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SEC Proposal Slams the Brakes on Tech Progress

Technological innovation in the financial services industry has driven huge benefits for Main Street investors, slashing costs and ushering in new investment opportunities. This innovation has taken place within a strong legal framework that protects investors.

Yet a new proposal by the Securities and Exchange Commission (SEC) would slam the brakes on technological progress, bringing everyday industry practices to a screeching halt and giving investors whiplash in the process. The proposal threatens to impose unprecedented and unnecessary compliance costs on the industry—costs that ultimately would harm the very investors the SEC aims to protect. Further, it would contradict the well-established legal principles governing the obligations of investment advisers and broker-dealers to investors.

The Commission claims its proposed rules are intended to address potential conflicts of interest raised by AI and other *covered technologies*, preventing these technologies from steering Americans toward investments that primarily benefit advisers and brokers. But the proposal is so breathtakingly broad that it would disrupt almost every aspect of a firm's operations and interactions with investors.

This proposal's all-encompassing approach to covered technologies would ensnare robo-advice, online investing tools, investor education materials, and even basic spreadsheets. SEC Commissioner Mark Uyeda noted that tools as simple as a calculator could be swept in under the proposal. The SEC doesn't limit the proposal's reach to technologies that directly touch investors. It also scoops up portfolio management and trading systems, limiting the ability of advisers and brokers to efficiently perform the very services investors hire them to provide.

While the technology risks the Commission points to are hypothetical, the burdens the proposal would impose are real and substantial. ICI's economic analysis finds that the costs of the proposed rules, if adopted, could total $30 billion in the first ten years alone. The proposal fails to demonstrate any potential benefits to outweigh its staggering price tag.

Under the proposal's requirements, firms would be obligated to continually catalogue all their covered technologies, determine whether their use takes into consideration an *interest* of the firm, and eliminate or neutralize any conflict that places the firm ahead of its clients—all while painstakingly documenting each of these steps in real time. The *elimination or neutralization* requirement would likely cause firms to abandon beneficial technologies and overhaul established business models.

Imagine This Scenario

Many portfolio managers use quantitative programs to inform their investment decisions and manage risk in clients' portfolios. Common applications of these programs include scenario analysis and stress testing, which allow managers to gauge the potential performance of portfolio holdings under an economic recession, an inflation shock, and various other market conditions.

Due to the SEC's proposal, however, the use of such programs could be restricted, thereby limiting the toolkit that many portfolio managers use to navigate markets.

The proposal also takes the well-understood concept of a conflict of interest and turns it on its head. Namely, it assumes that a conflict exists anytime an adviser or broker takes its own interests into account when using a covered technology. Any for-profit business considers its interests when employing technology—that doesn't mean the interests conflict with those of its clients. And by taking the extreme view that elimination or neutralization is the only way a firm can address a technology-related conflict, the SEC would discard centuries of precedent on the obligations of fiduciaries, as well as its own conflicts standards adopted less than five years ago. The SEC doesn't say what, if anything, has changed in that short time.

What's more, the proposed rules would violate the First Amendment by unduly restricting information firms can communicate to current or prospective investors. Even purely educational interactions would be constrained if they involve a covered technology. Since the SEC doesn't indicate how covered technologies present unique harms that existing regulations can't sufficiently address, it fails to demonstrate a compelling interest for these speech restrictions.

The investment management industry has spent vast sums on technology to improve investor outcomes. Firms have also long adhered to sound legal principles in their business practices and client interactions. Instead of staying in its lane and building on these successes, the SEC's attempt at regulating technology endangers the services that Main Street investors value and even endangers the industry at large. The SEC should withdraw this flawed proposal before it drives the industry and the investors it serves into a ditch.
