



RESEARCH

Insights

The 2024 C&L Annual Seminar Debrief

Perspectives & Key Themes from Compliance and Legal Professionals

April 2024

Recently, SIFMA hosted our C&L Annual [Seminar](#). Here we gained insights into top-of-mind topics for compliance and legal professionals from across the financial services industry, including:

- **Regulatory Environment:** Neither market failures nor direction of Congress precipitated the SEC agenda, with 31 final rules since 2020 and 19 more to be finalized. AI – holds great promise but brings risks; PDA proposal was meant to address these risks, says the SEC. CAT – transactional data objective understood, personal data brings security concerns. Reg BI – Reg BI effective regulation for customer protection, no need for DOL proposal 2.0. Remote work – hybrid work here to stay, FINRA pilot begins this summer.
- **AI Perspective:** AI is not new, but the speed and (advanced) technology is new. Firms are in different stages of AI use cases, dividing them into low (summarizing meetings) and high (predictive tools) risk. Panelists highlighted considerations for risk management – regulatory, legal, intellectual property – and governance – policies, data, disclosures to avoid AI washing. PDA proposal extremely broad and could significantly impact markets, covering any technology used in investment recommendations. Broad definitions include future people and interactions. Duties for firms around conflicts are to evaluate, determine, & eliminate or neutralize.
- **More on Market Themes:** Equities - Rule 605 adopted, industry is disappointed there is no template; tick sizes and access caps are expected to be next; best ex remains a top SEC priority; and panelists believe auctions may be encouraged not mandated. Fixed income – many rules could have significant operational and compliance burdens, such as Treasury clearing, and could decrease liquidity.
- **Market Touchpoints:** This report also includes our pre-conference survey and audience polling results.

To see details from topics covered throughout the year, please see SIFMA Insights at: www.sifma.org/insights

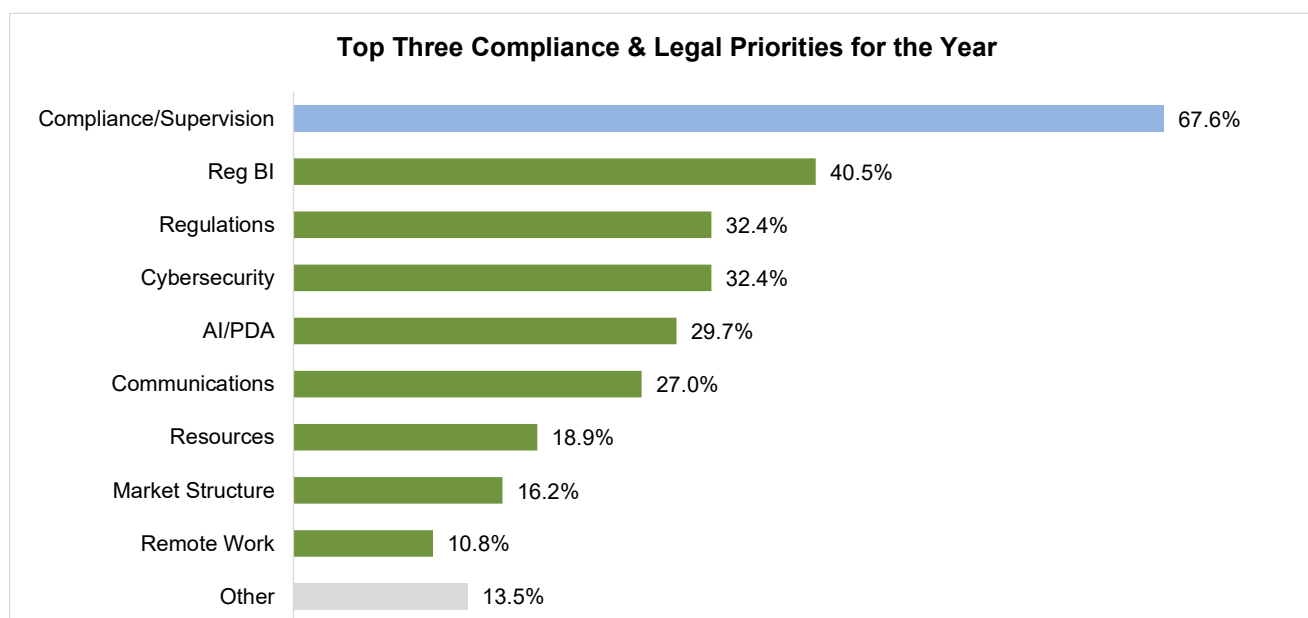
Contents

The Industry Outlook	3
Setting the Scene: Top Compliance & Legal Themes	3
Setting the Scene: Survey Says	5
The Regulatory Environment.....	6
Setting the Scene: Survey Says	6
SEC Rulemaking Agenda.....	10
Artificial Intelligence (AI).....	10
Predictive Data Analytics (PDA)	11
Consolidated Audit Trail (CAT) – FINRA Shares Industry’s Data Concerns.....	11
Regulation Best Interest (Reg BI).....	12
Remote Work	12
The Artificial Intelligence (AI) Perspective	13
Setting the Scene: Survey Says	13
What Is AI.....	14
Use Cases in AI.....	15
AI Best Practices	17
AI Regulatory & Legislative Environment	21
Predictive Data Analytics Proposal.....	22
More on Market Themes	24
Setting the Scene: Survey Says	24
Equity Market Structure	26
Fixed Income Market Structure	29
Issues Impacting Prime Brokers/Hedge Funds	30
Appendix: Pre-Conference Survey Methodology.....	31
SIFMA Insights Research Reports	32
Author.....	33

The Industry Outlook

Setting the Scene: Top Compliance & Legal Themes

To set the scene of the Seminar, we surveyed attendees and select SIFMA members on the top member-identified compliance and legal priorities for the year. As various perspectives on market themes arose during the week, it was a reminder of the importance of market participants coming together to discuss best practices as well as pain points that the industry must work together to overcome.



Source: SIFMA Insights pre-conference survey

Several member-identified priorities addressed include:

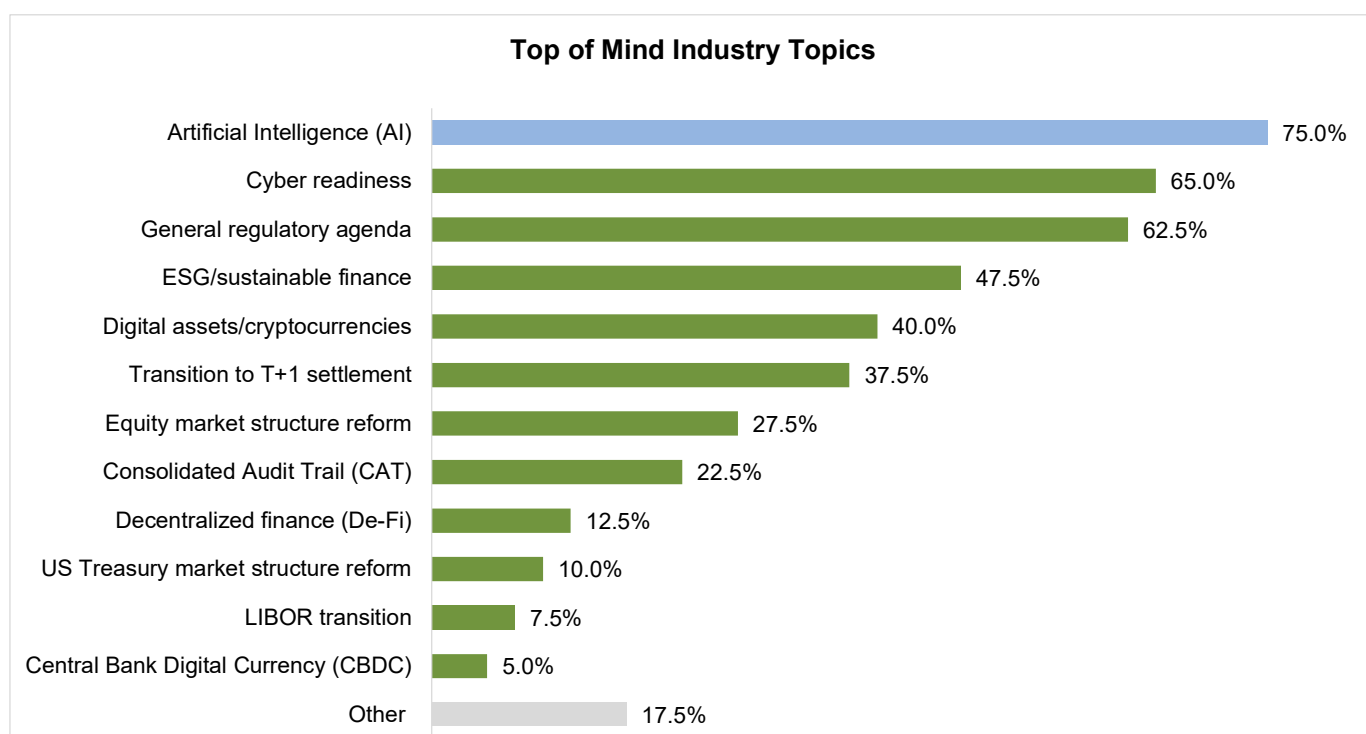
- **Compliance/Supervision** – Anti money laundering (AML), books and records, compliance testing, disclosures, expansion of compliance program testing, governance (clearing agency), implementing updated policies and procedures, improve procedures/risk assessments/controls/MNPI controls, information barriers, investment research compliance, oversight of affiliates, privacy regulatory compliance, sanctions, Section 15, supervision, surveillance, trade reporting/surveillance
- **Regulation Best Interest (Reg BI)** – Conflicts management/disclosing conflicts, improvements/continuing to refine Reg BI/fiduciary practices, DOL proposed fiduciary rule, compliance
- **Regulations** – FINRA priorities, marketing rule changes, preparing for reporting of securities lending transactions, Reg M, regulatory change, Rule 15c2-11, SEC SPAC rule, soft dollars, T+1, vendor management

