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

May 28, 2024

Second supplemental comment letter from scholars of securities regulation, financial advice, and technology law (Profs. James Tierney, Chicago-Kent College of Law; Kyle Langvardt, University of Nebraska College of Law; Ben Edwards, University of Nevada–Las Vegas William S. Boyd School of Law)

Re: File No. S7-12-23

Dear Ms. Countryman:

We appreciate the opportunity to provide further submission to the above-numbered comment file, for what we'll refer to as the "predictive data analytics" proposal or the "proposed rule."[1] We previously submitted comment letters in October 2023 (coauthored with two colleagues) and January 2024. We wrote then and now in our capacity as scholars of the regulation of retail financial advice with an interest in promoting the development of federal securities law.

Our comment letters have generally supported the SEC's efforts related to predictive data analytics, consistent with our scholarship on conflicts of interest and sales practices related to the use of technology in retail investor interactions.[2] In addition, a draft article submitted in connection with a January 2024 letter by one of us (Tierney), and forthcoming in the MICHIGAN STATE LAW REVIEW, generally supports the proposed rule and addresses a range of matters that the proposal raises.[3] As disclosed in the file, we have met with various stakeholders at the

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

[2] *See*, *e.g.*, James Fallows Tierney, *Investment Games*, 72 DUKE L.J. 353 (2022); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": How Not to Regulate Gamified Investing*, 131 YALE L.J. FORUM 717 (2022); Kyle Langvardt, Regulating Habit-Forming Technology, 88 FORDHAM L. REV. 129 (2020); Benjamin P. Edwards, *The Rise of Automated Investment Advice: Can Robo-Advisers Rescue the Retail Market*, 93 CHI.-KENT L. REV. 97 (2018) (Edwards, *Robo-Advisers*); Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 OHIO ST. L.J. 181 (2017) (Edwards, *Conflicts*).

[3] James Fallows Tierney, *Algorithmic Conflicts in Financial Advice*, MICHIGAN STATE LAW REVIEW (2025).

Commission on this rulemaking, and appreciate the engagement with us and our scholarly work in this area.

While we and other investor-protection stakeholders still support the proposed rule,[4] not all commenters have been so supportive. Major themes of other commenters' submissions on the proposed rule include perceived troubles with implementation and compliance, partly arising from broad definitions of concepts like "investor interaction" and "covered technology." Other commenters have also raised many questions about economic effects, costs of compliance, and the Commission's statutory authority to adopt the proposed rule.

Recent media reports indicate that the Commission is considering shifting course with the proposed conflicts rules. There are still important justifications for the rule as proposed, and by submitting this comment letter we don't mean to withdraw our support for the rule, or to withdraw our prior letter. But we work within the realm of the possible, so we're describing here a second (alternative) approach for the sake of giving the Commission options. In this second proposal, we identify some elements of a regulatory approach that we contend could be "for the protection of investors" (and, maybe, "in the public interest"). **Table 1** on **page 3** details the prescriptions that flow from this view. **Table 2** on **page 15** compares this approach to several other options on the table as well as a longer term investor protection agenda.

With this hedging in mind, we'll now talk about this "second proposal," which we call the "**Reg BI+ option**." Like the 2019 rules, this option would involve extending certain aspects of the duties in Reg BI to non-recommendation interactions with self-directed investors, and issuing a new fiduciary interpretation. Under the Reg BI+ option, the SEC could **shift focus away from** the current proposed framework, which prohibits certain **conflicts of interest** and requires firms to adopt compliance requirements related to the management of those conflicts. As a regulatory problem, "conflicts of interest" not only loom large but are moreover hard to regulate effectively because they are a source of compensation to financial advisers. So **instead** of targeting conflicts in this rulemaking, the SEC should **prohibit sales practices** involving the use of DEP or PDA technology that has the effect of putting the BD/IA's interests ahead of the client's. Other sales practices would be permissible if they were conflicted, so long as they did not place the BD/IA's interests first.

Reg BI+ can be understood as one component of a longer-term strategy to reform retail investor regulation. We continue to urge the SEC to consider how to target "conflicts of interest" in the retail investor space, including revisiting the deal struck in 2019. As discussed

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[4] *See*, *e.g.*, Tierney, *supra* note 2; Langvardt and Tierney, *supra* note 2; *see also*, *e.g.*, Letter of Better Markets, File No. S7-12-23 (Mar. 26, 2024).

