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Regulating the Use of Predictive Data Analytics: This Ain't No Rom-Com

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Thank you, Jack [Murphy].

Good afternoon. Students, graduates, and faculty -- I am delighted to join you all today among so many fellow Catholic law grads.

Securities law is a topic near and dear to me. I have spent much of my career at the SEC – as a Commissioner and also on the staff, including serving as Deputy Director and Co-Acting Director of the Division of Trading and Markets. And before that I started life, out of Catholic's night law school, as a baby lawyer working for Securities Law legends like Bill McLucas at Wilmer, Cutler & Pickering. And now, I am Robinhood's Chief Legal Compliance and Corporate Affairs Officer.

Robinhood's mission is to democratize finance for all. We were the first to successfully eliminate trading commissions and account minimums, and the industry followed our lead – a move which has opened the stock market to millions of new investors and saved them billions of dollars in unnecessary fees.¹ Robinhood's easy to use, accessible mobile app combined with low-cost, innovative products and services has helped usher in a retail investor revolution.

Perhaps predictably, government regulators, hewing to nanny state notions of “investor protection,” have responded to the influx of retail investors by proposing a slew of unnecessary, costly, and, in some cases, duplicative rules – none of which were mandated by Congress and a number of which I believe exceed the SEC's statutory authority.

Today, I would like to talk a bit more about one of those proposed rules, which in my opinion would be one of the most consequential rules to come out of the agency in its nearly 100 year history – and I don't mean that as a compliment. I'm referring to the SEC's proposed rule to regulate

¹ See SP Kothari, Travis Johnson, and Eric So, “Commission Savings and Execution Quality for Retail Trades” (Dec. 6, 2021) (commissioned by Robinhood), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3976300.



broker-dealers' and investment advisers' use of so-called predictive data analytics, which I like to not so affectionately refer to as the PDA proposal.²

The SEC marketing around this rule makes it sound like a sensible regulation. But peel the onion back, and you'll quickly see that the PDA proposal is extraordinarily broad and sets a new standard that would be expensive and difficult, if not in most cases impossible, to meet.

The proposal defines "covered technologies" and "customer interactions" so expansively that the rule would capture almost any technology used to interact or communicate with a customer in almost any way. This includes advanced AI, but it also includes basic technologies like spreadsheets, emails, and graphic designs that have been used by brokers and advisers for decades.

The proposal would also designate technology as "conflicted" if the firm considers "an interest" – and here I mean *any* interest – it may have when using the technology to interact with customers. In other words, almost every use of technology would be conflicted under this ridiculously broad definition, even where, for example, the firm's interest involved conducting proper risk management or advertising a product that promotes tax-advantaged, long-term investing.

This rule would be a sea change in the regulation of broker-dealers and investment advisers. Under current SEC rules, brokers and advisers must act in their clients' best interests when they make investment recommendations or provide ongoing investment advice, respectively.

The provision of investment recommendations and advice often involves conflicts of interest between the firm and the customer – for example, firms typically make money when clients deposit more money into their accounts, make trades, or buy firms' proprietary products. The securities laws – which date back almost a century – allow firms to manage most conflicts through full and fair disclosure to and informed consent by the customer. Importantly – and logically – the securities laws do not impose the same "best interest" legal duty on a firm that provides a self-directed platform where the customer is making his or her own investment and trading decisions.

But the PDA proposal would apply broadly to the use of technology, whether or not a firm uses it to make an investment recommendation or provide investment advice. It would also expand the definition of "conflict of interest" so far that the term would essentially become meaningless. And the proposal would depart from nearly a century of securities law by preventing firms from managing conflicts of interest through full and fair disclosure to the customer.

² See SEC Rel. Nos. 34-97990; IA-6353, 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/files/rules/proposed/2023/34-97990.pdf>.



In other words, the PDA proposal is yet another attempt to establish a uniform, federal fiduciary duty for brokers and advisers, this time keyed to their use of technology.

In practice, firms will need to inventory and then periodically review hundreds, if not thousands, of individual uses of technology and make determinations about whether and how to eliminate or neutralize the so-called “conflicts” associated with these technologies. This would be a particularly difficult and expensive endeavor for any firm, and even more so for smaller firms and new entrants to the market.

What’s worse, firms would constantly be staring down the barrel of an SEC enforcement action based on the regulator’s rather subjective conclusions about compliance with an extremely broad and prescriptive rule. As a result, the PDA proposal would likely cause firms to pass along increased costs to investors and pull back on offering some technologies, products, and services that would otherwise benefit retail investors.

When the SEC proposed the rule last July, the Chairman said it was necessary to protect retail investors from being harmed by advanced AI programs. But, this rule wasn’t always about AI.

The rationale for the PDA proposal has changed over time, and it can be traced back to the GameStop events of early 2021. Once it became clear that there was no conspiracy between retail broker-dealers and hedge funds to manipulate trading in meme stocks, the SEC conveniently turned to the so-called “gamification” of stock trading.³ The term “gamification” has no standard definition, especially when it comes to stock trading, and most serious market participants knew that the volatility in meme stocks wasn’t caused by “game-like features and celebratory animations.”⁴

As they say, never let a good crisis go to waste.

Just a few months later in August 2021, the SEC adjusted its approach when it issued a request for comment on potential regulations focused on so-called “digital engagement practices” or “DEPs” by

³ See Testimony Before the House Committee on Financial Services (May 6, 2021), *available at* <https://www.sec.gov/news/testimony/gensler-testimony-20210505>.

