Securities Regulation Daily Wrap Up, BROKER-DEALERS—Better Markets previews upcoming public comment letter on SEC's PDA proposal, (Oct 6, 2023)

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The group said that even if firms don't put their interests ahead of clients' interests, bias in data sets could still influence investor choices.

Better Markets issued a new FAQ on the SEC's proposed predictive data analytics (PDA) regulation that previews its forthcoming full comment letter on the proposal. The FAQ highlights concerns the group has about how PDA can be used by investment firms to disadvantage clients, but also how, even if a firm does not put its interests ahead of clients' interests, bias in data sets might still influence investors choices. The Better Markets FAQ comes just a few days before the October 10, 2023 close of the public comment period on the SEC's PDA proposal and follows early opposition to the rule from numerous industry groups.

"Conflicts of interest lie at the heart of many types of investor abuse in the financial markets, and today we are seeing the emergence of a new breed, based on technological advances," said Stephen Hall, Legal Director and Securities Specialist at Better Markets in a press release. "Increasingly sophisticated technologies can be touted as offering state of the art financial advice, yet they can also cause harm on a broad scale by influencing investors to trade in ways that enrich the firm but lead to inferior results for investors. The proposed rule represents a vitally important step to combat the specific risks that these technologies pose to investors, now and in the future."

Proposal as first step. Better Markets issued the FAQ as a preview of its forthcoming public comment on the SEC's PDA proposal. While the group sees PDA technologies as making it more efficient to link investing opportunities to investors' preferences, profiles, and risk tolerances, the group also suggested that there remain risks from PDA technologies that the SEC may need address over the long run. Such risks could involve bias in data sets that may impact clients of brokers and advisers, even if the bias is of a type that does not put the broker's or adviser's interests ahead of their clients' interests.

Moreover, Better Markets suggested how its forthcoming comment letter may attempt to debunk arguments the group foresees industry groups making in their comments on the proposal. For one, Better Markets sees potential harm if PDA can "nudge" clients to trade more frequently than they otherwise would trade.

According to Better Markets, the SEC's proposed PDA rule would not bar firms from using PDA technologies. Instead, the proposed rule, said the group, appropriately concludes that disclosure alone would be insufficient and that the proposed eliminate or neutralize approach to conflicts is the best approach. For example, Better Markets said that the eliminate or neutralize approach could help to prevent younger investors from being nudged by investment firms.

Better Markets also urged the SEC not to be swayed by claims from industry groups that the proposed rule would sweep too broadly or impose too onerous burdens on investment firms. The group said the proposed rule is limited to predictive technologies and would not apply to just any algorithm or model. The group also said the proposal would use the SEC's existing authorities.

Early industry comments. Perhaps the most strident opposition to the PDA proposal thus far has come from a fourteen-member group of broker-dealers and investment advisers who urged the Commission to withdraw the PDA proposal. The groups said the proposed rules would sweep too broadly, may conflict with other existing rules, would add to a complex of interrelated rulemakings, and should be paused at least until the Fifth Circuit decides a petition for review of another rulemaking that invoked similar SEC authorities. The Commission's proposal, said the groups, contributes to what they characterized as a "War on Technology."

The National Bankers Association urged the SEC to reconsider the PDA proposal because of its broadly defined terms, which could reach technologies beyond AI. The NBA said that regulators had failed Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs), of which MDIs are a particular focus of the NBA.

With respect to the SEC's PDA proposal, the NBA said, "We believe the proposed rule would not only limit potential avenues for the expansion of services to the communities serviced by MDIs but has the real potential to turn back the clock and threaten future innovations that drive financial inclusion."

A letter submitted by 20 House Republicans and two Republican Senators cautioned the SEC that its PDA regulation may require additional Congressional authority, albeit without specifically mentioning the Supreme Courts decision in *West Virginia v. EPA* regarding the major questions doctrine. The members of Congress added: "Regulations should be technology-neutral to promote innovation and efficiency in capital markets. A reduction in innovation could result in less orderly and efficient capital markets, increased complexity, higher costs for retail investors, and a decline in retail investor participation."

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