disclosures regarding conflicts resulting from such technologies can be reasonably expected to address the different scale of investor harm that is now possible.

Finally, a requirement to eliminate conflicts or their effects builds upon existing regulations and does not represent a dramatic departure from firms' existing regulatory obligations. I do not share the IAC's concern that the proposed requirement to eliminate conflicts or their effects "takes these technologies into a regulatory realm that is beyond decades of the SEC's own guidance for investment advisers and broker-dealers." In fact, the IAC PDA Recommendation itself indicates that "Regulation Best Interest and the Adviser Fiduciary Duty Interpretation both provide that a firm, notwithstanding any disclosure, may not place its interest ahead of its customers or clients, which is the linchpin of the requirement under the PDA Rule Proposal to neutralize or eliminate conflicts." Allowing firms to merely disclose conflicts of interest associated with inherently complex and opaque technologies—rather than eliminate the conflicts or their effects—would serve more likely to protect *firms* instead of *investors*. Such disclosures could help shield firms that provide conflicted advice or recommendations generated by complex and opaque technologies from responsibility for the harm caused by the conflicted advice or recommendations. Simultaneously, the disclosures would add to an already-unmanageable disclosure burden shouldered by investors. Requiring firms to eliminate or neutralize conflicts associated with complex and opaque technologies, however, could help protect investors from harm caused by such conflicts without exacerbating investors' disclosure burden.

As technologies employed by the financial services sector evolve, so do the opportunities as well as the risks for investors. Even as digital engagement tools and platforms continue to multiply avenues for greater numbers of retail investors to participate in our capital markets, so can technologies create new risks that are more difficult to identify, assess, and manage. Protections developed in 1940, of course, often do not account for technology developed more than 80 years later. Regulation should also evolve to so that investor protections can keep pace with technological innovation.

Should you have any questions with respect to this comment letter, please do not hesitate to contact me or my counsel, John Foley.

Sincerely,

Cristina Begoña Martin Firvida

Cristina Martin Firvida
Investor Advocate

[8] *See, e.g.,* proposal at n.16 and accompanying text ("[PDA-like] technologies could rapidly and exponentially scale the transmission of any conflicts of interest associated with such technologies to investors."