IAA INVESTMENT ADVISER ASSOCIATION

October 10, 2023

Via Electronic Filing

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

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (SEC Rel. Nos. 34-97990; IA-6353; File No. S7-12-23)

Dear Ms. Countryman:

The Investment Adviser Association (**IAA**)[1] appreciates the opportunity to comment on the Commission's proposed rules regarding conflicts of interest associated with the use of predictive data analytics (**PDA**) and other "covered technologies" by investment advisers.[2] We believe that the Proposal is fundamentally flawed because it undermines the well-established, principles-based fiduciary duty under the Investment Advisers Act of 1940 (**Advisers Act**), which has served as the bedrock principle of investor protection for over 80 years. Moreover, the Proposal is contrary to the interests of investors, would impose significant costs and burdens, and would ultimately prove to be impractical – and in some cases impossible[3] – for advisers to

[1] The IAA is the leading organization dedicated to advancing the interests of investment advisers. For more than 85 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices, and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than $35 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, SEC Rel. Nos. 34-97990; IA-6353 (July 26, 2023) (**Proposal**), 88 Fed. Reg. 53960 (Aug. 9, 2023), available at https://www.sec.gov/rules/2023/07/s7-12-23#34-97990. Our comments herein are generally limited to the applicability of the Proposal to investment advisers.

[3] For example, the Commission simultaneously acknowledges and disregards the fact that "[i]n certain cases, it may be difficult or impossible to evaluate a particular covered technology or identify any conflict of interest associated with its use or potential use within the meaning of the proposed rules … [for example] there may be situations where a firm does not have full visibility into all aspects of how a covered technology functions, such as if the firm

implement. Accordingly, the IAA respectfully requests that the Commission withdraw the Proposal.[4]

I. Overview

The IAA greatly appreciates the constructive dialogue we have had with the Commission over the years on important issues facing investors, advisers, and market participants more broadly. We remain committed to working with the Commission and its staff on our shared goals of protecting investors while at the same time encouraging innovative practices that benefit investors.[5] However, we are profoundly troubled by the breathtakingly broad scope of this Proposal, which would implicate virtually all interactions, direct and indirect, an adviser has with investors, whether existing or prospective clients and regardless of an investor's sophistication. And while focusing on concerns about the use of emerging technology, including "artificial intelligence," the Proposal is ***in fact*** primarily intended to address a concern about conflicts of interest more broadly, a concern that is thoroughly covered by the existing regulatory framework governing advisers.[6]

As fiduciaries, advisers are required to act in their clients' best interest at all times, not put their own interests ahead of those of their clients, and manage any conflicts of interest in accordance with these core principles. The Commission recently reaffirmed these fundamental principles in its comprehensive 2019 interpretation regarding the fiduciary duty.[7] Yet the Proposal would have the effect of replacing these long established core principles of the

licensed it from a third party." For example, a firm may be unaware that a third-party vendor has modified the way that AI software is functioning let alone able to require assessing for conflicts before any material modification to the technology. However, despite these concerns, the Commission concludes that "a firm's lack of visibility would not absolve it of the responsibility to use a covered technology in investor interactions in compliance with the proposed conflicts rules." Proposal at 53978.

[4] As discussed below, we do not believe the Proposal or any rulemaking is necessary to address the Commission's stated concerns about conflicts of interest in connection with the use of covered technologies. We also do not believe that the Commission could attempt to address our foundational concerns in a final rule without significant modification of the Proposal, which would necessitate the Commission's withdrawing and re-proposing a new rule for notice and opportunity for comment.

[5] The IAA strongly supports the principles of investor protection, market integrity, and efficiency. We view facilitating exploration and implementation of innovative technology as important to maintaining these principles. Accordingly, we believe it is incumbent on policymakers when evaluating new technology to consider both its risks and the potential benefits to investors, the markets, and efficiency. *See Letter to SEC Chair Gary Gensler Regarding Regulation of Investment Advisers* (May 17, 2021), available at https://investmentadviser.org/resources/regulation-of-investment-advisers/.

[6] Indeed, the proposed rule is titled "Prohibition against conflicts associated with investor interactions employing covered technology," and "covered technology" is defined to capture virtually any technology, not just emerging technologies.

[7] The Interpretation was intended by the Commission to reaffirm, and in some places clarify, the fiduciary duty and the special relationship of trust and confidence an adviser has with its clients. *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Rel. No. 5248 (June 5, 2019) (**Interpretation**).

fiduciary duty relating to the management and disclosure of conflicts of interest with an entirely new and unproven framework.

The Proposal also reflects another consequential departure by the Commission in recent years from the principles-based approach to regulating advisers to more prescriptive and rigid "one-size-fits-all" requirements. Moreover, the Proposal would needlessly impose insurmountable operational and compliance burdens, jeopardize advisers' ability to rely on beneficial technology to the detriment of investors, and significantly impede the relationship of trust and confidence between an adviser and its clients.

In sum, the Proposal would:

- Without justification, effectively replace the robust fiduciary duty principles for managing conflicts of interest with clients – principles that have been in place and worked well for decades – with an unproven and questionably expansive regulation;
- Unnecessarily duplicate principles-based regulations adopted under the anti-fraud provisions of the Advisers Act that already govern interactions with investors, and require advisers to adopt and implement prescriptive compliance policies and procedures;[8]
- Impose costly and burdensome compliance, testing, and recordkeeping obligations that are operationally infeasible due to overly expansive defined terms covering virtually every tool used in almost every interaction between an adviser and investors, including both existing and prospective clients;
- Have the unintended consequence of impeding beneficial and important communications between an adviser and its clients and limiting clients' ability to control the contours of their relationship with their advisers;
- Stifle innovation and the beneficial use of emerging technology, contrary to the interests of investors; and
- Severely underestimate the significant economic impact, including the cumulative costs and burdens that would be imposed on advisers, particularly smaller advisers.

We discuss each of these concerns in more detail below.

[8] The Commission should not promulgate regulations that overlap or are duplicative of existing regulations because they may lead to inconsistent results, inefficient or unnecessary deployment of valuable resources by advisers, or unintended consequences to the detriment of advisers, investors, and the markets. *See IAA Comment Letter to SEC Regarding Adviser Proposals* (June 17, 2023), available at https://investmentadviser.org/resources/iaa-comment-letter-to-sec-regarding-adviser-proposals/ (**Adviser Proposals Letter**). For example, under the Marketing Rule, advisers are permitted to use compensated testimonials and endorsements in advertisements subject to clear and prominent disclosures regarding such conflicts of interest. Thus, the Proposal could be interpreted to prohibit the use of paid client testimonials and endorsements that are explicitly permitted under the Marketing Rule.

II. The principles-based fiduciary duty and Advisers Act regulatory framework have proven capable of addressing conflicts of interest relating to emerging business practices and technology.

A. The Proposal fundamentally misconstrues the special relationship between an adviser and its clients.

The Proposal is antithetical to the special relationship between an adviser and its clients that is fundamentally based on "trust and confidence." The fiduciary duty and the principles-based approach to regulating advisers have worked remarkably well over the years in large part because that regulatory framework is consistent with the special relationship between advisers and their clients. The Proposal misconstrues this relationship, however, because it advances a view that an adviser's relationship with its clients is no more than a series of individual arm's length "investor interactions" where two parties are acting independently and each in its own self-interest. However, as commonly understood by advisers and reaffirmed by the Commission, the fiduciary duty is overarching, and an adviser's interactions with its clients are relationship based, not transaction based, and are intended to help clients holistically navigate the complex financial markets and meet their financial goals over the long term.