Type	*Scope of duty*	*Existing duty*	*Implications of proposed rule for current system*	*This alternative proposal (this rulemaking and in the future)*
RIA	Full scope of advisory relationship	Fiduciary duties of care and loyalty	New framework for evaluation and compliance on top of existing functional duties (see below)	In this rulemaking, provide new fiduciary interpretation on duties of care and loyalty over good and bad uses of DEPs and PDAs
BD	Recommendation to a "retail customer"	Reg BI	Retain existing obligations with respect to "recommendations," though spillovers from new compliance obligations may occur	In **next** presidential administration, amend Reg BI to require un-conflicted recommendations ("without regard" / "place investor's interest first" options rejected in 2019; see then-Comm'r Jackson's dissent to Reg BI). Note that if recs **and** non-rec investor interactions must be unconflicted, BDs face the "financing problem" from Choi (2004), discussed below; BD equity capital may decide to leave the market.
BD	Non-recommendation interactions with self-directed investors	Antifraud, some sales practices, marketing, etc. rules	New framework for evaluation and compliance related to conflicts of interest that may taint the inputs to the technological processes that shape non-recommendation interactions with investors	In **Reg BI+**, prohibit DEP and PDA use having effect of putting firm's interest first, while naming specific examples of problematic sales practices (compare A/B testing here with sales contest prohibition in Reg BI) that categorically put firm's interest first. Otherwise do not require these interactions to be "unconflicted." Adopt sales practices regulation involving non-rec PDA with subset of obligations from Reg BI (see pp. 12-13 below).

Table 1

below, because the Congressional Review Act deadline has passed, the endurance of this rulemaking will be a function of how it fits with an agenda for retail investor regulation in a next presidential administration. This could include making "recommendations" conflict-free, or even making broker-dealers subject to a fiduciary standard, akin to then-Commissioner Robert J. Jackson Jr.'s dissent that Reg BI wasn't ambitious enough.[5]

Here is where the "Reg BI+ option" fits in, as the flip side to an ambitious policy agenda to make recommendations conflict-free. Retail broker-dealers face a nuanced financing problem that they may try to solve through nonsalient pricing and cross-subsidization. (If the service is free, you are the product being sold, and so forth.) If the Commission wants to keep the brokerage business available, it "needs" to keep some dimension of nonsalient pricing available or brokers' own investors will quit (decide it's not profitable enough to stay in business). Brokers take this compensation in different ways from investors to whom they make recommendations and from self-directed investors to whom they do not make recommendations. The question is whether to make non-recommendation investor interactions conflict free—or instead take a different, more ambitious, and more holistic approach. In this "second proposal" for this rulemaking, we articulate the "Reg BI+ option" that leverages existing legal frameworks while filling regulatory gaps, aligning the SEC's goals with some of the practical difficulties raised by commenters under the rule.

Remember: examine tables 1 and 2 before continuing.

I. The regulatory baseline

The fiduciary duties imposed on RIAs and the standards under Regulation Best Interest ("Reg BI") serve as foundational components of current regulations. These duties and standards should serve as the framework for effective governance of the use of technology-mediated sales practices without the need for sweeping new rules. Under the 2019 rulemaking package that included Reg BI and the fiduciary interpretation, "the retail investor [was promised to] be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or the financial professional ahead of the interests of the retail investor."[6]

Let's begin with the existing legal framework applicable to advisers, as set forth in the July 2019 fiduciary interpretation. The fiduciary duty of loyalty "means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own,"

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[5] *See infra* note 33.

[6] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33,318, 33,321 (July 12, 2019) ("Reg BI Adopting Release").

and thus "cannot place its own interests" first. In this context, fiduciary duty "is principles-based and applies to *the entire relationship* between the adviser and its client."[7] The duty of loyalty also requires an adviser to "eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline [them]—consciously or unconsciously—to render advice which was not disinterested."[8]

Having discussed advisers, let's turn now to the regulatory baseline applicable to broker-dealers, especially as set forth under Reg BI. The loyalty obligation in Reg BI, like the fiduciary standards applicable to RIAs, aims to prevent firms from prioritizing their interests over their clients'. This approach requires that a broker-dealer not put its interests first. Longstanding precedent in SEC administrative proceedings confirms that interests include "economic conflicts of interest, such as undisclosed compensation."[9] The Commission in 2019 chose not to "require a broker-dealer to eliminate all of its conflicts when making a recommendation (i.e., require recommendations that are conflict free)."[10] In doing so, the Commission did not adopt a proposed alternative phrasing that would've required the recommendation be without regard to the firm's interests, or place the customer's interest first. As we discuss below, the SEC could reopen this question in the future.[11]

The existence of a conflict of interest does not necessarily mean it breaches the fiduciary duty of loyalty. Conflicts of interest are inevitable in principal-agent relationships.[12] As a baseline, some conflicts are impermissible for advisers and brokers alike. Advice that puts the

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7 *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. 5248, 84 Fed. Reg. 33,669, 33,671 (July 12, 2019) ("Fiduciary Interpretation"); *see also* Restatement (Third) of Agency, § 8.01 (2006) (under general principles of agency law, an agent may not use "the agent's position or the principal's property to benefit the agent or a third party").

8 Fiduciary Interpretation, 84 Fed. Reg. at 33,676; *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92 (1963). For expert commentary putting these obligations in context, see Douglas I. Koff, Charles J. Clark, Derek N. Lacarrubba & J. Eric Prather, *Investment Adviser Conflicts Under the SEC's New Enforcement Paradigm,* Bloomberg Law (June 2022).

