August 23, 2024

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

Re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (File Number S7-12-23), 88 Fed. Reg. 53960 (Aug. 9, 2023); Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies (File Number S7-04-22), 87 Fed. Reg. 13524 (Mar. 9, 2022); Outsourcing by Investment Advisers (File Number S7-25-22), 87 Fed. Reg. 68816 (Nov. 16, 2022)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rules.[2] We write to emphasize that the Fifth Circuit's recent decision in *National Association of Private Fund Managers v. SEC*, 103 F.4th 1097 (5th Cir. 2024), does not mean that the Commission should withdraw the rule proposals.[3] Any assertion that the rule proposals should be withdrawn in light of the Fifth Circuit's holding in that case is erroneous.

The Fifth Circuit held that neither Section 211(h) nor Section 206(4) of the Investment Advisers Act of 1940 authorized the Commission to adopt rules imposing specific requirements on investment advisers to private funds. But that holding does not mean the Commission cannot regulate investment advisers generally, and it has no impact on the regulation of broker-dealers. And regardless of the ramifications of the Fifth Circuit's holding on the Commission's ability to regulate private funds, there is no question that the Commission retains the authority to adopt rules to protect retail investors from conflicts of interest in their interactions with broker-dealers and

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 88 Fed. Reg. 53,960 (Aug. 9, 2023) (Predictive Data Analytics proposal); 87 Fed. Reg. 13,524 (Mar. 9, 2022) (Cybersecurity proposal); 87 Fed. Reg. 68,816 (Nov. 16, 2022) (Outsourcing proposal).

3 *Cf.* Comment Letter from The National Association of Private Fund Managers et al. re: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers; Outsourcing by Investment Advisers; and Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies (July 9, 2024), https://www.sec.gov/comments/s7-12-23/s71223-489403-1406006.pdf.

investment advisers and to minimize the risks that retail investors face when they entrust broker-dealers and investment advisers with helping them to invest their savings.

Section 211(h) provides that the Commission may "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."[4] Section 206(4) prohibits investment advisers from engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative and provides that the Commission shall, "by rules and regulation define, and prescribe means reasonably designed to prevent, such acts, practices, and course of business as are fraudulent, deceptive, or manipulative."[5] Notwithstanding the Fifth Circuit's decision regarding private fund advisers, these statutory provisions provide ample authority for the Commission to proceed with the proposals.

Predictive Data Analytics

The Fifth Circuit's decision has led commenters to assert that the Commission should withdraw the Predictive Data Analytics rule proposal on the ground that the Commission invoked Section 211(h) as one of the sources of its authority for the proposal, the Fifth Circuit held that Section 211(h) applies only to retail customers, and the Commission therefore does not have the authority to apply the Predictive Data Analytics rule to investment advisers' interactions with clients that are not retail customers.[6] But even if that is so it is no reason for the Commission to withdraw the proposal. The Predictive Data Analytics rule is designed to protect retail investors.

The proposal notes that the "advent and growth of services available on certain digital platforms, such as those offered by online brokerages and robo-advisers, have multiplied the opportunities for retail investors, in particular, to invest and trade in securities."[7] Firms have also increased their use of "behavioral prompts, differential marketing, game-like features . . ., and other design elements or features designed to engage retail investors when using a firm's digital platform."[8] Technological advancements have further allowed firms "to analyze the success of specific features and marketing practices at influencing retail investor behavior."[9] The problem is that these technologies can harm investors by prompting them to enroll in products or services that benefit the firm but may be inconsistent with their investment goals or risk tolerance, by encouraging them to enter into more frequent trades or employ riskier trading strategies that will increase the firm's profit at their expense, or by steering them towards complex and risky securities products inconsistent with their investment objectives or risk profiles.[10] As a result, these

4 15 U.S.C. § 80b-11(h).
5 15 U.S.C. § 80b-6(4).
6 *See* Comment Letter from The National Association of Private Fund Managers et al., supra note 3, at 2.
7 88 Fed. Reg. at 53,963.
8 *Id.* at 53,964.
9 *Id.*
10 *Id.* at 53,967.

technological advancements may "increase investors' costs, undermine investors' performance, or expose investors to unnecessary risks based on their individual investment profile."[11]

All this means that, without "specific oversight obligations" tailored to the specific risks of the use of these technologies, firms may benefit at the expense of investors.[12] The rise in the use of these technologies has therefore made it imperative to "address the standards of conduct applicable to broker-dealers and investment advisers when interacting with retail investors through digital platforms."[13] The Predictive Data Analytics rule proposal is designed to do just that.

It would make no sense to withdraw a rule designed to protect retail investors in light of a decision about a rule designed to regulate private fund advisers. At the least, the Fifth Circuit's decision has no bearing on the Commission's ability to regulate the sales practices, conflicts of interest, and compensation schemes relevant to broker-dealers' interactions with retail customers. It also has no bearing on the Commission's ability to regulate the sales practices, conflicts of interest, and compensation schemes relevant to investment advisers' interactions with retail clients.

It is also not clear that the Commission could not apply the Predictive Data Analytics rule to investment advisers' interactions with clients who are not retail customers. As discussed above, Section 206(4) of the Advisers Act authorizes the Commission to adopt rules to prevent all investment advisers from engaging in fraudulent, manipulative, or deceptive acts, practices, or courses of business. Although the Fifth Circuit held that Section 206(4) did not authorize the private fund advisers rule because the Commission did not explain how the rule would prevent fraud, that does not mean the Commission cannot explain how the Predictive Data Analytics rule would help prevent fraud, including in investment advisers' interactions with non-retail clients.

