October 10, 2023

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

RE: Release Nos. 34-97990; IA-6353; File No. S7-12-23; RIN 3235-AN00; 3235-AN14
Proposed Rule: Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers

Ladies and Gentlemen:

Morningstar welcomes the opportunity to comment on the Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers, or Proposed Rule, recently published by the Securities and Exchange Commission, SEC or Commission.[1] Morningstar is a leading provider of independent investment research and has a long history of advocating for transparency in global markets and brings several perspectives to the Proposed Rule. Morningstar's mission is to empower investors to reach their financial goals. Because we offer an extensive line of products for individual investors investing for retirement and other purposes, professional financial advisers, and institutional clients, we have a distinct view on the Proposed Rule's possible effect on the financial advice investors saving for retirement and other goals will receive.

This letter contains: 1) a summary of our views and 2) detailed answers to selected questions posed in the Proposed Rule, attached as Appendix A.

Executive Summary
To assist the Commission in achieving its objectives, we offer the following comments and recommendations:

1. Morningstar appreciates the Commission's concerns about new technology and the potential harms to investors that can come from conflicts of interest present in these technologies; however, the definitions of covered technologies, investor interaction, and conflicts of interest are overly broad making the Proposed Rule require burdensome testing. We believe a rule addressing emerging technologies should be scoped to address those technologies specifically, and we urge the Commission to revisit the requirements, guidance, and enforcement around Regulation Best Interest, or Reg BI, instead of promulgating new definitions and approaches to conflicts of interest.
    - Covered Technology:
        - The definition of "covered technology" is expansive. Rather than addressing emerging concerns from artificial intelligence, it sweeps in many older, well-established, and well-regulated products such as quantitative equity or fund ratings and robo-advice.
        - In fact, many covered technologies use computer algorithms to help firms mitigate, or completely avoid, conflicts of interest a firm or representative may face in making a recommendation.
        - The uniform categorization of all technologies does not account for varying risks and functions across these technologies.
    - Investor Interaction:

[1] SEC. 2023. Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers. https://www.federalregister.gov/documents/2023/08/09/2023-16377/conflicts-of-interest-associated-with-the-use-of-predictive-data-analytics-by-broker-dealers-and (Proposed Rule).

    - The definition of "investor interaction" is overly broad and should distinguish between investor-initiated and institution-initiated interactions.
    - Not all interactions, especially interactions providing objective information, should be considered investor interactions.
  - Conflicts of Interest:
    - The proposed definition of "conflict of interest" lacks clarity regarding how firms can provide services for revenue.
    - Firms already have fiduciary duties and obligations to identify and mitigate conflicts of interest.
    - Reinforcing existing regulations, like Reg BI, regarding what constitutes a recommendation and what conflicts should be mitigated would help address the concerns the Commission raises, while being product neutral.
2. Morningstar strongly recommends the Commission consider exempting the provision of data and information from the current definition of an investor interaction to facilitate access to important investment information.
  - Algorithms and analytical tools, such as quantitative investment ratings, could fall under the definition of covered technologies, but these technologies do not offer a recommendation, and the analysis they provide can be very useful for retail investors.
  - The regulation should be scoped to cover primarily investor interactions that nudge participants to make trades or engage in other activity that constitutes a securities transaction.
3. We encourage the Commission to consider risk assessment as a means to tailor compliance measures to be commensurate with the risk posed by Predictive Data Analytics, or PDA.
  - A one-size-fits-all approach to conflicts of interest from PDA will stifle innovation.
  - Risk assessments can be utilized to determine appropriate compliance measures based on factors like technology complexity, investor exposure, and potential conflict consequences.
  - We believe the Commission should modify the proposal to better embrace adaptability through continuous risk assessments as new PDA technologies emerge.

By adopting these recommendations, the Commission can refine its Proposed Rule to better align with the realities of technology, investor interaction, and conflicts of interest while fostering innovation and enhancing investor protection. These comments and suggestions aim to refine the Proposed Rule, ensuring alignment with industry practices while promoting transparency and investor protection.

I. The proposed definitions are overly inclusive and would require cumbersome testing on existing, regulated services that have served investors for a long time.

Morningstar understands the Commission’s concern that in light of applicable PDA-like technologies, firms may intentionally or unintentionally take their own interest into account when employing PDA, resulting in investor harm. We believe, however, that the definitions of covered technologies, investor interaction, and conflict of interest are all too broad and would result in burdensome testing, discouraging products that have long served investors.

A. Covered Technology

Morningstar views the Commission’s ability to provide specific definitions as integral to the Commission’s opportunity to provide clear guidelines. The Commission defines covered technology as “analytical, technological, or computational functions, algorithms, models, correlation matrices, or similar methods or processes that optimize, predict, guide, forecast, or direct investment-related behaviors or

outcomes in an investor interaction."[2] This definition does not in any way consider the deterministic nature of the technology – compare the case when outputs are essentially predictable and do not change when inputs are entered at different points in time versus when the technology yields a different answer to the same question when asked only a few days apart in time. We recognize the Commission's concern about investors relying on technologies whose outputs could change, particularly in ways that promote conflicts of interest favoring the firm selling services. This definition of covered technology, however, encompasses many products that follow predictable algorithms.

The scope of this definition is wide-ranging, encompassing not only cutting-edge technologies but also well-established products like robo-advisers, managed accounts, and informational tools, such as quantitative ratings. Some of these products provide low-cost adviser services. Other products help provide investors with objective information, such as quantitative ratings, thereby mitigating existing conflicts in the financial industry that do not arise from the use of technology. In particular, quantitative ratings are an objective evaluation based on a rigorous algorithmic methodology of stocks and funds based on financial data, price performance, analyst estimates, and more. These ratings are computed according to predetermined rules based on statistical or mathematical models which would make them covered under the definition.

While the Proposed Rule treats all technologies as having an equal impact, we emphasize that this uniform categorization does not accurately reflect reality. Both the risk posed by the technology and the purpose and function of the technology are relevant to whether it could present conflicts for investors. For instance, correlation matrixes, which are essentially excel spreadsheets with a formula, do not present the same risk as a chatbot. More sophisticated, but similarly, qualitative ratings follow an objective, repeatable algorithm to assess securities.