In fact, most investors seek the wide range of services an adviser may offer including long-term goals-based advice about saving for retirement, funding education, or buying a home, comprehensive financial planning, and discretionary investment advice. In contrast to the one-by-one investor interactions that the Proposal focuses on, advisers' interactions with clients are part of a "big picture" client relationship designed to identify client needs in the context of the client's broader circumstances, and ultimately to provide ongoing advice that is in the best interests of clients. Unfortunately, the Proposal ignores the bigger picture—the fact that advisers value their ongoing relationships with clients and that clients choose advisers precisely for this holistic relationship based on trust and confidence.[9]

[9] We are also troubled that the Proposal attempts to regulate advisers and broker-dealers in a uniform manner that ignores the differences in the services that are offered and the nature of the investor relationships in which advisers provide ongoing advice over the long term, as opposed to transaction-by-transaction recommendations or product sales. The Commission explicitly acknowledged this distinction as part of the standards of conduct rulemakings in 2019. *Regulation Best Interest: The Broker-Dealer Standard of Conduct,* Exchange Act Rel. No. 86031 (June 5, 2019), 84 Fed. Reg. 33318 (July 12, 2019) at 33319. In so doing, the Proposal would also further blur the lines between advisers and broker-dealers, which could lead to further investor confusion. One example of this is the fact that proposed Rule 15l-2(a) would define an investor interaction for a broker-dealer the same as for an investment adviser to mean "engaging or communicating with an investor, including by ***exercising discretion*** with respect to an investor's account." (Emphasis added.) However, with narrow exceptions, broker-dealers are not permitted to exercise discretion without registering as an investment adviser. *See Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser,* Advisers Act Rel. No. 5249 (June 5, 2019), available at https://www.sec.gov/files/rules/interp/2019/ia-5249.pdf. The IAA is concerned that using the identical language relating to exercising discretion, without any explanation of any limitation in the release, exacerbates the problem of investor confusion and risks stretching the solely incidental exclusion well beyond what the statute could plausibly have intended.

B. The Proposal significantly undermines the well-established, principles-based fiduciary duty under the Advisers Act.

The Proposal undervalues – and indeed undermines – the very core of the fiduciary duty that applies to all aspects of the agreed-upon advisory relationship, including management of an adviser's conflicts of interest. Under the fiduciary duty, advisers have an affirmative duty of care and loyalty to their clients. They must act in the best interests of their clients and must not put their own interests ahead of those of their clients – including by appropriately managing their conflicts such that their advice is still in their clients' best interest, notwithstanding the conflict.[10] The Commission and its staff have explained and enforced the fiduciary duty according to these principles for decades.[11]

The duty of loyalty in particular requires advisers to "eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which is not disinterested such that a client can provide informed consent to the conflict."[12] The duty of care requires advisers "to provide investment advice in the best interest of its client, based on the client's objectives."[13] Advisers must thus manage their conflicts in a way that prevents the conflicts from tainting their advice – meaning that the conflict does not cause the adviser to provide advice that is not in the client's best interest. In some cases, elimination of the conflict could be warranted, while in others disclosure and informed consent would suffice, and in others, in addition to disclosure and informed consent, the conflict could be effectively managed or mitigated through policies and procedures designed to prevent the conflict from tainting the adviser's advice (*e.g.,* through information barriers and/or compliance testing). But in every instance, the adviser must fully and fairly disclose the conflict such that the client is put in a position to make an informed decision as to whether to accept the conflicted arrangement or otherwise alter the relationship with the adviser as the client deems appropriate.

These duties and a client's ability to provide informed consent are at the heart of the relationship of trust and confidence between an adviser and its clients. The Proposal merely glosses over these important principles and the Commission fails to demonstrate or even assert

[10] Interpretation at 33676 (noting that "while full and fair disclosure of all material facts relating to the advisory relationship or of conflicts of interest and a client's informed consent prevent the presence of those material facts or conflicts themselves from violating the adviser's fiduciary duty, such disclosure and consent do not themselves satisfy the adviser's duty to act in the client's best interest").

[11] In addition to bringing enforcement actions against advisers for violating the conflicts disclosure principles of the fiduciary duty, the staff has promoted the fiduciary duty through compliance examinations and issuance of informal guidance, such as risk alerts sharing industry practice observations or other guidance clarifying the applicability of the fiduciary duty to emerging practices. *See, e.g., Robo-Advisers*, IM Guidance Update No. 2017-02 (Feb. 2017), available at https://www.sec.gov/investment/im-guidance-2017-02.pdf (**2017 Guidance**).

[12] Interpretation at 33671.

[13] *Id.*

that the fiduciary duty framework has in fact failed to adequately address conflicts that are specifically related to use of technology.

C. The Proposal seeks to broadly extend fiduciary duty principles applicable to advisers' clients to all investors without adequately considering the practical ramifications.

Prior to the beginning of the fiduciary relationship, all clients, including prospective clients, are protected by the explicit anti-fraud provisions of Section 206 of the Advisers Act, and the regulations adopted thereunder. Under these provisions, advisers are prohibited from engaging in ***any*** fraudulent, deceptive or manipulative practices – including through the use of PDA-like and other covered technologies. These anti-fraud provisions prohibit, among other things, "transactions, practices, or courses of business which operate as a fraud or deceit upon prospective clients, including those regarding investment strategy, engaging a sub-adviser, and account type."[14] Moreover, as discussed further below, the Commission has adopted an array of regulations under the anti-fraud provisions of the Advisers Act to address specific fraudulent or misleading practices that would include an adviser's use of "covered technologies" in an "investor interaction" as those terms are defined in the Proposal.

The fiduciary duty, by contrast, only applies "at the point in time at which the prospective client becomes a client of the investment adviser (*e.g.*, at account opening)."[15] Thus, interactions with prospective clients are not subject to fiduciary duty unless and until the prospective client becomes a client of the adviser. The Proposal disregards this important distinction and attempts to subject interactions with prospective clients to fiduciary obligations without fully considering the practical ramifications.

For example, under the fiduciary duty, advisers go through an extensive process in connection with providing investment advice to understand a client's objectives, which includes, "at a minimum, [to] make a reasonable inquiry into the client's financial situation, level of financial sophistication, investment experience, and financial goals."[16] The Proposal would greatly expand these obligations beyond the limited situations involving the provision of investment advice and require advisers to make a similar best interest determination for purposes of addressing conflicts of interest with respect to any use of a covered technology in any interaction with clients or prospective clients. However, the Proposal provides no explanation as to how an adviser can reasonably be expected to make such a determination regarding its interest relative to the interests of prospective clients in the case of investor interactions that do not rise

[14] Interpretation at n.42.

[15] *Id*.

[16] Interpretation at 33673. Moreover, according to the Interpretation, the anti-fraud provisions of the Advisers Act require advisers to make a similar determination in connection with providing investment advice to prospective clients. *See* Interpretation at n.42 (stating that advisers should have "sufficient information about a prospective client and its objectives to form a reasonable basis before providing any advice" about matters relating to "investment strategy, engaging a sub-adviser, and account type").

to the level of investment advice (*e.g.*, calculators and predictive tools that are designed to generally estimate education and retirement income needs).

