October 5, 2023

VIA ELECTRONIC FILING

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Number S7-12-23
RIN 3235-AN00; 3235-AN14: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

Dear Ms. Countryman:

On behalf of our members, the National Association of Insurance and Financial Advisors ("NAIFA") submits the following comments in response to the *Notice of Proposed Rulemaking on Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers* ("Proposed Rule") and to express support for the comments filed by our fellow trade associations ***sharing the many and diverse concerns we have with this rulemaking.***[1] ***Investment advisers and broker-dealers rely on technology to both directly and indirectly benefit investors by providing efficiencies that reduce costs. The Proposed Rule broadly classifies technology used in connection with investment issues and imposes new burdensome requirements without an analysis of any corresponding benefits of technology. We are writing to emphasize the Proposed Rule's devastating effect on our members and their primary clients: low- and middle-income savers and investors.***

The Securities and Exchange Commission's ("SEC" or the "Commission") failure to undertake, as required by law, a thorough economic or practical analysis of the consequences of this Proposed Rule on the very consumers it purports to protect will lead to a sharp drop-off in the savings and financial planning for low- and middle-income households.[2] ***Given the substantial costs that would be imposed on investment advisers and broker-dealers without any corresponding benefit to investors, we urge the SEC to withdraw the Proposed Rule.***

Founded in 1890 as The National Association of Life Underwriters ("NALU"), NAIFA is the

[1] *See* Comments of American Benefits Council, et. al. (September 19,2023); *see also* Comments of American Council of Life Insurers, et. al. (September 12, 2023).

[2] *See* 15 U.S.C. § 80a-2(c)*; see also Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) ("The Commission also has a 'statutory obligation' to determine as best it can the economic implications of the rule.")

NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS
1000 Wilson Boulevard, Suite 1890, Arlington, Virginia 22209 | 703-770-8100 | www.naifa.org

oldest, largest, and most prestigious association representing the interests of insurance professionals from every Congressional district in the United States. Our mission – to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members – is the reason NAIFA has consistently and resoundingly stood up for agents and called upon members to grow their knowledge while following the highest ethical standards in the industry. In fact, NAIFA members are required to operate under NAIFA's own Code of Ethics, which requires them to work in the best interests of their clients, in addition to the existing federal (including the SEC's Regulation Best Interest ("Reg BI")) and state regulatory frameworks (National Association of Insurance Commissioners ("NAIC") Model Best Interest Regulation).[3]

NAIFA members serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial advisor for multiple counties. Our members' relationships with their clients often span decades and various phases of clients' financial and retirement planning needs. For small business owners, our advisors encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Summary of the Proposed Rule

The Proposed Rule requires broker-dealers and investment advisers to evaluate their use of predictive data analytics ("PDA") and other covered technologies in interactions with investors to identify conflicts of interest and to eliminate or neutralize conflicts that put the interests of the broker-dealer or investment adviser ahead of the investor.

The Proposed Rule's definition of "covered technology" is overly broad and is defined as any "analytical, technological or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts or directs investment-related behaviors or outcomes."[4] The Proposed Rule requires a broker-dealer or investment adviser to evaluate "any use or reasonably foreseeable potential use" of such covered technology in order to identify any conflict of interest.[5]

Even if a covered technology is not used for investment advice or a securities recommendation, the broker-dealer or investment adviser must still evaluate and test the covered technology to determine if a conflict of interest exists.[6] The Proposed Rule includes a similarly broad definition of "conflict of interest" that covers any situation in which the covered technology takes into consideration the interest of the broker-dealer or investment adviser.[7] Accordingly, testing and evaluation of conflicts will be required even if the conflict does not put the interests of the broker-dealer or investment adviser ahead of the investor. If a problematic conflict of interest is found or reasonably should have been found, the broker-dealer or investment adviser must take affirmative steps to "eliminate or neutralize" any such conflict.[8]

---

[3] *See* 17 C.F.R. § 240.15l-1 (Reg BI); *see also* NAIC, *Suitability in Annuity Transactions Model Regulation* (Spring 2020) available at https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf.

