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Strategic Perspectives

AI Regulation: When New Tech Meets Old Rules, Companies Beware

By Frank Weigand and Morrease Leftwich

As artificial intelligence (AI) tools proliferate, the financial services industry, and more specifically, the securities industry, is working to keep pace -- adopting AI and other algorithmic technologies for a wide range of core functions. This includes compliance, risk management, data & analytics, trading, marketing, and customer service, among others.

Regulators have issued guidance on testing and supervision requirements for applications and business processes incorporating AI. But as a matter of course, the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) have chosen to focus on applying existing regulatory requirements to AI and algorithmic technologies, rather than drafting new rules.

While emphasizing that their existing rules are technologically neutral, regulators note that the fundamental obligations for supervision, recordkeeping, and risk management apply regardless of whether firms use traditional systems or emerging AI tools.

This approach places the onus on firms to ensure their use of AI meets existing standards, utilizing the regulators' traditional compliance frameworks to address technology-specific risks, including but not limited to explainability, bias, and algorithmic drift.

Key takeaways

1. Existing guidance in this space and recent enforcement actions from both the SEC and FINRA make it clear that firms must continuously test and supervise their AI tools to ensure they are in line with regulatory expectations, as defined by the current, technology-neutral regulatory frameworks.
2. Firms can expect that examiners from both agencies will continue to probe how AI is being deployed, how its usage is supervised, and how related risks are being managed.
3. Having clear, documented AI-related policies and procedures is essential for firms to demonstrate that they are meeting these expectations.

SEC

Although the SEC first proposed specific requirements relating to AI and algorithmic technologies in July 2023,[1] the agency withdrew this proposal on June 12, declaring that it does not intend to issue a final rule with respect to the proposal.[2] The regulator further noted that if it "decides to pursue future regulatory action" in this area, "it will issue a new proposed rule."[3]

Significantly, however, the SEC's March 27, 2025 roundtable and request for comments on the risks, benefits, and governance of AI in the financial industry signaled that new proposed rules could be imminent.[4]

What's more, in its fiscal year 2025 report on priorities for examination, the SEC's Division of Examinations specifically noted that if "advisers integrate artificial intelligene (AI) into advisory operations, including portfolio management, trading, marketing, and compliance, an examination may look in-depth at compliance policies and procedures as well as disclosures to investors related to these areas."[5]

FINRA

The SEC is not alone. FINRA has provided ample guidance with respect to the wide-ranging requirements applicable to a broker-dealer's utilization of AI. More than ten years ago, in March of 2015, FINRA issued Notice 15-09 advising that "testing of algorithmic strategies prior to being put into production is an essential component of effective policies and procedures."[6]

Three years later, FINRA issued a new report in 2018 to define "RegTech" as "new and innovative technologies designed to facilitate market participants' ability to meet their regulatory compliance obligations," and in so doing clarified that firms must maintain "reasonable supervisory policies and procedures related to supervisory control systems" in connection with such technologies under FINRA Rules 3110 and 3120.[7] This was a

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significant step with attention to emerging AI technologies in the financial services space because it provided very clear guidance emphasizing that outsourcing compliance functions to RegTech vendors "does not relieve [firms] of their ultimate responsibility for compliance."

In 2020, FINRA issued a new report clarifying that to comply with FINRA Rule 3110 and 3120, firms should test AI technologies "across various stages of their lifecycle"; establish a "cross-disciplinary technology governance group" with representation from business, technology, information security, compliance, legal and risk management functions; and maintain "a detailed inventory of all AI models, along with any assigned risk ratings."[8] It also confirmed that existing business continuity requirements apply to AI systems, suggesting that firms establish "back-up plans in the event an AI-based application fails (e.g., due to a technical failure or an unexpected disruption)."

Fast forward to the present day, FINRA issued Regulatory Notice 24-09 in June 2024 calling for "reasonably designed supervisory system[s]" for AI tools, with specific focus on "technology governance … reliability and accuracy of the AI model." It also notes that the "rules applicable to Gen AI use will depend on how a member firm deploys the technology."[9]

Then, in its 2025 annual regulatory report, FINRA states that because its rules are technologically neutral, they apply to the utilization of Gen AI tools.[10] The report recommends that firms supervise the use of Gen AI at both individual and enterprise levels, identify and mitigate associated risks such as those related to accuracy or biases, and ensure the cybersecurity program is robust enough to identify and address cybersecurity risks associated with Gen AI use and has strategies to identify how threat actors may utilize AI or Gen AI.