Moreover, clients that hire an adviser to provide investment advice or guidance are more likely to respond to an adviser's inquiry (*e.g.*, through an online questionnaire) for sensitive information regarding their "financial situation, level of financial sophistication, investment experience, and financial goals." However, investors exploring their options for professional financial services or just seeking helpful information (and not investment advice) are less likely to provide more than cursory non-specific information regarding financial interests or objectives. Thus, advisers that are unable to determine the interests of non-client investors would be disincentivized from making such tools or information available to investors.

D. Eliminating an adviser's ability to manage its conflicts of interest, including through disclosure and informed consent, would effectively carve out a core principle of fiduciary duty, to the detriment of investors.

The Proposal would eliminate an adviser's ability to fully and fairly disclose a conflict and obtain informed consent, ***even where the adviser has mitigated the conflict as necessary to determine that the adviser's advice continues to be in the best interest of the client***. Under the Proposal, if an adviser identifies ***any*** "conflict of interest" (as newly defined in the Proposal) of the adviser or its associated persons involving a covered technology that results – or could potentially result – in an investor interaction that places the interests of the adviser ahead of the interests of investors, it would have to "eliminate or neutralize" the conflict. Thus, an adviser could identify a conflict of interest and manage that conflict by fully and fairly disclosing it so that an existing or new client could provide informed consent, and, if necessary, mitigate it to prevent it from tainting the adviser's advice, and it still would not be able to proceed with using the covered technology. Moreover, the elimination of the principles of disclosure and informed consent, and mitigation as necessary, would significantly undermine an investor's ability to choose a financial professional.

First, as discussed above, this approach disregards longstanding fiduciary principles about how advisers should address conflicts of interest that have proven to be highly effective. Without pointing to evidence of failure of these principles to address conflicts related to PDA-like technologies, the Commission instead concludes that disclosure and consent are not appropriate because of the rapid acceleration of these technologies, their scalability, and perceived challenges associated with identifying conflicts due to their "inherent complexity and opacity." These theoretical concerns do not support the Commission's position that full and fair disclosure and informed consent, with additional mitigation as may be necessary, are collectively insufficient to manage conflicts. As we have previously commented, we are "unable to identify situations where material facts concerning a conflict cannot be fully and fairly disclosed, including the nature, extent, magnitude, and potential effects of the conflict."[17] Under the

[17] *See IAA Comment Letter on Regulation Best Interest, Form CRS, and Advisers Act Fiduciary Duty Interpretation* (Aug. 6. 2018), available at https://investmentadviser.org/resources/comments-on-regulation-best-interest-form-crs-and-advisers-act-fiduciary-duty-interpretation/.

Interpretation, in those cases where an adviser cannot "fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent, the adviser should either eliminate the conflict or adequately mitigate (*i.e.*, modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible."[18] The ***potential*** conflicts-related risks associated with covered technologies do not warrant abandoning the fundamental principles of fiduciary duty by concluding both that advisers cannot provide full and fair disclosure or that clients cannot make informed decisions.[19]

Indeed, we note that technology itself is capable of improving the quality of disclosure. Digital experiences give advisers the ability to test disclosures prior to the launch of new capabilities to obtain quick feedback on more effective ways to communicate information to investors. For example, advisers have done testing around fee disclosures to evaluate how well clients understand the cost of advisory services.

Second, the Proposal fails to recognize that an adviser can act in its clients' best interest notwithstanding a conflict. The presence of an adviser interest does not inherently mean that the adviser is failing to act in the client's best interest as contemplated by the Proposal. The Proposal jumps from the presence of any conflict that could put the interest of the adviser ahead of the interests of clients directly to requiring elimination or neutralization without consideration of whether the adviser can or has effectively managed the conflict to prevent the conflict from tainting the adviser's advice. Thus, even where the covered technology would provide financial education, coaching, guidance, or advice that are in the best interest of clients, notwithstanding the presence of a conflict, the adviser would be *per se* prohibited from proceeding to use the technology without first eliminating or neutralizing the conflict altogether.

The Proposal also fails to fully appreciate that advisers' business models, compensation structures, and overall objectives typically align closely with clients' interests. Appropriate management of advisers' conflicts, including through disclosure and informed consent, permits advisers to provide solutions that are in the best interest of clients and that facilitate client choice so that ***both*** advisers and clients benefit. For example, many of the covered technologies that advisers would no longer be able to use under the Proposal are, in fact, designed to provide more highly customized and personalized interactions with clients. That is, they are designed to ensure that advisers are able to provide advice that is tailored to the needs and in the best interest of

[18] Interpretation at 33677.

[19] We are also troubled by the Proposal's premise that investors are unable to "think for themselves," *i.e.*, make informed decisions in their own interest based on full and fair disclosure. *See* Commissioner Hester M. Peirce, Statement, Through the Looking Glass: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers Proposal (July 26, 2023), available at https://www.sec.gov/news/statement/peirce-statement-predictive-data-analytics-072623 (noting that [t]he long-term ramifications of the Commission's rationale for dismissing the value of disclosure – namely, that disclosure is of no use to investors – cannot be exaggerated …. The whole premise of our disclosure regime is that investors can think for themselves.") (**Peirce Statement**).

clients based on a particular client's objectives.[20] We are concerned that the Proposal would potentially have the unintended effect of preventing advisers from using covered technology to assist them in learning more about client objectives in order to provide services and information that are in their clients' best interest. This outcome would be contrary to an adviser's fiduciary obligation to develop a "reasonable understanding of the client's objectives."[21]

Third, the proposed requirement to "eliminate or neutralize" conflicts is a significant departure from the existing regulatory framework, which appropriately gives advisers the ability to manage conflicts in numerous ways to ensure that they are acting in their clients' best interest. However, the Proposal appears to reject this concept. Instead of focusing on mitigation, the Proposal inexplicably introduces the new concept of "neutralization," an undefined term whose meaning is unclear. The Commission notes that it is including neutralization as a method of addressing conflicts of interest "because of the unique ways that technology can be modified or counterweighted to eliminate the harmful effects of a conflict, as well as the ways it can be tested to confirm the modification or counterweighting was successful."[22] However, the Proposal never explains why the current fiduciary framework's approach to mitigating conflicts is not sufficient in the context of covered technology or how neutralization differs from mitigation under the fiduciary duty. It is thus likely to create confusion and result in inconsistent interpretation and application.

The Proposal takes aim at "common business practices" that would now inherently be deemed as being contrary to client interest, such as revenue sharing payments, proprietary products, and the ability of dual registrants to make account type recommendations. In fact, the Proposal seems designed to eliminate these practices without regard for the fact that the Commission specifically addressed them in the Interpretation and advisers have long managed related conflicts and made appropriate disclosures and obtained informed consent from clients. Where advisers have not adequately disclosed or mitigated these conflicts, the Commission has used the ample tools in its toolbox to bring enforcement actions and communicate its expectations to advisers.[23] The Proposal instead would effectively apply a "strict scrutiny" standard to these common business practices, requiring that they be eliminated or neutralized if they arise in the context of covered technology. This black-and-white standard would lead to a series of illogical, inconsistent, and detrimental outcomes. For example, advisers recommending affiliated proprietary funds that they (and their clients) believe are in their clients' best interest would be prevented from using the very products that non-affiliated advisers recommend as core building blocks in their portfolios. In fact, the Proposal fails to recognize that ***clients may choose*** a particular adviser precisely to invest in these proprietary products or that a client would consent to specific arrangements as part of the value of the overall relationship and services that a

[20] *See* Interpretation at 33672 (noting that the "duty of care includes a duty to provide advice that is in the best interest of the client, including a duty to provide advice that is suitable for the client").

