October 10, 2023

*VIA ELECTRONIC DELIVERY*

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

RE: **Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker- Dealers and Investment Advisers, Release Nos. 34-97990, IA-6353, File No. S7-12-23 (July 26, 2023)**

Dear Ms. Countryman:

Virtu Financial, Inc. ("Virtu") respectfully submits this letter in response to the above-referenced rule proposal issued by the Securities and Exchange Commission (the "SEC" or "Commission") on July 26, 2023 (the "Proposal"). Specifically, the Proposal would require broker-dealers and investment advisers to evaluate whether their "use of certain technologies in investor interactions involves a conflict of interest that results in the firm's interests being placed ahead of investors' interests. The Proposal would also mandate that firms eliminate, or neutralize the effect of, any such conflicts, but firms would be permitted to employ tools that they believe would address these risks and that are specific to the particular technology they use, consistent with the proposal."[1] In addition, the Proposal would require covered firms "to have written policies and procedures reasonably designed to achieve compliance with the proposed rules and to make and keep books and records related to these requirements."[2]

Virtu is a leading financial firm that leverages cutting edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients. Virtu operates as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu's market structure expertise, broad diversification, and execution technology enables it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in 36 countries worldwide.

Virtu broadly supports innovation and enhancements to transparency and fairness that increase liquidity and promote competition to the benefit of all marketplace participants. Unfortunately, the Proposal is yet another example of an effort by the current Commission to do just the opposite. Rather than promoting innovation, the Proposal will stifle the use of technology

[1] U.S. Securities & Exchange Commission, Press Release, *SEC Proposes New Requirements to Address Risks to Investors From Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers* (July 26, 2023), available at https://www.sec.gov/news/press-release/2023-140.
[2] *Id.*

by market participants, putting the U.S. capital markets at a significant disadvantage to its global peers. Rather than identifying an actual market failure that needs to be addressed, the Proposal seizes on artificial intelligence as a red herring for what the Commission is actually trying to achieve – jettisoning Regulation Best Interest and the Commission Interpretation Regarding Standard of Conduct for Investment Advisers in favor of a uniform fiduciary standard under which conflicts cannot be cured through disclosure and informed consent. **Rather than pursuing measured and tailored regulation that is calibrated to address a specific and verified technological risk to retail investors that market participants could implement, the Commission instead chose to issue a proposal so incredibly broad, with costs of compliance so staggeringly high, that it will be impossible for any firm to comply.**

For these reasons, Virtu strongly opposes the Proposal and encourages the Commission to withdraw it. As Commissioner Peirce suggested in her dissent,[3] instead of pursuing unnecessary standalone rules on novel topics that are not within the SEC's expertise or experience, Virtu implores the Commission to consider hosting roundtables and pursuing studies to enhance the agency's understanding of developments such as the use of adaptive artificial intelligence.

Proposal Will Stifle Use of Technology and Chill Innovation

The Proposal claims to be technology-neutral, but it is instead squarely aimed at discouraging firms from using technology. Given the incredibly broad definition of "covered technology" in the Proposal, market participants will have no choice but to substantially limit their use of a wide array of technological tools that are used today to increase automation and efficiency and enhance the retail investor experience and that have produced the most vibrant, liquid, and transparent markets in the world. As Commissioner Peirce astutely observed in her dissent, "[l]et us be honest about what we are doing here: banning technologies we do not like. As the release admits, one consequence of this initiative is that 'a firm might opt not to use an automated investment advice technology because of the costs associated with complying with the proposed rules.' We risk depriving investors of the benefits of technological advancement."[4]

We are puzzled why the Commission would issue a Proposal that would explicitly stifle innovation in our capital markets and put us at a competitive disadvantage to other jurisdictions. As noted in the Joint Trades letter submitted to the Commission on September 11, 2023, "[b]roker-dealers and investment advisers, regardless of their size, rely on technology to deliver better outcomes and innovative, cost-efficient products and services to their customers or clients, to the benefit of investors who now have greater access to more products at lower costs. Technological advances in auditing, reporting, recordkeeping, trading, and surveillance have left investors better

[3] Commissioner Hester Peirce, *Through the Looking Glass : Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers Proposal* ("Peirce Dissent") (July 26, 2023), available at https://www.sec.gov/news/statement/peirce-statement-predictive-data-analytics-072623
[4] *Id.*

protected. Our capital markets are at the forefront of the global economy due to technological innovation and competition."[5]

We are highly concerned that the Proposal's hostile approach to technology and innovation will have serious and long term negative and detrimental consequences for the competitiveness of the U.S. markets and will deprive investors of the tools that have fostered an unparalleled experience for U.S. investors.

Proposal Is A Risky Regulatory Experiment in Search Of A Problem

As with so much of the Commission's rulemaking activity since April 2021, the Proposal is a risky regulatory experiment in search of a problem. Regulation Best Interest and the Commission Interpretation Regarding Standard of Conduct for Investment Advisers, which were both adopted just a few short years ago, already govern market participants' communications and interactions with retail investors, including through the use of technology. Under these regulatory regimes, broker-dealers and investment advisers are required to put the interests of their customers first and are prohibited from engaging in conflicted activity without disclosure and informed consent. The Proposal fails to identify evidence of widespread misconduct or investor harm resulting from the use of technology, nor does it offer a persuasive justification for why the Commission's existing ruleset is inadequate to prevent inappropriate conflicts of interest that present a risk of harm to investors.

