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October 10, 2023

Via Electronic Mail (rule-comments@sec.gov)

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

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

Dear Ms. Countryman,

Robinhood Financial LLC[1] ("Robinhood") submits this letter in response to the U.S. Securities and Exchange Commission's ("Commission" or "SEC") recently proposed rules under the Securities Exchange Act of 1934 ("Exchange Act") and Investment Advisers Act of 1940 ("Advisers Act") intended to address theoretical conflicts of interest related to the use of "predictive data analytics" by broker-dealers and investment advisers (the "Proposal").[2] Robinhood incorporates by reference its comment letter submitted in response to the Commission's 2021 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 ("DEP Request").[3]

Robinhood's mission is to democratize finance for all, regardless of a customer's background, income, or wealth. There is a large investment and wealth gap in the United States, which has created a divide in our country between the "haves" and the "have nots." Robinhood was founded to close this gap with its accessible product offering and user-friendly mobile application, which rely on technology to remove traditional barriers to investing and empower investors so that they can take control of their financial futures.

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[1] Robinhood Financial LLC, a FINRA-member broker-dealer, is a wholly owned subsidiary of Robinhood Markets, Inc.

[2] Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, 88 Fed. Reg. 53,960 (Aug. 9, 2023) ("Proposing Release").

[3] *See* Letter from David Dusseault, President, Robinhood Financial LLC, to Vanessa A. Countryman, Secretary, SEC (Oct. 1, 2021), https://www.sec.gov/comments/s7-10-21/s71021-9316498-260092.pdf; *see also* DEP Request, 86 Fed. Reg. 49,067 (Sept. 1, 2021).

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Using technology to open the markets to retail investors from all backgrounds is central to our mission. Through our mobile app and website, Robinhood demystifies investing by providing free educational resources, financial literature, and user-directed subscriptions to news updates and information regarding securities in investors' portfolios. Because customers have 24/7 access to these tools and information, they have the freedom to consider and make decisions on their own schedule and time frame. In addition, Robinhood makes trading more accessible by eliminating account minimums and trading commissions and offering investors IPO access, fractional trading, and the first IRA with a match, no employer necessary. Using our mobile app, our customers can engage with their investments and access capital markets as they plan for their financial well-being and their futures. Engagement in this context is good; the more retail customers are involved in their finances, paying attention to their assets, and learning about investing, the better equipped they are to achieve their financial goals.

We are deeply concerned that the SEC's misinformed Proposal will jeopardize the progress we and the industry have made in making U.S. markets more diverse and accessible to everyone. The SEC's Proposal starts from the apocryphal premise that broker-dealers' and investment advisers' use of technology is inherently conflicted and necessarily causes investor harm. The Proposal then places such onerous burdens and costs on broker-dealers and investment advisers (collectively, "firms") that use technology that—by the SEC's own admission—some firms will stop providing certain (maybe most) technologies to customers altogether.

Disregarding the many benefits that technology provides to investors and the marketplace,[4] the Proposal's anti-technology, regressive approach appears primarily based on a false narrative regarding the so-called "meme stock" events in early 2021.

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[4] *See, e.g.*, SEC, *Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets*, Executive Summary (Nov. 26, 1997), https://www.sec.gov/news/studies/techrp97.htm (During the dawn of the Internet Age, noting that "[t]he Commission is mindful of the benefits of increasing use of new technologies for investors and the markets, and has encouraged experimentation and innovation by adopting flexible interpretations of the federal securities laws[,]" and that "[t]he Commission also has adopted rules that permit markets and market participants to make use of technology, and has modified other rules or interpretive positions that might conflict with technological innovations."); Conference Report on H.R. 3005, National Securities Markets Improvement Act of 1996 (Oct. 21, 1996) (In enacting the SEC's general exemptive authority under Section 28 of the Securities Act and Section 36 of the Exchange Act, which permit the SEC to grant exemptions from the requirements of such Acts as "necessary or appropriate in the public interest," one Congressman highlighted that the "public interest" included "the promotion of responsible financial innovation."). *See also* Judy T. Lin et al., *Investors in the United States: The Changing Landscape: A Report of the FINRA Foundation National Financial Capability Study* (Dec. 2022), https://www.finrafoundation.org/sites/finrafoundation/files/NFCS-Investor-Report-Changing-Landscape.pdf.

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While certain SEC officials persist in using early 2021's trading in GameStop Corp. stock and the findings of the GameStop Report[5] as a boogeyman to attack retail brokers that use technology to interact with investors,[6] we and others who actually know the markets continue to reject the theory that so-called "digital engagement practices" in any way caused GameStop to experience volatile trading, and we reject today that such market events had anything to do with predictive data analytics or similar technologies that the Proposal would regulate.[7] The facts, and the GameStop Report itself, simply do not support such a conspiracy theory.[8] Like most market participants, Robinhood knows that conspiracy theories damage investor trust and confidence in our markets. And to the extent that the SEC is concerned about certain technologies being used in a manner that directly or indirectly causes a substantial number of retail investors to trade large volumes of securities in a short period of time, the SEC has failed both to substantiate this concern and to demonstrate how the Proposal would address this concern. Among other things, the SEC has failed to provide a single shred of real evidence that: (1) broker-dealers or investment advisers are using technology in a manner that would cause problematic trading at all, let alone at a level significant enough to justify further regulation, and (2) firms' customers are actually engaged in such trading. The responses to the SEC's DEP Request also do not support the theory that firms are using technology in a manner that causes or promotes problematic trading by retail investors. As we stated in our response to the DEP Request, Robinhood does not use technology in that manner.

Robinhood recognizes the promise that technology—from the most basic spreadsheet to emerging artificial intelligence, natural language processing, and

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[5] SEC Staff Report, *Equity and Options Market Structure Conditions in Early 2021* at 2 (Oct. 14, 2021), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf ("GameStop Report") (drawing unsupported normative conclusions regarding how retail traders "might trade more frequently" due to no commission trading and so-called "digital engagement practices" of broker-dealers).

[6] *See, e.g.*, Gary Gensler, Chair, SEC, *Testimony Before the House Committee on Financial Services* (May 6, 2021), https://www.sec.gov/news/testimony/gensler-testimony-20210505.

[7] GameStop Report at 2 (The SEC Staff itself recognized that "these features are not necessarily the cause of the meme stock volatility.").

[8] The volatile trading in GameStop was caused by a unique confluence of factors, including increased retail investor participation in the stock market, which the SEC and SEC officials are now quick to malign and ascribe to the use of digital engagement practices of broker-dealers without consideration of other significant contributing factors relating to those events or the benefits of retail investor market participation. Notably, the GameStop Report merely recommended that game-like features be studied, which the SEC did not do prior to publishing the Proposal. *See id*. at 15-17 (identifying potential contributing factors, such as increased individual market participation, large price fluctuations and short interest in GameStop stock, and social and mainstream media buzz about GameStop, as well as "underlying causes of the meme stock phenomenon that are unrelated to market structure are a subject of speculation that is beyond the scope of this report.").

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other advanced technologies—holds for the future of investing. Robinhood also recognizes the importance of developing and implementing these technologies in a responsible and regulated manner, consistent with the full panoply of SEC and FINRA rules that already apply to protect investors and the markets, including rules that specifically focus on investor interactions. Instead of meaningfully enhancing the existing regulatory framework, the SEC would simply displace it with a regulatory land grab that would result in its overseeing nearly all uses (or potential uses) of any mode of technology by broker-dealers and investment advisers that may occur in interactions with investors—from a simple calculator, Excel spreadsheet, or email to a quantum computer and advanced artificial intelligence.[9] Through this Proposal, the SEC would also impose an unsupported new uniform standard of conduct on any retail broker-dealer and any investment adviser that uses technology to interact with its customers, effectively overriding years of study and analysis that led to the Commission's Regulation Best Interest ("Regulation Best Interest" or "Reg BI") and its Interpretation Regarding Standard of Conduct for Investment Advisers ("Fiduciary Interpretation").[10] The SEC seeks to justify this broad expansion of its authority by speculating about the potential, theoretical, and future harm that technology might cause, without identifying any actual harm that its Proposal would address. And along the way, the SEC confesses its belief that retail investors—millions of Americans working hard to improve their financial positions—are too stupid to understand basic customer disclosures.[11]

The SEC's approach to regulation in the Proposal is extreme and out of step with modern markets and the Biden Administration's approach to innovation and technology.[12] The Proposal also raises significant constitutional issues and vastly exceeds the authority given the SEC by Congress. It is not only contrary to decades of securities law precedent using disclosure to address conflicts of interest, but it is also contrary to the SEC's own mission to protect investors, facilitate capital formation,

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[9] *See* Proposing Release, 88 Fed. Reg. at 53,973-74.

[10] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (codified at 17 C.F.R. § 240.15l-1); Fiduciary Interpretation, 84 Fed. Reg. 33,669 (July 12, 2019).

[11] *See* Proposing Release, 88 Fed. Reg. at 53,967. *See also id*. at 53,998 ("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.").

[12] For example, a key piece of President Biden's Investing in America agenda is the development of regional technology and innovation hubs across the United States. *See* Press Release, U.S. Econ. Dev. Admin., *Biden-Harris Administration's Tech Hubs Competition Applications Show Nationwide Excitement for Investing in America's Technological Future* (Aug. 30, 2023), https://www.eda.gov/news/press-release/2023/08/30/biden-harris-administrations-tech-hubs-competition-applications-show.

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promote competition, and maintain fair, orderly, and efficient markets. In short, the Proposal is vague and overbroad, excessively burdensome, and overall bad policy that would harm not only broker-dealers and investment advisers, but also the markets in which they operate and, most importantly, the investors they serve.

EXECUTIVE SUMMARY

The Commission's Proposal would create new Rule 15l-2 under the Exchange Act and Rule 211(h)(2)-4 under the Advisers Act. These rules would be adopted under the SEC's statutory authority to "examine and *where appropriate*" prohibit or restrict "*certain* … conflicts of interest… *contrary to the public interest and the protection of investors.*"[13]

In reality, the proposed rules represent an unprecedented expansion of the SEC's role and far exceed this modest statutory authority.[14] The Proposal seeks to impose a framework that would regulate almost *any use* of almost *any technology* by investment advisers and retail broker-dealers in almost *any interaction* with their customers—regardless of whether doing so is appropriate or necessary for the protection of investors. There is no principled limitation on the so-called "covered technology" that the SEC seeks to control—the SEC would regulate everything from mundane forms of technology, such as spreadsheets, emails and graphic design (which have been widely used across industries for decades), to the most sophisticated algorithms used by firms.[15] The SEC would impose excessive burdens and costs on firms that use this covered technology to interact with investors—including technology that investors specifically seek out for their own purposes. For example, if a broker-dealer provides news updates regarding stocks in a customer's portfolio, even at the customer's request and for free, that would be "covered technology" subject to costly regulation. So too would a website that allows users to self-select and view or download financial literature from a database. The proposed rules would impose costly regulation on even these simple technological tools that are unquestionably good for the investing public.

The breadth of the rule's application and the excessive costs and burdens that would apply to firms' use of technology cannot be overstated. First, firms would be required to survey and identify *every* individual technology that could be a "covered

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[13] 15 U.S.C. §§ 78o(l)(2)80b–11(h)(2) (emphasis added). *See* Proposing Release, 88 Fed. Reg. at 53,971.

[14] This concern is heightened because the authority the SEC is relying on is currently pending court review. *Petition for Review, Nat'l Ass'n of Private Priv. Fund Managers v. SEC*, No. 23-60471 (5th Cir. Sept. 1, 2023), ECF No. 1-1.

[15] The proposed rules broadly define "covered technology" as "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." Proposed Rules 15l-2(a; 211(h)(2)-4(a); Proposing Release, 88 Fed. Reg. at 54,021-22, 54,023.).

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technology." This could capture everything that broadly relates to securities and investments.

Next, firms would be required to identify whether the technology is used or "potentially could be used" in an "investor interaction." Again, this includes virtually every contact with an investor—both direct and indirect—from emails to phone calls to in-person meetings, to simply hosting a website or operating a mobile app or providing investors with tools to get market updates. Then, firms would be required to identify if a "conflict of interest" exists for the technology. Again, effectively every use of technology would be "conflicted" because contrary to the conventional understanding of "conflicts of interest," the SEC has stated that "[c]onsideration of *any* firm interest would be sufficient for a conflict of interest to exist" under the proposed rules.[16]

But the burdens do not stop there. After a firm has identified almost every piece of technology that it uses in almost any communication—directly or indirectly—with investors, it would be obligated to undertake a series of laborious, manually intensive tasks *for each spreadsheet, automated email, calculator, web page, and every other piece of covered technology*: (1) evaluate the technology (including testing) to identify any actual use *or potential use* of the technology that might take into consideration *any* firm interest; (2) determine whether this "conflict of interest" places the firm's or its associated persons' interests ahead of investors; (3) eliminate or neutralize the effect of any such conflict of interest; and (4) repeat steps 1-3 on a periodic basis and every time there is a material change to the technology. Firms would need to have detailed descriptions and written policies and procedures for identifying covered technology that could be used in investor interactions, identifying conflicts, and neutralizing or eliminating conflicts. They would need to conduct annual reviews of these policies and create new, highly detailed books and records of *each piece of covered technology* to document their compliance.

Not only are these tasks extraordinarily burdensome and daunting, but in some cases they would be "impossible"—as the SEC itself even admits in the Proposal.[17] Even when not "impossible," the SEC acknowledges that "the requirement to identify conflicts of interest in a technology could dissuade firms from using certain technologies when it is too difficult or costly to adequately evaluate the use of the covered technology, identify a conflict of interest, or determine whether they place the firm's or an associated person's interest ahead of an investor's."[18]

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[16] Proposing Release, 88 Fed. Reg. at 53,985 (emphasis included).

[17] *See id*. at 53,978 ("In certain cases, it may be difficult or impossible to evaluate a particular covered technology or identify any conflict of interest associated with its use or potential use within the meaning of the proposed rules.").

[18] *Id*. at 54,010-11.

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Ultimately the costs will be borne by investors.[19] As the SEC admits, "[f]irms might pass the cost of the requirements along to investors through higher fees, commissions, or other methods" and "[i]nvestors would lose the benefit of such technologies if firms determine that the process of eliminating, or neutralizing the effect of, conflicts is too difficult, costly, or uncertain to succeed."[20] Given the breadth of "covered technology" and "conflict of interest," this means that even free educational tools, resources, and information, including customer-requested updates about their portfolio or the market, are susceptible to being eliminated because of the costs and regulatory burdens imposed by this Proposal.

