The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

Washington, DC // Brussels // London // www.ici.org

ICI President's Address, 2024 ICI Innovate

ICI President's Address

Eric J. Pan
President and CEO
Investment Company Institute

ICI Innovate
San Diego, California

February 8, 2024

The Right Way To Regulate Technology: Three Guidelines for the SEC

Good morning! It's a pleasure to kick off the second day of ICI Innovate—and it's a privilege to address all the people here who are moving finance into the future.

I hope you've enjoyed your time in San Diego. I certainly have. Unfortunately, the weather was supposed to make my colleagues in Washington jealous that we're in southern California. Maybe one of our presenters can show us how to create AI-generated images of us basking in the sun. Weather aside, it is nice to be in a place that truly values innovation. Generally speaking, DC struggles to embrace new ways of doing things, while California is synonymous with entrepreneurial energy and progress. There's a palpable sense that the future is bright—and worth bringing into the present.

That attitude defines you and your companies, and your work at the intersection of technology and finance holds great promise for individual investors. As an industry, we're on the verge of historic leaps in accessibility and affordability, giving far more people the chance to achieve long-term financial security.

And yet, there's a risk we don't get there—and indeed, that we're blocked from getting there. This morning, I will look at the regulatory challenges facing innovation, using the recent work of the Securities and Exchange Commission as an example. Then I will look at how ICI is addressing those challenges, arguing for a better way to develop the rules that govern the intersection of technology and investing. ICI is committed to being good partners to regulators, and we fully support prudent rules that unleash innovation while protecting investors. We have to get this right, so that you can continue to pioneer the advances that will benefit investors for generations to come.

That's where I want to begin: With the tangible progress that technology is already bringing to the world of investing.

Any discussion of tech and finance should start with the most exciting innovation of our time. I'm talking, of course, about artificial intelligence. While most people are focused on AI's ability to generate text and images, it has great potential to transform how people invest. With AI's vast processing and predictive power, we will soon be able to help investors make better decisions and provide them with better portfolios. In fact, with AI, we could further tailor products to provide personalization to more investors, helping more people from every income bracket.

Remarkably, AI is just one of many technological breakthroughs that could transform investing. Another major development is blockchain. It's a powerful technology that could have many applications to benefit investors in powerful ways. For example, it can make financial transactions significantly faster, while also making them more transparent.

The final innovation area I'll name is data science. Many of you are finding new ways to distribute products to a broader array of investors. For example, data science has enabled more effective outreach on social media, pairing specific products with the individuals most likely to want them. It's another chance to bring a new generation into investing. Without advances in data science, many would-be investors would still be on the sidelines, never knowing about the products that speak to them and meet their unique financial needs.

There are more innovations I could name, and while they're broadly different, they all contribute to the same forward momentum. Even bigger advances are on the way, and you're working hard to bring them to market. Because of you, investors can look forward to a future where investing is more affordable than ever, more individualized than ever, and more advantageous than ever.

The rapid pace of technological progress has, understandably, drawn the attention of Washington, DC Regulators have responded by rushing out new policies, with the goal of keeping investors safe. To be clear, these officials are well-meaning, and it's certainly true that prudent regulation is needed in this brave new era. We need commonsense rules of the road. We don't need to grind the wheels of progress to a halt.

Unfortunately, some regulations are trending in that direction. A case in point is the SEC's proposed rule on predictive data analytics. The SEC drafted this rule in response to the rise of artificial intelligence. Chair Gary Gensler has spent much of his career studying technology, and he has major concerns about how it will affect the broader economy. He wants to put a stake in the ground to show that the SEC is taking this danger seriously.

Chair Gensler deserves praise for trying to prevent potential problems caused by the rapid adoption of AI technology, but his agency's proposed rule is fundamentally flawed. It was poorly developed and hastily rolled out, and, as a result, it will harm far more investors than it protects. This rule will dramatically hike costs, hold back the most promising technologies, and hamstring your efforts to democratize investing. In fact, it will disrupt almost every aspect of a firm's operations and interactions with investors, while eviscerating the certainty and stability on which innovators and investors depend. Harmful and dangerous—those are the words that best describe what the SEC is proposing to do.

