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October 10, 2023

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

Re: *Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers; File No. S7-12-23*

Dear Ms. Countryman:

The Vanguard Group, Inc. ("Vanguard") appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposal to address conflicts of interest associated with the use of predictive data analytics and other "covered technologies" by broker-dealers and investment advisers ("Proposal").[1] We agree with the Commission that responsibly implemented technologies, such as those that analyze behavior to guide investment activities, can improve outcomes by decreasing costs, improving risk management, and enhancing investor experiences.[2] We also recognize the potential risks associated with certain complex technologies, including the risk that some firms may deploy these technologies in ways that could be contrary to client interests. Vanguard has long advocated for business practices and policies that seek to protect individual investors and put investor interests first. We also believe that regulatory standards for investment advisers and broker-dealers should encourage these firms to deploy investor-facing technology, particularly retail-investor-facing technology, in ways that align with *investor* interests.

We are concerned, however, that the Proposal's breadth, scope, and burden will unintentionally chill the use of technologies that can—and do—have significant *pro-investor* benefits. We provide examples below to illustrate how Vanguard employs technologies for investor *benefit*—through a digital savings optimizer for investors, nudges to boost retirement success, and identification of clients with an interest in advice. These technologies—along with many others—have contributed to enhanced retirement security for millions of investors, better preparedness for unexpected life events, better asset allocation, greater peace of mind, and overall increased financial wellness. We are concerned that the Proposal could reduce investor access to these technologies and the *improved* outcomes associated with their use.

To simultaneously protect pro-investor activity and reduce behavior contrary to investor interests, we recommend the Commission consider a straightforward approach that (1) tailors

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

[2] *See* Proposal at 53962. We use the term "outcome" to refer to an investor's ability to achieve a goal, which is broader than simply investment performance or return.

new compliance requirements and targeted regulatory action to areas where investor interests and corporate interests *diverge* (e.g., where a firm encourages a client to take an action that benefits the firm but that has no clear client benefit, such as encouraging frequent short-term trading) and (2) prohibits broker-dealers and investment advisers from engaging in practices that are designed or found to operate contrary to investor interests.[3] Rather than applying a new regulatory framework to *all technologies* and investor interactions, including those where corporate and investor interests align (e.g., encouraging clients to consider saving more toward their financial goals), regulators should build on the existing legal framework and, where necessary, set a clear, simple standard and impose additional compliance requirements on areas where investor and corporate interests *diverge*.

The Proposal would reduce access to technologies that help investors reach their financial goals.

Since its inception, Vanguard has leveraged technology across all areas of the firm to help investors achieve investment success. Incorporating technology into the investment process has been shown to improve investor understanding, decision-making, and outcomes, and should be protected—if not actively encouraged—by regulators. As described below, however, the Proposal's broad definitions would (1) classify virtually all technology used in the industry in investor interactions as "covered technologies"—triggering significant conflict analyses—and (2) potentially mislabel many basic technologies as "conflicted" even when designed and implemented in ways that *improve* investors' financial outcomes.

Ultimately, we are concerned the breadth and scope of the Proposal will reduce the willingness of firms to provide pro-investor prompts either because of the additional compliance cost and burden involved or out of fear that they will unintentionally create legal and regulatory risk because even basic pro-investor actions could be mislabeled as "conflicted" under the Proposal. We are concerned the net result will reduce investors' access to positive technologies and prompts that *enhance* their financial outcomes.

The Proposal defines key terms broadly.

The Proposal would require firms to take three primary steps to protect investors when using a covered technology in investor interactions:

- Evaluate whether the use of a "covered technology" involves a "conflict of interest";[4]

[3] Individuals may certainly still choose to engage in trading activities that may not traditionally correlate to long-term financial well-being, but broker-dealers and investment advisers should not use digital prompts and other technologies to drive actions contrary to investor interests, particularly alongside other messages that suggest a desire to help these same investors achieve their long-term financial goals.

[4] The Proposal would require a firm to evaluate the use, or reasonably foreseeable use, of all covered technologies in all investor interactions. Firms would need to regularly test each covered technology to determine if its usage would constitute a conflict of interest.

- Determine whether the conflict could put the firm's interests ahead of investors' interests;[5] and, if so,
- Eliminate or neutralize the conflict (a departure from the SEC's typical, disclosure-based approach to regulation).[6]

A "covered technology" would include 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. This proposed definition encompasses virtually any feature or communication designed to influence investment-related behaviors from investors.

