

THE RELEVANT STATUTES DO NOT AUTHORIZE THE PREDICTIVE DATA ANALYTICS PROPOSAL

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Conflicts of Interest Associated with the Use of Predictive Data Analytics

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This is a comment on the predictive data analytics proposal from the Securities and Exchange Commission (Proposal).¹ I am a scholar with the Mercatus Center at George Mason University. I taught securities regulation at the University of Virginia School of Law, served as deputy general counsel at the SEC, and practiced securities law. The Mercatus Center is dedicated to bridging the gap between academic ideas and real-world problems and advancing knowledge about the effects of regulation on society. This comment is not submitted on behalf of any other person or group.

INTRODUCTION

The SEC proposed to adopt rules to require broker-dealers (BDs) and investment advisers (IAs) to identify and to eliminate or neutralize conflicts of interest associated with their use of technologies, widely defined, such as predictive data analytics. As statutory authority for the Proposal, the SEC relied mainly on two subsections of statutes passed in the Dodd-Frank Act.

This comment analyzes those provisions the way an appellate court might consider them in a challenge to the SEC's statutory authority to adopt final rules based on the Proposal and concludes that the SEC overstated the authority granted in the cited statutes. A court is likely to decide that the Proposal went beyond the limited aims Congress set for the SEC in the relevant statutory provisions.

Others have this same concern. A former attorney general and a former member of Congress said that the Proposal read "nonexistent authority in vague provisions to provide the SEC with the authority to

¹ SEC, Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (Proposal), 88 Fed. Reg. 53960 (proposed Aug. 9, 2023).

regulate new and transformative technologies like [artificial intelligence], which Congress never intended to give the agency.”²

Two commissioners also do not subscribe to the legal reasoning supporting the Proposal. They challenged it when the SEC employed the same subsections and a similar legal interpretation for new regulations on investment advisers to private funds. Commissioner Peirce said the SEC ignored the totality of the relevant congressional enactment and “its undeniable focus on standards of conduct as they apply to retail investors.”³ Commissioner Uyeda said the private fund rules relied “on a tortured reading” of the relevant statute and ignored the context of surrounding sections. The majority’s construction read out any limiting principle on the prohibition or restriction of adviser conflicts.⁴

FEDERAL AGENCY INTERPRETATION OF AN ENABLING STATUTE

When the SEC proposes and adopts a legislative rule, it needs a statutory source of authority.⁵ Under the Constitution, Congress, not a federal agency, sets the scope and terms of an agency’s rulemaking and enforcement powers. Actions by an agency inevitably demand that the agency read and construe the relevant statutes.

When an agency interprets a federal statute, it has a responsibility, just as a court does, to be a faithful agent of Congress and a steward of Congress’s choices.⁶ The goal of statutory interpretation is to enforce a decision made by the legislature,⁷ to do what the legislature wanted,⁸ without exceeding what the text permits. The principle of legislative supremacy guides statutory interpretation.⁹ Agencies and judges are expected to implement policies selected by Congress and not their own personal policy preferences or the policy goals of political leaders.

The Supreme Court’s normal method of determining an agency’s rulemaking power is to examine the text and context of the relevant statutes with a view to their place in the overall statutory scheme.

In determining whether Congress has specifically addressed the question at issue, a reviewing court should not confine itself to examining a particular statutory provision in isolation. The meaning—or ambiguity—of certain words or phrases may only become evident when placed in context. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme. A court

² William P. Barr & Barbara Comstock, “Gary Gensler’s Plan to Control Information,” *Wall St. J.* (Sep. 10, 2023), https://www.wsj.com/articles/gary-genslers-plan-to-control-information-sec-financial-regulation-firms-investors-technology-market-927579dc?mod=Searchresults_pos5&page=1.

³ Hester M. Peirce, SEC Comm’er, Uprooted: Private Fund Advisers (Aug. 23, 2023), <https://www.sec.gov/news/statement/peirce-statement-doc-registered-investment-adviser-compliance-reviews-08232023>.

⁴ Mark T. Uyeda, SEC Comm’er, Statement on Private Fund Advisers (Aug. 23, 2023), <https://www.sec.gov/news/statement/uyeda-statement-private-fund-advisers-082323>.

