October 10, 2023

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

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

The Securities Industry and Financial Markets Association and the Securities Industry and Financial Markets Association's Asset Management Group (collectively "SIFMA")[1] appreciate the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission") on proposed rules that would require the elimination or neutralization of certain conflicts of interests associated with the use of "covered technologies" (including predictive data analytics ("PDAs") and PDA-like technologies) by Broker-Dealers ("BDs") and Registered Investment Advisers ("RIAs" and, together with BDs, "Covered Firms") pursuant to the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 (the "Proposed Rules"), as described in the release titled *Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, Release No. IA-6353; File No. S7-12-23 (July 26, 2023) (the "Proposing Release").[2]

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[1] SIFMA is the leading trade association for BDs, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (the "GFMA").

SIFMA's Asset Management Group ("SIFMA AMG") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS, and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

[2] Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Release No. IA-6353; File No. S7-12-23 (July 26, 2023), 88 Fed. Reg. 53960 (Aug. 9, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-08-09/pdf/2023-16377.pdf.

The Proposed Rules would broadly impose a new conflicts elimination or "neutralization" requirement on BD and RIA interactions with investors, covering both (i) advisory relationships and the provision of recommendations and (ii) arms-length communications where the BD or RIA has not undertaken special duties to the investor or invited reliance on the provider's expertise. As such they would fundamentally rewrite the existing regulatory regime under which RIAs and BDs provide services to investors.[3] The Proposing Release fails, however, to justify such a radical regulatory expansion. Among other shortcomings, the Proposing Release fails to provide any rational basis for concluding that the existing, robust regulatory regime is insufficient to address the specific concerns raised in the Proposing Release. The Proposing Release also does not establish a rational relationship between the limited and speculative theories of harm it describes and the costs that would be imposed by the Proposed Rules. To the extent the Commission believes that there is a need to augment the existing regulatory regime, it can and should work constructively with industry to address those concerns in an appropriately targeted and evidence-based manner. The Proposed Rules do not reflect such a reasoned approach and for that reason should not be adopted.

EXECUTIVE SUMMARY

The Proposed Rules are fundamentally flawed, and adoption by the Commission would be arbitrary and capricious, for the following reasons:

- There is already a robust, reasonable, and effective regulatory regime that governs investor interactions associated with BDs' and RIAs' uses of technology, both in connection with providing recommendations and advice and in the context of marketing communications. The Proposing Release does not provide meaningful evidence of any shortcomings in that regime and gives no reason to believe that there is a significant risk of harm to investors arising from BDs' and RIAs' potential future uses of technology in either context.

- The Proposed Rules would impose uniform conflicts elimination or neutralization requirements across both of these contexts without regard to the existing regulatory framework or the underlying relationship established between the parties. Indeed, the proposed definitions and requirements are so expansive in scope that they would encompass (and burden) countless uses of technology – including many routine and long-standing practices – that have no rational relationship to the limited concerns expressed in the Proposing Release.

- The requirements of the Proposed Rules are also fundamentally flawed in design and unworkable in practice as they would impose inventory and balancing-of-interests requirements that would be impractical, if not impossible, to administer much of the time. Beyond imposing substantial and unjustified burdens, they would often simply

[3] As used herein, the term "investors" should be understood to mirror the definition provided in the Proposing Release, which encompasses all individual and institutional clients and retail customers, as well as prospective clients and prospective retail customers. For the avoidance of doubt, however, and for the reasons described in Sections II and IV below, the members of SIFMA believe that this definition is overbroad and unprincipled.

prevent a vast array of beneficial investor interactions and advisory practices. Because the requirements of the Proposed Rules would severely inhibit BDs' and RIAs' uses of technology and their ability to communicate with retail customers and clients, the Proposed Rules would undermine market efficiency, inhibit competition, and harm investors by limiting the ability of BDs and RIAs to provide valuable education, information, and services, potentially jeopardizing the preeminence of the U.S. securities markets.

- For RIAs, the decision to apply the Proposed Rules to institutional clients and discretionary investment decisions is unexplained in the Proposing Release, and it is inconsistent with the logic underlying the Proposed Rules and illogical in light of the underlying business relationships and activities.
- Adoption of the Proposed Rules would be unlawful, arbitrary, and capricious, including because adoption would exceed the authority of the Commission, and because the resulting rules: (i) would be too vague to provide effective notice to BDs and RIAs of their obligations; (ii) would impose extraordinary, unconsidered costs without any countervailing benefits; and (iii) would lack a reasonable fit between the burdens imposed on commercial speech and any legitimate government interest.

For these reasons, as described further below, SIFMA urges the Commission not to move forward with the proposed framework. We would be happy to discuss more suitable ways to address the Commission's concerns about uses of PDA-like technologies (including risks related to conflicts of interest), but the Proposed Rules are too imprecise and logically flawed to be a constructive starting point for developing appropriate regulation.

I. The Proposing Release fails to demonstrate a need for the Proposed Rules in light of existing effective regulation.[4]

A. Technologies covered by the Proposed Rules significantly benefit investors.

Modern technologies – including online and interactive communications, high-speed processing and transferring of data, large and accessible electronic databases, and sophisticated analytical tools – provide substantial benefits to markets and investors. The widespread adoption of these technologies in the securities industry reflects substantial advances, changes in the ways that investors conduct their personal and professional lives, and the significant value that modern electronic tools provide for individuals and companies. The recent development and use of

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[4] To facilitate the Commission's review and consideration of our comments, we identify at the start of each section, a non-exclusive list of questions from the Proposing Release to which our comments are responsive.

The comments in Section I respond to a variety of questions in the Proposing Release, including (but not limited to) the following: with respect to Section I(B), questions 21, 27, 53, 60, 62, 67, 75, 78, 82, and 85; with respect to Section I(C), questions 25, 52, and 58.

"digital engagement practices" ("DEPs"),[5] PDAs,[6] and PDA-like technologies (as defined by the Proposing Release)[7] all reflect similar trends.

Together, these tools have facilitated and enhanced opportunities for investors, particularly retail investors, to save, invest, and participate in the securities markets. They have supported and promoted paths toward effective financial planning, retirement planning, and financial literacy.[8] They also have enhanced the ability of investment advisers to perform analysis with higher degrees of sophistication at reduced cost and to pass those benefits on to clients and advised accounts through a multitude of channels. Finally, they have enhanced firms' understanding of investors' financial needs, fostered more sophisticated alignment between investors and product offerings, and provided financial education to better inform conversations between advisers/broker-dealers and investors.

Collectively, these developments have been a critical factor in the increase of retail investor engagement seen in the modern era,[9] and they are an important driver of the continued preeminence and performance of U.S. securities markets.

B. *The SEC's theories of harm are both narrower than implied and adequately covered by existing regulation.*

Despite the benefits of digital engagement, the Proposing Release paints a disproportionately negative picture of technology in support of a rulemaking that is affirmatively hostile to it. In particular, the Proposing Release suggests that features of some modern technologies – including complexity, the ability to "scale" deployment, and opacity – necessitate draconian new regulatory requirements.

The Proposing Release presents just two concrete theories of harm to justify this conclusion:

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[5] The Proposing Release does not define DEPs, but provides a series of examples such as social networking tools, games and other contests; notifications of ideas; celebrations for trading; visual cues; and curated lists or features. More generally, it describes DEPs as design elements of other features designed to engage retail investors when using a firm's digital platform for services such as trading, advice, or education. Proposing Release at 53,964 and fn. 29.

[6] The Proposing Release describes PDAs as tools that "draw…inferences from large data sets, relying on hypothesis-free data mining and inductive reasoning to uncover patterns to make predictions about future outcomes, and may use natural language processing, signal processing, topic modeling, pattern recognition, machine learning, deep learning, neural networks, and other advanced statistical methods." *Id.* at fn. 9.

[7] The Proposing Release defines PDA-like technologies as "artificial intelligence ("AI"), including machine learning, deep learning, neural networks, natural language processing ("NLP"), or large language models (including generative pre-trained transformers) as well as other technologies that make use of historical or real time data, lookup tables, or correlation matrices." *Id.* at 53,961 and fn. 3.

[8] *Id*. at 53,962.

[9] *Id.* at 53,963-53,964 and fn. 27.

1. the concern that PDAs used to produce investment recommendations or advice could be influenced by hidden biases that skew the outputs toward products, strategies, and investments that are profitable for the BD or RIA to the detriment of an investor; and

2. the concern that enhanced data analysis and computing power may allow for faster and more effective development and deployment of "behavioral nudges," which may induce sub-optimal investment behaviors – primarily excessive trading or choosing inappropriate investments.[10]

As to these two sets of concerns, the Proposing Release suggests that current regulation is inadequate and that these risks of harm cannot be effectively cured through disclosure. We emphatically disagree.

