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October 10, 2023

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

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

Dear Ms. Countryman:

Investor Choice Advocates Network ("ICAN")[1] is pleased to submit this response to the Securities and Exchange Commission ("Commission" or "SEC") request for comment on its recent rule proposal, "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers" ("the Proposal").

The Commission has heard, and no doubt will continue to hear, from many commenters who have highlighted the certain harm the Proposal will have on investors and those who serve them. Numerous commenters have urged you to withdraw this Proposal; we join their voices and implore you to do so before precious time is spent considering detrimental changes that will inflict lasting damage on the very investors and markets the Commission pledges to protect in its longstanding mission.

Our call to withdraw this Proposal is further shaped by our view that the Commission lacks the statutory authority to promulgate this rule. In this Proposal, the Commission relies on the same misplaced reading of Section 211 of the Investment Advisers Act of 1940 ("Advisers Act") that has led the Commission to pursue other fundamental changes in the marketplace without seeking further authority from Congress.

[1] Investor Choice Advocates Network (ICAN) is a nonprofit public interest litigation organization dedicated to breaking down barriers to entry to capital markets and pushing back against regulatory overreach, serving as a legal advocate and voice for investors and entrepreneurs whose efforts help fuel vibrant local and national economies driven by innovation and entrepreneurship.

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Finally, we remind the Commission that the Proposal accompanies what now are dozens of rulemaking efforts over the past two years, many of which, even if considered in isolation, pose significant change to business practices and the markets, proposing as they do to rewrite longstanding terms of business for market participants. None of those rulemakings were simple or brief, and all were deserving of thorough, thoughtful review and consideration by those in scope. Sadly, and particularly when considered collectively rather than in isolation, the level of thorough review these proposed rules merit cannot occur, especially when overlapping proposals are accompanied by disproportionately short comment periods. Like those before it, the comment period for this Proposal is wholly insufficient.

The Proposal Reflects an Uninformed View of Technology Use in Investment Management

The Proposal states that its rules are designed "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." However, the Proposal neither succinctly defines the scenarios for harm nor the technology at issue. This vagueness appears intentional. The release states that the Proposal is "designed to be sufficiently broad and principles-based to continue to be applicable as technology develops" and to provide firms with flexibility in developing their approaches to using this technology – as long as it meets "the over-arching requirement…to be sufficient to prevent the firm from placing its interests ahead of investor interests."

Of course, the Advisers Act and existing rules such as Regulation Best Interest ("Reg BI") already address advisers and brokers placing their interests ahead of investors' interests, suggesting that the Proposal is intended to address specific conflicts relating to technology that are not captured by existing law and regulation. However, rather than define specific conflict scenarios that are so objectionable as to need elimination versus mitigation, the Proposal creates confusion and traps for the unwary by using poorly defined terms such as "investor interaction" and "covered technologies", two terms that seem to be all encompassing and are at the core of the proposed regulatory requirements.

The Proposal broadly defines 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 investor."[2]. This definition is so broad that it would capture everything from correspondence and conveyance of information to interaction with an investor's account, whether discretionary or not. For broker-dealers, the definition includes resources "to provide investors with the ability to obtain or request research reports, news, quotes, and charts from a firm-created website; or firm's use of technologies to generate emails to investors as part of a firm-run email communication subscription that investors can sign up for and customize, and which alerts investors to items such as news affecting the securities in the investor's portfolio or on the investor's 'watch list.'"[3]

The Proposal's "Covered Technology" definition is no less broad: "An analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes."[4] The definition was designed to capture use of technologies employing "Predictive Data Analytics", such as AI, machine

[2] Proposing Release, at 54022.
[3] Proposing Release, at 53975.
[4] Proposing Release, at 53972.

learning, or deep learning algorithms, neural networks, NLP, or large language models (including generative pre-trained transformers). However, it goes on to identify inclusion of "other technologies that make use of historical or real-time data, lookup tables, or correlation matrices among others."

The practical result is that "Investor Interaction" and "Covered Technology" definitions are so overly broad that they could include anything from simple coverage emails to spreadsheet macros, to complex investment technologies. The Proposal's breadth begs the question of whether the Commission understands and has considered the immense benefits that technology offers investors.