- **Cybersecurity** – Building out better data security program, cyber risk framework, business continuity planning, compliance
- **Artificial Intelligence/Predictive Data Analytics (AI/PDA)** – Impact on business processes, governance, compliance, what will we allow, Gen AI and analytics
- **Communications** – Electronic, off channel, recordkeeping
- **Resources** – Supporting business growth, data management, efficiencies, expanding team knowledge, outsourcing, reducing spend
- **Market Structure** – market access, Treasury clearing, reform, new SEC rules/staying abreast of SEC rule changes
- **Remote Work** – Offices/supervision, Residential Supervisory Locations (RSL), remote pilot
- **Other** – ESG, crypto, options, technology

Setting the Scene: Survey Says

To continue setting the scene of the conference, our survey asked respondents what general industry topics were top of mind for them. Survey respondents were asked, **“What industry topics are top of mind for you? (please select all that apply)?”**

The majority said: Artificial intelligence (AI) came in on top with 75.0% of responses. This was followed by cyber readiness at 65.0% of responses and the general regulatory agenda at 62.5% of responses.



Source: SIFMA Insights pre-conference survey

Note: Other = privacy, municipal bond regulation, residential supervisory locations, pile on fines and penalties, consolidation of independent model firms and the decreasing access for small town America, surveillance, and research

The Regulatory Environment

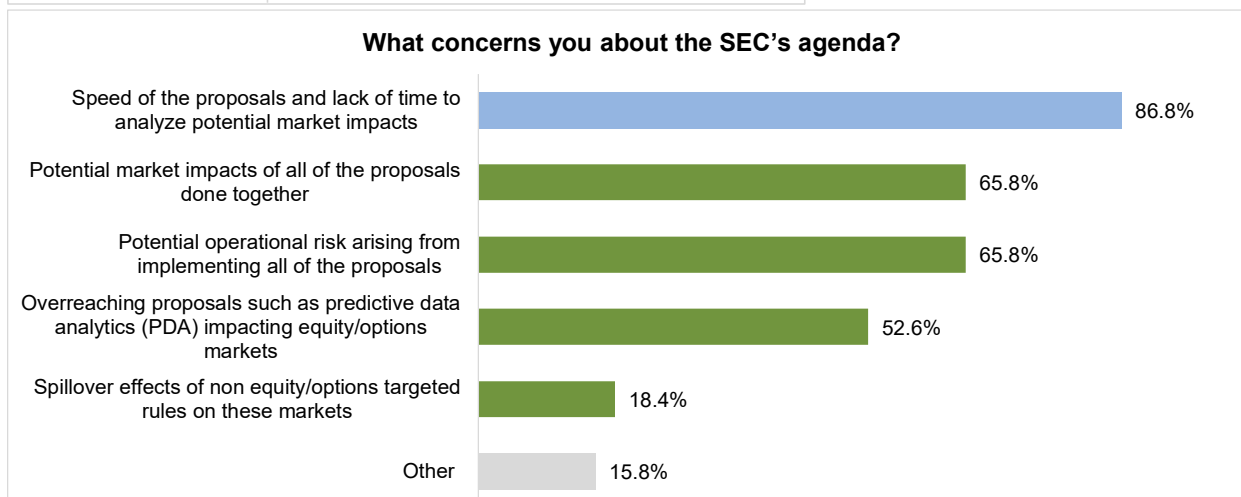
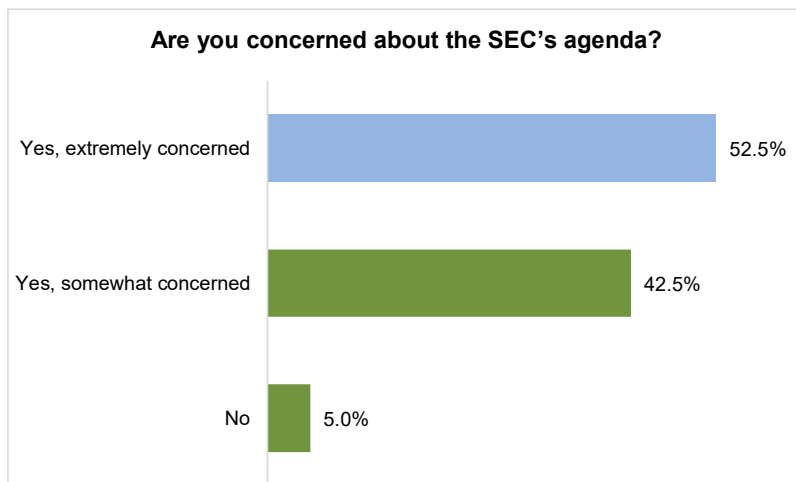
Setting the Scene: Survey Says

To set the scene for this section, we recap our pre-conference survey results on the regulatory environment. Survey respondents were asked, **“In general, are you concerned about the SEC’s agenda?”**

The majority said: 95.0% of respondents are concerned about the SEC’s agenda, with 52.5% extremely concerned and 42.5% somewhat concerned.

The survey then asked, **“In general, what concerns you about the SEC’s agenda?” (please select all that apply)**

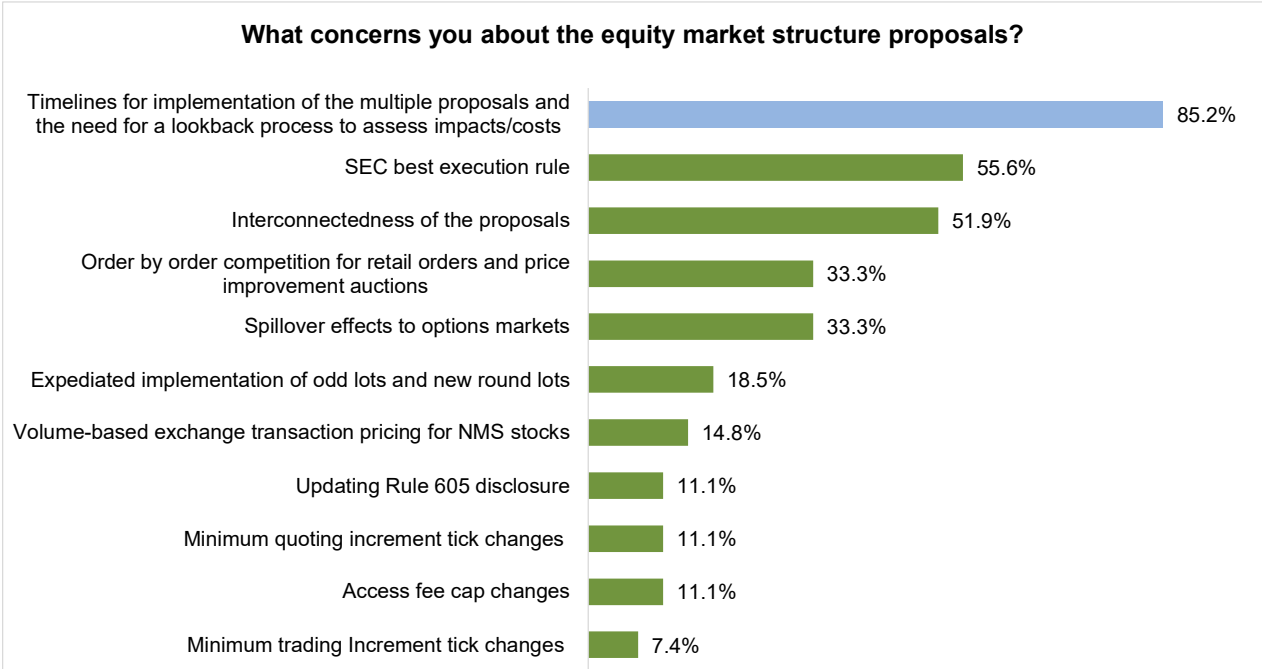
The majority said: Speed of the proposals and lack of time to analyze potential market impacts came in on top at 86.8%. This was followed by a tie at 65.8% each for potential market impacts of all the proposals done together and potential operational risk arising from implementing all of the proposals. We note that the operational risk has been rising in surveys.



Source: SIFMA Insights pre-conference survey

We closed out survey questions to the overall SEC agenda by asking, **“Specific to equity market structure, what concerns you about the SEC’s proposals?” (please select all that apply)**

The majority said: Timelines for implementation of the multiple proposals and the need for a lookback process to assess impacts/costs, at 85.2%. This was followed by the SEC best execution rule at 55.6% of responses.