Regarding the first of the Commission's theories, existing rules and regulations already require that any recommendation or advice be in the best interest of the investor. These rules and regulations include, for BDs, Regulation Best Interest ("Reg BI") and suitability rules promulgated by Self-Regulatory Organizations ("SROs"), and, for RIAs, the obligations imposed under the Advisers Act, as recently interpreted by the Commission in its 2019 interpretation[11] (referenced herein as the "RIA Fiduciary Standard"). Collectively, these require that BDs or RIAs not put their own interests ahead of the interests of investors and that material conflicts of interest related to the provision of recommendations or advice be disclosed.[12]

These existing requirements rightly focus on the ultimate substance of the recommendation or advice and not the way the recommendation or advice is generated. Whether or not a covered technology is used, they hold BDs and RIAs to appropriate standards. The Proposing Release provides no evidence for the hypothesis that the existing standards are in fact inadequate or that they cannot continue to be applied effectively to uses of covered technology.[13]

As to investor interactions that are not recommendations or advice – including basic marketing, education, research, the provision of news, databases, investment tools, and DEPs – existing rules and regulations impose robust requirements that are appropriate for the context: content standards, disclosure requirements, and prohibitions on improper manipulation. SIFMA has discussed these BD and RIA requirements in detail in its prior letter to the Commission in

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[10] The Proposing Release also suggests that a BD or RIA could provide its clients with a non-advisory investment tool or model that provides potentially biased or defective results, which is a combination of both concepts. *Id.* at 53,968.

[11] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019), 84 FR 33669 (July 12, 2019).

[12] Additionally, FINRA Rules 2241 and 2242 specifically require BDs to identify and manage conflicts of interest that relate to a recommendation, rating, or price target to the extent they are produced by the BD's research analysts.

[13] More troubling still, as discussed further in Section III, the Proposed Rules would not merely be duplicative or additive; they would actually conflict with Reg BI and the RIA Fiduciary Standard and introduce an unworkable set of requirements into an otherwise functioning regulatory regime.

response to its Request for Information and Comment on Digital Engagement Practices.[14] While our prior arguments are not recounted in full, we refer the Commission to our prior letter and note the following major points:

> First, DEPs (and other similar communications and engagements) are not new. They pose the same potential conflicts that arise any time a seller of services engages a potential purchaser in any medium or form of communication. DEPs are merely a particular form of communication, and PDAs are merely a potential way of developing or tailoring DEPs and other communications that do not rise to the level of advice or recommendations. As such, they are subject to the same fiduciary duties (in the case of RIAs) and compliance and regulatory obligations that all BDs and RIAs have with respect to every other communication or engagement with clients.
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> Second, these requirements are comprehensive and effective. For BDs, existing regulations: (i) cover communications with retail investors (in any medium) as well as the provision of investment analysis tools and research;[15] (ii) require that all written communications be fair and balanced, provide the recipient with a sound basis for evaluating the material facts regarding the relevant investment or service, and consider the audience to which the statement(s) is/are made;[16] (iii) require disclosure of general and product specific conflicts of interest and risks;[17] (iv) require disclosure of the broker-dealer's commission or mark-up and, in the case of payment for order flow ("PFOF") or issuer payments, whether the BD is receiving such PFOF or issuer payments;[18] (v) require pre-trade consent for certain principal trading activities and prescribe customer order handling practices where real time conflicts with a BD's trading desk may arise;[19] and (vi) prohibit conduct that is "manipulative" or that is not consistent with high

[14] Letter dated October 1, 2021, available at: https://www.sifma.org/wp-content/uploads/2021/10/SIFMA-comment-re-DEPs-10.1.2021-FINAL.pdf.

[15] *See, e.g.*, FINRA Rule 2210 (communications with the public) and related guidance; FINRA Rule 2241 (Research Analysts and Research Reports); FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports); MSRB Rule G-17 and related guidance.

[16] *See, e.g.*, FINRA Rule 2210 (communications with the public) and related guidance; FINRA Rule 2241 (Research Analysts and Research Reports); FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports); MSRB Rule G-17 and related guidance.

[17] *See, e.g.*, SEC Form CRS relationship summary, 17 CFR 240.17a-14; SEC Regulation Best Interest, 17 CFR 240.15l-1; SEC Rule 10b-10; FINRA Rule 2241 (Research Analyst and Research Reports); FINRA Rule 2360 (Options); FINRA Rule 2264 (Margin Disclosure Statement); FINRA Rule 2270 (Day-Trading Risk Disclosure Statement); 17 CFR 242.605; 17 CFR 242.606.

[18] *See, e.g.*, Exchange Act Rule 17a-5 (financial responsibility rules); Exchange Act Rule 15c3-1 (minimum net capital requirements); Exchange Act Rule 15c3-3 (customer protection requirements); Exchange Act Rule 10b-10; 17 CFR 240.15c2-5 (disclosure and other requirements when extending credit); 17 CFR 240.10b-16 (disclosure of credit terms in margin transactions); FINRA Rule 4210 (Margin Requirements).

[19] *See, e.g.*, FINRA Rule 2124 (Net Transactions with Customers); FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders).

> standard of commercial honor and just and equitable principles of trade, as well as conduct that is fraudulent or deceptive.[20]
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> For RIAs, the existing regulatory framework: (i) establishes that investment advisers owe fiduciary duties to their clients (including the duties of care and loyalty) that broadly cover conflicts and are enforceable through existing antifraud provisions of the securities laws;[21] (ii) prohibits RIAs from providing investors with marketing materials (including interactive analysis tools) that, among other things, are not fair and balanced, or that are otherwise misleading;[22] (iii) requires RIAs to establish and implement a comprehensive compliance program that, among other things, addresses material conflicts;[23] and (iv) imposes broad recordkeeping responsibilities on RIAs related to their advisory services and communications with clients regarding investment advice.[24]
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> In light of the foregoing, and as explained in SIFMA's prior letters to the Commission, the Commission and FINRA already have more than adequate enforcement authority to bring actions related to DEPs and other general advertisements and communications that are deemed manipulative or harmful to investors or otherwise do not disclose material conflicts of interest.

C. *The SEC's arguments for the inadequacy of current regulation are unsupported and unconvincing.*

Against the backdrop of this comprehensive set of requirements, the Proposing Release provides no evidence of systemic unmanaged conflicts or investor harm associated with uses of covered technology. This is true, despite the fact that the Commission's Department of Examinations has included use of predictive analytics in its published exam priorities for the last

[20] *See, e.g.*, Exchange Act Rule 10b-5; Exchange Act section (10)(b); FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices); FINRA Rule 3110(b)(5) (Supervision); FINRA Rule 4530 (Reporting Requirements); FINRA Rule 4311(g) (Carrying Agreements) (addressing certain requirements for carrying agreements relating to customer complaints); 17 CFR 240.17a-3(a)(18) (requiring broker-dealers to make and keep a record for each written complaint received regarding an associated person).

[21] *See* Advisers Act section 206; RIA Fiduciary Standard.

[22] *See, e.g.*, Advisers Act rule 206(4)-1. For example, an interactive analysis tool that analyzes various investment products can be used with investors but only if it "describes the universe of investments considered in the analysis, explains how the tool determines which investments to select, discloses if the tool favors certain investments and, if so, explains the reason for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being analyzed." Advisers Act rule 206(4)-1(d)(6); Advisers Act rule 206(4)-1(e)(8)(ii)(A).

[23] *See, e.g.*, Advisers Act rule 206(4)-7.

[24] *See, e.g.*, Advisers Act rule 204-2.

three years.[25] The absence of specific, relevant findings from the extensive work of the Department of Examinations is empirical evidence that there is, in fact, no problem to solve.[26]

Lacking empirical evidence of failures, the Proposing Release attempts to justify the need for broad new regulation based on speculative reasoning and logical fallacies.

First, with respect to uses of covered technology to provide recommendations or advice, the Proposing Release hypothesizes that conflicts of interest could go unaddressed due to the complex and opaque manner in which the technologies analyze data to predict outcomes.[27] There is no evidence, however, that AI-supported analyses of market data are in fact embedding data or design choices that favor BDs or RIAs to the detriment of investors.[28] Even if one were to assume (without accepting) that such a risk may arise in isolated instances, it would not justify the need to adopt the Proposed Rules. Such circumstances would already be covered by existing law requiring BDs and RIAs to provide recommendations or advice in the best interest of the investor, regardless of how it is produced or delivered.

Outside the context of a recommendation or advice, the Proposing Release speculates that there may be risks due to conflicts of interest arising from the use of "behavioral nudges" or other design choices and that these risks may not be adequately addressed by disclosure because

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[25] The Proposing Release does not cite examples of systemic issues identified from these examinations as support for the Proposed Rules. Moreover, the Department of Examinations has not issued any "Risk Alerts" to identify deficiencies and improve industry practices. To the extent the Proposed Rules are supported by evidence from examinations, that evidence should be stated and provided to the public for consideration. *See Portland Cement Assoc. v. Ruckelshaus*, 486 F.2d 375, 393 (D.C. Cir. 1973) ("[i]t is not consonant with the purpose of a rulemaking proceeding to promulgate rules on the basis of inadequate data, or on data that, to a critical degree, is known only to the agency.").

[26] In a proposal and rulemaking, the Commission is required to demonstrate (provide "substantive evidence") that there are harms that support a rule change. 15 U.S.C. § 78y(a)(4); *Susquehanna Int'l Grp. v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017). The Commission is required to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choices made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (discussing review under 5 U.S.C. § 706).