And for what benefit and whose benefit? One of the primary potential benefits that the SEC identifies is that the new written documentation and recordkeeping requirements "would serve to aid the examinations staff."[21] Stated differently, the SEC is imposing massive new burdens and costs on the industry and investors for its own convenience.

Given the significant substantive and process concerns with the proposed rulemaking, we urge the Commission not to move forward with the Proposal.

As discussed more fully below in Section I, the Proposal is arbitrary and capricious. The SEC has not demonstrated a need for placing unprecedented regulatory burdens on firms' use of technology. The SEC also has provided no evidence that there is any actual harm caused by "covered technology" that would be addressed by its Proposal and that cannot be addressed by existing regulation. There also is no evidentiary support for the Proposal's radical requirement to "eliminate or neutralize" conflicts in lieu of addressing them through disclosure, which remains permissible and, in many instances, is prescribed under the federal securities laws to address other conflicts of interest. The lack of evidentiary support for the Proposal is not surprising given that the SEC failed to conduct the necessary analysis or fact gathering that is required for rulemaking.

As discussed in Section II, the Proposal is fatally flawed because the SEC has failed to conduct any credible cost-benefit analysis. In particular, the SEC has not gathered the requisite information to conduct a serious cost quantification and analysis and, instead, offers a speculative and incomplete assessment. There is limited discussion

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[19] The costs facing retail investors only would be compounded if the SEC's equity market structure proposals are adopted; however, the SEC has made no attempt to reconcile how those proposals would interact with this one or to assess the cumulative effects on retail investors or the industry overall. *See* Disclosure of Order Execution Information, 88 Fed. Reg. 3,786 (Jan. 20, 2023); Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, 87 Fed. Reg. 80,266 (Dec. 29, 2022); Order Competition Rule, 88 Fed. Reg. 128 (Jan. 3, 2023); Regulation Best Execution, 88 Fed. Reg. 5,440 (Jan. 27, 2023).

[20] Proposing Release, 88 Fed. Reg. at 54,010-11.

[21] *Id.* at 54,006.

of the benefits technology provides to investors today that could be impacted by the Proposal. And for the few costs that it does quantify, the SEC greatly underestimates the cost of compliance. At the same time, the SEC has failed to quantify and identify any clear benefits to the Proposal that could offset the Proposal's significant costs. Finally, the SEC has failed to consider the sufficiency of existing regulation in its cost-benefit analysis. Specifically, the SEC has failed to identify any problems relating to the use of covered technology that could not be addressed by existing SEC and FINRA regulations.

As discussed in Section III, the SEC has unlawfully exceeded its statutory authority with this Proposal. The Proposal would restrict nearly every aspect of a modern customer-facing securities business, presenting numerous questions about the SEC's authority to promulgate such a rule. The SEC seeks to expand its statutory authority beyond any reasonable reading of the statutory provisions it relies on, Section 15(l)(2) of the Exchange Act and Section 211(h) of the Advisers Act. The Proposal also violates the First Amendment because it improperly seeks to regulate free speech. The SEC's entire Proposal is based on the false premise that technology is inherently and irrevocably conflicted when used by broker-dealers and investment advisers to interact with investors. While regulators may prevent the dissemination of false or misleading information (and already have tools to do that), the SEC may not suppress ideas, opinions, or truthful information because it fears investors exposed to such expression will make decisions that the SEC believes are not in their best interests.

Finally, as discussed in Section IV, the SEC should withdraw the Proposal because it is bad policy and unlawful for a multitude of other reasons. As a threshold matter, the Proposal cannot be squared with the SEC's recently adopted Reg BI or the SEC's longstanding tradition of relying on a disclosure-based framework to address conflicts of interest for broker-dealers. The Proposal is also bad policy because it would disempower investors and is blatantly anti-technology and anti-innovation. It would indiscriminately and broadly regulate and restrict communications because of the medium through which they are delivered. And, fatally, the Proposal is unlawful and inconsistent with the SEC's rulemaking mandate because it will reduce efficiency, stifle competition, and deter capital formation.

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I. The Proposal Is Arbitrary And Capricious Because The SEC Has Not Demonstrated A Need For Placing Unprecedented Regulatory Burdens On Firms' Use Of Technology.

The Proposal represents one of the most radical, unprecedented rulemaking initiatives in the SEC's history (or that of any other federal regulator for that matter). Based on an unsubstantiated theory that investment technology is rife with treacherous conflicts of interest, the SEC seeks to impose an unnecessarily expansive framework that would regulate almost *any use* of technology by retail broker-dealers and investment advisers in almost every interaction they have with investors, effectively creating a uniform, heightened standard of conduct for firms that use

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technology, i.e., virtually all firms today. The Proposal would regulate all "covered technology" that is directly or indirectly used or "reasonably foreseeable" to have "potential use" in any investor interaction, thereby imposing on the industry excessive costs and burdens which would harm investors as well as broker-dealers and investment advisers. The SEC would upend a marketplace that has worked so well for millions of investors and fails to provide any credible justification for doing so. Specifically, the SEC has (1) failed to identify any actual investor harm posed by conflicts of interest in firms' use of covered technology, (2) failed to provide any basis for its claim that disclosure is inadequate to address conflicts, and (3) failed to explain why the existing regulatory framework does not adequately address firms' use of this technology. The SEC's failure to identify an actual harm or need for its Proposal is the inevitable result of its flawed rulemaking process. Rather than conducting a data-driven, fact-based process before issuing the Proposal, the SEC broke from tradition and relied primarily on speculation, hearsay, and irrelevant academic literature. The SEC is better than this proposal.

A. There Is No Evidentiary Support For The Proposal's Application To A Broad Swathe Of Technologies And Investor Interactions.

While the purported purpose of the Proposal is to address broker-dealers and investment advisers that improperly use "predictive data analytics," "artificial intelligence," and "machine learning," technologies, these terms appear to be window dressing. The SEC does not bother to identify any firms that use such technology or any use of such technology that creates an actual harm to investors. And to the extent that the SEC is concerned about retail investors trading a large volume of securities in a short period of time, the SEC has failed to demonstrate how the Proposal would address this concern. Among other things, the SEC has failed to provide a single shred of evidence that: (1) broker-dealers or investment advisers are using technology in a manner that would cause problematic trading, and (2) firms' customers are engaged in such trading. Moreover, the responses to the SEC's DEP Request (including Robinhood's response) cannot support the theory that firms are using technology in a manner that causes problematic customer trading.

Instead of identifying a real problem and then drafting a rule appropriately targeted to that problem, the Proposal captures almost every form of technology interaction, including the use of mundane programs that are clearly not predictive data analytics, artificial intelligence, or machine learning—such as spreadsheets, emails, and graphic design—and requires firms to identify and "eliminate or neutralize the effect of" certain "conflicts of interest" relating to this technology.[22] In the absence of any evidence that there is a discernible problem that requires solving and is not already addressed by the existing regulatory framework, the SEC relies on irrelevant, conclusory and outlandish claims to justify the need for the Proposal. These "sources" include, among other things:

[22] *See id*. at 53,963, 53,974.

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- academic literature that has nothing to do with the use of technology in a customer-facing investment services business[23];
- speculative fear-mongering with hyperbolic, clickbait titles about the future of technology[24];
- unsupported emotional appeals and claims by individuals that demonstrate a fundamental misunderstanding of the state of the securities markets and regulation[25];
- publications that amount to little more than political marketing spin intended to generate "buzz" around existing or planned AI technology programs[26]; and
- comment letters responding to the DEP Request taken out of context or used to make points those letters do not support.[27]

With these sources, the SEC may as well also consult *The Terminator* (1984) for a showcase of the potential dangers of technology.

The SEC also presents no credible analysis or evidence that technology (in general or with regard to a specific technology) causes investors harm by causing them to trade in a manner that is too "frequent" or "excessive." Nor is there evidence that technology leads investors to any particular outcome—positive or negative. The so-called "support" the SEC cites for this proposition includes outdated academic articles from an era where customers were charged commissions on every trade.[28] Thanks to Robinhood, the commission era is over, and today's investors are able to self-direct their trading at historically low costs and, thanks to technology, with ready access to tools and information that many could not afford when investors were required to pay commissions. The scant, outdated academic literature referenced by the SEC is hardly sufficient to justify the Proposal's excessive costs and the harm it would do to disempower investors. But instead of doing the hard work of conducting a robust

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[23] *See, e.g.*, *id*. at 53,963, nn.24 & 26.

[24] *See, e.g.*, *id*. at 53,963, n.27, 53,964, nn.41 & 42, 53,968, nn.84 & 85.

[25] See, e.g., *id*. at 53,968, n.81, 53,969, n.92.

[26] *See, e.g.*, *id*. at 53,962, n.15, 53,964, n.31, 53,965, n.54, 54,001, n.266.

[27] *See, e.g.*, *id*. at 53,969-70, nn.92, 99 & 101 (letters from Robinhood and Scopus Financial Group).

[28] *See, e.g.*, *id*. at 53,999, n.240 (citing Brad M. Barber & Terrance Odean, *Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors*, 55 J. Fin. 773–806 (2000), which includes as part of its thesis why trading is hazardous to your wealth the finding that "[t]rading costs are high" due to commissions that were prevalent during that time, *id.* at 775)); Proposing Release, 88 Fed. Reg. at 53,998, n.232 (citing Hamid Mehran & René M. Stulz, *The Economics of Conflicts of Interest in Financial Institutions*, 85 J. Fin. Econ. 267–96 (Aug. 2007) (discussing in the context of mutual funds that a "broker's advice might be biased if the broker earns more by directing an investor to specific funds." *id*. at 271)).

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economic analysis, the SEC relies on political talking points in a vain attempt to justify this Proposal.

The only time the SEC cites an actual example of a firm's use of technology to support its Proposal, it is in a wholly irrelevant and inapposite context that has nothing to do with broker-dealers.[29] Specifically, the SEC cites an example of robo-adviser conduct for which, as the SEC concedes, there are already regulations and protections that are sufficient to address the entity's use of technology—which moots any need for the Proposal.[30]

Even on the Proposal's own terms, the Proposal's stated rationales cannot justify its draconian remedies. The Proposal is predicated on claims about the uniquely powerful and supposedly conflict-prone nature of new technologies, such as artificial intelligence. These claims are the given justification both for the onerous obligations the Proposal places on firms to scour all their technologies for possible conflicts of interests, and for the unusually draconian remedy the Proposal prescribes—disclosure is insufficient, the Commission argues, because of the insidious "scalability" of new technologies. Although the Commission is mistaken on these matters even with respect to the *new* technologies it uses to justify this rule, there is simply no basis in reason to apply obligations targeted at *those* technologies to the full range of "covered technologies" under the Proposal, including Excel spreadsheets, for example, or calculators. The Commission's stated rationale for the Proposal cannot begin to justify the onerous obligations and restrictions it places on all technologies, and not merely on the handful of new technologies used to justify this Proposal. The mismatch between the Proposal's narrow premise on the one hand, and its sweeping coverage and crushing burdens on the other, is the essence of arbitrary and capricious agency action. It must be rectified. And of course, such a fundamental re-tooling of the Proposal will also require re-proposal.

Rather than invoking inapposite examples and propagating conspiracy theories that inject doubt into the fairness of our markets, the SEC should rely on facts and data in explaining why its Proposal is necessary—because the nation's securities regulator will receive no deference from a court for its dystopian musings about the wickedness of technology.

B. There Is No Evidentiary Support for the Proposal's Radical Requirement To "Eliminate or Neutralize" Conflicts In Lieu of Addressing Conflicts Through Disclosure.

The SEC's justification for the Proposal's "eliminate or neutralize" requirement is equally problematic. Without any basis, the SEC now claims that its 90-year-old convention of addressing conflicts of interest with disclosure is no longer valid: "due to the scalability of [covered] technologies and the potential for firms to reach a broad

[29] *See* Proposing Release, 88 Fed. Reg. at 53,968.

[30] *See id*.

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audience at a rapid speed."[31] The SEC also points to the "inherent complexity and opacity" of technology as justification for eschewing disclosure as an effective mitigant, even while broadly defining covered technologies to include simple calculators and excel spreadsheets.[32]

Putting aside the fact that the SEC fails to explain what it means by "scalability" and how it applies to its vast universe of "covered technology," these conclusory statements that "disclosure will not work" fail to demonstrate how and why disclosure will not work when it has worked well for decades in contexts involving actual conflicts of interest. Unlike the Proposal's amorphous, undefined "conflicts," these conflicts are real and significant. For example, SEC and FINRA rules rely on disclosure to customers of critical conflicts of interest such as compensation, third party remuneration, and control relationships in connection with securities transactions.[33]

More recently, in the context of recommendations, the SEC adopted Reg BI[34] which relies primarily on disclosure to manage even *material* conflicts of interest and identifies only a specific and limited set of conflicts that must be eliminated.[35] When making a recommendation to a retail customer, broker-dealers are required by Reg BI to disclose "[a]ll material facts relating to conflicts of interest associated with the recommendation."[36] Reg BI only requires the elimination of "sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time."[37] These provisions were adopted by the SEC in 2019, after a multi-year rulemaking process that involved lengthy studies, several requests for information, over 6,000 comment letters, and in-person feedback from multiple investor roundtables and forums. Surely, conflicts of interest in the context of recommendations are by any measure more important and sensitive than "investor interactions" where only information is provided, and yet, the Commission determined that disclosure was generally appropriate. The Commission must explain why "conflicts" that are not even true conflicts (*see infra* at Section III.A.3), in interactions that may not even involve advice

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[31] *Id*. at 53,961.

[32] *Id*. at 53,967.

[33] *See, e.g.,* 17 C.F.R. § 240.10b-10 (Confirmation of transactions), 17 C.F.R. § 240.15c1-5 (Disclosure of control), 17 C.F.R. § 240.15c1-6 (Disclosure of interest in distribution); FINRA Rules 2262, 2269.

[34] Regulation Best Interest, 84 Fed. Reg. 33,318.

[35] Rule 15l-1(a)(2), Regulation Best Interest, 84 Fed. Reg. at 33,491.

