VIA E-MAIL

March 31, 2025

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Service Newfoundland and Labrador
Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Nunavut Securities Office

Attention:

The Secretary Ontario Securities Commission 20 Queen Street West 22nd Floor, Box 55 Toronto, Ontario M5H 3S8 comments@osc.gov.on.ca	Me Philippe Lebel Corporate Secretary and Executive Director, Legal Affairs Autorité des marchés financiers Place de la Cité, tour PwC 2640, boulevard Laurier, bureau 400 Québec (Québec) G1V 5C1 consultation-en-cours@lautorite.qc.ca

Re: CSA Staff Notice and Consultation 11-348 - *Applicability of Canadian Securities Laws and the use of Artificial Intelligence Systems in Capital Markets*

OVERVIEW

The Portfolio Management Association of Canada (**PMAC**) is pleased to have the opportunity to submit the following comments regarding the CSA Staff Notice and Consultation 11-348 - *Applicability of Canadian Securities Laws and the use of Artificial Intelligence Systems in Capital Markets* (**AI Guidance** and **Consultation**).

PMAC represents over 320 investment management firms registered to do business in Canada as portfolio managers (**PMs**) with the members of the Canadian Securities Administrators (**CSA**). In addition to this primary registration, approximately 70% of our members are also registered as investment fund managers (**IFMs**) and/or exempt market dealers (**EMDs**). PMAC's members encompass both large and small firms and manage total assets in excess of $3.5 trillion as fiduciaries for institutional and private client portfolios.

PMAC's mission statement is "advancing standards". We are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit the capital markets.

KEY RECOMMENDATIONS

1. **Maintain a principles-based, risk-based and flexible approach to emerging technologies such as AI, and adapt existing regulations where possible rather than enacting new requirements**

2. **Continue to monitor the uses of AI in the asset management industry and periodically consult with stakeholders on new developments**

GENERAL DISCUSSION

PMAC applauds the work the CSA is doing to address the risks and opportunities presented by Artificial Intelligence (AI) in the asset management industry, including issuing the AI Guidance and Consultation. We acknowledge that this project builds upon a number of initiatives by various member jurisdictions of the CSA over the last several years.[1]

We agree that AI innovation is progressing at a rapid pace, and that it will be important for registrants and regulators to consider the implications of this (and other) new technologies for the capital markets. We believe it is also important to highlight that many firms have been using more traditional forms of AI, such as non-generative machine learning and linear statistical AI models, for several years. To our knowledge, at this time, the uses to which the majority of our members are putting AI systems are predominantly administrative in nature (if using AI systems at all) and do not include autonomous investment decision-making or other more sophisticated use cases.

We believe that the CSA should continue to monitor and consult with industry participants on their use of AI systems and their governance and oversight frameworks for managing the associated risks. At this point in time, our feedback on the consultation is somewhat limited, given that it is difficult to predict how the technology and its uses will evolve. We

[1] See for example, Ontario Securities Commission and Ernst & Young LLP, *Artificial Intelligence in Capital Markets, Exploring use cases in Ontario*, 2023; Autorité des marchés financiers, *Issues and Discussion Paper, Best practices for the responsible use of AI in the financial sector*, 2024; Ontario Securities Commission and Behavioural Insights Research, *Artificial Intelligence and Retail Investing: Use Cases and Experimental Research*, 2024

encourage the CSA to take a principles-based and flexible approach should it conclude that regulation is required to address the emergence of AI systems at this time. A risk-based and flexible approach that avoids duplication of existing rules will allow registrants to adapt as their use of AI systems evolves, and will provide investor protection without stifling innovation and adding regulatory burden.

We have responded to the specific consultation questions below.

CONSULTATION QUESTIONS

1. Are there use cases for AI systems that you believe cannot be accommodated without new or amended rules, or targeted exemptions from current rules? Please be specific as to the changes you consider necessary.

We are of the view that at this time, existing rules adequately accommodate contemplated use cases for AI systems as set out in the AI Guidance. We urge the CSA to take a principles-based approach to rulemaking with respect to AI. As noted in the Consultation, CSA regulations are intended to be technology-neutral. Currently, exemptions could be granted on a case-by-case basis, as use cases expand, where the existing rules cannot accommodate such use cases. Given that this is a rapidly evolving area, the CSA should continue to monitor for significant developments and should periodically consult with stakeholders to determine whether new regulation or additional guidance is required, and in particular, if circumstances arise that put investors at risk.

2. Should there be new or amended rules and/or guidance to address risks associated with the use of AI systems in capital markets, including related to risk management approaches to the AI system lifecycle? Should firms develop new governance frameworks or can existing ones be adapted? Should we consider adopting specific governance measures or standards (e.g. OSFI's E-23 Guideline on Model Risk Management, ISO, NIST)?