The proposed definition of "conflict of interest" refers to any situation where a broker-dealer or investment adviser uses a covered technology that *takes into consideration* any interest of the broker-dealer or investment adviser or a natural person who is an associated person of the firm. The Proposal states that firms should interpret "takes into consideration" broadly so that consideration of "*any* firm-favorable information in an investor interaction" would create a "conflict" that would need to be evaluated.[7] The Proposal further notes that under this standard, a "conflict" could exist anytime a broker-dealer or investment adviser's covered technology *benefits* the firm, even if that benefit is entirely aligned with investor interests.[8]

Valuable tools used to promote investor outcomes could be deemed "conflicted" covered technologies under the Proposal.

Vanguard's self-directed brokerage and advice businesses[9] use a variety of technologies to encourage investors to consider their risk profile, set and save for their goals, improve portfolio

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[5] Firms also would be required to create and maintain detailed policies and procedures to document the firm's compliance with the requirements above. The Proposal's requirements also appear to attach to asset managers' activities as adviser to pooled investment vehicles, including mutual funds and ETFs, and would likely frustrate their ability to employ certain technologies in the management of these products.

[6] We share the view of the Investment Company Institute and SIFMA that applying the Proposal to sophisticated institutional investors, such as registered funds and similar pooled investment vehicles, is unnecessary and could harm investors in these products. *See* Letter from Susan Olson, General Counsel, Investment Company Institute to Vanessa Countryman, Secretary, Securities and Exchange Commission, dated October 10, 2023; Letter from Melissa MacGregor, Deputy General Counsel & Corporate Secretary, Securities Industry and Financial Markets Association ("SIFMA"), and Kevin Ehrlich, Managing Director, SIFMA Asset Management Group to Vanessa Countryman, Secretary, Securities and Exchange Commission, dated October 10, 2023.

[7] *See* Proposal at 53982 (emphasis in original).

[8] *See* Proposal at 53982, n. 159. We agree with the concerns of the Investment Adviser Association that the proposed definition of "conflict of interest" could create new uncertainty and risk. *See* Letter from Gail C. Bernstein, General Counsel, and Sanjay Lamba, Associate General Counsel, Investment Adviser Association to Vanessa Countryman, Secretary, Securities and Exchange Commission, dated October 10, 2023.

[9] Within the U.S., Vanguard Marketing Corporation is the distributor and principal underwriter of the Vanguard Funds and registered with the SEC as a broker-dealer (dba, Vanguard Brokerage Services®) that provides a self-directed brokerage platform for retail clients.

Vanguard's advice services are provided by Vanguard Advisers, Inc., a SEC-registered investment adviser, or by Vanguard National Trust Company, a federally chartered, limited-purpose trust company.

diversification, and generally take an active role in their financial wellness. We provide three examples below to illustrate how we deploy technology to improve investment outcomes for clients of these businesses. While each technology considers the interest of the client to provide targeted educational or marketing material, firms also may benefit if clients respond by increasing their use of their funds or advice services. The potential for the tools below to generate additional revenue could cause them to be mislabeled as "conflicted" covered technologies under the Proposal.

Digital savings optimizer for advice clients. Vanguard's advice business uses various technologies to encourage investors to take an active role in their financial well-being by providing educational materials, questionnaires, and tailored outreach designed to help investors understand key trade-offs and make informed choices to advance their financial goals.[10] For example, our Digital Advisor service provides clients with a tool that analyzes the sufficiency of their emergency savings to withstand unexpected changes in spending or income (e.g., home repairs or job loss, respectively). This tool uses machine learning technology to provide personalized projections of a client's likelihood of job loss and potential length of unemployment based on historical job market data. The tool then uses the projections to provide a range of estimates so a client can make better decisions regarding where and how much to save for different types of emergencies. The nature of the tool seeks to help clients optimize their savings strategy as part of a fee-based advisory service and may result in modifying investment allocations in a way that brings more assets into the service.

Nudges designed to boost retirement success. Our 401(k)-recordkeeping business uses client data to identify clients whose employer offers to match retirement contributions and nudge them to take full advantage of this match to boost their savings and increase the odds of achieving a successful retirement. We also deploy nudges to encourage clients to consider boosting their retirement savings. For our self-directed clients who rely on individual retirement accounts ("IRAs") to save for retirement, our technology reviews contribution data and encourages clients to contribute earlier in the year to benefit from compounding and potentially maximize returns. We also nudge non-contributors to make at least one contribution per year because even one contribution annually can build momentum and returns that compound over time. Our clients are undeniably better off as a result of these prompts. Approximately 60 percent of 401(k) plan participants took action after receiving a nudge from Vanguard,[11] and 14,000 IRA clients acted after Vanguard nudged them, boosting their retirement savings by $50 million.