[27] *See* Proposing Release at 53,961, 53,962, 53,967.

[28] For example, the Proposing Release speculates that a firm's algorithm could rely on outdated information about competitor products but current information about its own products to generate a biased result. *See* Proposing Release at 53,968. The Proposing Release provides no evidence that this kind of comparison is common or that it would be a particular problem associated with PDAs versus more traditional forms of analysis. The Proposing Release points also to the possibility that an investment adviser might configure robo-advisory services to favor keeping cash at an affiliate in order to profit from such allocations. *Id.* However, this fact pattern would involve a conscious, deliberate, and undisclosed effort to benefit the RIA to the detriment of its client – a scenario well-covered by existing rules that has no particular connection to the kinds of complex, scalable technologies discussed in the Proposing Release.

(a) such tools may rely on "psychological factors" that may be impervious to disclosures,[29] and (b) the complexity of certain technologies might render effective disclosure impossible.[30]

The Proposing Release's appeals to the risk of psychological manipulation and technological complexity do not justify its attempt to expand conflicts to a non-fiduciary context. Outside of the context of a fiduciary or quasi-fiduciary relationship – the context of an arms-length interaction – there is no reasonable expectation of lack of conflicts. Attempting to impose fiduciary-like obligations in that context is fundamentally in tension with market principles, respect for investor autonomy and the precepts of market-based regulation.[31]

In any event, the Proposing Release's claim that "psychological factors" would render disclosure ineffective lacks any meaningful evidentiary support. The Proposing Release cites limited academic studies looking at lab-based experiments as support for this hypothesized risk. But the narrow findings of these studies do not reflect the real-world circumstances that would fall within the scope of the Proposed Rules. It is more plausible, and more consistent with the foundations of market-based regulation, to presume that the best way to manage the hypothetical risk of investor manipulation from the use of DEPs and other design choices remains full and fair disclosure, which allows investors to make informed decisions in their own best interest.

There also is no logical or empirical basis for the claim that complexity would make conflicts disclosure ineffective or impractical for DEPs. The Proposing Release's argument proceeds by (1) noting the technical complexity of certain predictive covered technologies, (2) ascribing that same complexity to the technology used to design and deploy DEPs, and then (3) asserting that the (ascribed) complexity of DEP design and delivery technologies would make full and fair disclosure impractical.[32]

There is no reason to assume that DEPs will be designed by PDAs or that effective disclosure would require detailed technical explanations of the technology used to design and deploy such DEPs. Instead, if the concern is that DEPs could lead to inappropriately frequent or costly trading, the appropriate disclosures would be: (i) the fact that the BD or RIA is deploying DEPs; (ii) the possibility that they might influence trading decisions; and (iii) the actual expected costs or risks of engaging in trading, including when such trading may be excessive or unsuitable for the particular investor's profile. And to the extent that a firm is found to be shirking such disclosure obligations and consistently inducing behavior to benefit its own business at the expense of investors, there are existing rules and regulations sufficient to permit the Commission to take action to address such conduct.

Finally, the Proposing Release argues in a number of places that the Proposed Rules are necessary due to the ability of covered technology to "scale" the production or delivery of

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[29] *Id.* at 53,968, 53,970, 53,999, 54,000, 54,014.

[30] *Id.* at 53,967, 53,977, 53,987-53,988.

[31] As explained further in Section III, the attempt to impose fiduciary-like obligations on BDs outside the context of a recommendation also is fundamentally unworkable.

[32] *Id.* at 53,988.

conflicted interactions.[33] But the tools and practices covered by the Proposed Rules are not defined by their scalability or by the volume and frequency of investor interactions they would produce. The argument also is a non-sequitur insofar as it does not point to a failure of existing substantive regulations; it merely suggests the possibility of a multiplier effect were there to be an underlying problem that was not adequately regulated. Perhaps most critically, the argument has no principled boundaries: appeals to the observation that technology may act as a multiplier of speculative harms could justify virtually any form of regulation or restriction. Regulating on that basis, without requiring empirical evidence of material harms or concrete factual basis, would overturn fundamental respect for the limited and appropriate role of regulation.

II. The definitions in the Proposed Rules are vague and overbroad, encompassing a wide range of commercial activities and uses of technology that have no nexus to the concerns raised by the Proposing Release.[34]

As described above, the concerns described in the Proposing Release relate to limited categories of modern, complex technologies with atypical risks. The scope of the Proposed Rules does not match the scope of those concerns. Instead, the requirements of the Proposed Rules are triggered whenever a “covered technology” is “used” (or reasonably foreseeably may be used) in connection with an “investor interaction.” As explained below, this would encompass an extraordinary range of technologies and practices (including tools and solutions that have been used by BDs and RIAs for decades without evidence of any substantial detriment to investors), the vast majority of which have no rational connection to the concerns described in the Proposing Release.

A. The definition of covered technology is so vague and overbroad as to capture countless technologies and practices employed by BDs and RIAs.

The term “covered technologies,” as defined by the Proposed Rules, is broad enough to cover almost any application of knowledge to facts that a firm might leverage when conducting forward-looking client-facing activities, providing investment advisory services, or engaging in commercial speech.[35] The definition is not limited to artificial intelligence, machine learning, complex computational functions, or even computer-based tools. Instead, a wide range of routine practices and applications would be in-scope for purposes of the Proposed Rules,

[33] *Id.* at 53,962, 53,965, 53,998, 53,999, 54,002, 54,006, 54,007.

[34] The comments in Section II respond to a variety of questions in the Proposing Release, including (but not limited to) the following: with respect to Section II(A), questions 1-9, and 17; with respect to Section II(B), questions 10 and 11; with respect to Section II(C), questions 13, 15, 16, 24, and 36; and with respect to Section II(D), questions 18 and 36.

[35] *Id*. at 53,972 (stating that covered technologies include any “analytical, technological, computational functions, algorithms, models, correlation matrices, or similar methods or process that optimize for, predict, guide, forecast, or direct … investment-related behaviors or outcomes”).

including innumerable functions and models (*e.g.*, simple excel spreadsheets) that are necessary to support day-to-day operations of BDs and RIAs.[36]

The outer bound of covered technologies is drawn by the vague and subjective condition that they must "optimize for, predict, guide, forecast, or direct … investment-related behaviors or outcomes."[37] However, in the context of a commercial investment-related enterprise, nearly every direct or indirect investor interaction will arguably involve a technology that satisfies this condition. Certainly, technologies used to analyze investments or strategies are clearly covered. But it is also the case that advertising theory – or empirical observation that advertising a product increases its sales (in this case "investment related behavior") – would appear to be a "covered technology" when applied to investment products. Accordingly, any email or other communication that could be said to be part of a marketing effort would arguably be covered by the Proposed Rules even without the use of an investment analysis tool.

The Proposing Release does attempt to define a safe harbor for technologies that are used purely to inform investors of basic historical information. These would be excluded, ostensibly, because they would not involve optimizing for, guiding, predicting, or directing investment-related behaviors or outcomes.[38] However, this safe-harbor is too vague to be administrable and would invite subjective and arbitrary second-guessing of firms' good faith determinations. For example, even if using technology to analyze or deliver historical data could be out of scope, the use of technology to decide how to present or deliver that data could be a covered technology that "optimizes for" or "guides" investment-related behavior (insofar as the decision about *how* to present the information would be made with an eye toward fostering future business and investment activities).[39]

B. The differing definitions used for the term "investor" are imprecise, overbroad for purposes of the Proposed Rule, and inconsistent with the scope of existing regulations.

While the term "investor" is defined differently for BDs and RIAs, its scope is also overbroad in both instances.

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[36] It is not clear on the face of the definition why "covered technologies" would not include functions and models that exist only on paper. For example, there is no apparent reason why application of basic advertising theory, a form of "behavioral science framework," to the investment business would not fall within the definition of a covered technology.

[37] *Id*. at 53,972.

[38] *Id.* at 53,972 (stating that the definition of covered technologies would not include technologies designed purely to inform investors).

[39] Similarly, the Proposed Rules expressly exclude from the definition of investor interactions those interactions that are "solely" for the purpose of providing "clerical, ministerial, or administrative support." But the scope of these exclusions is once again too vague to be administrable. The Proposed Release suggests that certain "back-office" functions are excluded from the scope of the rule because they do not involve investor interactions. However, there is no clarity as to the scope of functions that may be considered sufficiently "back-office" to qualify for these exclusions.

As to the BD-specific Proposed Rule, the Proposing Release purports to focus on retail investors and to define the term "investor" as it is used in Reg BI and Form CRS. In fact, the use here is significantly broader because (at least as written) it would include family offices (which have already been carved out of Reg BI via a no-action letter[40]) as well as any and all prospective retail clients who "seek to receive" services for personal or family business.[41]

For purposes of the RIA-specific Proposed Rule, the term is effectively limitless and lacks any connection to the concerns discussed in the Proposing Release. It includes not only actual or potential institutional and non-institutional clients but also all investors in actual or potential pooled investment vehicles that are actual or potential clients of the adviser. As explained further below, the decision to include sophisticated individuals and entities – including institutional investors – within the scope of "investors" for purposes of the RIA-specific rule is unexplained, unjustified, and inconsistent with other mandated disclosures under various regulations requiring and allowing informed consent by these groups.

