August 12, 2024

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Re: Request for Information on Uses, Opportunities, and Risks of Artificial Intelligence in the Financial Services Sector; Document Number 2024-12336; 89 FR 50048 (June 12, 2024)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the Request for Information ("RFI") cited above.[2] The RFI seeks information regarding uses, opportunities, and risks presented by developments and applications of artificial intelligence ("AI") in the financial services sector.

AI has become ubiquitous in the daily lives of Main Street Americans, with technology being leveraged to provide everything from real-time driving directions to language translation to weather forecasts. Of course, financial services companies have employed AI in all corners of the banking, investment, and financial services sector. Without question, many of these changes are helpful for consumers, financial companies, and society as a whole. AI has the potential to bring greater efficiency, lower cost, and improved access to customized financial services; enhance compliance and risk management; and improve financial performance and outcomes.[3] At the same time, however, AI poses serious risks and threats to consumers and financial stability including fraud, discrimination, market crashes, and illegal activity.[4] Enormous amounts of money are being

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Request for Information on Uses, Opportunities, and Risks of Artificial Intelligence in the Financial Services Sector; Document Number 2024-12336; 89 FED. REG. 50048 (June 12, 2024); https://www.federalregister.gov/documents/2024/06/12/2024-12336/request-for-information-on-uses-opportunities-and-risks-of-artificial-intelligence-in-the-financial.

[3] *See, e.g.*, Better Markets, *Artificial Intelligence (AI) in the Financial Markets: Potential Benefits, Major Risks, and Regulators Trying to Keep Up* 5 (Mar. 21, 2024), https://bettermarkets.org/wp-content/uploads/2024/03/Better_Markets_AI_Fact_Sheet-3.21.24.pdf.

[4] *Id* at 7-10.

put toward its development. In fact, spending by financial services companies on AI now exceeds spending on AI in all other industries, even tech.[5]

A 2023 Executive Order detailed both the benefits and challenges that AI presents to society:

> Artificial intelligence (AI) holds ***extraordinary potential for both promise and peril***. Responsible AI use has the potential to help solve urgent challenges while making our world more prosperous, productive, innovative, and secure. At the same time, irresponsible use could exacerbate societal harms such as fraud, discrimination, bias, and disinformation; displace and disempower workers; stifle competition; and pose risks to national security. ***Harnessing AI for good and realizing its myriad benefits requires mitigating its substantial risks. This endeavor demands a society-wide effort that includes government, the private sector, academia, and civil society.***[6]

The Silicon Valley motto of "move fast and break things" simply cannot apply in the case of AI. The stakes are far too high. Not only are Main Street Americans' pocketbooks, retirement accounts, and consumer data vulnerable to misuse and manipulation, but broader financial stability is increasingly vulnerable to the threats of AI. While financial regulators have taken initial steps to address the use of AI in finance, largely amounting to policy statements, guidance, and consumer advisories, ***more urgency and action are needed to protect Main Street Americans and financial stability***.

However, we cannot allow the challenges and risks of AI to overshadow its incredible potential to improve the financial services industry for all Americans. As Better Markets has detailed, AI has already been used to strengthen and streamline internal and back-office operations at financial firms; improve trading operations; and enhance client interactions.[7]

Effective management and oversight of the safe and fair implementation of AI throughout the financial industry will be one of the greatest balancing acts of our time. It will require the highest levels of cooperation, coordination, and foresight to maximize AI's upside while also minimizing its downsides. We urge the Treasury Department ("Treasury") and the Financial Stability Oversight Council ("FSOC") to take the lead in this critical effort. At the same time, we urge the Federal Reserve ("Fed"), Federal Deposit Insurance Corporation ("FDIC"), Office of the Comptroller of the Currency ("OCC") (collectively the "Banking Agencies") as well as the Securities and Exchange Commission ("SEC"), Commodity Futures Trading Commission ("CFTC"), and the Consumer Financial Protection Bureau ("CFPB") (collectively the "Financial

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5 *See* Justin Kloczko, *Hallucinating Risk*, CONSUMER WATCHDOG 2 (Jan. 2024), https://consumerwatchdog.org/wp-content/uploads/2024/01/Hallucinating-Risk.pdf.

6 The White House, *Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence* (Oct. 30, 2023), https://www.whitehouse.gov/briefing-room/presidential-actions/2023/10/30/executive-order-on-the-safe-secure-and-trustworthy-development-and-use-of-artificial-intelligence/ (emphasis added).