[36] Rule 15l-1(a)(2)(i)(B), Regulation Best Interest, 84 Fed. Reg. at 33,491.

[37] Rule 15l-1(a)(2)(iii)(D), Regulation Best Interest, 84 Fed. Reg. at 33,491.

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or recommendations, are less capable of being addressed by disclosures than real and genuine conflicts of interest relating to a recommendation.

The Proposal fails to explain what has changed since 2019 to make the SEC now reject disclosure as an effective means for addressing potential conflicts of interest even in interactions that do *not* involve a recommendation or actual transaction. Mobile apps and online trading sites have been available to retail investors well before 2019 when Reg BI was issued, and "technology" like calculators and spreadsheets have been used for decades. Why and how technology in all forms has suddenly become "conflicted" and to such a degree that disclosure is no longer effective is inexplicable.

The SEC's conclusory statement that "disclosure will not work" is flawed for a second reason: it ignores the fact that delivery of information to customers through technology can *better* inform customers of potential conflicts and risks. The SEC suggests that the delivery of information to customers through technology has some unbridled capacity to cause mischief because of its "scalability." However, the SEC ignores the fact that information delivered through technology can provide disclosures and risk statements in a more effective manner than if that same information were delivered through a different medium. Instead of sending a hard copy disclosure statement by mail and assuming that the customer will eventually receive and review it, firms use technology to provide more timely and targeted disclosures, such as through in-app messages, alerts, and education. Information delivered through technology also can reinforce the importance of disclosures, for example, by requiring customers to acknowledge or scroll-through important disclosures regarding the securities markets or securities products.

The SEC's weak attempts to explain why disclosure is inadequate are unsupported and unconvincing. As stated in the Proposal: "disclosure alone may not necessarily address negative outcomes when 'the issue lies in human psychological factors, rather than a lack of information.'"[38] However, the SEC does not even attempt to identify what these "human psychological factors" are or to provide any evidentiary support that its decade-long disclosure policy is no longer adequate because of these "psychological factors" (nor do we think the SEC has the expertise or authority to evaluate human psychology). Even the SEC's own economists acknowledge that this justification cannot be supported by facts or data, noting that certain benefits and costs identified in the Proposal are "impractical to quantify because quantification would necessitate general assumptions about behavioral responses that would be difficult to quantify."[39]

In truth, for retail investing, technology has meant simplicity, comprehensibility, accessibility, actionability and lower fees—and it is these very features that animate this Proposal, as the Commission worries that technology makes it too easy for individuals to trade "frequently." Given that this is one of the Proposal's premises—

[38] Proposing Release, 88 Fed. Reg. at 53,986, n.181.

[39] *Id.* at 53,998

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technology simplifies trading—the Commission bears a heavy burden to explain why technology cannot also simplify and facilitate disclosure.

C. The SEC Has Failed To Provide Any Credible Basis For Why The Existing Regulatory Framework Is Inadequate To Address Any Concerns With Covered Technology.

The Proposal is a highly flawed solution in search of a problem. In addition to failing to provide evidence of an actual harm the Proposal would address, the SEC fails to explain why the existing regulatory framework is not adequate to address any perceived concerns. To the contrary, the SEC seems to recognize that it has all the tools it needs at its disposal to address any concerns relating to covered technology, stating that it: "has and will continue to bring enforcement actions for violations of the Federal securities laws that entail the use of PDA-like technologies."[40]

Throughout the Proposal, the SEC concedes there is an extensive regulatory framework in place applicable to broker-dealers and investment advisers, including the SEC's broad antifraud authority under the Exchange Act and Advisers Act by which it can police potential misconduct and address investor harm that could result from the misuse of technology. For example, the SEC recognizes that "a broker-dealer has a duty to disclose material adverse information to its customers" which "the Commission has enforced … under the antifraud provisions."[41] The SEC also recognizes this existing authority with respect to investment advisers. In fact, just last year, the SEC settled an enforcement action under the Advisers Act Section 206's broad antifraud authority where the SEC alleged that conflicts of interest associated with a firm's use of PDA-like technologies resulted in harm to investors.[42] Because conflicts of interest involving technology have already been and can continue to be addressed by the existing antifraud provisions, the potential benefits of the Proposal are marginal at best.

In addition to the antifraud provisions of the federal securities laws, Reg BI is another tool the SEC already has to ensure that broker-dealers adequately address conflicts of interest in the context of a recommendation. As noted above, Reg BI already would apply to conflicts of interest related to covered technology where a "recommendation" is made to retail customers.[43] Reg BI enhanced the standard of conduct for broker-dealers providing recommendations to customers under the theory that conflicts of interest related to recommendations, more than other types of customer interactions, could lead to investor harm. When adopting Reg BI, the SEC

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[40] *Id.* at 53,967.

[41] *Id.* at 53,966.

[42] *See Charles Schwab & Co.*, Exchange Act Release No. 95,087 (June 13, 2022), https://www.sec.gov/files/litigation/admin/2022/34-95087.pdf; *see also* Proposing Release, 88 Fed. Reg. at 53,968.

[43] *See generally* Regulation Best Interest, 84 Fed. Reg. 33,318.

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"proposed to limit conflicts of interest to those associated with recommendations as broker-dealers may provide a range of services not involving a recommendation, and *such services are subject to general antifraud liability and specific requirements to address associated conflicts of interest*."[44] The SEC very explicitly declined to apply Reg BI to communications that serve an educational purpose, such as "[g]eneral financial and investment information, including: [b]asic investment concepts …, effects of inflation, estimates of future retirement income needs, and assessment of a customer's investment profile," and even asset allocation models and interactive investment materials as long as "they do not include, standing alone or in combination with other communications, a recommendation."[45]

It is not clear what has changed in the short time since Reg BI was adopted that would require the imposition of a heightened standard of conduct to nearly every customer interaction where a broker-dealer involves the direct or indirect use of technology. Nowhere in its attempted explanations does the SEC demonstrate that technology poses unique risks to investors even outside the context of recommendations and consequently requires such a heightened standard.

On top of the existing SEC regulatory framework, the SEC has delegated to self-regulatory organizations ("SROs"), including FINRA, the ability to create and enforce rules governing broker-dealer conduct, communications with the public, and supervision that also capture the use of covered technology by broker-dealers and address conflicts of interest.[46] Congress and the SEC deliberately shifted primary responsibility for broker-dealer oversight from the SEC to FINRA, noting that SEC oversight of broker-dealers "was unnecessarily costly and diverted the SEC's limited resources away from areas of major concern, merely to duplicate the functions of the NASD [now FINRA]"[47] and recognizing that "the Commission could not effectively carry out the detailed responsibilities required."[48] Under FINRA rules, broker-dealers are required to observe high standards of commercial honor and just and equitable principles of trade in conducting their business—these standards are a catch-all designed to capture a broad array of conduct.[49] FINRA examines broker-dealers annually (and sometimes more frequently) for compliance with its rules and standards of conduct, including when a firm uses technology to engage in or facilitate

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[44] *Id*. at 33,387 (emphasis added).

[45] *Id*. at 33.337-38.

[46] *See, e.g*., FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2020 (Use of Manipulative, Deceptive, or Other Fraudulent Devices); FINRA Rule 2111 (Suitability); FINRA Rule 2210 (Communications with the Public); FINRA Rule 3110 (Supervision).

[47] Concept Release Concerning Self-Regulation, 69 Fed. Reg. 71,256, 71,267 (Dec. 8, 2004).

[48] *Id*. at 71,282.

[49] *See* FINRA Rule 2010.

regulated brokerage functions, whether they are supported by proprietary technology or technology provided by an affiliate or third-party vendor.[50] SRO regulation supplements existing SEC authority to provide meaningful oversight of broker-dealers' interactions with customers without the need for new requirements that the Proposal would impose.[51]

In sum, the SEC puts forth no evidence that the existing regulatory framework is insufficient to address potential conflicts of interest in investor interactions. This is intriguing, to say the least, given the adamant pronouncements by SEC officials that the 90-year-old securities laws are more than adequate to regulate the inherently technology-driven crypto markets.[52] Accordingly, the SEC fails to demonstrate the need for the Proposal.[53]

D. In A Troubling Departure From Long-Standing Tradition, The SEC Failed To Engage In A Serious Fact-Gathering Or Data-Driven Process Before Issuing The Proposal.

As detailed above, the SEC has failed to demonstrate a need or factual basis for the Proposal. The questionable analysis in this Proposal is a departure from the SEC's traditionally robust, data-driven process for obtaining information and feedback prior to engaging in rulemaking. This is a basic tenet of SEC rulemaking that has been long recognized by SEC Commissioners and should not be controversial.[54] As aptly noted

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[50] *See, e.g.*, FINRA, Regulatory Notice 21-29, *FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors* (Aug. 13, 2021), https://www.finra.org/rules-guidance/notices/21-29; FINRA, Notice to Members 05-48, *Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers* (July 22, 2005), https://www.finra.org/rules-guidance/notices/05-48.

[51] *See, e.g.*, FINRA, *Cloud Computing in the Securities Industry* (Aug. 16, 2021), https://www.finra.org/rules-guidance/key-topics/fintech/report/cloud-computing; FINRA, *Artificial Intelligence (AI) in the Securities Industry* (June 10, 2020), https://www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry.

[52] *See, e.g.*, Ephrat Livni & Matthew Goldstein, *Even After FTX, S.E.C. Chair Sees No Need for New Crypto Laws*, N.Y. Times (Dec. 22, 2022), https://www.nytimes.com/2022/12/22/business/gary-gensler-sec-crypto.html.

[53] *See, e.g.*, Fiduciary Interpretation, 84 Fed. Reg. 33,669 (interpreting the fiduciary duties of an investment adviser in dealings with clients generally, which requires an adviser to act in its client's best interest at all times).

[54] *See, e.g.*, Luis A. Aguilar, Comm'r, SEC, *Exemplifying Fundamentals—Back to Basics* (Mar. 28, 2011) https://www.sec.gov/news/speech/2011/spch032811laa.htm ("A regulator must possess expertise that is informed by current, accurate data and must exercise judgment that is grounded in the mission of the institution and service to the public at large."); Mary Jo White, Chair, SEC, *Keynote Address: Securities Traders Association 83rd Annual Market Structure Conference, Equity Market Structure in 2016 and for the Future* (Sept. 14, 2016), https://www.sec.gov/news/speech/white-equity-market-structure-2016-09-14 (touting the

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by then-Commissioner Luis Aguilar, when it comes to rulemaking, "[k]nowledge is always better than speculation"[55] and "new regulatory regimes and rules promulgated by the SEC must have real and verifiable investor protections."[56]

For example, prior to proposing Reg BI, the SEC spent years reviewing the standard of care applicable to broker-dealers and investment advisers, including through the RAND study of investor perspectives commissioned in 2006, the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") Section 913 staff study conducted in 2010-2011, and a request for data and other information in 2013.[57] In response to the 2013 request, the SEC received more than 250 comment letters from industry groups, individual market participants, and other interested persons who provided both qualitative and quantitative data and surveys regarding the benefits and costs of the current standards of conduct for broker-dealers and investment advisers, as well as alternative approaches to these standards. In November 2013, the SEC's Investor Advisory Committee adopted a recommendation on the standard of care that should apply to broker-dealers when providing personalized recommendations to retail customers. In 2017, the SEC again solicited comments from the public on specific areas relating to broker-dealers' standard of care when making recommendations and data and other information that could inform the Commission's analysis.[58] In addition to this request, SEC Chairman Clayton and the staff continually engaged in other outreach, including meetings with retail investors, investor advocacy groups, and industry participants, to better understand these issues.[59] And only after this extensive fact-gathering process was completed did the SEC issue its Reg BI proposal in 2018.

In contrast to this tradition of robust study and analysis before engaging in significant rulemaking, the Proposal is the product of very limited outreach prior to jumping straight into proposing expansive new rules. We are aware of no recent examination

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Commission's "deliberate, data-driven process to assess … more fundamental changes to equity market structure" because "[b]road changes to this market structure—especially those executed precipitously or without adequate data—can have serious unintended consequences for investors and issuers as their impact is fully realized, sometimes years down the road").

[55] Luis A. Aguilar, Comm'r, SEC, *U.S. Equity Market Structure: Making Our Markets Work Better for Investors* (May 11, 2015), https://www.sec.gov/news/statement/us-equity-marketstructure.

[56] Luis A. Aguilar, Comm'r, SEC, *An Insider's View of the SEC: Principles to Guide Reform* (Oct. 15, 2010), https://www.sec.gov/news/speech/2010/spch101510laa.htm.

[57] Jay Clayton, Chairman, SEC, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017), https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.

[58] *Id*.

[59] Regulation Best Interest, 83 Fed. Reg. 21,574, 21,582 (May 9, 2018).

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sweep, study, or other information-gathering exercise that was launched in advance of the Proposal regarding the use of predictive data analytics by broker-dealers or investment advisers. The only industry engagement we are aware of with respect to this Proposal is the DEP Request, which underwent a flawed process that limited industry responses due to the brevity of the comment period and the breadth of the SEC's requests.[60] Moreover, the SEC failed to follow up with broker-dealers submitting responses to the DEP Request.[61] And while the DEP Request solicited information regarding broker-dealers' use of technology, the SEC failed to discuss these practices in the Proposal or its cost-benefit analysis (which also underscores a fatal flaw with the SEC's economic analysis).[62]

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[60] DEP Request, 86 Fed. Reg. 49,067; *see, e.g.,* Letter from Kevin M. Carroll, Managing Director and Associate General Counsel, SIFMA, to Vanessa A. Countryman, Secretary, SEC (Sept. 7, 2021), https://www.sec.gov/comments/s7-10-21/s71021-9208235-250006.pdf; Letter from Gail C. Bernstein, General Counsel, IAA, to Vanessa A. Countryman, Secretary, SEC (Oct. 1, 2021), https://www.sec.gov/comments/s7-10-21/s71021-9316151-260068.pdf (letters from industry groups expressing concern about the short comment period and requesting extensions on behalf of the industry).

[61] Indeed, the SEC's website shows that SEC officials met with a financial institution that has a broker-dealer in its corporate structure on only four occasions (two of which were meetings with Robinhood, and two of which involved firms that do not appear to have submitted comment letters) in connection with the DEP Request. *See* SEC, Comments on 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, https://www.sec.gov/comments/s7-10-21/s71021.htm#meetings (last modified July 14, 2023).