⁵ *City of Arlington v. FCC*, 133 S. Ct. 1863, 1868 (2013) (“No matter how it is framed, the question a court faces when confronted with an agency’s interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority.*”) (emphasis in original).

⁶ See *Biden v. Nebraska*, No. 22-506 (Sup. Ct. Jun. 30, 2023) (“Agencies have only those powers given to them by Congress, and enabling legislation is generally not an open book to which the agency may add pages and change the plot line. We presume that Congress intends to make major policy decisions itself, not leave those decisions to agencies.”); *id.* (Barrett, J., concurring) (stating that Congress is in control of the nation’s policy and that “no reasonable interpreter” should ignore this).

⁷ John F. Manning & Matthew C. Stephenson, *Legislation and Regulation* 24-25 (3d ed. 2017).

⁸ Abbe R. Gluck & Richard A. Posner, *Statutory Interpretation on The Bench: A Survey of Forty-Two Judges on the Federal Courts of Appeals*, 131 *Harv. L. Rev.* 1298, 1313, 1343 (2018).

⁹ Jesse M. Cross & Abbe R. Gluck, “The Congressional Bureaucracy,” 168 *U. Pa. L. Rev.* 1541, 1637 (2020) (“modern judges have never been willing to assert the mantle of being anything other than ‘faithful agents’ of Congress with their work tethered to the principle of legislative supremacy.”); see also Manning & Stephenson, *supra* note 7, 24.

must therefore interpret the statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into an harmonious whole.¹⁰

In the Proposal, the SEC did not follow this approach. Contrary to the Supreme Court’s method, the SEC relied on a specific statutory provision in isolation. That provision was section 15(l)(2) of the Securities Exchange Act together with the identical companion in section 211(h)(2) of the Investment Advisers Act.¹¹ Those subparts should not be considered alone and out of context. They were part of a larger set of related congressional enactments in section 913 of the Dodd-Frank Act (Dodd-Frank 913),¹² but the SEC did not assess the history, structure, and context of Dodd-Frank 913 to develop an informed understanding of Congress’s choices and boundaries.

A more comprehensive review was necessary. As discussed below, that review requires consideration of all of section 913 and the debate over many years about the standard of care BDs and IAs owe their retail customers when recommending a securities transaction. The review demonstrates that the Proposal disregarded critical limitations on the SEC’s power to adopt rules addressing possible conflicts of interest between customers and BDs or IAs.

SECTION 913 OF THE DODD-FRANK ACT AND ITS HISTORY

Knowing the history of Dodd-Frank 913 helps to understand it. For years the SEC and investors have been discussing the standards of care for the relationship between customers and BDs as opposed to IAs. When providing investment advice about securities, BDs and IAs were subject to different standards under federal law. Investors were confused by the different standards, and for a long time that confusion was a concern for Congress and the SEC. As far back as 2004 and 2006, the SEC commissioned studies on investor understanding of the differences in the roles and obligations of BDs and IAs.¹³

Then in 2010 Congress passed the Dodd-Frank Act. Section 913 required another study of the BD and IA standards of care “for providing personalized investment advice and recommendations about securities to retail customers” and also granted the SEC rulemaking authority to address the different standards of conduct for BDs and IAs. The structure and a summary of section 913 follow:¹⁴

- Section 913(a) defined “retail customer” for purposes of section 913.
- Section 913(b) required the SEC to conduct a study of the standards of care for BDs and IAs “for providing personalized investment advice and recommendations about securities to retail customers.”
- Section 913(c) listed the considerations for the study.
- Section 913(d) required a report of the study.
- Section 913(e) required the SEC to seek public comment to prepare the report.

¹⁰ *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132–33 (2000) (citations and quotation marks omitted); see also *West Virginia v. EPA*, 142 S. Ct. 2587, 2607–09 (2022); *Alabama Assoc. Realtors v. HHS*, 141 S. Ct. 2485 (2021) (on application to vacate stay); *AMG Capital Management, LLC v. FTC*, 141 S. Ct. 1341, 1348–49 (2021); *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 318–20, 321 (2014); *Texas v. United States*, 809 F.3d 134, 179–84 (5th Cir. 2015).

¹¹ Proposal, 88 Fed. Reg. 53971.