7 Better Markets, *supra* note 3 at 4-5.

Regulators") to take an active role to increase oversight, regulation, supervision, and consumer protection. AI's growth trajectory and penetration into all corners of the financial industry demands a new approach to regulation, one that effectively incorporates agile and forward-looking regulatory frameworks and a focus on consumer protection, ethics, transparency, accountability, and financial stability.[8]

We recommend that the Financial Regulators take specific actions to allow for AI's continued innovation while at the same time protecting consumers, investors, banks, the economy, and the financial system from harm:

- **Coordinate the understanding of and communication about AI—including its benefits and risks**—to facilitate appropriate actions by the public, regulators, and financial industry;
- **Increase funding** to build staff, expertise, testing, and other capabilities to appropriately oversee and regulate AI and strengthen enforcement in this area;
- **Recognize and address the inherent data problems** that permeate AI;
- **Develop a pre-approval process** for acceptable applications and usage of AI;
- **Increase regulatory standards and enforcement** to punish and deter violations, recidivism, and the attitude that such behavior is simply a cost of doing business; and
- **Enhance public transparency** around the enforcement of AI rules and regulations.

BACKGROUND

President Biden's October 2023 Executive Order, defines AI as:

> [A] machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments.[9]

AI includes a range of systems that can process vast amounts of data extremely rapidly and execute tasks based on that analysis. It also encompasses the next generation of technology enabling these programs to exercise judgment or "think" in the same way that humans do. The question of whether machines can think is not new; academic research explored this question many

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8 *See, e.g.*, Jeff Pedowitz, *AI In Financial Services Will Require Robust, Transparent Regulation*, AM. BANKER (Dec. 12, 2023), https://www.americanbanker.com/opinion/ai-in-financial-services-will-require-robust-transparent-regulation; Barry Quinn, Fearghal Kearney & Abhishek Pramanick, *How Will Artificial Intelligence Affect Financial Regulation?*, ECONOMICS OBSERVATORY (Oct. 18, 2023), https://www.economicsobservatory.com/how-will-artificial-intelligence-affect-financial-regulation.

9 The White House, *supra* note 6.

decades ago[10] and popular culture followed, most famously with HAL, the human-like machine in the movie *2001: A Space Odyssey* in 1968.[11] Such questions have resurfaced recently with the emergence of AI and questions about appropriate oversight and regulation.

Notably, SEC Chair Gary Gensler explained that while AI systems, technology, and data inputs have grown exponentially and increasingly imitate human intelligence, at its core AI still relies on data inputs.[12] Similarly, Acting OCC Comptroller Michael Hsu detailed the evolution of AI—first as a source of inputs to human decision-making, then to a co-pilot that enhances human actions, and finally as an independent entity that makes its own decisions—but underscored that all of these phases are rooted in code, data, and other instructions developed by humans.[13]

Even the phrase "artificial intelligence" leads to the incorrect conclusion that computers are somehow "thinking" on their own. Thought leaders, academics, and other experts in the field have emphasized that currently AI is not actually intelligent and is instead using applied statistics based on data, coding, and statistical models that are created by inherently biased humans.[14] For example, writer Ted Chiang astutely identified this misnomer and explained that AI is not intelligent; instead it is only applied statistics:

> "I think that if we had chosen a different phrase for [AI], back in the '50s, we might have avoided a lot of the confusion that we're having now."
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> So if he had to invent a term, what would it be? His answer is instant: applied statistics.

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[10] *See, e.g.*, A.M. Turing, *Computing Machinery and Intelligence* 59 MIND (Oct. 1950), https://phil415.pbworks.com/f/TuringComputing.pdf.

[11] *See, e.g.*, Stephen Wolfram, *2001: A Space Odyssey Predicted the Future—50 Years Ago* WIRED (Apr. 3, 2018), https://www.wired.com/story/2001-a-space-odyssey-predicted-the-future50-years-ago/.

[12] Gary Gensler, *"Isaac Newton to AI" Remarks before the National Press Club*, U.S. Securities and Exchange Commission (July 17, 2023), https://www.sec.gov/newsroom/speeches-statements/gensler-isaac-newton-ai-remarks-07-17-2023.

[13] Michael J. Hsu, *AI Tools, Weapons, and Accountability: A Financial Stability Perspective*, U.S. Office of the Comptroller of the Currency (June 6, 2024), https://www.occ.gov/news-issuances/speeches/2024/pub-speech-2024-61.pdf.

[14] *See, e.g.*, Magdalene L. Crowley, *Michael Jordan calls for a more practical and advantageous approach to AI*, University of California Berkeley Electrical Engineering & Computer Sciences (Nov. 26, 2021), https://eecs.berkeley.edu/news/michael-jordan-calls-more-practical-and-advantageous-approach-ai/; Ron Miller, *MIT Robotics Pioneer Rodney Brooks Thinks People Are Vastly Overestimating Generative AI*, YAHOO NEWS (June 29, 2024), https://www.yahoo.com/news/mit-robotics-pioneer-rodney-brooks-150000727.html; University of Washington Paul G. Allen School of Computer Science & Engineering, *Uncovering Secrets Of The "Black Box": Pedro Domingos, Author of "The Master Algorithm," Shares New Work Examining the Inner Workings of Deep Learning Models*, ALLEN SCHOOL NEWS (Dec. 2, 2020), https://news.cs.washington.edu/2020/12/02/uncovering-secrets-of-the-black-box-pedro-domingos-author-of-the-master-algorithm-shines-new-light-on-the-inner-workings-of-deep-learning-models/; Jenny Toomey & Lori McGlinchey, "*Weapons Of Math Destruction": Data Scientist Cathy O'Neil On How Unfair Algorithms Perpetuate Inequality*, Ford Foundation (Oct. 11, 2016), https://www.fordfoundation.org/news-and-stories/stories/weapons-of-math-destruction-data-scientist-cathy-oneil-on-how-unfair-algorithms-perpetuate-inequality/.