⁴ Staff Report on Equity and Options Market Structure Conditions in Early 2021 (Oct. 14, 2021), p.43, *available at* <https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf>.



brokers and advisers, which basically includes every digital communication between a firm and its retail customer.⁵

In July 2023, the SEC shape-shifted again when it finally released the PDA proposal, citing the need for new regulations to govern “transformational” predictive data analytics and AI technology.⁶

I have little doubt that Chair Gensler has good faith concerns about the potential risks of advanced AI for retail investors. But the origins of the PDA proposal – the meme stock events of 2021 and the so-called “gamification” of investing – tell me that this rule is also animated by a paternalistic, nanny state view that a new generation of retail investors, who are generally younger, less wealthy, and more diverse than in years past, are not capable of investing on their own.

More specifically, the PDA rule starts from the premise that brokers and advisers are using technology surreptitiously to nudge or trick retail investors into trading excessively or making other decisions that favor the firms’ interests at the expense of their customers.

I reject these harmful narratives. At Robinhood, we see customers every day responsibly taking advantage of the same technologies and information available to professional investors to make financial decisions that *they believe* are in *their best interests*. We don’t think our customers necessarily want or need more “help” from the government. And while it should go without saying, we want to see our customers do well, or they probably won’t want to be our customers for much longer.

Imagine, hypothetically, that a similar federal rule were to be adopted in the consumer goods space that made it more difficult or impossible for companies like Amazon to use even basic technologies to sell you those new sneakers, that blender, or that flat screen TV you’ve been wanting. All out of a concern that these purchases might benefit Amazon more than you.

Of course, that would be a very frustrating experience for most consumers who simply need ready access to basic clothing or household items – maybe so bad that people would start going back to malls instead of shopping online, which by the way would be a boon for stores like Orange Julius and,

⁵ See SEC Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice, Release Nos. 34-92766; IA-5833 (Aug. 27, 2021), available at <https://www.sec.gov/files/rules/other/2021/34-92766.pdf>.

⁶ See SEC Press Release 2023-140, “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>



ironically, Gamestop! While we don't have a law like this for consumer goods companies – at least not yet⁷ – just substitute sneakers, a blender, or a TV sold on Amazon for actual Amazon stock, and that's exactly what the SEC's PDA proposal may do in the world of investing – make it harder, more expensive, and in some cases, impossible for customers to buy and sell stocks online.

The PDA proposal also quite clearly advances some policymakers' efforts for over the last two decades to impose a uniform fiduciary standard on brokers and advisers and, more recently, to re-litigate Regulation Best Interest, which explicitly rejected a uniform approach. The fact remains that Americans want choice when it comes to investing and trading, including the option to go self-directed, but this choice could disappear under one-size fits all rules like the PDA proposal that betray a preference for one business model over others. My guess is that investors' pitchforks will come out for the SEC if they choose to adopt the PDA proposal, just like they did for DOL after it issued its first fiduciary rule back in 2016.

We're living in a rather extraordinary time in the history of our capital markets. Technology has proven to be the equalizer, ushering in a new generation of retail investors who are participating in much greater numbers than in decades past. According to a Federal Reserve Survey of Consumer Finances released last Fall, about 58% of U.S. households owned stocks in 2022, up from 53% in 2019.⁸ According to a recent FINRA report, "data shows an increase of 9 points in the percentage of Black/African American respondents who are investors, 6 percentage points among Hispanic/Latino respondents, and 7 percentage points among Asian American/Pacific Islander respondents, relative to 2015."⁹ Robinhood's own surveys show that our customers are more diverse than customers at incumbent firms.¹⁰

⁷ I say "yet" because the Federal Trade Commission's so-called "dark patterns" case against Amazon suggests the SEC's PDA proposal may just be the tip of the iceberg, and that the federal government may start aggressively regulating all forms of digital commerce and communication. See FTC Press Release, "FTC Takes Action Against Amazon for Enrolling Consumers in Amazon Prime Without Consent and Sabotaging Their Attempts to Cancel" (June 21, 2023), available at <https://www.ftc.gov/news-events/news/press-releases/2023/06/ftc-takes-action-against-amazon-enrollng-consumers-amazon-prime-without-consent-sabotaging-their>.

⁸ See Hannah Miao, More Americans Than Ever Own Stocks, The Wall Street Journal (Dec. 18, 2023), available at <https://www.wsj.com/finance/stocks/stocks-americans-own-most-ever-9f6fd963>.

⁹ FINRA Investor Education Foundation, "Investors of Color in the United States" (Jan 2024), available at <https://www.finrafoundation.org/sites/finrafoundation/files/investors-of-color-in-the-us.pdf>.

¹⁰ Data comes from a monthly Robinhood survey, powered by Dynata. Sample is representative of the US population with brokerage accounts across age, gender, income, race/ethnicity, and regional residence. Incumbent firms include: Charles Schwab, E*Trade, Fidelity, TD Ameritrade, Vanguard. And here is the full list of FinTechs: Webull, Acorns, Wealthfront, Stash, M1 Finance, Betterment, SoFi, Coinbase, Cash App, Public, Robinhood.



More retail investors participating in the stock market, particularly those from underserved demographics, has long been a bipartisan goal. I believe it is critical that the SEC pursue policies that preserve and advance these positive developments because it's simply good for the country. The PDA proposal, however, is not one of these policies. Robinhood is now part of a long list of participants from all corners of the market who have serious concerns that the PDA proposal will stifle technological innovation and make investing and trading less accessible, all of which could disenfranchise the new generation of retail investors.

This would be a bad result, and not just for Robinhood. Millions of retail investors who are finally able to share in one of history's greatest generators of wealth now are at risk *again* of being left out in the cold. I said in the title of this speech, the PDA proposal ain't no rom-com. If it were, the SEC would come to its senses, ghost the PDA rule and pick the retail investor.

Thank you, and I look forward to answering any questions you may have.