¹² Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1824–30 (Jul. 21, 2010).

¹³ SEC Staff, Study on Investment Advisers and Broker-Dealers 95-101 (2011). The Congressional Research Service provided additional history in Regulation Best Interest (Reg BI): The SEC’s Rule for Broker-Dealers 3-7 (Dec. 12, 2019), <https://crsreports.congress.gov/product/pdf/R/R46115/1>.

¹⁴ Appendix A of this comment includes all of Dodd-Frank 913 as it appears in the Statutes at Large.

- Section 913(f) gave the SEC rulemaking power to address the standards of care for BDs and IAs “for providing personalized investment advice about securities to such retail customers” based on the study. This provision was put in a note to section 15 of the Exchange Act (15 U.S.C. § 78o).¹⁵
- Section 913(g)(1) added two subsections to section 15 of the Exchange Act. Subsection (k), called “Standard of Conduct,” gave the SEC rulemaking power to apply the standard of conduct applicable to an IA under section 211 of the Advisers Act to a BD “when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide).” Subsection (k) also specified how a standard should apply to three situations, one of which was when a BD sold only proprietary or other limited range of products. Sales of a limited range of products was not to be a violation of a BD’s standard of conduct, but the SEC could require the BD to give notice to a retail customer and obtain a consent or acknowledgement from the customer.
- Subsection (l), also added to section 15 of the Exchange Act, called “Other Matters,” said (1) the SEC shall “facilitate the provision of simple and clear disclosures” about the relationship between investors and BDs, “including any material conflicts of interest,” and (2) the SEC shall “examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for” BDs and IAs that the SEC deems contrary to the public interest and the protection of investors.
- Section 913(g)(2) added two subsections to section 211 of the Advisers Act. Subsection 211(g), called “Standard of Conduct,” gave the SEC power to adopt rules that required BDs and IAs, “when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide),” to act in the best interest of the customer. Any “material conflicts of interest shall be disclosed and may be consented to by the customer,” and the rules were to set a standard “no less stringent than the standard applicable to investment advisers under [two of the anti-fraud provisions in the Advisers Act] when providing personalized investment advice about securities.” Subsection 211(g) specified that commission or fee compensation should not be considered a violation of the standard and again defined “retail customer.”
- Subsection (h) of section 211, called “Other Matters,” was identical to Exchange Act section 15(l) added by Dodd-Frank section 913(g)(1).
- Section 913(h) added provisions to the Exchange Act and the Advisers Act to harmonize enforcement against violations of the standards of conduct for BDs and IAs.

A fair reading of the entirety of section 913 leaves no doubt that it addressed standards of care for BDs and IAs “for providing personalized investment advice and recommendations about securities to retail customers,” with an emphasis on disclosure and specifically disclosure of material conflicts of interest. Those words and concepts dominated section 913.

¹⁵ The placement of a section of a Public Law in the U.S. Code does not affect its legal status. Congress enacts each part of a Public Law. It might specify the placement of a provision in the U.S. Code, but Congress does not always have the last word on placement. The Office of Law Revision Counsel of the House of Representatives has discretion on placement and even a limited power on wording and punctuation. See Cross & Gluck, *supra* note 9, 1541, 1554, 1570-73, 1662, 1664, 1680.

In 2011, the SEC did the further study required by Dodd-Frank 913¹⁶ and continued to review the matter and hold investor roundtables. In 2019, the SEC invoked one of the sources of rulemaking authority in Dodd-Frank 913, primarily the authority in section 913(f),¹⁷ and adopted Regulation Best Interest to set standards of conduct for BDs. Regulation Best Interest complied with the limitations in Dodd-Frank 913. It applies when a BD makes “a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer” and requires full and fair disclosure of many items, including all “material facts relating to conflicts of interest that are associated with the recommendation.”¹⁸ The SEC also issued an interpretation discussing the standards of conduct for investment advisers.¹⁹

THE PROPOSAL DID NOT COMPLY WITH KEY LIMITATIONS IN DODD-FRANK 913

Now the SEC wants to use Dodd-Frank 913 to go much further to address BD and IA conflicts of interest. In doing so, the Proposal disregarded the essential limitations in Dodd-Frank 913 and proposed rules with concepts and definitions that the SEC admitted were extremely broad.

