CSA Consultation - Applicability of Canadian Securities Laws and the use of Artificial Intelligence Systems in Capital Markets

March 31 2025

Submission to the Canadian Securities Administrators (**CSA**)

ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

The Canadian Bankers Association (**CBA**)[1] appreciates the opportunity to provide input on the *CSA Staff Notice and Consultation 11-348 - Applicability of Canadian Securities Laws and the use of Artificial Intelligence Systems in Capital Markets* (**Consultation**).

CSA 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.**

i) A risk-based, principles-driven, and harmonized approach

Given the ongoing development of Artificial Intelligence (**AI**), we believe CSA rules should remain risk-based and principles-driven and avoid any duplication or overlap with other regulatory frameworks to ensure Canadian organizations can serve consumers in a manner that fosters confidence and builds trust in the responsible development, deployment and use of AI systems while continuing to meet investor protection standards. We believe prescriptive new or amended rules for AI use cases are not necessary and could impede innovation and unnecessarily burden low risk use cases when other regulatory frameworks are already effective.

Banks are heavily regulated and the AI models they use are designed, developed and deployed in adherence to, among other existing regulatory frameworks, Office of the Superintendent of Financial Institutions (**OSFI**) guidance, which provides principles-based, risk-based guidance on model risk (i.e. Draft Guideline E-23 Model Risk Management[2]) and other non-financial risks more broadly (e.g., Guideline B-10 Third-Party Risk Management and Guideline B-13

[1] The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals.
[2] OSFI has announced that it will issue its Final Guideline E-23 Model Risk Management in September 2025, which is likely to include greater clarity on expectations around AI models. (OSFI policy release and announcement schedule)

Technology and Cyber Risk Management). The AI models banks develop and the use cases they deploy are additionally subject to existing securities laws, privacy laws, human rights law and the *Bank Act* (including with respect to consumer protection). This reinforces the importance of avoiding the introduction of any overlapping or duplicative requirements that could hinder innovation and positive consumer experiences.

ii) Use cases

In our view, existing CSA rules can adequately address existing use cases of AI systems. AI has been an established concept for decades and encompasses everything from personal computing to generative AI. The use of machine learning within algorithms (e.g. linear regressions) has been embraced by the financial industry for decades and the use of algorithms by financial institutions (**FIs**) is highly regulated.

Regarding the emergence of generative AI, currently, its use in Canadian capital markets is limited, often due to the cautious adoption by market participants aimed at ensuring that its use is safe and effective. The generative AI models that are currently deployed by capital markets participants are often used internally for purposes of gaining efficiencies. These models do not directly interact with the market (e.g. trading, providing investment advice). Furthermore, the rapid evolution of generative AI technology may render any specific prescriptive rule obsolete by the time it completes the various stages of the CSA rule making process. Adopting a prescriptive approach risks hindering innovation while making Canadian FIs uncompetitive globally due to regulatory arbitrage, especially relative to the United States, where the recent changes in government have created uncertainty regarding the approach to AI regulation going forward.[3]

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

[3] SEC's broker-dealer regulation for AI will probably be scrapped | Insights | Bloomberg Professional Services

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)?

In our view, existing CSA rules adequately address risks associated with the use of AI systems in capital markets and firms should have the flexibility to adapt existing model risk requirements and governance frameworks to the use of their AI systems**.**

As stated in our response to Question 1 above, we believe a risk-based, principles-driven approach to any new or amended CSA rules with respect to AI that avoids any duplication or overlap with other frameworks is appropriate. This includes avoiding overlap with the above-noted existing OSFI guidance.

We would also note that AI risk management frameworks based on industry standards such as those issued by the National Institute of Standards and Technology (**NIST**) or the International Organization for Standardization (**ISO**) are already widely used in the industry. Because these standards vary, their suitability depends on the specific application. They constantly evolve, and new ones may emerge. Favouring one such standard over another in any CSA rule may lead to unintended negative consequences, such as potentially limiting innovation or relying on a standard that may be outdated and not achieve regulatory objectives.

Finally, Canadian banks are intrinsically motivated to ensure that the AI they use is adequately governed, fit for purpose, and does not produce unreliable results, as the alternative could lead to financial and reputational losses. Being highly regulated, Canadian banks continuously manage their risks as an integral part of banking operations and continuously enhance their governance and record-keeping practices.

3. Data plays a critical role in the functioning of AI systems and is the basis on which their outputs are created.

i) 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)?

Market participants typically consider the following when determining what data sources they deploy:

- Privacy, confidentiality and data protection laws (e.g., consent and purpose limitation, data minimization, and encryption).
- Data accuracy and completeness (e.g., data validation and bias mitigation), data source (e.g., internal and external data sources, open datasets).
- Ethical and other legal considerations (e.g., fairness, transparency, client and employee trust, copyright considerations).
- Risk management and governance (e.g., data governance framework, monitoring, and auditing).

ii) 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)?

To account for the unique risks tied to data sources used by AI systems, market participants could consider the following factors, which banks already address through existing regulatory and legislative oversight, as appropriate:

- **Privacy and confidentiality:** Data minimization, anonymization, consent management, privacy by design, and internal audits.
- **Accuracy:** Data validation, source verification, dataset refresh and maintenance, and feedback loops.
- **Security:** Encryption, access controls, data breach response plan, secure integration (e.g., using Application Programming Interfaces (**APIs**)), and third-party risk management.
- **Quality:** Dataset analysis and cleaning, relevance assessment, and quality

benchmarks.

