

August 12, 2024

Via Electronic Mail: Federal eRulemaking Portal at <http://www.regulations.gov>

Moses Kim
Director, Office of Financial Institutions Policy.
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Request for Information on Uses, Opportunities, and Risks of Artificial Intelligence in the Financial Services Sector, TREAS-DO-2024-0011

Dear Mr. Kim:

MFA¹ appreciates this opportunity to submit comments to the U.S. Department of the Treasury (“**Treasury**”) on the above-referenced request for information (“**RFI**”) on the uses, opportunities, and risks presented by developments and applications of artificial intelligence (“**AI**”) within the financial services sector.² We thank the Treasury for considering our comments.

MFA acknowledges the value of the Treasury’s thoughtful and consultative approach by issuing this RFI, which reflects the Treasury’s desire to constructively engage with various market participants regarding the role of potential new technologies, including AI. We appreciate that Treasury supports “responsible innovation and competition in the financial sector,” while

¹ Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA’s mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over \$3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

² U.S. Department of the Treasury, Request for Information on Uses, Opportunities, and Risks of Artificial Intelligence in the Financial Services Sector, 89 Fed. Reg. 50048 (June 12, 2024), available at: <https://www.govinfo.gov/content/pkg/FR-2024-06-12/pdf/2024-12336.pdf>.

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“maintaining stability and market integrity, protecting critical financial sector infrastructure, and combating illicit finance and national security threats.”³

MFA believes existing regulatory frameworks are well-designed to address the current and potential uses of AI in the alternative asset management industry because the rules regulate activities and avoid regulating specific technological tools. We support technology neutral frameworks that address specific activities rather than technologies as being the most appropriate regulatory approach to AI. While use cases for AI are still evolving, the technology has demonstrated the potential to unlock important efficiencies and yield benefits. As a result, while regulators must ensure their regulatory frameworks are adequate to govern the marketplace as it exists today, we urge regulators to avoid any potential actions that could unintentionally stymie the development of new technological tools that could augment human capabilities and ultimately amplify benefits to investors.

We would be pleased to meet with Treasury staff to provide additional background on the use of AI and on our comments on the RFI.

I. Executive Summary

We submit the following four high-level recommendations we believe Treasury should carefully consider in connection with the use of AI in the financial services sector:

- Alternative Asset Managers Use AI to Enhance Existing Processes and Procedures
- Fiduciary Duty and other Existing Regulations Already Sufficiently Address Potential Concerns Posed by the Use of AI Tools
- Past Attempts to Regulate Specific Technologies Confirm that Regulators Should Remain Technology Neutral and Prioritize Regulating Activities
- Potential Use Cases for AI Are Still Developing and Could Unlock Important Benefits

II. High-Level Recommendations

In the following, we outline four high-level recommendations we believe Treasury and other regulators should consider carefully before evaluating any further action derived from this RFI.

³ *Id.* at 50048-49.

A. Alternative Asset Managers Use AI to Enhance Existing Processes and Procedures

The alternative investment industry is using AI the same way many other industries are: to enhance existing standard processes and procedures, such as research and analysis, risk management, portfolio optimization, fraud detection, and compliance. AI is not the sole input for investment decisions but rather is one of the many inputs alternative asset managers consider. Tools like natural language processing allow researchers to diversify the range of inputs used for investment analysis. As with any automation—from stoplights to conveyor belts to algorithmic trading—a human is always involved.

An infamous story of the lawyer who submitted AI legal briefs that cited nonexistent precedents underscores why AI is only one part of investing decisions, and why humans are always in the loop. In his reprimand in the case, Judge P. Kevin Castel noted that “[t]echnological advances are commonplace and there is nothing inherently improper about using a reliable artificial intelligence tool for assistance.... But existing rules impose a gatekeeping role on attorneys to ensure the accuracy of their filings.”⁴ New technological advances will always be incorporated into existing processes. As technology improves standard processes, oversight procedures can and are adapted accordingly. Regulators are right to seek to ensure that the use of new technologies are used appropriately within current regulations. Current regulations such as the fiduciary duty standard continue to effectively capture new technologies, as discussed further below.

The U.S. capital markets and the alternative investment industry rely heavily on intellectual property. Information forms the inputs into every investor's decision-making process, and no two investment theses are identical, creating the depth and breadth of liquidity that make our capital markets the envy of the world and the backbone of the American economy. Investors protect their intellectual property, and alternative asset managers have significant concerns about information leakage when using open-source AI models. To mitigate this, models are placed in internal sandboxes before being trained on proprietary data, preventing proprietary information and processes from being incorporated into the publicly-available version. Concerns regarding so-called “herding” thus fail to account for these intrinsic checks against model groupthink, are based on assumptions, and are entirely unfounded.

⁴ *Mata v. Avianca, Inc.*, 22-cv-1461 (PKC) (S.D.N.Y. Jun. 22, 2023).