C. Limiting the Proposed Rules' application to technology that is "used" in connection with an "investor interaction" is not a meaningful constraint.

The fact that covered technology must be "used in connection with an investor interaction" to be within the scope of the Proposed Rules does not reasonably constrain the scope of the Proposed Rules either, nor does it yield a reasonable fit between the Proposed Rules and the concerns described in the Proposing Release.

As explained in the Proposing Release, "investor interaction" includes any form of direct or indirect engagement or communication with an investor or prospective investor, as well as any exercise of discretion with respect to an investor's account, regardless of the context or content.[42] The term "use" is similarly expansive, encompassing direct and indirect uses of all kinds.

Therefore, covered uses in connection with an investor interaction would include both circumstances where the covered technology provides the means of interaction (*e.g.*, an app, model, chatbot, or investment tool provided via a website), as well as circumstances where the covered technology is used to inform the content of, or context for, the interaction (*e.g.,* a model or tool that is used to design or generate content for newsletters or that helps assist in tracking

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[40] Timothy Perry, *Status of Institutional Family Offices for Purposes of Regulation Best Interest, SEC File No. S7-08-18 (Sept. 10, 2019)* and *Form CRS Relationship Summary, SEC File No. S7-08-18 (Sept. 10, 2019)*, Dec. 23, 2020 (https://www.sec.gov/divisions/marketreg/mr-noaction/2020/sifma-122320-regbi.pdf).

[41] As a discrete example of the hidden breadth of the proposal, we note that it appears the inclusion of "seek to receive" in the definition would effectively cause the Proposed Rules to apply to any communications sent out to prospective customers who do not currently have a relationship with a BD. This is because the BD would only know whether the prospect might seek to receive services as a result of being contacted after the fact – at which point it is presumably too late to eliminate or neutralize the "conflict."

[42] *Id.* at 53,974 (investor interaction expressly includes "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").

and planning investor engagement). The term is not limited to actual or planned uses, either, and instead encompasses all reasonably foreseeable uses, without temporal limitation.[43]

D. Based on these overbroad and vague definitions, the Proposed Rules would regulate countless uses of tools and technology, almost none of which have any rational connection to the concerns described in the Proposing Release.

Taking these terms together, any connection of any kind, whether actual or reasonably foreseeable, between a covered technology (which, again, is essentially any application of knowledge in furtherance of the commercial goals of a BD or RIA) and an investor interaction will trigger the application of the Proposed Rules. This will bring innumerable uses of routine business tools in-scope, without any limitations or connections to the types of complex, opaque, and highly scaled predictive technologies described in the Proposing Release.

By way of example, it appears the Proposed Rules would be triggered by any and all of the below uses of technology (many of which have been used by BDs and RIAs in the course of doing business, in some cases, for decades).

Use of technology	**Why the example would involve a use of covered technology within the meaning of the Proposed Rules**
Making available to investors any website related to the business of the BD or RIA.	The creation and publishing of a website would involve countless technological and analytical functions, methods, and/or processes that are covered technologies insofar as they either (a) provide investment analytical materials and therefore can be said to predict, guide or forecast investment-related outcomes or (b) involve design elements intended to make the website attractive, useful, accessible, and/or user-friendly, as such design is a commercially motivated activity to encourage ("optimize for") investment-related behaviors, *e.g.*, effective use of the site by the investor to engage in trading or similar activity.

[43] The vagueness of this definition could further obligate participants that are far removed from the actual interaction with an investor to the proposed requirements. This especially could be an issue for dual-registered firms where the BD arm provides information prepared by using a "covered technology" to market participants, including via the RIA arm of the same firm, which could indirectly reach retail investors (who may not be the BD's customers) even though it is not the BD that is engaging in an actual interaction. Without a clear limit, it is unclear whether the BD would be subject to the proposed requirements for an indirect interaction with a participant for whom the BD has no incentive to influence investing decisions.

Any internal use of technology to perform analysis in order to inform in-person delivery of recommendations or advice to investors (including presentations to private fund investors or clients) regarding, *e.g.*, potential investment ideas and investment strategies.	Insofar as the technology is used to perform an analysis of investment ideas or investment strategies, it would be a technological or analytical function, model, method, or similar process that guides investment related behaviors or that predicts or forecasts investment related outcomes. More broadly, to the extent the technology is used to identify potentially interested investors, vet investor interests, or otherwise market the services of the RIA or BD, it would optimize for investment-related behaviors because it would be used to generate investment related business.
Any advertising regarding a product or investment service directed toward an investor.	There are several potential uses of covered technology at issue: (a) the application of advertising theory (which would be a kind of analytical or technological model); (b) the design choices made in connection with presenting the advertising content to the investor (same); and/or (c) the actual transmission of the advertising to the investor (which would likely involve one or more technological or computational functions, models, or similar methods or processes). All of these uses could be said to optimize for, guide, forecast, or direct investment-related behaviors or outcomes insofar as they all would be intended to generate sales or increase business (*i.e.*, investments) from the recipient-investors.
Any creation or use of a spreadsheet that arrays potential investment options with comparative data and that may be useful to guide investment decisions.	The spreadsheet would be a technological or computational model or correlation matrix (or similar method or process). It could be said to optimize for, guide, forecast, or direct investment-related behavior because it would be used to provide or to guide potential investment decisions, recommendations, or advice. The technology would be used in investor interactions whenever provided directly to an investor or used to inform communications with an investor.

Making available to investors educational tools and content regarding, *e.g.*, market insights, wealth management, or financial planning.	There may be several covered technologies at issue, including: (a) the underlying analytical or computational models, or functions (or similar methods or processes), which inform the tools and content provided to investors; and/or (b) the technological or computational functions that support the investors use and consumption of the tools and content, along with any design choices associated with such tools or content. Both sets of technologies can be said to optimize for, guide, or direct investment-related behaviors because they would be built with an eye toward supporting and enabling investment decisions by the relevant investor(s).
Any use of technology to generate and distribute investment research for use and consideration by investors or prospective investors.[44]	The research would be generated and delivered with the assistance of analytical models or other similar technologies, which could be said to optimize for, guide, or direct investment-related behaviors or outcomes insofar as the research would either (i) include predictive investment analysis of the securities or companies covered or (ii) be produced and provided to generate business or influence the investor's activity.
Any use of any investment model or analysis by an RIA in connection with managing client assets on a discretionary basis.	The model or analysis would involve at least one covered technology, including various forms of analytical, technological, or computational functions, algorithms, models, or correlation matrices. The technology would be used to guide, predict, or direct investment-related behaviors or outcomes, and would also be used in connection with an investor interaction, because it would be used to manage client assets on a discretionary basis.

The concerns described in the Proposing Release are not presented with respect to almost any real-world instances of the use cases described above. Nor do these uses of technology necessarily exhibit the extraordinary scalability, complexity, or opacity properties that the Proposing Release claims would render existing rules inadequate and disclosure ineffective. Yet these are just a few examples of the many existing practices and activities that currently provide many benefits to investors – including promoting investor knowledge about markets, enhancing

[44] The Proposing Release explicitly states that a covered technology would encompass "use of PDA-like technologies that analyze investors' behaviors to proactively provide curated research reports on particular investment products." Proposing Release at 53,972. But there is nothing in the definition of covered technologies that would appear to exclude research products that were not curated based on analysis of investor behaviors, so long as the reports are (a) generated with the assistance of analytical models or other similar technologies, and (b) produced in order to optimize for, guide, or direct investment-related behaviors or outcomes.

efficiency, providing personally tailored advice, and enabling the development of new products – that would be improperly restricted under the Proposed Rules.

III. The requirements of the Proposed Rules are flawed in concept and in design and would impose unreasonable costs on firms and investors.[45]

A. The "evaluation" requirement under the Proposed Rules is immensely and unduly burdensome, requiring testing and analysis of practically all commercial uses of technology, even absent any evidence of a conflict or a credible risk of harm.

With respect to every use or reasonably foreseeable use of a covered technology in an investor interaction, firms would be required to "evaluate" the use for potential conflicts of interest. A conflict would exist, for purposes of the Proposed Rules, whenever a use (or reasonably foreseeable use) takes into account any interest of the BD or RIA or of an associated person of the BD or RIA. A conflict can arise from any aspect of the design, function, or use of a covered technology, without any threshold of intent or materiality. The process of evaluating uses and testing for conflicts would have to be repeated annually and in response to certain changes in the use or design of the technology.