The Proposal covered “investor interactions,” which “have generally been viewed as outside the scope of ‘recommendations’ for broker-dealers,”²⁰ and beyond the statutory concept of personalized investment advice about securities. A BD or IA would have an obligation to eliminate or neutralize a conflict of interest; disclosure would not be sufficient.²¹ The presence of any BD or IA interest to any degree would constitute a conflict of interest.²² No materiality qualification would apply.²³ According to the Proposal, investors for an IA would include institutional clients, contrary to the definition of retail customers Congress specified in Dodd-Frank 913.²⁴

Other elements of the Proposal were expressly labeled as broad. For example, “covered technology” was “designed to capture a broad range of actions.”²⁵

DIFFICULTIES WITH THE SEC’S INTERPRETATION OF STATUTORY AUTHORITY

The SEC singled out the words in subsections 15(l)(2) and 211(h)(2) as the basis for the Proposal without fitting those subsections into the history or context of Dodd-Frank 913. Sections 15(l) of the Exchange Act and 211(h) of the Advisers Act are identical. For simplicity, I will refer only to section 211(h). Subsection 211(h)(2) states the SEC shall “examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for” BDs and IAs that the SEC deems contrary to the public interest and the protection of investors.

That subsection does not specifically mention the same words of limitation used in section 211(g) or other parts of Dodd-Frank 913, and the SEC treated it as an unbounded, separate, and independent

¹⁶ SEC Staff, *supra* note 13.

¹⁷ See *XY Planning Network, LLC v. SEC*, 963 F.3d 244, 253-54 & n.8 (2d Cir. 2020).

¹⁸ 17 C.F.R. § 240.15f-1; see also Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (Jul. 12, 2019) (BI Adopting Release).

¹⁹ Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669 (Jul. 12, 2019).

²⁰ Proposal 53975, 53988.

²¹ *Id.* 53985-88.

²² *Id.* 53982.

²³ *Id.* 53985-86.

²⁴ *Id.* 53974. Congress allowed SEC rules under subsections 15(k)(1) and 211(g)(1) to apply to personalized investment advice to “other customers” as well as retail customers, but the primary concern of Congress in Dodd-Frank 913 was retail customers.

²⁵ *Id.* 53972; see also *id.* 53974 (investor interaction) and 53982 (conflict of interest).

authority for rules prohibiting any and every IA conflict of interest (same for subsection 15(l)(2) and BD conflicts). The SEC chair articulated this broad view of subsection 211(h)(2) in his statement on new rules for advisers to private funds. He said: “Congress also gave the Commission specific new authorities under the Investment Advisers Act of 1940 to prohibit or restrict advisers’ sales practices, conflicts, and compensation schemes.” He specifically noted that Congress did not confine subsection 211(h)(2) “only to retail investors.”²⁶

This is not a fair or the better reading of subsection 211(h)(2). Section 211(h) follows the longer and more specific section 211(g) and is entitled “Other Matters.” That means other matters related to the rulemaking authorized in section 211(g) on the standard of conduct for IAs when giving advice to retail customers. It does not mean the universe of matters outside the rulemaking authorized in section 211(g). Section 211(h) therefore links directly to section 211(g) and its more detailed and limited rulemaking power.

Subsection 211(h)(1) confirms the connection. It provides additional guidance to the SEC when it acts under subsection (g). It instructs the SEC to prefer “simple and clear disclosures” to investors about their relationships with BDs and IAs and states that the preference for disclosures applies to “material conflicts of interest.” Subsection 211(h)(1) makes sense only as an integrated elaboration of the rulemaking power in the preceding section 211(g).

Subsection 211(h)(2) also follows from and is subservient to section 211(g). Subsection 211(h)(2) cannot be read outside of the context of section 211(g), subsection 211(h)(1), or the rest of Dodd-Frank 913. Because subsection 211(h)(1) must be seen as a congressional instruction supplementing the rulemaking source in section 211(g), so must subsection 211(h)(2).