9 *See IMS/CPAs & Assocs.*, Advisers Act Release No. 1994, 2001 WL 1359521 (Nov. 5, 2001) (subsequent history omitted); Clarke T. Blizzard & Rudolph Abel, Advisers Act Release No. 2253, 2004 WL 1416184 (June 23, 2004) ("An investment adviser's arrangement to direct brokerage in exchange for benefits to the adviser creates a conflict of interest that is material and that must be disclosed."); *Kingsley, Jennison, McNulty & Morse, Inc.*, 1993 WL 538935, 51 S.E.C. 904, 907 (Dec. 23, 1993) ("[T]he adviser may not use its client's assets for its own benefit without prior consent, even if it costs the client nothing extra.").

10 Reg BI Adopting Release, 84 Fed. Reg. at 33,332.

11 Given the passage of the Congressional Review Act deadline, what we describe would be a big lift that you would not want to allocate staff time to speculatively.

12 *See* Anita Krug, *Beneficial Conflicts of Interest*, 45 CARDOZO LAW REVIEW 175 (2023).

RIA's interest first is an impermissible breach of loyalty.[13] Not all conflicts put the RIA's interest first, however, so some will remain permissible.

These regulatory frameworks generally allow for the possibility of disclosure as a remedy for potential conflicts of interest that do not involve placing the firm's or its persons' interests first (ahead of the client's). For instance, the requirement to provide Form CRS encourages the consumption of information about conflicts of interest, partly to "encourage retail investors to inquire about these conflicts."[14] In addition, when making "recommendations," broker-dealers must "disclose material adverse information to . . . customers."[15] And the fiduciary interpretation explained that "the adviser, as a fiduciary, *should* seek to avoid [these] conflicts, but at a minimum *must* make full and fair disclosure of the conflict and obtain the client's informed consent."[16]

The fiduciary interpretation also identified circumstances involving difficulties with disclosure, and concluded: "In all of these cases where an investment adviser cannot fully and fairly disclose a conflict … such that the client can provide informed consent, the adviser should either eliminate the conflict or adequately mitigate (i.e., modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible." When disclosure is impractical, including "for retail clients in particular" with respect to "complex or extensive" conflicts that are hard to understand, the fiduciary duty shifts to the elimination or (at least) neutralization of these conflicts.[17]

II. What does the regulatory baseline say about the "disclosure out"?

If you squint hard enough, existing law thus already provides for a large share of what the Commission is seeking to accomplish in this rulemaking as a "new" framework for regulating conflicts in the use of covered technologies. What the rule proposal does is place an overlay of concepts—covered technology, investor interactions—that can be combined with a subset of the obligations from the 2019 package of rules.

Within the scope of an advisory relationship (for an RIA) or a recommendation to a retail customer (for a BD), the firm's or person's interest cannot be placed ahead of the client's. There may yet be other conflicts, such as an economic conflict in higher remuneration that

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13 *See* Fiduciary Interpretation, 84 Fed. Reg. at 33,671 (emphasis added). In addition, "disclosure and consent do not themselves satisfy the adviser's duty to act in the client's best interest." *Id.* at 33,676.

14 Fiduciary Interpretation, 84 Fed. Reg. at 33,678.

15 Data Analytics Proposal, 88 Fed. Reg. at 53,966.

16 Fiduciary Interpretation, 84 Fed. Reg. at 33,676 n.57.

17 *Id.* at 33,677.

will always exist in a principal-agent relationship. As to permissible conflicts, there is an obligation to fully and fairly disclose and secure knowing consent. This framework thus contemplates that some kinds of conflicts are inevitable and puts the question to the clients.[18] But as a conceptual matter, it raises many questions. For instance, when does a conflict result in placing the firm's interest first? Is there a reasonable basis to believe that disclosure will elicit under the circumstances knowing consent so as to not require elimination or mitigation of conflicts? And note what the doctrine does not reflect—that firms can effectively waive conflicts through "disclosing away," or that disclosure is permissible if more attractive or practical than eliminating or mitigating conflicts in context.

The view of doctrine that can be gleaned from a close reading of the Commission's and staff's releases on the 2019 rules reflects a second regulatory gap. From the measure of many comment letters, the notion instead seems to be that disclosure cleanses a conflict pretty much always. To be certain, the Commission's vision of existing doctrine and practice is contested.[19] But the Commission's vision focusing on whether interests are placed ahead of the client's is not how the industry necessarily sees the balance struck in Reg BI.[20] The disclosure

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[18] Restatement (Third) of Agency § 8.02 & n. 2 (2006) (citing, e.g., *O'Malley v. Boris*, 742 A.2d 845, 850-51 (Del. 1991)).

[19] The defense bar's goal is to protect their clients, including by paring back the scope of obligation and thus of risk, so there is some degree with which characterization of the regulatory framework is intended to frame the comments made and the regulatory output produced. *Consider* James Fallows Tierney, *Contract Design in the Shadow of Regulation*, 98 NEB. L. REV. 874 (2020). The Commission's staff is familiar with the difficulty of "get[ting one] to understand something, when [their] salary depends on ... not understanding it." UPTON SINCLAIR, I, CANDIDATE FOR GOVERNOR: AND HOW WE GOT LICKED 109 (1935).

