

# SEC Proposal Balances AI-Like Technology Use With Investor Best Interests: Has the Regulator Picked a Winner?

September 28, 2023

Like other savvy businesses, investment advisers and broker-dealers have increasingly embraced the use of predictive data analytics, artificial intelligence, and similar technologies (AI-like technologies) to help generate cost-savings, among other things. However, unlike other businesses, investment advisers are fiduciaries and are required to place their clients' interests ahead of their own. Similarly, broker-dealers are obligated to act in the best interests of their retail customers under the SEC's Regulation Best Interest. Therefore, while cost-savings and profitability can be a priority for firms, these aims cannot take precedence over the best interests of investors. To address potential conflicts that can arise with respect to a firm's use of AI-like technologies, which could intentionally or unintentionally place the firm's interests ahead of those of clients or customers, the SEC proposed new rules on July 26. **Proposal Overview** The proposed rules would require, among other things, that investment advisers and broker-dealers:

- Evaluate any use (or reasonably foreseeable potential use) of “covered technology” in any “investor interaction” to identify any conflicts of interest associated with that use.
- Determine whether any such conflict of interest places or results in placing the firm's (or its associated person's) interest ahead of investors' interests.
- Eliminate or neutralize the effect of any conflicts of interest that place the firm's (or its associated person's) interest ahead of investors' interests.

For these purposes, “**covered technology**” is defined to include an 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.

**“Investor interaction”** generally includes engaging or communicating with an investor, including by exercising discretion regarding an investor’s account, providing information to, or soliciting an investor. A firm that engages in any investor interaction using covered technology would also be required to adopt written policies and procedures reasonably designed to achieve compliance with the proposed rules. As applicable, such procedures must include, among other things, a written description of the process for:

- Evaluating any use (or reasonably foreseeable potential use) of a covered technology in any investor interaction.
- Determining how to eliminate or neutralize the effect of any conflicts of interest determined pursuant to the proposed rules to result in an investor interaction that places the interest of the firm or an associated person ahead of the interest of investors.

Firms would also be obligated to conduct, at least annually, a review of the adequacy and effectiveness of policies and procedures adopted pursuant to the proposed rules and to retain certain records. **Some Serious Concerns** Few would argue that the use of AI-like technologies is risk-free. However, the proposed rules appear to be drafted more broadly than is reasonably necessary to accomplish the commission’s stated goals. For instance, the commission claims that the proposed rules would “supplement, rather than supplant, existing regulatory obligations related to conflicts of interest.” However, as fiduciaries, investment advisers are required to eliminate or make full and fair disclosure of conflicts of interest so that a client can provide informed consent. The proposed rules would effectively create a subcategory of conflicts, i.e., those associated with the firm’s use of “covered technologies” in an “investor interaction,” which must be treated differently. Full and fair disclosure, it seems, cannot cure such conflicts. The rules also would appear to have the effect of altering the obligation of broker-dealers from one centered on investor best interests at the time of a recommendation to an ongoing obligation in connection with the firm’s use of covered technologies. As drafted, the proposed definition of “covered technology” would capture both sophisticated and simple tools commonly used by firms. These include, for example, investment analysis tools and models used to predict stock returns, as well as technology that makes use of lookup tables and historical or real-time data, such as spending behavior data, web browsing histories, and social media posts used to curate or target content and guide investor behavior. In a joint comment letter submitted in August, 16 trade associations noted that the proposed rules “threaten to upend longstanding precedent.” They also requested an extension of the 60-day comment period to allow market participants “sufficient time to thoroughly analyze and provide comment on the implications of the proposal.” Unless extended in response to this or other requests, comments on the proposal must be submitted to the commission by October 10, 2023.

# Authored By



Mederic A. Daigneault

## Related Practices

[Technology](#)

[Financial Services Regulatory](#)

[Life, Annuity, and Retirement Solutions](#)

## Related Industries

[Life, Annuity, and Retirement Solutions](#)

[Technology](#)

[Life, Annuity, and Retirement Solutions](#)

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.