Some products that the rule presumes have embedded conflicts are actually designed to help firms avoid conflicts. For example, low-cost algorithmic investing through managed accounts and robo-advisers has made asset management accessible to the masses in a way that mitigates conflicts. Specifically, retirement plan providers use managed accounts programmed by third parties precisely to completely avoid conflicts that may arise if the plan provider has a financial interest in recommending one fund over another to retirement plan sponsors.[3]

B. Investor Interaction

The Proposed Rule defines investor interaction as "engaging or communicating with an investor, including by exercising discretion with respect to an investor's account; providing information to an investor; or soliciting an investor."[4] This definition is extremely broad and will include situations where securities transactions or fiduciary obligations do not exist. While Morningstar agrees that the use of covered technologies to solicit an investor could pose conflicts of interest, the portion of the definition covering "providing information" is overly broad.

The SEC should recognize a critical distinction between scenarios in which an investor initiates the interaction with the intent of seeking information from a financial adviser and instances where a financial

---

[2] Proposed Rule, P. 53970.
[3] DOL. 2001. Advisory Opinion 2001-094. https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2001-09a
[4] Proposed Rule, P. 53974.

institution initiates the interaction with the investor. In the first scenario, the investor is seeking out information and providing insight into their needs and interests. Broker-dealers, or BDs, and registered investment advisers, or RIAs, may use this information to supplement their existing knowledge and expertise when providing information to an investor. This situation is different from when the financial institution initiates an interaction, where there is a greater chance that a firm will use game-like prompts or marketing to "nudge" investors to take a particular investment-related action. Nudging may be even more apparent when an institution is initiating a sale; however, providing information sought out by investors is completely different. Providing information can be used for financial education rather than for a sale or than to nudge a particular buy/sell/hold transaction; we agree that nudges that tend to inspire such transactions could be viewed in some cases as a recommendation under Reg BI. Reg BI could also be amended to provide clarity on when these nudges become a recommendation.

Covering all interactions within the Commission's definition would severely impede the ability to provide valuable information to investors, especially when such information is a source of revenue for financial advisers or broker-dealers. This Proposed Rule could effectively render it nearly impossible to educate investors effectively. As an example, automated account support may use a level of chatbot or language learning models to provide answers to questions around a clients account. In these interactions, no attempt to solicit a transaction, recommend a product/service or engage in activity that is generally deemed to be "regulated" may be present. When purely providing information to an investor, it may be difficult to see a conflict, and there are many facets of the industry where this type of interaction is not even considered regulated activity. If the Commission's concern primarily revolves around chatbots, we propose that specific exemptions or demarcations regarding their usage should be delineated. Morningstar suggests that exemptions from this proposal, particularly in the context of providing information, data, and the use of automated learning tools, warrant consideration.

C. Conflicts of Interest

The Proposed Rule states that a conflict of interest arises when "an [investment adviser / broker-dealer] uses a covered technology that takes into consideration an interest of the [investment adviser/broker-dealer], or a natural person who is a person associated with the [investment adviser/broker-dealer]."[5] The Commission proposes the elimination or neutralization of conflicts of interest stemming from certain PDA-like technologies in investor interactions where the firm's interests potentially overshadow those of the investors. This approach is a significant departure from Reg BI, both in terms of definition and approach. Reg BI defines a conflict of interest as "an interest that might incline a broker-dealer, investment adviser, or financial professional—consciously or unconsciously—to make a recommendation or render advice that is not disinterested."[6] Reg BI also requires the disclosure and mitigation of conflicts – not elimination or neutralization.

The proposed definition of conflict of interest is unclear on how an RIA or BD can provide a service for revenue. In any interaction, there exists a mutual exchange of benefits between RIAs, BDs, and investors. Under this Proposed Rule, managed accounts and providing data to investors is included under covered technologies, and such services are provided in exchange for fees. When the transaction is mutually

---

[5] Proposed Rule, P. 54021 & 54023

[6] SEC. 2019. Regulation Best Interest: The Broker-Dealer Standard of Conduct. https://www.federalregister.gov/documents/2019/07/12/2019-12164/regulation-best-interest-the-broker-dealer-standard-of-conduct.

beneficial in this way, it is unclear if the firm is taking into account its “interest” and putting its interest ahead of that of its customers. Therefore, it is essential for the Commission to provide more comprehensive guidance on how firms can demonstrate that investors' interests are given priority while still permitting RIAs and BDs to charge fees for their services. The unintended consequence of this proposal, if adopted, would be to discourage many useful services to investors.

Advisers already have a fiduciary duty to disclose and address all conflicts of interest which might incline them to render advice that is not disinterested. Likewise, broker-dealers are obligated to identify and mitigate conflicts of interest under Reg BI. Under this rule a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest associated with its recommendations to retail customers. Both the SEC and FINRA have implemented measures mandating disclosures and imposing outright prohibitions on certain activities when addressing conflicts of interest. Satisfactory policies and procedures are already in place under SEC Rule 206(4)-7 and FINRA Rule 3120, rendering the Proposed Rule potentially duplicative. SEC Rule 206(4)-7 requires registered advisers to annually review the adequacy and effectiveness of their policies and procedures, while FINRA Rule 3120 requires that broker-dealers maintain a system of policies and procedures subject to annual testing and verification of supervisory controls.

Considering that the identification of conflicts of interest is an inherent component of meeting fiduciary and best interest standards, Morningstar believes that labeling certain conflicts as 'technology conflicts' would have no discernible impact on their importance in fulfilling regulatory obligations and should be avoided. The Proposed Rule only further narrows the means by which firms have to meet their obligations and could have unintended consequences. For example, a firm may attempt to justify its determinations as not in scope of regulatory obligations, such as deeming the conflict associated with selling only funds on which it receives a revenue-share as non-conflict, simply because technology is not implicated, even though selling agreements with fund companies may not align with customer interests. Firms in regulated spaces should already possess adequate knowledge of conflict identification through reports, risk alerts, and other materials released by the SEC and FINRA, including enforcement actions. Instead of expanding the definition of conflicts, Morningstar recommends reinforcing Reg BI to clarify what constitutes a recommendation and give more guidance on when disclosure is not sufficient and mitigation is required.

