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April 6, 2023

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

RE: **Establishment of an Ethical Artificial Intelligence Framework for Investment Advisors**

Dear Chair Gensler:

On behalf of the U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee (IAC), we are pleased to submit the views articulated below as a consensus of the IAC Members. While choosing not to publish a formal IAC recommendation, the committee nevertheless feels it is important to share these perspectives based on discussions within the IAC.

On March 10, 2022, the SEC's IAC shared initial perspectives on the importance of providing ethical guidelines for artificial intelligence ("AI") and algorithmic models utilized by investment advisers and financial institutions. The panelists discussed a wide range of issues related to algorithms used today that impact how consumers make financial decisions. Technology continues to evolve at a rapid pace, and AI increasingly has an impact on nearly all Americans. While there is a lot of promise for the future of AI in the investment industry, there also have been serious blind spots brought to light with algorithms in other industries, and it is important not to perpetuate potential bias and discrimination manifested through computer code.

As advisory firms obtain and mine more data, it is imperative they also are following clear best practices from regulators, which includes the SEC. A significant number of investment advisory firms utilize computer code for determining appropriate asset allocation recommendations for their clients. Whether the asset allocation advice is communicated via digital engagement or via a human, it is imperative these programs are tested for bias and discrimination. SEC staff provided guidance to robo-advisors in 2017[1] on their disclosure and compliance program—including testing—obligations about the use of algorithms. Other U.S. regulators, such as the Federal Trade Commission ("FTC")[2] [3] and National Institute of Standards and Technology ("NIST"), have also provided frameworks on the use of AI to their constituencies. On January 26, 2023, NIST released their *AI Risk Management Framework* with a goal to tackle AI-based discrimination in recruiting and learning more about the benefits and risk of AI and machine learning in the life insurance industry.

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[1] (SEC Source) https://www.sec.gov/news/press-release/2017-52
[2] (FTC Source) https://www.ftc.gov/business-guidance/blog/2023/02/keep-your-ai-claims-check
[3] (FTC Source) https://www.ftc.gov/business-guidance/blog/2020/04/using-artificial-intelligence-and-algorithms

With the 118th United States Congress now in session, there is bipartisan momentum behind drafting legislation focused on ethical AI standards. Now more than ever, is the time to provide clear ethical frameworks around the use of automated systems for businesses regulated by the SEC. These computer algorithms will continue to evolve in our modern economy and capital markets. While there are many benefits to leveraging this technology, certain pitfalls need not be inevitable.

The IAC believes that the SEC has ample authority under the Investment Advisers Act of 1940 to oversee and monitor the investment adviser industry's use of technology to provide investment advice to investors. First, under the Investment Advisers Act, investment advisers are fiduciaries to their clients. Accordingly, advisers have an affirmative duty of care, loyalty, honesty and utmost good faith to act in the best interests of investors when providing investment advice. As fiduciaries, advisers have a special relationship of trust and confidence with their clients. The use of technology by advisers does not change the fiduciary nature of advice or the regulatory environment in which they operate. The SEC's recent fiduciary duty interpretation reaffirms these principles. See Commission Interpretation Regarding Standards of Conduct for Investment Advisers, 84 FR 33669 (July 12, 2010). In reaffirming application of this Advisers Act fiduciary duty, the SEC cited earlier SEC staff guidance that addressed how digital advisers can meet their suitability, disclosure and compliance obligations under the Advisers Act. See Robo-Adviser IM Guidance Update No. 2017-02 (Feb. 2017) ("2017 Guidance"). The compliance with an ethical framework for the use of artificial intelligence is therefore consistent with the fiduciary duties of advisers. The foundation of effective capital markets is grounded in ethical dealings and trust.

Moreover, the Compliance Rule under the Advisers Act (Rule 206(4)-7) requires all advisers to establish a compliance program that addresses the investment advisers' performance of its regulatory obligations. The 2017 Guidance reminds advisers that when they develop their compliance programs, they should be mindful of the unique aspects of algorithm-based investment models, including enhanced monitoring and/or conduct risk-based reviews of the use of artificial intelligence. We encourage the Commission to expand on this guidance.

In addition to the existing guidance on the use of algorithms, should the SEC or staff further develop its guidance to investment advisers on the use of AI, the IAC encourages including the following key tenets that would support better financial outcomes for all:

1. **Equity –** While technology rapidly advances, humans are still responsible for creating and selecting inputs that affect the algorithms utilized by investment advisory firms. Neurological and psychological research demonstrates that bias can manifest in human beings in a variety of ways, including in an unconscious fashion, and that these biases (unconscious or otherwise) may be replicated in the inputs selected for the algorithms. It is important, therefore, to understand the context of the data and consider the historical and structural issues that may undergird these inputs to minimize the risk of unintended biases and forms of discrimination. One way to accomplish this is to seek multi-disciplinary guidance from experts in these fields.