[4] Prop. § 240.15l-2(a); *see also* 88 Fed. Reg. 53,960, 54,021 (Aug. 9, 2023).

[5] Prop. § 240.15l-2(b)(1); *see also* 88 Fed. Reg. at 54,022.

[6] *See* Prop. § 240.15l-2(a) (definition of "Investor interaction"); *see also* 88 Fed. Reg. at 54,022.

[7] Prop. § 240.15l-2(a); *see also* 88 Fed. Reg. at 54,021.

[8] Prop. § 240.15l-2(b)(3); *see also* 88 Fed. Reg. at 54,022.

The Proposed Rule Will Impose Significant Costs on Investment Advisers and Broker-Dealers Without Any Identifiable Benefit

The Proposed Rule includes an ongoing testing requirement for investment advisers and broker-dealers of each covered technology prior to its implementation or material modification, and periodically thereafter.[9]

Some investment advisers and broker-dealers will potentially have tens of thousands of covered technologies to test and re-test. A vast number of such technologies raise no conceivable conflict of interest issues, but, under the Proposed Rule, would still need to be tested at a significant cumulative expense. Examples of the beneficial technologies covered by this Proposed Rule include simple programs used by individuals to determine (1) how much money they need in total to retire, (2) how much they need to save annually to achieve their retirement goals, and (3) how much money they can afford to spend annually during retirement. The Proposed Rule would also cover educational efforts, such as programs used to demonstrate to individuals the advantages of saving for retirement. At a time when there is a significant retirement savings gap and pre-retirees are concerned about having enough savings for retirement, this Proposed Rule will harm all forms of savings, without any identifiable benefit.

The Proposed Rule Upends Longstanding Disclosure Practices and is Contrary to the SEC's Recent Guidance

NAIFA strongly believes that modifying the existing regulatory structure to adopt new conflict of interest rules for PDA technology is unnecessary at this time and will hurt the future development of technology that will benefit consumers.

In a stark departure from a touchstone of federal securities law for almost a century, the Proposed Rule does not allow for disclosure to mitigate potential conflicts of interest. Disclosure is a long-standing practice relied upon by broker-dealers and investment advisers and recognized as effective by both regulators and the Supreme Court.[10]

The SEC adopted Reg BI in 2019 to provide strong protections for consumers who engage broker-dealers on a commission basis by requiring all broker-dealers and their registered representatives to always act in their clients' best interest without putting their own interests first. Reg BI went into effect on June 30, 2020, and the SEC, the Financial Industry Regulatory Authority ("FINRA"), and state securities regulators have been actively and aggressively enforcing it. In addition, forty states have now enacted the NAIC model regulation that requires insurance producers to satisfy a best-interest standard that aligns well with Reg BI.

The Proposed Rule's approach is at odds with the SEC's own disclosure framework in Reg BI in which a broker-dealer or investment adviser satisfies the best interest obligation by fully and fairly disclosing conflicts of interest to investors.[11] Instead of relying on simple and clear disclosures, if a broker-dealer or investment adviser uses PDAs or PDA-like technologies, the Proposed Rule requires the broker-dealer or investment adviser to "eliminate or neutralize" the conflict of interest.[12] It is unclear how, for example, digital engagement practices that both encourage a client to trade and generates revenues for the relevant firm could continue to be utilized under Proposed

---

[9] Prop. § 240.15l-2(c)(1); *see also* 88 Fed. Reg. at 54,022.

[10] *See, e.g. SEC v. Capital Gains Bureau*, 375 U.S. 180 (1963).

[11] *See* 17 C.F.R. § 240.15l-1(a)(2)(i).

[12] Prop. § 240.15l-2(b)(3).

Rule. There may be instances where eliminating a conflict, rather than simply disclosing it, could harm an investor. For instance, a broker-dealer may recommend an investment in a company that is also its client, yet based on independent research, facts would indicate it would be an excellent investment. The client should be able to make that investment decision with full disclosure of the conflict.