We recognize the Commission’s concern that in some cases disclosure has not gone far enough and firms should have mitigated conflicts instead of simply disclosing them. We also recognize that in some instances, regular nudges with information and suggestions to take an action via a human or artificial intelligence, or AI, could constitute a recommendation but have not to date been considered as such and so have gone unimpacted by Reg BI. Despite these limitations of Reg BI, we urge the Commission to revisit the requirements, guidance, and enforcement around Reg BI instead of promulgating new definitions and approaches to conflicts of interest.

Conflicts of interest permeate various aspects of an organization's processes and procedures, extending beyond the realm of technology. Purely looking at conflicts in technology that use PDA or other AI powered functions would limit the scope required by a RIA’s fiduciary duty or a broker-dealers best interest standard. Additionally, this Proposed Rule could have unintended consequences whereby technology outside of the scope are included. For instance, Monte Carlo simulations, employed for decades by firms under modern portfolio theories, present no inherent conflicts. These simulations do not steer customers towards proprietary products but rather assist in portfolio management using the best available products. Even when conflicts are absent, the proposal mandates testing, documentation, and

policies and procedures, thereby increasing the cost of such products and services. While we support the Commission's efforts to extend best interest obligations beyond mere disclosure, we assert that encompassing every technology, every investor interaction, and applying such a sweeping definition of conflict of interest is not in the best interest of investors.

II. The provision of data and information should be carved out of being considered an investor interaction.

In light of the expansive definitions encompassed within covered technologies, investor interactions, and conflicts of interest, we strongly recommend that the Commission consider exempting data and information provision from the current definition of an investor interaction. This exemption would enable investors to access necessary information without incurring excessive costs or administrative burdens. Within the existing framework, algorithms and analytical tools, such as quantitative ratings, have the potential to be classified as covered technologies. When these tools are utilized to generate and provide information to interested investors based on their profiles, this action qualifies as an investor interaction. In this context, an exchange of information for revenue between firms and investors could potentially be categorized as a conflict of interest under the Proposed Rule.

While conflicts of interest can potentially arise from providing information, investor interactions more often hold the capacity to be informative and serve as a means to mitigate conflicts. Morningstar's perspective rests on the belief that data and information exchanges possess inherent mitigation factors rather than exacerbating conflict-related issues. Given that providing information can help mitigate conflicts with investors, the inclusive definition would take away what the rule is trying to accomplish, which is mitigating conflicts. We advocate, therefore, for the exclusion of data provisions from the current definition of an investor interaction.

The Commission's position is that providing information directly to investors or through a financial adviser can be construed as an investor interaction. It is important to consider the dual nature of these interactions. On one hand, firms derive revenue from sharing information with investors. Conversely, financial advisers employ objective metrics derived from this information to proactively manage and mitigate conflicts in the advisery process. An exemplary instance of such objective metrics is an asset allocation algorithm designed with no awareness of revenue-sharing agreements or proprietary fund affiliations. Its sole objective is to impartially select the optimal asset allocation for an investor from the pool of available funds. In essence, this technology serves to provide investors with an objective perspective.

The proposed approach by the Commission could inadvertently hamper the accessibility and utility of objective data analysis and provision, potentially impeding the overall effectiveness of the rule. We urge the Commission, therefore, to reconsider the inclusion of the provision of data or other investor-solicited investment information from the scope of covered technology, preserving the ability to leverage data analysis as a tool for informed decision-making.

III. The Commission should consider the use of risk assessment to make compliance commensurate with the risk of a given PDA product.

Morningstar encourages the Commission to add in the concept of risk assessment as a means of achieving compliance relative to the risks posed. While the SEC’s overarching goal of addressing conflicts of interest within PDA interactions is commendable, it is essential to take into account the varying degrees of risk associated with different PDA technologies and the broader implications for regulatory requirements. As a fundamental principle, risk assessment suggests that firms should proportion

compliance measures to match the risk posed by the specific technology or interaction. The SEC could explore the idea of risk-adjusted compliance, where firms determine the rigor of compliance efforts based on the potential harm that conflicts related to a particular PDA product could cause.

As an initial matter, we note that many existing technologies, such as managed accounts and robo advisers, already have policies and procedures and robust compliance processes under current regulatory requirements. Adding more testing and compliance is redundant and burdensome. Consequently, the Commission's requirements should have compliance align with the risks of conflicts presented by a PDA that are not already sufficiently covered under existing regulation. While we recognize the Commission's concerns regarding the development of technology that may encompass inherent bias towards the firm's bottom-line via the data that is utilized, programming code, or learning by the model in the case of models that evolve via learning, we believe that all of these issues should be addressed through current testing or can be called out with specific guidance tailored to the risks presented in these cases.

The risks of PDA fall on a continuum. At one end, the risks associated with a correlation matrix are similar to that of a spreadsheet. This level of risk should not be treated as equal to that posed by a chatbot. The imposition of the Proposed Rule could stifle predictable technology that has been assisting investors for years, which is already accompanied by sufficiently robust risk assessment. The imposition of overly stringent compliance requirements could stifle innovation and discourage firms from exploring new ways to enhance the investor experience.

Morningstar recognizes the need for a balance between the implementation of rigorous compliance measures and the fostering of innovation within the financial industry. Striking this balance requires a nuanced understanding of the potential benefits and risks associated with PDA technologies. The risk associate with PDA technology is fundamentally akin to the challenge the Commission faces in addressing Reg BI. We concur with the Commission's viewpoint that the mitigation and disclosure of conflicts of interest, as mandated by Reg BI, may fall short of comprehensive solutions. Applying a one-size-fits-all approach to conflicts of interest stemming from PDA, however, does not appropriately address the diverse range of risks present across different technologies and interactions.