Given the breadth of the scope of covered technologies, and the extensive searching, analysis, and documentation required to preclude the possibility of a conflict of interest, as well as the annual (endless) testing and re-testing required to support compliance, the Proposed Rules would amount to an immense, Sisyphean burden on BDs and RIAs. These burdens would be especially severe for smaller BDs and RIAs that may not have the resources to take on (or to hire consultants to facilitate) the annual evaluation processes required under the Proposed Rules, even after increasing costs to investors or limiting their offerings. Retail BDs that offer investors self-directed trading products – including tools that have lowered costs and increased individual involvement in and engagement with capital markets, and that have enhanced investors' ability to plan and save for retirement or education, or to pursue other financial goals – would also be required to conduct searching inquiries for potential conflicts, jeopardizing their ability to provide access to beneficial trading tools and technologies.[46]

RIAs commonly use a variety of analytical models and datasets to provide advice to their clients and to make discretionary investment decisions for funds, pooled investment vehicles,

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[45] The comments in Section III respond to a variety of questions in the Proposing Release, including (but not limited to) the following: with respect to Section III(A), questions 20-23, 28-32, 51, and 54; with respect to Section III(B), questions 37, 38, 41-49, 56, and 58; with respect to Section III(C), questions 63-65, 68, 70, 71, 73, 74, 77, 79, 83, 84, 88, and 89.

[46] In addition to retail BDs, the Proposing Release holds the potential to stifle innovation by BDs with primarily, but not exclusively, institutional customers. From a practical perspective, a BD with mainly institutional customers, but some natural person customers, would need to consider its use of covered technology broadly. Bifurcating a BD's technology offering and interactions by customer type (natural person versus institutional customer) would be a significant challenge. The result of the scope of the Proposed Rule, again, would create unnecessary burdens for BDs related to technologies that are intended to make the investment experience more personalized and efficient.

and other client portfolios.[47] These tools, all of which would be considered covered technologies, are essential to providing advice in the clients' best interests. Nonetheless, they would suddenly be subject to burdensome (and at times impossible) requirements set out in the Proposed Rules. This would necessarily limit the ability of RIAs to offer products and services and to make discretionary investment selection and trading decisions on behalf of their clients.[48]

Importantly, all of these costs would be imposed in the absence of any reason to believe either that conflicts are present or that they are leading firms to put their interests ahead of the interests of investors (something that, in the case of a BD or RIA providing a recommendation or advice to an investor, or in the context of an existing fiduciary relationship, would already be prohibited and subject to enforcement).

Further, while these obligations would be enormously and unduly burdensome generally, they would be especially problematic with respect to third-party technologies and data sources. In today's marketplace, many sophisticated analytics tools used by BDs and RIAs are developed and licensed from third parties. The Proposing Release suggests these tools can be used after a measure of diligence, including a review of documentation and completion of testing. However, the Proposing Release immediately undercuts this claim by acknowledging that in "certain cases, it may be difficult or impossible to evaluate" a covered technology when a firm lacks "full visibility" into the technology's functions.[49] The collective experience of SIFMA's members suggests that this result would be far more common than the Proposing Release seems to appreciate – that it would be the rule, and not the exception, for the vast majority of cases involving third-party software and analytics technologies.

The most likely outcome of the Proposed Rules, therefore, would be that BDs and RIAs would be unable to use a wide range of otherwise unobjectionable third-party solutions and data sources. The technologies subject to this kind of de facto and needless prohibition would appear to include popular, commercially available closed-source technologies based on large language models ("LLMs"). These technologies offer tremendous promise for investors and may enhance competition between firms, all to the benefit of investors who will receive better service and better information, and who will experience cost savings as a result of inter-firm competition. Given the expertise and resource-intensive nature of developing such tools, it often is not cost effective or practical for firms to develop comparable models internally. To the extent any firms were able to develop them in-house, one would expect those firms exclusively to be large, well-resourced institutions. As a result, the impact of the Proposed Rules would be to allow only a small minority of firms and investors to reap the efficiencies and benefits of these products, reducing competition and increasing costs to investors and other market participants.

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[47] For example, consider a discounted cash flow ("DCF") analysis. A DCF is a valuation method that estimates the value of an investment using its expected future cash flows. In a hypothetical portfolio of 100 companies, an RIA would have 100 DCF models (one for each company) that it would need to review.

[48] As discussed further below in Section IV, including institutional clients and discretionary trading decisions in the scope of investors and investor interactions for purposes of the RIA-Specific Rule is independently arbitrary and capricious.

[49] *See* Proposing Release at 53,978.

To be clear, this issue is not limited to third-party LLM-based technologies: the Proposed Rules are likely to curtail the use of a wide range of proprietary and third-party technologies, even when there is no reason to believe they incorporate or consider a BD's or RIA's interests, products, or services. While the Proposing Release acknowledges that the requirements could result in some technologies becoming unavailable, it makes no effort to assess the scale of the issue or the practical implications.[50] As such, it severely underestimates how often BDs and RIAs would be forced to simply forgo use of a third-party tool – not due to any identified harm such technologies cause (and certainly not because of any evidence of systemic harm), but only because firms will be unable to comply at a reasonable cost with the Proposed Rules' prescriptive evaluation requirements. Nothing in the Proposing Release explains why the speculative benefits anticipated from the Proposed Rules would justify such a substantial cost.

B. *The requirement to determine whether an identified conflict puts the interests of a BD or RIA ahead of the interests of an investor is fundamentally flawed.*

Once a covered technology used in connection with an investor interaction is found to have a conflict of interest, as defined under the Proposed Rules, the firm is required to determine whether the conflict would ever result in putting the interests of the firm (or a person associated with the firm) ahead of the interests of any investor. But because BDs and RIAs are commercial entities – and because a conflict can arise from any aspect of the design, function, or use of a covered technology – it will be nearly impossible to preclude the possibility that a use of covered technology could involve a "conflict" as defined in the Proposed Rule.

Even when an investor's and firm's interests are aligned, or the firm's interests have no actual influence on outcomes, in all such cases, the mere presence of even a de minimis firm-favorable consideration in construction or deployment of the analytical model, method, or process would be deemed a conflict. As a result, the Proposed Rules would require firms to determine – for each of a large number of activities – whether, under any set of reasonably foreseeable uses or circumstances, such a factor may place the firm's interests ahead of the interests of any possible investor.

The Proposing Release presents the required "determination" as a flexible facts-and-circumstances analysis that is conceptually parallel to the existing requirements of the Care Obligation under Reg BI[51] and to duties under the RIA Fiduciary Standard. But the Proposed Rules differ starkly from those existing regulatory structures. For the reasons explained below, unlike the requirements of Reg BI and the RIA Fiduciary Standard, the "determination" requirement described in the Proposing Release is unsound in concept and unworkable in practice.

1) With respect to recommendations and advice, the "determination" requirement would disrupt the careful balance established in Reg BI and the RIA Fiduciary Standard.

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[50] For this reason and the other reasons described further below, the Proposing Release's estimate of costs associated with the rules is not credible, and likely underestimates the burden of compliance by several orders of magnitude.

[51] 17 CFR 240.15l-1.

BDs and RIAs providing recommendations and advice to investors are subject to robust and carefully constructed regulatory requirements under Reg BI and the RIA Fiduciary Standard. Regarding BDs, Reg BI carefully balances the BD's obligations with the practical recognition that the BD model involves product- and execution-based revenue. As such, Reg BI's disclosure obligation requires and permits a BD to fully and fairly disclose – rather than neutralize or eliminate – all conflicts (defined under Reg BI as interests that might incline the BD to give a recommendation in which they are not disinterested) associated with a recommendation[52] and to mitigate or eliminate any related conflicts at the associated person level that create improper sale incentives.[53] To satisfy the Care Obligation at the point of making a recommendation, the BD must reasonably believe that the recommendation is in the best interest of the retail customer in light of the customer's investment profile, and after conducting reasonable diligence in order to consider the risks, rewards, reasonably available alternatives, and costs of a recommended product, along with the customer's needs.[54]

Though Reg BI does also require that the BD or associated person not put its own interest ahead of the customer's, this has never been construed to require the BD to proactively identify and eliminate or neutralize the effect of its own interests. Instead, the adopting release to Reg BI simply notes that the customer's interest must come first, acknowledges that the BD generally will have some financial interest in a recommendation, and states that it would be improper for a firm to make a recommendation in order to maximize its own compensation, further business relationships, or satisfy firm targets.[55]

In explaining the Care Obligation in this manner, the Commission explicitly acknowledged that BDs are ***not*** required to take impractical steps in order to exclude entirely their own interests in order to maximize the possible benefit to a retail investor. For instance, Reg BI does not require BDs to: (i) offer all products available in the market; (ii) consider or recommend products other than those they offer or sell; (iii) recommend the "best" single product amongst all that they offer or sell; or (iv) execute exhaustive product searches when developing a recommendation. Instead, BDs are required to consider reasonably available alternatives approved for sale through their firm based on information reasonably known to the relevant associated person after exercising reasonably diligent search strategies.[56] This balancing reflects the recognition that producing recommendations entails cost, while also protecting the interests of the investor and putting them first.

The RIA Fiduciary Standard similarly requires an adviser to act in the best interests of its client but recognizes that the RIA business model will almost always involve a potential conflict of interest in one respect or another. The existence of these conflicts is not allowed to prevent RIAs from conducting business and meeting their fiduciary obligations to clients. Nor are

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[52] 17 CFR 240.15l-1(a)(2)(i)(B).

[53] 17 CFR 240.15l-1(a)(2)(iii).

[54] 17 CFR 240.15l-1(a)(2)(ii).