[21] *See* Interpretation at 33673.

[22] Proposal at 53986.

[23] *See, e.g., SEC Share Class Initiative Returning More Than $125 Million to Investors*, SEC Press Rel. 2019-28 (Mar. 11, 2019), available at https://www.sec.gov/news/press-release/2019-28.

particular adviser provides, *i.e.*, the client would determine, based on full and fair disclosure, that the relationship is "worth it." We are also concerned that dual registrants would be prohibited from offering investors the choice of different account types that may be in their best interest.

It is not clear why common business practices that have been disclosed and managed for decades suddenly would not be permissible merely because advisers are using covered technology, including technology that advisers have been using without an issue for decades. Again, the Commission departs from existing principles of fiduciary duty without sufficient justification or explanation and without considering the potential impact on clients and other investors.

Fourth, contrary to the Commission's assertion, the Proposal does not merely supplement existing regulatory requirements for conflicts of interest.[24] While that may be the Commission's intent, the Proposal would have the effect for all practical purposes of replacing them entirely, without the Commission having provided notice and opportunity for comment as required.[25] This outcome is likely, in part, because advisers, as fiduciaries, would be hesitant to treat client interactions that don't use technology differently from those that do and would manage their conflicts under the fiduciary duty at their own risk. But it is also a reasonably foreseeable consequence of the sheer breadth and prescriptive nature of the Proposal that elimination and neutralization would become the *de facto* standard, effectively overriding fiduciary duty in the case of all client interactions.

E. The Commission provides no factual basis or policy rationale for abandoning the existing regulatory framework governing advisers and replacing it with an expansive, questionable, and unproven regulation.

Indeed, the fiduciary duty and the overall regulatory framework governing advisers have proven to be remarkably flexible and adaptable as technology has evolved and new market practices have developed.[26] The Commission has demonstrated the effectiveness of this framework through examinations and enforcement actions relating to conflicts of interest and violations of the anti-fraud provisions of the Advisers Act, and its authority in this regard has never been dependent on the nature of the products and services offered by advisers – nor is it

[24] Proposal at 53976 (stating that "[t]he proposed conflicts rules thus supplement, rather than supplant, existing regulatory obligations related to conflicts of interest, laying out particular steps a firm must take to address conflicts of interest arising specifically from the use of covered technologies in investor interactions").

[25] According to the Commission: "Compliance with the proposed conflicts rules would not alter a broker-dealer's or investment adviser's existing obligations under the Federal securities laws. The proposed conflicts rules would apply in addition to any other obligations under the Exchange Act and Advisers Act, along with any rules the Commission may adopt thereunder, and any other applicable provisions of the Federal securities laws and related rules and regulations." Proposal at n.62.

[26] In the Interpretation, the Commission declined to codify its interpretation of fiduciary duty, noting that "[t]he relationship between an investment adviser and its client has long been based on fiduciary principles not generally set forth in specific statute or rule text. We believe this principles-based approach should continue as it expresses broadly the standard to which investment advisers are held while allowing them flexibility to meet that standard in the context of their specific services." Interpretation at 33670.

dependent on the nature of the technology or type of interaction between an adviser and its existing or prospective clients.

Against this regulatory backdrop, the Commission provides no factual justification to create an unnecessarily burdensome new rule and fails to identify any conflicts of interest or risks that are not already addressed through the existing regulatory framework for advisers. Rather, it merely cites academic studies and the theoretical "potential" for investor harm from PDA-like and other covered technologies as the basis for its sweeping new framework. In fact, the Commission points to only one case involving conflicts of interest associated with an adviser's use of PDA-like technologies.[27] However, as the Commission itself notes, the focus of that case was on alleged disclosure failures that resulted in investors being "unable to make a fully informed decision regarding whether the lack of an advisory fee benefitted them." The case did not focus on the use of any particular technology, nor was there any allegation that the conflicts at issue related to use of that technology. The Commission argues that the case "highlights the ***potential*** for PDA-like technologies to be used in ways that advance a firm's interests at the expense of its investors' interests," despite the fact that this case did not implicate any of the risks that the Proposal associates with PDA-like technologies. (Emphasis added.)

The Proposal is also based on an assumption that "[d]ue 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." However, the definition of a covered technology is broadly defined irrespective of any notion of "scalability" to include the use of any "analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes in an investor interaction."

Such a broad definition would include "technologies" that have been used by advisers for decades including a calculator, computer, electronic communications (*e.g.*, email, text messaging, social media, etc.), and software (*e.g.*, spreadsheets for financial calculations). Yet, we are aware of no Commission enforcement actions or examination observations or any public statements by the Commission or its staff alleging that these electronic tools have resulted in any "harm to investors in a more pronounced fashion and on a broader scale than previously possible."

III. The potential concerns associated with the use of covered technologies, including conflicts of interest, are also addressed through existing and effective principles-based regulations and guidance.

The Proposal is both unnecessarily prescriptive and duplicative of existing requirements. Advisers are already subject to a panoply of regulations based on the anti-fraud provisions of the Advisers Act that apply to interactions with existing and prospective clients and to the use of covered technologies. Further, the Commission and its staff have numerous tools, including

[27] *In re Charles Schwab & Co., Inc., et al.,* Advisers Act Rel. No. 6047 (June 13, 2022).

examinations, risk alerts, and informal guidance that the Commission and its staff can use to establish best practices for addressing PDA-like technologies.[28]

A. The substance of investor interactions and any related conflicts of interest are more than adequately addressed under the Marketing Rule.

Advertisements and marketing practices are subject to extensive regulation under Advisers Act Rule 206(4)-1, which was recently amended and updated, among other things to reflect advances in technology. The Marketing Rule is incredibly broad in its application. For example, the Marketing Rule defines an advertisement broadly to include "any direct or indirect communication an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance" that offers advisory services to new clients or investors in private funds or that offers new advisory services to existing clients or investors.[29] Thus, it applies to adviser communications broadly directed to all investors, including existing and prospective clients. Further, the general prohibitions under the Marketing Rule effectively codify the anti-fraud provisions of Section 206 of the Advisers Act as they apply to adviser communications subject to the rule.

The Marketing Rule is also truly technology neutral in that it does not attempt to apply new regulatory obligations based on the use of technology, whether general or specific. Rather, it regulates advertising practices by establishing general principles and specific requirements that apply regardless of whether technology, or any specific technology, is used.[30] Moreover, even though examinations for compliance with the Marketing Rule are ongoing and it has not yet been a year since the November 2022 compliance date, it is clear from the Commission's recent enforcement activity that the Commission is able to effectively apply the Marketing Rule to address a broad number of investor interactions, even those that are presented to prospective clients through public websites.[31]

Further, as noted above, to the extent that the Commission is attempting to address investor interactions and communications that may not be considered an "advertisement," the Interpretation makes clear that all communications with clients and prospective clients are subject to the general anti-fraud provisions under Advisers Act Section 206.[32] Both the

[28] *See, e.g.*, 2017 Guidance; *see also Observations from Examinations of Advisers that Provide Electronic Investment Advice*, Division of Examinations Risk Alert (Nov. 9. 2021), available at https://www.sec.gov/files/exams-eia-risk-alert.pdf. While these examples focus primarily on digital advisers, we believe the practices suggested in this guidance could be helpful for advisers using technology more generally.

