

## The SEC's Proposed Predictive Data Analytics Rule is Essential to Protect Investors from Conflicts of Interest as Financial Firms Increasingly Use Artificial Intelligence

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The SEC has proposed a [new rule](#) to eliminate certain conflicts of interest associated with the use of predictive data analytics (PDA) and similar technologies that use artificial intelligence (PDA-like technologies) by broker-dealers or investment advisers. The adoption and use of PDA-like technologies can benefit firms and investors by enhancing the efficiency of identifying investment opportunities that match an investor's preferences, profile, and risk tolerances. But the use of this technology can also lead to conflicts that place a firm's interest ahead of investors' interests. That can happen if an algorithm advises or recommends investments that are more profitable for the firm but riskier or more costly to the client or if the dataset underlying the algorithm is biased towards investments more profitable to the firm. It can also happen if firms use PDA-like technologies to nudge investors to trade more frequently on their platforms, or to invest in products that are more profitable for the firm despite exposing investors to higher costs.

The rule the SEC proposed would require that a firm eliminate, or neutralize, any conflicts of interest associated with its use of PDA-like technologies in investor interactions that place the firm's interests ahead of investors' interests. Better Markets strongly supports the proposal. **As the comment period for the [proposed rule](#) comes to a close on October 10, here are some of the issues that we will be highlighting in our comment letter urging the SEC to adopt a strong rule:**

- **The proposed rule is narrowly tailored to address an obvious risk from the use of PDA-like technologies.** There is no question that the use of PDA-like technologies poses a risk of conflicts of interest, as the algorithms that underlie these technologies may lead investors to invest in a way that prioritizes the interest of the firm over the interest of investors. The proposed rule in no way prevents broker-dealers and investment advisers from using these technologies in their interactions with investors; it simply requires that they eliminate or neutralize the conflicts of interest that could arise from the use of these technologies. Broker-dealers and investment advisers should be able to comply with these sensible requirements since they are in control of the PDA-like technologies that they use.
  - **The time to address the risks that these conflicts of interest pose is now.** The use of PDA-like technologies in the financial sector has increased in recent years. The risks arising from the use of these technologies will only grow if left unaddressed.
  - **Demographic shifts in the market make eliminating or neutralizing these conflicts all the more important.** Technological innovations have introduced younger investors



to the market. But the familiarity younger investors have with technology makes them susceptible to PDA-like technologies that deliver electronic nudges to prompt certain investing behaviors. Effective regulation is necessary to prevent financial firms from taking advantage of the faith younger investors place in technology.

- **The proposed rule is right to take the position that disclosure is not sufficient to cure the conflicts of interest.** While it is clear that disclosure plays a foundational role in securities regulation, it is equally clear that disclosure is not an adequate safeguard against conflicts of interest and other abuses. Disclosures of dense and complex information concerning the use of advanced technology to deliver securities recommendations or investment advice are especially unlikely to enable investors to understand the conflicts that may arise from the use of such technology.
- **The Commission must reject industry attempts to characterize the proposed rule as overly broad and burdensome. It is not.** The rule addresses the specific risks to investors from conflicts of interest in the use of PDA-like technologies and prevents broker-dealers and investment advisers from using technology to infect their investor interactions with conflicts.
  - **The proposed rule does not apply to all the technology that a firm uses.** Rather, it applies only to an “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 in an investor interaction.” Thus, it is not sufficient that the technology involves a computational function, algorithm, or model; the technology must predict, guide, forecast, or direct investment-related behaviors or outcomes.
  - **The proposed rule does not exceed the Commission’s authority to regulate the way broker-dealers and investment advisers conduct their business.** The federal securities laws provide the Commission with the authority to “promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.” The proposed rule invokes those provisions to do precisely what they authorize the Commission to do—address conflicts of interest.
  - **The proposed rule does not stifle innovation.** As financial firms have incorporated PDA-like technologies into their investor interactions the risks of resulting conflicts of interest have become apparent. The proposed rule’s only impact on the ability of those firms to use PDA-like technologies is to require that they eliminate any conflicts that result from such use. Firms should not be able to deploy PDA-like technologies that create conflicts of interest under the guise that preventing such conflicts stifles innovation. Broker-dealers and investment advisers should be no more able to provide conflicted recommendations and advice using PDA-like technologies than they can using other more traditional means.

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- **The Commission must treat the proposed rule as only the first step toward effective regulation of the use of PDA-like technologies in the securities markets.**
    - **Conflicts of interest are not the only risk to investors from financial firms' increasing use of PDA-like technologies.** Biases in the dataset used by algorithms—even biases that do not elevate a firm's financial interests—may impact the decisions the algorithms make and produce undesirable outcomes for retail investors. The Commission must take steps to ensure that the algorithms financial firms increasingly use to guide investor behavior do not lead to investor harm.
    - **Few rules currently exist to regulate the way securities professionals use PDA-like technologies.** Absent effective regulation, they may use these technologies to harm investors, not just through conflicts of interest but by causing investors either intentionally or unintentionally to invest in a manner inconsistent with their objectives. The Commission must step into this breach to prevent investor harm.

  


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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buy-side and protect investors and consumers.

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