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Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Nunavut Securities Office

Re: Canadian Securities Administrators (CSA) Staff Notice and Consultation 11-348 Applicability of Canadian Securities Laws and the Use of Artificial Intelligence Systems in Capital Markets, issued on December 5, 2024

The **Canadian Independent Finance and Innovation Counsel (CIFIC)** appreciates the opportunity to provide comments to the CSA regarding its consultation on the use of artificial intelligence systems in capital markets.

The Canadian Independent Finance and Innovation Counsel represents national Investment Dealers and their industry's position on securities regulation, public policy, and industry issues. We represent notable CIRO-regulated Investment Dealers in the Canadian securities industry.

CSA Focus on Artificial Intelligence

We welcome the CSA's commitment to advancing smart and responsive regulatory actions that proactively address significant emerging issues, trends, technologies, and business models. We also support the CSA's dedication to maintaining an ongoing dialogue with market participants in alignment with its mission that requires the CSA to act when necessary to protect investors, foster fair, efficient, and transparent capital markets, and contribute to the stability of the financial system while mitigating systemic risk.

Furthermore, we fully agree that the CSA should strive to cultivate an environment in which the deployment of AI systems enhances the investor experience while effectively addressing potential risks of investor harm.

We support an approach that allows markets to benefit from the efficiencies and increased competition that AI can bring, ensures that capital is invested in Canadian companies developing AI responsibly, and appropriately mitigates any new risks, including systemic risks, that may arise from AI adoption in the financial sector.

Industry Views

We firmly believe that Investment Dealers should have the ability to leverage artificial intelligence in ways that enhance their operations, improve efficiency, strengthen their bottom line, and ultimately provide greater value to their clients. To achieve this, regulatory frameworks must evolve to support the adoption of AI and other emerging technologies that drive innovation and create tangible benefits for both dealers and Canadian investors.

At the same time, we recognize that the use of AI must be governed by principles that prioritize investor protection and market integrity. We agree that AI applications should not create conflicts of interest, should undergo regular testing and validation to ensure their effectiveness and fairness, and that clients should be fully informed about the use of AI, including any associated

risks and limitations. Transparency and accountability in AI deployment are essential to maintaining trust in the financial system.

Use in Capital Markets

Furthermore, it is important to acknowledge that Investment Dealers are utilizing artificial intelligence and machine learning in their operations:

- To optimize internal processes;
- enhance customer support;
- mitigate external risks (cyber-attacks, fraud, money laundering); and
- enhance capital management.

Automated algorithmic trading systems have been used in capital markets for a long time, demonstrating that technology-driven efficiencies are not new to the industry. As AI capabilities evolve, it is crucial that regulatory approaches remain adaptive—fostering innovation while ensuring appropriate safeguards are in place to mitigate risks and uphold market confidence.

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.

CIFIC Response: The Investment Dealers we represent do not believe that rule amendments are necessary, as artificial intelligence is simply a tool that enhances the efficiency of standard dealer activities rather than fundamentally altering their nature. In our view, AI falls within the scope of the existing regulatory framework, which already governs the responsible use of technology in financial services as well as Dealer operations.

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)?

CIFIC Response: Rather than introducing new regulation or governance standards, thoughtful and well considered tools or guidance could be provided and updated on a rolling basis to help Dealers understand and minimize their risks and develop their own internal governance frameworks.

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)?

CIFIC Response: The Investment Dealers we represent believe it is important to ensure there is understanding amongst market participants of AI risks related to hallucination, data privacy, intellectual property within a firm, potential bias, and randomness/ inconsistency of generative AI tools, among other risks.

The data sources utilized must be reliable and trustworthy. Equally important are robust data hygiene and management processes, ensuring that information is well-organized and harmonized. This prevents inconsistencies or multiple conflicting sources of truth that could compromise the effectiveness and accuracy of AI tools. A structured and coherent data framework is essential to maintaining the integrity and reliability of AI-driven decision-making.

Governance teams should ensure they have measures in place to protect the safety of client data in their investor portals and ensure client trust is maintained with respect to any information they may be providing to an AI chatbot on a Dealer's website, for example.

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.

CIFIC Response: The Investment Dealers we represent believe that a decision framework for AI usage, developed by CIRO, could serve as a valuable tool to guide firms in evaluating their AI adoption and the necessary level of human oversight.

Such a framework would enable firms to assess AI-related cases based on the level of risk they introduce (their **potential for harm**), and the degree of autonomy granted to the technology. In shaping a structured approach to human intervention, AI tools can be categorized by their level of autonomy and potential for harm, helping determine whether human intervention is necessary and what form it should take.

