



# Compliance In a Digital Age

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# Content Questions & Technical Help

If you have questions about the content of this course or need technical help, please contact us via the email address below:

[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)

# Your Instructor



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# Course Overview

- ▶ ***Electronic Messaging***
- ▶ ***Digital Marketing***
- ▶ ***Artificial Intelligence***
- ▶ ***Questions***

# Regulatory Resources

SEC Rule 204-2(a)(7): Books & Records to Be Maintained by an Investment Adviser @ <https://www.law.cornell.edu/cfr/text/17/275.204-2>

SEC Administrative Proceeding: In the Matter of Wedbush Securities Inc. (8/8/2023) @ <https://www.sec.gov/files/litigation/admin/2023/34-98074.pdf>

SEC Administrative Proceeding: In the Matter of Deutsche Bank Securities Inc., DWS Investment Management Americas, Inc., and DWS Distributors, Inc. (9/27/2022) @ <https://www.sec.gov/files/litigation/admin/2022/34-95928.pdf>

SEC Risk Alert: Observations from Investment Adviser Examinations Relating to Electronic Messaging (12/14/2018) @ <https://www.sec.gov/ocie/announcement/ocie-risk-alert-electronic-messaging>

SEC Rule 206(4)-1: Investment Adviser Marketing @ [https://www.law.cornell.edu/cfr/text/17/275.206\(4\)-1](https://www.law.cornell.edu/cfr/text/17/275.206(4)-1)

SEC Risk Alert: Examinations Focused on Additional Areas of the Adviser Marketing Rule (6/8/2023) @ <https://www.sec.gov/files/risk-alert-marketing-rule-announcement-phase-3-060823.pdf>

Proposed SEC Rule 275.211(h)(2)-4 entitled “Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers” (7/26/2023) at <https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf>

SEC Chair Gary Gensler: “Isaac Newton to AI” Remarks before the National Press Club (7/17/2023) at <https://www.sec.gov/news/speech/gensler-isaac-newton-ai-remarks-07-17-2023>

SEC Rule 3a-4 at <https://www.law.cornell.edu/cfr/text/17/270.3a-4>

Electronic  
Messaging:  
SEC  
Enforcement  
Actions

**In the Matter of Deutsche Bank  
Securities Inc. (9/27/2022)**

- Employees advised that use of unapproved electronic communications was not permitted, and they should not use personal email, chats, or text-messaging applications for business purposes
- Firm failed to implement sufficient monitoring to assure that their recordkeeping and communications policies were being followed

# Electronic Messaging: SEC Enforcement Actions

## **In the Matter of Wedbush Securities Inc. (8/8/2023)**

- Wedbush employees were advised that use of unapproved electronic communications, including on their personal devices, was not permitted
- A sampling of senior leadership uncovered pervasive Off-Channel Messages
- Wedbush's employees sent and received Off-Channel Messages related to providing investment advice to clients
- Wedbush failed to preserve Off-Channel Messages their employees sent/received related to investment adviser businesses
- Wedbush is required to pay a fine of \$10,000,000 and retain Independent Consultant



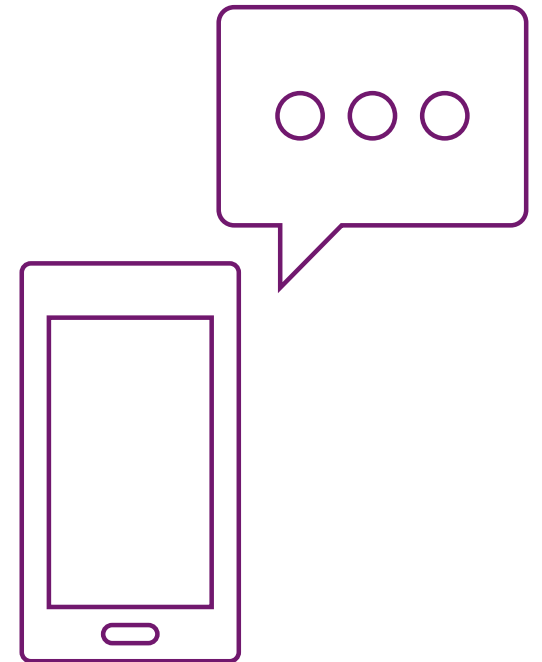
# SEC's Authority Over Electronic Messaging

Under Rule 204-2(a)(7), an investment adviser is required to preserve in an easily accessible place the following:

*“Originals of all written communications received and copies of all written communications sent by such investment adviser relating to:(i) Any recommendation made or proposed to be made and any advice given or proposed to be given; ii) Any receipt, disbursement or delivery of funds or securities; (iii) The placing or execution of any order to purchase or sell any security; and, for any transaction that is subject to the requirements of § 240.15c6-2(a) of this chapter, each confirmation received, and any allocation and each affirmation sent or received, with a date and time stamp for each allocation and affirmation that indicates when the allocation and affirmation was sent or received....”*