Cybersecurity

Similarly, Section 206(4) provides a basis for the Commission to apply the Cybersecurity proposal to all investment advisers. The Commission notes that it proposed the requirement that all advisers adopt and implement cybersecurity policies and procedures containing certain elements as a means reasonably designed to prevent fraud.[14] Because "fraudulent activity could result from cybersecurity or data breaches from insiders, such as advisory or fund personnel,"[15] the Commission has explained how the rule would help prevent fraud at all investment advisers.

In any case, there is no reason to withdraw the proposal. Regardless of the impact of the Fifth Circuit's decision on the application of the Cybersecurity proposal to private fund advisers, it has no impact on the application of the proposal to all other advisers, and the proposal is a necessary measure to protect investors' personally identifiable information and funds from cyberattacks, enhance the resiliency of the financial system, and promote investor confidence in

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11 *Id.* at 53,967-68.
12 *Id.* at 53,967.
13 *Id.* at 53,970.
14 87 Fed. Reg. at 13,527 & n.21.
15 *Id.* at 13,527.

our financial markets.[16] The fact that there are no rules that currently require advisers and funds to adopt and implement a comprehensive cybersecurity program poses unnecessary risks to investors and the stability of our financial markets, and the proposal would remedy this situation.[17]

This is especially important as cybersecurity threats continue to increase. The proposal recognizes that "cyber threat actors have grown more sophisticated and may target advisers and funds, putting them at risk of suffering significant financial, operational, legal, and reputational harm."[18] Cybersecurity incidents affecting advisers and funds can also "cause substantial harm to their clients and investors."[19] The Commission issued the proposal because it believed "that clients and investors would be better protected if advisers and funds were required to have policies and procedures that include specific elements to address cybersecurity risks."[20] That remains the case. Private funds aside, the proposal will "enhance investor protection and contribute to financial stability" by making advisers and funds "more resilient to cyberattacks and data breaches."[21]

Outsourcing

There is also no reason to withdraw the Outsourcing proposal. As an initial matter, notwithstanding the Fifth Circuit's decision that Section 206(4) did not authorize the private funds rule because the Commission did not explain the rule's connection to preventing fraud, Section 206(4) again provides a basis for the Commission to apply this proposal to all investment advisers. Outsourcing, as the Commission says, "has the potential to defraud, mislead, or deceive clients."[22]

> For example, outsourcing necessary advisory functions could have a material negative impact on clients, such as: inaccurate pricing and performance information that advisory clients rely on to make decisions about hiring and retaining the adviser and that advisers rely on to calculate advisory fees; compliance gaps that enable fraudulent, deceptive, or manipulative activity by employees and agents of such service providers to occur or continue unaddressed; or poor operational management or risk measurement that leads to client losses.[23]

For this reason, the Commission proposed—as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices, or course of business—making it unlawful for an investment adviser to retain a service provider to perform certain functions

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16 Better Markets, Comment Letter re: Cybersecurity Risk Management for Investment Advisors, Registered Investment Companies, and Business Development Companies (Apr. 11, 2022), https://www.sec.gov/comments/s7-04-22/s70422-20123291-279593.pdf, at 1.

17 *Id.* at 6.

18 87 Fed. Reg. at 13,525.

19 *Id.*

20 *Id.*

21 Better Markets, supra note 16, at 5.

22 87 Fed. Reg. at 68,818.

23 *Id.*

unless the investment adviser conducts certain due diligence and monitoring of the service provider.[24] The Commission has therefore explained how the rule would prevent fraud.[25]

Even if the Fifth Circuit's decision is relevant to the application of the Outsourcing proposal to private fund advisers, it provides no justification for withdrawing the proposal entirely. Because an adviser is a fiduciary, which means it must act in the best interests of its client at all times, it "should be overseeing outsourced functions to ensure the adviser's legal obligations are continuing to be met despite the adviser not performing the functions itself."[26] Outsourcing a function or service "does not change an adviser's obligations under the Advisers Act and the other Federal securities laws."[27] Indeed, it would be a "deceptive sales practice and contrary to the public interest and investor protection for an investment adviser to hold itself out as an investment adviser, but then outsource its functions that are necessary to its provision of advisory services to its clients without taking appropriate steps to ensure that the clients will be provided with the same protections that the adviser must provide under its fiduciary duty and other obligations under the Federal securities laws."[28] So the Commission issued the proposal to "enhance oversight of advisers' outsourced functions" and ensure their compliance with their fiduciary duty.[29] The Fifth Circuit's decision regarding private fund advisers provides no basis for the Commission to decline to impose this enhanced oversight consistent with the fiduciary duty on all other advisers.

Conclusion

We hope these comments are helpful as the Commission finalizes the Proposed Rules.

Sincerely,

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24 *Id.* at 68,821.

25 *See id.* at 68,850 ("Clients and investors would benefit from this minimum and consistent regulatory framework for identifying, mitigating, and managing risks associated with outsourced functions. They would benefit through . . . reduced risk of fraud associated with outsourced functions . . . .").

26 *Id.* at 68,819.

27 *Id.*

28 *Id.*; *cf.* Advisers Act Section 211(h), 15 U.S.C. § 80b-11(h) (authorizing rules prohibiting or restricting investment adviser sales practices that are contrary to the public interest and the protection of investors).

29 87 Fed. Reg. at 68,819.