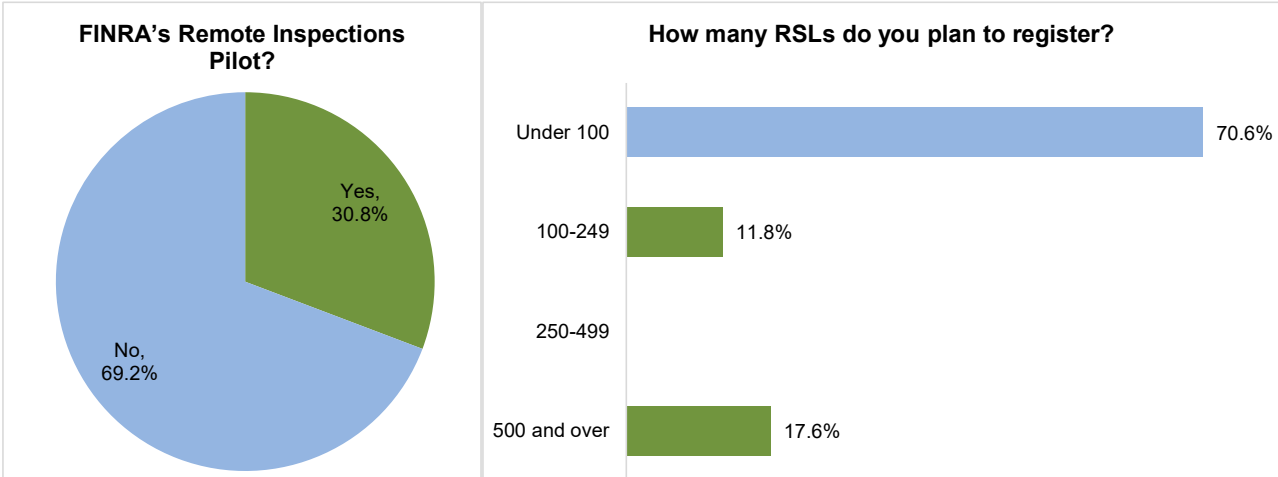
Source: SIFMA Insights pre-conference survey

Specific to the FINRA agenda, our survey asked, **“Do you plan to participate in FINRA’s Remote Inspections Pilot, and if not, why?”**

The majority said: most respondents replied no, at 69.2%. This was followed by yes at 30.8% of responses. The main reasons listed as to why not were: Not applicable to my role or firm at 66.7%, followed by the reporting burden is too great at 23.8% of responses.

The survey then asked, **“How many Residential Supervisory Locations (RSL) do you plan to register?”**

The majority said: Under 100, at 70.6%. This was followed by 500 and over at 17.6% of responses.



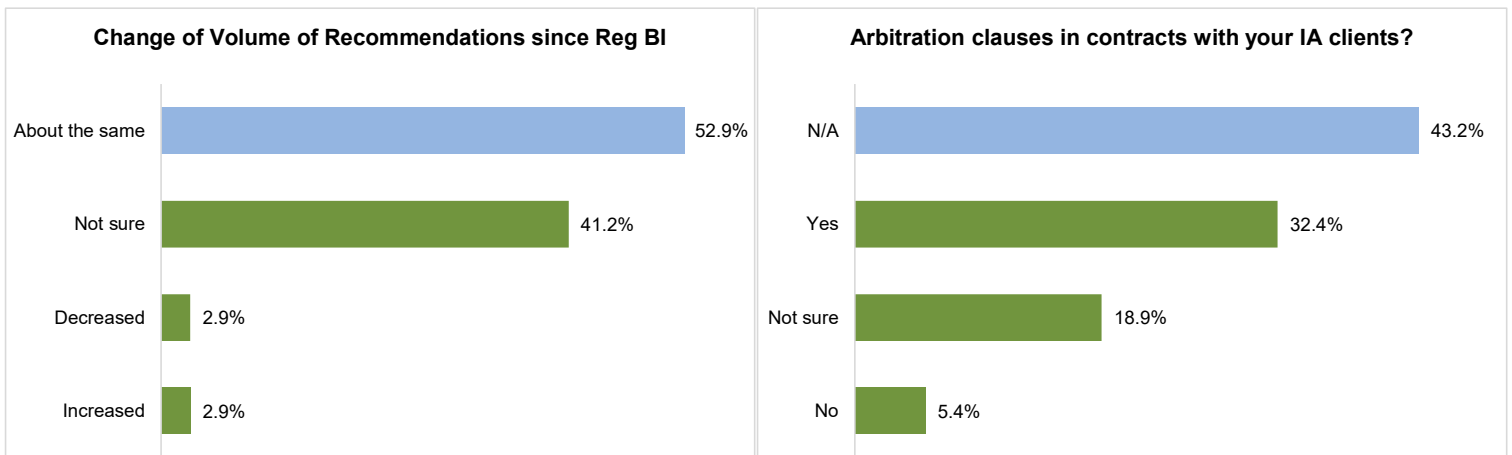
Source: SIFMA Insights pre-conference survey

Specific to SEC agenda, our survey asked, **“Since the effective date of Reg BI in June 2020, how has the volume of recommendations of complex products to retail investors at your firm changed?”**

The majority said: About the same, at 52.9%. This was followed by not sure at 41.2% of responses.

The survey then asked, **“Does your firm include arbitration clauses in contracts with your investment advisory clients?”** Respondents were then asked to list designated arbitration forums.

The majority said: N/A, at 43.2%. This was followed by yes at 32.4% of responses.



Source: SIFMA Insights pre-conference survey

SEC Rulemaking Agenda

Historically, new regulations were driven by a market failure or direction of Congress. Much, though not all, of the slate of Securities and Exchange Commission (SEC) rulemaking has a tenuous relation to Congressional intent or existing statute. There have been 31 final rules since 2020 and 19 more to be finalized.

The volume of rulemakings is coupled by short comment periods for the industry to weigh in, despite the fact that regulators benefit from industry input on rulemakings. Many of the rule proposals lack adequate economic analyses to justify the costs/benefits. There are multiple proposals out there that will have significant market impacts, raising the stakes for unintended consequences. Additionally, operations teams will be required to implement all of these changes – many of which have short timelines – increasing the potential for operational risk in the system.

The current SEC rulemaking agenda has significantly outpaced rulemaking agendas of the prior two chairs in volume and speed. The fast pace of the rulemaking leaves the industry, as well as FINRA, a short timeframe to analyze rules and prepare for implementation. FINRA confirmed that they will adapt as always. FINRA also indicated that they will look at the cumulative impact of all rules from all regulators and, therefore, be thoughtful with their own rules. They are rethinking if some of their rule changes need to move forward now or can be paused at this time.

Artificial Intelligence (AI)

We always have technological change, and regulators have dealt with this before. While AI holds great promise, it also brings risks. According to the SEC, regulators should see where we are and where we are headed, assessing risks but allowing for technological change. The Commodity Futures Trading Commission (CFTC) added to this by noting that critical infrastructures and intermediaries need to be thoughtful about the promise of faster, more efficient transactions. They should worry about potential issues like the Flash Crash in 2014.

The Office of the Comptroller of the Currency (OCC) shared these concerns, citing excitement but weariness. They also reminded the audience that, as with all models, users should be aware of the garbage-in-garbage-out concept. For example, if the data used to train models holds biases, these biases will be included in model outcomes.

Beware of AI washing warned the SEC on one panel. While they indicated they are agnostic on the technology, the language must match the technology. They have brought two enforcement actions against investment advisers who claimed they were using AI, but the technology did not match what was said publicly. The North American Securities Administrators Association (NASAA) seconded AI washing concerns. It further noted that it expects fraud related to AI to be a top threat to retail investors going forward.

Regulators noted that they will be looking for firms to have AI policies and procedures in place and documentation explaining models, on both the training of models and how they are used.

Specific to sell-side research, FINRA weighed in on the use of AI. The focus of research rules are on the content. If research analysts use AI to generate content, firms should know that current research rules apply. The definition of a research report include any communications generated on which to base investment recommendations.

Therefore, if firms use AI to build a summary of the report, it must be approved in the same way as a standard report.

Research must be objective and reliable. There must be a reasonable basis for investment recommendations. If an analyst builds a company price target with AI, there must be a reasonable basis. Also, firms need to have a person that can explain how the AI models/systems work to produce the results that they do. Firms will not be able to just say ChatGPT told me the number. As an example where a firm went wrong in the past, in 2023, a firm was fined \$2 million for poor conflict of interest disclosures because its automated data feeds broke down.

Predictive Data Analytics (PDA)

Following on to the AI section, the SEC weighed in on its objectives behind and considerations of the PDA rule proposal. The requirement for broker-dealers and investment advisors to disclose and mitigate conflicts is not new. In Reg BI, the recommendation is the key – no recommendation no BI. What is new is the technology. The technology advanced so fast, the SEC was concerned about how it would work with existing regulations and if current rules were sufficient.

Under investor protection and conflict management, the SEC was looking at firm objectives. Why is one news feed showing and not others? Is a firm's revenue stream being optimized? The SEC was also concerned that disclosures may not work with predictive data analytics. What would disclosure look like? It would need to be long and detailed, but then could it still be too simplistic re AI? (Of note, to this a panelist replied, "Then rewrite it to specifically cover say Gen AI used as predictive analytical tools.")

Finally, the SEC noted that it believed it performed a compliant economic analysis. (Market participants disagree.)

Consolidated Audit Trail (CAT) – FINRA Shares Industry's Data Concerns

FINRA noted that despite strongly held views on the CAT, it takes a more nuanced stance toward it. While it finds value from the transaction data for regulatory purposes, FINRA shares industry and policymaker concerns around the need for and security of the personal information collected in the customer database. Regarding CAT, FINRA noted that:

- Funding – FINRA is not in favor of the model approved by the SEC and wrote comment letters expressing their disappointment. The funding model is now being litigated.
- Customer database – This is expected to be completed in June of this year, yet significant concerns remain over the use of personally identifiable information (PII) in the CAT. There are two parts to the CAT:
 - Transaction database – This is an audit trail on orders and transactions in securities and options which regulators need to surveil the over \$600 billion traded each day in markets. FINRA is in favor of this database.
 - Customer database – This holds data on everyone who has a securities account. The idea behind it was that when regulators see something in the transaction database, they can use the customer database to quickly identify the person behind the problematic trading (insider trading, market manipulation, etc.). The model was to pull all the customer data in upfront so that it is immediately accessible if it was needed later. FINRA shares concerns about privacy and security and the overall need for this approach.

