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

On behalf of the Ontario Securities Commission's Investor Advisory Panel (the "Panel"), I wish to thank you for this opportunity to comment on the Canadian Securities Administrators' (the "CSA") Staff Notice and Consultation regarding the applicability of Canadian securities laws and the use of artificial intelligence systems in capital markets (the "Consultation").

The Panel is an initiative of the Ontario Securities Commission ("OSC") to ensure investor concerns and voices are represented in the OSC's policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

Comments

The Panel commends the CSA for its research and consideration of the use of AI systems in the capital markets. We agree that market participants should develop policies and procedures that will govern their use of AI systems, depending on the proposed use case of the system. As noted in the Consultation, AI systems can be used for various purposes, and different market participants will have different uses for AI in their businesses.

As the Panel is focused on investor protection, our comments are focused on identifying areas of concern in the use of AI by registrants in their interactions with retail investors. While market participants may use AI systems differently, regulation should be rooted in foundational principles that anticipate the types of risks and conflicts that AI systems may introduce, particularly where an AI system is used to make or influence investment recommendations. Regulation should also include principles for data transparency and conflict detection, ensuring AI does not unintentionally prioritize firm interests over those of the investor.

As noted above, issues are more likely to arise in situations where AI is used for tasks where judgment is required, rather than for automation of processes that do not directly affect investors. We are also concerned about the risk of AI being used in a manner where conflicts cannot be readily identified or flagged. For example, if an AI system is trained to recommend illiquid or other risky investments given the benefits to the firm, such a recommendation may not be flagged by the AI system. That said, these concerns might be mitigated based on the use case. For example, AI could be used to provide input that a human can use to make a decision (for example, a risk rating), so long as the AI system gathers data from verified and reliable sources. In contrast, tasks involving suitability, KYC or investor recommendations require a principles-based framework that recognizes the limitations of AI in replicating human judgment and duty of care responsibilities.

The Panel agrees with the potential risks of AI in the capital markets that are identified in the Consultation. We are most concerned about the following issues and their potential impact on retail investors:

- AI tools that gather information should only use sources that have been verified for accuracy and completeness, rather than social media forums or the internet more broadly
- Technological risks (e.g. cybersecurity and privacy of client information)
- Prompt design and AI literacy at the input stage as well as the output stage (this includes having a human in the loop, but is also related to fitness for purpose)
- Disclosure to clients and investors that AI is being used, and ensuring that disclosure is clear and easy to understand
- The use of AI in scams and fraud

However used, we are concerned that AI models can unintentionally inherit biases from the data they use as inputs, which may lead to prejudicial outcomes or incorrect decisions. Excessive reliance on AI could also lead to vulnerabilities if systems fail or if unexpected scenarios arise.

Market participants should develop policies and procedures that ensure that data sources for AI systems are verified for accuracy and completeness, and ensure that conflicts of interest are not present in the data sets that might otherwise skew the decision-making process. Market participants should also establish policies and procedures to monitor and oversee their arrangements with third parties. We also believe that regulators should provide additional guidance with respect to verification of the elements of products or services, and that investors should be notified of their exposure to AI systems. If market participants provide investors and clients with tools that incorporate AI, or information that is generated using an AI system, market participants must also provide disclosure that includes the source of the data the AI system is using and information about the reliability of that data, and other characteristics of the AI system, to ensure that clients and investors can understand how the AI system is being used and whether it is relying on accurate and complete information. The ultimate goal is to enable investors to make informed decisions.

Given the concerns identified above, the Panel believes that a "human in the loop" is critical in overseeing AI systems to ensure they are used ethically, responsibly and in the investor's best interest. Humans can provide the judgment that AI systems lack, and a principles-based approach to AI governance should require firms to designate accountable individuals responsible for ensuring that AI outputs align with core investor protection values, not just technical accuracy.

Instances where human oversight is important include the following:

1. Defining Ethical Guidelines: Regulators must establish the ethical principles AI systems should follow, such as fairness, accountability, and transparency. Once established, a human in the loop could then address issues of replicating biases, conflicts of interest or misuse.

2. Validation and Monitoring: AI systems should be continuously validated to ensure they operate as intended and adapt to changes without unintended consequences. Monitoring AI's behaviour can help catch errors or unethical outcomes early. The Panel believes that regulation may be required to ensure adequate testing and monitoring, but we are concerned about how regulators can ensure that testing and monitoring will be adequate. In our view, testing and monitoring should include stress tests to evaluate how the system performs under extreme conditions, such as high data loads or unexpected scenarios.

3. Accountability: AI developers, firms deploying AI and users should be held accountable for the system's impact. Firms should ensure that someone always takes ownership of AI's decisions.

4. Intervention: Firms should have the ability to override AI systems if they pose risks to investors or if the AI systems fail to meet security or ethical standards.

5. Education and Awareness: Investors must be informed about when AI is being utilized and AI's capabilities and limitations, fostering a balanced understanding of its potential and risks. A 'human in the loop' should include an educational component so that investors can make informed decisions about accessing AI systems for investment purposes.

AI can assist and augment human decision-making, but the ultimate control and responsibility should remain with the firm so that AI is used to enhance its capabilities while humans provide the moral compass and oversight.

The Panel believes that additional guidance or standards that specifically address the risks associated with the use of AI would be helpful for market participants and promote both investor protection and confidence in the capital markets. We also recommend that a robust governance framework should be established for organizations that incorporate AI into the investment process, including compliance audits with respect to each organization's AI policies and procedures.

We suggest that the guidelines developed by OSFI and others should be considered in developing additional guidance and a new governance framework. The OSFI-FCAC Risk Report on AI Uses and Risks at Federally Regulated Financial Institutions refers to guidelines and voluntary codes of conduct that could also be considered in developing guidance or standards for market participants. Many of the principles in the existing standards and guidelines are addressed in the guidance published in the Consultation, but in our view, there should be consistency among regulators.

The Panel believes that many of the risks identified in the OSFI-FCAC Risk Report and in the Consultation could be exacerbated or created by the use of AI. For example, the Risk Report identifies the following internal and external risks, which we believe could arise from the use of AI by market participants:

- Amplified risks from use of AI by financial institutions related to data governance, modelling, operations and cybersecurity
- New and sophisticated attacks on financial institutions using AI, and increased risk of attacks on smaller institutions
- Increased volatility due to market and liquidity risks
- Geopolitical risks associated with misinformation and disinformation

Increasing use of AI may also lead to increased usage of digital engagement practices, which research reveals can affect decision-making by retail investors. We recommend that the CSA consider whether new or amended rules about AI should also include the use of digital engagement practices by registrants and other market participants.

Finally, research reveals that scams are being developed based on false claims of "AI-enhanced" investment opportunities. If market participants are providing information to investors about their use of AI systems, care should be taken to provide disclosure in a manner that not only avoids "AI-washing" (inaccurate, false, misleading, or embellished claims about an organization's use of AI systems) but also enhances transparency and credibility.

Again, thank you for the opportunity to comment on the Consultation. We would be pleased to clarify or elaborate on our comments should the need arise.

Sincerely,

[redacted]

Chair, Investor Advisory Panel