IAC Panel Discussion: AI Regulation - Embracing the Future

May 28, 2024

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SEC: Areas of Potential AI Concerns

Areas of AI impact in maintaining fair, orderly, and efficient markets, and facilitating capital formation

Systemic Risk: Widespread use of AI in the financial industry could potentially lead to increased interconnectedness and complexity, which could amplify systemic risks.

Disclosure and Transparency: If AI systems are used to make investment decisions or generate financial reports, there may be concerns about the transparency and interpretability of these systems. The SEC requires clear disclosure of material information to investors.

Robo-Advising: AI-powered robo-advisors that provide investment advice to clients must comply with the same regulations as human advisors, including fiduciary duties and disclosure requirements. The SEC will continue evaluating this robo-advisors, as they proliferate and become more advanced.

Cybersecurity: AI systems used in the financial industry may be vulnerable to cyber attacks, which could lead to market disruptions, theft of sensitive information, or unauthorized trading activities. The SEC has emphasized the importance of cybersecurity for financial institutions.

AI Concerns

Algorithmic Bias: If AI systems used in financial decision-making are trained on biased data or have inherent biases in their algorithms, they could potentially discriminate against certain groups of investors or companies. The SEC is concerned with ensuring fair and equal access to markets.

Regulation of AI-Based Financial Products: As AI is increasingly used to create and manage financial products, such as exchange-traded funds or structured products, the SEC will need to ensure that these products are properly designed, disclosed, and sold to investors. This may require new rules or guidance specific to AI-based financial products.

AI and Corporate Governance: As AI is increasingly used in corporate decision-making, there may be questions about the role and liability of corporate boards in overseeing these systems. The SEC rules related to corporate governance and the responsibilities of boards and management will likely need adaptation for AI decision making.

AI and Accounting Fraud: AI could potentially be used to commit or conceal accounting fraud, such as by manipulating financial data or creating fake transactions.

SEC: Areas of Potential AI Concerns

Areas of AI impact in maintaining fair, orderly, and efficient markets, and facilitating capital formation

AI Concerns

AI and Investor Education: With the growing use of AI in finance, there may be a need for investor education to help investors understand the risks and benefits of AI-based investment products and services.

AI and Blockchain: As AI is increasingly used in conjunction with blockchain technology for applications like smart contracts or decentralized finance (DeFi), there may be new regulatory challenges. The SEC has been grappling with how to regulate cryptocurrencies and other digital assets, and the addition of AI could add further complexity.

AI and Investment Research: If AI is used to generate investment research or ratings, there may be questions about the objectivity, reliability, and transparency of these outputs. The SEC has rules related to investment research and conflicts of interest that could apply to AI-generated research.

AI and Customer Privacy: As financial institutions use AI to analyze vast amounts of customer data, there may be concerns about privacy and the potential for misuse of this information. While primary responsibility for customer privacy falls to other regulators, the SEC does have rules related to safeguarding customer information and preventing identity theft.

Surveillance and Enforcement: The SEC may need to adapt its market surveillance and enforcement tools to detect and investigate potential misconduct involving AI, such as market manipulation or insider trading. This could require new technological capabilities and expertise within the SEC.

AI and Financial Inclusion: While AI has the potential to expand access to financial services, it could also potentially exacerbate existing inequalities if not implemented responsibly. The SEC, along with other regulators, has an interest in promoting financial inclusion and ensuring that the benefits of AI are widely shared.

International Coordination: As AI is used globally in financial markets, there will be a need for international coordination among regulators to ensure consistent standards and prevent regulatory arbitrage. The SEC is already working with international counterparts through organizations like IOSCO and this dialogue will likely expand with AI's capabilities.

Unintended Consequences: As with any powerful new technology, this is a potential risk. For example, the interaction of multiple AI systems could potentially lead to unexpected market dynamics or cascading failures. The SEC and other regulators will need to stay vigilant to identify mitigate these types of risks as they emerge.

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Two Approaches To Regulating AI

THERE ARE BROADLY TWO APPROACHES TO REGULATING AI

Both approaches will require a substantial increase in the understanding of continually evolving technical developments in AI, as well as its impacts at deployment

REGULATING THE TECHNOLOGY

REGULATING USE-CASE OUTCOMES

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Regulating The Technology

Algorithmic Transparency

Requiring companies to disclose information about how their AI algorithms work, what data they use, and how they make decisions. This could include requiring the use of explainable AI techniques

Testing and Certification

Requiring AI systems to undergo rigorous testing and certification before they can be deployed. This could include testing for bias, fairness, safety, and robustness

Technical Standards

Developing technical standards for AI systems related to performance, safety, security, and interoperability. Compliance with these standards could be mandatory or voluntary

Compute Power Limits

Regulating AI based on the amount of computational power used, such as setting limits on the number of computations or the energy consumption of AI systems

Data Governance

Regulating the collection, use, and sharing of data used to train and operate AI systems. This could include data privacy rules, data quality standards, and requirements for data provenance & lineage

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Regulating Use-Case Outcomes

Sectoral Regulations

- Developing specific regulations for AI applications in different sectors, such as healthcare, finance, transportation, and criminal justice. These regulations would focus on the unique risks and requirements of each sector