Regulated firms, trade groups, and the securities bar have every incentive to ignore the effectiveness of disclosure. So too do they have every incentive to conclude that an unknowing, un-read acceptance of an opaque disclosure of a complex conflict is effective to secure knowing consent from an unsophisticated retail investor. Because if disclosure is thought to "work" in this context, they can avoid the unattractive alternative: eliminate or mitigate those conflicts because such disclosure would not practically produce informed consent by the principal. On why disclosure does not "work" in this context, see Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 17 (2022); Tierney, *supra* note 3 (manuscript submitted in connection with my second comment letter).

[20] Some confusion may flow from the Commission's decision in 2019 to prohibit some conflicts (those put first) and permit disclosure of other conflicts (those considered along with client's interest but not put first). Most legal analysis of the 2019 rulemaking from outside the Commission incants that you can't place your interest first, and then here's what you can do with respect to disclosure of the interests that remain. Whether the conflict puts the interest first rarely enters into the analysis, which instead goes straight to the disclosure option.

There is also always room for more efforts by the Commission and staff to educate the market and the bar on these aspects of existing law, so long as the selective-audience concerns can be managed. Just as retail investors

solution is attractive because it is a way to have one's conflict and eat it too. It allows firms largely to ignore the proviso that otherwise permissible conflicts (those not put first) should be eliminated or mitigated when disclosure is ineffective—treating it the other way around. Although not reflected in "the doctrine," this approach essentially permits firms to continue practices that may not align with the best interests of their clients, provided these conflicts are disclosed.

The effectiveness of disclosures in managing conflicts of interest is a contentious issue. Disclosures are intended to inform clients about potential biases in recommendations, allowing them to make more informed decisions. However, research and practical observations frequently question the efficacy of disclosures, particularly when they are complex or when clients are unable to understand the implications fully. This ineffectiveness is even more pronounced in the case of non-recommendation interactions, where conflicts are less salient and harder to disclose effectively.

The Commission should also describe its vision of how disclosure effectiveness influences the production of knowing consent, and consider an alternative vision that looks more deeply into knowing consent. If we think consent is impractical (perhaps because disclosure is ineffective) for some kinds of complicated and obscure conflicts, then we should not look to disclosure to work through the channel of retail-investor self-help. As Spamann (2022) notes, we should be skeptical of disclosure-based proposals for investor protection, such as the dissemination of disclosed information to protect non-readers, where the emergent self-interested conduct of third party actors is not likely to produce investor-protective effects (as it is in price discovery in liquid markets).[21]

But it doesn't follow that there shouldn't be *any* disclosure; there might still be discerning consumers of disclosures to be included in Form CRS about programmatic-level conflicts not involving recommendations. As discussed below, we propose some disclosure, just not just-in-time disclosure. And there is empirical work to be done in this space. In any case, all of this prompts the question of whether the Commission is indeed finding disclosure impractical in a new category of situation which warrants direct prohibition or neutralization.

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do not always effectively consume disclosures, even sophisticated securities lawyers do not adequately consume and meditate on the Commission's adopting releases for long enough to appreciate the finer distinctions of proposed rules. That may be especially the case here because the Commission's broad initial proposed rule appears to have set off alarm bells all along K Street among securities lawyers who might otherwise not really be paying attention closely to the retail investor space. Or, of course, the reaction may also simply reflect motivated reasoning on the part of commenters. *See supra* previous note.

[21] Spamann, *supra* note 19.

It is worth explaining the stakes of getting rid of the disclosure option. Let's begin by comparing impermissible conflicts that result in placing the firm's interest first, and permissible ones that can be effectively "disclosed away." This reflects the distinction between compensation or not for many financial advisers. When some retail investors cannot discern quality and thus have a depressed willingness-to-pay (WTP) for advisory services, broker-dealers (in particular) face a problem of financing the production of costly financial advice. BDs seek to solve what Choi (2004) calls the "financing problem" through other forms of cross-subsidy, of which fund loads, commissions, and other inducements are solutions.[22] The existence of permissible conflicts is existential to broker-dealers' ability to solve the "financing problem," which is why you hear all the claims that getting rid of all conflicts with a fiduciary standard is going to reduce choice. In other words, equity owners of broker-dealers may decide to quit for lack of profits if they can no longer subsidize low-cost retail brokerage by taking other compensation that is nonsalient.

III. Structuring a new rule reframing

Despite this regulatory baseline, and contrary to claims by commenters that existing law is sufficient, the Commission is well-aware that there is a significant investor-protection gap, especially around investor interactions not rising to the level of a "recommendation." This creates an opportunity for the Commission to articulate how existing law applies to advisers, and to create a new package of rules tailored to fill the gap in Reg BI for conflicted sales practices in investor interactions outside the "recommendation" context (such as for self-directed brokerage investors). We discuss next steps in Part V and return in Part VII to situating it within a longer-term agenda for the SEC in the next presidential administration to further reform the framework for BD/IA regulation for the protection of investors.