[55] *See* Regulation Best Interest, Exchange Act Release No. 34-83062 (August 7, 2018), 83 FR 21574 at 21,577.

[56] *Id*.

advisers required to conduct endless efforts to identify and eradicate every perceived conflict, regardless of materiality. Instead, the RIA Fiduciary Standard allows the adviser (a) to shape its duty by disclosing its investment strategies and the investments that it does and does not analyze, and (b) to retain conflicts of interest after providing full and fair disclosure and after obtaining consent. Subject to these requirements of disclosure and informed consent – the RIA Fiduciary Standard permits the relationship between an adviser and its client to be shaped via negotiated agreements. This paradigm has long provided sufficient flexibility to serve as an effective standard of conduct for investment advisers.

While superficially similar to the Reg BI and RIA Fiduciary Standard (insofar as they include the concept of managing conflicts of interests, and of not putting the firm's interests ahead of the interests of an investor), the logic of the Proposed Rules is actually fundamentally at odds with the balancing provided in the current regimes.

First, Reg BI and the RIA Fiduciary Standard – consistent with long-standing Supreme Court precedent – require addressing conflicts when they might incline a firm to provide a recommendation or advice in which it is (consciously or unconsciously) not disinterested.[57] The Proposed Rules are not so limited. They require elimination or neutralization unless the firm can prove that its interests would never be placed ahead the investor. Much of the burden of the Proposed Rules would be imposed simply by the use of covered technology in connection with an investor interaction, even in the absence of any ***material*** conflict, and without any evidence that a use of a covered technology could ever result in putting the firm's interests ahead of the interests of an investor.

Second, the Proposed Rules (1) center the requirements on a comparison of the benefits to the BD or RIA versus the benefits to the investor (or potential investor), instead of focusing primarily on the interests of the investor; (2) fail to include ***any recognition of the costs*** to BDs and RIAs in generating recommendations or advice; and (3) do not acknowledge the need to place reasonable limits on the search and comparison requirements imposed on BDs and RIAs.

For example, the preamble affirmatively states that, in the context of an investor interaction, omitting or de-prioritizing investments that are not profitable to the BD or RIA would constitute putting the firm's interest "ahead" of the interests of the investor, even if the resulting recommendation or advice is otherwise good for the investor from the perspective of the investor's own needs.[58] The Proposing Release asserts that, to use a covered technology in such circumstances, the BD or RIA would have to determine that "the outcome is equally (or more) favorable to the investor regardless of whether the [firm favorable] factor is considered."[59] This test would require a radical departure from the reasonable cost-benefit approach in place today. Logically (if not explicitly), satisfaction of the "determination" and "eliminate or neutralize" requirements would necessitate comparison of all products available through the Covered Firm, as well as those that are not, and the rank ordering of the options according to

[57] *See SEC v. Capital Gains Research Bureau, Inc*., 375 U.S. 180 at 190-192 (1963).

[58] Proposing Release at 53,983-53,984.

[59] *Id.* at 53,984.

their potential benefits to the investor in order be able to "back out" any influence from the Covered Firm's interest.

It necessarily follows that under the Proposed Rules, BDs and RIAs would ***not*** be permitted to (i) offer a limited product set or investment strategy, (ii) impose reasonable limits on its searching of those products it does offer to provide a recommendation or deploy advice, or (iii) recommend a product that is good for the client and profitable for the BD or RIA, without eliminating the possibility that another product not provided (and therefore not profitable) might be better. In essence, limited-product BDs would not be permitted to market, and RIAs would not be permitted to limit their advice to particular kinds of products. This draconian outcome is precisely what was contemplated and rejected by the Commission in the course of constructing Reg BI, and it is one that has never been embraced by the Commission in guidance related to the RIA Fiduciary Standard. The Proposing Release provides no rational basis for abandoning these sound and consistent policy choices, much less one compelling enough to warrant such a major change from an already highly protective and costly regime.

2) The "determination" requirement is unclear and flawed.

Besides upending the important balancing of considerations in the existing regimes, the balancing test that would be required under the Proposed Rules is largely unworkable. In stating that BDs and RIAs would be required to determine whether an identified conflict results in putting the firm's interests "ahead" of the interests of an investor, the Proposed Rules would mandate that Covered Firms somehow weigh their own interests against those of the investor or potential investor in an apples-to-apples comparison in order to determine which was put "ahead."

To suggest how that might be done in the context of a recommendation or advice, the Proposing Release puts forward a simple and unrealistic model – one in which there are explicit firm-favorable and non-firm-favorable data points and calculations that come together in a fully specified algorithm, and from which the firm-favorable factors can be excised (or counterbalanced by inserting other factors) in order to allow for A/B comparisons.[60] But the process envisioned by the Proposing Release diverges wildly from the practical realities of BD and RIA business operations. Outside of the Proposing Release's stylized picture of rank-order scoring of essentially all comparable investment options, it is simply unclear how a BD or RIA could ever go about comparing its own interest to that of an investor or potential investor in order to make the necessary determination – and there is no precedent in existing law or regulation to guide such an analysis.

The test would appear to require the ability to score all investments analyzed or even available to be analyzed, as this would be the only way to "back out" the interest of the firm providing the analysis (which would be, at least in part, a function of the profitability of the

[60] The Proposing Release also hypothesizes (without evidence) that perhaps "explainability" features could be used to help determine whether and when a firm's interests are placed ahead of the interests of an investor. The Proposing Release at 53,977, 53,985. But it provides no evidence as to how these features could work in practice, and no support for the idea that they are even technologically feasible in the real-world applications of the Proposed Rules. *Id*. at fn. 149.

products or services the BD or RIA actually provides). But in most instances, this will not be possible. Only in rare circumstances would a firm be expected to analyze all potential investments that are reasonable substitutes for each other (whether or not accessible through the BD or RIA). And absent this condition, firms will almost never be able to exclude the possibility that a better product could be available if the firm's own (economic, practical, or other) interests were to be eliminated or neutralized.

Outside the context of providing a recommendation or advice, the requirement to determine whether a conflict could result in the firm putting its interests ahead of the interests of an investor would be even less administrable, for several reasons.

First, in many instances the Covered Firm – essentially every broker-dealer that provides self-directed brokerage, as well as RIAs communicating with fund investors – will simply not have conducted the investor-specific diligence necessary to determine the interests of investors who might participate in an "interaction." Accordingly, it would appear to be impossible to determine whether a reasonably foreseeable use of a covered technology could result in an investor interaction that puts the firm's interests ahead of that investor: the firm does not actually know what the investor's interests are or what they may be at the time the interaction occurs.

Second, in many cases, the content of the investor interaction created in connection with use of a covered technology may change from moment to moment. For example, a news feed may identify and forward news about any number of different products or entities. In this case, distribution of the feed would clearly be a use of covered technology involved in an investor interaction, but it would not be possible to anticipate the content of each communication in advance in order to perform the required comparison of interests (even if the recipient's interests were known or knowable).

Third, unlike the case with recommendations or advice, which generally provide an explicit and specific direction to an investor, it may in fact be impossible to anticipate the impact of a non-recommendation on an investor's thinking or the precise directional force imposed by a "nudge." To this end, the Proposing Release is entirely silent on how a firm could possibly determine whether choices involving "nudges," DEPs, or design features lead to particular outcomes, much less how the firm could assess whether that outcome would be better or worse for an investor than the one that could result from any other possible choices.[61]

The Proposing Release in fact acknowledges that firms often will be unable to determine whether a conflict could ever result in putting their interests ahead of the interests of an investor. In such cases, the Proposing Release suggests, firms are required simply to move directly to the step of neutralizing or eliminating the conflict. But the test for whether a conflict has been neutralized or eliminated (according to the Proposing Release) is whether it no longer results in the interests of the firm being placed ahead of the interests of the investor. This logic is fatally circular: if you cannot tell whether a conflict could ever result in putting your interests ahead of the interests of an investor, you – by definition – cannot tell whether or when that conflict could

[61] The Proposing Release also fails to consider the impossibility of implementing reasonably effective supervisory procedures to support compliance with the Proposed Rules.

no longer result in putting your interests ahead of the interests of the investor except by forgoing the use or interaction altogether.[62]

The Proposing Release attempts to cast the vagueness of the determination requirement as beneficial flexibility and fails to consider the practical implications of its application to the many and diverse real-world circumstances where it would be triggered. Respectfully, the absence of any credible analysis as to the feasibility of the Proposed Rules' determination requirement is a bug, not a feature. The Commission is obligated to consider the breadth and diversity of situations in which the Proposed Rules would apply, including the legal uncertainty they would create, and to contemplate when it would simply be impractical or cost-prohibitive for BDs and RIAs to comply without eliminating broad and beneficial types of investor interactions.

C. *The policies and procedures requirements of the Proposed Rules are immensely burdensome and are not reasonably related to any legitimate objectives described in the Proposing Release.*

In addition to the substantive requirements related to the elimination or neutralization of conflicts in connection with the use of covered technologies, the Proposed Rules would require firms to comply with prescriptive policies and procedures requirements as well as exhaustive documentation requirements that would further escalate costs. While perhaps designed to function as a deterrent, these obligations go far beyond what is reasonably necessary to achieve compliance with the Proposed Rules or to achieve the policy objectives of the Proposing Release.