Risk-Based Frameworks

- Categorizing AI applications based on their level of risk and applying different levels of regulatory scrutiny accordingly. Higher-risk applications would face more stringent requirements

In practice, effective AI regulation is likely to require a combination of both technology-level and use-case-based approaches. For example, general technical standards and algorithmic transparency requirements could be combined with specific sectoral regulations and impact assessment requirements

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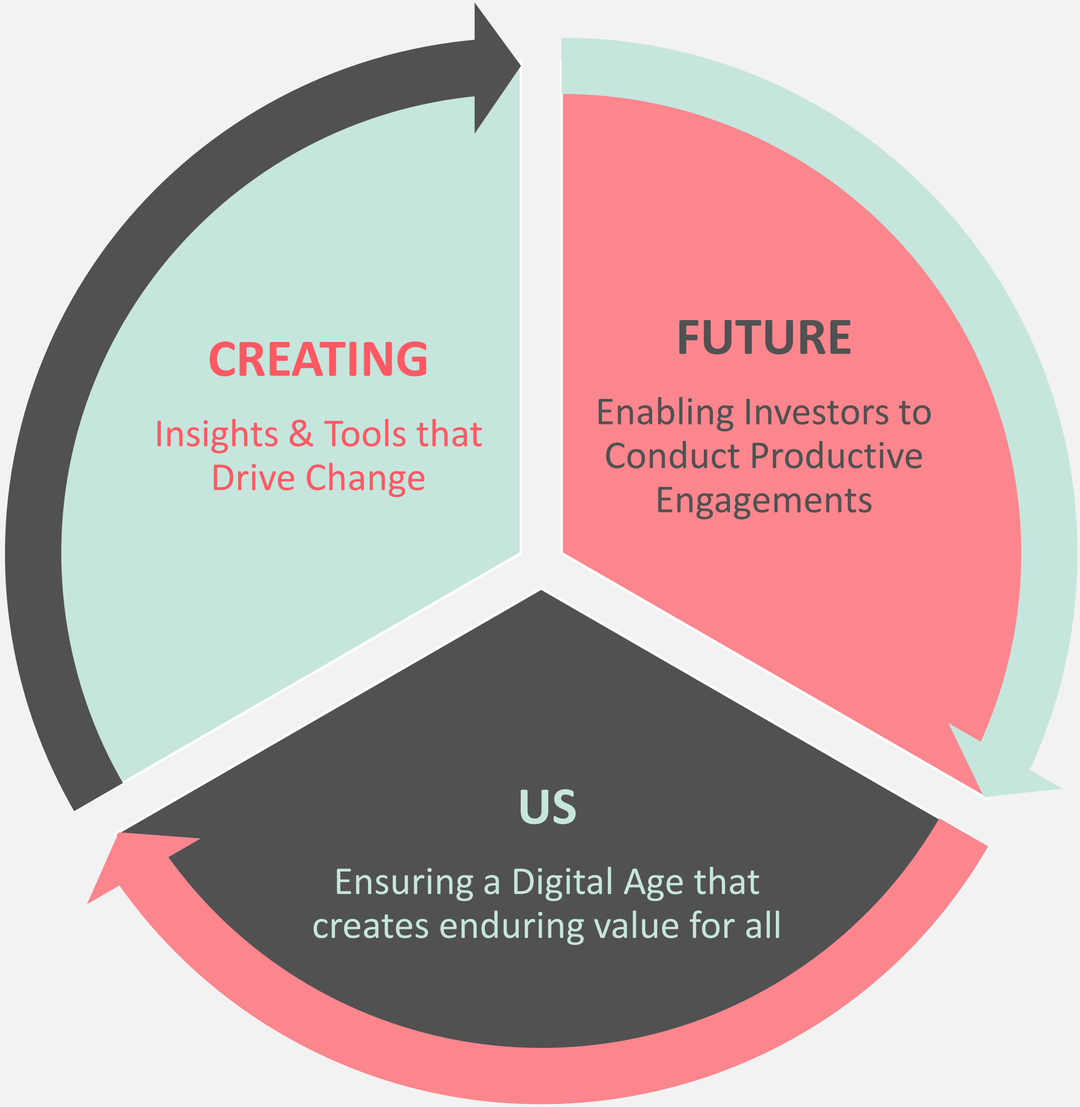
A not-for-profit that champions investor action contributing to enduring value -creation in a Digital Age



Changing practices to anticipate consequences; keeping pace with & thriving alongside digitalization & automation

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CFU Vision

A Future in Which the Digital Economy is Enduring and Inclusive

CFU Mission – The Time is Now

At the Heart of CFU's Mission: Harnessing Shareholder Power to Create a Sustainable Digital Economy

Creating Future Us

Is a not-for-profit founded in early 2017, dedicated to advancing responsible approaches towards technology use

Our Aspiration

A Digital Age in which technology is a force for good, enduring value creation, with minimal externalities

Our Mission

Empowering investors in conducting productive engagements, with targeted research, insights and tools that raise standards, increase resilience, reduce risk and power performance

Investor Leadership

Responsible tech stewardship will be the defining feature of successful, sustained growth in a Digital Age economy - and investors have a significant role to play

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