[62] For example, the DEP Request posed the following questions to which the Proposal contains no responsive information:

2.1 To what extent, and how, do firms use (or in the future expect to use) tools based on AI/ML (including deep learning, supervised learning, unsupervised learning, and reinforcement learning) and NLP and NLG, to develop and evolve DEPs? What are the objective functions of AI/ML models (e.g. revenue generation)? What are the inputs relied on by those AI/ML models (e.g. visual cues or feedback)? Does the ability to collect individual-specific data impact the effectiveness of the ML model in maximizing its objective functions?

2.10 Are there any particular challenges or risks that firms face in using AI/ML (including deep learning, supervised learning, unsupervised learning, and reinforcement learning), including AI developed or provided by third parties? If so, what are they and how do firms address such challenges or impediments and any risks associated with them? Have firms found that using AI/ML or retail investor data gathered in connection with DEPs raises unique issues related to financial privacy, information security, or identity theft prevention?

2.12 What are the benefits associated with the use of the tools and methods identified above (e.g., AI/ML, predictive data analytics, cross-industry research, behavioral science) in connection with the design, implementation, and modification of DEPs from the perspective of firms, retail investors, and other interested parties? How do these benefits differ depending

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The SEC also failed to gather any meaningful evidence regarding investors' use of covered technology, including what technology they want and use, why they want or use it, and how it affects them, and failed to address the many benefits that technology can provide. And yet the SEC chose to ignore these uses and benefits in its rulemaking.

Rather than taking a methodical, data-driven approach to rulemaking, the SEC's rulemaking appears to be based on unsupported speculation and academic theories.

II. The SEC Has Failed To Conduct A Credible Cost-Benefit Analysis And Any Theoretical Benefits Cannot Outweigh The Proposal's Significant Costs And Burdens.

The SEC is required, by law, to undertake a thorough and accurate analysis of the costs that the Proposal would impose on regulated entities and the economy as a whole.[63] This economic analysis must be reasonable and substantiated, and the conclusions that the Commission draws from it must have a reasoned, rational basis in the data the Commission gathers. Guidelines issued by the SEC also mandate that the data used in this analysis be "accurate, reliable and unbiased," that it be carefully

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upon the type of tools or methods? Do the tools and methods mitigate, or have the potential to mitigate, biases in the market that may have prevented participation by some retail investors (e.g., by lowering barriers to entry)? Please provide or identify any relevant data and other information.

2.13 What are the risks and costs associated with the use of the tools and methods identified above (e.g., AI/ML, predictive data analytics, cross-industry research, behavioral science) in connection with the design, implementation, and modification of DEPs from the perspective of firms, retail investors, and other interested parties? How do these risks differ depending upon the type of tools or methods used? What are the most significant investor protection concerns arising from or associated with the use of such tools and methods by broker-dealers and investment advisers in the context of DEPs? Please provide or identify any relevant data and other information.

2.15 Are there any particular challenges or risks associated with the use of AI/ML (including deep learning, supervised learning, unsupervised learning, and reinforcement learning), including AI developed or provided by third parties? If so, what are they and how should firms address such challenges or impediments and any risks associated with them? What model risk management steps should firms undertake? Does the use of AI/ML or retail investor data gathered in connection with DEPs raise unique issues related to financial privacy, information security, or identity theft prevention?

3.13 What additions or modifications to existing regulations, including, but not limited to, those identified above, or new regulations or guidance might be warranted to address investor protection concerns identified in connection with the use by broker-dealers and investment advisers of DEPs, the related tools and methods, and the use of retail investor data gathered in connection with DEPs? What types of requirements, limitations, or prohibitions would be most appropriate to address any such identified investor protection concerns?

[63] *See, e.g.*, 44 U.S.C. § 3501 *et seq.*; 5 U.S.C. § 601 *et seq.*; 5 U.S.C. § 500 *et seq*.

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reviewed by subject matter experts and appropriate levels of management, and that there be "adequate disclosure about underlying data sources, quantitative methods of analysis and assumptions used, to facilitate reproducibility of the information, according to commonly accepted scientific, financial or statistical standards, by qualified third parties."[64]

By its own admission, the SEC has failed to satisfy this fundamental statutory obligation. Here, the SEC concedes that it lacks the ability to reasonably estimate important components of the cost-benefit balance; entirely ignores other aspects of the supposed problem, such as the sufficiency of existing protections and the potential for technology to make disclosure more effective for retail investors; and provides estimates of the proposed rules' costs and burdens that are inadequate and far too low. Moreover, the costs that will be imposed by the proposed rules far outweigh any purported benefits identified by the Commission.

A. The SEC Has Failed To Gather The Requisite Information To Conduct A Serious Cost Analysis And Instead Offers A Speculative And Incomplete Cost Assessment.

1. The SEC Admits That It Lacks the Data To Conduct A Complete Analysis.

The SEC's economic analysis and numerous, multi-part requests for information are admissions that the SEC lacks critical data to estimate key components of the costs the proposed rules will impose. For example, the SEC expressly concedes the following:[65]

- "[T]he Commission is unable to quantity certain economic effects because it lacks the information necessary to provide estimates or ranges."
- "Some of the benefits and costs discussed below are impractical to quantify because quantification would necessitate general assumptions about behavioral responses that would be difficult to quantify."
- "The Commission seeks comment on any data that could aid quantification of these responses."
- "Based on Commission staff experience, the Commission believes that … third-party providers play a growing role with respect to the development of covered technologies…. Due to data limitations, we are unable to quantify or characterize in much detail the structure of these various service provider markets. The Commission lacks specific information on the exact extent to which third-party service providers are retained, the specific services they provide, and the costs for those services. We also do not have information

[64] SEC, *Final Data Quality Assurance Guidelines* (modified July 18, 2019), http://www.sec.gov/about/dataqualityguide.htm.

[65] Proposing Release, 88 Fed. Reg. at 53,997-98, 54,001.

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about the market for these services, including the competitiveness of such markets."

The SEC also asks commenters to provide it with the following information that is fundamental to the rulemaking and information that the SEC should have gathered *before* issuing the Proposal so that it could provide a reasonable cost-benefit analysis:[66]

- "The Commission seeks comment on the conflicts of interest associated with the use of covered technologies. What types of conflicts of interest are associated with the use of these technologies? What costs do they impose on investors? What practices exist for eliminating, or neutralizing the effect of, these conflicts of interest? What practices exist for mitigating the effects of these conflicts of interest? What are the current costs of these methods?"
- "The Commission seeks comment on the potential costs associated with the proposed conflicts rules and proposed recordkeeping amendments. What types of costs are likely to be incurred by firms in order to comply with the proposed conflicts rules and proposed recordkeeping amendments? How might these costs vary depending on the types of technology, the business model, or the nature and extent of investor interactions used by the firms? To what extent do firms already incur these costs in order to comply with their existing obligations? What costs would there be for investors?"
- "The Commission seeks comment on the types of labor and other resources that would be required for firms to comply with the proposed conflicts rules and proposed recordkeeping amendments. What personnel would need to be involved in complying with the proposed conflicts rules and proposed recordkeeping amendments? What types of expertise would be required? How might the size and complexity of a firm impact the resources needed to comply with the proposed conflicts rules and proposed recordkeeping amendments?"
- "The Commission seeks comment on how the proposed conflicts rules and proposed recordkeeping amendments might impact a firm's or a technology provider's software development process. What changes might be necessary in order to help ensure that firms using covered technologies in investor interactions are in compliance with the proposed conflicts rules and proposed recordkeeping amendments? How might the proposed conflicts rules and proposed recordkeeping amendments impact the speed or efficiency of software development?"

With so many explicit admissions that it is either missing critical data or needs more data to complete its analysis, it is not possible for the SEC to satisfy its obligation to conduct a reasonable cost-benefit analysis.

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[66] *Id*. at 54,014-15.

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2. The SEC's Analysis Also Fails To Provide A Complete Cost Estimate Because It Fails To Consider The Effect Of The Proposal On Key Groups.

The SEC also fails to provide a complete cost estimate because it fails to fully quantify the effect of the Proposal on small firms or investors. With regard to small firms, many of these firms rely on third-party vendors for technology because they do not have the internal resources to produce or manage those technologies. Because the Proposal requires firms to go through the same exercise with covered technology from third parties, it would make it more challenging to outsource technology solutions, thereby creating barriers to entry and innovation and favoring firms that have the resources to manage technology in-house. The SEC recognizes the significant competitive disadvantages that the Proposal would create for smaller firms: "Smaller firms subject to the proposed conflicts rules could also face a competitive disadvantage compared to larger firms when negotiating with technology companies to build software that complies with the proposed conflicts rules."[67] The Proposal, however, fails to quantify any of these costs.

Similarly, the Proposal fails to quantify the costs to investors in two significant ways. First, it is undeniable that the Proposal will result in higher costs for firms and, by extension, investors. The SEC admits that investors could bear higher costs but does not even try to estimate the costs they would bear.[68] These costs could include the elimination of tools and features that retail investors take advantage of every day, like recurring investments, direct indexing, and portfolio rebalancing. The SEC, however, made no attempt to quantify the cost of losing or restricting access to these types of technologies.

And many benefits that covered technology provides are at risk of being reduced or eliminated under the Proposal. To this end, the SEC admits that a likely effect of the Proposal is for broker-dealers and advisers to reduce or eliminate certain covered technology that they provide (or could in the future provide) to investors.[69] The SEC expressly acknowledges that its Proposal will lead to firms *not providing* certain covered technology at all.[70] Also, if a firm is *too slow* in its implementation and cannot "promptly" address a potential conflict relating to a covered technology, it may eliminate the practice that gives rise to it (i.e., stop offering the technology to investors).[71] However, the SEC fails to quantify the costs to investors of this reduced access to technology. The SEC would entrench the divide between institutional investors and retail investors by making retail investors into second-class citizens by

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[67] *Id*. at 54,012.

[68] *Id*. at 54,010.

[69] *Id*. at 54,012.

[70] *Id*. at 53,986.

[71] *Id*. at 53,987.

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depriving them of access to technology and information because the SEC views them as incapable of understanding or participating in the securities markets.

This very real harm may be the most significant cost of the Proposal. Greater access to technology has increased financial participation in the securities markets; reducing this access ultimately will push investors out of the market. The obvious outcome of the Proposal, then, is that it will result in a worse, more expensive, less informed and more intimidating investor experience. Such an outcome is anti-investor and antithetical to the SEC's mission to protect investors. It is also ignored in the SEC's cost-benefit analysis.

B. For The Costs That It Does Quantify, The SEC Woefully Underestimates The Cost Of Compliance.

Although the Proposal purports to relate to the use of "predictive data analytics" by broker-dealers and investment advisers, the definitional triggers in the SEC's Proposal are overly broad and would capture a much broader range of communications. To illustrate the extreme burdens that would be imposed on firms, below are the steps a broker-dealer or adviser would need to take under the Proposal:

- First, a firm would need to identify all technology that could be "covered technology." This is a problem because the definition of "covered technology"[72] captures far more than the predictive AI and other advanced technologies identified as a concern by the SEC. The SEC acknowledges that the definition can capture even mundane technologies, such as spreadsheets.[73] The SEC, however, provides no guidance on the level of abstraction required to analyze a technology. To start, while internet websites and mobile applications are covered under the proposed rules,[74] every individual piece of a website or app would need to be evaluated, and, in many instances, the underlying code would need to be analyzed. It would be a significant hurdle for a firm even to undergo an initial assessment of which technologies are "covered" before it can determine which covered technologies are involved in an "investor interaction."[75]

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[72] "Covered technology" means "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." Proposed Rules 15l-2(a), 211(h)(2); Proposing Release, 88 Fed. Reg. at 54,021-22, 54,023.

[73] Proposing Release, 88 Fed. Reg. at 53,972.

[74] *Id*. at 53,974.

[75] "Investor interaction" means 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; except that the term does not apply to interactions solely for purposes of meeting legal or regulatory obligations or providing clerical, ministerial, or

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- Second, a firm would need to identify all covered technology that could be used—directly or indirectly—in an "investor interaction." This is again a problem because the definition of "investor interaction" is similarly over-broad. It encompasses a universe just as broad as "covered technology," from formal correspondence in person, by phone, email, or text, to any user display a customer can view or notification a customer can request on a website or app. Although intended to alleviate the burden of the expansive definition, a firm would need to assess which "investor interactions" were eligible to be excluded from the "investor interaction" definition for functions that are "solely for purposes of meeting legal or regulatory obligations or providing clerical, ministerial, or general administrative support." Additionally, the firm must consider not only its *actual* use of covered technology but also any *reasonably foreseeable potential* uses as well, requiring the firm to use a crystal ball to divine how it may in the future use a technology, even if it does not end up using the technology in that manner.

- Third, after identifying which technologies are covered technologies and which covered technologies are used in investor interactions, a firm would be required to determine whether any of those technologies involve a "conflict of interest" under the Proposal. Again, this is a problem because the definition of "conflict of interest" is also incredibly broad. It captures any technology that "takes into consideration an interest" of the firm or a natural person who is an associated person of the firm.[76] As the SEC states: "[c]onsideration of *any* firm interest would be sufficient for a conflict of interest to exist under the proposed conflicts rules."[77] And yet, it is both necessary and appropriate that firms' decisions consider the interests of their business. Taking into account those interests does not subvert the principal-agent relationship, nor does it create a true *conflict* of interest between those parties. Only through the SEC's complete re-definition of "conflict of interest" to include any consideration of a firm's interests can such a theory gain any traction. The consequence may be that every technology implemented by a broker-dealer necessarily involves a so-called "conflict of interest" because such technology could eventually lead to a transaction (even if the transaction is entirely self-directed by the customer) and thus, more business for the broker-dealer. In other words, firms will likely need to assume that every use of technology is "conflicted" and then undergo the task of attempting to identify such "conflicts."

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general administrative support. Proposed Rules 15l-2(a), 211(h)(2)-4(a), Proposing Release, 88 Fed. Reg. at 54,021-22, 54,023.

[76] Proposed Rules 15l-2(a), 211(h)(2)-4(a), Proposing Release, 88 Fed. Reg. at 54,021, 54,023.

[77] Proposing Release, 88 Fed. Reg. at 53,985.