With such vague definitions, market participants in legitimate businesses will err on the side of caution rather than risk employing technology in ways that the Commission or its staff may later determine fall afoul of the definitions; when in doubt, a conservative approach is the only safe haven. That safe haven will in most cases be one that excludes the use or eliminates the availability of many beneficial technologies for the sake of compliance. This, in turn, raises the costs of doing business for everyone and eliminates innovation and technological experimentation.

The Proposal Would Inflict Harm on Smaller Investors

In a September 19, 2023, comment letter to the Commission[5], a group of retirement and financial industry trade groups highlighted the devastating effect the Proposal would have on low- to middle-income investors, who currently benefit from a lower-cost brokerage model for their investments and advice. The cost benefits of a brokerage model can be enhanced by the use of "covered technology", as well as the normal commissions and similar payments that may be viewed as conflicts of interest under the Proposal. Costs for the brokerage model would rise significantly in order to comply with the Proposal, rendering it out of reach to most smaller investors.

In their comment letter, the retirement and financial industry trade groups compare the Proposal's likely impact to that of the failed 2016 Department of Labor Fiduciary Rule, a relevant analogy. In addition to explaining the way in which the brokerage model would cease to provide services to small accounts if it became too costly, the letter cites studies where institutions reported limiting or eliminating access to brokerage advice for smaller retirement accounts, and further modeling that demonstrated harm to "small savers, especially in communities of color."

And, in fact, in the context of implementing Reg BI, the Commission itself recognized the benefit to investors of maintaining a brokerage model that does not impose the same costs as the investment adviser model. Specifically, in determining not to subject brokers to the same fiduciary standards imposed on investment advisers, the SEC cited the adverse impact such a decision would have on investors:

> *We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act. . . . we believe (and our experience indicates), that this approach would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations. . . .*

[5] https://www.sec.gov/comments/s7-12-23/s71223-261319-615782.pdf

> *Our concerns about the ramifications for investor access, choice, and cost from adopting either of these approaches are not theoretical. With the adoption of the now vacated Department of Labor ("DOL") Fiduciary Rule, there was a significant reduction in retail investor access to brokerage services, and we believe that the available alternative services were higher priced in many circumstances.*[6]

Members of Congress from both parties have made similar observations about the Proposal's overbreadth and impact on investors. In opening remarks at the recent House Financial Services Committee hearing, *Oversight of the SEC's Division of Investment Management*[7], Representative Ann Wagner (R-MO) offered a sharp critique of the Proposal, stating that its "…burdensome, one-size-fits-all approach will limit investor choice and access, increase costs for retail investors, and lead to a decline in retail investor participation right when it has reached an all-time high." Rep. Wiley Nickel (D-NC) also noted how broad the Proposal is in his remarks, adding that it "…could stifle innovation and stop the technological deployment that's creating avenues of access and choice for traditionally underserved communities. Tens of millions of retail investors now participate in the stock market at extremely low costs, and we can't risk losing that." Yet we would lose precisely that under this Proposal. Small investors are least able to absorb higher access costs, forcing them to make hard choices that may result in reverting to fixed rate products with significantly lower yields. So not only will investor choice be harmed generally, but the brunt is sure to be borne more specifically by smaller investors from underrepresented communities.

Forcing Retail Investors into a Technology Wilderness

Even for those retail investors who may well be able to continue to trade through brokers under the Proposal, they likely will do so without the benefit of the broadest range of investment advice using the latest technological innovations.

Absent investment advice, be it bespoke using all available technology or more generalized, investors will be left to sift unaided through publicly available information to make their investment decisions. When faced with the prospect of wading through investment information, investors are not likely to shun the use of technology. Instead, they will use what technological tools are available to them to mine publicly available information in the form of company disclosures, media stories that may hold bias, and the many online investment forums and blogs. Making technology more costly and risky for advisers and brokers to use (as the Proposal would do) will not protect investors. However, it will cause investors to use technology in less predictable ways.