Leading Enforcement Actions and Key Conclusions

The SEC and FINRA are paying close attention to the use of AI within the securities industry, and even in the absence of new rules crafted specifically for these technologies, they are acting to enforce existing rules.

On Jan. 16, the SEC charged a registered investment advisor with breaching their fiduciary duties by failing to reasonably address known vulnerabilities in their algorithmic investment models, and for related alleged compliance and supervisory failures.[11]

The case involved an employee of Two Sigma Investments LP and Two Sigma Advisors LP who made unauthorized changes to model-trading parameters while bypassing required approval processes. The company paid a combined $90 million in penalties.

Key Conclusion: Firms using algorithmic trading models must implement proper supervisory oversight of technical personnel who typically handle algorithmic system modifications, along with robust access controls and approval processes to prevent unauthorized modifications.

A faulty update to an algorithm can also result in FINRA enforcement. Interactive Brokers updated the algorithm it utilized to identify securities to customers. The update inadvertently created or increased its segregation deficits on multiple occasions, for a sum total of approximately $30 million. FINRA fined Interactive Brokers $475,000.[12]

Key Conclusion: The faulty update to the algorithm was compounded by insufficient supervisory oversight, including a lack of direct monitoring of the creation, launch and testing of the algorithm.

Anti-money laundering (AML) program failures tied to AI can also draw regulatory scrutiny. FINRA fined Brex Treasury $900,000 on August 30, 2024 for the AML failures that resulted in the approval of hundreds of deficiently vetted accounts.[13]

Key Conclusion: Algorithmic tools must be fit for purpose and reasonably designed to achieve the stated goals. In this case, the goal of verifying customer identities and meeting other AML compliance elements simply was not met by the tool.

These matters highlight the growing regulatory risks associated with these technologies and the need to implement robust governance, testing, and oversight frameworks. Further, these enforcement actions make clear even sophisticated firms with mature compliance programs can face challenges when implementing this evolving technology.

Business Activities and Functions Vulnerable to Enforcement Risk

Based on this enforcement track record, financial services firms should consider the following key areas:

Business Lines

Algorithmic Trading

Automated pricing decisions based on flawed information and failed systems controls can immediately affect the market and result in regulatory violations for the firm, including potential market manipulation.

Research, Investment Advisory Services and Portfolio Management

AI-driven analysis affects investment recommendations and client outcomes, and if based on inaccurate information produced by flawed models, can violate a range of regulatory requirements, including

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obligations to appropriately manage conflicts of interest and transact in the best interest of a client.

Control Functions

Compliance

With respect to monitoring trade activity, AI compliance tools that fail could mask or enable violations across multiple regulatory areas. Additionally, the SEC relies on accurate trade data reporting; if AI systems inaccurately report this data, they would create an inaccurate picture of market activity and diminish the SEC's effectiveness as a regulator.

Risk Management

Faulty AI risk models could lead to inaccurate or biased assessments of market risk, credit risk and other financial exposures, leading to a range of issues, including potential losses to the firm and inaccurate regulatory reporting.

Surveillance and Monitoring

AI systems that fail to detect suspicious activity could create situations in which inappropriate employee trading activity, anti-money laundering violations, fraud or other noncompliant activity could occur.

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Endnotes

1 Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisors, Exchange Act Release No. 97990 (July 26, 2023), https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf.

2 Withdrawal of Proposed Regulatory Actions, Exchange Act Release No. 103247 (June 12, 2025), https://www.sec.gov/files/rules/final/2025/33-11377.pdf.

3 Id.

4 SEC Roundtable on Artificial Intelligence in the Financial Industry (Mar. 27, 2025), https://www.sec.gov/newsroom/meetings-events/sec-roundtable-artificialintelligence-financial-industry.

5 SEC, Examination Priorities: Fiscal Year 2025, (Oct. 21, 2024), https://www.sec.gov/files/2025-exam-priorities.pdf.

6 FINRA Regulatory Notice 15-09, https://www.finra.org/rules-guidance/notices/15-09.

7 FINRA Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry, https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.

8 FINRA Artificial Intelligence (AI) in the Securities Industry, https://www.finra.org/rulesguidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry/keychallenges.

9 FINRA Regulatory Notice 24-09, https://www.finra.org/rules-guidance/notices/24-09.

10 2025 FINRA Annual Regulatory Oversight Report, https://www.finra.org/rulesguidance/guidance/reports/2025-finra-annual-regulatory-oversight-report.

11 SEC Administrative Proceeding File No. 3-22418.

12 FINRA Case #2021069316201.

13 FINRA Case #2021071100401.

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