In other words, the Proposal fails the first prong of the Commission's own internal policies governing cost-benefit analysis – identifying a market failure that needs to be addressed. As we and others have noted in many recent comment letters on other SEC proposals, the Commission's Division of Risk, Strategy, and Financial Innovation – now known as the Division of Economic and Risk Analysis ("DERA") – and the Commission's Office of the General Counsel ("OGC") issued guidance in 2012 on economic analysis in Commission rulemakings. The guidance provides that:

> Rule releases ***must include a discussion of the need for regulatory action and how the proposed rule will meet that need***. In some circumstances, there will be more than one justification for a particular rulemaking. Frequently, the proposed rule will be ***a response to a market failure that market participants cannot solve because of collective action problems***. Traditional market failures include market power, externalities, principal-agent problems (such as economic conflicts of interest), and asymmetric information.[6]

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[5] Joint Trades Letter (Sept. 11, 2023), available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2023/09/Trade-Associations-PDA-Comment-Letter-Final.pdf?#.

[6] Current Guidance on Economic Analysis in SEC Rulemakings at 3-4 (Mar. 16, 2012), available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

The Commission has failed to identify a need for regulatory action, nor has it identified a market failure that market participants cannot solve. The Proposal is a prime example of the "perils of regulation by theory and hypothesis", a phrase coined by Commissioner Uyeda in a speech earlier this year.[7] Rather than identifying an actual market failure or pointing to actual examples of investor harm that have resulted from artificial intelligence or other technology, the Proposal merely hypothesizes that technological interactions between market participants and retail investors could result in conflicts of interest. As Commissioner Uyeda observed, the "SEC has been focused on rulemakings based on unrealistic expectations of how the world functions and how it ought to be."[8]

We suspect that the real motivation for the Proposal was not to address a market failure, but rather a thinly-veiled end around Regulation Best Interest and the Commission Interpretation Regarding Standard of Conduct for Investment Advisers in favor of a uniform fiduciary standard under which conflicts cannot be cured through disclosure and informed consent. This is a highly concerning development that goes against the fundamental tenets of our securities laws. There have always been, and always will be, potential conflicts that arise in the course of an investment relationship with a customer. Our securities laws require disclosure of conflicts, but also permit an investor to waive those conflicts through informed consent. **The Proposal represents a dramatic departure for the regulatory regime that has governed our markets for decades.** Never before has an SEC proposal required a firm to "eliminate" or "neutralize" (an ambiguous term that is not adequately defined in the Proposal) any potential conflict. The magnitude of this expansion of a market participant's obligations and duties to its customers cannot be overstated and has not been adequately considered or quantified by the Proposal.

Scope of Proposal Is Unprecedented And Will Be Impossible To Comply

The scope of the Proposal is simply unprecedented. The definition of "Covered Technology" goes far beyond artificial intelligence, encompassing any "analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes." As Commissioner Peirce noted in her dissent, "spreadsheets, commonly used software, math formulas, statistical tools, and AI trained on all manner of datasets, could fall within the ambit of this rulemaking."[9] The definition of an "Investor Interaction" is also inappropriately broad, capturing any communication with an investor, including on websites, smartphones, computer apps, chats, emails, texts, advertisements. Even code changes to an app or other technology platform that investors can access would be included.

[7] Commissioner Mark Uyeda, *Remarks to Investment Company Institute 2023 Investment Management Conference* (Mar. 20, 2023), available at https://www.sec.gov/news/speech/uyeda-remarks-ici-2023-imcon-palmdesertca-032023.
[8] *Id.*
[9] Peirce Dissent.

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The Commissions Cost Analysis is Fatally Flawed

And like so many other recent rulemakings, the actual cost of compliance is likely to be many orders of magnitude greater than the Commission's highly questionable estimate of $78,050 for a "complex covered technology firm".[10]

As is discussed above, given the incredibly broad scope of the Proposal, compliance will be virtually impossible to achieve. Even if covered firms could comply, the Proposal would mandate a virtually unlimited inquiry is in scope and into whether the technology used by the firm presents a theoretical risk of a conflict of interest. As with so many of its other rulemakings, the Commission boldy, yet incorrectly assumes that the contemplated requirements in the Proposal are are clearly written and that firms will have personnel on staff with the expertise to conduct the analysis, and that the staff has bandwidth to perform the required analysis, and that the cost of these staff is in line with the Commissions estimates. On all of these fronts the Commission is being unrealistic.

Affected firms will be required to hire many more staff, engage lawyers and other professionals, and spend countless hours assessing the compliance requirements and revising policies and procedures – in addition to finding less efficient and more costly ways to service clients' needs. Perhaps the Commission's goal is to create a cottage industry aimed at supporting new compliance requirements that will make up what the lost economics that ensue from stifling competition and innovation.

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Virtu has long been a vocal proponent of smart, data-driven regulation that supports the goals of enhancing transparency, fostering robust competition among market participants, and ensuring the high quality of the retail investor experience. Unfortunately, the Commission's Proposal does none of these things. Instead, the Proposal represents a paternalistic attempt by the Commission to expand its regulatory ambit to include technology products, and in the process impose substantial and needless burdens and costs on market participants that will ultimately be passed on to investors.

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[10] Proposal at pp. 184-85.

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The Commission is not a technology regulator and has no business making judgements about what technologies firms can offer and what technologies investors want to access. The Proposal is a dangerous theoretical exercise that, if adopted, would have very serious real-world consequences that will chill the use of technology in the financial services sector and deprive investors of the technological innovations that make our capital markets the most vibrant in the world.

Respectfully submitted,

Thomas M. Merritt
Deputy General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime E. Lizarraga, Commissioner
Mr. William A. Birdthistle, Director, Division of Investment Management
Dr. Haoxiang Zhu, Director, Division of Trading and Markets