The proposed rule outlines extensive regulatory and compliance obligations that cover various aspects of technology use, which has attracted considerable criticism. Many of these criticisms appear to flow from a mismatch between what appears to be the SEC's goal in proposing this rule—managing the use of technology in ways that put the firm's interest ahead of the client's—and the framing of a proposed rule in a way that suggests a maximalist approach to defining the scope of prohibited conduct. There is also a special challenge associated with the proposed rule's framework focusing on "conflicts" in the use of AI, in

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[22] Stephen J. Choi, *A Framework for the Regulation of Securities Market Intermediaries*, 1 BERKELEY BUS. L.J. 45 (2004).

which firms become accountable for technologies that they have outsourced rather than kept in house.[23]

So there are tradeoffs in designing a framework for eliminating conflicts in these contexts, as compared to targeting particular sales practices. There is a compelling argument that a more robust regulatory framework would make recommendations conflict-free, while providing that brokers may have conflicts in non-recommendation investor interactions as long as they don't result in placing the broker's interest first, as some kinds of sales practices do.

IV. Shifting to sales practices by BDs

Instead of constructing an entirely new framework, the SEC could (and should!) redefine these outlined obligations to sharpen the focus on prohibited sales practices by BDs—essentially aligning what is prohibited for RIAs with what should be prohibited for BDs. Although the primary focus is to fill a gap that is primarily a risk for broker-dealer sales practices, it is important to consider as well whether there are analogous sales practices by registered investment advisers that are currently prohibited but not adequately enforced against.

In considering how to implement this proposal, the Commission's general approach in the 2019 package of rules offers a good template—in its structure, though in (at least some of) our view not in its policy particulars. With respect to RIA issues, the fiduciary interpretation stated

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[23] The current framing of the proposed SEC rule raises a practical concern about its applicability to both regulated and non-regulated entities, and what it means for the reach of regulated firms' ability to control their outsourcing to unregulated third parties. While we don't mean to get into the Commission's proposed rules on outsourcing, the buy-or-make decision certainly relates to outsourcing.

The problem arises from the broad definition of covered technology and the integration of AI technologies everywhere (even where end users decidedly don't want it), like in Google search, Adobe Acrobat, or Microsoft Office. Financial advisory firms often rely on externally provided technologies and are typically 'takers' of these technologies, accepting non-negotiable terms that may include AI functionalities they cannot fully control or opt out of. They may not be able to negotiate contract terms, to be able to do due diligence into black-box AI models, and the like. Firms may find themselves bound by their contractual terms with technology providers, with limited influence over how these technologies are developed or the specific ways AI is employed. To be clear, these are problems of contract law. The complexities they raise are beyond the scope of this rulemaking.

As a supporter of the Commission's goals with this rulemaking, we contend it is crucial to right-size the rule to better distinguish between situations where financial advisors can reasonably manage and mitigate conflicts of interest versus those where they have little control over the technology tools mandated by external providers. Combined with a shift in focus from "conflicts" to "sales practices," the approach we are proposing would find a breach of the conflicts duty where the financial adviser has not managed conflicts and so the use of technology results in placing their interests first.

the Commission's view on existing interpretations of the principles-based fiduciary duty with application to particular scenarios. With respect to BD issues, Reg BI introduced new duties with respect to recommendations for retail investors to try to fill some of the gap that had been left by legacy suitability doctrines. And with respect to both, the Form CRS release tinkered with disclosure requirements.

The Commission should follow that template. It should adopt a new fiduciary interpretation with respect to the use of covered technology, stating how the Commission views the application of existing law in this context (like it did for "level of specificity" and "allocating investment opportunities" in the Fiduciary Interpretation in 2019). The SEC should begin by making crystal clear how these aspects of existing law highlight the baseline expectation for all financial service providers under SEC oversight. In particular, the Commission should explicitly illustrate the existing prohibition on placing one's interests ahead of (rather than merely considered along with) the client's interests in the context of PDA-mediated investor interactions. Existing obligations are trans-substantive. They already apply to the use of technology in ways that influence the advice or recommendations to investors, but they also apply without regard to technology.[24] The Commission could play an important market-education role in explaining how covered technologies (and maybe digital engagement practices in particular) can be used in sales practices that result in placing the firm's interest ahead of the customer's, and would be prohibited under current law.

This new fiduciary interpretation could also speak to some of the more enduring questions about care and loyalty obligations in connection with "prosocial" uses of covered technology. To the extent that these sales practices do not have the effect of putting the firm's interest first, they would not be covered under the proposed framework (which would not prohibit them but also would not independently change the law governing their use). This is important in light of customer market research evidence about the relative preferences of retail investors for algorithmic vs. other forms of investment advice.