- Fourth, the firm would be required to prove that no *actual* conflicts of interest exist when it seeks to use (or potentially use) a covered technology. Once each so-called "conflict of interest" has been identified, a firm must determine whether any conflict places the interests of the firm or an associated person ahead of the interests of investors. If the conflict places, or *could place*, an interest of the firm or its associated person ahead of the customer, then the firm must undertake to "eliminate, or neutralize the effect of" the conflict so that it "no longer places the interests of the firm ahead of the interests of investors."[78] This turns the enforcement framework on its head; rather than requiring the SEC to prove that firms have violated their obligations by failing to disclose an actual conflict of interest, the proposal would presume wrongdoing unless a firm can prove that no conflict exists.
- Fifth, each step of this laborious process is expected to be documented in a firm's policies and procedures and accompanied by onerous recordkeeping requirements that will require a firm to identify and describe each "covered technology" and its "material features," "investor interaction," use and foreseeable potential use, "conflict of interest," how a conflict of interest did or did not place the firm's or an associated person's interests ahead of a customer, and the process used to eliminate or neutralize any identified conflict that did so, and then justify (with documented support) each decision the firm made along the way.[79]
- Finally, the above steps would need to be repeated on a periodic basis and every time a firm rolls out a new technology or makes a material change to existing technology. And every year, firms would need to review and update their documentation and processes.[80]

Each of the above steps and requirements involves reading tea leaves about all the possible interpretations of what is required and what the terminology means. This process is made only more costly and burdensome where a firm seeks to use a third-party technology vendor because the firm may not have readily available access to the information that the Proposal would require. As SEC itself concedes, "the requirement to identify conflicts of interest in a technology could dissuade firms from using certain technologies when it is too difficult or costly to adequately evaluate the use of the covered technology, identify a conflict of interest, or determine whether they place the firm's or an associated person's interest ahead of an investor's."[81] This would be a bad result for markets, firms, and investors.

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[78] *Id*. at 53,986.

[79] *Id*. at 53,990.

[80] *Id.*

[81] *Id*. at 54,010-11.

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Notably, the SEC makes no attempt to quantify the costs associated with the use of third-party service providers.[82] Shockingly, the SEC estimates that these laborious steps would, for a firm such as Robinhood,[83] amount to a paltry:

- 25 hours and $11,150 for initial compliance, and
- 12.5 hours and $5,575 for each year thereafter.[84]

These projections have no grounding in reality and grossly underestimate the costs associated with the Proposal. At the same time the SEC maintains that it will cost less than $6,000 to comply with the Proposal on a yearly basis, it concedes that the new process for "identifying, evaluating, eliminating or neutralizing conflicts of interest" could be challenging and, in some cases, *may not even be possible*.[85] It is not clear how the SEC can reconcile an admittedly impossible, challenging task with its anemic cost estimates.

The implementation of Reg BI is instructive on the SEC's economic analysis for the Proposal. Compliance with Reg BI involved extensive industry resources. Even though the SEC estimated initial industry costs of $5.96 billion and ongoing annual costs of $2.37 billion (split among 2,766 broker-dealers amounting to a per firm initial cost of approximately $2,154,736 and ongoing annual cost of approximately $856,833), an independent third party estimated $17 billion in initial costs and $6.25 billion in annualized costs (a per firm initial cost of approximately $6,146,059 and ongoing annual cost of approximately $2,259,581).[86]

It is no surprise that compliance with Reg BI was an expensive task—and significantly more expensive than the SEC's economic analysis suggested. For Reg BI, firms had to

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[82] *See id.* at 54,001 ("Due to data limitations, we are unable to quantify or characterize in much detail the structure of these various service provider markets. The Commission lacks specific information on the exact extent to which third-party service providers are retained, the specific services they provide, and the costs for those services.").

[83] Based on the SEC's definition of "complex covered technology firm" (i.e., firms that use machine learning or NLP algorithms or process large data sets), Robinhood has determined that it would be characterized as a "simple covered technology firm" because it does not utilize complex covered technology at this time.

[84] Proposing Release, 88 Fed. Reg. at 54,009 tbl.2.

[85] *See id.* at 53,978 ("In certain cases, it may be difficult or impossible to evaluate a particular covered technology or identify any conflict of interest associated with its use or potential use within the meaning of the proposed rules.").

[86] *See* Deloitte & Touche LLP and SIFMA, *Regulation Best Interest: How wealth management firms are implementing the Rule Package* at 25 (Mar. 6, 2020), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/regulatory/us-regulation-best-interest-survey-report.pdf ("The aggregate up-front costs for the industry are estimated at approximately $17.07 billion, while the aggregate annualized spend is estimated at approximately $6.25 billion. These aggregates are across people, process and technology.").

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establish cross-functional teams with stakeholders across the business to complete a comprehensive analysis of all customer communications that could involve a recommendation and then take steps to comply with Reg BI general standards and obligations. Additionally, firms needed to operationalize future compliance by establishing controls for when products, services, or compensation plans changed.

Unlike Reg BI, the Proposal does not stop at customer communications involving recommendations. Now, the SEC would require broker-dealers and investment advisers to undertake a similar process to examine not only customer communications but also any investor interaction that involves covered technology and take steps to eliminate or neutralize the effect of any identified conflict that place the firm's interest ahead of investors' interests. Yet the SEC's estimated costs are *significantly less* than its estimated costs of Reg BI. This makes no sense. To illustrate how onerous this process would be, we offer a sample analysis of a relatively simple mobile app interaction—the IRA page of the Robinhood App.

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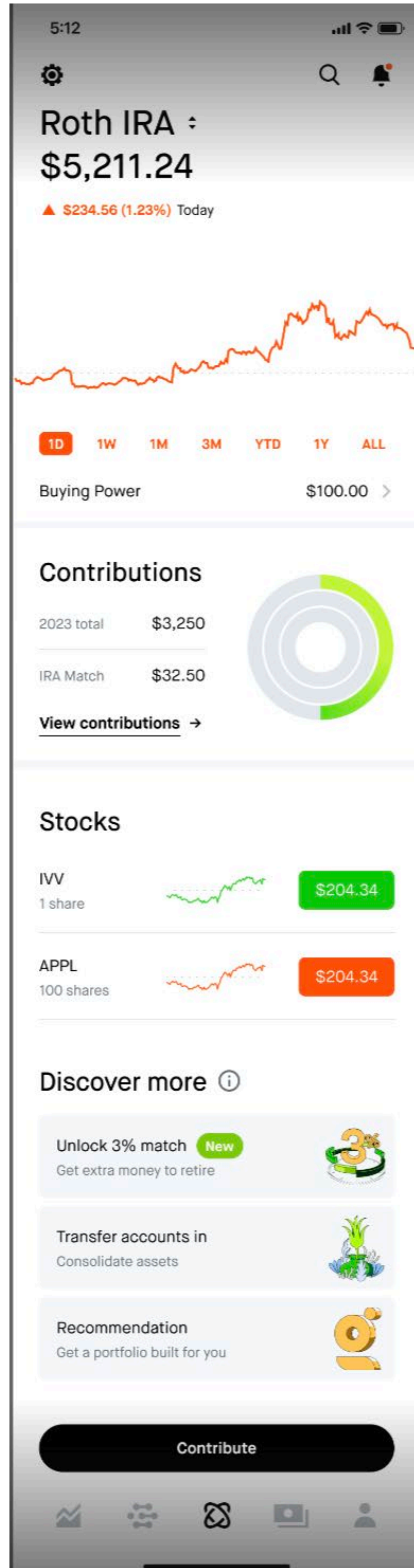

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Starting at the top of the page and pointing out only the most obvious uses of technology,[87] we would need to review:

- the appearance of a red dot to signify the customer has a notification;
- the inclusion of "Gold 3%," which is Robinhood's subscription product that includes larger matches on contributions; larger instant deposits; Level 2 stock data; Morningstar research reports; and 4.9% interest on uninvested cash in the customer's account;
- the use of the color gold with "Gold 3%" box;
- the use of colors to depict price movement—green is up and red is down;
- the font type and size of the numbers representing the total value in the account;
- how the total value of the account changes;
- disclosing "Buying Power";
- disclosing the amount of "Contributions" for this year;
- the button "Contribute";
- the use of "Find investments," which lets customers search for stocks and ETFs by different categories;
- the use of "Discover More"; the three prompts underneath: "Have an old 401(k)?," "Consolidate IRAs," and "Options trading"; and the graphics next to each prompt; and
- the icons that are static at the bottom of the page.

Arguably, each feature described above would need to be analyzed under the Proposal. If the customer decides to purchase a security, this exercise would involve reviewing every step the customer must take, from the landing page through the decision on what order type to use and the eventual submission of the order by "swiping up."

To undertake this analysis, a cross-functional team would need to be able to evaluate and understand any code, technology, computation, or algorithmic functions that underlie or determine what is displayed to customers. Each function will largely fall into one or more buckets: (1) features that make understanding an investment account easier ("ease of use"); (2) informational; (3) educational; and (4) promotional. Then, the firm would need to assess whether these technologies take into account an interest of the firm and whether the firm is placing its own interests ahead of those of investors. There is no clear or easy way for firms to evaluate these

[87] This list is not intended to be exhaustive. We expect that this analysis could require reviewing additional elements not listed here that may be drawn in by the expansive definition of "covered technology" upon further review.

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interests under the Proposal. Firms will shoulder the burden of establishing a consistent approach only to be subject to second-guessing at every turn during a regulatory examination or inquiry.

For “ease of use” features, one would think that the firm is not placing its interests ahead of investors because the purpose of those features is to make it easier for customers to invest—the exact reason they have come to Robinhood and downloaded our App. We at Robinhood think investors having easy access to the capital markets is a good thing. However, it could be argued that any “ease of use” feature benefits the firm because it makes it easier for investors to place trades or contribute money to their accounts—both of which benefit the firm by increasing the firm’s revenues. The same analysis could apply to informational or educational features. Again, one could argue both the investor and the firm benefit from these features. But what if interests are aligned but result in customers trading more or depositing more into their account? When does the firm’s profit motive outweigh the benefits that investors receive from features like educational tools designed to teach investors important financial skills?

Conversely, would all promotional features, such as including the “Gold 3%” box to promote Robinhood’s Gold offering, put the firm’s interest ahead of the investor’s interest? The Proposal would muddy at what point the benefits an investor receives for taking advantage of this offering outweigh the firm’s own interests.

These are just a small sample of the questions that Robinhood would need to consider in evaluating whether conflicts of interest exist that would need to be addressed under the Proposal. Although how to perform the analysis is not clear, it is clear that this first step of the analysis will involve significant time and resources to perform.

Once we have decided a “conflict of interest” exists where the firm’s interests are placed ahead of an investor’s interests, if it is even determinable, we would need to eliminate or neutralize the effects of the conflict. Having to eliminate/neutralize a promotional conflict would mean that the firm likely could not include references to other products and services the firm offers. Likewise, if an ease of use, informational, or educational feature was deemed to place the firm’s interest ahead of the investor’s (i.e., investors trade more, and the firm makes more money), it would need to be eliminated or at the least heavily restructured. For example, would “green” and “red” need to be eliminated and replaced with “black” and “white?” Would using black and white be sufficient to eliminate or neutralize the effect of a conflict associated with using colors? Would graphics need to be eliminated? What about the use of buttons to contribute to accounts, transfer funds or place trades? Is “swiping up” to place a trade out?

Finally, all the above identification and consideration would need to be documented in the firm’s books and records.

One screen down ... thousands to go.

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As stated above, the Proposal estimates that a "simple" covered technology firm would incur initial costs of $11,150 and annual costs of $5,575. It appears that Robinhood would largely be considered a simple covered technology firm because of its limited use of artificial intelligence and machine learning to back office or compliance functions. Given the above examples and how many times this process would need to be repeated, the Proposal's estimate strains credulity.

While Robinhood does not currently have an estimate of how many times the above example assessment would need to be completed per year, the ongoing assessment of $5,575 is nowhere near an accurate assessment. Robinhood estimates that it makes tens of thousands of coding changes each year to the Robinhood App and website related to brokerage, and during the last 12 months, Robinhood released 50 iOS and 50 Android updates. Arguably, each brokerage code update, whether it involves technology underlying the user interface or a change visible to customers in the App or website would need to be reviewed to understand the impact, whether the change resulted in a "conflict of interest" and whether the change was placing the firm's interest ahead of customers' interests. Completing an assessment of each of the tens of thousands of changes would require a dedicated team of employees spending thousands of hours each year conducting the review and creating and maintaining the records required under the Proposal.

Even assuming the ongoing review of coding changes, the rollout of new products and changes to existing products would require Robinhood to hire the equivalent of five full time employees in legal, compliance, product management, engineering, and operations (a hypothetical, conservative estimate to demonstrate how far off base the SEC's estimate truly is). Using the SEC's blended rate of $446 per hour for personnel required to conduct the necessary reviews,[88] the annual costs of these five employees would be over $4.8 million, a far cry from the $5,575 for ongoing annual costs to simple covered technology firms, or even $78,050 per year for complex covered technology firms. And if we add the tens of thousands of dollars in outside legal fees that Robinhood would accrue in reviewing and developing its process, the SEC's underestimate is even more egregious.

C. The SEC Has Failed To Quantify Any Benefits To The Proposal.

In the absence of any demonstrable regulatory gap and given the significant costs and burdens that would be associated with the Proposal, the SEC's burden for substantiating the benefits of the Proposal is high. The SEC does not meet this burden because any potential benefits of the Proposal that are cited by the SEC are unclear and speculative at best.

The SEC's economic analysis fails to quantify any benefits of the Proposal, or even identify any clear benefits. The SEC repeatedly states that the proposed rules "*could*" or "*might*" generate unspecified benefits for investors, but there is no attempt to

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[88] Proposing Release, 88 Fed. Reg. at 54,016 tbl.3.

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describe or quantify these benefits.[89] The SEC itself states: "the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges" and that "[s]ome of the benefits and costs discussed below are impracticable to quantify because quantification would necessitate general assumptions about behavioral responses that would be difficult to quantify."[90] It also admits that the incredibly costly undertakings it requires may often prove totally unnecessary, since "[i]n the case of many covered technologies, it may be readily apparent that, while the technology may take into account an interest of the firm, it does not result in the firm's interests being placed ahead of investors' interests."[91] The Proposal seems to suggest this reflects the rule's reasonableness—remedial measures often won't be required. But in fact, this is a foundational problem of the rule—it requires a costly, no-stone-unturned search for hypothetical conflicts that in "many" cases don't exist. The Commission cannot adopt this rule without properly estimating how frequently, in the costly enterprise it is requiring, actual problems will be unearthed.