As demonstrated by the "meme stock" phenomenon of 2020 and 2021, many retail investors are eager to use technology to assist them in making investment decisions – with or without the involvement of brokers or advisers. In describing the share price run-up in one of the "meme stocks," the SEC staff noted in its report on Equity and Market Structure Conditions in Early 2021:

> *The price and volume movements in GME coincided with substantial interest expressed in certain online forums devoted to investing, including YouTube channels and the subreddit*

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[6] Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031, 84 FR 33318, 33320-21 (June 5, 2019) ("Reg BI Adopting Release") at 19 -21 (available at https://www.sec.gov/rules/final/2019/34-86031.pdf).

[7] https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408963

> *WallStreetBets. Some social media posts heavily touted the prospects for GME. Some of this discussion argued that GME was undervalued based on fundamental analysis and therefore constituted an attractive investment, while other discussion focused on its ability to transition to an e-commerce company. Alternatively, others contended that unusually high levels of short interest in GME presented the potential for a coordinated "short squeeze."*[8]

And, of course, the meme stock phenomenon occurred prior to the broad public adoption of large language models and other "predictive data analytics" technology tools that are increasingly used by retail investors.[9] Investors should, of course, be free to use whatever technology they want to use in connection with their investing decisions. The Proposal will inhibit advisers and brokers from offering as wide a range of technologies as possible, which will push investors to seek out technological investing tools elsewhere. If the Commission's hope is that the Proposal will slow down investors' adoption of technology, that hope is misplaced. The Proposal will merely change the nature of the technology investors adopt, and those changes may have unintended adverse consequences that the Commission has not fully considered.

An Abrupt Departure from Historical and Global Standards of Managing Conflicts of Interest

The Commission has cast the Proposal as necessary to protect against the conflicts of interest that "predictive data analytics" used by advisers or broker-dealers could pose in their dealings with clients. Notably, the Proposal does not allow for these envisioned conflicts to be mitigated by full and fair disclosure with informed client consent – a standard that has been consistently recognized by the Commission and other global regulators as an effective means of addressing conflicts of interest. Instead, the Proposal deems that these presumed conflicts of interest must be eliminated or neutralized. To date, the Commission has offered no reasonable explanation[10] for this substantial deviation in practice.

If regulation is approached through this lens of hard paternalism, the Commission will impose its own risk and cost/benefit preferences on investors, depriving investors of the opportunity to consider for themselves the cost/benefit and risk trade-offs presented by employing a broker or adviser that uses technology in a way that may involve a perceived conflict of interest.

A Fictional Crisis of Conflicts

The Proposal paints a picture of fraud and mismanagement risk, where investors are merely prey to those servicing them. In doing so, it finds justification for these ill-conceived rules. No doubt there are bad actors who will use any edge – technology enabled or not – to put themselves first and do harm, but rulemaking of this magnitude in no way reflects the reality that this is exceedingly rare. Conflicts of interest exist in every aspect of business, and the overwhelming majority are handily mitigated by disclosure and consent.

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[8] Equity and Market Structure Conditions in Early 2021 at 17 (Oct. 14, 2021) available at https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf

[9] *See*, Alex Kim & Maximilian Muhn & Valeri Nikolaev, 2023. "Bloated Disclosures: Can ChatGPT Help Investors Process Financial Information?" available here: https://www.researchgate.net/publication/371729260_Bloated_Disclosures_Can_ChatGPT_Help_Investors_Process_Financial_Information.

[10] Proposing Release at 53988. In the Proposal, the Commission states that it was eliminating the option of disclosure "…because a conflict can replicate to a much greater magnitude and at a much greater speed than would be possible to address through timely disclosure." This characterization of technology creating a "runaway train" effect for conflicts is a highly imaginative falsehood.

Technology has brought immense benefits to all in the financial markets. Those benefits now are at risk of being unwound with this Proposal for the sake of eliminating potential conflicts outright. This will result in sharply reduced investor choice and strike yet another harsh blow to retail investors by limiting legitimate information, tools, and market access.

In light of the foregoing concerns, ICAN urges the Commission to withdraw this Proposal. We would welcome the opportunity to elaborate further on the points raised in this letter. For further information, please contact me by email.

Sincerely,

Nicolas Morgan
Founder and President, ICAN

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
William A. Birdthistle, Director, Division of Investment Management