The SEC has stated that it's trying to prevent conflicts of interest when advisors and brokers use AI. To that end, it has developed a new standard that assumes that any time a financial firm takes its own interest into account, it's potentially creating a conflict with investors. But that's simply not true. Financial institutions have already gone to great lengths to mitigate conflicts of interest, and regulators have also taken important steps to protect investors. For instance, disclosure mandates are a powerful regulatory tool, one that empowers investors to make informed decisions. Yet the SEC ignores disclosure, and in fact, this proposal prevents investment firms from using disclosure to avoid conflicts.

In that sense, the rule is a solution in search of a problem. And worse, at the same time, the SEC is creating a host of new problems.

The SEC wants to require that when advisors and brokers use artificial intelligence and emerging technologies, they consider every instance in which it may advance their own interest. Then they must eliminate or neutralize any potential conflict, all while painstakingly documenting every step in real time. This will be an administrative nightmare, and it's an obvious barrier to using AI. Financial firms will avoid new technologies, lest they expose themselves to massive compliance costs. The most promising innovations will never see the light of the day.

But it's not just new technologies that will be affected. As SEC Commissioners Peirce and Uyeda pointed out, the SEC's definitions are so broad that most old technologies will also be covered. Financial planning, allocation formulas, forecasting tools—even spreadsheets and retirement calculators could all be banned or limited. The same goes for portfolio management and trading systems, all of which are essential to investing. Think, for a moment, about what that means. The SEC is creating a world in which advisors and brokers struggle to provide the very services that led investors to hire them in the first place. This proposed rule undermines the architecture of modern investing.

The cost of this mandate will be enormous. Firms will be forced to completely redo the vast majority of their operations, and we estimate this rule will cost at least $30 billion over the next ten years. It could

be one of the most expensive rules we've ever seen, yet the SEC has failed to justify such a staggering price tag. It says it's preventing conflicts of interest, but there are more effective and targeted ways to do that. It's going a mile when a foot was sufficient.

I can't stress enough that ICI strongly supports smart regulation on emerging technologies and conflicts of interest. But the SEC's predictive data analytics rule doesn't fit the bill. It chills innovation instead of creating safeguards to guide it, while piling on costs without any clear benefit. In its current form, this rule will back the future while causing investing to get stuck in the past.

Thankfully, we aren't the only ones who recognize the danger. Just this week, Senators Ted Cruz and Bill Hagerty introduced the Protecting Innovation in Investment Act, which would prohibit the SEC from finalizing this proposal. ICI strongly supports this bill.

But we aren't just focused on the predictive analytics rule. It's emblematic of a broader attitude toward regulation in our nation's capital. That attitude can be summed up as "regulation by hypothesis" where regulation is based on theory and supposition and not by understanding the problem. Yet the better approach is the opposite—understand before you regulate.

The ICI is leading the way back toward this commonsense approach. While you're on the frontlines of innovation, we're on the frontlines of regulation. We make sure your voices are heard in the halls of government, and right now, we're speaking directly with the SEC, as well as key policymakers in the Administration and Congress. We're advocating a regulatory process that protects investors while promoting the progress that comes with innovation. This shouldn't be "either/or." Investors deserve "both/and"—both protection and progress.

To that end, in our conversations with policymakers, ICI recommends three guidelines for better regulation. Each one can be summed up in single words—deliberation, communication, and imagination. I'd like to unpack each one, briefly.

The first guideline, deliberation, is an essential ingredient of sound policy. It refers to the wisdom of carefully studying an issue, instead of moving straight to mandates. The rush to regulate is dangerous, not least because hastiness leads to sloppiness. It's far better to seek clarity before unleashing the full force of government.