While the SEC removed social security numbers, the customer database still contains names, years of birth, and addresses/zip codes. Based on comments at the conference, FINRA believes – as does the industry – that this information should be removed. Information on every person trading – including retail investors trading small numbers of shares – does not need to be captured and maintained for the CAT system to work. One suggestion from FINRA was to use the large trader IDs instead. These are people who can move markets, and they are required to be identified under SEC rules. Their information could be retained, with the other data removed. Another idea FINRA mentioned was to have a system where if a regulator saw something in the transaction database, they can make a request for more information on the parties involved from the firms through which they traded. This “request response system” is modeled off a design SIFMA created and advocated for back in 2018.

While it would be easier for an investigator to have everything and anything upfront, FINRA noted that you cannot base policy decisions on whether a choice makes regulatory oversight easy. Removing this PII would alleviate data privacy concerns, as well as reduce costs – smaller data footprint, less fees assessed.

Regulation Best Interest (Reg BI)

A couple of years into passage, and FINRA continues to assess:

- When and how do firms look at reasonably available alternatives?
- Is there a conflict when there is compensation?
- How do firms assess risks to customers around complex and higher risk products? When do they recommend these products?

Moving forward, firms may have more rules with which to comply. The North American Securities Administrators Association (NASAA) and the Department of Labor proposed rules broader than Reg BI, despite litigation on the last proposal which was then vacated by the Fifth Circuit.

The industry believes Reg BI is an effective regulation for customer protection. They are concerned about regulatory inconsistency with the new proposal and believe the DOL proposal is in conflict with Reg BI. The competing rule imposes challenges for firm compliance and the ecosystem as a whole when it comes to preserving investor choice. Market participants suggest the DOL defer to Reg BI or remake their rule to be consistent.

Remote Work

As hybrid work here to stay, the industry made it clear that they need flexibility in how they manage their workforce. FINRA is listening, having taken the first steps to modernize Rule 3110 with the Residential Supervisory Location (RSL) and Remote Inspections Pilot program. Further provisions of Rule 3110 desperately need modernization to reflect accurately how the industry supervises registered persons and other employees today.

Firms may begin designated supervisors’ private residences as RSLs on June 1st. Eligible firms may opt into the remote inspections pilot from June 1 through June 26, 2024. The goal of the pilot is to collect data that demonstrates remote inspections are a viable, risk-based option for firms, leading to a permanent rule change. As such, FINRA urged firms to participate so they can collect meaningful data.

The Artificial Intelligence (AI) Perspective

Setting the Scene: Survey Says

To set the scene for this section, we recap our pre-conference survey results on AI. Survey respondents were asked, **“How is your firm using AI today?”**

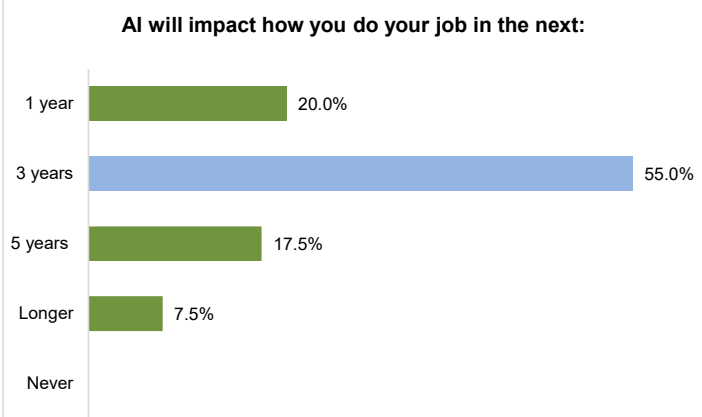
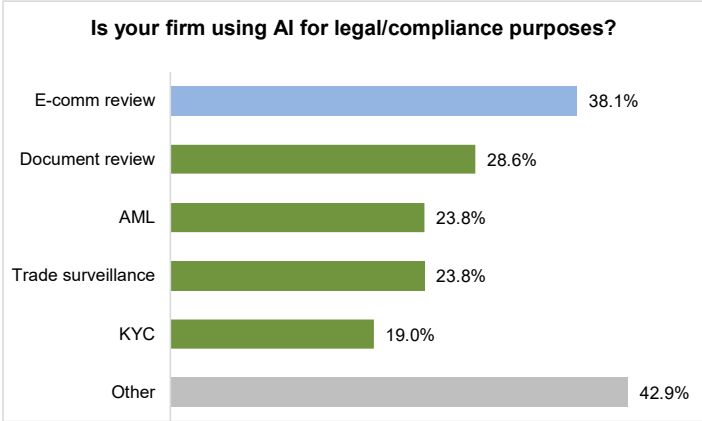
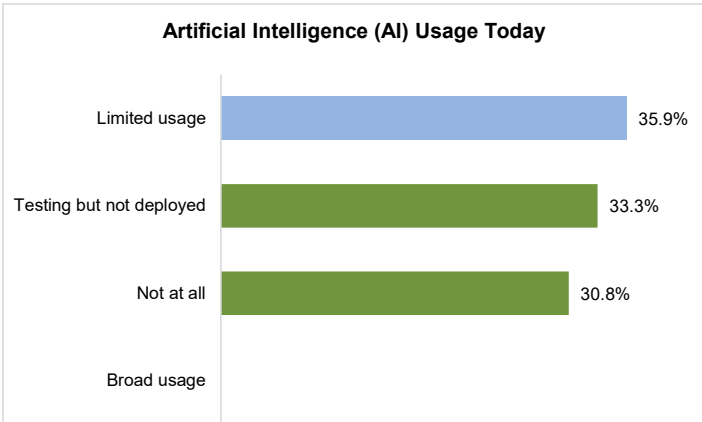
The majority said: Limited usage, at 35.9%. This was followed by testing but not deployed at 33.3% of responses.

The survey then asked, **“Is your firm using AI for legal/compliance purposes now?” (please select all that apply)**

The majority said: The top response E-communications review at 38.1%, followed by document review at 28.6%.

We closed out survey questions for this topic by asking, **“How long until AI will impact how you do your job?”**

The majority said: Three years came in as the top response, at 55.0%. This was followed by 1 year at 20.0% of responses.



Source: SIFMA Insights pre-conference survey

What Is AI

Artificial intelligence (AI): A term which includes a variety of technologies or computer systems that are able to perform processes normally requiring human intelligence.

AI is not new. For example, iPhone users speaking with Siri have been using AI since 2011. AI is widely used in online shopping and advertising to provide personal recommendations to consumers. Chatbots are used by various help desk to answer common questions.

AI is a broad term. It includes machine learning (ML; ex: autonomous vehicles), or computers learning from data sets without being programmed by humans. It includes generative AI (Gen AI; ex: ChatGPT), or models used to create new outputs differing from training inputs and which can go beyond text into images, etc. It includes large language models (LLM; ex: GPT4), a subset of Gen AI, which take very large amounts of text data and analyze it to create models for predicting future outcomes.

What is new is (a) the speed and (b) the (advanced) technology. While it seems we cannot go a day without discussing AI, OpenAI's ChatGPT was only launched in November 2022 (with GPT4 coming out in March 2023). However, it exploded onto the market, reaching 100 million users in only two months. In comparison we look at this level of adoption in other popular products:

- Netflix, launched in 1999 = 10 years, 60.0x ChatGPT
- Meta (formerly Facebook), launched in 2004 = 4.5 years, 27.0x ChatGPT
- Instagram, launched in 2010 = 2.5 years, 15.0x ChatGPT
- TikTok, launched in 2016 = 9 months, 4.5x ChatGPT

The advancement in technology is that Gen AI models are predictive. LLMs understand and connect across concepts. Data goes into the model. It creates a cloud of connections. Data comes back out of the model with a suggested outcome. This has given way to developing use cases where the data is used to forecast future events.

These models are very diverse and can produce not just code but also language. The models can use Excel and PowerPoint, as well as being trained to do Internet searches. While this seems impressive, it does have drawbacks. As of today, the models are good at words but not at math. Models know $2 + 2 = 4$ but do not know why. The models are good at sounding like human but not at understanding the answer, i.e. thinking.

Additionally, while models are good at reading new data sets and using baseline training to make decisions, the success of these tools is dependent on the data used to train the models. Are data sources trusted? Have they been vetted? Further, we have heard the term hallucinations – incorrect or misleading results, driven by insufficient training data, incorrect model assumptions, or biases in training data. This is a risk that can be minimized but not fully removed.