Reg BI applies only when a broker-dealer makes an investment recommendation and requires broker-dealers to make individualized recommendations in the best interests of customers.[13] The Proposed Rule expands beyond recommendations and applies to all communications, whether or not they are individualized recommendations to specific investors.[14]

Last, the Proposed Rule applies to marketing communications that use technology to target potential investors or retain current investors.[15] This approach conflicts with the SEC's own Marketing Rule and is an expansion beyond the application of Reg BI or the statutory fiduciary duty requirement.[16]

The SEC, in issuing the Proposed Rule, has failed to present any evidence suggesting that this existing comprehensive regulatory framework implemented under Reg BI and the NAIC Model Best Interest Regulation is not effectively working to protect investors. Even if such evidence exists, it is incumbent upon the SEC to consider a thorough economic analysis of the benefits and costs of the Proposed Rule to address any such deficiencies.

The Proposed Rule Fails to Consider a Thorough Analysis of the Economic Impact

The D.C. Circuit Court of Appeals has held that a rule is "arbitrary and capricious" under the Administrative Procedure Act ("APA") "if [the Commission] fails to consider factors it must consider under its organic statute."[17] The Investment Company Act of 1940 ("ICA") requires that when the Commission "engage[s] in rulemaking and is required to consider or determine whether an action is consistent with the public interest [it] shall ... consider ... whether the action will promote efficiency, competition, and capital formation."[18]

The D.C. Circuit Court of Appeals has clearly held that the SEC must examine the economic implications of any rule. In *Business Roundtable v. SEC*, the D.C. Circuit vacated an SEC regulation for failing to consider statutorily required factors of efficiency, competition, and capital formation in part because the SEC "did nothing to estimate and quantify the costs it expected companies to incur" under that regulation.[19] The D.C. Circuit held that:

> Under the APA, we will set aside agency action that is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. . . . We must assure ourselves the agency has examine[d] the relevant data and articulate[d] a satisfactory explanation for its

---

[13] 17 C.F.R. § 240.15l-1(a)(1).

[14] 88 Fed. Reg. at 53, 972. (The scope of the Proposed Rule includes "design elements, features or communications that nudge or prompt, cue, solicit, or influence investment-related behaviors or outcomes from investors.")

[15] *Id*. at 53, 974.

[16] *See* 86 Fed. Reg. 13,024 (Mar 5. 2021) (Investment Adviser Marketing Final Rule).

[17] *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 140 (D.C. Cir 2005) (citing *Public Citizen v. Federal Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004)).

[18] *See* 15 U.S.C. § 80a-2c.

[19] *See Business Roundtable,* 647 F.3d at 1150.

> action including a rational connection between the facts found and the choices made. . . . The Commission also has a statutory obligation to determine as best it can the economic implications of the rule. . . . Indeed, the Commission has a unique obligation to consider the effect of a new rule upon efficiency, competition, and capital formation, . . . and its failure to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation makes promulgation of the rule arbitrary and capricious and not in accordance with law.[20]

NAIFA has carefully reviewed the Proposed Rule's economic analysis and did not find any underlying data or analysis regarding any potential benefits to support the Proposed Rule. In fact, the SEC even admits in the preamble to the Proposed Rule that it has an extensive lack of knowledge and cannot provide an estimate of the benefits to investors of PDA technology:

> Where practicable, the Commission quantifies the likely economic effects of the proposed rules and amendments; however, the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges.[21]

The Proposed Rule's economic analysis is based entirely on speculation:

> We ***preliminarily*** believe the primary benefit of the proposed conflicts rules and proposed recordkeeping amendments would stem from the requirement to eliminate, or neutralize the effect of, conflicts of interest that place the firm or associated person's interest ahead of investors' interests. This requirement ***could enhance investor protection*** by eliminating or neutralizing the effects of certain conflicts of interest. . . . Eliminating, or neutralizing the effect of, conflicts of interest would have two principal competition-related effects. ***First, investors could have greater confidence in interactions with firms using covered technologies, and could therefore be more likely to participate in financial markets.*** Second, when evaluating firms, investors would likely put additional weight on key factors such as advisory, management, or brokerage fees and execution quality. . . . These two effects ***could*** positively affect competition between firms and result in lower fees and higher service quality for investors.[22]