There's a famous adage to describe this guideline—measure twice, cut once. Yet while the phrase is old, it's especially apt with new technology. Artificial intelligence is inherently complicated, both in terms of how it works and how it can be applied. It defies simplistic narratives, and it requires substantial analysis to understand its potential uses and misuses. Sadly, that's not what the SEC did with its predictive data analytics rule. It moved too quickly, with all the unintended consequences that quick action entails.

Frankly, it's impossible to understand AI in a short period of time, given its rapid evolution and the only now developing evidence as to its effects. With a more deliberative approach, the SEC could have crafted a rule that encouraged responsible AI innovation, instead of undermining it. For that matter, had it waited and weighed the full effect of its words, the SEC could have defined its terms to focus solely on emerging technology, instead of covering everything going back to the pocket calculator. When the stakes are so high, the goal should be sound rules that stand the test of time, not rushed rules that ignore the needs of the time.

The second guideline is communication.

Put simply, whenever regulators are considering action on an emerging technology, they should have open and active dialogue with industry. Regulators should be right here, in this room, talking with all of you, all conference long. Practitioners like you deserve such respect—and you deserve to be heard. You are best suited to help regulators understand how new technology works. By the same token, you are best equipped to explain the damage that a bad regulation will do. In finance, industry voices can predict how a mandate may hike costs or hurt investors. Regulators should be eager to collect that information to minimize a rule's pain and maximize its benefits. By contrast, if they refuse or fail to communicate, regulators are much more likely to do more harm than good.

Once again, the SEC rule is a case in point. Its understanding of AI appears to reflect an academic mentality. That's all well and good, but practicality is key to good regulation in our dynamic economy, and you must have the best insight into the practical effects of this mandate. The best regulations account for real-world consequences. The moment they don't, the more damage they are likely to do.

The final guideline that we're advocating is arguably the most important. It's imagination, and it simply means that regulators need to believe in technology's potential. They must imagine that technology can be used for good, not just evil—and indeed, that its capacity for progress defies prediction. The alternative to imagination is fear and a defense of the status quo. If you assume the worst about a new technology, you'll block it in favor of the status quo. You may think you're protecting people, but in fact, you're preventing them from experiencing untold benefits.

Instead of giving into fear, the SEC should look to the lessons of history. Over 30 years ago, the internet was just getting started—and it wasn't pretty. The early internet was overrun with less than savory activity, including but not limited to criminal activity. It would have been easy for policymakers to kill the use of the internet, based on the belief that it was a tool that benefits wrongdoers. Instead, our nation's leaders recognized that it could transform our economy in unexpected and frankly incredible ways. They had imagination, and over 30 years later, the internet is still the cornerstone of economic growth. It has made everyday life immeasurably better, and in many respects, the internet revolution is still continuing.

The same lesson holds for emerging technologies like artificial intelligence. Is there cause for concern? Of course there is. But there's also great cause for optimism. AI has the potential to transform investing

and empower a new generation of investors. We don't know what benefits we'll see, but we do know that regulation grounded in fear will block them from materializing.

Regulators owe it to investors to let technology flourish, while putting up guardrails to prevent its abuse. The SEC is going the opposite direction, on the assumption that abuse is all we'll get. But that's not the case, as everyone in this room can attest. You are working every day to empower investors with AI and other cutting-edge tools—and you deserve regulators who share your belief in a better future.

This is the message we're delivering to the SEC and all of Washington. It's a message of partnership, based on our deep desire to develop the best rules for investors. We're ready to aid regulators in devising a stronger and more sensible framework for emerging technologies. We can aid with deliberation. We can offer good insights through communication. And we absolutely have that optimistic imagination. We know that technology's potential is truly unlimited—and that investors deserve to discover it

What gives us such confidence? The answer is you. And so I want to end my remarks where I began. Thank you for pushing the boundaries through innovation, for the sake of investors. And thank you for partnering with all of us at the Investment Company Institute. We are your voice in Washington, DC, and other capitals around the world—and we are proud to tell your story and support your efforts to move investing into a new and better era for all.

Thank you again for joining us this week.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.