

August 14, 2026

Via Electronic Submission

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: Request for Information on AI Risks and Modernization in Financial Services

Dear Ranking Member Waters:

Managed Funds Association¹ ("MFA") appreciates the opportunity to submit comments in response to the Ranking Member's Request for Information ("RFI") regarding artificial intelligence ("AI") risks and modernization in financial services. MFA recognizes the important role policymakers play in better understanding this rapidly evolving technology, how it impacts markets and investors, and whether regulatory changes are warranted. MFA is committed to being a resource to policymakers globally as this important work moves forward.

Attached are MFA's prior submissions to the U.S. Department of the Treasury and the Financial Stability Board regarding AI. These submissions address many of the broader policy considerations raised in the RFI and underscore the importance of maintaining a proportionate, technology-neutral, and principles-based approach to AI oversight.

High-Level Considerations Regarding AI

As policymakers consider the role of AI in financial markets, several considerations should guide the discussion:

- First, existing securities laws already provide a robust framework governing the use of AI by investment advisers. Investment advisers remain responsible for complying with their legal and regulatory obligations regardless of whether they perform a function through employees, traditional software, quantitative models, algorithms, or AI-enabled tools.
- Second, AI technologies and use cases continue to evolve rapidly. Because AI is being deployed differently across firms and functions, policymakers should avoid prescriptive or technology-specific requirements that may

¹ Managed Funds Association (MFA), based in Washington, D.C., New York City, 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 it, 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 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

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quickly become outdated, discourage beneficial innovation, or impose unnecessary compliance burdens without corresponding investor protection benefits.

- Third, AI should be viewed mainly as a technological tool rather than a distinct regulated activity. Alternative asset managers use a wide range of technologies to support investment research, portfolio management, trading, compliance, risk management, cybersecurity, operations, and investor communications. The federal securities laws generally do not regulate particular technologies. Instead, they establish principles-based obligations governing how regulated activities are conducted and the outcomes firms must achieve.

For these reasons, policymakers should continue to evaluate AI through a technology-neutral framework focused on activities, risks, and outcomes rather than through rules directed at a specific technology.

Existing Regulatory Framework Already Governs the Use of AI

The Investment Advisers Act of 1940 and the SEC's rules thereunder already provide a comprehensive framework governing how private fund advisers develop, oversee, and deploy AI. Investment advisers are fiduciaries and must act in the best interests of their clients and investors. The SEC has recently reiterated that existing fiduciary standards apply to the use of AI, and that AI-related compliance remains an examination priority.

- **Existing Fiduciary Requirements** - Existing fiduciary obligations require advisers to exercise appropriate oversight and judgment when using AI, just as they do when using other technologies or third-party service providers. These principles-based standards are particularly well-suited to rapidly evolving technologies because they allow firms to tailor governance, testing, monitoring, and controls to the specific use cases and risks presented.
- **Existing Regulatory Requirements** - Beyond fiduciary obligations, advisers are subject to a broad range of existing regulatory requirements that are relevant to AI-enabled activities. These include requirements relating to compliance programs, books and records, disclosures, best execution, trading controls, vendor oversight, and other supervisory and governance obligations. These requirements provide regulators with significant visibility into adviser operations and create clear accountability for firm conduct.

This approach is consistent with how securities regulation has historically accommodated technological innovation. Over time, advisers have adopted increasingly sophisticated software, quantitative models, algorithmic systems, cloud computing technologies, cybersecurity tools, and operational platforms. Regulators generally have not created separate regulatory regimes for each new technology. Instead, existing principles-based obligations have applied regardless of the specific tools firms choose to use.

AI Use Cases Continue to Evolve

AI is being used across a wide range of business functions, including investment research, operational efficiency, compliance monitoring, cybersecurity, data analysis, trade support, and risk management. The scope and sophistication of these applications continue to develop rapidly.