This would not, standing alone, solve the specific regulatory gap involving broker-dealer sales practices not covered by Reg BI. So the Commission should also adopt a package amending Reg BI to adopt a new set of duties, discussed on the next page, with respect to conflicted sales practices in investor interactions not involving "recommendations." By adapting Reg BI to include prohibitions on certain practices already disallowed for RIAs, the SEC would promote a better harmonized regulatory landscape that better addresses the

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[24] It is in this way that we have encouraged the Commission in the past to rely on "legacy" doctrines and devices, like concepts of "behavioral churning" or "quantitative suitability" in the design of user interfaces for broker-dealer mobile phone apps. *See supra* note 2.

complexities introduced by modern technologies in financial markets. This approach would avoid the pitfalls (identified by commenters critical of the rule) of over-regulation and focus on closing a specific gap in the current system. Relative to the proposed rule's approach, incorporating these standards into Reg BI could facilitate a more integrated and less burdensome compliance regime, a point we return to in Part VII below.

In contrast with the proposed rule's new compliance framework for evaluating all potential conflicts, this "Reg BI+ option" would extend certain components of Reg BI to sales practices involving investor interactions using covered technologies. Under this version of the conflicts rule, advisers or broker-dealers could still have permissible conflicts as long as they did not place their interests ahead of the client's (as under the existing regime). Rather, an adviser or broker-dealer would breach these duties by engaging in "sales practices" involving "covered technologies" in "investor interactions" in ways that result in placing their interest ahead of the client's.

V. How would the Reg BI+ option be implemented?

Under the Reg BI+ option, you would not want to import all four obligations of Reg BI and apply them directly to sales practices involving covered technologies in investor interactions. This is essentially the approach suggested by the Investor Advisory Committee regarding the definition of digital engagement practices as "recommendations." Instead, you would identify certain DEPs or sales practices as being candidates for prohibition because the Commission finds that they categorically have the effect of placing the firm's (or person's) interest ahead of the client's. As to other, permitted conflicts, you would adjust the four component obligations of Reg BI as follows:

- **Conflict of Interest Obligation**: This would be how you implement the requirement to have systems in place to identify and address conflicts of interest in the use of covered technologies in investor interactions. As in Reg BI, you would require reasonable policies designed to ensure that sales practices involving covered technologies in investor interactions do not result in placing the firm's interest first. You would also categorically prohibit certain (DEP-mediated?) sales practices that do result in placing the firm's interest first. You might determine, for instance, that A/B testing of mobile app user interface design to promote more trading without regard to the customer's interest,[25] is a conflicted sales practice that results in placing the firm's interest first and therefore should be prohibited. You would otherwise assume that firms take into account their interests in interactions other than recommendations, and do so to solve

[25] Or a "higher volume of noisy order flow to sell to wholesalers."

the financing problem associated with low willingness-to-pay by retail investors. You could explicitly leave open the possibility of making recommendations unconflicted in the future, or to go full fiduciary standard.

- **Care Obligation**: Akin to Reg BI, you would want to frame this in terms of adopting sales practices involving covered technologies in investor interactions in a way that offend legacy notions of the care obligation. But because the regulatory trigger is not a "recommendation," not all sub-components of the care obligations might need to be at play in this rulemaking. The Commission should look to legacy doctrines like concepts of churning and "quantitative suitability," including as implemented in Reg BI's Care Obligation.[26]

- **Compliance Obligation**: If this amendment were made part of Reg BI, you might need some minor conforming amendments here but the compliance obligation would remain largely as it is.

- **Disclosure Obligation**: In this framework, you would **not** want to impose an obligation of just-in-time disclosure akin to the delivery of Form CRS in connection with recommendations. But industry wants disclosure, so give them disclosure: the Commission should amend Form CRS to include an affirmative disclosure obligation respecting all "permissible" conflicts associated with sales practices involving covered technologies in investor interactions.

VI. The Reg BI+ option offers a modest role for the SEC in AI industrial policy

The debate surrounding the integration of AI in finance not only touches on regulatory compliance and ethical considerations but also reflects broader societal attitudes towards technology.[27] Among various regulatory approaches to AI in finance, the "Reg BI+ option"

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[26] *See* Langvardt and Tierney, *supra* note 2; Tierney, *supra* note 2.

[27] This is mostly beside the point. On one side, recent executive orders and other federal agency initiatives promote the vision of leveraging AI to enhance efficiency, decision-making, and competitiveness across various sectors, including finance. This vision aligns with a techno-utopian perspective, which sees AI as a pivotal tool in driving future economic growth and innovation. However, this optimistic stance is counterbalanced by significant skepticism. The use of data analytics in finance follows a pattern that we see elsewhere. Though less obviously so in finance, in many economic domains it is becoming increasingly clear that optimism about the transformative potential about AI might be overhyped in the short term. Other critics, echoing neo-Luddist concerns, question the trustworthiness of techno-utopians, particularly given the opaque nature of AI systems and the potential for these technologies to exacerbate existing inequalities or introduce new vulnerabilities. Such concerns highlight

involves a more measured, "small-potatoes" strategy rather than aiming to control "finance in AI" broadly. This focused approach would allow the SEC to address specific, identifiable issues related to conflicted sales practices without overreaching into areas that are still evolving and thus difficult to regulate effectively. By targeting the application of DEPs and PDA technologies in sales practices where the Commission can clearly define and enforce rules, you can make more immediate improvements to investor protections and market integrity.