# Sample Information Request During SEC Exam

*“Please explain the steps taken by the Adviser to monitor, review, and retain electronic Communications related to the Adviser’s business. Electronic Communications include, but are not limited to, email, text messages, messaging apps, instant messages, Bloomberg messaging, and private messaging on social media sites. Please address the following: (1) whether supervised persons are permitted to use personal devices for firm business or are permitted to use any form of electronic Communication other than Adviser email accounts for business purposes; (2) if so, what steps the Adviser takes to approve the use of such personal devices or additional means of electronic Communications; and (3) **what steps the Adviser takes to ensure that supervised persons only use approved means of electronic Communications to conduct firm-related business.**”*



# Electronic Messaging Requirements & Best Practices

## Written Policy & Procedure If Messaging Authorized

- Do Not Authorize Apps That Allows Anonymous Messages, Automatic Destruction of Messages, or Prevents 3<sup>rd</sup> Party Monitoring Service
- Need to Select Pre-Approved Apps That Allow for Surveillance and Archiving
- Need Method to Move Message from Unapproved to Approved App
- If Personal Device Allowed for Messages, Need Minimum Standards for Device to Protect Confidentially
- Include Statement that Violations Will Result in Discipline
- Need Regular Reminders to Staff of Firm's Policy
- Need to Periodically Check with Supervisors that Staff Are Following Firm's Policy

# Electronic Messaging Requirements & Best Practices



Written Affirmation by Each Supervised Person Initially & Annually Thereafter



Training Topic at Least Annually & Multiple Reminders Each Year



Surveillance for Non-Compliance - Email for Indications of Unauthorized Messaging and/or Unauthorized Messaging Apps



Supervision - If Authorized, Review of Messages



Books & Records – Archive/Preserve Messages



# Electronic Messaging Requirements & Best Practices

## **Corrective Action**

If Individual Violates Policy, Then

- Collect, Analyze & Preserve Messages Sent/Received Outside Approved Systems
- Require Corrective Training of Supervised Person and Possibly Supervisor and Colleagues
- Consider Other Discipline Depending Upon Policy and Circumstances

# Digital Marketing



Client Testimonials



Paid Endorsements by  
Athletes & Celebrities



Compensated Referrals  
with Bloggers, Podcasters &  
Other Professionals

# SEC's New Marketing Rule

- ▶ SEC Rule 206(4)-1 Is Fully Effective 11/3/2023
  - Authorizes Client Testimonials
  - Replaces Previous SEC Rule for Solicitors (Rule 206(4)-3)
  - Broadens Definition and Recharacterizes Solicitor as Endorser
  - Collectively Refers to Clients Giving Testimonials and Non-Clients Making Endorsements as "Promoters"
  - Promoters Are Subject to Various Requirements & Disclosures
  - Requirements Designed to Work for Online Marketing
- ▶ Several States Adopt SEC's New Marketing Rule Including (But Not Necessarily Limited to): AR; GA; KY; NE & VT

# Regulatory Questions to Ask Related to Testimonials & Endorsements

**Practice Pointer:**

*Include Disclosure that Other Clients May Have Had A Different Experience or Opinion.*

Does the Investment Adviser's Regulator Permit Client Testimonials?

Is the Investment Adviser Authorized by the Promoter to Use the Testimonial or Endorsement?

Is the Testimonial or Endorsement Accurate?

Is the Testimonial or Endorsement Compensated?

# Regulatory Questions to Ask for Testimonials & Endorsements

## If Compensated,

- Is the Promoter Barred by the Securities Regulator from Serving as Compensated Promoter?
- Did Promoter Disclose Clearly and Prominently Promoter's Status (Client or Non-Client) and Compensated Nature of Promotion?
- Did Promoter Provide Additional Disclosures Explaining the Compensation Terms and Any Conflicts of Interest Associated with the Promotion?
- Does the Investment Adviser Have a Reasonable Basis for Believing Disclosures Were Made

If Compensated More Than \$1,000 During Past 12 Months, Is There an Agreement Between the Promoter & Investment Adviser

# Best Practices for Testimonials & Endorsements

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Require Written Authorization for Uncompensated Promotions

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Periodically Re-Verify In Writing Accuracy of Promoter's Statements Still In Use

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Disclose Affiliated Promoter's Status

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For Compensated Referrals, Require Either (a) Evidence of Disclosures Statements Built Into Digital Marketing, or (b) Signed Separate Promoter Disclosure Statement

# Artificial Intelligence for Investment Advisers

Technology that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes:

- Algorithm
- Predictive Modeling
- Large Language Model (e.g., OpenAI's ChatGPT, Google's Bard, Meta's Llama 2)