There is no data in the economic analysis to support the Proposed Rule's "preliminary" beliefs. Similarly, there is no justification for what the Proposed Rule says "could" result. NAIFA urges the SEC to identify any shortcomings in the current law and regulatory framework, gather information on whether investors currently lack confidence in or face harm from the use of covered technology, and analyze the potential impact of the Proposed Rule on investor decisions. Without such an analysis, the Proposed Rule only contains vague speculation on any perceived potential benefits while triggering billions of dollars of costs.

The Proposed Rule Recognizes the Costs to Investors but Makes No Effort to Compare the Costs to the Benefits of New Technologies.

The Proposed Rule's economic analysis found that investors could bear substantial costs and lose access to beneficial PDA technology even where there is no conflict of interest that would harm the investor:

> ***Firms might pass the cost of the requirements along to investors through higher fees, commissions, or other methods.*** It is difficult to estimate or quantify how much of these

[20] *Id*. at 1148 (internal quotation marks and citations omitted).

[21] 88 Fed. Reg. at 53,998.

[22] 88 Fed. Red. at 54,006, 54,012 (emphasis added).

> costs firms will end up paying themselves instead of passing on to investors . . . . Some types of AI and machine learning, or a marketing algorithm with a large dataset, could be costly to test or difficult for the firm to assess. In these situations, ***investors would lose the potential benefit of these types of technologies, which could in theory have no conflict of interest*** . . . . The requirements to test and document conflicts related to the use of technologies would not only add costs to firms that use covered technologies in investor interaction, they could also slow down the rate at which firms update existing or develop or adopt new technologies. . . . ***These delays and associated monetary costs could reduce the quality or increase the cost of the technology or service for investors,*** and could reduce the revenues of the firms.[23]

The SEC did not attempt to quantify this cost or compare it to any benefits of the proposal, especially since the Proposed Rule does not contain any analysis of any benefits of PDA technology.

The Proposed Rule Overlooks the Devasting Effect on Low- and Middle-Income Investors.

The SEC failed to consider how the Proposed Rule would likely create a gap in access to professional financial services and advice for low- and middle-income families. Further, the SEC chose to ignore evidence of similar rules promulgated by other agencies, such as the Department of Labor's ("DOL") final rule, Definition of the Term Fiduciary and Conflict of Interest Rule—Retirement Investment Advice ("DOL 2016 Fiduciary Rule") issued in April 2016.[24]

The Proposed Rule is likely to have the same effect as the DOL 2016 Fiduciary Rule, the failure of which is well-documented, and was invalidated by the 5th Circuit as arbitrary and capricious.[25]

Similar to the DOL 2016 Fiduciary Rule, the Proposed Rule puts additional costs on the brokerage model because normal commissions and similar payments are viewed as conflicts of interest. The Proposed Rule will similarly accelerate the trend away from brokerage services and adversely impact small investors who obtain investment advice through the brokerage model. The advisory model is generally only available to larger investment accounts because broker-dealers and investment advisers realistically cannot have a year-round fiduciary duty in exchange for, for example, $60 (1% of a $6,000 account). The advisory model is generally only available to smaller accounts through the use of covered technologies that drive down costs. Unfortunately, the Proposed Rule will discourage the use of technology for smaller accounts under the advisory model. The SEC failed to address the benefits of technology to low- and middle-income investors in the economic analysis of the Proposed Rule.

An SEC rule that discourages the use of technology to provide advisory services to clients will harm low- and middle-income investors' access to sound guidance from professionals. If the brokerage model becomes too costly and risky due to the Proposed Rule, broker-dealers will stop providing services to small accounts. Before it was invalidated, NAIFA members saw firsthand the adverse impact of the 2016 DOL Fiduciary Rule. Similar to this Proposed Rule, the DOL 2016 Fiduciary Rule eliminated consumer support from financial professionals who receive one-time commissions and left only fiduciaries available for those with substantial savings willing to pay ongoing service fees. The DOL 2016 Fiduciary Rule made the brokerage model so expensive and risky that many of our members could no longer serve small accounts. Low- and middle-income

---

[23] 88 Fed. Reg. at 54,010-11 (emphasis added).