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[10] The technologies used in connection with Vanguard's advice business are generally marketing or educational in nature. We serve in a fiduciary capacity when providing advice and resolve our conflicts within our discretionary advice offers by offsetting any additional compensation received by Vanguard (e.g., when recommending proprietary funds or receiving revenue sharing from third-party funds). Within our non-discretionary advice offers (i.e., those where an adviser recommends an asset allocation, corresponding investments, and rebalancing and trading parameters to which the client consents to in advance and also consents to any material changes in the future) we mitigate our conflicts through disclosure and informed consent.

[11] *See* webcast by Vanguard titled "A Look Ahead with Vanguard," (Jan. 27, 2023), at 41:10 – 41:25, *available at* https://corporate.vanguard.com/content/corporatesite/us/en/corp/articles/a-look-ahead-2023.html.

Identifying clients with an interest in advice. Vanguard also uses digital technologies to encourage investors to enroll in our low-cost advice offers, which can significantly improve their outcomes over time.[12] One tool we use reviews clients' account behaviors (e.g., transactions and profile changes), holdings, interactions with Vanguard's website, and other inputs to assess clients' need and interest in learning more about one of our advice offerings. For instance, the tool may recognize that a client approaching retirement age is logging into her Vanguard account more frequently and visiting advice-related pages on our website. The tool may hypothesize that this client may benefit from receiving additional outreach regarding our advice offers and enable Vanguard to reach out to offer the client individualized advice solutions as part of a holistic needs assessment conversation.[13] If the client determines to enroll in an advice offer, she will pay a reasonable fee for this service just like other advice clients.[14]

The examples above illustrate just a few ways we leverage technology, particularly behavioral nudging and machine learning, to provide value to clients and help them reach their financial goals. We want to continue these practices in the future and develop and responsibly implement new ones, as technology evolves, to give investors the best chance for investment success. We urge the SEC to ensure the continued availability of these practices to promote investment success.

The Proposal's broad conflict standard imposes significant new risks and obligations.

As noted above, the Proposal appears to deem as conflicted technologies those that facilitate investor interactions—along with dozens of other technologies—even though they are deployed to promote better financial outcomes for our clients. Treating as "conflicted" *aligned* incentives that improve investor outcomes does not improve investor outcomes.[15] It will more likely do the opposite, chilling pro-investor engagement and risking long-term investor harm.

Under the Proposal, broker-dealers and investment advisers must subject each covered technology used in investor interactions to extensive analysis, testing, and documentation requirements that will significantly raise the costs and risks associated with these interactions.[16] Covered technologies that involve any consideration of the firm—even an aligned incentive that

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[12] *See* "The Value of Personalized Advice," *available at* https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2022/value-of-personalized-advice.pdf. We have found that, in addition to providing increased financial returns and better diversified portfolios, advice provides many investors with emotional value—i.e., peace of mind—and time value, which arises from an advice provider performing tasks that investors would otherwise need to perform on their own.

[13] We provide clients an opportunity to opt out of the marketing communications described above.

[14] Net advisory fees for Vanguard's U.S. advice offerings range from approximately 0.15 percent to 0.35 percent depending on service and investment strategy selected by the client. The average cost for financial advice from full-service providers is around 1 percent per year (e.g., typically those whose operations are not as technology based).

[15] This is particularly true with respect to Vanguard because our clients are also our owners. Vanguard is owned by its U.S. funds, which, in turn, are owned by their shareholders. Our unique investor-owned structure aligns our interests with those of our clients.

[16] The value of robust testing cannot be understated and, as a good practice, should encompass a range of factors, including data integrity, bias, security, general functionality, and potential conflicts of interest.

promotes investor interests—would require additional review and impose additional burden and legal risk. These obligations would be broad, ambiguous, and duplicative of existing standards. At a minimum, these new requirements would significantly raise costs on a broad range of beneficial investor interactions. More importantly, the new obligations may lead companies to reduce these pro-investor efforts or target them to a narrower subset of clients, leaving investors to navigate myriad investment options without important and helpful tools. We fear the net effect of such a broad approach could be less investor education, less access to high quality advice, a less personalized experience, and worse investor outcomes.[17]

Firms and the Commission should focus on helping investors directly, rather than regulating technology.

We encourage the Commission to consider alternative ways of protecting investors from the risk that broker-dealers and investment advisers may deploy new technologies in ways that are contrary to their clients' interest. An array of SEC and FINRA rules effectively prohibit broker-dealers and investment advisers from using technology to mislead or deceive clients. These rules govern a broad array of broker-dealer and investment adviser investor interactions, including recommendations, marketing, advice, and disclosure.[18] We believe these rules—and the associated requirements to fully disclose conflicts of interest—remain highly relevant and are core elements to protecting investors.