The SEC also alludes to the Proposal enhancing "investor protection" and "investor confidence" without describing how the Proposal would produce these abstract benefits.[92] In that discussion, the SEC necessarily assumes that investors are not adequately protected by existing regulations and do not currently possess sufficient confidence in the markets to support their participation (a proposition that flies in the face of the significant growth of retail investing we have had in recent years). However, the SEC does not identify *which* investors currently exhibit these characteristics and would benefit from the Proposal. The Proposing Release is littered with conclusory statements about how technology can influence customer trading behavior, even where recommendations or investment advice are not provided, and how investors could not possibly understand the technologies being used and the conflicts such technologies create. But the SEC does not delve into whether these technologies do, in fact, have that effect, or even whether any effects are harmful for investors. There is no effort to test these academic hypotheses and almost no support cited by the SEC. Instead, the SEC caveats or couches in uncertain terms the potential benefits that it thinks the Proposal could generate. In several cases, the SEC also casts doubt on the likelihood that these potential benefits will materialize.[93] The level of uncertainty in the SEC's own description of the Proposal's benefits should mean that they are taken with a massive grain of salt or simply discarded. The SEC

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[89] *See, e.g.*, *id.* at 53,998 (generally disclaiming quantification of likely economic effects of the Proposal because the SEC "lacks the information necessary" or it is "impracticable" or "difficult" to do so).

[90] *Id*.

[91] *Id*. at 53,983.

[92] *See, e.g.*, *id.* at 54,006-08.

[93] *See, e.g.*, *id*. at 54,011-12.

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has not met its burden to justify the costs of the Proposal with commensurate benefits.

At the end of the day, the costs of this rule are clear—and clearly immense. The benefits are dubious and speculative. Such a rule cannot legally be adopted.

D. The SEC Has Failed To Consider The Sufficiency Of Existing Regulations In Its Cost-Benefit Analysis.

Related to its failure to quantify any "benefits," the SEC's cost-benefit analysis is also incomplete because the SEC has failed to identify any problematic practices relating to the use of covered technology that could not be addressed by existing SEC and FINRA regulations. This failure renders the SEC's cost-benefit analysis meaningless. Without any such assessment, it is impossible to estimate the expected benefits from the proposed rules. If there is no need for those rules, there can be no benefits to outweigh the billions of dollars in costs.

Notably, the one real example of a problematic practice involving covered technology that the Commission identifies proves our point that existing regulations are more than adequate.[94] In that case, the SEC brought an enforcement action against a robo-adviser for marketing that its "no fee" portfolios were determined through a "disciplined portfolio construction methodology" when they allegedly were pre-set to hold a certain percent of assets in cash because the adviser's affiliate was guaranteed revenue at these levels.[95] There, existing regulations were more than adequate to allow the SEC to successfully bring and settle an enforcement action. In the case of the Proposal, the SEC's failure to identify a real example of a harmful practice that cannot be addressed by existing regulations necessarily means that there is no need for the Proposal and any speculative benefits cannot outweigh the very real costs. This lone example illustrates another point as well because the alleged practice would have been easy to describe in a disclosure. A central premise of the Proposal is that the (imaginary) conflicts arising from technology are so complex they cannot be addressed by disclosure. Mostly, these conflicts are merely imagined.[96] But in the rare instance where the Commission gives actual evidence—an example—of what might occur, it is an issue that a disclosure could have simply described.

This reflects a peculiar (and legally unsustainable) feature of the Proposal: it uses the imaginary, speculative nature of the harm it addresses as a basis to mandate an especially onerous solution. First, the Proposal imagines future conflicts of interest

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[94] *Id*. at 53,968.

[95] *Charles Schwab & Co.*, Exchange Act Release No. 95,087 (June 13, 2022).

[96] *See, e.g.*, Proposing Release, 88 Fed. Reg. at 53,965 (speculating that "[f]irms' nascent use of AI *may already* be exposing investors to these" risks, and types of risks," and expressing "concern[ ] that firms *will* . . . take their own interest into account" in developing AI) (emphasis added).

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that it does not concretely identify or describe, and then—having conjured these unidentified behaviors—imagines that they are so complex, they cannot effectively be described in a disclosure. Under the law, however, a dearth of facts is not a reason to impose a burdensome rule. It is a reason to shelve this costly, speculative Proposal until appropriate study has been done.

III. The SEC Lacks The Authority To Adopt The Proposal.

In addition to being unjustified, the Proposal would exceed the Commission's statutory authority and violate the First Amendment.

A. The Proposal Exceeds The SEC's Statutory Authority, As Illustrated By The Plain Language Of The Provisions On Which The Commission Relies.

Like other federal agencies, the Commission "literally has no power to act … unless and until Congress authorizes it to do so by statute."[97] Moreover, the Commission's authority must be read narrowly in the circumstances here to avoid triggering the "serious constitutional problems" the Proposal raises.[98]

The Commission offers the Proposal under its "authority under section 211(h) of the Advisers Act and section 15(l) of the Exchange Act."[99] The Proposal exceeds this authority in multiple ways.

First, the Commission's authority is limited to prohibiting or restricting "certain" conflicts of interest that the Commission has "examine[d]"; the Commission cannot just regulate "*all* conflicts of interest" without specification. *Second*, the Commission's authority to "prohibit[]" or "restrict[]" conflicts of interest is a negative power; the Commission can bar certain arrangements that involve competing interests; it cannot force broker-dealers and investment advisers to develop procedures to identify "*any* conflict of interest," even if the Commission itself has not identified it. *Third*, the Commission may regulate "conflicts of interest," not any interaction with an investor in which the broker-dealer or investment adviser "takes into consideration" an interest of its own. *Fourth*, and finally, the Commission's authority is limited to addressing practices that are "contrary to the public interest and the protection of investors"; using technology to facilitate affordable access to investment services is anything but.

1. The Proposal Exceeds The SEC's Authority To Bar "Certain" Conflicts of Interest.

The Commission's authority is limited to prohibiting or restricting "*certain*" conflicts of interest. Sections 15(l)(2) and 211(h)(2), enacted as part of Section 913 of Title IX

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[97] *Franciscan All., Inc. v. Becerra*, 47 F.4th 368, 378 (5th Cir. 2022) (quoting *Fed. Election Comm'n v. Cruz*, 142 S. Ct. 1638, 1649 (2022)).

[98] *See Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Const. Trades Council*, 485 U.S. 568, 575 (1988); Section III.C, *infra*.

[99] Proposing Release, 88 Fed. Reg. at 53,971.

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of the Dodd-Frank Act, are identical: each authorizes the Commission to "examine and, where appropriate, promulgate rules prohibiting or restricting *certain* sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers."[100] The Proposal does not simply restrict or prohibit "certain" conflicts of interest, however. Instead, the Proposal requires broker-dealers and investment advisers to, with respect to "covered technologies," identify and address "*all* conflicts of interest."[101] "Certain" does not mean "all."[102] It is the *Commission's* responsibility to "examine" and, "where appropriate," prohibit or restrict "certain" conflicts of interest—not to command regulated parties to themselves go out and identify "*any* conflict of interest" that might arise from the use of a covered technology.[103] The Commission has not undertaken such an examination here, despite the SEC Staff's recommendation to do so in the GameStop Report.[104]

The Commission itself recently rejected the very authority it claims here. In its final order adopting regulations governing private fund advisers, the Commission "agree[d] that 'certain,'" in section 211(h)(2), "indicates that [the statute] does *not* apply to all sales practices, conflicts of interest and compensation schemes, but rather only those that, after examination, the Commission deems contrary to the public interest and protection of investors."[105] The Proposal here—which reaches "*all* conflicts of interest,"[106] rather than any specifically identified conflict of interest—is inconsistent with the Commission's own reading of its authority.

That the Proposal extends only to conflicts of interest associated with "any use or reasonably foreseeable potential use of a covered technology" is immaterial to the

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[100] 15 U.S.C. §§ 78o(l)(2), 80b-11(h)(2) (emphasis added).

[101] Proposing Release, 88 Fed. Reg. at 53,978 (emphasis added).

[102] *The Am. Heritage Dictionary of the English Language* (5th ed. 2022) (defining "certain" as "[a]n indefinite but limited number; some"), https://tinyurl.com/yc7dsxyj; *see El Al Israel Airlines, Ltd. v. Tsui Yuan 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 certain rules only, not with all the rules relating to international carriage by air.'" (quoting *Sidhu v. British Airways plc*, [1997] 1 All E.R. 193, 204) (second alteration in original)).

[103] Proposing Release, 88 Fed. Reg. at 53978 (emphasis added).

[104] *See* GameStop Report at 43-44.

[105] *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 88 Fed. Reg. 63,206, 63,216 (Sept. 14, 2023) (codified at 17 C.F.R. Part 275) (emphasis added); *see also id.* ("There are other examples of sales practices, conflicts of interest and compensation schemes in the private fund industry that are not addressed in this rulemaking, some of which we do not currently view as rising to the level of concern set forth in section 211(h).").

[106] Proposing Release, 88 Fed. Reg. at 53,978 (emphasis added).

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statutory analysis.[107] A conflict of interest is defined by two competing interests at stake, not by the setting in which that competition may arise. In other words, the Commission's authority to prohibit certain conflicts of interest is limited to outlawing specific scenarios involving competing interests that the Commission believes harm the public interest, not issuing a blanket regulation on any and all competing interests that happen to arise while using technology.[108]

2. The Proposal Does Not Merely "Prohibit" Or "Restrict" Conflicts Of Interest.

The Proposal also goes beyond "*prohibiting or restricting*" conflicts of interest.[109] The words "prohibiting and restricting" unambiguously impart only a negative power—the power to restrain certain specific scenarios involving competing interests.[110] Those words immediately precede, and modify, the phrase "certain … conflicts of interest," thus making clear that the Commission may only "ban" existing conflicts.[111] The Proposal goes well beyond this. It requires broker-dealers and investment advisers to independently undertake an onerous, detailed process to "[e]valuate any use" of a covered technology, "identify" any conflict of interest, as defined by the Proposal, "[d]etermine" whether that use gives rise to a conflict of interest that place's the firm's or an associated person's interests ahead of an investor, and "[e]liminate, or neutralize the effect of," those conflicts, and to "adopt, implement, and maintain[/adopt and implement] written policies and procedures" to do the same.[112]

The Commission does not have the authority to require this. When Congress wants to authorize the Commission to go beyond restricting or prohibiting a particular practice—it says so. Under the statute that Congress enacted, the Commission can ban "certain" conflicts that it has identified and then "examine[d]," but the Commission cannot use this limited authority to require broker-dealers and investment advisers to establish and undergo a highly prescriptive process to identify and address all conflicts of interest for themselves.

[107] *Id*. at 53,971, 54,021–24.

[108] The Proposal's broad application is even too much for the SEC's own economists, who had difficulty with assessing the costs and benefits of the Proposal because the Proposal's application of "conflicts of interest" is broader "than how economists usually define 'conflicts of interest,' such as in the context of the principal-agent problem. *Id*. at 53,998 n.232.

[109] 15 U.S.C. §§ 78o(l)(2), 80b-11(h)(2) (emphasis added).

[110] *See Webster's Third New Int'l Dictionary* 1813 (1961) (defining "prohibition" as "a declaration or injunction forbidding an action"); *id.* at 1937 (defining "restrict" as "to set bounds or limits to").

[111] *See Nat. Res. Def. Council, Inc. v. U.S. Consumer Prod. Safety Comm'n*, 597 F. Supp. 2d 370, 387 n.10 (S.D.N.Y. 2009) ("'Prohibition' and 'ban' have the same meaning in everyday use.").

[112] Proposed Rule 15l-2(b), Proposing Release 88 Fed. Reg. at 54,022.

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3. The Proposal Does Not Regulate "Conflicts Of Interest."

The Proposal also does not regulate "conflicts of interest" within any recognizable meaning of that term. The Commission adopts what it modestly calls a "broad definition of conflict of interest."[113] According to the Proposal, a conflict of interest arises whenever a broker-dealer or adviser "takes into consideration an interest" of its own.[114] That stretches the concept of "conflict of interest" beyond recognition. "Conflict of interest" is a term of art. A "conflict of interest" arises in the context of a "principal-agent relationship"[115]; it is a "real or seeming incompatibility between one's private interests and one's public or fiduciary duties."[116] By contrast, a conflict of interest has never been understood to encompass (as the Commission now claims) *any* decision that considers "*any* firm-favorable information,"[117] whether there is an actual divergence of interest between the broker-dealer or adviser and its customer or not, and whether that divergence concerns a duty of the broker-dealer or adviser. Participants in the marketplace legitimately and properly consider their own interests regularly and in countless ways; their doing so is no proxy, or close approximation, to the far narrower range of circumstances where a "conflict of interest" arises because one party's interests conflict with another's *and* the party is to be acting as the agent for the other.

Yet here, for example, the Proposal would regulate as a "conflict of interest" a technology that alerted customers to the risk of a potential margin call, on the ground that the broker-dealer has an interest in the customer having sufficient funds in his or her account. But that is not a conflict; the customer *also* has an interest in having sufficient funds in his or her account. The fact that a broker-dealer or adviser *has* an interest does not mean that the interest conflicts with that of its customer, and even if it does, that does not mean that the conflicting interests have anything to do with the duties of the broker-dealer or adviser.

The immediate statutory context further undermines the Commission's overbroad conception of "conflict of interest." The statutory provisions on which the Commission relies in Section 15(l) of the Exchange Act and Section 211(h) of the Advisers Act grant rulemaking authority to restrict "sales practices, conflicts of interest, and compensation schemes."[118] Under the interpretive principle of *noscitur*

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[113] Proposing Release at 53,982.

[114] *Id.* at 53,981.

[115] Regulation Best Interest, 84 Fed. Reg. at 33,319.

[116] *Conflict of interest*, *Black's Law Dictionary* (11th ed. 2019).

[117] Proposing Release, 88 Fed. Reg. at 53,982.

