

MEMO# 35589

January 22, 2024

SEC Investment Advisory Committee Discussion on Recommendation regarding Digital Engagement Practices

[35589]

January 21, 2024

TO: Broker/Dealer Advisory Committee

Investment Adviser and Broker-Dealer Standards of Conduct Working Group

Investment Advisers Committee

Retail SMA Advisory Committee

SEC Rules Committee SUBJECTS: Advertising

Compensation/Remuneration

Compliance

Disclosure

Distribution

Fees and Expenses

Intermediary Oversight

Operations

Recordkeeping

Technology & Business Continuity RE: SEC Investment Advisory Committee Discussion on Recommendation regarding Digital Engagement Practices

The SEC's Investor Advisory Committee ("IAC") held a meeting on December 7, 2023^[1] which featured a discussion on draft recommendations regarding digital engagement practices ("DEPs"), including the SEC's predictive data analytics ("PDA") rule proposal ("the Proposal").^[2] The IAC's draft recommendation suggested that rather than adopting new rules, the Commission rely on existing regulations and principles with necessary modifications sufficient to address issues identified with DEPs.

The IAC reviewed, but did not vote on, its draft recommendations and will likely revise them before a planned vote at the committee's March 7 meeting.^[3]

While the IAC acknowledged potential issues with the use of DEPs, the IAC's draft recommendation reflected a concern that certain aspects of the Proposal may have the unintended consequence of harming the very investors the Proposal is intended to protect. The draft recommendation warned that the Proposal is overly broad and emphasized that it would curtail access to valuable information, tools, and assistance and could impede the

adoption of new, beneficial technologies. The IAC also expressed concern that the Proposal would impose many rigorous and prescriptive requirements on a limitless range of technologies and investor interactions and includes an unworkable definition of conflict of interest.

The IAC provided the following draft recommendations for the Commission:

- Narrow the scope of the proposed new rules to target the unique risk of PDA and artificial intelligence ("AI") as described in the Proposal and limit the Proposal's scope only to covered technologies that are opaque and complex and involve interactions directly with investors or assist those interactions with investors.
- Rather than create a separate parallel standard of conduct for addressing conflicts of interest when using technology, build upon the existing regulatory framework (Regulation Best Interest ("Reg BI") and the Adviser Fiduciary Standard Interpretation) which rely on settled law and require firms to "eliminate, mitigate or disclose conflicts of interest." Any new rulemaking should recognize that for certain inherently opaque and complex PDA and AI technologies, disclosure is not sufficient.
- Rely on existing regulations and principles to improve the oversight of DEPs by clarifying the definition of what constitutes a recommendation. For example, DEPs that encourage trading should be deemed to be recommendations for purposes of Reg BI. However, significantly the IAC noted educational or informational DEPs should not be deemed recommendations and that many DEPs employed by firms are valuable tools that can help investors make more informed decisions.
- The SEC and FINRA ("Financial Industry Regulatory Authority") should promote investor education through the use of DEPs.
- The SEC and FINRA should bring the full weight of their enforcement authority against DEPs that are determined to be abusive, misleading, and manipulative.

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

Cooper D'Anton
Legal Intern

Notes

[1] The SEC Investor Advisory Committee meeting agenda for December 7, 2023 is available at <https://www.sec.gov/advocate/iac120723-agenda>. More information about the Committee is available at <https://www.sec.gov/spotlight/investor-advisory-committee.shtml>.

[2] For a summary of the Proposal, see ICI Memorandum No. 35390 (Aug. 2, 2023), available at <https://www.ici.org/memo35390>. ICI submitted a comment letter to the SEC on October 10 urging the Commission to withdraw the Proposal, citing detriment to retail investors, constitutional and process concerns, failure to identify a problem, and lack of statutory authority. See Comment Letter to Ms. Vanessa A. Countryman, Secretary, SEC, from Susan Olson, General Counsel, and Sarah Bessin, Deputy General Counsel, Investment Company Institute (October 10, 2023), available at

<https://www.sec.gov/comments/s7-12-23/s71223-271119-653822.pdf>. ICI also circulated a memorandum to ICI members confirming submission and outlining the comment letter. See ICI Memorandum No. 35484 (October 10, 2023), available at <https://www.ici.org/memo35484>.

[3] The SEC Investor Advisory Committee 2024 tentative meeting schedule is available at <https://www.sec.gov/about/advisory-committees/investor-advisory-committee/investor-advisory-committee-schedule>.

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