Morningstar emphasizes that risk assessment can be a powerful tool in tailoring compliance approaches to match the specific risks posed by PDA products. The SEC could encourage firms to conduct thorough risk assessments that consider factors such as the complexity of the technology, the data utilized in developing the technology, the protocols for development intended to mitigate conflicts, the types of investor exposure implicated, and the potential consequences of remaining conflicts. After all, not all conflicts are bad for the investor. When an investor is encouraged to fund an account or save more through "investor interactions," such interactions tend to benefit both the investor and the firm encouraging this behavior. Given that the firm benefits, this interaction may be seen as creating a conflict of interest, and yet we would argue that actually it is a mutually beneficial interaction where the incentives of the investor and the RIA/BD are aligned as they should be.

Risk assessments can determine the appropriate compliance measures needed to address certain issues such as gamification features and push notifications. This approach would allow firms to implement compliance measures that are commensurate with the identified risks, avoiding both over-regulation and under-protection.

Morningstar believes that risk assessment inherently emphasizes adaptability. The financial industry is characterized by rapid technological advancements and changing investor preferences. As new PDA technologies emerge, firms can perform continuous risk assessments to evaluate the evolving conflicts landscape. This approach ensures that firms keep their compliance efforts current and relevant, allowing them to proactively address new conflicts that may arise over time.

By embracing the principle of risk assessment, the SEC can promote a compliance framework that is both effective and adaptable. Recognizing the unique risk profiles of different PDA products and interactions and tailoring compliance efforts accordingly will strike a balance between investor protection and industry innovation. Ultimately, a risk-adjusted compliance approach can lead to better outcomes for investors, firms, and the industry as a whole.

Conclusion

In summary, we support the Commission's goal of addressing conflicts of interest arising from a rapidly evolving landscape of financial technology. The proposed definitions, however, are overly inclusive and would require cumbersome testing on existing products and services that have been serving investors for a long time. The broader definition of investor interaction would encompass data and information provision, which should be carved out from the proposal entirely. Furthermore, Morningstar encourages the Commission to give careful consideration to the concept of making compliance commensurate with the risk posed by a particular investor interaction and covered technology as a means of achieving its goals without discouraging beneficial services for investors. We have summarized our views above and answer some specific questions from the Proposed Rule in Appendix A.

Morningstar thanks the Commission for the opportunity to comment on the Proposed Rule. We would be pleased to engage with the Commission on an ongoing basis, leveraging our global organization of experts operating in multiple jurisdictions. Should you wish to discuss these and other comments, please do not hesitate to contact either of us as indicated below:

Jasmin Sethi at jasmin.sethi@morningstar.com or (617) 501-5446
Aron Szapiro at aron.szapiro@morningstar.com or (732) 322-2464

Sincerely,

Aron Szapiro
Head of Government Affairs
Morningstar, Inc./Morningstar Investment Management, LLC

Jasmin Sethi
Associate Director of Policy Research
Morningstar, Inc.

Appendix A: Responses to Selected SEC questions on Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers

A. Proposed Conflicts Rules

1. Scope

a. Covered Technology

1. **Is the scope of the proposed definition of a covered technology sufficiently clear? We intend for the proposed definition to cover PDA-like technologies; are there ways we could revise the proposed definition in order to better accomplish this? Are there any technologies covered by the proposed definition that go beyond PDA-like technologies and should be excluded? For instance, should the proposed definition distinguish between different categories of machine learning algorithms, such as deep learning, supervised learning, unsupervised learning, and reinforcement learning processes? Do one or more of these categories present more investor protection concerns related to conflicts of interest relative to other categories? Would firms be able to identify what would and would not be a covered technology for purposes of the proposed rules? If not, what additional clarity would be beneficial? We have described examples of technologies to which the definition would or would not apply. Should the definition be revised to include or specifically exclude such examples?**

The proposed definition's scope presents challenges due to both its broadness—it covers many routine uses of technology—and its narrowness—it fails to account for the rapid pace of technological innovation, a crucial consideration given the proposed regulation's timing. Investor protection concerns should extend beyond technology and permeate the entire organization, becoming a primary focus for RIAs and BDs, regardless of technological involvement. Narrowing this rule to technology alone could inadvertently overlook significant threats from conflicts in other areas, such as trading and marketing. However, the Proposed Rule as written is very broad in its scope, bringing about unintended consequences for low-risk technologies that have long-served investors.

2. **Would the definition adequately include the technology used by firms that would present the conflicts of interest and resulting risks to investors that these proposed rules are designed to address? If not, how should this definition be changed to further the objective of the proposed conflicts rules? Please explain your answer, including the extent to which these technologies do or do not present conflicts of interest risks to investors. Alternatively, do the technologies included in the proposed definition include technology that does not typically result in risks to investors that these proposed rules are designed to address?**

Conflicts of interest may exist across an organization's processes and products, extending beyond the realm of technology alone. Focusing solely on conflicts within technology utilizing PDA or other AI-powered functions might unduly narrow the scope required by the fiduciary duty of RIAs or the best interest standard of BDs, diverting attention from the numerous other areas where conflicts of interest are prevalent.

Furthermore, this rule may unintentionally encompass technologies that lie outside its intended scope. For instance, firms using Monte Carlo simulations to illustrate expected outcomes may consider these

simulations to be within scope, even though they pose no genuine conflicts beyond the firm's intent to promote a product or service to a client. Such simulations utilize common algorithms and operate on technology that is generally not proprietary to a single firm. They have been used for decades in the context of modern portfolio theory. Requiring firms to assess these technologies for which they lack intellectual property or code ownership could be burdensome and detract from their fiduciary duties to serve their clients.

b. Investor Interaction

3. Is the proposed definition of investor interaction sufficiently clear? Would firms be able to identify what would be an investor interaction for purposes of the proposed conflicts rules? Are there activities that are not covered by the proposed definition of investor interaction that should be? Are there activities that are covered by the proposed definition that should not be? For instance, should a firm soliciting prospective investors be included within the definition? Should the proposed definition be limited to interactions in which investors directly interact with, or otherwise directly use, covered technology? Do situations in which investors do not directly interact with covered technology raise the same concerns of scalability as those in which investors do interact directly?