One particular example depicts the inconsistency between the Proposal and a fair reading of sections 211(g) and (h). In subsection 211(g)(1), Congress stated categorically that the SEC “shall not ascribe a meaning to the term ‘customer’ that would include an investor in a private fund” that has an advisory contract with an adviser. That statutory command from Congress logically and structurally carries over to a rulemaking on conflicts under subsection 211(h)(2), yet the Proposal paid no attention to it. The proposed rules would apply to investment advisers to private funds and would define investor to include a client and “any current or prospective investor in a pooled investment vehicle advised by the investment adviser.”²⁷

An appropriate reading of subsection 211(h)(2) is that the SEC was first to address the major issues in section 211(g) and then “examine” other conflicts or sales or compensation practices. Subsection 211(h)(2) explicitly refers only to “certain” conflicts of interest or practices. That naturally means less than the matters in section 211(g). If the SEC identified “certain” exceptional situations that were harmful to investors and that were not already addressed and could not be addressed through disclosure, the SEC could prohibit or restrict conduct in those areas.

²⁶ Gary Gensler, SEC Chair, Statement on Private Fund Advisers (Aug. 23, 2023), <https://www.sec.gov/news/statement/gensler-statement-private-fund-advisers-082323>. A Senior Advisor to Chair Gensler has held and lobbied for this same view of subsection 211(h)(2) since at least 2017. In a comment about a possible Department of Labor rule on retirement fund fiduciaries in her capacity as the director of investor protection for a consumer organization, the Senior Advisor argued that disclosure and management of IA conflicts were generally not adequate and that the SEC needed to ban harmful practices. Letter from Consumer Federation of America to Department of Labor 43-47 (Aug. 7, 2017), <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00529.pdf>.

²⁷ Proposal 53974, 54003 n.288, 54023.

The overarching limitations in section 211(g) and Dodd-Frank 913 still apply to subsection 211(h)(2). The rulemaking power in subsection 211(h)(2) cannot properly be read to disregard the recurring themes in Dodd-Frank 913 on personalized investment advice, retail customers, disclosure, and materiality. The placement and terms of subsection 211(h)(2) stamp it as a narrow exception to the emphasis on disclosure in the rest of Dodd-Frank 913.²⁸

This is how the SEC construed Dodd-Frank 913 when it promulgated Regulation Best Interest in 2019. It relied mainly on the rulemaking authority in Dodd-Frank 913(f) and limited the regulation with language on recommendations of a securities transaction, retail investors, disclosure, and materiality. For one particular provision, the SEC invoked subsection 15(l)(2), which is identical to the companion subsection 211(h)(2), for a narrow exception requiring the elimination rather than disclosure of certain specified practices. The SEC explained and justified the exception on the ground that the specified practices created too strong an incentive for BD personnel to make a recommendation that would put their financial interests ahead of the interests of a retail customer.²⁹

The Regulation Best Interest precedent confirms that the legal approach for the Proposal is not reasonable. The SEC should not, as it did in the Proposal, construe subsection 211(h)(2) as an independent source of general rulemaking power, unconnected to the limiting words in Dodd-Frank 913 and sections 211(g) and 211(h)(1), to prohibit or restrict the conduct of IAs (or BDs). The SEC seized the broadest and severest possible rulemaking power and made the carefully wrought provisions in other parts of sections 15 and 211 superfluous. As understood by the SEC, subsection 211(h)(2) means that the agency has not ever had to comply with sections 211(g) and 211(h)(1) and has never needed to give effect to Congress's words "personalized investment advice," "retail customer," "recommendation," "material conflicts of interest," and "disclosure." The SEC would have been able to use section 211(h)(2) to regulate narrow or broad conduct of IAs and BDs on sales and compensation practices and conflicts of interest. The SEC would have been able to use subsection 15(l)(2) similarly, but instead it used Dodd-Frank 913(f) for Regulation Best Interest and relied on subsection 15(l)(2) specifically for a narrow exception.

If Congress had meant to give the SEC unconstrained rulemaking power to prohibit or restrict conduct of BDs and IAs, it would have enacted sections 15(l)(2) and 211(h)(2) alone and would not have led with the other provisions in sections 15 and 211. That is not what Congress did. The Proposal's interpretation flouts Congress's will.