Use Cases in AI

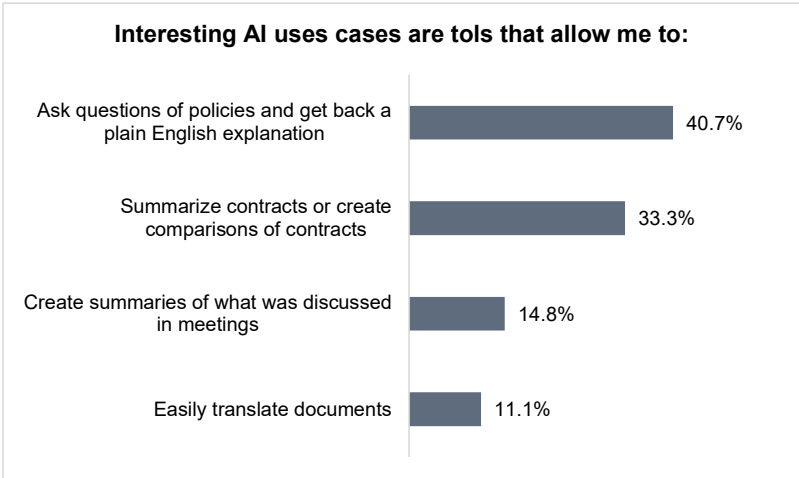
Firms are in different stages of testing and deploying AI use cases. Market participants are dividing AI use cases into low and high risk. AI models developing summaries of meetings or internal policies are considered low risk. Once the AI models advance into helping employees create content or interact with clients, the level of risk increases. Utilizing predictive tools represents the higher level of risk, and firms are mostly in the testing stage here.

Another common theme from panelists is that firms and users should not have a total reliance on the technology. They should keep a human involved in the process to monitor and control the models.

Below we highlight a few use cases either currently being utilized or under consideration by firms:

Compliance & Legal Departments	General/Multi Departments	Research Department
<ul style="list-style-type: none"> •Automated customer onboarding/KYC •Document review •E-communication Reviews •Creating or analyzing contracts •Fraud detection •Aggregating regulatory data sources •Content generation (policies/procedures, training) 	<ul style="list-style-type: none"> •Process automation and efficiency •Risk management monitoring •Microsoft Teams Copilot to review meeting main points, action items, and decisions •Chatbox assistance for client help desks; improve time to respond to clients •Developers automatically generate and test code •Financial education •Read structured data to look for trends •Future use? use model to predict trends 	<ul style="list-style-type: none"> •Summarize published research •Extract information from earnings releases to populate models •Improve search functionality •Advanced translation of reports, ex: English to Japanese •Create the summary paragraph in reports •Check company names in report for disclosures •Future use? generate reports from earnings releases

Additionally, in one of the AI focused panels, we surveyed audience members on what types of AI use cases are of interest to their compliance and legal staff. The majority responded that they would like to use AI tools to ask questions of policies and get back an answer in “plain English,” at 40.7%. This was followed by 33.3% responding the use of AI tools to summarize a single or compare multiple contracts.



Source: Audience polling

AI Best Practices¹

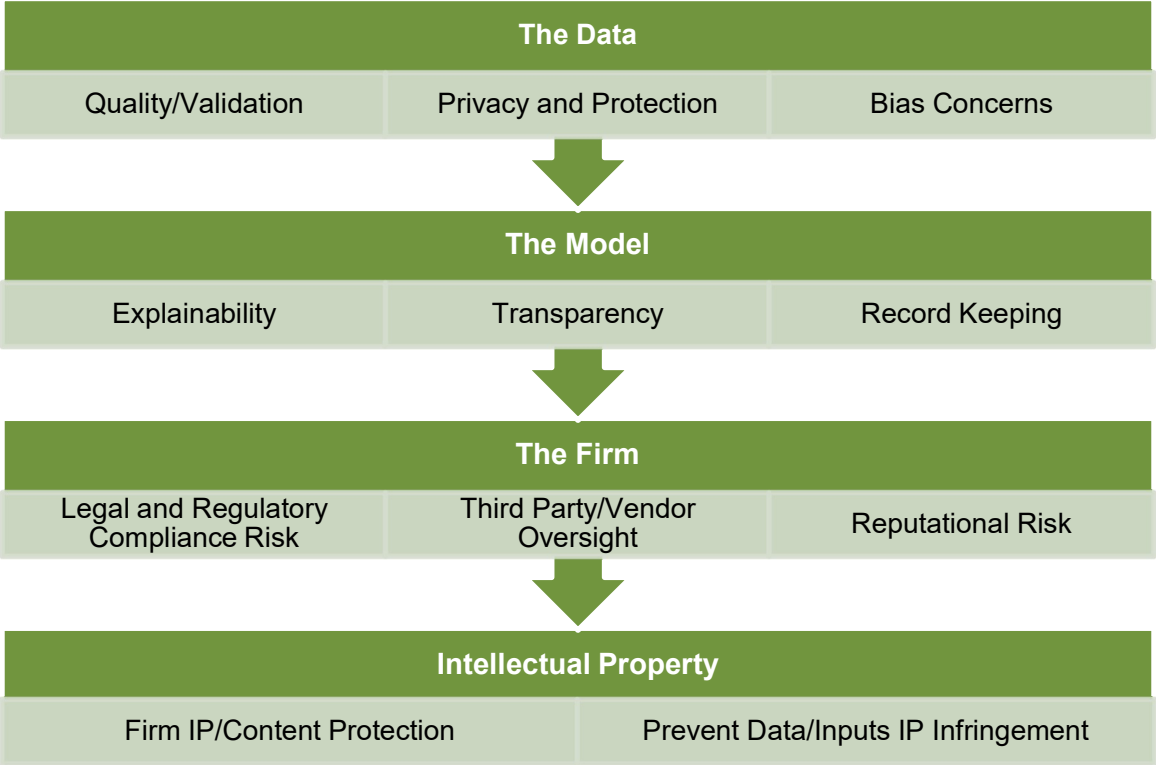
Risk Management Considerations

The use of Gen AI raises numerous and novel risks. Panelists throughout the conference highlighted some of these risks, including:

- **Regulatory** – Data privacy was top of mind here, as it always is in this industry. How do firms collect, store, and use data, and how long do they keep customer data are under consideration. Current and proposed regulations focus on protecting customer data. This is particularly true for personally identifiable information (PII) or other sensitive data. Is data intermingled or released in output. Regulators are also looking at disclosures, vendor reliance, and utilizing AI in generating published content.
- **Legal** – There are concerns around data licensing rights. How – if at all – can a firm use third party data in their training models and in the content output.
- **Intellectual property** – Research departments are concerned around the uncertainty of IP ownership in AI-generated output and whether a research creator loses IP ownership when third parties use AI to create derivative content.
- **Concentration** – Concerns have been raised by regulators around firms in the industry all using the same base models or data sets. The Bank for International Settlements expressed concerns for financial stability, particularly under times of stress. If firms use the same models, they will all be advised to act in the same manner, potentially leading to liquidity hoarding, interbank runs, or fire sales.
- **Model and data** – This includes identifying the source and quality of the data used to train models and being able to explain the inputs used to derive the output. It also includes assessing the type of system – closed access versus open source – and what that means for training and the output/sharing of results. This involves assessing data access and usage.
- **Employee development** – Use of AI for tasks typically done by junior staff could impact their skill development. For example, junior associates/analysts learn by pulling financial data from company reports or attempting the first draft of an earnings report. They lose this valuable training when letting AI take over.
- **Employee shadow usage** – Are employees using AI even though it is not with an approved enterprise system. And are they trained in the risks of such systems.

¹ This commentary comes from panelists throughout the conference, as summarized by SIFMA Insights, and should not be considered formal recommendations or legal advice from SIFMA or its members.

Putting together a roadmap for risk monitoring – based on conference commentary – we highlight:



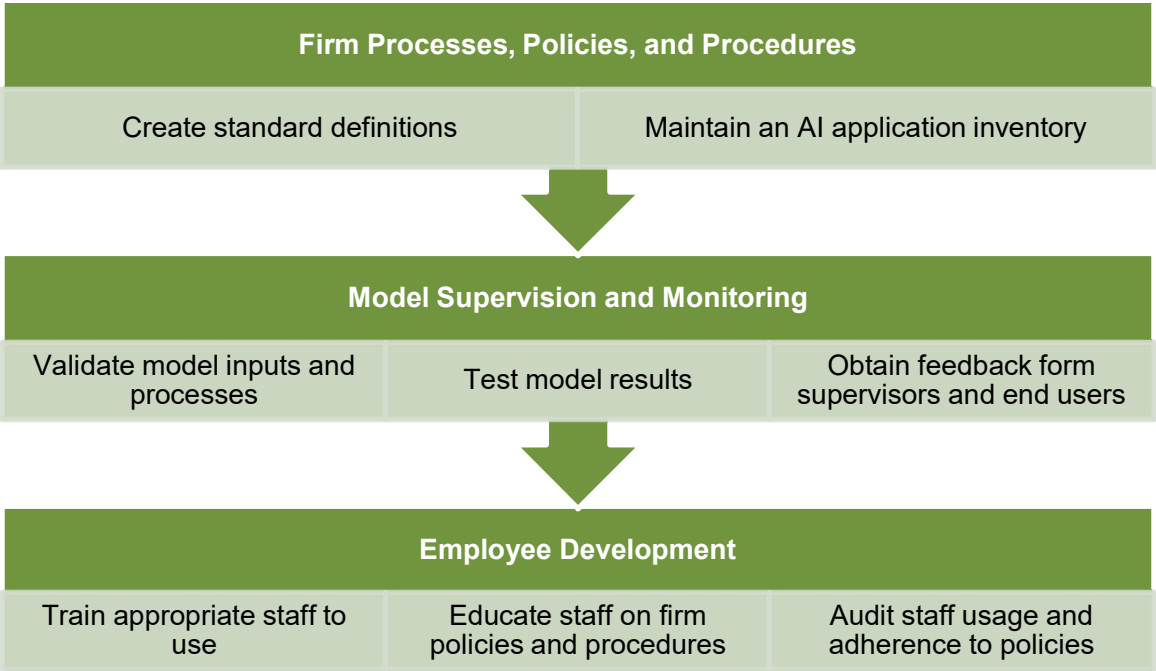
Governance Considerations

While firms are in various stages of their AI journey and are considering or using different AI tools, panelists throughout the conference highlighted some best practices for AI usage. To begin, it was recommended that firms have clear processes, policies, and procedures for usage. Systems should be catalogued and monitored. Oversight should include how data feeds are being used. Employees should be trained in usage, understanding the model's limitations and risks. Disclosures should be clear and detailed as to which tools were used to avoid AI washing.