[29] Advisers Act Rule 206(4)-1(e)(1).

[30] *See Investment Adviser Marketing*, Advisers Act Rel. No. 5653 (Dec. 22, 2020), 86 Fed. Reg. 13024 (Mar. 5, 2021) at 13025 (noting that "the rule contains principles-based provisions designed to accommodate the continual evolution and interplay of technology and advice").

[31] *See In re Titan Global Capital Management USA LLC*, Advisers Act Rel. No. 6380 (Aug. 21, 2023); *see also SEC Sweep into Marketing Rule Violations Results in Charges Against Nine Investment Advisers*, Press Rel. 2023-173 (Sept. 11, 2023), available at https://www.sec.gov/news/press-release/2023-173.

[32] *See* Interpretation at n.42.

Marketing Rule and Section 206 already "protect against, among others, adviser conflicts of interest that may taint such marketing."[33]

B. The policies and procedures and testing requirements in the Proposal are unnecessarily burdensome, overly prescriptive, and redundant of the Compliance Rule.

The Proposal would require advisers to adopt and implement written policies and procedures that include: (i) a written description of the process for evaluating any use or reasonably foreseeable use of a covered technology in an investor interaction; (ii) a written description of any material features of, including any conflicts of interest associated with the use of, any covered technology, along with periodic updates; (iii) a written description of the process for determining whether any conflict of interest places the interest of the adviser ahead of the interests of investors; and (iv) a written description of the process for eliminating or neutralizing the effects of the conflicts of interests.

We understand that the Commission's intent in prescribing detailed policies and procedures is to require advisers to go through an explicit process of identifying conflicts of interest associated with the use of covered technology and to prescribe minimum standards for reviewing and addressing those conflicts. However, Advisers Act Rule 206(4)-7 (**Compliance Rule**) already requires advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.[34] A critically important aspect of the Compliance Rule is that "[e]ach adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks."[35] Under the Compliance Rule, advisers generally should already have in place a conflicts inventory and assessment process that is based on their size and business practices, as well as a process for revisiting their conflicts inventory periodically based on changes in the business, the market, and the regulatory environment.

In addition to being duplicative, the approach to policies and procedures under the proposed rule is overly broad, impractical, and unduly burdensome. For example, while proposed Rule 211(h)(2)-4(c) would require advisers to adopt and implement written policies and procedures "reasonably designed" to prevent violations of proposed Rule 211(h)(2)-4(b), it then articulates prescriptive obligations that are virtually unlimited, making it difficult to determine what would be considered "reasonable." Advisers would be required to undertake a "written

[33] Proposal at 53966.

[34] Notably, in adopting the Compliance Rule, the Commission elected not to "enumerate specific elements that advisers must include in their policies and procedures" and correctly noted that advisers are "too varied in their operations" for the rules to impose a "single set of universally applicable required elements." The Compliance Rule permits advisers to appropriately tailor their compliance programs to their size and business practices. *See Compliance Programs of Investment Companies and Investment Advisers*, Advisers Act Rel. No. 2204 (Dec. 17, 2003), 68 Fed. Reg. 74714 (Dec. 24, 2003), available at https://www.sec.gov/rules/final/ia-2204.pdf.

[35] *Id*. at 74716.

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 ***any*** material features of, including ***any*** conflicts of interest associated with the use of, ***any*** covered technology used in ***any*** investor interaction prior to such covered technology's implementation or material modification, which must be updated periodically."[36] (Emphasis added.)

Further, the proposed policies and procedures would require an adviser to memorialize the material features of the operation of its technology or any third-party technology that it licenses ***before*** the adviser has even determined whether the use of that technology involves an interaction that places the interests of the adviser ahead of the interests of investors. Such a requirement is completely impractical. It is also inconsistent with how advisers currently manage – or should reasonably be expected to manage – conflicts of interest, which is focused on evaluating material conflicts where the interests of the adviser and its clients actually diverge.

In addition, the extraordinarily expansive definitions set forth in the proposed rule, along with the obligation to address not only the actual use of a covered technology in an investor interaction, but any "reasonably foreseeable potential use of a covered technology," would make compliance exceedingly challenging if not infeasible. Advisers could very well be required to develop a compliance infrastructure to evaluate ***all*** technology used throughout the firm, regardless of whether such technology is used for internal purposes, such as to inform portfolio management decisions or facilitate trading, or whether it involves a direct investor interaction. We are concerned that, besides being unnecessarily burdensome, implementation of these requirements would divert limited compliance resources that would otherwise be deployed to address critical issues.

The Proposal also requires advisers to test each covered technology (and memorialize each aspect of the testing) before its implementation or material modification and periodically thereafter.[37] Advisers are already required to have robust compliance programs and conduct annual reviews to ensure they are working as intended, as required by the Compliance Rule. However, the Proposal would set an almost impossible standard for review of and recordkeeping related solely to covered technology, including every possible input of data and every modification or upgrade to the covered technology regardless of the materiality of their impact. Unlike the Compliance Rule, the Proposal does not provide the flexibility for advisers to take a risk-based approach to developing compliance policies and procedures relating to covered technologies to implement ongoing controls that reflect the nature of their business and their reliance on covered technologies in investor interactions. As a result, the highly prescriptive requirements to memorialize and test the extremely expansive list of covered technologies would impose an unreasonably burdensome compliance obligation on advisers. Advisers would likely find themselves in a position where they would be conducting almost continuous reviews of covered technology, including potentially whether the interactions among technologies could result in additional conflicts. This lack of proportionality also raises concerns that valuable

[36] *See* Proposed Rule 211(h)(2)-4(c)(1) of the Advisers Act.

[37] *See* Proposed Rule 211(h)(1)-4(b)(1) of the Advisers Act.

resources would be diverted from the testing of controls under the Compliance Rule more broadly, such as those relating to managing critical data integrity and data security systems and processes, among other things.

Moreover, advisers would be required to conduct a review at least annually of the policies and procedures established under the Proposal, and the related determinations under proposed Rule 211(h)(2)-4(c)(4), and to memorialize that review. This requirement is almost identical to the general requirement under the Compliance Rule that advisers annually review the adequacy of the firm's compliance policies and procedures and the effectiveness of their implementation. Moreover, the Commission recently amended Advisers Act Rule 206(4)-7 to require advisers to document their annual reviews.[38] Given the existing obligations under the Compliance Rule, the proposed annual review is duplicative and unnecessary.

IV. The Commission inexplicably disregards the operational feasibility of the Proposal.

The Commission's decision to broadly define key terms in the Proposal, specifically conflicts of interest, covered technology, investor, and investor interaction, means that the proposed rule would impact nearly all communications between an adviser and its existing and prospective clients. Further, certain aspects of the Proposal are so broad or vague as to be nearly impossible to implement. Advisers would either be tasked with massive operational and compliance burdens or risk non-compliance with the proposed rule. Compliance would be a significant burden on resources that will be stretched thin by the cumulative impact of the Commission's rulemaking agenda without any meaningful benefit for investors.

A. The Proposal establishes a new definition of and framework for conflicts of interest without any regard for the impact on current obligations.