CONCLUSION

The SEC's use of subsections 15(l)(2) and 211(h)(2) as the statutory authority for the Proposal did not reflect a balanced or objective effort to determine the best understanding of Congress's meaning. Those subsections are subordinate to sections 15(k), 15(l)(1), 211(g), and 211(h)(1), as well as the limiting language that recurs throughout Dodd-Frank 913. Instead, the SEC ignored the statutory limitations and treated the two subsections as free-standing authority for a far-reaching proposal of detailed and intrusive rules to govern and restrict the way BDs and IAs employ technological innovation. The structure and context of the statutes surrounding the two subsections on which the SEC relied show that Congress did not grant the rulemaking power the SEC grabbed.

²⁸ See *generally* Biden v. Nebraska, No. 22-506 (Sup. Ct. 2023) (Barrett, J., concurring).

²⁹ See 17 C.F.R. § 240.15/-1(a)(2)(iii)(D); BI Adopting Release, *supra* note 18, 33390, 33394-96, 33491.

In our system, courts are a back-stop to this kind of agency behavior, but the system of government and the country would be better off if agencies themselves took on more responsibility for staying well within the boundaries of statutory authority. The SEC should not pursue the Proposal and instead should continue to address BD and IA conflicts of interest, including any presented by the use of technology, with Regulation Best Interest and the many other regulatory controls it cited in the Proposal and currently has available.³⁰

³⁰ See Proposal 53965-67, 53970, 54002-05.

APPENDIX A

Section 913 of the Dodd-Frank Act as it appears in the Statutes at Large



PUBLIC LAW 111-203—JULY 21, 2010

DODD-FRANK WALL STREET REFORM AND
CONSUMER PROTECTION ACT

SEC. 913. STUDY AND RULEMAKING REGARDING OBLIGATIONS OF BROKERS, DEALERS, AND INVESTMENT ADVISERS.

15 USC 78o note. (a) **DEFINITION.**—For purposes of this section, the term “retail customer” means a natural person, or the legal representative of such natural person, who—

(1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and

(2) uses such advice primarily for personal, family, or household purposes.

15 USC 78o note. (b) **STUDY.**—The Commission shall conduct a study to evaluate—

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care

for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

(c) CONSIDERATIONS.—In conducting the study required under subsection (b), the Commission shall consider— 15 USC 78o note.

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards;

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute;

(3) whether retail customers understand that there are different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers in the provision of personalized investment advice about securities to retail customers;

(4) whether the existence of different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers is a source of confusion for retail customers regarding the quality of personalized investment advice that retail customers receive;

(5) the regulatory, examination, and enforcement resources devoted to, and activities of, the Commission, the States, and a national securities association to enforce the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers when providing personalized investment advice and recommendations about securities to retail customers, including—

(A) the effectiveness of the examinations of brokers, dealers, and investment advisers in determining compliance with regulations;

(B) the frequency of the examinations; and

(C) the length of time of the examinations;

(6) the substantive differences in the regulation of brokers, dealers, and investment advisers, when providing personalized investment advice and recommendations about securities to retail customers;

(7) the specific instances related to the provision of personalized investment advice about securities in which—

(A) the regulation and oversight of investment advisers provide greater protection to retail customers than the regulation and oversight of brokers and dealers; and

(B) the regulation and oversight of brokers and dealers provide greater protection to retail customers than the regulation and oversight of investment advisers;

(8) the existing legal or regulatory standards of State securities regulators and other regulators intended to protect retail customers;

(9) the potential impact on retail customers, including the potential impact on access of retail customers to the range of products and services offered by brokers and dealers, of imposing upon brokers, dealers, and persons associated with brokers or dealers—

(A) the standard of care applied under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) for providing personalized investment advice about securities to retail customers of investment advisers, as interpreted by the Commission and the courts; and

(B) other requirements of the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.);

(10) the potential impact of eliminating the broker and dealer exclusion from the definition of “investment adviser” under section 202(a)(11)(C) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)(C)), in terms of—

(A) the impact and potential benefits and harm to retail customers that could result from such a change, including any potential impact on access to personalized investment advice and recommendations about securities to retail customers or the availability of such advice and recommendations;

(B) the number of additional entities and individuals that would be required to register under, or become subject to, the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.), and the additional requirements to which brokers, dealers, and persons associated with brokers and dealers would become subject, including—

(i) any potential additional associated person licensing, registration, and examination requirements; and

(ii) the additional costs, if any, to the additional entities and individuals; and