The proposed definition of investor interaction, which states that "rules would generally define investor interaction as engaging or communicating with an investor, including by exercising discretion with respect to an investor's account; providing information to an investor; or soliciting an investor"[7] warrants further clarification. This definition encompasses a broad range of scenarios where neither a recommendation regarding a securities transaction nor a fiduciary obligation exist. In particular, the inclusion of data or information provision within this definition needs clarification. It is important to note that data/information provision typically does not create conflicts in the same manner as the Commission is concerned about with the sale of proprietary products. Data and information dissemination can often serve as an essential component of informed decision-making for investors, promoting transparency and aiding in their understanding of financial matters. The proposed definition's current wording could inadvertently categorize such benign interactions as potential conflicts of interest. Therefore, a more nuanced delineation is necessary to ensure that legitimate and valuable investor education and communication activities are not unduly burdened or misinterpreted as conflicts, while still addressing the Commission's valid concerns related to proprietary product sales.

For instance, consider the use of automated account support, which may involve chatbots or language learning models to provide answers to client account-related questions. In these interactions, there is no attempt to solicit a transaction, recommend a product or service, or engage in regulated activity. Clients may simply seek balance information or data on holdings (e.g., cost basis, gain/loss), which are typically non-regulated inquiries. While we acknowledge that using covered technologies to solicit investors could pose conflicts of interest, the portion of the definition that covers "providing information" is overly broad. It may be challenging to identify conflicts in situations where information is provided to investors, especially in areas of the industry where such interactions are not considered regulated activities.

[7] Proposed Rule, P. 53974.

16. **Do commenters agree that investor interactions, as proposed, may entail conflicts of interest that are particularly likely to result in investor harm or to take additional effort to discern? Are there types of activities we should specifically include or exclude within the definition?**

Investor interactions involving covered technologies may lead to conflicts of interest that pose risks to investors or require additional scrutiny. Conflicts of interest can exist, however, in interactions unrelated to technology. For instance, conflicts may arise during in-person client meetings where financial advisers are selling products with undisclosed revenue-sharing agreements. Focusing solely on technology-driven interactions may lead to an incomplete view of the conflicts landscape and fail to provide comprehensive investor protection. The SEC should prioritize conflict identification and mitigation or neutralization regardless of the context in which they occur. Firms should be required to identify conflicts and implement appropriate mitigation/neutralizing measures for conflicts that require such a response, whether they involve technology or manual processes. Furthermore, the testing of controls to mitigate or mitigate conflicts should be risk-based and reasonable, covering both technological and non-technological processes. This approach ensures a holistic and effective approach to safeguarding investors' interests.

17. **Do commenters agree that the definition of investor interaction should exclude interactions solely for purposes of meeting legal or regulatory obligations or providing clerical, ministerial, or general administrative support? Should we remove any or all aspects of these exclusions from the definition in the final conflicts rules? In the case of interactions solely for the purpose of meeting legal or regulatory obligations, should we broaden or narrow the exclusion? For example, should we take into account legal or regulatory obligations as a result of compliance with foreign law, or with policies, rules, or directives of SROs (including securities exchanges) or other bodies? Generally, would investor interactions that fall under the proposed exclusions employ covered technology (e.g., technologies that optimize for, predict, guide, forecast, or direct investment- related behaviors or outcomes)? If so, how? If not, is the exception for legal or regulatory obligations additive? Is the exclusion for providing clerical, ministerial, or general administrative support sufficiently clear? For instance, is it clear this phrasing would capture trade settlement and the routing of customers' orders or would further explanation be helpful?**

Addressing the scope of certain obligations, such as rollover analysis under the best interest standard, holds several important considerations. Advisers frequently employ PDA to assess cost implications or obtain information from the Form 5500 Report for comparative purposes. To enhance clarity and effectiveness, it may be beneficial to clarify and potentially broaden the definition of legal or regulatory obligations to encompass those arising from compliance with foreign laws or directives issued by self-regulatory organizations (SROs) and securities exchanges. Moreover, ensuring the exclusion for providing clerical, ministerial, or general administrative support is sufficiently clear, particularly concerning trade settlement and order routing, becomes necessary to eliminate any potential ambiguity.

2. Identification, Determination, and Elimination, or Neutralization of the Effect of, a Conflict of Interest

a. Evaluation and identification

21. **Do the proposed conflicts rules' identification and evaluation requirements complement, overlap with, or duplicate the existing regulatory framework for broker-dealers and investment advisers? If so, in what ways? Specifically, would firms' compliance with those other regulatory requirements contribute to compliance with the proposed conflicts rules, and vice versa?**

The proposed rules focus solely on PDA and covered technology, which may ignore the fact that many RIAs and BDs already have mechanisms in place to identify conflicts of interest across the organization. Firms conduct annual risk assessments, focusing on conflicts, whether under SEC Rule 206(4)-7 or FINRA Rule 3120. This proposal is duplicative, as RIAs and BDs already have this obligation regardless of the type of investor interaction that occurs. Focusing solely on covered technology or PDA could misallocate compliance resources within the first line of defense. Firms might divert considerable resources to comply with this rule, potentially at the expense of addressing more serious conflicts elsewhere.

23. **The identification and evaluation requirement would also require firms to identify and evaluate conflicts of interest associated with use or potential use of a covered technology by an associated person; what challenges, if any, would firms face due to this aspect of the proposed conflicts rules? Should we make any changes as a result? For example, should we limit the scope of the requirement to conflicts of interest of which the firm is aware or reasonably should be aware or should we limit the scope to any conflict that is reasonably foreseeable? Instead of or in addition to covering conflicts of interest associated with firms' associated persons' use of covered technologies, should we prescribe any additional requirements, such as additional diligence or policies and procedures, relating to conflicts of interest associated with firms' associated persons' use of covered technologies? The proposed conflicts rules would consider conflicts of associated persons only for associated persons that are individuals, and not of entities that control, are controlled by, or are under common control with a firm, but many of the Commission's enforcement actions relating to undisclosed conflicts have involved conflicts of firms' affiliated entities, and not of individuals.152 In addition to natural persons, should we broaden the requirement to cover entities controlling, controlled by, or under common control with firms?**

The current standard, which limits the scope of conflicts to situations where a firm should reasonably be aware, is appropriate and should be retained. However, defining the scope to cover only associated persons' conflicts and not those of the firm is misguided. Many associated persons rely on tools provided by the firm rather than implementing their own. Therefore, the standard should apply to both individuals and entities. Firms already have established standards of care related to the use of vendors or tools in regulated activities, and they should continue to perform due diligence as they do currently.

