

MEMO# 35431

September 12, 2023

ICI and Other Trade Associations File Letter on SEC's Predictive Data Analysis Proposal

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TO: ICI Members
Investment Company Directors
Broker/Dealer Advisory Committee
Chief Compliance Officer Committee
Investment Adviser and Broker-Dealer Standards of Conduct Working Group
Investment Advisers Committee
Operations Committee
Retail SMA Advisory Committee
SEC Rules Committee
Small Funds Committee SUBJECTS: Compensation/Remuneration
Compliance
Disclosure
Fees and Expenses
Investment Advisers
Operations RE: ICI and Other Trade Associations File Letter on SEC's Predictive Data Analysis Proposal

On September 11, 2023, ICI, along with 13 other trade associations, filed a letter with the Securities and Exchange Commission (SEC or "Commission") raising serious concerns regarding the Commission's recent proposal on conflicts of interest associated with the use of predictive data analytics by broker-dealers and investment advisers ("Proposal").[\[1\]](#)

The letter requests that the Commission withdraw the Proposal because it is unnecessary, inadequately reasoned, and fatally flawed. The letter is attached, and the key points are summarized briefly below.

First, the letter argues that the Proposal illustrates the Commission's continued war on technology. The letter explains that broker-dealers and investment advisers, regardless of their size, rely on technology to deliver better outcomes and innovative, cost-efficient products and services to their customers or clients, to the benefit of investors who now have greater access to more products at lower costs. The Commission only superficially

recognizes these benefits in the Proposal, however, and the onerous and, in some cases operationally unfeasible, requirements in the Proposal would likely make firms opt out of deploying technological innovations. This will harm competition in the markets and the investors the Commission seeks to protect.

Second, the letter explains that the Commission lacks statutory authority to adopt the proposed rules. The Commission relies on Sections 211(h) of the Investment Advisers Act of 1940 and 15(l) of the Securities Exchange Act of 1934 (the "Exchange Act") as sources of authority for the extraordinarily broad Proposal. These sections were enacted in the context of a Dodd-Frank Act provision focused on harmonizing standards of conduct between broker-dealers and investment advisers when providing advice to retail customers. They were not intended to regulate any activity of a broker-dealer or adviser. The letter urges the SEC to not promulgate rules under these provisions, especially while a lawsuit is currently pending challenging the Commission's statutory authority under Section 211(h) to adopt the recent private fund adviser rulemaking.

Third, the letter asserts that the proposed rules are another example of the SEC issuing rules that do not account for the implications of interconnections and dependencies.^[2] The letter explains that the Commission's separation of interconnected rules proposals in time and analysis renders the comment process deficient for purposes of the APA and may cause harm to investors and the markets.

Fourth, the letter explains that the Proposal conflicts with, and potentially overrides without appropriate notice and comment under the APA, certain of the Commission's current regulations (some of which were recently adopted) including Regulation Best Interest ("Reg BI") and the Commission's Final Interpretation of the Investment Advisers Fiduciary Duty (collectively, the "Standards of Conduct"), the Investment Adviser Marketing Rule (the "Marketing Rule"), and the regulatory framework around soft dollars and securities lending. For example, the Proposal would eliminate the ability of firms to meet their best interest obligations to investors, under the Standards of Conduct, by disclosing or mitigating conflicts, as appropriate. The SEC does not explain why the Standards of Conduct do not apply to conflicts of interest presented in the use of covered technologies and why such a standard is not sufficient to address the concerns noted in the Proposal. The Proposal also conflicts with, and potentially overrides, the SEC's recently finalized marketing rule for investment advisers and would potentially conflict with statutory provisions, such as Section 28(e) of the Exchange Act, although the SEC cannot, through rulemaking, override securities law statutes.

Finally, the letter explains that, due to the sweepingly broad scope of the Proposal and its onerous compliance requirements, compliance with its obligations would be challenging at best, and impossible at worst. Given the breadth of the Proposal, it is unclear whether an investment adviser or broker-dealer would ever be able to service an investor. The letter notes that the Commission has acknowledged 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 . . ." but goes on to state 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." The letter asks how the Commission can propose rules it acknowledges are "difficult or impossible" to comply with.

The letter concludes by urging the Commission to withdraw the Proposal and engage with market participants to better understand the use of technology by firms and how firms

holistically handle conflicts of interest to determine the necessity of further regulation in this area. In the guise of addressing speculative concerns relating to predictive data analytics, the Commission would dramatically change how advisers and broker-dealers interact with investors. The letter notes that the Commission's proposed imposition of onerous requirements on advisers' and broker-dealers' use of technology to run their day-to-day businesses and better serve investors will only serve to harm the very investors the Commission purports to help.

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Notes

[1] For a summary of the Proposal, please see ICI Memorandum No. 35390 (Aug. 2, 2023), available at <https://www.ici.org/memo35390>. ICI also plans to submit our own comment letter on the Proposal, which we expect to file on October 10, the SEC's comment deadline.

[2] ICI recently filed a letter with the SEC noting that it has issued a wide range of interconnected rule proposals over the last two-and-a-half years but, in violation of the Administrative Procedure Act (APA), has failed to consider and analyze the interconnected rules holistically. See ICI Memorandum No. 35420 (Aug. 24, 2023), available at <https://www.ici.org/memo35420>.

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