> "***It's genuinely amazing that . . . these sorts of things can be extracted from a statistical analysis of a large body of text," he says. But, in his view, that doesn't make the tools intelligent.*** Applied statistics is a far more precise descriptor, "but no one wants to use that term, because it's not as sexy."[15]

It is true that computer models in use today contain vast amounts of data—more than any one person may have to make a decision. This has led to the belief that computers or AI are therefore able to outperform humans in a range of activities from investment decisions to bank examinations. While this is a potential outcome in theory, it is also a flawed conclusion because it misses the key consideration and evaluation of the motivation, intentions, and bias of the humans that programmed the computer or selected the data set that the AI uses to make decisions. The continued development of AI technology has obscured the line between human thought and computer or algorithmic decision-making. Chiang rightly stated how this evolution, when paired with corporate greed, can be devastating for Main Street Americans:

> ***[T]he rise of AI threatens to worsen wealth inequality, weaken worker power, and fortify a tech oligarchy.*** 'What does progress even mean, if it doesn't include better lives for people who work?' he wrote. 'What is the point of greater efficiency, if the money being saved isn't going anywhere except into shareholders' bank accounts?'[16]

However, embracing AI's the transformative possibility for innovation and inclusivity promises better, fairer, more accurate, more accessible financial outcomes for all Americans:

> The status quo is not something society should uphold as nirvana. Our current financial system suffers not only from centuries of bias, but also from systems that are themselves not nearly as predictive as often claimed. ***The data explosion coupled with the significant growth in [machine learning] and AI offers tremendous opportunity to rectify substantial problems in the current system***.[17]

Now, more than ever, Main Street Americans are relying on Financial Regulators, to take intentional and well-informed actions that protect society and the financial system from AI's threats while allowing AI's benefits to flourish.

SUMMARY OF THE RFI

With this RFI, Treasury is seeking to understand the uses, opportunities, and risks of AI in the financial sector. While Treasury is responsible for supporting innovation and competition within the financial sector, it recognizes that that cannot come at the cost of inclusive and equitable

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15 Madhumita Murgia, *Sci-fi Writer Ted Chiang: 'The Machines We Have Now Are Not Conscious'*, FIN. TIMES (June 2, 2023), https://www.ft.com/content/c1f6d948-3dde-405f-924c-09cc0dcf8c84 (emphasis added).

16 Billy Perrigo, *Time100 AI: Ted Chiang*, TIME (Sept. 7, 2023), https://time.com/collection/time100-ai/6308990/ted-chiang/ (emphasis added).

17 Aaron Klein, *Reducing Bias In AI-Based Financial Services*, THE BROOKINGS INSTITUTION (July 10, 2020), https://www.brookings.edu/articles/reducing-bias-in-ai-based-financial-services/ (emphasis added).

access to financial services for consumers, businesses, and investors. It also cannot come at the cost of financial stability.

The RFI is intended to increase Treasury's knowledge in three areas:

- How AI is being used within the financial services sector and the opportunities and risks presented by developments and applications of AI within the sector,
- How the use of AI by financial institutions affect consumers, investors, financial institutions, businesses, regulators, and other users of financial companies, and
- Recommendations for enhancements to legislative, regulatory, and supervisory frameworks applicable to AI in financial services.

SUMMARY OF COMMENTS

Our comments are focused on the third area of the RFI, which is related to the development of robust regulatory and supervisory frameworks related to AI in the financial system. Without strong, forward-looking regulation in place, the dangers and abuses associated with AI are likely to outweigh the gains it can provide. Importantly, the interventions, rules, and regulation needed to reduce the risks of AI for Main Street Americans and financial stability "are likely quite different than the traditional interventions in finance."[18]

We applaud the work that Treasury and others have already done to protect consumers and the financial markets. For example, Treasury's November 2022 report on nonbank firms' impact on consumer finance markets detailed how nonbank firms evade safety and soundness and consumer protection laws by operating outside of the "bank regulatory perimeter" and shed light on how AI presents data privacy and discrimination concerns.[19] Additionally, in March 2024, Treasury published a report on AI-related cybersecurity risks within the financial services industry, emphasizing the need to protect against cybersecurity and fraud.[20] This work, as well as events such as the Treasury's recent conference focused on AI and financial stability,[21] clearly show that

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18 William Magnuson, *Artificial Financial Intelligence*, 10 HARV. BUS. L. REV. 377 (2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3403712.

