

United States Senate

WASHINGTON, DC 20510

May 24, 2024

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chair Gensler,

We write to express our concerns with the U.S. Securities and Exchange Commission's proposed rule, "Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers" ("the Proposal"). If finalized, we worry the Proposal would harm American innovation and curtail the use of many beneficial technologies, including artificial intelligence (AI), by financial services firms, potentially limiting market access to both retail and institutional investors. Therefore, we request the SEC withdraw the Proposal, and consider re-proposing only after addressing the significant flaws to core elements of the Proposal described below.

Developed over decades, the SEC's existing regulatory framework is technology neutral and gives the SEC ample authority to protect investors from conflicts of interest. Regulation Best Interest and the fiduciary duty imposed on investment advisers already prohibit firms from putting their interests ahead of their customers' interests. Importantly, these obligations apply regardless of whether or not technology is used in making recommendations or providing advice. When there are conflicts of interest associated with a broker-dealer's recommendation or an adviser's advice, the existing regulatory framework requires firms to eliminate or mitigate and disclose such conflicts.

The SEC has demonstrated that it has the authority to take enforcement actions¹ against firms when the use of technology produced advice or recommendations that were not in the best interest of the investor. These actions show that the current regulatory framework provides the SEC ample authority to protect investors from conflicts of interest even as the technologies that broker-dealers and advisers use are rapidly evolving. A recent example includes a \$65.6 million disgorgement after failing to disclose conflicts of interest to clients who could have invested in lower cost mutual funds based on that information.²

The Proposal would upend today's rules by adopting broad definitions of foundational regulatory concepts and a one-size-fits-all approach to addressing conflicts of interest. The Proposal would apply to firms' current and future use of "covered technologies" in "investor interactions." However, the broad definitions of these terms would extend the Proposal's reach to technologies and firm activities far beyond its stated purpose. The scope of "covered technologies" would capture virtually every technology used by firms, including artificial intelligence, formulas in spreadsheets and numerous other basic tools that have been in common use for decades. Similarly, the definition of "investor interaction" would cover almost any communication or engagement with a current or prospective investor. For investment advisers, the Proposal would apply to both retail and institutional investors. Taken together, these definitions

¹ <https://www.sec.gov/news/press-release/2014-289>
<https://www.sec.gov/whistleblower/award-claim/award-claim-2011-16>
<https://www.sec.gov/whistleblower/award-claim/award-claim-2018-96>

² <https://www.sec.gov/litigation/litreleases/lr-24550>
<https://www.law360.com/compliance/articles/1819741/sec-wins-72m-judgment-against-commonwealth-financial>

establish a very broad scope with no clear limit. Firms would need to review almost all technology – regardless of use – and document compliance. This would be extremely challenging and expensive.


In addition, the Proposal would fundamentally redefine conflict of interest. In a departure from the existing framework, under the Proposal a conflict of interest would exist if an interest of the firm is considered when using a covered technology, even if that interest is aligned with the investor’s interest (e.g., providing financial literacy tools in hope of gaining or maintaining investor relationships). Furthermore, the Proposal would require firms to “eliminate or neutralize” potential conflicts with no option to mitigate and disclose. This could significantly impact the tools and products that can be offered, potentially cutting off low cost services to retail investors. Transparency through disclosure remains an important tool to build and gain trust and in the era of artificial intelligence, must be preserved.

A broad and diverse set of stakeholders have raised concerns about the negative impacts the Proposal would have on the current use of and future innovation in technologies. Most recently, the SEC’s Investor Advisory Committee posted a draft of its recommendation on the adoption of the Proposal, which states that the Proposal may “discourage firms from exploring new technologies” by taking “all technology, including tools and technologies that have been used without meaningful concerns for decades,” into “a regulatory realm that is beyond decades of the SEC’s own guidance for investment advisers and broker-dealers.”³

Finally, in general regulatory agencies that implement rules related to the use of data analytics, AI, and other technological tools need to design those rules carefully so that they complement existing rules related to human behavior and narrowly target the specific and unique properties of the technology. New rules that apply existing general standards of conduct to the use of AI systems risk creating a lack of clarity about what rules apply in a given situation.

In summary, technology has significantly increased access for retail investors to our capital markets. These advancements have democratized investing, making it more accessible, efficient, and cost-effective for individuals. Looking to the future, artificial intelligence offers transformative potential for both our capital markets and retail investors by enhancing efficiency, accuracy, and access. Although we recognize there are risks and challenges that the SEC must address as AI evolves, the agency should strive to keep regulation outcome based and aim for technology neutral regulations, except where emerging technology poses unique risks that cannot be adequately addressed by those technology neutral regulations. Based on the concerns outlined, we believe that following robust stakeholder engagement, the SEC should only consider re-proposing after making extensive, material changes to the Proposal.

Sincerely,


M. Michael Rounds
United States Senator


Martin Heinrich
United States Senator


Mike Crapo
United States Senator


Mark Warner
United States Senator

³ Available at, <https://www.sec.gov/files/20240214-draft-recommendation-use-dep.pdf>