Specific to sell-side research, it was advised to review and clarify a firm's terms of use for parties receiving/using the firm's research. The language should be included to prevent third parties from using research content to train LLMs without consent. This concern is heightened if third parties use public facing LLMs to analyze and summarize research content without ensuring content is kept confidential. Firms do not want their content put in an open AI system for the whole world to see and potentially access. Content needs to be encrypted and not leave the system. The language should also be written to prevent third parties utilizing research from multiple firms to create derived works without consent to use such research.

Example of language for terms of use (from panelists): "You are not permitted to use, extract, download or retrieve this information, in whole or in part, to train or finetune a third-party machine learning or artificial intelligence system, or to provide or reproduce this information, in whole or in part, as a prompt or input to any such system without our prior consent."

Putting together a roadmap for governance – based on conference commentary – we highlight:



AI Regulatory & Legislative Environment

As to laws and regulations, the environment keeps evolving. Panelists advised firms to keep abreast of ever changing regulations and any other business specific laws. We highlight keys areas to watch below:

- U.S. Executive Order – enacted October 2023
- Congress – Market participants do not expect it to advance any legislation
- SEC – Predictive Data Analytics proposal (PDA, see next section)
- FINRA – Market participants indicated that FINRA is looking into it and expect examiners to ask “probing” questions (systems to monitor, vendor management, etc.)
- States – Trends are around required governance, with bills aimed at AI technology itself if sufficiently large models. California set up the Privacy Protection Agency, applicable to retail prospects data, commercial data, and financial services employees, with the ability to opt out.
- EU AI Act – enacted December 2023

Below we compare the U.S. EO and EU AI Act:

US	EU
<ul style="list-style-type: none"> • Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence • October 2023 • Not legislation, rather directions for government agencies to develop rules for disclosures from companies that develop or provide infrastructure for AI models • No enforcement provisions 	<ul style="list-style-type: none"> • AI Act • December 2023 • New regulation • Detailed set of technical and organizational requirements for providers and users of AI systems • Complex oversight and enforcement regime (fines of EUR 30M or 2-6% of global annual turnover)
<p>Both focus on high-risk AI systems, require transparency and labelling, and note the creation of standards and sandboxes.</p>	

Predictive Data Analytics Proposal

On July 26, 2023, the SEC proposed new rules to regulate conflicts of interest associated with the use of predictive data analytics and AI technologies by broker-dealers and investment advisers. This proposal is expected to have a – if not the most – significant impact on financial services.

The proposal is extremely broad and could impact multiple business lines. Under the guise of targeting AI, the rule as written could conceivably cover any technology used in making investment recommendations. This could be an Excel worksheet, a list of stocks, a research website, etc.

The **definitions** are very broad and include future people and interactions:

- Covered technology – An analytical, technological, or computational function, algorithm, model, or correlation matrix used to predict, forecast, direct or guide investor behavior.
- Investor and investor interaction – People who seek to receive or receive services; in other words, current and prospective clients. Interactions include any engagement or future engagement with investors, with a few exceptions (clerical, administrative, etc.).
- Conflict of interest – A broker-dealer uses a covered technology that takes into consideration an interest of the broker or dealer.

The **duties** for firms around conflicts of interest would include:

- Evaluate the use or reasonably foreseeable use of a covered technology in any investor interaction to identify any conflict of interest resulting from that use.
- Determine if any such conflict of interest places the interest of the broker-dealer or advisor ahead of the interests of the investor.
- Eliminate or neutralize the effect of any such conflict of interest.
- Additional policy, procedure, and record keeping requirements.

It is unclear to market participants why this rule was necessary. What harm or event occurred to spur this rulemaking? What is new in this proposed rule that is different from what is covered under Regulation Best Interest (Reg BI)? Market participants believe the current rules are sufficient – there is no gap to be filled.

Further, market participants are confused as to why it is so broad. As written, everything is conflicted, and everything is covered. One panelist suggested renaming this proposal the “Regulate Everybody, Everything, All the Time” rule. This proposed rule includes every communication with investors – charts, lists, etc. – and market participants do not believe that the SEC has the authority to regulate every communication with clients.

Market participants also noted the **conflicts** between PDA and other laws/rules, including:

- Dodd Frank Act (DFA) Section 913 on Statutory Authority – The SEC has the authority to propose a fiduciary duty on broker-dealers but not an ongoing duty of care. The SEC has the authority to eliminate certain/specific conflicts. This section also references the disclosures and consent regime.
 - PDA includes a heightened standard of care greater than fiduciary duty.
 - PDA includes perspective customers, where DFA only references actual customers.
 - PDA eliminates the disclosures and consent regime.
 - PDA would force the elimination of every conflict and even potential/future conflicts (also, DFA was meant to address high pressure sales tactics).
- Administrative Procedures Act – This statute governs the process by which federal agencies develop and issue regulations. This includes a requirement for agencies to consider the costs and benefits of regulations, ensuring the benefits justify the costs of regulation.
 - PDA lacks an economic analysis to substantiate the economic benefits.
- First Amendment to the U.S. Constitution – This states that Congress shall make no law abridging the freedom of speech (among other aspects).
 - PDA restricts speech as it constrains communications with clients.

Additionally, market participants note that the industry already has rules guiding interactions with clients. Reg BI requires broker-dealers serve the best interest of retail investors, and firms need a reasonable basis for investment recommendations. Reg BI also includes a disclosure and consent standard. The disclosure standard has been the industry standard for around ninety years, noted one panelist. The duty of care standard requires firms have a reasonable understanding of investment objectives, products, and the client. PDA includes current and prospective clients – this is outside the advisor relationship and outside the scope of a recommendation. PDA also rejects the longstanding disclosure/consent paradigm.

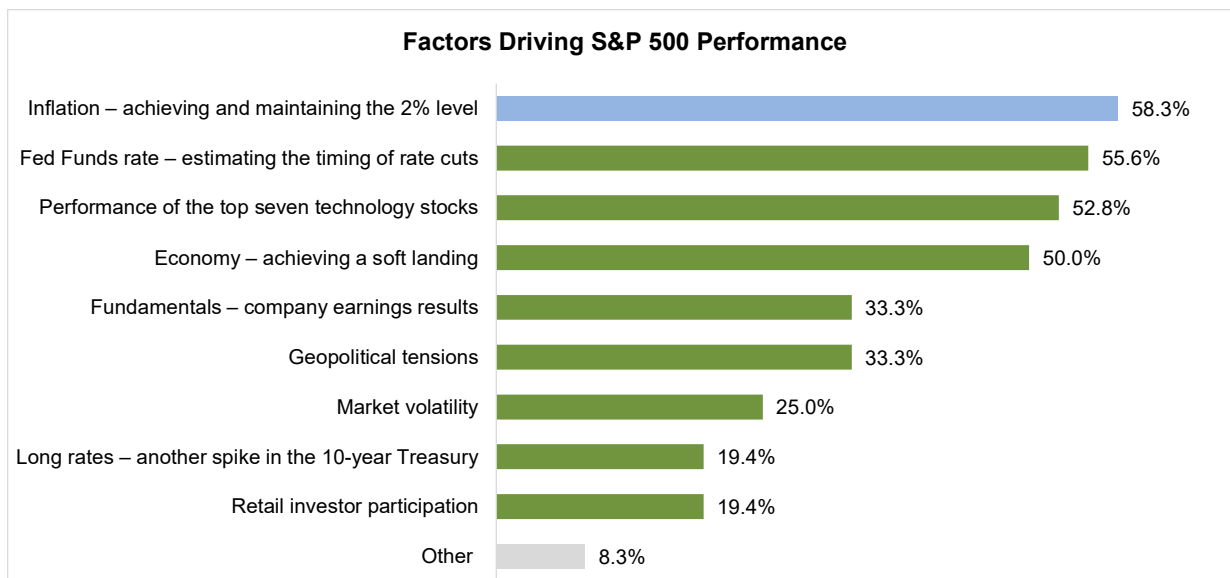
What could be the impact to investors? One panelist indicated that this rule as written could have a “chilling effect” in terms of access for retail investors and also on innovation. PDA is too broad and could force firms to cut off access to investor tools. It is a very burdensome regulation, and firms – particularly smaller firms – have limited resources. As such, firms may be forced to pass along costs to investors, even though they do not want to. PDA could also decrease choices for investors. Conflicts arise when firms present choices to investors. To eliminate any and all conflicts, firms will need to eliminate choices. This will harm investors.