19 U.S. DEPARTMENT OF THE TREASURY, ASSESSING THE IMPACT OF NEW ENTRANT NON-BANK FIRMS ON COMPETITION IN CONSUMER FINANCE MARKETS 4 (Nov. 2022), https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

20 U.S. DEPARTMENT OF THE TREASURY, MANAGING ARTIFICIAL INTELLIGENCE-SPECIFIC CYBERSECURITY RISKS IN THE FINANCIAL SERVICES SECTOR (Mar. 2024), https://home.treasury.gov/system/files/136/Managing-Artificial-Intelligence-Specific-Cybersecurity-Risks-In-The-Financial-Services-Sector.pdf.

21 U.S. Department of the Treasury, 2024 CONFERENCE ON ARTIFICIAL INTELLIGENCE & FINANCIAL STABILITY (last visited Aug. 9, 2024), https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/financial-stability-oversight-council/2024-conference-on-artificial-intelligence-financial-stability.

the risks of AI are well known within Treasury and that ***it is now time to act to protect consumers and the broader financial system***.

To that end, we offer the following comments and recommendations, primarily focused on Question 18 in the RFI regarding actions that are necessary to protect the range of consumers, investors, financial institutions, businesses, regulators, and other users of financial companies that are affected by AI:

- Coordinate the understanding of and communication about AI—including its benefits and risks—to facilitate appropriate actions by the public, regulators, and financial industry. The FSOC should take the lead to develop and maintain an official definition and taxonomy to frame the usage and risks of AI within the financial industry. In 2023, the FSOC included AI as a risk in its Annual Report for the first time.[22] However, this lagged many other similar discussions and publications from regulators around the world. The absence of a cohesive framework and approach to understanding AI and its risks leads to more confusion for market participants, less coordination among regulators, and ample opportunity for fraudsters or other bad actors to evade the regulators and law enforcement.

- Increase funding to build staff, expertise, testing, and other capabilities to appropriately oversee and regulate AI and strengthen enforcement in this area. Funding for Financial Regulators must be increased to support staff, training, and other resources related to AI to achieve the goals of protecting Main Street Americans and financial stability. As mentioned earlier, the financial industry is spending billions of dollars on AI research, patents, and other activities. The federal government has started to focus on the need to hire AI professionals, but it is far behind. Financial Regulators must think bigger and broader. Additional funding will also be necessary to support AI-related enforcement, as explained below.

- Recognize and address the inherent data problems that permeate AI. Data serves as a critical cornerstone for AI systems. There are a range of problems that exist with the data itself—ranging from bias due to correlations within datasets to selection bias that occurs when certain groups are over-represented or under-represented to recency bias resulting from the fact that a majority of the data that exist today represent only the last few years of historical experience. In addition, financial companies are increasingly challenged by the need to protect data.

- Develop a pre-approval process for acceptable applications and usage of AI. We recommend the Financial Regulators put in place a system of pre-launch testing and evaluation, formal approvals, and continuous monitoring for AI that is deployed for use in financial companies. Such a framework of transparency and accountability will support the goals of protecting consumers and financial stability.

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[22] FINANCIAL STABILITY OVERSIGHT COUNCIL, ANNUAL REPORT 91-93 (2023), https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf.

- Increase regulatory standards and enforcement to punish and deter violations, recidivism, and the attitude that such behavior is simply a cost of doing business. To deter abuses of AI technology by bad actors, enforcement capabilities, tools, and sanctions must be dramatically increased throughout the financial industry.

- Enhance public transparency around the enforcement of AI rules and regulations. Increased transparency is necessary to protect consumers from the hidden dangers of AI in financial services. The SEC has moved in the right direction with cases against companies that make unfounded claims about their usage of AI. The next step may be to require standard disclosures by financial companies about their usage of AI so customers can make their own informed decisions. The CFPB could also play a role in this effort to track and share information about companies that have broken consumer protection laws.

COMMENTS

I. COORDINATE THE UNDERSTANDING OF AND COMMUNICATION ABOUT AI—INCLUDING ITS BENEFITS AND RISKS—TO FACILITATE APPROPRIATE ACTIONS BY THE PUBLIC, REGULATORS, AND FINANCIAL INDUSTRY.

The FSOC should take the lead to develop and maintain a definition and taxonomy to frame the usage and risks of AI within the financial industry in the U.S. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") assigned several important duties to the FSOC in the wake of the 2008 Financial Crisis.[23] Many of these can be directly applied to AI, including monitoring threats to financial stability, facilitating regulatory coordination, and facilitating information sharing.

In recent years, Financial Regulators as well as other entities in the U.S. and around the world have attempted to define AI and describe its uses and risks. As mentioned earlier, in 2023, the FSOC included AI as a risk in its Annual Report for the first time.[24] Also, the Congressional Research Service issued a report on the same topic in 2024, outlining several policy considerations that should be evaluated by Congress as it considers AI legislation,[25] and the House Financial Services Committee issued a report summarizing its work and recommendations related to AI.[26]

Years earlier however, in 2017, the Financial Stability Board published a report that defined AI, described its uses within the financial sector as well as its risks, and provided thoughts

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[23] Public Law No. 111-203, 124 Stat. 1376 (July 21, 2010).