Some firms are already applying existing governance and/or risk management frameworks, such as the OSFI Guideline, to address risks associated with the use of AI systems. Rather than creating new standards, we believe that existing frameworks can be applied to satisfy current risk management requirements. If new standards are adopted, they should be principles-based and should align to the extent possible with existing standards that firms may be using. This will avoid duplication by maintaining consistency where possible, reducing regulatory burden and allowing for regulation to keep pace with evolution in technology and use cases over time.

If it is decided that any regulatory action is required, it should be risk-based and proportional, and tailored to AI systems' complexity and impact. Specific risks to investors should be considered. For example, some uses may be higher-risk (e.g., autonomous trading decisions) and may require enhanced oversight, while others may be lower-risk (e.g., certain automated reporting and analysis – such as segmentation insights,

churn/attrition prediction, thematic insights based on market trends, summarization of unstructured data such as client commentary, etc.) and should face minimal regulatory burden.

3. Data plays a critical role in the functioning of AI systems and is the basis on which their outputs are created. What considerations should market participants keep in mind when determining what data sources to use for the AI systems they deploy (e.g. privacy, accuracy, completeness)? What measures should market participants take when using AI systems to account for the unique risks tied to data sources used by AI systems (e.g. measures that would enhance privacy, accuracy, security, quality, and completeness of data)?

We agree data is critical to the functional integrity of AI systems. The considerations for stakeholders with respect to data may depend on the technology and uses to which it is put, and whether the technology and data are developed in-house or sourced from a third party. There is no one-size-fits-all, and we believe that the CSA should take a principles-based approach to allow for flexibility; firms can best determine their data needs based on their size, business models and technology uses. Firms should have policies and procedures to oversee the use of AI systems, including their data sources. We believe that data integrity and privacy are particularly important considerations, which should be addressed in the policies and procedures. When assessing data integrity, completeness and quality of data, security of data and encryption should all be considered. Data sources should be accurate and complete, and should be reviewed for ethical considerations such as unintentional biases.

4. What role should humans play in the oversight of AI systems (e.g. "human-in-the-loop") and how should this role be built into a firm's AI governance framework? Are there certain uses of AI systems in capital markets where direct human involvement in the oversight of AI systems is more important than others (e.g. use cases relying on machine learning techniques that may have lesser degrees of explainability)? Depending on the AI system, what necessary skills, knowledge, training, and expertise should be required? Please provide details and examples.

We believe that the role humans play in the oversight of AI systems will depend on the nature of the system, how it is being used, the level of complexity and other considerations. Firms should be given the flexibility to determine the level of human oversight needed based on the model's risks, impact, and explainability. We believe that if firms are using an AI system, they should provide relevant information and training to staff to understand how the system works and the system's limitations. We also believe that if an AI system is being relied on to provide services to clients, it must be explainable to clients. As such systems become more complex, explainability becomes more important and additional oversight may be required.

Human oversight in AI systems should also be risk-based and proportional to the AI's role in decision-making, rather than overly prescriptive. A principles-based approach ensures responsible AI deployment without stifling innovation. Higher-impact AI (e.g., client suitability recommendations) may require human-in-the-loop oversight, where AI decisions are reviewed before execution, while lower-impact AI (e.g., certain automated reporting for internal firm use, as noted above, and back-office workflows) should be lighter-touch, with periodic testing.

We recommend a flexible, principles-based approach to the training and expertise required to oversee AI systems, depending on the specific purposes for which it is used. Relevant staff should be trained on the AI system itself, should understand its functionality as well as its limitations. They should also have training on the subject matter the AI is being used for to enable them to verify that the AI output is reasonable, expected and accurate.

5. Is it possible to effectively monitor AI systems on a continuous basis to identify variations in model output using test-driven development, including stress tests, post-trade reviews, spot checks, and corrective action in the same ways as rules-based trading algorithms in order to mitigate against risks such as model drifts and hallucinations? If so, please provide examples. Do you have suggestions for how such processes derived from the oversight of algorithmic trading systems could be adapted to AI systems for trading recommendations and decisions?

We believe that AI systems could be effectively monitored using existing best practices from algorithmic-trading oversight, with adaptations for AI-specific risks such as model drift and hallucinations. There are standard tools that exist for monitoring machine learning models and standards for tracking AI model performance and output. The business team responsible for the model development should also be responsible for using industry-standard practices for model monitoring. We do not believe that excessive testing requirements are necessary for risk management; for example, AI monitoring could focus on exception-based intervention rather than constant human validation of AI-driven processes. Firms should have the flexibility to determine what monitoring and testing is required to appropriately manage the relevant risks.

