

Adopting AI in the Financial Services Sector

The compliance impact of AI technologies
in regulated industries

Introduction

Advances in artificial intelligence technologies — including generative AI — present every financial services organization with unprecedented opportunities. These technologies have the potential to transform internal processes, speed decision making and drive deeper customer relationships.

However, it can also be a source of new digital risks centering on information accuracy, security, privacy and ownership.

While the opportunities of high-touch customer service, boosting internal collaboration and workplace transformation can't be ignored, neither can regulatory obligations and risk management. This brief will explore the multifaceted concerns compliance leaders have with new tools and platforms.

The regulatory perspective on AI

Regulators have been watching AI closely, and new guidance is almost certain to occur over the coming months. They have, and will continue, to target a wide variety of risks ranging from cyber fraud, cyberattacks, identity theft, investor protection, introduction and management of biases, and a variety of other topics.

Several regulatory perspectives have already been offered:

Security and Exchange Commission (SEC)

The SEC has provided several public comments about generative AI, with Chairman Gensler warning of its potential to impact “**financial market stability**” given its ability to attract fraud and conflicts of interest. Firms will no doubt struggle in attempting to ensure that investor interests are being protected and balanced against the interests of the firm.



Industry disagreements with the SEC's direction¹

“The SEC’s predictive data analytics proposal was originally framed to cover gamification and [similar] technologies but was later reframed to try to regulate AI. [At SIFMA], we think that they went about this as a conflict of interest proposal. So, firms will be required to eliminate or “neutralize” conflicts of interest with technology that is used to interact with investors.

Ultimately, the definitions they use are extremely broad and go much further than what the rule says on its face. The SEC is essentially rewriting the existing regulatory regime for registered investment advisers and broker-dealers and how they provide services to investors.

There already is a robust and effective regulatory regime, which covers AI as well as other types of technology that governs investor interactions with broker-dealers and RIAs. [Many in the industry] think it’s damaging to try to adopt regulation for particular technologies.

As a result, the proposal would severely inhibit how broker-dealers and RIAs use technology, and how they communicate with customers and clients, which can harm investors and the markets as a whole.

This did not just cover retail clients. It also covers institutional clients due to how the definitions were created in the proposed rule.

Melissa MacGregor
SIFMA Deputy General Counsel & Corporate Secretary

1. [The Compliance Impact of AI in Regulated Industries](#), Smarsh Advance session November 2023

Biden Administration Executive Order on Artificial Intelligence

This is a [broad executive order](#) proposing standards for AI safety and security, focusing on consumer privacy protection.

EU AI Act

This publishes the [first regulation of AI](#), providing a number of consumer and individual protections according to specific risk categories.

National Institute of Standards and Technology (NIST)

A number of works have been published attempting to [define standards to govern the use of AI](#), including risk management frameworks and research into what the organization considers 'trustworthy' AI technologies.

Federal Trade Commission (FTC)

The FTC is [conducting an investigation](#) of OpenAI's data protection capabilities. The goal is to ensure that information used to develop and train models is appropriately managed, that information ownership rights are not questioned, and that OpenAI is properly governing the data protection and data privacy obligations.

Office of the Comptroller of the Currency (OCC)

There is an ongoing investigation of the use of AI and its [potential impact on discrimination](#) being built into banking algorithms.

Consumer Financial Protections Bureau (CFPB)

The CFPB issued a spotlight on the [use of chatbots in banking](#) based upon an increase in consumer complaints about the difficulty of resolving disputes. The CFPB noted that all top 10 commercial banks in the US are using chatbots to engage with customers.

How firms can move forward with AI adoption

Clearly, regulatory guidelines are developing and are expected to evolve. How are firms going to do anything until all the regulations are finalized?

“Well, you don’t really need to wait,” says Jake Frazier, FTI Consulting’s Senior Managing Director.

Adopting AI technology is similar to the process of embedding other types of technologies into compliance workflows. Previous technology implementations can serve as a good framework for how firms adopt new tools.

“As firms are navigating this space, they’re looking at the technology not necessarily in a vacuum for each type of purpose,” says MacGregor. “They’re looking at it across different types of purposes that they’re going to use this technology for.”

Firms should determine which AI applications are in scope of their framework when they’re building their governance programs. This includes having an inventory of their AI applications, including details to allow them to be risk rated.

“Firms are going to need to consider legal risks and regulatory risks, as well as operational, reputational, contractual, discrimination, cyber, privacy and consumer harm,” says MacGregor. “A lot of firms already have technology onboarding committees, and I think we’re going to see that more and more, specifically for AI applications because of the particular risks.”

Look to other regulated industries for best practices

The financial services sector isn’t the first regulated industry to explore AI adoption either. The legal sector has already started the AI journey with predictive analytics and technology-assisted review. Financial services organizations can capitalize on many compliance lessons learned from using AI in the litigation and discovery space.

This wouldn't have been the case 10 years ago. But given the increasing regulatory clarity and allowance of AI, firms should feel comfortable that they have the space to explore and take advantage of benefits offered by the technology.

"I think what helped get that technology over the hump is what we're going to see in AI and what we're seeing in some of the proposed regulations," says Frazier. "The key was explainability. The judge or tribunal regulator needs to know that there's no funny business going on, that this isn't just a shortcut or a trick. They need to know that the science is valid, that it's not just wrong."

Frazier notes that firms can make a strong case for the use of AI if they can communicate to executives, board members and regulators that AI tools:

- Still require humans to be in key roles
- Use real datasets and don't generate new data
- Operate under tight guardrails

Look to other regulated industries for best practices

Not all emerging technologies are created equal. While using AI to analyze and review business-generated data is one thing, using AI to create requires more consideration.

"I think most firms are exploring using any type of AI to improve their compliance particularly and improve their legal functions," says MacGregor. "But I think on the ChatGPT side and those types of generative AI solutions, firms are a little slower on accepting those into mainstream business because they don't control those inputs."

It's understandable why many firms may not be comfortable with using third-party applications like ChatGPT where the underlying data that's used to drive content creation isn't controlled by the firm.

But this is where Frazier's comments on requiring humans in key roles are important. There are benefits to using generative AI applications to create content — such as a first draft of a speech or presentation — before having a human review, edit, finalize and present the content. The human element in the creation process is key to preventing misinformation, incorrect details, harmful financial advice and legal issues.

Start your AI adoption journey with Smarsh

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