[24] FINANCIAL STABILITY OVERSIGHT COUNCIL, *supra* note 22.

[25] Paul Tierno, ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING IN FINANCIAL SERVICES, CONGRESSIONAL RESEARCH SERVICE (Apr. 3, 2024), https://crsreports.congress.gov/product/pdf/R/R47997.

[26] HOUSE FINANCIAL SERVICES COMMITTEE, AI INNOVATION EXPLORED: INSIGHTS INTO AI APPLICATIONS IN FINANCIAL SERVICES AND HOUSING (July 18, 2024), https://financialservices.house.gov/uploadedfiles/bipartisan_working_group_on_ai_staff_report.pdf.

on governance by supervisors.[27] In August 2021, the Bank for International Settlements issued a report explaining that AI brings a range of unique challenges and complexities that demand a coordinated global response.[28]

These disparate discussions and publications prove that there is a serious lack of coordination on AI among financial supervisors. The message is further muddled by various international and domestic statements about actions that are necessary to respond to the risks of AI. For example, attendees at the international AI Safety Summit in November 2023, which included representatives from the U.S., issued a declaration recognizing the scope of AI's infiltration into nearly every part of humans' daily life and the significant risks that it poses to human rights, transparency, fairness, accountability, safety, ethics, bias mitigation, regulation, privacy, and data protection. Attendees agreed on a cooperative agenda to identify AI risks, build a shared scientific and evidence-based understanding of these risks, and sustain that understanding as capabilities continue to increase. They also agreed to build risk-based policies across countries to ensure safety in light of the risks, collaborating as appropriate with activities such as developing frontier AI capabilities, appropriate evaluation metrics, tools for safety testing, and scientific research.[29] These activities and tone have not carried through to Financial Regulators' approach to AI in the U.S. and contrasts with statements at the January 2024 Responsible AI Symposium, where leaders from the Fed, FDIC, OCC, and CFPB said that further development is not needed because regulators already have the tools to address AI risks, such as existing tools and laws that apply to consumer protection, third party entities, and model risks.[30]

We are hopeful that this RFI marks the start of Treasury—and the FSOC—taking a more active and visible leadership role to guide and inform regulators, the financial industry, and the public on AI risks and necessary interventions.

II. INCREASE FUNDING TO BUILD STAFF, EXPERTISE, TESTING, AND OTHER CAPABILITIES TO APPROPRIATELY OVERSEE AND REGULATE AI AND STRENGTHEN ENFORCEMENT IN THIS AREA.

Without question, funding for Financial Regulators must be increased to support staff, training, and other resources related to AI to achieve the goals of protecting Main Street Americans and financial stability.

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27 FINANCIAL STABILITY BOARD, ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING IN FINANCIAL SERVICES MARKET DEVELOPMENTS AND FINANCIAL STABILITY IMPLICATIONS (Nov. 1, 2017), https://www.fsb.org/wp-content/uploads/P011117.pdf.

28 Jermy Prenio & Jeffery Yong, *Humans Keeping AI in Check – Emerging Regulatory Expectations in the Financial Sector*, Financial Stability Institute, FSI INSIGHTS ON POLICY IMPLEMENTATION (Aug. 2021), https://www.bis.org/fsi/publ/insights35.pdf.

29 *The Bletchley Declaration by Countries Attending the AI Safety Summit*, Gov.UK (Nov. 1, 2023), https://www.gov.uk/government/publications/ai-safety-summit-2023-the-bletchley-declaration/the-bletchley-declaration-by-countries-attending-the-ai-safety-summit-1-2-november-2023.

30 Ebrima Santos Sanneh, *Regulators Say They Have the Tools to Address AI Risks*, AM. BANKER (Jan. 19, 2024), https://www.americanbanker.com/news/regulators-say-they-have-the-tools-to-address-ai-risks.

As mentioned earlier, the financial industry is spending billions of dollars on AI research, patents, and other activities. For example, JPMorgan (like other large banks) is heavily investing in AI, "spending what CEO Jamie Dimon has said is 'hundreds of millions of dollars per year' on AI efforts across the bank."[31] The bank reportedly spent $15 billion on technology and data in 2023[32] and has developed an entire operational arm devoted to AI.[33]

Regulators need adequate funding so that they have the necessary AI expertise and can dedicate resources to AI supervision and enforcement. Such funding, along with focus and attention can make a meaningful difference in the success of regulatory programs. One example of this is the expansion of resources related to oversight of crypto markets and cyber threats at the SEC. In 2017, the SEC created the Cyber Unit in the Division of Enforcement to protect investors in crypto markets and from cyber-related threats. In 2022, the SEC almost doubled the size of the unit and renamed it the Crypto Assets and Cyber Unit.[34] The SEC has taken similar, but smaller, steps with respect to the risks of AI—for example, it has established a team in the Division of Examinations to address issues regarding AI.[35] A dedicated unit in the SEC's Division of Enforcement for AI, as well as in other agencies such as the CFTC, would be even more beneficial.[36]

