

AI-generated Transcripts and Summaries

Compliance Risks to Consider

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AI-generated transcription tools (“AI tools”) such as Firefly and Copilot have the ability to take notes, update client data, and summarize an adviser’s investment approach, among other benefits that may be more convenient and even superior in some ways to traditional note taking during conversations with clients. However, these tools do not come without risks that may be underappreciated by advisers.



Books and Records

SEC Rule 204-2 (“Books and Records Rule”) requires advisers to make and keep certain books and records relating to their investment advisory business, including records relating to written communications received and copies of written communications sent, relating to

1. the recommendation proposed and advice given or proposed,
2. the receipt, disbursement or delivery of funds or securities,
3. the placement or execution of orders to purchase or sell any security, and
4. the performance or rate of return of any or all managed accounts or securities recommendations.

Advisers are also required to retain other records pertaining to their business such as accounting records like bills and statements, ledgers, check books, trial balances; compliance records, such as policies and procedures, code of ethics and violations thereof; client contracts, advertising, and regulatory filings.

Whether AI-generated transcripts and summaries (“AI-generated summaries”) are covered by the rule depends on the content they transcribe and whether it is shared with clients in writing. When AI-generated summaries are sent to clients, typically in an email, and fall into one of the four broad categories noted above, the SEC will likely consider these written materials to be communications relating to investment advice. Many advisers may consider this risk small as their email archiving technology is already retaining these communications.

Accuracy



AI-generated summaries made by AI “note keeping” tools, have the potential for inaccuracies particularly when people communicate incomplete thoughts or sentences which do not annunciate enough for the

AI tool to interpret, or use language unrecognized by the tool. Further, oral communications are far more relaxed and less formal than approved written communications that have been reviewed by supervisors, attorneys, and compliance professionals who endeavor to correct inadvertent violations of the SEC’s Marketing rule. The AI tool does not have the benefit of contextualizing non-verbal communications that modify verbal communications (wink wink), sarcasm, anyone? What is said is summarized in a literal manner by the AI tool without the benefit of such non-verbal communications and in hindsight could be interpreted incorrectly by third parties. Advisers should exercise caution and only rely on information they reasonably believe to be accurate by reviewing AI-generated summaries prior to dissemination to clients.

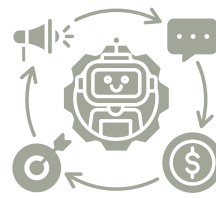
Privacy

When advisers have verbal communications with clients they frequently discuss and obtain personal, private information which is necessary for the management of client portfolios and in compliance with the adviser's fiduciary duty. When using an AI tool for these discussions the AI-generated summary will likely capture this sensitive client information and should only be transmitted back to the client and maintained in a secure environment. Transmitting sensitive client information by email may not be appropriate. Advisers should exercise caution and only transmit and maintain client personal private information in a secure manner.

Marketing

SEC Rule 206(4)-1 Investment Adviser Marketing Rule defines advertising in two separate parts.

- The first part includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services regarding securities to prospective clients or private fund investors, or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors.
 - The first part does not include one-on-one communications. However, hypothetical performance information does not qualify for this one-on-one exclusion unless provided in response to an unsolicited investor request or to a private fund investor.
 - The first part also does not include extemporaneous, live, oral communications, and information contained in a statutory or regulatory notice, filing, or other required communication.
- The second part generally includes any endorsement or testimonial for which an adviser provides cash or non-cash compensation directly or indirectly (e.g., directed brokerage, awards or other prizes, and reduced advisory fees).



When advisers use AI-generated summaries of live or oral communications with more than one prospect, client, or investor,

the communication becomes subject to the SEC's Marketing rule and likely requires written approval from the designated supervisor. There is a risk that Investment Adviser Representatives and other adviser personnel may inadvertently send the AI-generated summary that meets the definition of marketing without required approvals. Advisers should review AI-generated summaries and submit them to the applicable supervisors for approval when they meet the definition of Marketing.

Recording

The right to record conversations varies on a state-by-state basis. Some jurisdictions require that all parties consent before conversations are recorded, while others only require one party to consent. While a strong argument could be made that AI-generated summaries, produced by AI tools, are not recordings, there is little current case law that sufficiently addresses this. There is a risk that such summaries will be deemed "recordings" and thus the production of AI-generated summaries could be in violation of state law. Regardless of such state's rules and how they develop with respect to this new technology, advisers should obtain client consent to use AI tools to generate summaries during client conversations.

Discoverable

AI-generated summaries stored on a server, in an application, or in the cloud doesn't by itself, absent further action such as emailing to clients, constitute a written communication sent or received under the SEC's Books and Records rule (although it may constitute another type of required record under the rule). However, other firm records not subject to the Books and Records rule may be subject to discovery during litigation. While emails are somewhat easily searched, AI-generated summaries stored elsewhere may be more cumbersome to retrieve and present, with the same "out of context risk" discussed above.



The time and costs associated with discovery can be extensive even when the litigation is believed to be without merit. Advisers should take care and understand where and how AI-generated summaries are stored. When such records are not required by the SEC's Books and Records rule, advisers should consider a deletion procedure once the record is no longer needed by the adviser.

AI Risk

While AI tools and AI more generally, can provide meaningful benefits, AI also introduces risks that many companies have not fully identified or assessed. The question is not simply whether a company "uses AI." The more important questions are: i) where is AI already being used? ii) what information can AI tools access? iii) how are employees using AI (are they aware of their use), and iv) is their appropriate oversight of such use?

There are many unique risks to AI which we previously discussed more broadly which can be found here: <https://3ico.com/downloads>

A practical AI risk assessment can help establish a baseline so firms can better understand how AI is being used by their people, where material concerns may exist, and whether additional safeguards or oversight should be implemented.



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