B. Existing Regulations Already Sufficiently Address Potential Concerns Posed by the Use of AI Tools

MFA’s membership consists of market participants that use many different forms and types of technological tools to maximize business efficiencies, reduce costs for fund investors, decrease operational risks, and optimize regulatory compliance. MFA recognizes that as fiduciaries to investors and as market participants, any adoption, use or implementation of new technologies must promote the safety and soundness of the financial markets.

MFA’s membership consists of registered investment advisers (“**RIAs**”), subject to regulation by the Securities and Exchange Commission (“**SEC**”) as fiduciaries, and, in many cases, they are also commodity pool operators (“**CPOs**”) and commodity trading advisors (“**CTAs**”), subject to regulation by the Commodity Futures Trading Commission (“**CFTC**”).

Existing regulatory frameworks already apply to RIAs’ use of new technologies. Recent advancements in AI have not fundamentally changed or required wholesale revisions to the core tenets of regulatory and compliance frameworks. As a result, as new potential use-cases for AI are considered, existing control frameworks remain the proper mechanism for oversight of activities that involve the use of such tools. Existing regulatory frameworks applicable to private funds’ research, risk management, financial reporting, and customer protection sufficiently address existing and emerging risks related to AI.⁵

The Investment Advisers Act of 1940 (“**Advisers Act**”) and rules thereunder impose a broad fiduciary duty on RIAs to act in the best interest of their clients, which includes both a duty of care and a duty of loyalty. RIAs are subject to, among other things, a prohibition on principal trading and requirements to adopt and implement reasonably-designed policies and procedures to ensure compliance with the Advisers Act and rules thereunder (including rules related to portfolio management and trading practices) and to adopt and enforce a written code of ethics reflecting the adviser’s fiduciary duty to its clients. In addition, when an RIA directs a private fund to trade through a broker-dealer to access a market, SEC Rule 15c3-5 applies, which requires risk management controls for broker-dealers with market access. Thus, many controls are in place both at the RIA and the RIA’s broker-dealer before an order is exposed to the public markets.

MFA members that are also CFTC registrants are required to be members of the National Futures Association (“**NFA**”). Historically, the CFTC has relied upon NFA, a self-regulatory organization and the only registered futures association under Section 17 of the Commodity Exchange Act (“**CEA**”), to set forth and enforce its own rules that establish, among other things, training standards and proficiency testing, minimum standards governing the sales practices of its

⁵ See 7 U.S.C. § 21(p).

members and associated persons, as well as special supervisory guidelines to protect the public interest relating to the solicitation of new futures or options accounts. As a result, in addition to CFTC rules, registrants are also subject to NFA rules that apply to regulated activities where AI technologies may be deployed. As one example, NFA-registered MFA members are already subject to rules governing supervision, such as NFA Rule 2-9, which “places a continuing responsibility on every Member futures commission merchant . . . , [CTA], [CPO], and introducing broker . . . to diligently supervise its employees and agents in *all aspects* of their commodity interest activities.”⁶ NFA has also issued numerous Interpretive Notices under Rule 2-9 further setting forth detailed supervisory guidelines as applied to activities that involve the use of certain technologies, including but not limited to CPO control systems,⁷ information systems security programs,⁸ and automated order-routing systems.⁹ All told, NFA’s existing regulatory framework is a complementary balance between the CFTC’s principles-based approach and NFA’s more prescriptive approach. AI, as merely one of many new and emerging technological tools,¹⁰ should not necessitate altering this dynamic.

C. Regulators Should Remain Technology Neutral and Prioritize Regulating Activities

MFA believes that regulators should avoid regulating specific technological tools.¹¹ Instead,

⁶ NFA Interpretive Notice 9074, available at: <https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=9&RuleID=9074> (last visited Apr. 23, 2024).

⁷ *See id.*

⁸ *See* NFA Interpretive Notice 9070, available at: <https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=9&RuleID=9070> (last visited Apr. 23, 2024).

⁹ *See* NFA Interpretive Notice 9046, available at: <https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=9&RuleID=9046> (last visited Apr. 23, 2024).

¹⁰ As the Treasury is aware, much like other novel technological tools that have emerged in the recent past, AI is merely a tool. AI tools may support human decision-making in the investment process and enhance efficiency and productivity, but AI tools should not be a stand-in for ultimate human decision-making.

¹¹ The RFI adopts the very broad definition of AI utilized in President Biden’s Executive Order on Safe, Secure, and Trustworthy Development and Use of AI:

The term “artificial intelligence” or “AI” has the meaning set forth in 15 U.S.C. 9401(3): a machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments. Artificial intelligence systems use machine and human-based inputs to perceive real and virtual environments; abstract such perceptions into models through analysis in an automated manner; and use model inference to formulate options for information or action.

regulators should embrace a flexible approach to regulatory oversight that is premised on the understanding that the markets are ever-evolving.¹² For example, the CFTC generally has not strayed from this paradigm even in the face of rapid and widespread adoption of once-new technological tools such as the internet and electronic trading.¹³ This approach has served the markets well and has laid the groundwork for thriving and resilient derivatives markets in the United States because registrants are not burdened by cumbersome or soon-to-be anachronistic rules.