The federal government has started to focus on the need to hire AI professionals, but it must think bigger and broader to even keep pace with the well-funded and highly motivated industry. For example, earlier this year, the White House issued a statement recognizing the need for action to strengthen AI oversight. The statement outlined aspirations to hire 100 professionals who will be responsible for the trustworthy and safe use of AI across industries, not just financial services, and states that the 2025 budget includes $5 million for government-wide AI training.[37] While this is certainly a good first step, it is far too small, especially considering that the government and public sector is starting from the bottom with regards to investment in AI-related

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31 Jeremy Kahn, *JPMorgan Chase Tops First-Of-Its-Kind Ranking of A.I. Progress in Banking*, FORTUNE (Jan. 26, 2023), https://fortune.com/2023/01/26/jpmorgan-chase-tops-first-of-its-kind-ranking-of-a-i-progress-in-banking/.

32 Catherine Leffert, *JPMorgan Chase Aims to Create $1.5 Billion in Value with AI by Year-End*, AM. BANKER (May 30, 2023), https://www.americanbanker.com/news/jpmorgan-chase-aims-to-create-1-5-billion-in-value-with-ai-by-yearend.

33 JP Morgan, ARTIFICIAL INTELLIGENCE RESEARCH (last visited Mar. 19, 2024), https://www.jpmorgan.com/technology/artificial-intelligence.

34 Press Release, U.S. Securities and Exchange Commission, *SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit* (May 3, 2022), https://www.sec.gov/newsroom/press-releases/2022-78.

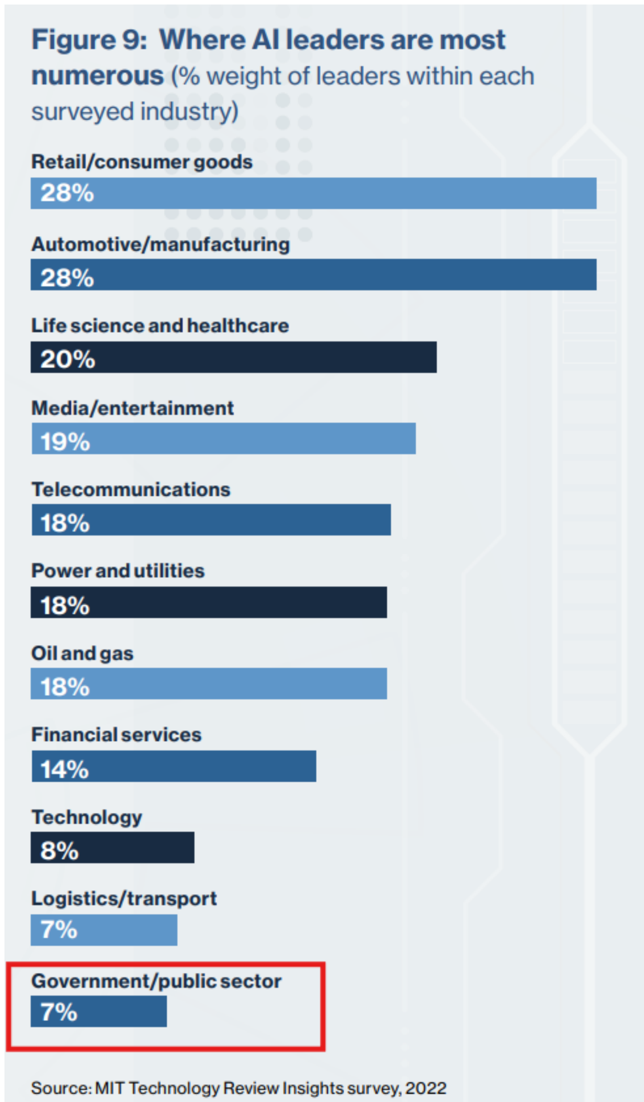
35 U.S. SECURITIES AND EXCHANGE COMMISSION, EXAMINATION PRIORITIES 3 (2024), https://www.sec.gov/files/2024-exam-priorities.pdf .

36 Better Markets Comment Letter, *Request for Comment on the Use of Artificial Intelligence in CFTC-Regulated Markets* 5 (Apr. 24, 2024), https://bettermarkets.org/wp-content/uploads/2024/04/Better-Markets-Comment-Letter-CFTC-Request-for-Comment-on-Use-of-AI-in-CFTC-Regulated-Markets.pdf.

37 The White House, *Fact Sheet: Vice President Harris Announces OMB Policy to Advance Governance, Innovation, and Risk Management in Federal Agencies' Use of Artificial Intelligence* (Mar. 28, 2024), https://www.whitehouse.gov/briefing-room/statements-releases/2024/03/28/fact-sheet-vice-president-harris-announces-omb-policy-to-advance-governance-innovation-and-risk-management-in-federal-agencies-use-of-artificial-intelligence/.

human capital (see Chart 1).[38] Moreover, it is dwarfed by the billions of dollars being dedicated to AI development by financial firms.

