

MEMO# 35660

March 27, 2024

SEC Investment Advisory Committee Discussion on Recommendation regarding Digital Engagement Practices

[35660]

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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 RE: SEC Investment Advisory Committee Discussion on
Recommendation regarding Digital Engagement Practices

The SEC's Investor Advisory Committee ("IAC") held a meeting on March 7, 2024^[1] which featured a continued discussion on the draft recommendations of its Disclosure Subcommittee (the "Subcommittee") regarding digital engagement practices ("DEPs"), including the SEC's predictive data analytics ("PDA") rule proposal (the "Proposal").^[2] The IAC had previously met on December 7, 2023 to discuss the draft recommendations on DEPs and the Proposal, however, did not vote on the draft recommendations at that time in order to further consider revisions to the recommendations.^[3] The revised recommendations, like the prior draft, suggest that the Commission significantly narrow the scope of the Proposal to the unique risks posed by artificial intelligence ("AI") and PDA to both avoid unintended consequences and to better align it with existing regulations and guidance. The IAC voted to approve the revised recommendations.

Similar to the previous draft, the revised recommendations acknowledge potential issues with the use of DEPs and AI. Nevertheless, the revised recommendations maintain a concern that certain aspects of the Proposal are overly broad and may have the unintended consequence of harming the very investors the Proposal is intended to protect by limiting investor choice and resulting in investors losing access to some benefits of the securities markets. The revised recommendations continue to emphasize that the Proposal would curtail access to valuable information, tools, and assistance and could impede the adoption of new, beneficial technologies. The Subcommittee also remains concerned 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.

In a change from the prior draft, the Subcommittee revised the "IAC Views on the PDA

Proposal" to reflect a position that the proposed PDA rules, if narrowed per the IAC recommendations, would be consistent with the existing standards of conduct under Regulation Best Interest ("Reg BI") and the Adviser Fiduciary Standard Interpretation.

Largely unchanged from the December draft, IAC provided the following recommendations for the Commission:

- Narrow the scope of the proposed new rules to target the unique risk of PDA and AI as described in the Proposal and limit the Proposal's scope only to covered technologies that involve interactions directly with investors or assist those interactions with investors.
- Build upon the existing regulatory framework (Reg BI and the Adviser Fiduciary Standard Interpretation) which requires 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. According to the Reg BI adopting release, a factor in determining whether a recommendation has taken place is whether a communication could be viewed as a call to action. The IAC believes that DEPs designed primarily to increase interaction with an application or platform, to encourage frequent trading, to engage in particular trading strategies, or to open particular types of accounts should be deemed communications that may reasonably be viewed as a call to action. 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 the Financial Industry Regulatory Authority ("FINRA") should bring the full weight of their enforcement authority against DEPs that are determined to be abusive, misleading, and manipulative.
- The SEC and FINRA should promote investor education in connection with the use of DEPs.

The IAC discussion at the March 7th meeting also highlighted the recommendations' tone and drafting process. An IAC member clarified that the Committee does not recommend abandoning the Proposal and that while the Subcommittee toned down what were characterized as overstatements in the recommendations, the Subcommittee left the recommendations virtually the same since their December meeting. It was noted that the current recommendations reflect the final conclusion of discussions that occurred after the previous IAC meeting in December and insisted that any changes were driven by internal IAC discussions and feedback, not external input. At the March meeting, four IAC members spoke in favor of the recommendations and two IAC members expressed their opposition to the recommendations.

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

Cooper D'Anton
Legal Intern

Notes

[1] The SEC Investor Advisory Committee meeting agenda for March 7, 2024 is available at <https://www.sec.gov/advocate/iac030724-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] See ICI Memorandum No. 35589 (January 21, 2024), available at <https://www.ici.org/memo35589>.

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