2. **Consistent and Persistent Testing –** Advisory firms that utilize AI must test their algorithms for the potential of bias and discrimination and continually monitor the algorithms (inputs and outcomes) while they are in use. The 2017 Guidance indicated that advisers should consider adopting and implementing policies and procedures addressing the development, testing and back-testing of the algorithmic code and the post-implementation monitoring of performance. As a best practice, either an internal governance team that is separate from the model creators or external auditors can test AI to minimize the potential for biased inputs or outcomes.

3. **Governance and Oversight –** Advisory firms should have a robust risk management and governance framework to ensure that AI is used in the best interest of investors and without bias. It is imperative that the SEC ensure the enforceability and monitor for compliance with any future best practices guidance or regulation provided to advisory firms. Many advisers are aware and eager to comply with these best practices, and the SEC has an opportunity to provide clear and enforceable guardrails for advisers that can increase the confidence of the American public in investment advisers' use of technology.

Technology will continue to evolve rapidly while the use of AI and machine learning proliferates within businesses and organizations providing investment advice. The IAC encourages the SEC to consider best practices with which advisory firms may comply while maintain some degree of flexibility to respond to technological advances in this area. The IAC further encourages the SEC to ground this regulatory framework in the three (3) tenets described

above while incorporating the key characteristics that NIST[4] has identified in its draft artificial intelligence framework. These characteristics include accuracy, interpretability, privacy, reliability, robustness, safety, resilience and mitigation of harmful bias among others. The CFA Institute provided a framework[5] for investment management professionals in 2022 that reemphasizes ethical considerations for professional standards.

The IAC encourages that any further SEC policymaking on ethical artificial intelligence incorporate in the three (3) tenets described above, as informed by investors, market participants, and the frameworks developed by other regulators (e.g., NIST, FTC) to mitigate the potential of harmful bias in investment advisor algorithms.

The IAC encourages the SEC to consider the following:

1. The SEC needs to continue to add staff with AI and machine learning expertise in the Divisions and Offices, including FinHub, as the use of these technologies continues to proliferate with investment advisers.

2. In August 2021, the SEC requested information and comment on broker-dealer and investment adviser digital engagement practices and investment advisors use of technology to develop and provide investment advice. (Release No. 34-92766; IA-5833; File No. S7-10-21) The SEC noted that investment advisory clients may face risks when artificial intelligence models use poor quality, inaccurate or biased data that produce outputs that are or lead to poor or biased advice. The SEC further noted that biased data may be incorporated unintentionally through use of data sets that include irrelevant or outdated information, including information that exists due to historical practices or outcomes, or through the selection by human personnel of the data or types of data to be incorporated into a particular algorithm. Accordingly, the SEC asked for input on how advisers account for, identify, evaluate and mitigate biases and disparities that raise investor protection issues.

   The SEC should use the information and input from this request for comment and observations from the Division of Examinations in its inspections of advisers using artificial intelligence to draft best practices regarding the ethical use of artificial intelligence. The SEC should also consider frameworks developed by regulatory authorities around the world, e.g., The Monetary Authority of Singapore[6], as well as organizations such as the CFA Institute[7]. This guidance will be a follow-up to the 2017 Guidance regarding robo-advisers and will not be limited to only robo-advisers. We also note that broker-dealers use artificial intelligence for purposes of developing and providing recommendations, so consideration should be given to developing a similar framework for broker-dealers.

3. The SEC Division of Examinations should be tasked with monitoring compliance with the new ethical artificial intelligence framework. This framework should incorporate the tenets of equity, consistent and persistent testing, and governance and oversight procedures.

Respectfully submitted on behalf of the Investor Advisory Committee,

Christopher Mirabile

Christopher Mirabile
Committee Chair

Leslie Van Buskirk

Leslie Van Buskirk
Committee Vice Chair

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[4] (NIST Source) https://www.nist.gov/itl/ai-risk-management-framework
[5] (CFA Institute Source) https://www.cfainstitute.org/-/media/documents/article/industry-research/Ethics-and-Artificial-Intelligence-in-Investment-Management_Online.pdf
[6] (MAS Source) https://www.mas.gov.sg/news/media-releases/2022/mas-led-industry-consortium-publishes-assessment-methodologies-for-responsible-use-of-ai-by-financial-institutions
[7] (CFA Source) https://www.cfainstitute.org/en/about/press-releases/2022/ethics-and-artificial-intelligence-in-investment-management-framework

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