[24] 81 Fed. Reg. 20,946 (Apr. 6, 2016).

[25] *See Chamber of Commerce of the U.S. v. U.S. Dep't. of Labor*, 885 F.3d 360 (5th Cir. 2018).

investors generally could not afford to hire a financial adviser subject to the fiduciary standards of the 2016 DOL Fiduciary Rule and, as a result of the rule, were shut out of the market for financial professionals.

The real-world data collected before the 2016 DOL Fiduciary Rule was vacated shows the impact moving to advisory-only services would have on low- and middle-income investors. In 2017, Deloitte studied institutions representing 43 percent of U.S. financial advisers and 27 percent of the retirement savings assets in the market. Deloitte's study found that, as of the 2016 fiduciary rule's first applicability date and before the rule was vacated, 53 percent of study participants reported limiting or eliminating access to brokerage advice for smaller retirement accounts, impacting an estimated 10.2 million accounts and $900 billion in savings.[26] A similar study in 2021, sponsored by the Hispanic Leadership Fund, showed the negative impact of a rule that moves investment advice to an advisory-only model would have in communities of color and found that the racial wealth gap with respect to individual retirement accounts ("IRA") would increase by 20 percent over 10 years if the 2016 DOL Fiduciary Rule is resurrected.[27]

In 2017, shortly after the 2016 DOL Fiduciary Rule was finalized, NAIFA surveyed its members to understand the potential effects of the rule and found that nearly 90 percent of financial professionals believe consumers will pay more for professional advice services, 75 percent have seen or expect to see increases in minimum account balances for the clients they serve, 92 percent said they expected or had already experienced a decrease in commission compensation since the rule went into effect, and 91 percent have already experienced or expect to experience restrictions of product offerings to their clients. We fear that the Proposed Rule will have a similar effect of increasing costs and limiting professional advice services for investors, yet the Proposed Rule does not meaningfully address the issue in its economic analysis.

The Existing Regulatory Framework Already Requires Broker-Dealers and Investment Advisers to Act in their Clients' Best Interest.

We emphasize again that registered representatives of a broker-dealer are already subject to the SEC's Reg BI and that registered investment advisers are already subject to a fiduciary duty under the Investment Advisers Act, which was clarified through guidance issued by the SEC in conjunction with the release of Reg BI.[28] Since becoming effective in 2020, Reg BI has ensured that financial professionals are always acting in the best interest of their client and that the client is aware of any potential conflict through standardized disclosures. These regulatory frameworks already cover the use of technology by broker-dealers and advisers when making recommendations. Importantly, these regulatory frameworks work and allow firms to preserve access to financial advice for all savers – regardless of income level.

The SEC's failure to analyze the Proposed Rule's potentially devastating impact on the ability of low- and middle-income households to save effectively and adequately for present and future

---

[26] *See* Appendix I, Comments of the Securities Industry and Financial Markets Association to RIN 1210-AB82, *Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions* available at https://www.regulations.gov/comment/EBSA-2017-0004-0601.

[27] *See* Hispanic Leadership Fund, *Analysis of the Effects of the 2016 Department of Labor Fiduciary Regulation on Retirement Savings and Estimate of the Effects of Reinstatement* (Nov. 8, 2021) available at https://hispanicleadershipfund.org/wp-content/uploads/2021/11/FINAL_HLF-Quantria_FiduciaryRule_08Nov21.pdf.

[28] *See* 84 FR 33,669 (July 12, 2019) (Commission Interpretation Regarding Standard of Conduct for Investment Advisers); 84 FR 33,681 (July 12, 2019) (Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser).

needs requires the SEC to withdraw this rule as proposed.

Thank you for your consideration of this comment.

Sincerely,

Bryon Holz
President
NAIFA