(C) the impact on Commission and State resources to—

(i) conduct examinations of registered investment advisers and the representatives of registered investment advisers, including the impact on the examination cycle; and

(ii) enforce the standard of care and other applicable requirements imposed under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.);

(11) the varying level of services provided by brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers to retail customers and the varying scope and terms of retail customer relationships of brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers with such retail customers;

(12) the potential impact upon retail customers that could result from potential changes in the regulatory requirements

or legal standards of care affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations to retail customers regarding the provision of investment advice, including any potential impact on—

- (A) protection from fraud;
- (B) access to personalized investment advice, and recommendations about securities to retail customers; or
- (C) the availability of such advice and recommendations;

(13) the potential additional costs and expenses to—

(A) retail customers regarding and the potential impact on the profitability of their investment decisions; and

(B) brokers, dealers, and investment advisers resulting from potential changes in the regulatory requirements or legal standards affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations, including duty of care, to retail customers; and

(14) any other consideration that the Commission considers necessary and appropriate in determining whether to conduct a rulemaking under subsection (f).

(d) REPORT.—

15 USC 78o note.

(1) IN GENERAL.—Not later than 6 months after the date of enactment of this Act, the Commission shall submit a report on the study required under subsection (b) to—

(A) the Committee on Banking, Housing, and Urban Affairs of the Senate; and

(B) the Committee on Financial Services of the House of Representatives.

(2) CONTENT REQUIREMENTS.—The report required under paragraph (1) shall describe the findings, conclusions, and recommendations of the Commission from the study required under subsection (b), including—

(A) a description of the considerations, analysis, and public and industry input that the Commission considered, as required under subsection (b), to make such findings, conclusions, and policy recommendations; and

(B) an analysis of whether any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.

(e) PUBLIC COMMENT.—The Commission shall seek and consider public input, comments, and data in order to prepare the report required under subsection (d).

15 USC 78o note.

(f) RULEMAKING.—The Commission may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized

15 USC 78o note.

investment advice about securities to such retail customers. The Commission shall consider the findings conclusions, and recommendations of the study required under subsection (b).

(g) AUTHORITY TO ESTABLISH A FIDUCIARY DUTY FOR BROKERS AND DEALERS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended by adding at the end the following:

“(k) STANDARD OF CONDUCT.—

“(1) IN GENERAL.—Notwithstanding any other provision of this Act or the Investment Advisers Act of 1940, the Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940. The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer. Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.

“(2) DISCLOSURE OF RANGE OF PRODUCTS OFFERED.—Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission may by rule require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer. The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of the standard set forth in paragraph (1).

“(l) OTHER MATTERS.—The Commission shall—

“(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

“(2) examine and, where appropriate, 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.”.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, is further amended by adding at the end the following new subsections:

“(g) STANDARD OF CONDUCT.—

“(1) IN GENERAL.—The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice. In accordance with such

rules, any material conflicts of interest shall be disclosed and may be consented to by the customer. Such rules shall provide that such standard of conduct shall be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of this Act when providing personalized investment advice about securities, except the Commission shall not ascribe a meaning to the term ‘customer’ that would include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such adviser. The receipt of compensation based on commission or fees shall not, in and of itself, be considered a violation of such standard applied to a broker, dealer, or investment adviser.

“(2) RETAIL CUSTOMER DEFINED.—For purposes of this subsection, the term ‘retail customer’ means a natural person, or the legal representative of such natural person, who—

“(A) receives personalized investment advice about securities from a broker, dealer, or investment adviser; and

“(B) uses such advice primarily for personal, family, or household purposes.

“(h) OTHER MATTERS.—The Commission shall—

“(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

“(2) examine and, where appropriate, 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.”.

(h) HARMONIZATION OF ENFORCEMENT.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934, as amended by subsection (g)(1), is further amended by adding at the end the following new subsection:

15 USC 78o.

“(m) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer shall include—

“(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

“(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser under the Investment Advisers Act of 1940, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to an investment advisor under the Investment Advisers Act of 1940.”.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, as amended by subsection

(g)(2), is further amended by adding at the end the following new subsection:

“(i) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser shall include—

“(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

“(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to an investment adviser under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934.”.