For example, operational AI tools such as AI notetakers, meeting summarizers, email-writing assistants, and coding assistants are already widely used in professional settings. These tools operate with a "human-in-the-loop" model, where a user directly interacts with and ultimately controls the AI's output. Given their relatively low autonomy and the fact that many of their tasks allow for multiple correct answers (e.g., different notetakers producing varied yet valid summaries of the same meeting), their potential for harm is minimal.

In contrast, AI systems with higher autonomy which require less human intervention can still present low risk while significantly enhancing efficiency. For instance, an AI that analyzes IT support tickets to determine whether they should be escalated operates with greater independence, yet final decisions remain in human hands. Similarly, an AI used for data extraction in Investment Dealer operations may function with high autonomy, but if a human ultimately reviews and approves the extracted data, the overall risk remains low.

The potential for harm in AI applications can often be mitigated through rigorous testing and robust data quality management. Many AI-driven efficiencies exist with minimal risk exposure, particularly when human oversight is built into the process. The Investment Dealers we represent believe that such tools provide substantial value with limited downside. For example, an AI meeting transcriber that generates summarized minutes for client approval, only finalizing notes, tasks, and CRM entries upon confirmation, demonstrates how AI can maintain a higher degree of autonomy while still operating within a human-in-the-loop framework that safeguards accuracy and reliability.

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?

CIFIC Response: The Investment Dealers we represent believe in having robust guidelines and internal governance frameworks for measuring risk acceptability. They believe transparency into the systems that have AI should be provided (see response to question 6), and it should be clear to users that they are communicating or working with AI.

Dealers should have human oversight and protection against algorithmic discrimination. Regular reviews, testing, and corrective actions should be an integral part of Dealer processes, as well as good AI governance and regular policy reviews.

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)?

CIFIC Response: Transparency and explainability must be present in a meaningful and demonstrable way. These tools, whether used for portfolio management, trade execution, risk assessment, client profiling, or compliance monitoring, must be designed with clear, interpretable decision-making processes. Investment Dealers, through information provided by the tools' developers, should be able to articulate how these AI systems function, including their data sources, underlying algorithms, and key decision drivers. This ensures that clients, regulators, and stakeholders maintain confidence in the integrity, fairness, and reliability of AI-driven financial services.

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?

CIFIC Response: The Investment Dealers we represent believe AI solutions that have a higher potential for harm require more scrutiny from a technology, compliance, and legal perspective. These cases might include predictive decisioning, credit worthiness, KYC and AML checks, and potential compliance engines. This type of AI tool has relatively low autonomy because it performs a specific function, but, if not managed correctly and provided with critical oversight, can create a lot of harm by excluding certain classes of people or types of clients from getting credit, accounts, and trading.

The Investment Dealers we represent believe access to these tools benefits both investors and Dealers, and that good governance; human oversight; and transparency with respect to client-AI interactions are the critical safeguards that should be in place.

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?

CIFIC Response: The Investment Dealers we represent do not see an immediate need for regulatory changes. However, they firmly believe that CIRO should actively monitor developments in AI-driven tools and emerging investment products, ensuring it remains well-positioned to respond appropriately should the need arise.

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?

CIFIC Response: Third-party AI products and services should undergo rigorous testing, thorough evaluations, and regular spot checks, just as any other non-AI third-party solutions. To foster trust with clients, market participants must be able to clearly articulate the workings of their systems. These AI-driven products must uphold the highest standards of transparency, data protection, reliability, consistent performance, and overall trustworthiness.

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.

CIFIC Response: Certain AI systems engaging in trading and market activities may have a higher potential for harm combined with higher autonomy. An AI that creates a portfolio, funds an account, and automatically places trades based on a conversation, for example, may introduce structural market risks.

The main systemic risk mitigation activities the Investment Dealers we represent are undertaking are the valuable industry collaborations and discussions they are having in forums such as CIFIC as well as discussions with service providers working in the AI space.

Applying good governance and risk management practices at the Dealer level and ensuring transparency with clients are top priorities for the Investment Dealers we represent with respect to AI systems.

Conclusion

We commend the CSA for its efforts to deliver smart and responsive regulatory actions in anticipation of significant emerging issues, trends, technologies, and business models.

Thank you for considering our comments on this important proposal.

As always, we are available to discuss the content of this submission further, address any concerns you may have, or provide additional information as needed. Your feedback is invaluable to us, and we are committed to ensuring that we all achieve our objectives effectively and efficiently.

Please feel free to contact me at annie@cific.co with any questions, comments, or to schedule a call to discuss any aspects of the letter or explore potential next steps. We look forward to our continued collaboration on this matter.

Sincerely,

A.Sinigagliese

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