Instead of layering new standards for technology on top of these existing investor protection rules, we suggest the Commission look to existing rules, such as Regulation Best Interest, and consider issuing updated guidance to clarify its views on how these existing rules apply to the

[17] Our research shows that there is a critical need to connect low-income workers with the capital markets so they can reduce their projected retirement readiness gap. *See* "The Vanguard Retirement Outlook: A national perspective on retirement readiness" *available at* https://corporate.vanguard.com/content/dam/corp/research/pdf/the_vanguard_retirement_outlook.pdf.

[18] *See, e.g.,* "Securities and Exchange Act of 1934," part 17 CFR 240.15l-1 (Regulation Best Interest), *available at* https://www.ecfr.gov/current/title-17/chapter-II/part-240/subpart-A/subject-group-ECFR541343e5c1fa459/section-240.15c1-1, which requires a broker-dealer only to make recommendations that are in the best interest of retail clients and to fully and fairly disclose conflicts of interest when making recommendations; "Commission Interpretation Regarding Standard of Conduct for Investment Advisors," *available at* https://www.sec.gov/files/rules/interp/2019/ia-5248.pdf, a 2019 SEC interpretation of the standard of conduct for investment advisers, which under the Investment Advisers Act of 1940 imposes fiduciary duties of loyalty and care that, collectively, prohibit an SEC-registered investment adviser from placing its interests ahead of those of its clients; "Investment Adviser Marketing Rule," *available at* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf, a 2020 SEC rule applicable to prospective and existing clients that establishes standards for investment adviser marketing by requiring advisers to disclose certain conflicts of interest and to present their offerings and results in a "fair and balanced" manner; FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade), *available at* https://www.finra.org/rules-guidance/rulebooks/finra-rules/2010 - the-rule, which requires that broker-dealers, in the conduct of business, observe the "highest standards of commercial honor and just and equitable principles of trade"; and FINRA Rule 2210 and its related guidance, *available at* https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210 - the-rule, which sets forth standards for all written communications to be fair and balanced and covers use of investment analysis tools and research. These existing rules, among others, focus on the substance of marketing communications, recommended actions, or advice delivered to a client, not the way the marketing communications, recommended actions, or advice were generated and, therefore, apply regardless of whether a covered technology is used and hold broker-dealers and investment advisers to relevant standards in either situation.

use of new and complex technologies by broker-dealers and registered investment advisers.[19] This approach would establish clear guidelines about the appropriate use of digital tools that can readily evolve alongside the technology itself and would provide broker-dealers and investment advisers clarity that they may continue to use pro-investor technologies while chilling the use of harmful ones. [20] Imposing a broad new framework on top of the existing standards could create regulatory ambiguity and uncertainty and directly impair innovation designed to benefit investors.

If the Commission continues to believe a new regulatory regime is necessary, we recommend the SEC modify its approach to tailor new compliance requirements and targeted regulatory action to areas where investor interests and corporate interests *diverge* and prohibit broker-dealers and investment advisers from engaging in practices that are designed or found to operate contrary to investor interests. This approach would anchor to analyzing client relationships for conflicts instead of individual technology processes or applications and would ensure that investors continue to benefit from technological advancements. Appropriately tailored regulatory action would give firms confidence to continue promoting savings and investment activities that *align* with investor interests (e.g., collecting an employer's full 401(k) match or offering advice to clients with an interest and need for the service) and restrain activity where the firm's interest *diverges* from that of the investor (e.g., prompts designed to encourage clients to engage in unnecessary or speculative trading or to retain suboptimal asset allocations).

[19] We recognize the importance of managing key risks associated with new technologies. For example, the industry should be held to a high bar to manage bias in artificial intelligence or any data-based model more generally. In our model governance processes, we have scrutinized the use of inputs like zip code data for healthcare cost estimators to provide clients with greater personalization and information. However, we are more skeptical about pulling zip code data into capabilities that forecast salary growth given the historical bias that is likely present in the data set.

[20] The Commission also could use its enforcement authority to police misconduct and further establish standards for firms to follow in their deployment of new technologies.

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Vanguard appreciates the opportunity to comment on the Proposal. If you have any questions or would like to discuss our views further, please contact George Gilbert, Head of U.S. Regulatory Affairs, at george_gilbert@vanguard.com or Christyn Rossman, Assistant General Counsel, at christyn_l_rossman@vanguard.com.

Sincerely,

/s/ Matthew Benchener

Matthew Benchener
Managing Director, Personal Investor
The Vanguard Group, Inc.

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