Under the Proposed Rules, BDs and RIAs would be required to have policies and procedures that document and describe the processes by which the firm will analyze, test, and review covered technologies, including how they will be evaluated for conflicts and how firms will determine whether a conflict puts its interests ahead of the interests of an investor. The policy and procedure requirements also include, in effect, a back-door model inventory requirement: firms would be required to generate and maintain documentation for every covered technology, including descriptions of any material features of the covered technology and details regarding its usage and supervision, as well as various records related to usage exceptions. This

[62] The Proposing Release suggests that the option to "neutralize" a conflict is meant to serve as a more practical alternative where "elimination" may not be possible. But the option to "neutralize" is not only entirely novel as a regulatory standard (with no actual comparable use in any SEC rule or requirement); it is also a dead end. The Proposing Release hypothesizes that, perhaps, firms can apply "counterweights" to address the quantitative impact of conflicts in order to prevent a firm's interests from being placed ahead of the interests of an investor. There is simply no evidence that the kind of counterweights imagined in the Proposing Release could ever be crafted to perfectly and effectively counter-balance the hypothetical firm interests at issue. Notably, the Commission provides no examples of how "neutralization" would work in ***any*** real-world scenarios, much less in the extraordinary and diverse universe of scenarios covered by the Proposed Rules. As a result, the option to neutralize would frequently lead, in practice, to the same place as the option to eliminate: in both instances, firms would simply be forced to forgo the use of the covered technology altogether.

documentation would also need to be reviewed and, if necessary, updated both annually and in response to certain changes in the use or development of the relevant technology.

Firms therefore will be required to expend massive resources and efforts, both initially and on an ongoing basis, to scour their systems and identify and assess all covered technologies that could ever reasonably be used in connection with an investor interaction. This will include countless tools, models, and other resources that will have been in use for many years, if not decades, and that are already fully integrated into day-to-day operations.

By requiring BDs and RIAs to generate documentation of all covered technologies, including inputs and data sources, and by requiring that documentation to be made available for inspection, the Proposed Rules also force firms to carry additional, unnecessary risk related to theft and loss of intellectual property. Many BDs and RIAs consider their trading and sales technologies, as well as their customer-facing models, to be protected proprietary information and among their most closely guarded secrets. The protection available to this sensitive information will be necessarily reduced, and the security compromised, by requiring compliance with the Proposed Rules.

The Proposing Release provides no countervailing benefit for these requirements. A written description of a process for evaluating a technology may be useful in a situation involving a particularly high risk of harm, where the technology is complex and its logic unclear. However, in many cases covered by the Proposed Rules, the risk of harm will be minimal to non-existent, and the "conflict of interest" (as defined in the Proposed Rules) will be so obvious that there will be no need or benefit to documenting the approach taken to evaluate whether and where such a conflict exists. Likewise, the material features involved in many covered technologies are likely to be numerous and uneventful. As a result, there would be little to no informational value to be gained from documenting all such features and only expense and risk to be carried by firms trying to comply.

Nor can the documentation requirements be redeemed by the possibility that they might facilitate easier examination and investigation of firms and their uses of covered technologies. The immense costs and operational burdens that would be imposed by the Proposed Rules cannot be justified by the incremental benefit to be gained from simplifying the work of the Commission's Staff.

D. The Proposed Rules will deter the provision of information to investors that is critical to informed investment decision-making and market efficiency.

While the above sections have highlighted the heavy costs that would be imposed by the Proposed Rules on BDs and RIAs, the negative consequences of the Proposed Rules would be borne primarily by investors. As we have highlighted above, the practical effect of the Proposed Rules would be to strongly deter BDs and RIAs from continuing to engage in the communication of valuable information (including educational content) and the provision of useful tools to investors.[63] The same would be true for any final rules similar in scope and structure to those proposed here.

As just one example, BD and RIA research departments routinely use search and retrieval functions that rely on algorithms to help clients identify content most relevant to them.[64] These tools are valued by clients, and the Proposing Release offers no evidence that they are ever – much less systematically – calibrated by BDs or RIAs to the detriment of investors.

Nonetheless, the Proposing Release would chill the use of these technologies by enhancing the cost and compliance burden associated with them, all based on the unfounded assumption that providing information to investors induces harms that cannot be addressed under existing law.

In this way, the Proposed Rules would inflict material harm on the investing public. This harm would fall particularly on retail investors and others who currently benefit from ready access to information from BDs and RIAs and self-directed investment technologies. These investors otherwise lack the resources to independently conduct research on securities and investment products, engage in extensive financial planning, or track and monitor portfolios. The Proposed Rules, therefore, would have the effect of exacerbating the "digital divide,"[65] harming those investors that the Proposing Release depicts as most in need of Commission protection.

IV. For RIAs, applying the requirements of the Proposed Rules to institutional clients and discretionary trading decisions is unsupported and is likely to cause more harm than good.[66]

Although the preceding discussion applies equally to BDs and RIAs, the Proposed Rules present further, unique challenges for RIAs for two related reasons. First, the requirements of the Proposed Rules are particularly difficult for RIAs with discretionary mandates. The

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[63] We note that removing the ability to use certain technologies covered by the Proposed Rules would place BDs and RIAs at a competitive disadvantage with respect to firms located outside of the United States. It would also result in United States-based investors receiving less sophisticated information than their international counterparts.

[64] As noted in Section II above, the use of technology to provide curated research reports would fall expressly within the scope of the Proposed Rules. *See* Proposing Release at 53,972.

[65] The term "digital divide" was purportedly termed Lloyd Morrisett, a founder of the Children's Television Workshop, and refers to inequality of access to information technology, which has the effect of reinforcing economic inequality more broadly. *See, e.g.*, Ragnedda, Massimo; Muschert, Glenn W, eds., *The Digital Divide* (2013); Smith, Craig Warren, *Digital Corporate Citizenship: The Business Response to the Digital Divide* (2002). In 1999, the WTO hosted the "Financial Solutions to Digital Divide" in Seattle, co-organized by Craig Warren Smith of Digital Divide Institution and Bill Gates Sr., the chairman of the Bill and Melinda Gates Foundation. It was the catalyst for a full-scale global movement to close the digital divide.

[66] The comments in Section IV respond to a variety of questions in the Proposing Release, including (but not limited to) the following: questions 12 and 59.

Proposing Release does not demonstrate an understanding of the commercial agreements that are the foundation for an RIA or client's decision to give RIAs a discretionary mandate through a negotiated contractual process. Second, these challenges, in addition to those addressed elsewhere in this letter, would be amplified because the definition of "investor" in Proposed Rule 211(h)(2)-4 under the Advisers Act is far broader than the definition of "investor" in Proposed Rule 15l-2 under the Exchange Act – RIAs would be required to apply the rule to all clients and investors, while BDs would only be required to apply the rule to retail customers. The Proposing Release fails to adequately explain why the Proposed Rules should apply to sophisticated clients and investors in their relationships with RIAs.

The Proposing Release fails to show that the purported concerns related to undue influence on investor behavior or conflicted uses of technology – particularly those concerns related to DEPs and other uses of technology outside the context of a recommendation – would logically apply to investment advisers providing discretionary advice to institutional clients or to investors in pooled investment vehicles.

In the context of a discretionary mandate, an investor's behavior is largely irrelevant after an advisory agreement has been finalized – the investor would decide to engage an RIA on a discretionary basis after evaluating the adviser and its personnel, and the terms agreed in a negotiated contractual process, following which the discretion would sit squarely with the RIA. The output of any model used to evaluate investment opportunities would be used internally by investment professionals and would not be used to influence an investor's behavior in any way, except that an investor may be encouraged to extend or terminate their relationship with the adviser upon seeing returns.

Not only would the RIA's existing fiduciary obligation prevent the adviser from relying exclusively on a flawed model or making an investment decision based solely on the compensation that the RIA would earn, but in this and similar circumstances, the adviser's interest is aligned with the investor's interest based on traditional fee and carried interest models.

For the vast majority of uses of covered technologies by RIAs making discretionary trading decisions for pooled investment vehicles and sophisticated institutional clients, there is simply no reason to think there is a conflict present that would justify the heavy burdens that the Proposed Rules would place on advisers using covered technologies in connection with discretionary investment decisions. Moreover, to whatever extent there may be such conflicts, the Proposed Rules do not demonstrate why sophisticated institutional clients would lack the resources or ability to assess and address those conflicts to the degree they feel is necessary. At the same time, imposing these burdens would have the perverse effect of discouraging innovation by RIAs (including development of new forms of analysis and modeling of investment decisions) because advisers will seek to avoid costly conflicts determinations and disclosure of their confidential and proprietary investment strategies.

In addition, the Proposed Rules also would burden advisers to institutional investors and pooled client vehicles without justifying why such paternalistic protections are needed – the Proposing Release fails to explain why clients of RIAs in general require this additional protection and fails to explain why the Proposed Rules sweep in institutional and other sophisticated investors.