The prescriptiveness of this rule could lead to unintended consequences. It would be more practical to allow firms the flexibility to design their own due diligence processes and procedures under a standard of reasonableness. Additionally, the requirement of foreseeability, particularly when looking into the 'foreseeable future,' is problematic. It is virtually impossible to anticipate how market changes may impact technology use accurately. Such a standard could lead to unfair consequences, with hindsight being used against firms.

24. **Do the proposed conflicts rules provide appropriate clarity around when a firm uses covered technology in an investor interaction? For instance, is the guidance included in this release clear that the proposed conflicts rules would not distinguish between a firm directly using a covered technology in an investor interaction, such as when an investor interfaces with the covered technology without an intermediary of the firm, and when a firm uses covered technology indirectly in an investor interaction, such as where staff of the firm receives the output and communicates it to the investor? Do commenters agree with this scope? Should we instead exclude "indirect" use in investor interactions? Alternatively, should we include indirect uses in investor interactions but apply the rule differently? If so, what safeguards, if any, would be necessary or appropriate for indirect uses in investor interactions? As an example, should the rule make a distinction between an investor interaction using a covered technology itself (e.g., a behavioral feature on a digital platform) and an investor interaction in which the firm uses covered technology indirectly (e.g., a broker emailing a recommendation that it generated using AI-tools)? Should we revise the rule text to explicitly include "indirect" investor interactions, for example by adding the phrase "directly or indirectly"? Alternatively, should the rule text include a definition of "use" within the context of a firm's use of a covered technology in an investor interaction?**

The use of both direct and indirect interaction is limited in scope. Firms should be required to identify all conflicts regardless of interaction and the use of technology. Focusing on whether a conflict exists should not depend on the manner of client/prospect interaction, but rather the type of conflict present and how it is mitigated or avoided.

26. **Are there particular methods that firms use to identify and evaluate conflicts of interest that we should discuss in the proposed conflicts rules? Should we describe particular methods of identification and evaluation that would comply with the rules? If we were to address such methods specifically, how would we ensure that the rule continues to apply to new technologies and new types of investor interactions as they develop?**

Many firms identify conflicts of interest through risk assessments, conflict committees, product committees/construction, and when updating disclosure language. Narrowly focusing a rule to deal with conflicts of interest in one type of interaction could detract from the efforts and resources put into identifying conflicts across the firm.

b. Testing

22. **Is the proposed requirement to test covered technologies used in investor interactions prior to implementation sufficiently clear? For example, are there circumstances where it would not be apparent when a technology has been "implemented" for purposes of the proposed conflicts rules? Should we specifically define the term "implementation," for example by defining it to mean the first time the technology is used in investor interactions? If a firm deploys a covered technology on a "pilot" basis to a limited group of users, should this not be considered to be an "implementation" for purposes of the proposed conflicts rules, even if the technology is used in investor interactions? If we were to provide such an exclusion, what additional safeguards should be required? For example, should firms seeking to rely on this exclusion be required to subject the covered technology to enhanced oversight, such**

as requiring regular reports on how the technology is being used, requiring members of the pilot group to determine independently whether their use of the technology is resulting in interactions that place the firm's interests ahead of investors' interests, or only permitting certain firm personnel to use the technology? Should the exclusion be time-limited, such as a limitation of 30, 60, or 90 days? Who would be eligible to be in the pilot group? Should investors be required to be notified, or to affirmatively consent before interactions with such investors are made part of such a pilot program? Would such a limitation create incentives not to test covered technologies thoroughly enough?

Monitoring and testing activities within the regulatory framework should be approached with a sense of pragmatism and adaptability, acknowledging the diversity among firms, their customers, and the technology they employ. It is imperative that these activities are both reasonable and risk-based, taking into account various factors such as transaction volume, the nature of business operations, inputs and outputs of processes, the effectiveness of internal controls, potential penalties, and other relevant considerations.

While regulatory compliance is essential, it is important for the final rule to strike a balance to avoid imposing overly specific testing requirements that may divert compliance resources away from areas of greater strategic importance. A one-size-fits-all approach might not be suitable given the distinct characteristics of different firms, their unique risk profiles, and the evolving technological landscape in which they operate.

Moreover, the determination of timeframes for testing should be guided by the outputs of a thorough risk assessment rather than being solely derived from rigid regulatory stipulations. This approach recognizes that each firm possesses its own set of risk factors and operational dynamics, necessitating a tailored approach to testing timelines. By adopting this perspective, regulatory compliance can be achieved in a manner that is both effective and adaptable, enhancing the overall resilience and sustainability of financial institutions and their operations.