[118] 15 U.S.C. §§ 78o(l)(2), 80b-11(h)(2).

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a sociis, "words grouped in a list should be given related meanings."[119] Here, the phrases "sales practices," "conflicts of interest" and "compensation schemes" refer to structural incentives, generally operating at the point of sale, such as sales contests, that may encourage a broker-dealer or investment adviser to push an investor into an unsuitable transaction.[120] The words cannot reasonably be read to reach *any* "communicat[ion]" with an investor, or the provision of *any* "information to an investor,"[121] no matter how related (or not) the communication or information is to a proposed transaction.

4. The Proposal Is Contrary To The Public Interest And The Protection Of Investors.

The Proposal exceeds the Commission's authority in a final way: it is contrary to the "public interest and the protection of investors."[122] The Commission provides no support for its blanket assertion that alleged "conflicts" associated with technology currently present any special threat to investors. In fact, as discussed elsewhere in this comment, the Commission's Proposal will discourage technology and innovation, stifle competition, and ultimately disempower investors.[123]

B. The Statutory Structure And Context Confirm That Congress Did Not Intend To Grant The Commission The Authority It Claims.

What the statute's text shows, its structure and context confirm: Section 15(l)(2) is not a plausible source of authority for the Commission's attempt to regulate a broker-dealer's use of virtually any form of technology in any investor interaction.

Section 15(l)(2) was enacted as a part of the Dodd-Frank Act, which required the Commission to "conduct a study to evaluate" the existing standards of care for broker-dealers and identify "legal or regulatory gaps" in the governing framework relating to the provision of "personalized investment advice about securities to retail

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[119] Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 195 (2012) (quoting *Third Nat'l Bank in Nashville v. Impac Ltd., Inc.*, 432 U.S. 312, 322 (1977)).

[120] *See, e.g.*, Regulation Best Interest, 84 Fed. Reg. at 33,454 (And the SEC at the time understood the limitations of its rulemaking authority under Section 15(l)(2). In a section titled "Elimination of Certain Sales Practices," the SEC required broker-dealers only to "establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time," because "the conflicts of interest associated with these practices [] may create high-pressure situations for the associated persons of the broker-dealer to recommend a specific security over another").

[121] Proposing Release, 88 Fed. Reg. at 54,023.

[122] 15 U.S.C. §§ 78o(l)(2), 80b-11(h)(2).

[123] *See supra* Section I.A; *infra* Section IV.

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customers."[124] The Dodd-Frank Act then authorized the Commission to promulgate rules setting a standard of conduct for broker-dealers and—in a subsection entitled "Other Matters"—prohibit certain sales practices, conflicts of interest, and compensation schemes.[125] The Commission's implementation of the Dodd-Frank Act ultimately culminated in the adoption of Reg BI, which requires broker-dealers to "act in the best interest of the retail customer at the time the recommendation is made."[126]

If Section 15(l)(2) were as broad as the Proposal claims, the statute's charge to study, assess, and promulgate rules concerning a standard of conduct would be superfluous—the Commission could promulgate those same rules as regulations of conflicts of interest. The statute should not be read in such a self-defeating way.[127] Rather, the only interpretation that harmonizes these distinct rulemaking powers is the one that accords with its plain meaning. Section 15(l)(2) targets specific conflicts of interest that the general standard could not address directly.

Reg BI is a perfect example of this interplay. After relying on the Commission's authority under Section 913(f) of the Act to set the general standard of conduct for disclosing conflicts of interest, it then (invoking authority under Section 15(l)(2)) requires broker-dealers to "eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time."[128] These are *specific* types of harmful sales practices and conflicts that could not be spelled out by the overarching standard. In contrast, the Proposal would cover *any* conflict of interest implicated in the use of technology and effectively create a new general standard of conduct, which Section 15(l)(2) does *not* authorize.

Moreover, if the authority granted in Section 15(l)(2) were broad enough to cover all conflicts of interest—including all conflicts touching on almost every technology that is used by a broker-dealer or investment adviser in any interaction with retail investors—Congress surely would not have tucked the provision away in a subsection unassumingly entitled "Other Matters."[129] Courts presume that Congress will "speak clearly" if it wants to delegate issues of major political or economic significance to

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[124] Pub. L. No. 111-203, § 913(b)–(d), 124 Stat. 1376, 1824–27 (2010).

[125] Pub. L. No. 111-203, § 913(f)–(g), 124 Stat. at 1827–29.

[126] 17 C.F.R. § 240.15l-1(a)(1).

[127] *See Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (quoting *FTC v. Mandel Brothers, Inc*., 359 U.S. 385, 389 (1959) (statutes must be construed to "fit, if possible, all parts into an harmonious whole")).

[128] 17 C.F.R. §§ 240.15l-1(a)(1), 240.15l-1(a)(2)(iii)(D).

[129] 15 U.S.C. § 78o(l).

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administrative agencies like the Commission.[130] Congress has given no indication whatsoever here that it intended this "ancillary" provision—whose own title suggests it is meant to be a "gap filler"—to vest the Commission with power to regulate the use of almost every form of technology in the securities industry that provides inputs into an investor interaction (and all conflicts of interest as they arise in that sphere).[131]

C. The Proposal Violates The First Amendment.

Statutory authority aside, the Proposal violates the First Amendment. Broker-dealers such as Robinhood have a First Amendment right to communicate with their customers, but the Proposal impermissibly burdens that right based on the content of the broker-dealer's speech. Before the broker-dealer can "interact[]" (i.e., speak) with its customers through virtually any form of technology, the broker-dealer must, under the Proposal, adopt and implement onerous procedures. The First Amendment does not allow the Commission to constrain speech in this way.

Strict scrutiny applies here. The Proposal would adopt "content-based" and "speaker-based" restrictions on speech.[132] It applies to broker-dealer's interactions with their customers and turns in large part on the content of that speech—whether the broker-dealer is "optimiz[ing] for, predict[ing], guid[ing], forecast[ing], or direct[ing] investment-related behaviors or outcomes," for example, by "providing information to [the] investor," "soliciting [the] investor," or "providing … general administrative support."[133]

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[130] *West Virginia v. Env't Protection Agency*, 142 S. Ct. 2587, 2605 (2022).

[131] *Id.* at 2610; *Whitman v. American Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001) (Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.").

[132] *Sorrell v. IMS Health Inc.*, 564 U.S. 552, 565–66 (2011).

[133] Proposed Rule 15l-2(a), Proposing Release, 88 Fed. Reg. at 54,023. The Proposal's application similarly turns on the speaker. Specifically, it targets the speech of those who communicate over digital platforms and not those who communicate through more traditional forms of communication used by broker-dealers and financial advisers—such as financial publications that routinely publish lists or information about the most active stocks or other widely traded securities. The selective burdening of those who communicate digitally is subject to strict scrutiny. *See infra*, Section IV.C; *Reed v. Town of Gilbert, Ariz.*, 576 U.S. 155, 170 (2015) ("Because speech restrictions based on the identity of the speaker are all too often simply a means to control content, we have insisted that laws favoring some speakers over others demand strict scrutiny when the [law's] speaker preference reflects a content preference." (internal citations and quotation marks omitted)).

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The Proposal cannot survive strict scrutiny. It is not narrowly tailored to promote a compelling government interest.[134] And there are less restrictive alternatives that would serve the Commission's purposes anyway.[135]

First, in the First Amendment context, the government cannot "rest on 'speculation or conjecture.'"[136] It needs evidence. And, here, the record lacks any evidence that the Proposal would in fact further a compelling government interest. On the investor-protection front, however, the Commission has not come close to meeting its burden. The Commission has not shown that broker-dealers' use of technology is somehow hurting investors; in fact, the record shows that the opposite is true.

Moreover, the Proposal is anything but narrowly tailored. This is not like the Commission's ordinary disclosure requirements. Rather than require the simple disclosure of true and factual information, the Proposal *prohibits* the communication of true and factual information pending the creation of costly policies and procedures and, in other instances, the elimination of conflicts of interest. And to the extent there is an "actual [investor protection] problem in need of solving"[137]—which there is not—the Proposal sweeps in far too many innocent and protected interactions (including those involving a simple spreadsheet or the communication of a change in stock price) to be "the least restrictive alternative that can be used to achieve" the Commission's asserted interests.[138]

The Commission cannot proceed with the expectation that a lesser degree of First Amendment scrutiny will apply here, as it could in the case of so-called "professional speech." Even if this *were* professional speech, and professional speech is a "difficult category to define with precision," the Supreme Court has held that the "ordinary First Amendment principles" discussed above apply anyway.[139] The Proposal would not survive even a lesser level of constitutional scrutiny. Under intermediate scrutiny, the Proposal fails because the Commission has not shown why less-restrictive alternatives, such as disclosure, would be inadequate.[140] Moreover, as discussed elsewhere in this letter, the Proposal is far more extensive than necessary to serve the Commission's purpose.[141] Thus, under even lesser scrutiny, the Proposal fails because it is "unjustified," "unduly burdensome," and "broader than reasonably

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[134] *See Nat'l Inst. of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361, 2371 (2018).

[135] *See id.* at 2376.

[136] *Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n*, 800 F.3d 518, 526 (D.C. Cir. 2015).

[137] *Brown v. Ent. Merch. Ass'n*, 564 U.S. 786, 799 (2011) (internal quotation marks omitted).

[138] *Ashcroft v. Am. C. L. Union*, 542 U.S. 656, 666 (2004).

[139] *Nat'l Inst. of Family & Life*, 138 S. Ct. at 2375.

[140] *Nat'l Ass'n of Mfrs.*, 800 F.3d at 555-56.

[141] *Id.*

necessary."[142] Simply put, under any standard, the Proposal cannot survive First Amendment scrutiny and, accordingly, should be withdrawn.

IV. Beyond The Issues With The SEC's Lack Of Authority And Basis For The Proposal, The Proposal Is Bad Policy That Is Unlawful For A Multitude Of Other Reasons.

The Proposal is arbitrary and capricious because it contradicts the SEC's recently adopted Reg BI and Fiduciary Interpretation, including the longstanding tradition of relying on a disclosure-based framework to address conflicts of interest. It is also ill-advised policy because it would disempower investors and discourage technology and innovation. The Proposal contradicts the SEC's rulemaking mandate because it would discourage efficiency, competition, and capital formation.[143] Not only does the SEC fail to identify any credible benefits of the Proposal, but it also acknowledges that the Proposal has the potential to impose significant costs and burdens on market participants and investors. Such a rulemaking is not necessary, appropriate, or in the public interest.

A. The Proposal Cannot Be Squared With The SEC's Recently Adopted Reg BI Or The SEC's Longstanding Tradition Of Relying On A Disclosure-Based Framework To Address Conflicts Of Interest For Broker-Dealers.

As we discuss above, throughout its history including as recently as Reg BI, the SEC has allowed market participants to rely on disclosure to cure conflicts of interest. Congress, the SEC, and the SROs have deemed disclosure sufficient to address conflicts of interest in a variety of contexts, including complex products.[144] The SEC would cast aside years of developed policy that is grounded in real statutory authority and the product of significant study and real-world application to establish a new and costly framework that applies only to the use of technology on the basis of highly speculative potential benefits.

The SEC recognizes that broker-dealers "are currently subject to extensive obligations under Federal securities laws and regulations, and … rules of [SROs (in particular, FINRA)], that are designed to promote conduct that, among other things, protects investors … from conflicts of interest."[145] Advisers similarly do not need specific new rules to govern their use of technology. As the SEC recognizes, advisory relationships with clients are governed by fiduciary duties, and the existing antifraud provisions of the Advisers Act and the rules thereunder provide a protective overlay on an adviser's

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[142] *Nat'l Inst. of Family & Life*, 138 S. Ct. at 2377.

[143] *See* 15 U.S.C. §§ 78c(f); 78w(a)(2); 80b-2(c).

[144] *See, e.g.*, Section 17(b) of the Securities Act, Section 15D of the Exchange Act; Exchange Act Rules 10b-10, 15c1-5, 15c1-6, 17g-5, 17g-7, Reg BI, Form CRS, Regulation AC, Regulation NMS Rules 606 and 607; FINRA Rules 2210, 2241, 2242, 2262, 2269, 5121, 5122; Municipal Securities Rulemaking Board Rules G-22 and G-42 (relating to broker-dealer conflicts of interest).

[145] Proposing Release, 88 Fed. Reg. at 53,965-66 (footnote omitted).

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relationships with clients and fund investors.[146] The SEC's sticking point is that these firms do not have a specific obligation to address conflicts of interest resulting from technology in every investor interaction. But these firms do not need specific obligations with respect to the use of technology—they currently have rules that govern their conduct irrespective of their use of technology in appropriate circumstances. The primary basis for addressing them is, and historically has been, disclosure.

Without articulating why technology would pose such a significant risk of investor harm, the SEC now would depart from this decades-long standard not just where there has been recognition of heightened risks (such as a recommendation under Reg BI) but in *any* investor interaction. As discussed above, this departure has no basis in law or fact, and it would deprive investors of valuable information and tools to plan for their financial well-being and future.

B. The Proposal Disempowers Investors.

The Proposal smacks of contempt for the ordinary person, who under the SEC's apparent world view is incapable of thinking for himself or herself. Robinhood customers have made a conscious decision to be self-directed investors—they don't necessarily *want* someone else taking investment decisions or information relevant to such decisions out of their hands. Many of these customers also want the ability to choose more than one model to meet their investment needs, for example, a managed account or full-service brokerage account along with the ability to make their own investment decisions through self-directed platforms. Others are unable to access full-service brokerage or advisory services, due to factors like cost or geography. Investors want access to technologies that give them more useful choices, tools, and information, not regulation that would seek to take those choices, tools, and information away.

The SEC's rejection of disclosure as a means to cure potential conflicts of interest is the worst example of demeaning paternalism. The requirement to "eliminate or neutralize the effect of" a conflict of interest associated with the use of technology rather than disclose potential conflicts tells investors one thing: *we think we know better than you*. Instead, the SEC would remove retail investors' ability to use the same technologies that institutional investors use. And those retail investors would have to pay more for using lesser technologies because of the additional costs introduced by the Proposal.

C. The Proposal Is Blatantly Anti-Technology, Anti-Innovation, And Anti-Commerce.

The Proposal purports to be "principles based" and "technology neutral," but in reality it is highly prescriptive and broadly anti-technology. The Proposal also purports to address "predictive data analytics" but goes far beyond that. The SEC's

[146] *Id*.