Rather than building upon existing legal standards – and more than 80 years of well-established and accepted common law and Commission interpretation – the Proposal needlessly redefines a conflict of interest.[39] As noted above, under the Proposal, the concept of a "conflict of interest" exists even where there is no conflict under any common understanding of the term.[40] Under the Proposal, a conflict exists whenever an adviser uses a covered technology "that takes into consideration an interest of" the adviser or its associated persons. For the adviser, this would likely be the case for any business decision. The definition of a conflict of interest fails to

[38] *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Advisers Act Rel. No. 6383 (Aug. 23, 2023).

[39] The Commission also fails to address how the Proposal interrelates with other applicable legal standards that impact how advisers manage client assets.

[40] We are especially baffled that the Proposal defines a "conflict of interest" to include the use of a covered technology that takes into consideration *a mere interest* of the investment adviser without any notion of a "conflict." *See, e.g.*, *Conflict*, Merriam-Webster (2023) ("competitive or opposing action of incompatibles: antagonistic state or action (as of divergent ideas, interests, or persons), available at https://www.merriam-webster.com/dictionary/conflict#:~:text=%3A%20competitive%20or%20opposing%20action%20of,a%20conflict%20of%20principles.

differentiate between a situation where the adviser or its associated person has an interest and a situation where that interest is in conflict with a client's interest. The result is that the Proposal's definition of a conflict of interest does not, in fact, involve a conflict of interest.

First, the term "conflict of interest" under the Proposal would itself impose an arduous process that would require advisers to inventory, test, and monitor all technology – including tools and technologies that have been used without raising meaningful concerns for decades – to determine whether "***any*** use or reasonably foreseeable potential use" involves any interest of the adviser or an associated person that could be used in an investor interaction. The result would be to create a wide "funnel" that would require advisers to establish a sweeping compliance system to inventory all technologies to determine whether they could be covered technologies that actually or potentially could consider the interests of the adviser in any investor interaction, a determination that only then would move them towards the narrow tube of the funnel.[41]

Second, even assuming an actual conflict is identified, the proposed concept of a conflict fails to incorporate any notion of materiality or to consider whether the conflict actually adversely affects the advisory relationship. The instructions to Form ADV state that "[a]s a fiduciary, [the adviser] also must seek to avoid conflicts of interest with [its] clients, and, at a minimum, make full disclosure of all ***material*** conflicts of interest between [the adviser] and [its] clients that could affect the advisory relationship."[42] The Commission is not writing on a blank page with respect to conflicts and it has not justified the need to overwrite the existing meaning of a conflict of interest under the Advisers Act including by ignoring the critical question of whether the conflict could actually adversely affect the investment advice provided.[43] While we recognize that the Proposal incorporates the concept of "investment-related behaviors or outcomes" into the definition of covered technology, by not including such a limitation in the definition of conflict of interest, the Proposal again provides no limiting principle to what advisers must put into the funnel.

We also fail to see how the Commission expects to limit this broad definition of conflict of interest to the context of covered technology, or how it expects to differentiate a conflict in this context from other situations where the Commission refers to conflicts of interest. For example, would advisers now be required to substantially rewrite their Form ADVs to disclose any situation where they use a covered technology that takes into consideration an interest of the adviser or its associated persons? Will the Commission now bring cases under Section 206 for a breach of fiduciary duty where an adviser takes its own interest into consideration but does not

[41] While we understand that the Proposal only requires elimination or neutralization in the case of an *actual* conflict of interest, that does not minimize the impact of the initial requirement under proposed rule 211(h)(2)-4(b)(1). To continue the metaphor, and as discussed below, the compliance funnel would need to be even wider since the Proposal also fails to limit the compliance obligations to situations where there is an actual use of a covered technology (as opposed to a reasonably foreseeable potential use), or even an actual interaction with an investor.

[42] *See* General Instruction 3 to Part 2 of Form ADV. (Emphasis added.)

[43] An adviser's obligation under fiduciary duty applies to conflicts of interest "which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested." *See* Interpretation at 33676.

use technology? We believe that the entire concept of a conflict of interest under the Proposal is irreparably flawed.

B. The definition of a "covered technology" has no discernable limits.

The proposed definition of covered technology is far too broad and vague. Covered technology is defined as "an analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes."[44] This definition encompasses a significant portion of an adviser's ordinary-course activities, as most technology used by advisers in connection with investor interactions is, at a minimum, used to "guide" investment-related behavior. Thus, the definition would capture technology used directly or indirectly in connection with a broad range of actions from providing investment advice and recommendations, to communications and advertisements, design elements incorporated into websites, or mobile applications that "nudge, prompt, cue, solicit, or influence investment-related behaviors or outcomes from investors."[45] In practice, therefore, the Proposal could cover even elementary computational or financial technology long used by advisers such as "spreadsheets, commonly used software, math formulas, [and] statistical tools."[46]

The Proposal fails to explain why nearly all "technology" must now be subject to a new regulatory regime, particularly given that many of the technologies that would be subject to the Proposal have been used by advisers for decades without concerns being raised about their use. The proposed definition is also inconsistent with (and far broader than) the discussion of PDA-like technologies in the Proposal. While the Proposal describes PDA-like technologies as AI, machine learning, or deep learning algorithms, neural networks, 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, among others,[47] this is not how the Proposal defines covered technology. While the description of "PDA-like technology" is also overbroad, it seems more focused than the definition in the rule.

The breadth of two phrases in the proposed definition –"optimizes for, predicts, guides, forecasts, or directs" and "investment-related behaviors or outcomes" will compel advisers to treat virtually any technology they use for virtually any activity as a potentially covered technology and document, test, and monitor all these uses of technology. These efforts would come at the expense of the advisers focusing on and managing actual conflicts of interest with

[44] According to the Proposal, a firm "could implement covered technology for automation of, for example, 'back office' processes like the routing of customers' orders and accounting and trade settlement. In each of these examples, the use of covered technology for these processes does not involve an investor interaction, and therefore would not be subject to the proposed conflicts rules." *See* Proposal at 53874. We are concerned, however, that the Proposal would encompass all other technologies used with respect to trading and portfolio management.

[45] *See* Proposal at 53972.

[46] *See* Peirce Statement.

[47] *See* Proposal at 53972.

their clients. The related compliance obligations would be significant and potentially overwhelming for advisers. As a result, some advisers may need to limit their use of technology or reduce or alter the services they provide to investors, either of which could result in investors missing the benefits technology could otherwise provide.

Our concerns are amplified by the Proposal's extension of the definition of covered technology from technology developed by an adviser to technology developed, maintained or licensed from third parties. The Proposal fails to appreciate just how difficult it would be for advisers to comply with the prescriptive requirements of the proposed rule with respect to technology licensed from a third party, particularly complex or newly-developed technology. For example, the Commission recognizes that advisers would not be given "full visibility into all aspects of how such covered technology functions," putting them in the position of either not using important and beneficial third-party technology or risking non-compliance with the proposed rule.[48]

C. The definition of investor is unnecessarily broad and illogical.

The Proposal's definition of investor in the context of adviser interactions would include institutional investors as well as retail investors.[49] As reaffirmed in the Interpretation, an adviser's fiduciary duty applies to all of its clients, whether retail or institutional. The Commission maintains, however, that its proposed new framework is different from the fiduciary framework. We thus question why the Proposal would extend to advisers' interactions with institutional investors. The Commission also has not sufficiently explained why this definition should be different for advisers and broker-dealers.[50] Why would institutional clients or prospective clients of an adviser need additional protections that the Commission appears to believe are not needed for institutional customers of broker-dealers?[51] The Commission has not provided sufficient justification for extending the Proposal to institutional investors with respect to interactions with advisers. Doing so is not only unnecessary but would result in disruptive and illogical outcomes.