Chart 1



III. RECOGNIZE AND ADDRESS THE INHERENT DATA PROBLEMS THAT PERMEATE AI.

Data serves as a critical cornerstone for AI systems. The programs and code that operate within AI systems require data to make decisions. However, there are a range of problems that

[38] CIO VISION 2025: BRIDGING THE GAP BETWEEN BI AND AI 19, MIT TECHNOLOGY REVIEW (2022), https://www.databricks.com/resources/whitepaper/mit-cio-vision-2025.

exist with the data itself, including bias, challenges with third party data providers, and the need for consumer protection.

Bias stems from a range of factors and is a key challenge for AI systems. Examples of bias include interaction bias, where AI absorbs bias from the users it interacts with; latent bias, due to correlations inherent in datasets; and selection bias—which occurs when datasets over- or under-represent certain groups. It can also facilitate the intentional targeting of groups most vulnerable to exploitation and tailor products, services, and messaging in a way that extracts wealth from vulnerable populations. Finally, the rapid expansion of digitalization and data availability has concentrated the data that is available to make decisions in recent years, increasing the risk for recency bias.

Third-party data provider challenges are widespread throughout financial services companies. While some financial companies may have the financial and technical resources to develop proprietary models or use proprietary data, others may choose to pool resources or purchase data and models from vendors. This leads to potential challenges with data sovereignty and security, especially if it is stored in the cloud and the physical data facilities are in another jurisdiction.

Data privacy is a constant and increasing challenge. Financial services companies may violate customers' privacy rights by inadvertently, and without specific consent, gathering publicly available customer data for profiling and prediction. Data constraint risks occur because some internal and customer data is private and confidential. Its use to train generative AI models can therefore be risky as it may unintentionally expose data externally.

Given these challenges and the continued, exponential growth of financial data, regulators must remain keenly focused on data risks to appropriately protect consumers and financial stability.

IV. DEVELOP A PRE-APPROVAL PROCESS FOR ACCEPTABLE APPLICATIONS AND USAGE OF AI.

We recommend the Financial Regulators put in place a system of pre-launch testing and evaluation, as well as continuous monitoring for AI that is deployed for use in financial companies. Such a framework of transparency and accountability will support the goals of protecting consumers and financial stability.

Pre-testing should be required before AI systems are deployed in finance. The testing must include not only assessments of efficacy and reliability but also resistance to hacking. A testing and pre-approval paradigm is important for all AI technology, but especially important for AI technology that is outward facing, not just AI used by financial firms to make internal operations more efficient. Outward-facing AI has the most chance of causing harm to consumers.

While we are not aware of a pre-approval requirement that is currently employed for AI systems, a pre-approval regulatory role is familiar in a general sense. For example, the SEC pre-approves securities offerings, not on the merits but in terms of making sure there is adequate disclosure of all material information about the company and its business model. Additionally, the

CFTC regularly assesses new products in the derivatives market.[39] These examinations are carried out with a focus on safeguarding the market's stability, ensuring customer protection, and preserving the overall financial integrity of the derivatives market.

We recommend that a similar system and framework be put in place for novel AI tools and processes. The framework would seek to maintain security, transparency, and overall health of the financial markets while still allowing for innovation.

V. INCREASE REGULATORY STANDARDS AND ENFORCEMENT TO PUNISH AND DETER VIOLATIONS, RECIDIVISM, AND THE ATTITUDE THAT SUCH BEHAVIOR IS SIMPLY A COST OF DOING BUSINESS.

To punish and deter the inevitable abuses of AI technology by bad actors, enforcement capabilities, tools, and sanctions must be dramatically increased throughout the financial industry. Similarly, fines and other penalties must be large enough to prevent bad behavior before it starts or at least stop it from continuing and to prevent a "cost-of-doing" attitude within the industry. To be effective, the enforcement policy must also prioritize accountability for the managerial individuals responsible for violations, not just the entities or low-level employees.

The SEC has started to routinely analyze the industry's use of AI. In late 2023, the SEC's Division of Examinations sent investment advisers requests for information regarding AI-related marketing documents, algorithmic models used to manage client portfolios, and contingency plans for system failure and reports on AI systems causing regulatory or legal issues.[40] Also, the SEC's Division of Examination's priorities for 2024 included automated investment tools, artificial intelligence, and trading algorithms or platforms, and the risks associated with the use of emerging technologies.[41]

Likewise, in a few areas involving AI in financial services, useful standards are emerging:

- First, robo-advisers employ algorithms to provide investment advice, in theory matching the financial products available to the investor and the attributes of the investor using the robo-adviser. The problem is that firms may use a biased matching or ranking algorithm, prioritizing what is best for the firm rather than investors, including investments that allow the firm to receive more compensation than it would have had if the algorithm had chosen other investments.