# Possible Uses of LLM at Investment Adviser Firms



Create Content for Newsletters, Social Media Posts and Webpages



Draft Investment Commentary



Review & Summarize Research



Analyze Investment Data or a Client's Portfolio



Write Emails and Letters to Clients



Prepare Personalized Investment Advice



Power Chatbot Which Is Used for Answering Client Questions



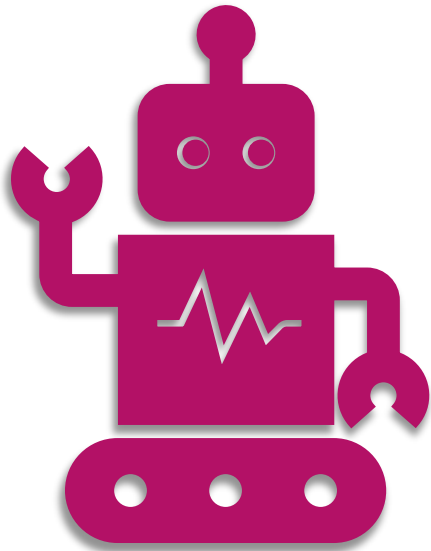
Create a Computer Programming Code to Automate a Function



# AI Regulatory Issues – Privacy

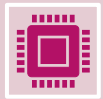
- ▶ Is the investment adviser sharing non-public personal information of clients with the AI LLM so that it may be used and/or revealed by LLM in a third-party's chat?
- ▶ Does your firm prohibit employees and reps from entering non-public confidential client information or firm trade secrets into AI LLM?
- ▶ Are you requiring employees to use an enterprise version with privacy protections?
  - See Microsoft's Azure OpenAI Service at <https://learn.microsoft.com/en-us/legal/cognitive-services/openai/data-privacy>
- ▶ Are you requiring disabling of chat history?
  - In ChatGPT go to Settings/Data Controls/Chat History & Training
- ▶ Are you requiring disabling training on chat (but not history)?
  - Go to OpenAI's Data Controls FAQs at <https://help.openai.com/en/articles/7730893-data-controls-faq> and [https://docs.google.com/forms/d/e/1FAIpQLScrnC-\\_A7JFs4LbluzevQ\\_78hVERINqqCPct3d8XqnKOfdRdQ/viewform](https://docs.google.com/forms/d/e/1FAIpQLScrnC-_A7JFs4LbluzevQ_78hVERINqqCPct3d8XqnKOfdRdQ/viewform)

# AI Regulatory Issues Conflicts of Interest



Is the AI technology designed in such a manner that it places the interest of the investment adviser before the client?

# AI Regulatory Issues – IAR Licensing



Is the individual making designing the algorithm essentially making investment decisions?



Is the individual programming/adding data to a chat bot for investors indirectly providing investment advice?



Which individual is ultimately responsible for the investment decisions or recommendations of the technology?



Is this individual required to be licensed as an investment adviser representative?

# AI Regulatory Issues: Unregistered Investment Company

- Is the algorithm treating the asset management of all clients in a similar way without any reasonable restrictions?
- Does the algorithm meet the SEC's Safe Harbor for avoiding registration as an investment company? See SEC Rule 3a-4 at <https://www.law.cornell.edu/cfr/text/17/270.3a-4>

# AI Regulatory Issues: Supervision

Is the AI technology being reviewed by compliance for regulatory issues

Are investment adviser representatives being trained on the regulatory risks of AI technology?

# Other AI Issues – Ownership of Content

Does Investment Adviser Have Copyright or Paywall Protected Content on Its Website Which Is Being Crawled and Scraped by LLM?

- Instruct Open AI's ChatGPT Not to Crawl Website:  
<https://platform.openai.com/docs/gptbot>

# SEC's Proposed AI Rule

**Covered Technology:** Any algorithm, computational tool, or technology that uses data analysis, predictive modeling, or machine learning to guide or influence investment-related behaviors or outcomes

**Examples:** Algorithmic-based tools used to provide tailored investment recommendations, financial modeling tools contained in spreadsheets, and large language models used in investor interactions



# SEC's Proposed AI Rule



## ***Evaluation of Conflicts of Interest:***

Investment adviser must evaluate any use of a covered technology to identify any conflict of interest associated with that use

## ***Determination of Conflicts of Interest:***

If a conflict of interest is identified, investment adviser must determine whether this conflict places the adviser's interest ahead of client's interest



# SEC's Proposed AI Rule

## ***Eliminate or Neutralize Conflicts of Interest:***

If covered technology results in investment adviser's interest being placed ahead of the client's interest, investment adviser must eliminate or mitigate this conflict of interest

## ***Policies and Procedures:***

An investment adviser is required to adopt, implement, and maintain written policies and procedures designed to ensure compliance

Should include a review, no less frequently than annually, of the adequacy of the policies and procedures and the effectiveness of their implementation

# SEC's Proposed AI Rule

## ***Recordkeeping Requirements:***

Must maintain the following for at least 5 years, with the first two years in an easily accessible place:

- Documentation of evaluations identifying conflicts of interest with use of covered technology;
- Documentation of determinations if these conflicts place adviser's interest ahead of client's;
- Documentation of actions taken to eliminate or neutralize such conflicts;
- Written policies and procedures for compliance;
- Annual reviews of the adequacy and effectiveness of these policies and procedures;
- List of all covered technologies used by investment adviser including when first used; and
- Records of alterations, overrides, or disabling of covered technology, including reasons and dates

# Questions

Please submit any question online or email with any questions about the content of this course.

[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)



Thank You