[48] *See* Proposal at 53978. We note that this is yet another proposal that would impose highly prescriptive, but unrealistic, requirements on advisers in connection with using the services of third parties. *See, e.g., Outsourcing by Investment Advisers,* Advisers Act Rel. No. 6176 (Oct. 26, 2022).

[49] Proposed Rule 211(h)(2)-4(a) defines investors of advisers to mean "any prospective or current client of an investment adviser or any prospective or current investor in a pooled investment vehicle (as defined in [Advisers Act Rule] 206(4)-8) advised by the investment adviser."

[50] For broker-dealers, the Proposal would govern interactions with retail investors, and incorporates that definition from Form CRS. *See* Proposed Rule 15l-2(a) under the Exchange Act, which defines an investor as "a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or household purposes."

[51] We note that the Commission primarily sought input from commentators on the use of digital engagement practices as they primarily related to retail investors in the *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice.* However, the Proposal would now cover retail and institutional investors of an adviser.

We are also troubled by the extension of the proposed definition of investor to include prospective clients of an adviser. As noted above, fiduciary duty is premised on the presence of an advisory relationship. Prior to the beginning of the fiduciary relationship, prospective clients are protected by the explicit anti-fraud provisions of Advisers Act Section 206, and the regulations adopted thereunder, which apply to both existing and prospective clients. Extending the definition of "investor" to prospective clients of an adviser is therefore unnecessary. It is also unwarranted. It is one thing to require that advisers have a reasonable basis for any advice provided to prospective clients and to disclose material facts about the advisory relationship so that prospective clients are able to make informed decisions about whether to engage the adviser as discussed in the Interpretation. It is quite another to require advisers to eliminate or neutralize conflicts of interest ***prior*** to the inception of the advisory relationship just because the adviser is relying on a covered technology.

D. The concept of an investor interaction would cover almost every substantive communication advisers have with clients.

Like much of the Proposal, the definition of an investor interaction is unnecessarily broad and effectively includes every substantive interaction with a client or prospective client. The Proposal defines an investor interaction as "engaging or communicating with an investor, including by exercising discretion with respect to an investor's account; providing information to an investor; or soliciting an investor; except that the term does not apply to interactions solely for purposes of meeting legal or regulatory obligations or providing clerical, ministerial, or general administrative support." Once again, the Commission fails to justify why nearly every interaction with a client or prospective client, except for certain back office tasks, would need to be covered by the proposed rule, particularly where there is already a comprehensive regulatory regime to regulate advisory communications and protect both clients and prospective clients.

In addition, the proposed definition would include situations such as exercising investment discretion and the use of covered technology by associated persons that do not involve direct investor interactions. Including such interactions within the scope of the Proposal would make covered interactions virtually limitless, potentially reaching, for example, into every employee training session and every trading- or portfolio management-related interaction. Including indirect interactions is not only overbroad, it is also unnecessary. Advisers that are relying on covered technologies to assist with formulating investment advice or to manage accounts are already subject to fiduciary duty and existing regulations that, as discussed above, more than adequately address any conflicts of interest.

V. The Proposal will effectively stifle innovation and the beneficial use of emerging technology, contrary to the interests of investors.

The Proposal would have the effect of chilling innovation to the detriment of investors because the "eliminate" concept means firms will likely be reluctant to invest in or adopt new technologies or be unable to use technology to formulate investment advice or interact with investors because of the onerous requirements under the proposed rule. We recognize that the Proposal provides a narrow exception to the definition of investor interaction for account opening in recognition of the fact that "generally attracting new investors is essential to the business of any firm."[52] However, opening an account is not the only investor interaction that is essential to the business of the firm and involves an inherent conflict of interest. The Proposal would potentially preclude the use of covered technology where an adviser has an interest to inform clients of strategies to maximize their investments or provide customized advisory solutions—even in situations where the interests of the adviser and its clients are aligned. It would also likely inhibit communications regarding fundamental matters like saving for retirement, education, and home ownership—beneficial financial strategies that are at the core of the advisory services that retail investors in particular look to advisers to provide and which are essential to the financial wellbeing of investors and our society.

The Commission also significantly underestimates the importance of technology to reducing barriers to entry for investors and to giving all investors access to diversification and portfolio construction services that they may not otherwise be able to afford. A major benefit of technology is to democratize the availability of such assistance at a lower price, thus providing the benefits of fiduciary advice to a much larger population of investors.

We are concerned that the potential for regulatory risk and the fear of technical violations would inhibit the use of technology and limit or preclude advisers from offering highly beneficial services such as:

- Portfolio diversification tools that show how a client could diversify his or her portfolio to reduce risk;
- Calculators and predictive tools that estimate education and retirement income needs;
- Periodic communications that encourage clients to reduce cash positions in advisory accounts or contribute to an individual retirement account;
- Communications that notify clients that their actual contributions to save for a particular goal such as retirement differ from their planned contributions;
- Investment proposals that recommend particular investment strategies to existing clients; and
- Portfolio construction tools that allow advisers and their clients to develop portfolios aligned with client risks and goals.

Finally, we note that the Proposal does not differentiate between situations where an investor seeks financial education, coaching, guidance, or advice through a covered technology and when the adviser or its representatives initiate the communications.

[52] *See* Proposal at n.160.

VI. The Commission severely underestimates the economic impact of the Proposal and the costs and burdens of the operational challenges that would be imposed on advisers.

While the Commission presented some data in its economic analysis of the Proposal, the analysis is cursory and fails to consider the full impact on advisers given the expansive nature of the Proposal. For example, the Proposal states that firms with simple covered technology would spend 25 hours a year initially and 12.5 thereafter, while firms with complex covered technology would spend 350 hours annually and 175 thereafter.

We believe these figures significantly underestimate the time and compliance resources that would need to be dedicated to managing the complexity of the processes required by the Proposal. For example, even firms using simple technology would need to inventory every piece of technology used, including by third parties, evaluate each technology to determine whether it considers any interest of the firm or its associated persons, then determine all the possible "investor interactions" that could use the technology, and whether the identified conflict puts, or potentially could put, the firm's interest ahead of existing or prospective clients in any of these interactions, and then determine how to eliminate or neutralize any such conflicts. These firms would also have to make and maintain extensive records of each of these steps. In addition to not adequately justifying the direct costs associated with the Proposal, the Commission fails to present a single data point as to how indirect costs may impact advisers or their clients.

The Proposal would require substantial investments in infrastructure, personnel, and technology for both initial and ongoing implementation. Advisers would be required to develop, change, and maintain new or upgraded systems and create and implement related policies and procedures, including testing, monitoring, frequent reviews of covered technologies, expansive recordkeeping, and extensive ongoing due diligence and monitoring of covered technologies being employed by every adviser employee and third parties.

We are, again, concerned about the impact the Proposal will have on smaller advisers. As we recently submitted to the Commission,[53] new regulations burden smaller advisers in unique ways and these burdens are only increasing. These considerable costs and burdens also create meaningful barriers to entry for new smaller and emerging businesses, and increase pressure on existing smaller advisers for industry consolidation, thereby reducing competition and the investment choices available to investors.