The SEC's predictive data analytics rule would require broker-dealers and investment advisers to eliminate, or neutralize the effects of, certain conflicts of interest associated with their

39 *See, e.g.*, Press Release, Better Markets, *Better Markets Advocates for Timely Derivatives Rules Update in an Ever-Evolving Financial Landscape* (Nov. 13, 2023), https://bettermarkets.org/impact/better-markets-advocates-for-timely-derivatives-rules-update-in-an-ever-evolving-financial-landscape/.

40 Richard Vanderford, *SEC Probes Investment Advisers' Use of AI*, WALL STREET JOUR. (Dec. 10, 2023), https://www.wsj.com/articles/sec-probes-investment-advisers-use-of-ai-48485279.

41 U.S. SECURITIES AND EXCHANGE COMMISSION, *supra* note 35 at 19.

use of AI-like technologies in their interactions with investors.[42] The rule is necessary to prevent securities professionals from using predictive data analytics, digital engagement practices, and gamification in a way that induces investors to engage in a series of transactions that are not in their own interest and that have the potential to turn retail investors into investing addicts. The rule does not simply require that conflicts of interest be disclosed but rather that they be eliminated or neutralized, which is essential as research increasingly shows that disclosures are insufficient to prevent the harm that occurs from conflicts of interest and because investors may be especially likely to misunderstand disclosures about complex technologies such as artificial intelligence.

- Second, the SEC is working to protect investors who are susceptible to AI-based fraud and scams. Firms may market their services to investors based on their use of AI, with claims that investors can't lose because the firm's investment strategy is backed by the use of artificial intelligence.[43]

In contrast, as mentioned earlier, the Banking Agencies and CFPB say that existing tools and laws related to third parties are sufficient to prevent AI failures from harming consumers or the financial system.[44] We encourage careful attention to be paid to all areas of the financial industry to watch for additional illegal or deceptive activities that arise and look for areas where additional rules and oversight need to be added to protect consumers and financial stability.

VI. ENHANCE PUBLIC TRANSPARENCY AROUND THE ENFORCEMENT OF AI RULES AND REGULATIONS.

Increased transparency is necessary to protect consumers from the hidden dangers of AI in financial services. The SEC has moved in the right direction with cases against companies that make unfounded claims about their usage of AI, but the work is not done. The next step may be to require standard disclosures by financial companies about their usage of AI so customers can make their own informed decisions. However, it is unlikely that Main Street Americans know how to search for SEC enforcement actions. The Financial Regulators must proactively work to make this

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42 *See, e.g.*, Press Release, Better Markets, *SEC's Predictive Data Analytics Rule Would Help Prevent Financial Firms From Using AI That Harms Investors* (Oct. 11, 2023), https://bettermarkets.org/newsroom/secs-predictive-data-analytics-rule-would-help-prevent-financial-firms-from-using-ai-that-harms-investors/; Press Release, Better Markets, *SEC's Predictive Data Analytics Rule Will Help Prevent Abusive AI Practices That Hurt Retail Investors* (Apr. 3, 2024), https://bettermarkets.org/newsroom/secs-predictive-data-analytics-rule-will-help-prevent-abusive-ai-practices-that-hurt-retail-investors/.

43 *See, e.g.*, Press Release, U.S. Securities and Exchange Commission, *SEC Charges Two Investment Advisers with Making False and Misleading Statements About Their Use of Artificial Intelligence* (Mar. 18, 2024), https://www.sec.gov/news/press-release/2024-36; Litigation Release, U.S. Securities and Exchange Commission, *SEC Charges Founder of Artificial Intelligence Start-Up with Defrauding Investors* (Apr. 19, 2024), https://www.sec.gov/enforcement-litigation/litigation-releases/lr-25980; Press Release, U.S. Securities and Exchange Commission, *SEC Charges Founder of AI Hiring Startup Joonko with Fraud* (June 11, 2024), https://www.sec.gov/newsroom/press-releases/2024-70.

44 Ebrima Santos Sanneh, *supra* note 30.

information easily accessible for regulators, businesses, financial services companies, or other members of the public who want to use it.

The CFPB's new registry[45] of recidivist companies and individuals could help in this effort or serve as a model for tracking AI companies that break the law and making that information easily available to the public. The CFPB's new registry was developed to bring together disparate enforcement actions and court orders related to consumer protection into a single system to make it easier for investors, creditors, businesses, and other members of the public to find information about companies that have broken consumer laws. A similar system is needed to collect and make available information about unlawful and discriminatory AI companies.

CONCLUSION

We hope these comments are helpful in the pursuit of our shared goals of financial stability and consumer protection.

Sincerely,

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45 Press Release, Consumer Financial Protection Bureau, *CFPB Creates Registry to Detect Corporate Repeat Offenders* (June 3, 2024), https://www.consumerfinance.gov/about-us/newsroom/cfpb-creates-registry-to-detect-corporate-repeat-offenders/.