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overly broad approach will impact technologies that are mundane as well as the more advanced technologies, like AI, NLP, and machine learning, that the Proposal is ostensibly designed to address. However, even if the Proposal were specifically targeted at those more advanced technologies, the Proposal would make it too costly and burdensome for firms to use those technologies for the benefit of their customers and clients. The SEC would stifle innovative ideas and uses of technology that could lead to significant cost savings, improve the overall investor experience, and continue to open the markets to more investors. This approach is not only bad for business, markets, and investors, but also contrary to the SEC's own mandate. The SEC and SEC officials have recognized the promise that innovative new technologies can have in the marketplace countless times and have demonstrated a commitment to fostering innovation.[147] It would be antithetical to the SEC's mission and its own historical approach to the use of technology to proceed with the Proposal.

Multiple times in the Proposing Release, the SEC recognizes the potential harm that the Proposal could generate by undermining the use of technology by broker-dealers and investment advisers: "Not only could this harm the firm and investors due to, for example, foregone cost savings, lack of tailoring of recommendations to individual investors, or unimplemented user experience improvements, but it also could slow down technological innovation and progress more broadly."[148] The SEC also acknowledges that capital formation could be hindered "to the extent that the costs of the technology are too high and firms avoid using certain covered technologies that benefit investors" or the Proposal "deter[s] firms from using covered technologies in investor interaction."[149] (It is ironic the Commission evidently believes it's sufficient to "disclose" such fatal flaws, rather than "eliminating" the problems by totally re-writing or abandoning the Proposal.) These are serious concerns that we think are likely, if not absolutely certain, to transpire. And they are not offset by the speculative benefits that the SEC believes the Proposal might offer. The Proposal instead would delay and deter U.S. broker-dealers and investment advisers from implementing technology across their businesses. It would put the U.S. securities industry at a significant disadvantage to other industries and to financial institutions in other

[147] Press Release, SEC, *SEC Announces Office Focused on Innovation and Financial Technology* (Dec. 3, 2020), https://www.sec.gov/news/press-release/2020-303; Press Release, SEC, *SEC Launches New Strategic Hub for Innovation and Financial Technology* (Oct. 18, 2018), https://www.sec.gov/news/press-release/2018-240; SEC Strategic Plan Fiscal Years 2018-2022, https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL.pdf; Kara M. Stein, Comm'r, SEC, *Supporting Innovation Through the Commission's Mission to Facilitate Capital Formation* (Mar. 5, 2015), https://www.sec.gov/news/speech/innovation-through-facilitating-capital-formation; Paul S. Atkins, Comm'r, SEC, *Speech by SEC Commissioner: Remarks at Vanderbilt University* (Oct. 20, 2006), https://www.sec.gov/news/speech/2006/spch102006psa.htm.

[148] Proposing Release, 88 Fed. Reg. at 54,011.

[149] *Id*. at 54,012.

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jurisdictions. The SEC's approach is not only bad for U.S. markets and investors, but also it is at odds with the approach that other U.S. government agencies are taking, which is to recognize and embrace the benefits of technology.[150]

The Proposal combines the SEC's unsubstantiated suspicion of technology with a hostility toward commerce that is entirely misplaced in a regulator charged with overseeing markets and furthering capital formation. The Proposal seemingly rejects the notion that a broker-dealer is a person who is "engaged in the business" of effecting securities transactions or buying and selling securities by requiring a broker-dealer to jump through hoops any time it seeks to consider the "business" in its interactions with customers. As a business, a broker-dealer has obligations to its own investors and stakeholders as well as its customers. Accordingly, every decision a broker-dealer makes is a *business* decision and takes into account the interests of the firm. The Proposal would characterize the natural workings of a business as a malignant conflict of interest that is harmful to investors.[151] However, the Proposal fails to consider that having something work from a business perspective is a prerequisite to any customer offering—otherwise, the business would not be able to support any of its customers for long. The Proposal would make it harder for firms to make necessary, day-to-day business decisions by requiring them to perform an onerous calculus any time they make a customer-facing change. The Proposal's subversive treatment of normal business processes is unbecoming of a regulator that is intended to regulate the financial system and antithetical to a society that values commerce and entrepreneurship.

D. The Proposal Will Reduce Efficiency, Stifle Competition, And Deter Capital Formation.

The Exchange Act and Advisers Act require the Commission to determine whether a rulemaking will "promote efficiency, competition, and capital formation."[152] The Proposal fails to achieve any of these objectives and, in fact, will have the opposite effect.

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[150] *See, e.g..,* David Vergun, *DOD Will Deploy AI-Enabled Detection System to Monitor D.C. Airspace*, DOD NEWS (Aug. 28, 2023), https://www.defense.gov/News/News-Stories/Article/Article/3507329/dod-will-deploy-ai-enabled-detection-system-to-monitor-dc-airspace/; IRS, IR-2023-166, *Agency Focus Will Shift Attention to Wealthy from Working-Class Taxpayers; Key Changes Coming to Reduce Burden on Average Taxpayers While Using Artificial Intelligence and Improved Technology to Identify Sophisticated Schemes to Avoid Taxes* (Sept. 8, 2023), https://www.irs.gov/newsroom/irs-announces-sweeping-effort-to-restore-fairness-to-tax-system-with-inflation-reduction-act-funding-new-compliance-efforts.

[151] The Proposal presumes that broker-dealers are inherently conflicted and have no incentive to manage their conflicts. The opposite is true—broker-dealers are incentivized to manage and mitigate conflicts of interest and not engage in activity that would cause a negative customer experience. That would be bad for retaining customers and bad for business.

[152] 15 U.S.C. §§ 78c(f), 80a-2(c), 80b-2(c).

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1. The Proposal Will Negatively Affect Competition.

With regard to competition, the Proposal will make it harder for new broker-dealers and investment advisers to break into the industry by introducing new and additional costs and making it harder and more expensive to rely on third-party technology service providers. This problem hits close to home for us at Robinhood. We began as a startup company with an innovative idea for an app that would make investing more accessible. The Proposal would have stifled Robinhood's own growth and now threatens to do the same to future innovators.

Moreover, many smaller firms rely on third-party vendors for technology because they do not possess the internal resources to produce or manage those technologies. The Proposal would make it more challenging to outsource technology solutions, creating barriers to entry and innovation and favoring larger incumbents who have the resources to manage technology in-house.

By introducing significant new costs associated with the use of technology, the Proposal would erect barriers that make it harder for new, innovative solutions to reach investors. While purportedly trying to put guardrails in place, the SEC instead would create a two-tiered system of broker-dealers and investment advisers—one with the resources to use complex technologies and the other without.

Indeed, the SEC concedes that the effects of the Proposal will be harmful to competition:

- "The proposed conflicts rules could also result in costs that could act as barriers to entry or create economies of scale, potentially making it challenging for smaller firms to compete with larger firms utilizing covered technologies—as firms continue to increasingly rely on covered technologies for investor interactions."[153]
- "Ensuring compliance with the proposed conflicts rules would require additional resources and expertise, which could become a significant barrier to entry, potentially hindering smaller firms from entering the market or adopting new technologies."[154]
- Larger firms "may have a competitive advantage over smaller firms because they may be better able to spread the (fixed) cost of the proposed conflicts rules across their clients, or more effectively negotiate with third party providers to obtain compliant technology externally."[155]
- "Smaller firms subject to the proposed conflicts rules could also face a competitive disadvantage compared to larger firms when negotiating with

[153] Proposing Release, 88 Fed. Reg. at 54,012.

[154] *Id*.

[155] *Id*.

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technology companies to build software that complies with the proposed conflicts rules."[156]

The so-called "positive" effects on competition that the SEC identifies are speculative and unconvincing: (1) investors could have greater confidence in interactions with firms using covered technology and therefore be more likely to participate in financial transactions; and (2) investors will put additional weight on fees and execution quality. Putting aside the fact that these effects have nothing to do with increasing competition among securities firms, the SEC has failed to quantify them or set forth any compelling evidence that they are real problems in need of regulatory solutions. Investors are already focused on fees and execution quality and receive extensive information about fees and execution quality today. The Proposal will not affect the way that fees and execution quality are presented to investors, so it is nonsensical to cite this as a potential effect of the Proposal.

2. The Proposal Will Negatively Affect Efficiency.

The Proposal would negatively impact efficiency by making it more difficult for firms to use technology when communicating with investors because of the new, onerous obligations that would be imposed on firms using technology. This is contrary to what Congress envisioned when it established the SEC in 1934 with the instruction to maintain fair, orderly, and efficient markets, when it directed the establishment of a national market system linked through technology in 1975, and when it embarked on modernizing securities regulation at the dawn of the Internet Age and enactment of the Dodd-Frank Act. The SEC concedes the Proposal could negatively impact technology in its economic analysis: "The proposed conflicts rules could negatively affect efficiency by impeding the use of technology in several ways."[157] The SEC then proceeds to identify numerous real ways that the Proposal could negatively impact efficiency:

- "First, the compliance costs of the proposed conflicts rules could dissuade some firms from using covered technologies in investor interactions. For example, a firm might decide that using a chatbot technology that provided investment advice would be too costly because of the obligations imposed by these rules, and instead opt for human alternatives. To the extent that the chatbot technology was more efficient at providing support to investors, the efficiency of the firm's ability to provide advice would be decreased."[158]
- "Second, certain types of technology might be too difficult or costly to evaluate, or to modify to comply with the rules, and firms could avoid using these technologies.... In these cases, firms and investors would not enjoy any

[156] *Id*.

[157] *Id.* at 54,011.

[158] *Id*.

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of the efficiency gains that the covered technology might have yielded, or have yielded if already implemented."[159]

- "Third, the costs and requirements could slow down the frequency or overall rate of technological updates to existing covered technologies and exploration of new covered technologies, as well as make the technology itself less efficient... Not only could this harm the firm and investors due to, for example, foregone cost savings, lack of tailoring of recommendations to individual investors, or unimplemented user experience improvements, but it also could slow down technological innovation and progress more broadly."[160]

Notably, the SEC identifies only a single way that the Proposal could positively impact efficiency: investors might have "greater confidence regarding the conflicts of interest associated with the use of covered technologies that they interact with."[161] Putting aside the fact that this potential outcome has nothing to do with the efficiency of the securities markets, this statement is wholly speculative, and the SEC fails to provide any credible support for it.

3. The Proposal Will Negatively Affect Capital Formation.

The SEC again identifies very real, negative effects of the Proposal on capital formation. Specifically, the SEC acknowledges that the costs associated with the Proposal could "result in increased fees for investors or deter firms from using covered technologies in investor interaction," which would hinder capital formation.[162] The SEC admits that this "could be particularly problematic for smaller firms who may struggle to absorb these additional costs."[163] Finally, the SEC concedes that because the Proposal will impose additional costs on firms' use of technology, firms could "avoid using certain covered technologies that benefit investors" and, as a result "capital formation could be hindered."[164]

Flagrantly disregarding its mandate, the Proposal fails to account—as it must—for the adverse impact it would have on capital formation, by deterring trading activity. An animating belief of the Proposal, albeit unsupported by the facts, is that technology is making it "too easy" for broker-dealers to reach investors, too easy to inform them of trades that might be of interest, and too easy to execute those trades. The Commission is sorely mistaken to view these aspects of technology as a problem. But in proposing a rule that is designed to complicate and, in some cases, "restrict" or

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[159] *Id*.

[160] *Id*.

[161] *Id.* .

[162] *Id*. at 54,012.

[163] *Id*.

[164] *Id*.

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"eliminate" these interactions, a central obligation of the Commission is to explain what the consequences will be for the markets and capital formation. Simply, the Commission cannot set out with the purpose of making it harder to market securities, without carefully documenting the impact on capital formation.

Notably, the SEC identifies only one way that capital formation could be positively affected: "the elimination or neutralization of the effects of certain harmful conflicts of interest … could enhance capital formation if the quality of services is improved or investment performance or execution quality is improved, and investors … invest more as a result."[165] Putting aside the fact that there is no support or basis for these statements, they are nonsensical because they contradict other statements by the SEC. The quality of services provided to investors will not be improved because the Proposal will make it more expensive and difficult for firms to provide beneficial technology to customers, as the SEC admits. And it is nonsensical to claim that the Proposal could improve execution quality; the Proposal has nothing to do with how securities transactions are executed,[166] and the SEC admits that the Proposal could make investing more expensive for retail customers through higher fees, which logically would lead to worse execution quality and less investment.

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Robinhood appreciates the opportunity to comment on the Proposal. The Proposal is a blunt instrument that would seek to regulate a wide swathe of broker-dealer and investment adviser conduct without any nuance. Although it purports to regulate the use of PDA and PDA-like technologies, the Proposal would extend far beyond that, applying to nearly any technology—even basic technologies—that could be used in an interaction with an investor. The SEC does not appreciate the significant costs and burdens the Proposal would impose on firms or the benefits that investors would stand to lose if the Proposal were adopted. Nor does it sufficiently consider the other rules that overlap and may conflict with the Proposal's requirements—creating a compliance nightmare for firms trying to figure out how to apply this framework. Instead, the Proposal takes a regressive, hostile view of the use of technology by firms without articulating a basis for or undergoing a data-driven analysis to support the need for the Proposal. The result would be an unmitigated disaster for retail investors, who will be sidelined from full and fair participation in the U.S. financial markets, while institutional investors not impacted by the Proposal continue to have access to important investment tools. The Commission's authority to adopt the Proposal also rests on shaky ground—not only is the Proposal outside of the SEC's statutory authority and inconsistent with the Commission's mandate to promote efficiency, competition, and capital formation, but the Proposal also presents significant constitutional issues that call into question its legitimacy.

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[165] *Id*.

[166] And, in fact, the SEC excludes back-office execution and trade processing functions from the proposed rules. *See id*. at 53,974.

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For all these reasons, the Commission should withdraw the Proposal.

Please contact Robinhood's Deputy General Counsel, Lucas Moskowitz, at lucas.moskowitz@robinhood.com if you have any questions or comments.

Sincerely,

DocuSigned by:
Dan Gallagher
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Daniel M. Gallagher

Chief Legal and Corporate Affairs Officer

Robinhood Markets Inc.