Smaller advisers typically lack the internal infrastructure of larger firms. They have fewer resources to spend, limited leverage to access the services of and negotiate terms with third parties and service providers, and very little ability to recognize savings through in-house leveraging of resources or scaling. They have a limited number of personnel, many of whom perform multiple functions within the adviser, and face increasing challenges attracting and retaining qualified personnel, including for compliance roles. As a result of these constraints and

[53] *See IAA Petitions SEC to More Accurately Consider Impact of Regulations on Smaller Advisers* (Sept. 14, 2023), available at https://investmentadviser.org/resources/iaa-petitions-sec-to-more-accurately-consider-impact-of-regulations-on-smaller-advisers/ (**IAA Petition**).

limited resources, smaller advisers face significant challenges to address ever increasing regulatory burdens. Smaller advisers today are required to meet governance, operational, data management, security, and compliance demands at an unprecedented level. In fact, the very technologies the Proposal would restrict can be used by smaller advisers to minimize these burdens and restraints and increase efficiencies and lower costs that ultimately benefit their clients.

Moreover, the IAA has urged the Commission to consider proposed regulations holistically and to assess the cumulative impact of regulations, both existing and proposed.[54] Thus, the Commission should not limit its economic assessment to this particular Proposal. Rather, it should consider the cumulative costs, including costs associated with the unprecedented pace of recently adopted and proposed regulations. The Commission should also consider and propose alternative approaches to balance the costs and potential benefits more appropriately. In general, the Commission should undertake a more expansive, accurate, and quantifiable assessment of the specific costs, burdens, and economic effects that would be placed on advisers to implement the Proposal.[55]

VII. The Commission does not have the authority to promulgate the Proposal under Section 211(h) of the Advisers Act.

The Commission relies on Section 211(h) of the Advisers Act, which was added by Section 913(g) of the Dodd-Frank Act, as the basis of its authority for the Proposal. Section 211(h)(2) gives the Commission the authority to "examine and where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors." We do not believe, however, that Section 211(h) gives the Commission the authority for the Proposal.

Neither the rules of statutory construction nor the legislative history[56] support reading Section 211(h), which is titled "Other Matters," as granting the Commission the authority to disregard its context by ignoring the rest of Section 913(g). The "other matters" must be related to its context. Section 211(h) is one part of a broader amendment to the Advisers Act that was designed to harmonize the investment adviser and broker-dealer standards of conduct when providing personalized investment advice to retail clients/customers. It is clear from the text and context of Section 913(g) and its legislative history that Congress was contemplating its

[54] *See* Adviser Proposals Letter.

[55] *See* IAA Petition.

[56] Dodd-Frank Wall Street Reform and Consumer Protection Act, Conf. Rept. 111-517, 111th Cong., 2d Sess. (2010) (**Dodd-Frank Conference Report**).

application to retail investors only.[57] Section 913(g) also makes clear that Congress did not intend for the Commission to apply any new rules to investors in private funds.[58]

Moreover, Section 211(h) does not authorize the Commission to create a completely new definition of "conflict of interest" under Section 211(h), especially one that substantially differs from the long-established understanding of what that term meant at the time, and as it is used in Section 211(g). There is no indication that Congress intended for the same term in the same statutory provision (Section 913(g)) to be read to mean different things. In addition, the legislative history demonstrates that, in using the term "conflicts of interest," Congress had certain types of conflicts in mind, such as sales contests, quotas, and proprietary trading. It did not intend to provide the Commission with unlimited authority to reimagine what a conflict of interest means.

Finally, Section 211(h) does not support the creation of an entirely new regulatory framework for addressing conflicts, especially one as broad as has been proposed. As discussed above, the breadth of the definitions of "conflict of interest," "covered technology," and "investor interaction" make it difficult to discern their limits. Had Congress intended to grant such broad discretion to the Commission, it would have made that clear in Section 913(g).

For these reasons, we do not believe that the Proposal is authorized under Section 211(h).

VIII. The Commission should carefully study and gather more information regarding emerging technologies before determining whether additional action is warranted.

For the reasons discussed above, the IAA respectfully requests that the Commission withdraw the Proposal. We are concerned that the impact of the Proposal would be to eliminate many of the benefits that technology offers – both to advisers and to investors – and to stifle innovation. We believe that the Proposal is wholly unnecessary as to conflicts.

To the extent that the Commission's concerns relate to risk governance of emerging technology, we believe that the Proposal is premature. We recommend that instead of pursuing new rulemaking in this area, the Commission carefully study the risks and promise for investors

[57] *See* Dodd-Frank Conference Report at 870, which describes the purpose of Subtitle A of Title IX, which included Section 913, as follows:

> Subtitle A [of Title IX] directs the SEC to study the standards of care applicable to broker-dealers and investment advisers giving investment advice to retail customers, and it authorizes the SEC to promulgate rules imposing a fiduciary duty on broker-dealers and investment advisers to protect retail customers …. Subtitle A also clarifies the authority of the SEC to require investor disclosures before purchase of investment products and services. Finally, the subtitle requires studies on the enhancement of investment adviser examinations, financial literacy, mutual fund advertising, conflicts of interest, improved investor access to information on investment advisers and broker-dealers, and financial planners and the use of financial designations.

[58] *See* Advisers Act Section 211(g)(1) (making clear that "the Commission shall not ascribe a meaning to the term 'customer' that would include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such adviser").

of emerging technology, including artificial intelligence and machine learning. We suggest that the Commission sponsor roundtables and other public events and should publish further requests for information and concept releases that are subject to robust notice and comment. This analysis should focus on how such emerging technologies are covered under the existing regulatory framework. After engaging in this comprehensive study to review these issues, the Commission should determine how best to approach any specific risks that are presented by these emerging technologies that are not effectively addressed by the existing regulatory framework and propose workable solutions that are carefully tailored to fill identified gaps in the least onerous way. However, rulemaking is not necessarily the most effective solution to every policy concern, and may in fact be counterproductive. The Commission and its staff have already demonstrated their ability to provide guidance to promote certain business or compliance practices where it is warranted.[59]

If the Commission determines after a thorough analysis that further action may be warranted, the IAA would be happy to work collaboratively with the Commission to determine the types of guidance relating to the use of predictive data analytics or any emerging concerns associated with the use of AI or machine learning that may be helpful.

*   *   *

[59] For example, the staff of the Division of Investment Management issued a 2017 guidance update that affirmed that digital advisers, like all advisers, are fiduciaries and addressed how digital advisers can meet their suitability, disclosure, and other fiduciary and compliance obligations under the Advisers Act. We understand that advisers generally support the suggested compliance practices in the 2017 Guidance and have considered and incorporated applicable practices into their overall compliance programs. *See* Letter from Gail C. Bernstein, General Counsel, IAA, Comments on Digital Engagement Practices (Oct. 1, 2021), available at https://investmentadviser.org/resources/sec-request-for-comment-on-digital-engagement-practices/ (noting that advisers may consider the 2017 Guidance and have similar procedures regarding digital engagement practices or technology more broadly, including artificial intelligence/machine learning tools). Moreover, advisers have also long looked to analogous guidance from the banking regulators relating to model risk management. *See Supervisory Guidance on Model Risk Management*, OCC 2011-12 (Apr. 4, 2011), available at https://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-12a.pdf.

We appreciate the Commission's consideration of our comments. Please contact the undersigned at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,

/s/ Gail C. Bernstein

Gail C. Bernstein
General Counsel

/s/ Sanjay Lamba

Sanjay Lamba
Associate General Counsel

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