We believe that currently, AI systems are more likely being used for research and information-gathering purposes, rather than autonomous decision-making. Ultimately the staff responsible for the know-your-product and investment decision-making would oversee trading recommendations and decisions, but the use of AI systems could expand to multiple departments within the registrant, depending on the business model and size of the firm (for example, investment, compliance, human resources, finance, privacy, technology and risk). The functioning of the system, including how it works, what it should be used for, and its limitations, should be understandable to the relevant staff; if it is not, the system should not be used. There should also be a mechanism to escalate and resolve problems encountered with the system.

It may also depend on whether the system is developed in-house or is outsourced. If it is the latter, the firm should adhere to existing regulatory requirements with respect to service provider oversight. A level of enhanced due diligence may be required.

6. Certain aspects of securities law require detailed documentation and tracing of decision-making. This type of recording may be difficult in the context of using models relying on certain types of AI techniques. What level of transparency/explainability should be built into an AI system during the design, planning, and building in order for an AI system's outputs to be understood and explainable by humans? Should there be new or amended rules and/or guidance regarding the use of an AI system that offer less explainability (e.g. safeguards to independently verify the reliability of outputs)?

We believe that existing rules and regulations can be adapted to address decision-making that is assisted by AI systems. We do not believe that AI systems should be subject to a lower standard because they offer less explainability. Currently, explainability is an important element if such systems are being used. Without explainability, it is difficult to test whether the system is operating as expected and whether the controls that are in place are functioning to meet regulatory requirements. The registrant should be able to explain how results were generated and to explain the results. If the AI system is being used in a way that will directly impact clients (such as performing a suitability or client risk assessment analysis), explainability becomes even more relevant, and registrants should be able to explain the process and outcome to the client.

However, this does not mean that the technological aspects of the system need to be explainable, although this aspect should be managed by the business team or technology support staff including those who are responsible for developing the system. Registrants should establish appropriate training for staff who are involved in the use of the system to provide a good understanding of how the system works, what it should be used for, and its limitations. Further, there should not be any system manipulation unless it has been vetted through a governance approval process. Firms should retain the ability to tailor AI explainability controls based on specific business needs and the associated risk/impact.

Also, given that regulatory approaches differ across jurisdictions, Canada should align with a flexible standard requiring enough transparency for accountability (e.g. key decision logs) but avoiding overly technical mandates that could disadvantage firms with competitors in jurisdictions that have adopted principles-based approaches or reliance on only existing rules to address AI.

7. FinTech solutions that rely on AI systems proposing to provide KYC and onboarding, advice, and carry out discretionary investment management challenge existing reliance on proficient individuals to carry out registerable activity. Should regulatory accommodations be made to allow for such solutions and, if so, which ones? What restrictions should be imposed to provide the same regulatory outcomes and safeguards as those provided through current proficiency requirements imposed on registered individuals?

We believe this question to be premature – our members are not aware of AI systems currently being used in this manner. At this time, we do not believe that registered individuals can be removed from the client relationship or investment processes. The AI use cases we are aware of are mostly in the form of assisting with administrative activities and research, with human intervention. If other use cases become more commonplace, firms should be able to explain and demonstrate that the system is making reliable, consistent and accurate decisions that can be explained and tested.

Other use cases will likely become more prominent and innovation in the space could prove to be very beneficial. For example, in the case of wealth management distribution firms, AI that improves KYP processes could allow for a larger breadth of product choice for clients while maintaining suitability and monitoring standards. Regulatory accommodations should permit AI-driven solutions for items such as KYC, onboarding, advice, and discretionary management, provided they demonstrate reliability comparable to human standards with outcome-based oversight. Canada should avoid overly prescriptive approaches to regulation that could deter foreign suppliers or impede Canadian firms that compete globally.

Ultimately the firm and registered individuals must remain accountable and responsible for meeting all regulatory requirements, regardless of whether or not AI is being utilized. Additional safeguards and controls may be required where technology (AI or not AI) is being utilized in the process of fulfilling regulatory obligations.

8. Given the capacity of AI systems to analyze a vast array of potential investments, should we alter our expectations relating to product shelf offerings and the universe of reasonable alternatives that representatives need to take into account in making recommendations that are suitable for clients and put clients' interests first? How onerous would such an expanded responsibility be in terms of supervision and explainability of the AI systems used?

We agree that it is possible that AI systems could potentially expand product shelves, since they can absorb and analyze more information. However, we do not believe the CSA should modify its approach; securities law should remain technology neutral, and firms must maintain the flexibility to decide how to meet the CSA's existing requirements, which may include incorporating the use of AI, if they so choose.

We do not believe that AI systems are likely to change PM service offerings, given that firms wish to understand, control and supervise the range of securities that they offer to clients.

Even if AI systems were used to assist with issuer or security analysis and selection, a human registrant would still need to review the recommendation, explain how it is suitable for the client, and verify the data source. An AI system could also be used to process information regarding a range of alternatives available to the client, but again, a human registrant would still be responsible for evaluating the information and communicating it to the client. AI-driven assessments should focus on reasonable alternative investment options rather than an artificially expanded set of alternatives.

Additionally, as noted above, different firms may comply with their Client Focused Reforms obligations in different ways. For example, when it comes to considering a reasonable range of alternatives, while some firms may choose to utilize AI with human involvement, other firms may choose to rely on a combination of advisor proficiency/judgment, product expertise, research, etc. The availability of technology as a tool should not override the ability of firms to meet their securities law obligations without such technology.

Therefore, as described above, in addition to ensuring compliance with existing requirements to meet suitability obligations, a firm will still need to have a human registrant oversee the activities performed by AI when utilized in these cases. This will also impose added client disclosure requirements on the firm to provide clear meaningful explanations on the use of the AI systems and any associated risks, because of its impact on registerable services provided to clients. As a result, this will inherently create additional ongoing supervisory and administrative obligations for the firm. If the CSA were to alter their expectations, this could be seen as mandating the use of AI, which could inadvertently increase investor risk if firms feel pressured to adopt AI but cannot meet those expanded obligations.

While AI may assist with expanding product shelves, access to and use of AI may be resource intensive (capital and human), and not all firms will have the capacity for this. The availability of AI systems and other technology should not alter regulatory expectations - this would be contrary to the concept that regulations are technology neutral.

9. Should market participants be subject to any additional rules relating to the use of third-party products or services that rely on AI systems? Once such a third-party product or service is in use by a market participant, should the third-party provider be subject to requirements, and if so, based on what factors?

Having a robust set of third-party products or services available to Canadian market participants will be strategically important due to the pace of change and innovation of this technology. Conditions that support this innovation will be important. We believe that existing requirements regarding the oversight of service providers adequately address AI system providers. Registrants are responsible for conducting sufficient due diligence and on-going oversight of service providers. This includes, for example, understanding the product/service being provided, drafting comprehensive service agreements, implementing controls such as spot checks and periodic attestations, obtaining a certificate of compliance,

etc. The registrant should take a risk-based approach and adapt these controls to the specific provider, system and its uses.

10. Does the increased use of AI systems in capital markets exacerbate existing vulnerabilities/systemic risks or create new ones? If so, please outline them. Are market participants adopting specific measures to mitigate against systemic risks? Should there be new or amended rules to account for these systemic risks? If so, please provide details.

    Examples of systemic risks could include the following:

    AI systems working in a coordinated fashion to bring about a desired outcome, such as creating periods of market volatility in order to maximize profits;

    Widespread use of AI systems relying on the same, or limited numbers of, vendors to function (e.g., cloud or data providers), which could lead to financial stability risks resulting from a significant error or a failure with one large vendor;

    A herding effect where there is broad adoption of a single AI system or where several AI systems make similar investment or trading decisions, intentionally or unintentionally, due, for example, to similar design and data sources. This could lead to magnified market moves, including detrimental ones if a flawed AI system is widely used or is used by a sizable market participant;

    Widespread systemic biases in outputs of AI systems that affect efficient functioning and fairness of capital markets.

We believe it is premature to provide a meaningful answer to this question. We are not aware of evidence of these types of risks arising due to the current use of AI systems in capital markets. We believe that some of the examples of systemic risks listed could be addressed by enhanced monitoring by regulators and market participants working together to mitigate potential negative impacts on both investors and the financial ecosystem. There is also an opportunity for AI to serve as a tool to address existing risks – such as those associated with human error. AI could be used to catch or identify patterns of behaviour that indicate wrongdoing, or flag human errors.

Existing regulatory requirements continue to apply and are technology neutral (e.g. the prohibition on market manipulation – regardless of whether it is done through the use of technology). The adoption of any new rules or amendments to current rules should be based on careful evaluation and determination that new risks have emerged particular to AI that cannot otherwise be addressed by existing frameworks.

CONCLUSION

We are appreciative of the thoughtful and proactive approach the CSA has taken to AI and the work CSA member jurisdictions have done over the years to arrive at the Guidance. We hope that the CSA will continue to consult with stakeholders as new technologies and their uses and impacts on the industry evolve. At this time, we believe that a principles-based and flexible approach is appropriate to address the existing state of AI use in the industry, and that continuous monitoring of new developments is advisable.

Please contact us if you would like to further discuss any of our comments. You may reach Katie Walmsely at kwalmsley@pmac.org or (416) 504-7018 or Victoria Paris at vparis@pmac.org or 416-802-4347.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

"Katie Walmsley"
Katie Walmsley
President

"Warren M. Rudick"
Warren M. Rudick
Director
Chair of Industry, Regulation & Tax Committee

Chief Counsel, Wealth and Asset Management Canada & Global Chief Counsel, Distribution Law, Manulife Investment Management