More on Market Themes

Setting the Scene: Survey Says

To set the scene for this section, we recap our pre-conference survey results on markets. Survey respondents were asked, **“Which factors do you believe are driving the performance of equity markets, in terms of the price of the S&P 500?”** (please select all that apply)

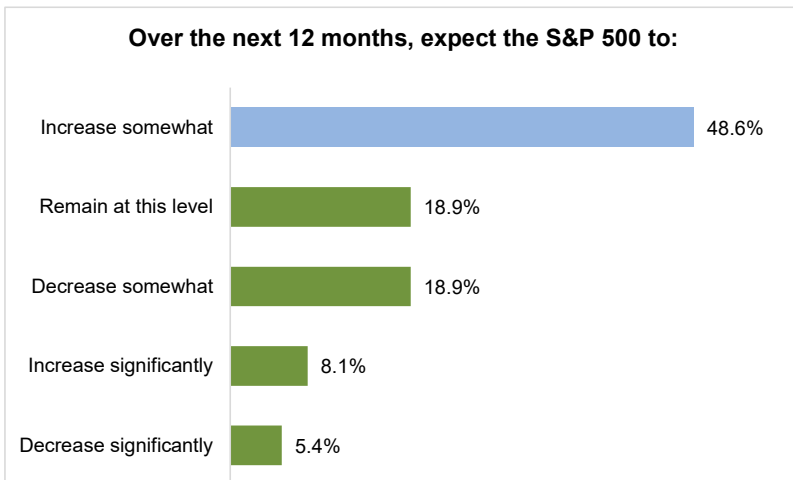
The majority said: Inflation – achieving and maintaining the 2% level, at 58.3%. This was followed by the Fed Funds rate – estimating the timing of rate cuts at 55.6% of responses.



Source: SIFMA Insights pre-conference survey

The survey then asked, **“Over the next 12 months, do you expect markets – in terms of the price of the S&P 500 index – to?”**

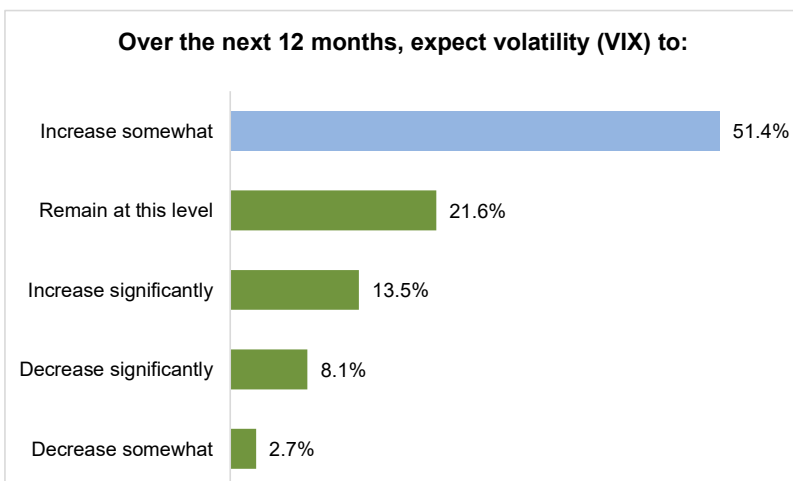
The majority said: Increase somewhat at 48.6%, followed by remain at this level and decrease somewhat at 18.9% each.



Source: SIFMA Insights pre-conference survey

We closed out survey questions for this topic by asking, **“Over the next 12 months, do you expect market volatility – in terms of the price of the VIX index – to?”**

The majority said: Increase somewhat at 51.4%, followed by remain at this level at 21.6% of responses.



Source: SIFMA Insights pre-conference survey

Equity Market Structure

History

On December 14, 2022, the SEC proposed four equity market structure rulemakings. Then, on October 18, 2023, the SEC proposed a fifth rule. These rules include:

1. (Amendments to) Exchange Act **Rule 605**, enhancing broker disclosure of order execution information. The new rule expands the scope of entities required to report to include: broker-dealers who introduce or carry 100,000 or more customer accounts; single-dealer platforms; and entities that would operate qualified auctions under the proposed Order Competition Rule. It also revises the scope and content of the information required to be included in the monthly reports, including: broadening the definition of covered order; modifying existing order size categories, basing them on round lots and including other size groups for fractional shares, odd-lots, and larger-sized orders; requiring new statistical measures of execution quality, including a size improvement benchmark calculating execution greater than the displayed size at the quote. The rule further revised report content and requires a summary report to be published.
2. (Amendments to) Exchange Act **Rules 610 and 612**, amending minimum pricing increments (tick sizes) and exchange access fee caps and enhancing the transparency of better-priced orders. This proposed rule would eliminate the current one-size-fits-all tick approach for NMS stocks priced at \$1.00 or more and establish variable minimum pricing increments according to certain criteria, which would apply to the quoting and trading of NMS stocks on any national securities exchange or alternative trading system as well as over-the-counter. Given changes to tick sizes, the proposed rule also recommends recalibrating access fee caps that limit what a trading center may charge for the execution of orders against a protected quotation. The proposal would also accelerate the modified round lot definition and inclusion of odd-lot information into consolidated market data. This will be the first time the SIP introduces an odd lot NBBO, which could lead to investor confusion since it will not be protected.
3. (New) **Regulation Best Execution**, establishing a best execution standard to which broker-dealers must achieve the most favorable price for customers under prevailing market conditions. It would also require policies and procedures for certain conflicted transactions with retail customers. To some extent, the proposal mirrored existing rules from FINRA for its broker-dealer members and the Municipal Securities Rulemaking Board (MSRB) for municipal securities dealers. However, it includes a conflicted transactions section which specifically targets payment for order flow (conflicted also includes principal trading and routing customer orders to affiliates), subjecting broker-dealers transacting with retail customers to additional best ex obligations. Further, the proposal requires exchanges disclose the fee for transactions at the time of execution, in contrast to proposal #5 below.
4. (New) **Order Competition Rule**, requiring certain retail orders to be sent to auctions or midpoint ATs before being internalized. This proposal would require segmented orders of natural persons in Reg NMS stocks to be exposed to competition in fair and open auctions before they could be executed internally by any trading center that restricts order-by-order competition, with certain exemptions. The duration of auctions would be between 100 and 300 milliseconds (an eternity in trading terms).

5. (New) Exchange Act **Rule 6b-1**, addressing volume based exchange transaction pricing for NMS stocks. This proposal would prohibit national securities exchanges from offering volume-based transaction pricing in connection with the execution of agency or riskless principal-related orders in NMS stocks.

In addition to these five proposals, participants in equity markets are dealing with a slew of other SEC proposals and issues, including but not limited to: definitions of exchange and dealer; Regulation Systems Compliance and Integrity (Reg SCI); Consolidated Audit Trail (CAT) funding; and the transition to T+1 settlement.

Today

These proposals individually could have a significant impact on markets, let alone the aggregate impact and potential for unintended consequences of implementing all five proposals together. Where are we today in the rulemaking process? As noted above, the amendments to Rule 605 were already adopted on March 6, 2024, and market participants expect the SEC to move forward with the other proposals this year.

As to **Rule 605 amendments**, the industry had called for this form to be updated for many years, since it had not been substantively updated since its adoption in 2000. Given how much markets, products traded, and technologies have changed, additional transparency is seen as necessary to assess market quality. However, panelists indicated that the amount of information requested is “enormous” and the rule expanded the universe of reporting firms. Yet, the SEC made no requirement for a standardized template. As such, panelists indicated FAQ (frequently asked questions) guidance will be necessary for this rule.

Further, given the eighteen month implementation timeline for the industry – let alone time for the SEC to collect and analyze the data – this means the SEC will not use new 605 data to redo the analysis for the other proposals, as the industry had suggested.

Moving onto **Rules 610 and 612** (tick sizes and access caps), panelists expect this proposal to be finalized next. This is another one that had been under discussion by market participants for years. While the industry agrees that changes could improve market quality, there had not been agreement on the changes themselves. The industry does agree that the proposal was more aggressive than people had expected. Panelists indicated the industry has asked for a phased-in approach for this proposed rule.

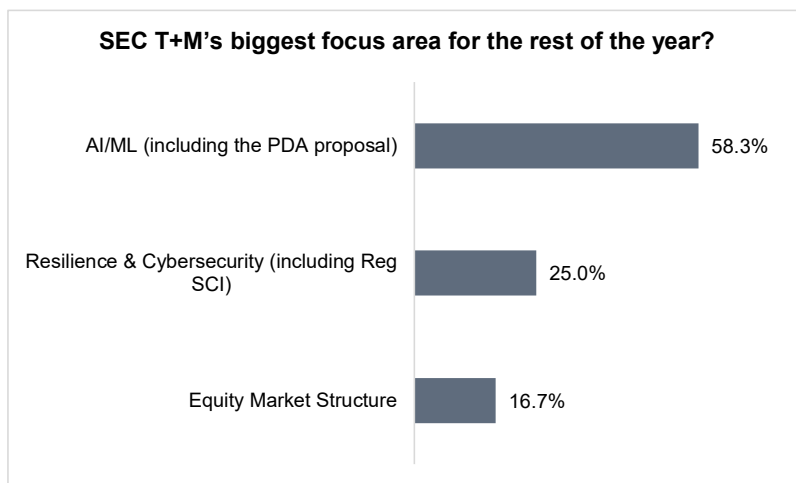
For the proposed **Regulation Best Execution**, panelists believe this rule proposal remains a high priority for the SEC. To begin, the industry still questions why this proposed rule was necessary, given the FINRA rule has worked well for decades. Overall, the proposed rule is considered too prescriptive, mostly relying on prevailing price and disregarding all other factors – broker-dealers know their clients and use judgement backed by experience and information on the current market environment to route orders – which could restrict broker-dealers’ actions.

