The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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ICI Fatal Flaw Draft Letter on SEC Proposal Regarding Conflicts of Interest Raised by Broker-Dealers' and Advisers' Use of Predictive Data Analytics – Your Final Comments Requested by Thursday, October 5

[35467]

October 02, 2023

TO: Investment Adviser and Broker-Dealer Standards of Conduct Working Group
Retail SMA Advisory Committee
SEC Rules Committee RE: ICI Fatal Flaw Draft Letter on SEC Proposal Regarding Conflicts of Interest Raised by Broker-Dealers' and Advisers' Use of Predictive Data Analytics - Your Final Comments Requested by Thursday, October 5

Thank you for your comments on our draft letter to the SEC on its proposal regarding conflicts of interest associated with the use of "covered technologies" by investment advisers and broker-dealers ("Proposal").[1]

We have attached a revised, fatal flaw draft of the letter that reflects your comments. The revised draft is summarized below. Please provide your final written comments on this draft to Sarah Bessin (sarah.bessin@ici.org) and Mitra Surrell (mitra.surrell@ici.org) no later than this Thursday, October 5. We apologize for the short deadline, but comments are due to the SEC on October 10, and we need time to incorporate any final comments.

ICI's letter urges the SEC to abandon these flawed rules. The Proposed Rules are unnecessary and would have detrimental consequences for the very investors the SEC seeks to protect. While focusing on the purportedly unique risks raised by investment advisers' and broker-dealers' use of certain technologies, the Proposed Rules would fundamentally change well-established legal principles that govern how firms' and their representatives' conflicts of interest must be addressed. The Proposed Rules raise constitutional issues by unduly restricting firms' ability to communicate with investors. The Commission has not adequately demonstrated the existence of a problem that would justify such a radical change in regulation, nor has it provided sufficient public notice of its intent

to do so. Furthermore, the Proposal exceeds the Commission's statutory authority and violates the Administrative Procedure Act (APA) and the Commission's rulemaking obligations under the securities laws. The Commission has failed to adequately analyze the tremendous costs of this vague, flawed, and wide-ranging proposal for market participants and investors, which would outweigh any potential benefits. We note that members of Congress recently raised similar concerns regarding the Commission's basis and authority for issuing the Proposed Rules.

The letter explains that the SEC should promptly withdraw the Proposed Rules for the following reasons:

- The Commission has provided no basis or evidence that the Proposed Rules are needed. The Proposed Rules are confusing, unworkable, overreaching, and would harm the very investors the Commission seeks to protect by stifling innovation, restricting financial education, and effectively limiting investors' ability to access, through technology, affordable advice and investment products;
- Existing Standards of Conduct for advisers and broker-dealers are appropriate to address any concerns the SEC may have regarding conflicts of interest raised by new technologies, as discussed in Appendix A;
- The Proposed Rules violate the First Amendment by unduly limiting, without adequate justification, how firms can communicate with investors and potential investors;
- The Proposed Rules exceed the Commission's statutory authority; and
- The Proposal violates the APA and the Commission's statutory duty to consider effects on efficiency, competition, and capital formation in rulemaking. While the Proposal focuses on potential concerns raised by new technologies, the Proposed Rules would broadly change existing regulation without adequate explanation or appropriate notice and comment. As discussed in Appendix C, the rules are arbitrary and capricious. The Commission's economic analysis is fundamentally flawed, as it does not identify or analyze the costs and benefits of such a radical change to existing legal standards. By not identifying and analyzing the extensive implications of the Proposed Rules for existing regulations applicable to firms and, more broadly, for how firms use technology in their day-to-day businesses and to interact with investors, the Commission fails to adequately identify or consider the Proposal's costs and burdens, which overwhelmingly outweigh any potential benefits.

ICI's letter explains that existing Standards of Conduct include well-developed principles for addressing conflicts of interest that can be readily tailored to new technologies and other market developments. The Commission should seek to promote a regulatory environment that encourages technological innovation that benefits investors and markets, rather than proposing rules that would have a severely chilling effect on technological innovation and are harmful to the investors and markets. The Commission therefore should first obtain additional industry feedback through roundtables and other opportunities for public input, carefully identify any existing problems that may need to be addressed, and tailor a solution proportionate to any concerns it identifies. Further, the Commission should consider holistically the implications of the Proposal in combination with those of its other proposed and existing rules.

ICI's comments focus on the Proposed Rules' implications for (i) registered investment advisers, in their capacity as advisers to registered investment companies and separately managed accounts; (ii) registered investment companies, including mutual funds, exchange-traded funds, and closed-end funds (together, "funds") and their investors; and (iii) registered broker-dealers that sell fund shares. Our perspective reflects the important

role each of these entities plays in helping retail investors achieve their investment goals.

Key changes in the fatal flaw draft from the last draft of the letter include:

- Changes made at the suggestion of our outside counsel, Gene Scalia, at Gibson, Dunn & Crutcher, on the constitutional, statutory, and APA arguments.
- Revisions to Appendix A and creation of a new Appendix B by our outside counsel, Brian Baltz, at Willkie, Farr & Gallagher, regarding existing standards of conduct for investment advisers and broker-dealers, how the Proposed Rules deviate from existing standards, and other SEC and SRO rules that address conflicts of interest.
- Modifying language throughout the letter to be more measured.
- Including examples provided by members throughout the letter.
- Improving the organization of the letter and making other changes intended to make it more effective.

Our final letter will also include an Appendix C, which will be an economic analysis of the Proposal prepared by ICI's Research Department.

Sarah A. Bessin
Deputy General Counsel - Markets, SMAs & CITs

Mitra Surrell
Associate General Counsel, Markets, SMAs, & CITs

Notes

[1] Proposed rules 15l-2 under the Securities Exchange Act of 1934 ("Exchange Act") applicable to broker-dealers and 211(h)(2)-4 under the Investment Advisers Act of 1940 ("Advisers Act") applicable to registered investment advisers (together, the "Proposed Rules") would require firms to evaluate their use of predictive data analytics and other covered technologies in connection with investor interactions and to eliminate or "neutralize" certain conflicts of interest associated with such use. The Commission also proposes amendments to rules under the Exchange Act and Advisers Act that would require firms to make and maintain certain records in accordance with the Proposed Rules. For a summary of the Proposal, please see ICI Memorandum No. 35390 (Aug. 2, 2023), available at https://www.ici.org/memo35390.