34. **Should we provide an exception from the testing requirement? For example, for urgent changes that are necessary to protect against immediate investor harm, for regulatory reasons, or to correct unexpected developments, such as major bugs, security issues, or conflicts of interest that had not previously been identified (or that developed between periodic testing intervals). Should we require firms to create or maintain any documentation in connection with relying on such an exception? Should reliance on such an exception be subject to any conditions, such as conducting testing as soon as practicable or only for a limited, specified period of time (for example, a few days, a week, or a month)?**

The focus should be on reasonable and risk-based testing rather than rigid regulatory requirements. Testing timeframes should be based on risk assessments and not statutory mandates. Mandating specific testing on certain areas could lead to gaps in other areas, undermining effective risk mitigation.

c. Conflict of interest

36. **Do commenters agree that a firm would have a conflict of interest with an investor if the firm takes into consideration its profits and revenues in its investor interactions using covered technology? Why or why not? Are there additional circumstances that should trigger the rule if the firm takes these circumstances into account in its investor interactions, such as considering any factor which is not directly in the interest of the investor? Should we narrow the proposed definition and, if so, are there particular activities that should be excluded, such as when a technology considers a very large dataset where the firm has no reason to believe that the data considers the interests of the firm, like a technology trained on all books in the English language? Are there other datasets that should be excluded and, if so, how broad should a dataset be required to be in order to qualify for the exclusion? If we were to provide an exclusion, should we do so by excluding particular activities or types of datasets by name, or through a more principles-based approach?**

Conflicts of interest can manifest across various aspects of a firm's sales practices, products, technology, and other operational processes. The inclusion or exclusion of specific data sets is a critical consideration in conflict mitigation, and the term 'profits' in this context can be overly broad. It should be the firm's responsibility to identify and address conflicts, irrespective of their technological tools, based on their unique business model and client base.

37. **Is the description of when a conflict of interest exists sufficiently clear? Would firms be able to identify what would and would not be a conflict of interest for purposes of the rules? Advisers already have a fiduciary duty to eliminate, or at least to expose, all conflicts of interest which might incline them—consciously or unconsciously—to render advice that is not disinterested, and broker-dealers already have a duty to identify and at a minimum disclose or eliminate all conflicts of interest associated with a recommendation and mitigate certain conflicts of interest under Reg BI. How do firms currently identify conflicts of interest associated with their use of what the proposed conflicts rules would define as covered technologies in order to ensure that such use complies with existing standards? Will it be confusing to firms that the proposed conflicts rules also use the term "conflict of interest" to describe a distinct, but related, concept? If so, should we use a different term other than "conflict of interest," such as a "technology conflict" or a "potential conflict of interest?"**

Given the fact that the identification of conflicts of interest is inherent to meeting fiduciary and best interest standards, these terms should not be codified as loopholes since it will inevitably be created through market factors outside of a firms control. Identifying something as a "technology conflict" would have no impact on its importance to meeting regulatory obligations and should be avoided. Firms in this regulated space should already have sufficient knowledge on what constitutes a conflict of interest. The SEC and FINRA have released reports, risk alerts, and other material (e.g., enforcement actions) on where firms either ignored or failed to mitigate conflicts. The identification of conflicts is already embedded in a firm's DNA, or at least it should be if they wish to remain compliant.

d. Determination

45. **Does the proposed conflicts rules' determination requirement complement, overlap with, or duplicate the existing regulatory framework for broker-dealers and investment advisers? If so, in what ways? Specifically, would firms' compliance with those other regulatory requirements contribute to compliance with the proposed conflicts rules, and vice versa?**

Firms are already required to determine when the interests of the firm are put ahead of a client, whether by fiduciary or best interest standards. Codifying this requirement only further narrows the means by which firms have to meet these obligations and could have unintended consequences. Those consequences could mean that firms will look for ways to justify their own determinations in contravention with their regulatory obligations. For example, a firm may determine that the conflict of selling funds in which they receive revenue share is not determined to be a conflict because they do not have selling agreements with fund companies that may provide more beneficial outcomes for customers.

46. **Is the proposed requirement that a firm determine whether any conflict of interest that it has identified places or results in placing its or its associated persons' interests ahead of investors' interests sufficiently clear? Is the requirement sufficiently general that it would continue to apply to future technologies with features we may not currently anticipate? If not, why not? Do commenters agree that a conflict of interest that places a firm's or its associated persons' interests ahead of investors' interests also results in placing its or its associated persons' interests ahead of investors' interests? If so, is the rule clearer by including both phrases or should the proposed requirement eliminate the phrase "results in placing"?**

The SEC's approach to this question may benefit from further clarification. We wholeheartedly share the perspective that any interests prioritizing the firm over its customers should be addressed comprehensively. However, it is essential to avoid a myopic focus solely on technology or PDA. The SEC's current emphasis appears to be primarily on regulating one aspect of a much broader spectrum of conflicts that can exist within a firm, regardless of whether they involve covered technology. Channeling firm resources exclusively into addressing technology-related conflicts, while overlooking other areas, may not necessarily enhance investor protection in a meaningful way. Exploring a more holistic approach to conflict management could potentially yield more comprehensive benefits for investors and the industry as a whole.

47. **How do firms currently determine whether their use of technology in investor interactions results in a conflict of interest that places the interests of the firm ahead of investors' interests? Are there particular processes or strategies that should be required in the proposed determination requirement? For example, should we specifically require the use of "explainability" features when the relationship between the outputs of a model and the inputs may be unclear (and it thus may be difficult to identify whether the interests of the firm are being placed ahead of investors' interests)? Do firms use A/B testing to determine the effects of conflicts of interest? What other types of testing do firms use to determine the effects of conflicts of interest, if any?**

Firms should have annual reviews of the risks that technology potentially contributes increasing conflicts of interest. Findings from these reviews should be shared with senior management and mitigants should be disclosed. Testing methodologies will vary across differing business practices and the SEC should not regulate process over outcomes when several different processes can be used to achieve the same outcome. Testing methodology relies heavily on risk assessments, particularly the frequency of tests, types of controls tested, and sampling methods to achieve higher confidence levels of controls. The SEC should not promulgate regulation on how tests are conducted.

