

# Conflicts of Interest and Predictive Data Analytics



The Securities and Exchange Commission proposed new rules and amendments to address certain conflicts of interest associated with the use of predictive data analytics by broker-dealers and investment advisers (“firms”) in investor interactions. The proposal would require:

- A firm to eliminate or neutralize the effect of conflicts of interest associated with the firm’s use of covered technologies in investor interactions that place the firm’s or its associated person’s interest ahead of investors’ interests;
- A firm that has any investor interaction using covered technology to have written policies and procedures reasonably designed to prevent violations of (in the case of investment advisers) or achieve compliance with (in the case of broker-dealers) the proposed rules; and
- Recordkeeping related to the proposed conflicts rules.

## Why This Matters

Firms have accelerated their use of certain newer technologies, such as predictive data analytics, artificial intelligence, or similar technologies. When the use of these technologies is optimized for investor interests, it can bring benefits in market access, efficiency, and returns. To the extent that firms use these technologies to optimize in a manner that places their interests ahead of investor interests, investors can suffer harm. Due to the scalability of these technologies and the potential for firms to reach a broad audience at a rapid speed, any resulting conflicts of interest could cause harm to investors in a more pronounced fashion and on a broader scale than previously possible. This proposal would require specific protections to compliment those already required under existing regulatory frameworks to better protect investors from harms arising from these conflicts.

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## How These Rules Would Apply

The proposed rules would apply when a broker-dealer or an investment adviser registered or required to be registered under section 203 of the Investment Advisers Act of 1940 (or, in each case, its associated persons) uses or reasonably foreseeably may use covered technology in an investor interaction.

“Covered technology” includes a firm’s use of analytical, technological, or computational functions, algorithms, models, correlation matrices, or similar methods or processes that optimize for, predict, guide, forecast, or direct investment-related behaviors or outcomes of an investor. The proposal generally would apply to a firm’s use of a covered technology to the extent it is used in connection with the firm’s engagement or communication with an investor, including by exercising discretion with respect to an investor’s account, providing information to an investor, or soliciting an investor.

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## **What Would Be Required**

A conflict of interest under the proposed rules generally would exist when a firm uses a covered technology that takes into consideration an interest of the firm or its associated persons.

The proposed rules and amendments would require a firm to evaluate any use or reasonably foreseeable potential use by the firm or its associated persons of a covered technology in any investor interaction to identify any conflict of interest associated with that use. Firms would be required to determine whether any such conflict of interest places or results in placing the firm’s or its associated person’s interest ahead of investors’ interests. Finally, the proposed rules would require a firm to eliminate or neutralize the effect of any conflicts of interest that place the firm’s or its associated person’s interest ahead of investors’ interests.

The proposal would also require a firm that has any investor interaction using covered technology to have written policies and procedures reasonably designed to achieve compliance with the proposed rules. The policies and procedures would require, among other things, a written description of the process for evaluating any use (or reasonably foreseeable potential use) of a covered technology in any investor interaction and a written description of the process for determining how to eliminate or neutralize the effect of any conflicts of interest determined pursuant to the proposed rule to result in an investor interaction that places the interest of the firm or an associated person ahead of the interest of investors. In addition, firms would have to make and keep books and records related to the requirements of the proposed rules.

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### ***Additional Information:***

Visit [sec.gov](https://www.sec.gov) to find more information about the proposal and the full text of the proposed rules. The comment period will be open for 60 days following publication of the proposing release in the Federal Register.