Such an approach acknowledges the limitations of the Commission's remit while still taking constructive steps to integrate thoughtful, practical AI regulations within the financial sector. But the SEC has statutory authority to regulate sales practices and conflicts of interest in this space, and so should be bold in pursuing efforts to cut back on "sales practices" that have the effect of putting an adviser's or broker's interest ahead of the customer's (or, in a second-best world, even *alongside* the customer's).

The challenge for the Commission in this regulatory update is balancing the need to be visionary with the practicality of implementing a rule that will endure. Although we have long been supporters of the data analytics rule proposal in many of its contours, many commenters do not share that view and consider it a broad and aggressive rule. Proposing a rule like that might appear forward-thinking but risks creating frameworks that will be rolled back or struck down, which we return to in the next Part.

VII. The role of Reg BI+ in retail investor protection moving past 2025

With all this in mind, the Reg BI+ option would involve shifting focus from regulating conflicts of interest directly, to regulating sales practices that have the effect of putting the firm's interest first. Focusing on defining and prohibiting specific "sales practices" rather than attempting to universally redefine "conflicts of interest" could achieve substantial compliance and enforcement objectives without appearing to overreach. For instance, consider the suggestion that under the proposed conflicts rule, "a firm merely having an interest would qualify as a conflict and require ongoing testing and documentation procedures even where the firm's interest is aligned with the interests of the investor."[28] The Reg BI+ option would mean firms would no longer have to identify and manage *every* potential interest, and instead would focus compliance efforts on sales practices involving technology in investor

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the risks of designing our economic systems around technologies that may not only be imperfect but also potentially out of public oversight or control, serving more to enrich the already wealthy rather than benefiting society at large.

[28] Letter of Members of Congress Ritchie Torres et al. (Feb. 27, 2024), https://www.sec.gov/comments/s7-12-23/s71223-436799-1083782.pdf.

interactions that result in placing the firm's (or person's) interest first. Focusing compliance efforts on sales practices rather than the underlying interests would remove some obligations perceived by commenters to be unnecessary or overly burdensome.

	Baseline	***Rejected in 2019***	***PDA proposal***	***This second supp. letter***	***State law (e.g., Mass.)***	***Retail investor protection beyond 2025***
Rec's	Reg BI	Fiduciary	Reg BI, and maybe spillover from new duties?	Reg BI	Fiduciary	Fiduciary
Non-rec's	—	—	New duties	**Reg BI +**	Fiduciary?	**Reg BI + or** Fiduciary?
Advice	Fiduciary	Fiduciary	Fiduciary, plus new duties	Fiduciary	Fiduciary	Fiduciary

Table 2. *Compares the treatment of recommendations, non-recommendations, and fiduciary advice for a variety of approaches, including regulatory baseline; option rejected in 2019; this proposed rule; the Reg BI+ option outlined in this supplemental letter; state law options; and a final column showing a speculative agenda for retail investor protection beyond 2025. Light grey means fiduciary where it isn't the baseline regulatory framework today. Medium grey means items added in the proposed rule. Dark gray shows additions as part of the "Reg BI+" proposal, with a goal of moving us toward the "retail investor protection beyond 2025" column.*

The Reg BI+ option also compares favorably to the proposed rule as a theoretical or doctrinal matter (which might be important for administrative law reasons!). This is because it better aligns *existing* regulatory intervention for "recommendations" and non-"recommendations." Remember that Reg BI distinguishes those recommendations that were conflicted and prohibited (firm's interests put first) those that were conflicted but permissible (not put first). The Commission adopted this distinction in 2019 rejecting an approach that would require recommendations be "conflict-free."[29] As proposed, the data analytics rule would require that "investor interactions," but *not* recommendations, be conflict-free. Do we

[29] *See supra* notes 13–16.

want conflicts to be eliminated in this manner, in the opposite, or in both? The Reg BI+ option, involving a switch from targeting "conflicts" in investor interactions to targeting specific problematic sales practices, leaves open the possibility for the Commission to revisit the deal struck in 2019 with respect to conflicted "recommendations."

This approach also offers something of a strategic compromise in light of "public choice"-inflected perspectives on how regulation is made, contested, and implemented. Conflicts are a form of compensation, especially in economic models of retail investment in which the intermediary faces a financing problem from retail investors who undervalue advice. For them, the provision of advice must be cross-subsidized to permit low or zero pricing on a high-salience dimension.