48. **What challenges will firms face when determining whether conflicts of interest associated with "black box" technologies (where the outputs do not always make clear which inputs were relied on, and how those inputs were weighted), result in their interests being placed ahead of those of investors? How prevalent are these situations? How do firms using "black box" technologies to aid in making recommendations or providing advice determine whether they are complying with existing conflicts obligations under the investment adviser fiduciary standard and Reg BI, as applicable? If a firm is not able to determine whether its use of such a technology results in a conflict of interest that places its interests ahead of those of investors, what additional steps will a firm need to take in order to eliminate, or neutralize the effect of, such conflicts and be able to continue to use the covered technology?**

What the Commission calls "Black box technologies" are employed by many different firms and should be tested on inputs and outcomes rather than the types of calculations/methods used to determine outcomes. The complexity of these technologies can vary depending on how the machine learning algorithm behind it is constructed and what data the algorithm is provided. Testing for conflicts by examining the inputs and outcomes would provide a consistent framework for firms to deploy.

e. Elimination or neutralization of effect

52. **Considering that the proposed conflicts rules' elimination or neutralization evaluation requirement may overlap with existing regulatory requirements for broker-dealers and investment advisers, would firms' compliance with those other regulatory requirements contribute to compliance with the proposed conflicts rules, and vice versa? If so, in what ways?**

The proposal under consideration calls for the elimination or neutralization of all conflicts of interest, a departure from longstanding and widely accepted industry practices. Historically, when conflicts cannot be entirely eliminated, the approach has been to disclose the conflict in clear and straightforward terms to clients and mitigate it. This practice has been upheld since the inception of the Investment Advisers Act and has not posed a significant threat to consumer protection.

For instance, the ADV Part 2A brochure currently mandates a dedicated section on conflicts of interest, allowing for comprehensive disclosure. The Form CRS also mandates a description of conflicts of interest arising from the fees investors will pay and from how the firm makes money. However, the proposed requirement to eliminate all conflicts, especially those where the firm or its associates may be placed ahead of the client, could effectively nullify the need for such disclosures. Elimination of conflicts could

potentially encompass scenarios where advisers or brokers receive compensation based on their recommendations, which, from a technical standpoint, could be viewed as a conflict because it introduces considerations related to their own compensation rather than the suitability of products for clients.

The question arises whether it would be prudent to prohibit compensation for advisers and brokers for their recommendations entirely, potentially impeding the ability to fairly compensate industry professionals for their expertise and services. We believe that the SEC's proposed requirement may be overly stringent and believe that it does not strike the appropriate balance between protecting consumers and ensuring the continued viability of compensation structures in the financial services industry.

55. **Should firms be required to eliminate, or neutralize the effect of, conflicts of interest that place the firm's interests ahead of investors' interests as required under the proposed rules? Instead, should the elimination or neutralization obligation (or the requirements of sections (b)(1) or (b)(2) of the proposed conflicts rules) be limited to investor interactions involving, as applicable, investment advice or recommendations by a firm or its associated persons (or by a covered technology employed by a firm or its associated persons)? Should that obligation or requirements be limited to investor interactions directly with covered technologies? What other ways could we address the risks that conflicts of interest associated with firms' use of covered technologies will result in investor interactions that place the firm's interest ahead of the investor interest?**

The requirement to eliminate or neutralize conflicts of interest that prioritize the firm's interests over investors' interests, as outlined in the Proposed Rule, should be carefully considered. Rather than imposing a broad obligation across all facets of the firm, it might be more prudent to focus a mitigation or neutralization requirement on specific areas, particularly in investor interactions involving investment advice or recommendations provided by the firm, its associated persons, or covered technologies employed by the firm or its associated persons. By narrowing the scope of this obligation, it could offer a more targeted approach to mitigating conflicts in areas that directly impact investors. To address the risks associated with conflicts of interest related to firms' use of covered technologies, additional strategies could include enhanced disclosure requirements, more robust oversight mechanisms, and industry-wide best practices. These measures can complement a mitigation or neutralization of conflicts, offering a multifaceted approach to safeguarding investor interests.

56. **Is the requirement to eliminate, or neutralize the effect of, certain conflicts of interest sufficiently clear? Should we provide any additional guidance on what we mean by "neutralize the effect of"? If so, how? Instead of, or in addition to, elimination and neutralization, should the proposed conflicts rules require mitigation of some or all of the effects of conflicts of interest determined to place a firm's interests ahead of investors' interests under section (b)(2) of the proposed conflicts rules? If so, which conflicts? Is there additional guidance we should provide, or changes we should make to the text of the proposed conflicts rules, to clarify the distinction between elimination or neutralization, on the one hand, and mitigation, on the other hand?**

In addressing conflicts it is essential to acknowledge that mitigation typically takes the form of avoidance or disclosure. These fundamental principles have been integral to the industry since the inception of regulatory frameworks. The proposal under consideration, which mandates the elimination or neutralization of all conflicts, represents a significant departure from this established paradigm.

It is imperative to recognize that such a profound shift in approach may have unintended consequences that warrant careful consideration. For instance, what would be the stance on investment portfolios containing proprietary funds, given that many firms derive revenue from account fees and potential holdings within these portfolios? A categorical prohibition on such portfolios could have far-reaching implications, potentially jeopardizing the diversity and competitiveness of product offerings throughout the industry. Moreover, it could impact investors' ability to access investment options essential for achieving their financial objectives. Therefore, a comprehensive examination of the potential ramifications of these actions is crucial before implementing such sweeping changes.

(3) Policies and Procedures Requirement

45. **Does the proposed conflicts rules' policies and procedures requirement complement, overlap with, or duplicate the existing regulatory framework for broker-dealers and investment advisers? If so, in what ways? Specifically, would firms' compliance with those other regulatory requirements contribute to compliance with the proposed conflicts rules, and vice versa?**

Firms are already required to have adequate policies and procedures under SEC Rule 206(4)-7 and FINRA Rule 3120. Statutorily requiring policies and procedures does not take into account the many different types of business many firms are engaged in—both large and small. This requirement would be duplicative in nature.

63. **Are all aspects of these proposed policies and procedures requirements, as well as the particular written descriptions and review to be required by a firm's policies and procedures, necessary and appropriate for achieving compliance with paragraph (b) of the proposed conflicts rules? If not, what elements should be added, deleted, or modified to better ensure firms' compliance with paragraph (b) of the proposed conflicts rules?**

These rules exhibit duplicative characteristics, as they replicate existing requirements imposed on firms. Imposing such a requirement could inadvertently lead firms to focus solely on drafting necessary policies and procedures related to this rule, while potentially overlooking conflicts present in other aspects of their business.