The Proposing Release provides no explanation for the decision to define "investor" for purposes of the RIA-specific rule as including all "clients and prospective clients of advisers as well as investors and prospective investors in pooled investment vehicles advised by those advisers,"[67] beyond making cursory statements that the "investor protection concerns" for institutional investors and investors in pooled vehicles are the same as for retail investors, which is not consistent with the Commission's past rulemaking and is not even consistent internally in the Proposed Rules as demonstrated by the narrower definition of "investor" in Proposed Rule 15l-2 under the Exchange Act.

Indeed, the Commission has previously acknowledged this point, explaining in the 2019 Fiduciary Duty Interpretation that "[f]ull and fair disclosure [of conflicts] for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications."[68] We note that the Proposing Release fails to support with cases (or even examples) the contention that conflicts considerations for retail investors are the "same" as those for sophisticated and well-resourced institutional clients and investors.

V. Adoption of the Proposed Rules would be arbitrary, capricious, and contrary to law.[69]

Adoption of the Proposed Rules would not just reflect bad policy for the reasons set out above; it would also be arbitrary, capricious, and contrary to law. In particular, the Proposed Rules are too vague to provide effective notice to BDs and RIAs, would impose extraordinary costs without adequate analysis or justification, and lack a reasonable fit between the burdens imposed and a legitimate government interest.[70]

The sprawling and uncertain scope of covered technologies, paired with the unworkable "evaluation," "determination," and "elimination or neutralization" requirements, would undermine the good faith efforts of BDs and RIAs to understand and comply with their obligations under the Proposed Rules. Absent far clearer and reasonably tailored definitions and concepts, the Proposed Rules would leave BDs and RIAs guessing at the actual scope and substance of their obligations and exposed to unpredictable regulation by post-adoption

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[67] *See* Proposing Release at 53,961, fn. 7.

[68] RIA Fiduciary Standard.

[69] The comments in Section IV respond to a variety of questions in the Proposing Release, including (but not limited to) the following: questions 94-102 and 105.

[70] We note also that the Proposing Release does not offer a transition period or an effective date for the Proposed Rules. This suggests the Commission Staff have not fully considered the immense burden and disruption that the Proposed Rules would impose. Moreover, it prevents interested parties from being able to provide feedback on one of the most important features of such a substantial rulemaking – namely the practical reality of the expected time needed to achieve compliance. For the avoidance of doubt, the members of SIFMA believe a substantial time period, measured in years, not months, would be required to achieve compliance with the Proposed Rules, and to do so without material disruption to the stability of our markets.

investigation and enforcement. This failure to provide adequate notice violates core principles of fairness and would render the adoption of the Proposed Rules arbitrary and capricious.[71]

Adoption of the Proposed Rules based on the reasoning in the Proposing Release also would be arbitrary and capricious insofar as the economic analysis set forth in the Proposing Release – and particularly its estimate costs of compliance – is simply not credible. The Proposing Release presents only a skeletal and inaccurate analysis of economic consequences and benefits, without reasonable consideration of various near-certain indirect and opportunity costs that the Proposed Rules would inflict. For instance, the Proposing Release indicates that the direct costs to covered entities will include the administrative costs of identifying conflicts, eliminating or remediating such conflicts, drafting policies and procedures, and maintaining records with respect to the PDA technologies.[72] For indirect costs, the Proposing Release merely indicates that loss of revenue might result if the requirements to "eliminate" or "neutralize" conflicts and the attached administrative costs result in firms refraining from engaging in certain communications or practices and that technologies might be less efficient.[73]

The analysis fails to reasonably consider, however, the loss of technological solutions that provide informational efficiencies to investors in the marketplace (*e.g.*, models that can provide prospective investment performance) or the deprecation of longstanding tools that will be taken offline based on the costs of maintenance under the Proposed Rules. The analysis also does not account for the likely reduction in the flow of information shared by covered entities with investors. BDs and RIAs will likely be required to curtail the amount of information they provide to avoid running afoul of the rule because, as written, certain conflicts will need to be eliminated even if the conflict contributes to interaction that is otherwise greatly beneficial to an investor. The Proposing Release barely addresses these costs, if at all, and makes no effort to quantify them.[74]

Even as to the costs ostensibly considered, the experience of SIFMA's members suggests that they are severely underestimated – likely by several orders of magnitude. For instance, members of SIFMA have indicated that, even for a relatively basic covered technology used by an RIA for a single portfolio (*e.g.*, a set of excel spreadsheets used by a single sub-advisory team of the RIA that incorporates data to assist in discretionary trading for a client or a pooled investment vehicle), the conflict evaluation exercise could take a minimum of 15 hours, and require input from legal, compliance, information technology, and portfolio management teams,

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[71] Note that the breadth of technologies and use cases covered (and hindered) by the Proposed Rules would go far beyond the scope of technologies falling under the AI-related regulatory schemes being considered elsewhere around the world (including in Europe, Canada, Singapore, and the People's Republic of China). Adoption of the Proposed Rules therefore would stand to put our capital markets at a significant competitive disadvantage.

[72] *See* Proposing Release at 54,009-54,010.

[73] *Id*. at 54,010-54,011.

[74] The Proposing Release attempts to indicate that simple technologies, as opposed to complex technologies, will require less time to determine whether a conflict exists; however, this distinction is not nearly as significant as suggested in the Proposing Release, in part because (i) there is no explanation provided as to the distinction between "simple" and "complex" technologies, and (ii) the complexity of the conflicts analysis under the Proposed Rules will require BDs and RIAs to spend substantial time and funds on analyzing both simple and complex technologies.

as well as third-parties, to determine the extent to which the technology (including all data on which it relies) may include a firm-favorable consideration (and therefore a conflict of interest). Given the breadth of covered technologies, even small investment firms would have hundreds, if not thousands, of covered technologies already in use; larger, more complex firms will have tens if not hundreds of thousands. At each end of the scale, it is clear that the cost estimates in the Proposing Release wildly understate the likely costs of achieving compliance.

While understating the reasonably expected costs of compliance, the Proposing Release provides as evidence of anticipated benefits only the conclusory statement that reductions of conflicts might reduce sub-optimal trading by investors, without reasonably comparing that benefit against the reasonably likely costs (a statement that runs contrary to the very competitive markets the Commission is meant to protect). The Proposing Release offers no meaningful empirical evidence for its valuation of reduced conflicts, just limited anecdotal evidence and the subjective view that the two concerns raised in the Proposing Release are actually at risk of occurring.

Nonetheless, the costs under the Proposed Rules would be imposed even in the absence of evidence that the concerns described in the Proposing Release have in fact materialized at a substantial level, or that investors and clients are currently being harmed by pervasive and unmanaged conflicts associated with firms' usage of covered technologies. Even if one assumes that there were some number of unidentified, unaddressed conflicts associated with the current usage of covered technologies that are causing harm, there is no basis to believe these issues are systemic or widespread. The substantial and continuing costs imposed by the Proposed Rules would be imposed – in the vast majority of cases – without evidence of ***any*** countervailing benefit.[75]

The Proposing Release also provides no credible comparison to the costs and benefits that might be obtained through other means of addressing those concerns, including enhanced guidance or disclosure requirements. We submit that the marginal benefits of the Proposed Rules could be achieved at substantially lower cost, with substantially less burden, if the Commission were to work constructively with industry members on a more reasonable and appropriately tailored proposal.

Finally, the Proposed Rules are arbitrary and capricious because they would severely restrain a broad range of commercial communications, without any nexus to a legitimate government interest. As explained above, the Proposed Rules are incredibly broad and vague, and are likely to have a substantial chilling effect on a wide range of communications, the vast majority of which would otherwise present no risk of harm from uncontrolled conflicts of interest. That is, even if the Commission can claim a legitimate interest in reducing the impact of conflicts of interest in interactions between BDs and RIAs and their investors and clients, the Proposed Rules lack any reasonable fit to that goal.

[75] *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (agency action is arbitrary and capricious when there is no "'rational connection between the facts found and the choice made'" (*quoting Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

Indeed, SIFMA members believe that the breadth of communications restrained without cause would likely be so substantial as to raise concerns under the First Amendment of the U.S. Constitution.[76] As explained by the U.S. Supreme Court in *Central Hudson Gas & Electric v. New York Public Service Commission*, regulation that restricts commercial speech that is not misleading and that concerns lawful activity must advance a substantial governmental interest and not be more extensive than necessary. The Proposed Rules would apply, however, to a substantial portion of all communications with an investor, including a broad array of communications that do not realistically involve a meaningful possibility of harm. As such, the Proposed Rules would have a substantial and unjustified chilling effect on the commercially motivated communication of information to investors (*i.e.*, commercial speech), raising the specter of an impermissible restraint on speech protected by the First Amendment.

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For this and the other reasons described above, we urge the Commission to withdraw the Proposed Rules and work with industry to propose for full notice and comment any alternative it might consider developing.

If you would like to discuss these comments further, please reach out to Melissa MacGregor at mmacgregor@sifma.org or Kevin Ehrlich at kehrlich@sifma.org.

Respectfully Submitted,

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[76] *See Central Hudson Gas & Elec. Co. v. Public Serv. Comm. of N.Y.*, 447 U.S. 557, at 557 (1980).