- **Completeness of data:** Dataset augmentation, imputation techniques (but ensuring that they do not introduce bias), and diversity of sources.

iii) New rules

Any potential future rules with respect to data governance requirements should take into account the varying levels of control the firm has when using a third-party system (or multiple systems, including subsidiaries of third parties). While the firm remains accountable, overly prescriptive requirements that fail to allow participants the flexibility needed to manage third party AI systems or infrastructure may stifle innovation or restrict the ability to use AI. Generally, any new rules should align with existing risk management rules.

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.**

In our view, existing rules provide sufficient principles-based guidance on the extent to which AI systems governance frameworks should include human-in-the-loop or other human involvement. These governance frameworks can be tailored to address the complexity of the model and use case of the applicable system.

As the technology is very rapidly evolving, so too are the required skills, knowledge, and training, of the individuals involved. The skills needed depend on the complexity of the system, its use case, and its associated risks. Oversight activities are traditionally performed by specialist support (e.g., Technology, Operations) or risk functions that constantly adapt to everchanging technology and financial industries.

Market participants are best positioned and require the flexibility to decide how to structure their risk management programs or what staff skills are necessary to enable functioning of the risk management programs that institutions implemented to comply with existing prudential and securities rules. Any new or amended rules in this regard may inadvertently stifle market innovation while becoming inadequate in addressing regulatory objectives.

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?**

Canadian banks apply existing model risk rules that cover machine learning and rules-based trading algorithms to AI systems. In our view, these existing rules are sufficient. Monitoring of AI systems is undertaken as needed in accordance with these rules, and the frequency of this monitoring depends on the nature of the system and its use. This is because the lifecycle stages of AI (e.g., tuning, evaluation) have traditional frequencies. For instance, tuning may occur every 12-18 months, while evaluation and more tuning can be conducted weekly or even daily, depending on application requirements. As AI technology evolves, supervision customs and standards will also change.

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)?**

In our view, the existing regulatory framework is sufficient to ensure that AI systems, including those with less explainability, are effectively managed such that the individuals using AI understand that the outputs of variable inputs might impact model outputs (e.g., existing model risk requirements are sufficient).

Financial institutions, especially large vertically integrated ones, have implemented robust risk management frameworks, policies, and procedures to address existing prudential and securities law requirements. These existing requirements address the management of risks associated with AI and are applicable to generative AI as well.

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?**

Current CSA rules are flexible enough to accommodate the use of AI solutions in the manner contemplated by this question provided the registered firm/individual ultimately remains accountable and responsible for ensuring regulatory requirements are met. Safeguards and controls include ensuring that proficient individuals are reviewing, monitoring the use, and validating/verifying the outputs of AI systems.

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?**

No. Registrants should be permitted flexibility to scale the adoption of AI to their business

model. The availability of technology, including but not limited to AI, should not drive regulatory expectations with respect to product shelf offerings, the reasonable alternatives that must be taken into account for suitability determinations, and business models. Many firms will choose not to utilize AI and our understanding is that the CSA is not mandating the use of AI.

As such, adjusting regulatory expectations according to the availability of a technology is arguably contrary to the overarching principle, noted in the Consultation by the CSA, that securities law is technology neutral. Firms may differ in how they comply with their Client Focused Reforms obligations; and a presumption should not be made that the existence of technology supersedes the value of advisor proficiency/judgement, product expertise, availability of research, etc., in meeting suitability obligations.

In addition, the availability of technology, AI or otherwise, does not necessarily and should not in all cases factor into a firm's product shelf development, which is more appropriately based on other influencing factors (such as client base, the firm's registration category, overall business model and strategy, product due diligence and ongoing review of product competitiveness), which align with the regulatory policy rationale underlying product shelf development. Moreover, the use of AI systems may impose additional costs which some firms may not be able to assume, creating barriers to entry, limiting competition, business models and investor choice.

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?**

Current securities law and OSFI guidelines with respect to third-party risk management and outsourcing are flexible enough to address the use of third-party products or services that rely on AI systems. For example, as outlined under Part 11 of Companion Policy 31-103CP, registrants are responsible and accountable for all functions that they outsource to a service provider, must undertake due diligence before contracting for outsourced services, and must supervise any outsourced service provider on an ongoing basis.

Instead of imposing additional AI-specific rules, firms should be required to demonstrate effective governance and oversight of AI-driven third-party services within existing regulatory obligations. Introducing duplicative or overly prescriptive AI-specific rules could increase compliance costs without enhancing investor protection. AI providers that do not directly engage with clients (e.g., model vendors, data providers) should remain subject to commercial agreements and industry best practices, rather than being directly regulated.

If the CSA concludes that additional rules may be necessary vis a vis independent smaller dealers, then we urge the CSA to provide substituted compliance exemptions for dealers that are part of large vertically integrated institutions that are already subject to OSFI guidelines.

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.

In our view, current AI systems do not pose net new systemic risks at this time as compared to existing systems already in use in the capital markets. These risks are assessed and addressed under existing risk management frameworks that are already mandated by existing prudential and securities rules.

Moreover, going forward, generative AI may become a tool to address existing risks and vulnerabilities. It may remove risks associated with human error or limitations that cannot be addressed by existing more primitive AI (e.g. rules-based trading algorithms). For example, generative AI may afford faster, more comprehensive, and active trade surveillance or reporting.

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We thank you for taking the time to consider our views regarding the Consultation and would be pleased to discuss the Consultation further at your convenience.