It is instructive to consider the CFTC’s determination to withdraw the proposed Regulation AT Notice for Proposed Rulemakings (“**NPRMs**”), when it decided “not to proceed with detailed prescriptive requirements.”¹⁴ When the CFTC attempted to regulate a specific technology (i.e., automated trading), it encountered tremendous challenges drafting proposed rules “just right” and ended up withdrawing its initiative in its entirety and solely deferring to existing rules and

WHITE HOUSE, E.O. 14110, SAFE, SECURE, AND TRUSTWORTHY DEVELOPMENT AND USE OF ARTIFICIAL INTELLIGENCE (Oct. 30, 2023), available at: <https://www.federalregister.gov/documents/2023/11/01/2023-24283/safe-secure-and-trustworthy-development-and-use-of-artificial-intelligence>.

¹² See Regulation Automated Trading; Withdrawal, 85 Fed. Reg. 42755, 42757 (July 15, 2020) (“The markets we regulate are changing. To maintain our regulatory functions, the CFTC must either halt that change or change our agency. Swimming against the tide of developments like electronic markets is not an option, nor should it be. The markets exist to serve the needs of market participants, not the regulator. *If a technological change improves the functioning of the markets, we should embrace it.*”) (emphasis added).

¹³ By contrast, in addressing the use of “predictive data analytics,” the SEC eschewed the “technology-neutral” approach it claims to employ in favor of proposing a regime so sweeping and restrictive that it would shut down not only innovation and technological advancement but also some registrants themselves. See Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, 88 Fed. Reg. 53960 (Aug. 9, 2023); see also Letter from Jennifer W. Han, Executive Vice President, Chief Counsel & Head of Global Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC (Oct. 10, 2023), available at: <https://www.mfaalts.org/wp-content/uploads/2023/10/MFA-Comment-Letter-to-SEC-on-Conflicts-of-Int-PDA-Proposal-101023.pdf>.

¹⁴ See note 12, *supra*, at 42756 (“In light of feedback the [CFTC] received in response to the Regulation AT NPRMs, and upon further consideration, the [CFTC] has determined to withdraw the pending Regulation AT NPRMs, to specifically reject the policy responses listed above as means of addressing the perceived risk underlying the Regulation AT NPRMs. *Furthermore, the [CFTC] has determined not to proceed with detailed, prescriptive requirements such as those contained within the Regulation AT NPRMs.* Finally, the [CFTC] has decided not to pursue regulatory proposals that would require additional classes of market participants to become registrants or compel market participants to divulge their source code and other intellectual property absent a subpoena.”) (emphasis added).

regulations.¹⁵ Through this rulemaking initiative and process, the CFTC ultimately realized that the markets it regulates and the technological tools used by its market participants are constantly changing.¹⁶ Similarly, the CFTC changed the definition of storage media recordkeepers could employ under CFTC Rule 1.31 from “optical disk” to “electronic storage media”¹⁷ and then again to “electronic regulatory records”¹⁸ in order to “modernize and make technology neutral the form and manner in which regulatory records must be kept.”¹⁹ In light of experiences such as this, we encourage regulators to maintain a commitment to remain technology neutral and avoid putting in place regulations tied to technological terms and concepts that will quickly become outdated and out of step with the marketplace.

Attempting to regulate any one specific technology over another could unintentionally stifle innovation, reduce returns to investors, and potentially circumscribe the ability of smaller and emerging managers to remain nimble and agile in an ever-competitive market.

D. Potential Use Cases for AI Are Still Developing and Could Unlock Important Benefits

MFA recognizes that advancements in technology, including AI, have benefitted fund investors. While use-cases for AI are still evolving, the technology has demonstrated the potential to unlock important efficiencies and yield benefits. MFA thus believes regulators should disfavor a reactive, proscriptive approach that could impede innovation and should instead carefully consider how best to responsibly capture the potential benefits of AI within its existing control framework.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Recordkeeping, 64 Fed. Reg. 28735 (May 27, 1999) (changing the term “optical disk” to “electronic storage media”).

¹⁸ Recordkeeping, 82 Fed. Reg. 24479 (May 30, 2017) (again changing the term “electronic storage media” to “electronic regulatory records”).

¹⁹ *Id.*

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We appreciate the opportunity to provide our comments to Treasury regarding the RFI, and we would be pleased to meet with the Treasury and its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to contact Matthew Daigler or the undersigned at (202) 730-2600 with any questions regarding this letter.

Respectfully submitted,

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