On the **Order Competition Rule**, panelists believe auctions may not be mandated, rather just encouraged through the best ex rule proposal. Previously, the regulatory structure allowed market participants to compete. This proposal would now force a routing path. This proposed rule could also increase the number of unfilled orders and increase operational risk given the scale of messages and surge of orders as brokers respond to multiple auctions across multiple exchanges. This would be a negative for investors.

Finally, on **Exchange Act Rule 6b-1**, the SEC had expressed concerns that volume-based exchange transaction pricing raises competitive concerns among exchange members and among exchanges. Panelists indicated that the industry had mixed feedback on this proposal, and, as noted above, it appears to contradict the fee disclosure at time of execution requirement under the tick size proposal.

In addition to these five proposals, market participants are dealing with a slew of other SEC proposals. Some of these were not necessarily directed at equity trading but could have significant market impacts regardless of the intended target. One of these proposals is the PDA rule discussed above. To say this proposal would impact markets is the understatement of the year.

To give you an extent of the concern, we surveyed the audience in one of the equity market structure panels regarding the focus for the SEC’s Trading and Markets division for the remaining of this fiscal year ending 9/30. Even though this panel was focused on equities, the majority responded that the SEC’s focus would be on AI and machine learning, including the PDA proposal and digital engagement practices, at 58.3%. This was followed by 25.0% responding resilience and cybersecurity, including Reg SCI.



Source: Audience polling

Fixed Income Market Structure

Not to be outdone by equity market structure reforms, there are many rules/proposals brewing in fixed income markets as well. In general, market participants see a lack of economic analysis or clear problem justifying the rules/proposals. Market participants are also concerned about the significant operational and compliance burdens these rules/proposals could put on firms of all types and sizes. Treasury clearing alone will be a significant operational lift with a short timeline (2025/26). And market participants will have to implement these changes along with all the other SEC rules/proposals. Further, market participants have expressed concerns that some of the rules could decrease liquidity in markets. For example, the dealer definition changes could force some firms to cease providing liquidity to the market rather than undertake the significant operational, financial and regulatory burden.

We highlight the following rules:

- **Mandatory Clearing of Treasury Securities:** On December 13, 2023, the SEC adopted a final rule to require central clearing of certain U.S. Treasury securities' (UST) transactions. Currently, there is only one UST covered clearing agency, the Fixed Income Clearing Corporation (FICC), and the only UST transactions that direct participants of FICC are required to submit for central clearing are their cash and repurchase (repo) transactions with other direct participants (this excludes principal trading firms, money-market funds, hedge funds, etc.). The rule requires SEC-registered clearing agencies that clear, settle, and novate transactions in UST to adopt policies and procedures requiring their direct clearing participants to clear: all repos collateralized by UST in which one of the counterparties is a direct participant (with limited exceptions); any cash UST transactions where the direct participant brings together multiple buyers and sellers using a trading facility and is a counterparty to both the buyer and seller in two separate transactions (acting as an interdealer broker) or between a direct participant and a counterparty that is a registered broker-dealer, government securities dealer, or government securities broker. The final rule amends certain margining requirements that apply to FICC by requiring it to calculate, collect, and hold margin separately for proprietary UST positions of a direct participant from customer positions of a direct participant and to permit margin required on deposit with FICC to be included under certain conditions as a debit in the broker-dealer reserve formulas.
- SEC Section 3(a)(5)/3(a)(44), **Definition of Dealer/Government Securities Dealer:** On February 6, 2024, the SEC adopted rules that further define what constitutes a dealer or government securities dealer, generally requiring any person that engages in a regular pattern of buying and selling securities (or government securities) that has the effect of providing liquidity to other market participants to register as a dealer. It further defines what it means to trade securities or government securities for one's own account as part of a regular business in a manner that would require a person to register as a dealer or a government securities dealer (with some exemptions).

Of note, the Managed Funds Association (MFA), National Association of Private Fund Managers (NAPFM), and Alternative Investment Management Association (AIMA) filed a lawsuit in March of this year to vacate this rule. They stated that the rule would mean in scope managers and their funds would lose customer protections with dealer counterparties and could not participate in IPOs. They believe the rule would harm markets, create investor uncertainty, and hinder capital raising.

- **15c2-11 in FI Markets:** The original rule governs the publication of quotations of securities on a quotation medium, i.e. certain mediums other than a national securities exchange and requires certain disclosures. In 2020, the SEC amended this rule and then, in follow-on guidance, asserted that the rule applies to fixed income securities. It was historically not viewed as applicable in the fixed income space. The SEC’s no-action letter that granted some relief in the FI space will expire in January 2025.

Issues Impacting Prime Brokers/Hedge Funds

As discussed above, market participants are concerned about the operational and compliance burdens these rules/proposals could put on firms and that they could decrease liquidity in markets. Panelists also pointed out contradictions between the rules (a theme identified in the equity market structure proposals as well). Specific to the short selling and securities lending rules, you see that while the SEC took one path in short selling, it took a materially different approach with securities lending:

	Securities Lending	Short Selling
Level of detail	Trade by trade	Aggregate trades
Report frequency	Daily	Monthly
Time to report	Next day	End of month

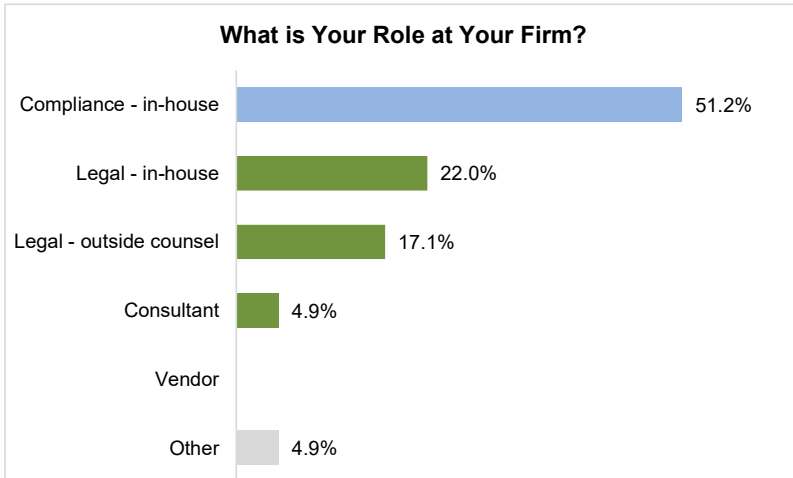
These points were made by the MFA, NAPFM, and AIMA in their March 2024 challenge on the securities lending and short reporting rules. They stated that the rules impose inconsistent requirements for public disclosure of the same market activity, i.e. short sales of securities. Despite being interconnected, neither rule considered how the two disclosure requirements interact.

We highlight the following rules/proposals:

- **New Exchange Act Rule 10c-1a, Reporting Securities Loans:** On October 13, 2023, the SEC adopted a rule requiring, for the first time, persons entering securities loans (or their intermediary or reporting agent, where applicable) to report specific terms of the loan to a registered national securities association (RSNA) by the end of the day on which the loan is either effected or modified. The rule will require FINRA – currently the only RSNA – to make publicly available certain transaction-specific information by the morning of the business day after the loan is effected or modified.
- **New Exchange Act Rule 13f-2, Reporting Short Positions:** On October 13, 2023, the SEC adopted a rule requiring, for the first time, institutional investment managers to report to the SEC extensive information on certain large short positions and short sale activity on a monthly basis. The SEC will then use this data to make publicly available aggregate data about short positions and short sale activity in individual securities.
- **SEC 206(4)-2, Adviser’s Act Custody Rule Proposal:** On February 15, 2023, the SEC proposed revisions to the Advisers Act addressing custody of client assets by registered investment advisers. The proposal could have far-reaching effects on how registered investment advisers manage and safeguard client assets, including digital assets, real estate, loans, and other emerging asset classes as well as physical assets. It would affect the services offered by qualified custodians to advisers.

Appendix: Pre-Conference Survey Methodology

This survey was sent out prior to the start of the conference, populated between March 8 to March 15. Survey respondents were broken out across the following roles:



Source: SIFMA Insights pre-conference survey

Note: Other = supervision in-house, regulator

SIFMA Insights Research Reports

SIFMA Insights: www.sifma.org/insights

- Ad hoc reports on timely market themes
- Market Structure Compendium (annual report)
- COVID Related Market Turmoil Recaps: Equities; Fixed Income and Structured Products

Monthly Market Metrics and Trends: www.sifma.org/insights-market-metrics-and-trends

- Statistics on volatility and equity and listed options volumes
- Highlights an interesting market trend

Market Structure Primers: www.sifma.org/primers

- Capital Markets Primer Part I: Global Markets & Financial Institutions
- Capital Markets Primer Part II: Primary, Secondary & Post-Trade Markets
- Global Equity Markets
- Electronic Trading
- US Capital Formation & Listings Exchanges
- US Equity
- US Multi-Listed Options
- US ETF
- US Fixed Income

Conference Debriefs

- Insights from market participants into top-of-mind topics
- Pre-Conference Survey Comparison, compares survey results across various conferences

Equity Market Structure Analysis

- The ABCs of Equity Market Structure: How US Equity Markets Work and Why
- Analyzing the Meaning Behind the Level of Off-Exchange Trading, Part II
- Analyzing the Meaning Behind the Level of Off-Exchange Trading
- Why Market Structure and Liquidity Matter

Top of Mind with SIFMA Insights

- Podcasts with market participants on key market and economic themes, including reference guides defining terms and providing charts on the topics discussed on the podcast

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