The theoretical financing problem highlights a practical dilemma about threats to the remaining existence of "conflicts." If broker-dealers are required to eliminate all conflicts of interest, including those in non-recommendation interactions, it could potentially undermine their business models, which rely on certain types of revenue-generating practices.[30] In 2019, the SEC opted to maintain a viable market for broker services by allowing these conflicts, under the condition they are disclosed. Revisiting this decision to require all broker interactions, recommendation or not, to be completely unconflicted would pose a direct challenge to the financing models of many brokerage firms. Does the Commission prefer that brokers earn from conflicted recommendations, conflicted sales practices not involving recommendations, or nothing at all (so that brokers with high costs of capital unable to profit from things like cash sweep will decide to exit the market)? It is also of theoretical and investor-protection significance to securities law whether certain conflicts of interest should be prohibited.[31]

Scholars have suggested that this may result in some loss of access, though that consequence is an empirical question that could be tested and shouldn't just be assumed. In a hot-off-the-presses working paper, Reuter and Schoar (2024) review supply-side constraints in markets for financial advice, including the effectiveness and market-structure consequences of regulatory interventions. Several other recent scholarly works strongly support the notion

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[30] Bald claims that retail brokerage will "go away" with a rulemaking along these lines should be rejected because they aren't true. *Cf.* Tierney, *supra* note 19. Many broker-dealers are able to provide conflicted non-recommendation services to clients that take into the BD's interests. Some brokers subsidize the retail investor's lower WTP with cash sweep interest arbitrage and the like, so clearly there are opportunities to solve the financing problem that do not involve drumming up noisy order flow to sell to wholesalers.

[31] *See, e.g.*, James Fallows Tierney, *Retail investors and capital markets intermediation*, in Deborah DeMott and Tan Cheng Han, eds., AGENCY AND INTERMEDIATION (2025).

that extending a fiduciary rule to brokers would not eliminate the market for retail brokerage, and would have important investor-protective effects.[32]

The fundamental question then becomes whether the Commission prioritizes the elimination of conflicts at the risk of reducing broker-dealer viability for low-sophistication retail accounts, or continues to permit certain conflicts, assuming they are transparently disclosed and managed. Should the Commission focus on the potential welfare losses from allowing salient, disclosed conflicts in recommendations, which might be partially mitigated through enhanced client awareness and understanding? Or should it address the more insidious, less visible conflicts in non-recommendation interactions that are difficult to disclose effectively and may be more harmful due to their opacity?

As we look ahead to the next presidential administration, the Commission should identify a critical opportunity to refine and align Reg BI with contemporary understandings of conflict management within the financial services sector. The essential question revolves around whether the most effective approach is to address conflicts of interest directly or to regulate the sales practices that mediate these conflicts. This influence can be significant, shaping financial decisions through mechanisms that are often not transparent or fully understood by the client.

In some models of the retail market, self-directed investors tend to be more sophisticated and more wary than those who take conflicted recommendations from brokers. As it may be more important to protect those most at risk from conflicted advice, the preferred regulatory intervention would be through the Reg BI recommendation channel rather than the "investor interaction" channel.

To that end, in the next administration, the Commission should align Reg BI with the best current thinking on managing conflicts. Reg BI should be amended to require that all recommendations be made "without regard" to the firm's interests, or better yet, to explicitly "place the investor's interest first." This would represent a significant shift towards prioritizing investor protection and ensuring that financial advisors and brokers act as true fiduciaries. Such a change would not only bolster investor confidence but also strengthen the

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[32] *See*, *e.g.*, Jonathan Reuter & Antoinette Schoar, *Demand-Side and Supply-Side Constraints in the Market for Financial Advice*, NBER Working Paper 32452, DOI 10.3386/w32452 (May 2024); *see also*, *e.g.*, Vivek Bhattacharya, Gastón Illanes & Manisha Padi, *Fiduciary Duty and the Market for Financial Advice*, NBER Working Paper 25861, DOI 10.3386/w25861 (revised Nov. 2023); Mark Egan, Shan Ge, & Johnny Tang, *Conflicting Interests and the Effect of Fiduciary Duty: Evidence from Variable Annuities*, 35 REV. FIN. STUDS. 5334 (2022); Nicole Boyson, *The Worst of Both Worlds? Dual-Registered Investment Advisers*, Northeastern U. D'Amore-McKim School of Business Research Paper No. 3360537 (2019).

integrity of financial markets by fostering a more transparent and client-focused advisory environment.

This harkens back to a debate on which then-Commissioner Jackson wrote in dissent regarding the 2019 rules, which he said did not go far enough.[33] Jackson was particularly critical of the Commission's approach to handling disclosures. He argued that merely requiring advisers to disclose conflicts of interest is insufficient and often ineffective in ensuring that advisers act in their clients' best interests. He pointed to a number of studies showing the tangible benefits of imposing fiduciary standards on brokers, as evidenced by states that had adopted such measures.

One takeaway for us today is that the Commission should be visionary in articulating a vision of a regulatory framework that unequivocally requires financial advisers and brokers to prioritize investor interests. One option is as Jackson showed: making brokers fiduciaries, full stop. A compromise solution in Reg BI+ might be one step of a plan to push in that direction. In the medium term, it might mean planning to make recommendations conflict-free, and using the Reg BI+ option to allow some subset of non-recommendation investor interactions be conflicted, while prohibiting other conflicted sales practices.

We urge the SEC to consider these perspectives in finalizing the rule.

Sincerely,

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33 Robert J. Jackson, Comm'r, Sec. & Exch. Comm'n, *Statement on Final Rules Governing Investment Advice* (June 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd.