The Next Move

Regulatory and policy developments in tech — March 2024

Merger guidelines signal growing scrutiny of tech deals

By Lori Bistis

The issue

The Department of Justice (DOJ) and Federal Trade Commission (FTC) have formalized a more aggressive approach to how they review mergers, including those in the tech sector, for potential antitrust law violations. The new merger guidelines — updated in December 2023 to reflect the realities of competition in today's digital economy — describe how both agencies evaluate a proposed deal's impact in deciding whether to intervene. While this marks a substantial shift in official policy, the guidelines reflect what's already become a practical reality for many companies seeking merger clearance.

The new guidelines signal increased scrutiny of tech acquisitions that eliminate potential entrants or nascent competitors, as well as deals involving multi-sided platforms. They also lower the market-concentration threshold for presuming a deal is anticompetitive and take a more skeptical view of a merger's purported efficiencies. In addition, they give increased attention to the impact on competition for workers, creators, suppliers and other providers — rather than just consumers. And they downplay the distinction between horizontal and vertical mergers (i.e., mergers between competitors versus noncompetitors), focusing instead on the products, services and other inputs that the merged entity may control.

The changes are likely to add more uncertainty, cost and time pressure into the dealmaking process, particularly in the tech sector. Companies should understand the agencies' expectations and prepare to answer their questions regarding any contemplated deals.

The agencies' take

According to the DOJ, the merger guideline updates reflect the dynamic, complex nature of competition in such diverse areas as pricing, employment and platforms. These changes, prompted by the Executive Order on Promoting Competition in the American Economy, describe how the agencies assess the commercial realities of the US economy when making enforcement decisions and protect competition in all its forms.

Markets have become more concentrated in many sectors, the White House noted, resulting in several concerning macroeconomic trends. For example, while corporate profits as a share of GDP and the economy-wide ratio of markups to costs have both increased, the share of GDP accruing to labor has fallen, especially in highly concentrated industries.

At the same time, the US economy has evolved, particularly due to tech advances. The 2023 Economic Report of the President documents how new technology has propelled digital two-sided platform markets — where an intermediary business (the platform) brings together buyers and sellers, such as on a ride-sharing or restaurant delivery app — to become enmeshed in the lives of consumers and business owners, raising new antitrust concerns.

The resulting guidelines are intended to help the legal profession, business community and broader public understand how the agencies' thinking reflects current economic evidence and the realities of today's market.

Merger guidelines at a glance

Guideline	Explanation
1. Mergers raise a presumption of illegality when they significantly increase concentration in a highly concentrated market.	Market concentration is often a useful indicator of a merger's likely effects on competition. The agencies therefore presume, unless sufficiently disproved or rebutted, that a merger between competitors that significantly increases concentration and creates or further consolidates a highly concentrated market may substantially lessen competition.
2. Mergers can violate the law when they eliminate substantial competition between firms.	The agencies examine whether competition between the merging parties is substantial because their merger will necessarily eliminate any competition between them.
3. Mergers can violate the law when they increase the risk of coordination.	The agencies examine whether a merger increases the risk of anticompetitive coordination. A market that's highly concentrated or has seen prior anticompetitive coordination is inherently vulnerable and the agencies will infer, subject to rebuttal evidence, that the merger may substantially lessen competition. In a market that's not highly concentrated, the agencies investigate whether facts suggest a greater risk of coordination than market structure alone would suggest.
4. Mergers can violate the law when they eliminate a potential entrant in a concentrated market.	The agencies examine whether, in a concentrated market, a merger would eliminate a potential entrant or eliminate current competitive pressure from a perceived potential entrant.

Merger guidelines at a glance (cont'd)

Guideline	Explanation
5. Mergers can violate the law when they create a firm that may limit access to products or services that its rivals use to compete.	When a merger creates a firm that can limit access to products or services that its rivals use to compete, the agencies examine the extent to which the merger creates a risk that the merged firm will limit rivals' access, gain or increase access to competitively sensitive information, or deter rivals from investing in the market.
6. Mergers can violate the law when they entrench or extend a dominant position.	The agencies examine whether one of the merging firms already has a dominant position that the merger may reinforce, thereby tending to create a monopoly. They also examine whether the merger may extend that dominant position to substantially lessen competition or tend to create a monopoly in another market.
7. When an industry undergoes a trend toward consolidation, the agencies consider whether it increases the risk a merger may substantially lessen competition or tend to create a monopoly.	A trend toward consolidation can be an important factor in understanding the risks to competition presented by a merger. The agencies consider this evidence carefully when applying the frameworks in Guidelines 1-6.
8. When a merger is part of a series of multiple acquisitions, the agencies may examine the whole series.	If an individual transaction is part of a firm's pattern or strategy of multiple acquisitions, the agencies consider the cumulative effect of the pattern or strategy when applying the frameworks in Guidelines 1-6.
9. When a merger involves a multi-sided platform, the agencies examine competition between platforms, on a platform or to displace a platform.	Multi-sided platforms have characteristics that can exacerbate or accelerate competition problems. The agencies consider the distinctive characteristics of multi-sided platforms when applying the frameworks in Guidelines 1-6.
10. When a merger involves competing buyers, the agencies examine whether it may substantially lessen competition for workers, creators, suppliers or other providers.	The agencies apply the frameworks in Guidelines 1-6 to assess whether a merger between buyers, including employers, may substantially lessen competition or tend to create a monopoly.
11. When an acquisition involves partial ownership or minority interests, the agencies examine its impact on competition.	The agencies apply the frameworks in Guidelines 1-6 to assess if an acquisition of partial control or common ownership may substantially lessen competition.

Source: DOJ-FTC Merger Guidelines (December 18, 2023).

Lower threshold for presumption of illegality. The guidelines lower the longstanding threshold for presuming that a horizontal merger will substantially diminish competition in the relevant market. Under the new test, the agencies will presume that a merger will substantially reduce competition and should be blocked if it would create a firm with greater than 30% market share or increase market concentration to the equivalent of moving from six to five equally sized competitors. Deal parties would have the burden of rebutting or disproving this presumption of illegality. The change lowers the bar significantly from the prior threshold, greatly expanding the pool of deals that may potentially be blocked as presumptively anticompetitive.

"Killer acquisitions" under scrutiny. The guidelines reflect the agencies' renewed focus on deals that would eliminate a potential entrant or eliminate current competitive pressure from a "perceived potential entrant." As the agencies explain:

> [A] merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

Examples may include a large platforms' acquisition of smaller companies that pose a nascent threat to the platforms' dominance in the relevant market, a practice that the FTC has criticized in recent years and challenged, unsuccessfully, in court. The guidelines' heavy emphasis on this subject may provide new opportunities for the FTC to test its legal theories in the courts.

Platform deals face holistic competition analysis. The guidelines note that platforms can offer different products or services to two or more different groups or "sides" that may benefit from each other's participation. This dynamic calls for a broader view of the potential anticompetitive impact of platform deals. These deals can harm competition, "even when a platform merges with a firm that is neither a direct competitor nor in a traditional vertical relationship with the platform." When evaluating a merger involving a platform, the agencies will consider three factors.

1. Competition *between* platforms. The agencies protect competition between platforms by preventing the acquisition or exclusion of other platform operators that may substantially lessen competition or create a monopoly. This scenario can arise, for example, when a dominant platform entrenches its position by systematically acquiring firms competing with one or more sides of a multi-sided platform while they're in their infancy. Or when a platform operator acquires a key platform participant (e.g., a major seller), which can entrench the operator's position by depriving rivals of participants.

2. Competition *on* a platform. The agencies protect competition on a platform in any markets that interact with the platform. When a merger involves a platform operator and platform participants, the agencies examine whether the deal would create anticompetitive conflicts of interest. A platform operator that's also a platform participant may be incentivized to give its own products and services an advantage over other participants competing on the platform.

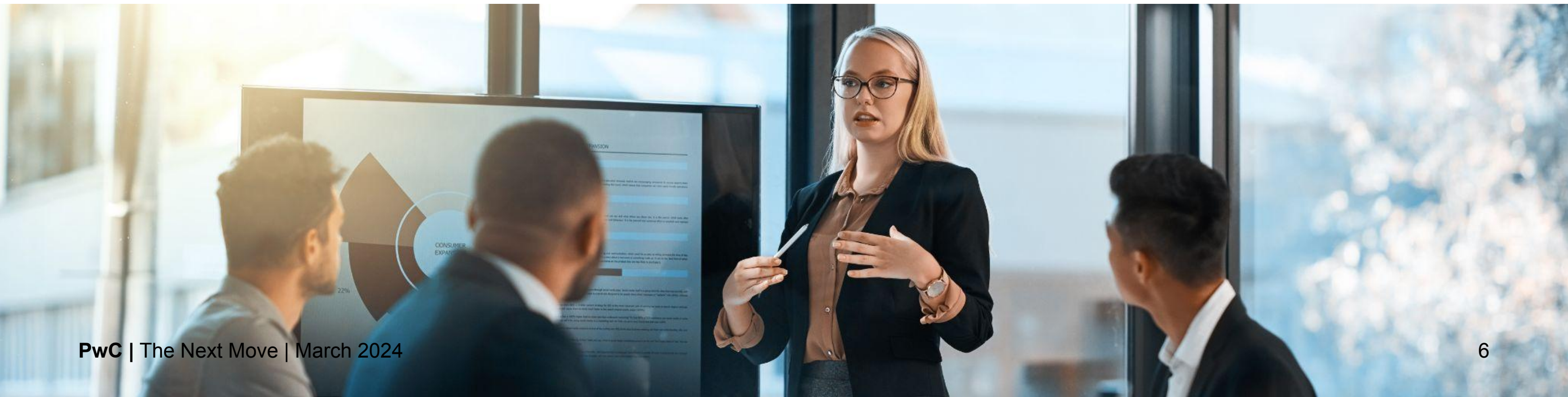
3. Competition to *displace* the platform. The agencies protect competition to displace the platform or any of its services. For example, new technologies or services may enable firms to replace one or more services the incumbent platform operator provides, helping some participants meet their needs elsewhere. When platform owners are dominant, the agencies seek to prevent even relatively small gains in power from inhibiting the prospects for displacing the platform or for reducing dependency on it.

Your next move

Although they merely formalize concepts we've seen applied in practice, the new merger guidelines will likely introduce more uncertainty, cost and time pressures into the dealmaking process, particularly in the tech sector. At the same time, they provide some clarity on the agencies' thinking and expectations, which can help with risk and strategy planning. Consider the following steps.

1. **Assess and plan for regulatory exposure.** Review the guidelines and assess their potential impact on your deal, identifying all potential concerns and anticompetitive effects on the relevant market that have a plausible basis in the guidelines. With those risks identified, develop a mitigation plan that includes various scenarios and possible responses to regulatory challenges. If uncertainty is high, develop a contingency plan that includes creative solutions, possibly through divestitures or joint ventures.
2. **Build in more lead time.** Prepare for more regulatory requests. These will be both time-consuming and time-sensitive, requiring input ranging from products to financials to customer volume and more. Your integration management office should establish a cross-functional team that's empowered to respond quickly to regulatory requests. This will require collaboration between teams on both sides of the deal to confirm the accuracy of data presented to authorities.
3. **Approach integration planning strategically.** With longer lead times required to address regulator concerns, you'll need to be intent on integration strategy and subsequent planning. Depending on approach, your options are to either frontload integration planning and execution during the sign-to-close period, if there's confidence in the deal getting approval (thus taking advantage of the longer lead time) or to focus on the “must haves” to take control of the acquired company and drive the most value based on the deal thesis. With this approach, the integration objectives beyond the highest priorities can be addressed once there's more certainty in the regulatory approvals and outcome, thus maximizing value in the short term while balancing the cost and effort of a full-scale integration.
4. **Develop a communications plan.** Aligning on messaging to customers, employees and investors around the transaction can help to enable stability, reduce disruption and stave off competitor attempts to poach customers or talent. This is even more critical with heightened regulatory scrutiny.
5. **Establish a robust governance process.** Implement processes (including clean teams) to maintain confidentiality when reviewing sensitive or competitive data and to confirm compliance with regulatory requirements.

For more information, see Dealmakers' regulatory playbook: How TMT companies can navigate the new era.



Federal agencies tackle AI risk, filling the legislation void

By Jocelyn Aqua, Rohan Sen, Jennifer Kosar and Manuj Lal

The issue

Absent broad federal legislation, AI policy in the United States is currently implemented through a patchwork of existing legal authorities, agency rulemaking and enforcement actions. While existing frameworks and developing industry standards — including many that aren't specific to AI — provide some direction on AI governance, federal agencies can recognize the need to issue specific guidance and rules for businesses on how to protect the public from discrimination, bias and other potential harms posed by the technology.

To that end, the Department of Justice (DOJ), Consumer Financial Protection Bureau (CFPB), Equal Employment Opportunity Commission (EEOC) and the Federal Trade Commission (FTC) released a joint statement last year announcing their priorities for combatting harm from "automated systems," including AI, used to automate workflows and help with tasks and decision-making. The agencies pledged to increase enforcement efforts against companies that develop, use and deploy automated systems that can be biased and discriminatory, to monitor the development and use of these tools and to help promote responsible innovation.

True to their word, the agencies have since undertaken a steady stream of actions to protect against AI risks. These include guidance and warnings about AI-powered hiring tools, video surveillance systems and credit underwriting algorithms, a proposed rule for real estate valuation models, a resolution ordering compulsory process for AI-related investigations, and multiple enforcement actions. Separately, the Biden Administration recently announced progress on key initiatives under its EO on AI. State legislatures and regulatory bodies are likewise pushing ahead with their own efforts to rein in AI bias and discrimination.

Companies need to understand that AI regulation and enforcement is happening now, even as federal legislation in this space has lagged.

The regulators' take

As the agencies explained in their joint statement, the development and use of automated systems should adhere to federal laws upholding civil rights, fair competition, consumer protection and equal opportunity.

Private and public entities use these systems to make important decisions that can affect individuals' rights and opportunities, the agencies noted, including fair and equal access to housing, to credit and job opportunities, and to other goods and services. While these tools are often marketed as providing insights, efficiency and savings, they can also perpetuate unlawful bias, automate unlawful discrimination and produce other harmful outcomes. For example:

- **Data issues.** Automated system outcomes can be skewed by unrepresentative or imbalanced datasets and by data sets that incorporate historical bias or contain other types of errors. Automated systems may also correlate data with protected classes, which can lead to discriminatory outcomes.
- **Model explainability and interpretability.** Many automated systems are "black boxes" with internal workings that may not be clear to most people — sometimes even the developers themselves. This lack of transparency can make it more difficult for developers, businesses and individuals to know whether the outcomes produced by these systems are "fair" in the context they're used.
- **Improper design and use.** Developers don't always understand or account for the contexts in which private or public entities will use their automated systems. They may design a system based on flawed assumptions about its users, about the relevant context or about the underlying practices or procedures it may augment or replace.

To help address these risks, the agencies reiterated their resolve to monitor the development and use of automated systems and to promote responsible innovation. They also pledged to vigorously use their collective authorities to protect the rights of individuals regardless of whether legal violations occur through traditional means or advanced technologies.

Subsequent activity at a glance. The four agencies, along with other federal regulators, have since acted on all fronts — issuing guidance, making rules and pursuing enforcement remedies — to help address misuse of automated systems. Some examples include:

May 2023 — DOJ's Civil Rights Division releases guidance on how employers can confirm that their AI-powered employment tools do not discriminate against people with disabilities.

May 2023 — FTC issues a policy statement warning about surveillance and misuse of consumers' biometric information and the marketing and use of biometric information technologies.

June 2023 — Fed, OCC, FDIC, CFPB, NCUA and FHFA release a joint proposal that would require mortgage originators and secondary market issuers to adopt quality control standards for the use of automated valuation models.

July 2023 — FTC investigates a leading AI developer for a data leak.

September 2023 — CFPB issues guidance about certain legal requirements that lenders must adhere to when using AI.

September 2023 — EEOC settles a case with a provider of tutoring services for allegedly programming its AI-powered hiring selection tool to automatically reject women applicants over 55 and men over 60.

November 2023 — FTC authorizes the use of compulsory processes in nonpublic investigations involving AI, meaning the FTC can issue civil investigative demands (CIDs) related to AI.

December 2023 — HHS issues a final rule for AI and other predictive algorithms used by healthcare providers to help clinical users assess the algorithms for fairness, appropriateness, validity, effectiveness and safety.

January 2024 — FTC orders five companies to provide information regarding recent investments and collaborations involving generative AI companies and major cloud service providers.

January 2024 — CFTC issues a request for comment to better inform it of the current and potential uses and risks of AI in the derivatives markets.

February 2024 — FCC outlaws robocalls using AI-generated voices, effective immediately.

February 2024 — FTC warns that surreptitious, retroactive changes to privacy policies (e.g., to allow sharing consumers' data with third parties or using that data for AI training) could be an unfair or deceptive trade practice.

Existing laws may apply. Recent speeches from agency officials serve as a reminder that current laws already address many potential harms from AI. On February 13, SEC Chair Gary Gensler reiterated that existing securities laws prohibit the use of AI to defraud investors and warned that public companies that misleadingly promote their AI use risk engaging in "AI-washing" that can harm investors in violation of those laws. One day later, Deputy Attorney General Lisa Monaco warned that the DOJ will use existing laws to punish harms (e.g., discrimination, identity theft, price fixing) committed when using AI and, where possible, will seek stiffer sentences for offenses made significantly more dangerous with AI.

Your next move

The recent guidance, rulemaking and enforcement actions highlight the importance of developing and using AI-powered systems responsibly. Consider taking the following steps.

1. **Inventory your AI use.** Identify AI and algorithmic processes and uses in your organization and their status (planning, development or operation). This inventory can form the basis for all further decisions in establishing AI governance. A starting point for this exercise might be your model governance function, but the proliferation of AI and GenAI-based systems likely requires you to look beyond governance programs that may not yet be adapted for current activities. Monitor your AI-based activities now to avoid rushing into this task during the compliance readiness period. Consider adopting a cloud-based model risk management governance solution like Model Edge, a PwC product.
2. **Assess the regulatory impact.** Based on your inventory, determine which items are within the purview of regulators. Assess the risks of the AI or algorithmic processes compared to the regulatory areas of scrutiny. Determine your potential exposure and the consequences for your strategy, product design, operations and compliance programs to get a preliminary view on the mitigation lift. PwC's Responsible AI toolkit is designed to help organizations build or adapt existing risk management programs to help mitigate new or increased risks and address regulator concerns.
3. **Develop an AI governance board.** The cornerstone of Responsible AI implementation is governance, including oversight and monitoring. Consider a diverse mix of professionals, including AI and technology leadership, data scientists, legal advisors and key business stakeholders, for the most effective review and challenge as AI systems are designed and implemented. Their role should be to set the standards and guidelines for Responsible AI use and confirm compliance with regulatory requirements and alignment with corporate values. This team should regularly review AI projects to confirm that AI solutions help enhance business operations without compromising corporate standards or posing unnecessary risk. They should also develop an approach for interacting with the board in its role overseeing strategic opportunities and risks.
4. **Prepare for transparency.** If your organization faces direct obligations, document your processes and controls and assess their readiness for external reporting. Make sure your public statements and internal practices are aligned to stand up to increasing scrutiny from regulators, customers and the media.

Bitcoin fund approval marks regulatory shift on crypto

By Matthew Blumenfeld, Andrew Hillyer and Kristin D'Ambrosio

The issue

The SEC has approved the listing and trading of 11 spot bitcoin exchange-traded products (ETPs). This move, taken on January 10, 2024, signals an important development in the integration of cryptocurrencies into mainstream financial products and reflects the evolving regulatory landscape surrounding digital assets.

The decision comes after a prolonged period of skepticism and caution from the SEC, which had previously rejected more than 20 applications to list bitcoin ETPs. These rejections were rooted in concerns over market volatility, the potential for fraud and manipulation, and the overall stability of the crypto market. The SEC's stringent approach mirrored the broader regulatory uncertainty surrounding digital assets, an area known for its considerable risks.

The SEC's approval is not simply a regulatory green light for these specific products. It reflects a broader recognition of the maturing crypto market. The immediate market response was robust, with over $7 billion of trading volume recorded in just the first two days following the approval. Market excitement about the ability to access this asset class more easily has continued in trading through February with cumulative trading volume across the ETPs surpassing $65 billion, outpacing historical volumes across all ETFs. This reception underscores the market's readiness for more accessible crypto investment options.

Bitcoin exposure is likely to continue expanding as traditional financial services firm customers can now invest in the digital asset without the friction and risk associated with opening accounts on crypto exchanges. Brokerages and investment advisors must decide how to respond to this important development and plan accordingly.

The regulators' take

The SEC's decision to approve the listing and trading of bitcoin ETPs marks a significant departure from its historically cautious approach toward crypto-based financial products. This shift was influenced by a recent court ruling that challenged the agency's prior rejections, citing a lack of adequate justification. In response, the SEC reevaluated its stance, leading to the landmark approval.

As Chair Gary Gensler explained, the SEC evaluates any rule filing by a national securities exchange based upon whether it is consistent with the Exchange Act and regulations thereunder, including whether it is designed to protect investors and the public interest. The agency is merit neutral and does not take a view on particular companies, investments or the assets underlying an ETP. If the issuer of a security and the listing exchange comply with federal securities laws, that issuer deserves the same access to regulated markets as anyone else.

Importantly, Gensler stressed, this action is limited to ETPs holding one non-security commodity, bitcoin. It should in no way signal the SEC's willingness to approve listing standards for crypto-asset securities. Nor does the approval signal anything about the agency's views as to the status of other crypto assets under the federal securities laws or about the current state of noncompliance of certain crypto-asset market participants with the federal securities laws. "As I've said in the past, and without prejudging any one crypto asset, the vast majority of crypto assets are investment contracts and thus subject to the federal securities laws."

Investor access and implications. The approval of bitcoin ETPs opens a new avenue for investors to diversify their holdings, allowing them to gain exposure to bitcoin through conventional brokerage accounts. It eliminates the need for investors to navigate the often-unfamiliar terrain of crypto exchanges and take custody of these assets, which can create liquidity risk.

By integrating bitcoin into more traditional investment structures, the SEC's decision greatly expands the potential investor base for bitcoin, making it more accessible to the general public. This move is expected to bridge the gap between traditional finance and the burgeoning world of digital assets, potentially ushering in a new era of investment strategies.

Looking ahead. The SEC is now poised to decide whether to approve Ethereum ETPs in May 2024, a decision that could further solidify the role of digital assets in mainstream finance. Because this also underscores the ongoing challenges and considerations in regulating a rapidly evolving and technologically advanced sector, the SEC's actions in the coming months will be closely monitored for indications of how the regulatory framework for digital assets might continue to evolve.

In the meantime, guidance from global standard-setters may provide a preview of the SEC's future regulatory approach.

- The Financial Stability Board (FSB) published its global regulatory framework for crypto-asset activities and crypto-asset roadmap in July 2023. The framework consists of interlinked recommendations for the regulation and oversight for crypto-asset activities and revised recommendations for "global stablecoin" arrangements. The FSB has also strengthened its previous recommendations, published in 2022, in three areas: protecting client assets, conflicts of interest and cross-border cooperation. The final framework includes ten recommendations for crypto-assets and markets.
- The International Monetary Fund (IMF) and FSB published a policy recommendation paper in September 2023. It outlines the commonly cited risks and benefits of crypto-assets, with a focus on macroeconomic and financial stability.

- The Financial Action Task Force (FATF) raised serious concerns over the lack of implementation of its AML/CFT standards application on virtual assets and virtual asset service providers in a June 2023 publication and will publish the steps jurisdictions have taken in H1 2024.
- The International Organization of Securities Commissions (IOSCO) set out its recommendations on how to regulate crypto- and digital-assets markets in a final report published in November 2023. It also published a consultation on global approach to address decentralized finance risks in September 2023.
- The Basel Committee on Banking Supervision (BCBS) issued rules on the prudential treatment of crypto-asset exposures in December 2022 and will implement its standards by January 2025. Most jurisdictions have indicated that they are taking steps to incorporate the rules into their national regulations.

Your next move

In the wake of the SEC's decision, brokerage houses and other customer-facing firms will need to decide whether to integrate these products into their offerings. Consider taking the following steps.

1. **Develop your position and strategy.** Prepare to respond to customer inquiries by formulating a rationalized point of view on the asset class. Think through how these products align with your firm's brand, customer base and existing products and decide whether to offer them. Explore how to leverage crypto and digital assets as well as blockchain technology to enable your business and processes to provide greater value to customers.

2. **Update your suitability policies.** Review and potentially revise your policies for determining the suitability of bitcoin ETPs for each client, considering factors such as the client's investment objectives, risk tolerance and financial situation.

3. **Ready your client disclosures.** Be prepared to communicate the volatility risks clearly to your clients who may not be familiar with these products. This might include using bold text and large pop-up boxes in digital interfaces, and requiring explicit acknowledgement from investors — the same disclosures you apply to similarly leveraged or volatile assets.

4. **Prepare for SOX compliance.** As these and other emerging products fall under the Securities Exchange Act of 1934, you'll likely have to establish a program for management to assess the effectiveness of the related financial controls. An external audit opinion over these financial controls will also be required.

5. **Stay abreast of regulatory expectations.** Track and follow SEC guidance, rulemaking and enforcement related to digital assets — as well as the activities of global standard setters — as regulatory expectations evolve in this fast-moving space.

For an overview of the global regulatory environment, see Navigating the Global Crypto Landscape with PwC: 2024 Outlook.

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Why do we publish The Next Move?

Regulators and policymakers — keen to build new guardrails for a digital society — stand on largely unfamiliar ground. They often take different, sometimes contradictory, approaches because they have different missions and visions. At the global level, regulatory divergences reflect profoundly different value systems. Building trust in technology is complex work.

Through PwC's Next Move series, we can provide context to policy and regulatory developments in technology and tell you how you can get ahead of what might come next.

For additional information on our Next Move series, please contact:

Matt Gorham

Cyber & Privacy
Innovation Institute Leader

202 951 0439

matt.gorham@pwc.com

LinkedIn

Chris Pullano

Financial Services
Advisory Partner

917 520 4447

christopher.pullano@pwc.com

LinkedIn

Contributing editors and authors: Ted Trautmann, Lexi Cafasso