

Securities Regulation Daily Wrap Up, BROKER-DEALERS—Commissioners disagree over emphasis in IAC’s draft recommendation on digital engagement practices, (Dec 8, 2023)

By [Mark S. Nelson, J.D.](#)

The IAC appeared to take a position closely aligned with industry comments that the SEC’s predictive analytics proposal sweeps too broadly.

The SEC’s Investor Advisory Committee recently met to consider a draft recommendation on digital engagement practices (DEPs). The committee recommended that the Commission seek to narrow a predictive data analytics (PDA) proposal that would address DEPs and DPAs, some of which incorporate artificial intelligence (AI), because the proposal’s key definitions may sweep too far and, thus, could limit investor choices if the PDA regulation were adopted. Three commissioners who attended the IAC meeting differed in public statements over whether the IAC’s [draft recommendation](#) adequately considered retail investors’ concerns.

IAC’s draft recommendation. The IAC surveyed the landscape for DEPs and PDAs over the past several years and reached some conclusions about whether the Commission should pursue the [PDA proposal](#) as drafted and whether existing regulations, such as Regulation Best Interest (BI) could help alleviate some of the problems posed by DEPs.

With respect to the Commission’s DPA proposal, the IAC noted that the terms “covered technology” and “investor interaction” sweep broadly and could include virtually all technologies and far more interactions with customers than is necessary to address the specific problems. A regulation that is overly prescriptive, said the IAC draft recommendation, could diminish the products and services available to investors.

The IAC also focused on the PDA proposal’s conflicts resolution approach, which requires the elimination or neutralization of the effect of conflicts, subject to some comparatively narrow exceptions. The IAC also observed that the PDA proposal does not limit its conception of a conflict to only those that are material. The IAC instead suggested that Regulation BI’s fully and fairly disclose approach coupled with that regulation’s mitigate or eliminate requirement would better serve investors in the DEP/PDA context.

As a result, the IAC draft recommended that the SEC staff narrow the PDA proposal to address PDAs and AI technologies that interact directly with investors.

The second portion of the IAC’s draft recommendation dealt with how best to leverage existing SEC regulations that can apply to DEPs and PDAs. Here, the IAC suggested that the modification of some existing rules might suffice. For example, the SEC could clarify “covered technologies” in the PDA proposal and further clarify what counts as a “recommendation” under Regulation BI. However, the IAC made clear that certain behaviors of broker-dealers and investment advisers should be deemed to be recommendations, such as DEPs that encourage trading.

Commissioner statements. Only three of the SEC’s five commissioners commented publicly about the IAC’s draft views on the PDA proposal. Thus far, industry comments on the PDA proposal have largely mirrored those of the IAC. The three commissioners who spoke were divided along the industry/IAC critique and the view that newer technologies must be more closely regulated.

Commissioner Jaime Lizarraga, for example, agreed that the IAC aptly described the problems that newer technologies pose to retail investors, but he [disagreed](#) with the IAC’s focus on the firm perspective when, in his view, the IAC should have given greater weight to the views of retail investors.

“That said,” Lizarraga stated, “the Subcommittee then pivots towards an extensive focus on the perspective of firms

and takes a substantial leap to assert, without much substantive basis, that the Commission's rule is 'far-reaching' with 'potential adverse impact on investors if adopted.'" Lizarraga added: "I question these assertions. To me, the Commission's proposal addresses the challenges highlighted by the IAC head on."

Speaking to the conflict resolution portion of the PDA proposal, SEC Chair Gary Gensler [noted](#) a key similarity between the PDA proposal and Regulation BI—that firms not place their own interests ahead of those of retail investors. "I would note that under those current rules and interpretation, brokers and advisers cannot address these conflicts of interest through disclosure alone," added Gensler. "There still is an obligation to act in an investor's best interest, and not to place the broker or adviser's interests ahead of the investor's interests, even after the conflict has been disclosed."

Commissioner Hester Peirce, however, [echoed](#) some of the themes raised by the IAC. Specifically, Peirce suggested an approach that is more grounded in the SEC's existing rulebook. Said Peirce: "Should we put the rule on hold until we can conduct investor outreach? Would guidance suffice to clarify the application of existing rules to certain digital engagement practices? What would an appropriately narrowed rule look like?"

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