The diversity of AI use cases underscores the importance of maintaining a flexible, principles-based regulatory approach. Different applications present different benefits, limitations, and risk considerations. A one-size-fits-all regulatory framework is unlikely to account for these differences and may unintentionally impede the beneficial adoption of technologies that can improve efficiency, strengthen controls, enhance risk management, and support better outcomes for investors.

The current regulatory framework appropriately allows advisers to tailor governance, testing, validation, monitoring, documentation, and oversight to the particular uses of AI within their organizations. This flexibility encourages responsible innovation while preserving strong investor protections and regulatory accountability.

Proportionality and Systemic Risk

As the Committee considers the regulatory framework and AI, the proportionality of risk and regulation is a key consideration. Alternative asset managers operate under a fundamentally different business model, role in the financial system, risk profile, size, complexity, and governance structure than other financial institutions, particularly global systemically important institutions. Further, each AI use case differs in materiality and risk. These differences and the proportionality of the risks and regulation for different types of financial institutions must be considered in any regulatory response.

Further, alternative asset funds do not present the risks associated with systemically important financial institutions and the use of AI should not impact this analysis. Alternative asset managers employ a diverse range of investment strategies, have asset and liability structures that match, use comparatively less leverage than other financial institutions, and are not of a similar size or complexity of other global financial institutions engaged in a wider range of activities. The use and risks of AI does not materially impact this assessment for alternative asset managers.

AI and Investment Processes

Some alternative asset managers may choose to incorporate AI into aspects of investment research, portfolio management, or trading-related processes. These applications build upon decades of experience using quantitative tools, statistical models, algorithmic processes, and other technologies in financial markets.

Importantly, existing governance, compliance, and risk management practices provide a strong foundation for overseeing these activities. Advisers employ processes for testing, validating, monitoring, and evaluating models and other technological systems used in investment decision-making and trading. In addition, trading activities remain subject to existing regulatory obligations relating to best execution, recordkeeping, compliance oversight, broker-dealer execution practices, and other established market safeguards.

Firms also employ controls designed to protect proprietary information, maintain data security, and promote operational resilience. AI models are accordingly placed in internal sandboxes and are trained on proprietary data. This prevents the proprietary information from being shared but also serves as an intrinsic check against so-called “herding” by models. Existing cybersecurity, operational risk management, incident response, and business continuity practices are likewise relevant to the use of AI and help firms manage potential risks associated with new technologies.

MFA members primarily manage assets on behalf of sophisticated institutional investors, including pension plans, endowments, foundations, insurance companies, and other large investors. Alternative asset managers providing investment advice to sophisticated institutional investors are not using AI to decide whether to offer a product or service to retail customers or the pricing of those products or services.

Conclusion

MFA believes that existing securities laws and regulations provide an effective framework for the responsible use of AI by private fund advisers. Policymakers should continue to support a technology-neutral, principles-based approach that focuses on activities, risks, and outcomes while allowing innovation and market practices to continue evolving. That said, policymakers should continue encouraging regulators to work cooperatively in examining potential risks associated with AI and in considering any potential regulatory responses. Further, policymakers should ensure that market or policy developments do not unfairly impact financial institutions of different sizes or types, for example due to early access to AI models resulting in market consequences.

We appreciate the opportunity to provide our views and would welcome further engagement with the Committee on these issues. Please do not hesitate to contact John Van Etten at jvanetten@mfaalts.org or the undersigned at jflores@mfaalts.org if you have any questions or would like to discuss further.

Sincerely,

/S/ Jillien Flores

Chief Advocacy Officer
Managed Funds Association

CC: U.S. House of Representatives Committee on Financial Services Chairman French Hill
U.S. Senate Committee on Banking, House, and Urban Affairs Committee Chairman Tim Scott
U.S. Senate Committee on Banking, House, and Urban Affairs Committee Ranking Member Elizabeth Warren

July 22, 2026

Via online submission portal

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel
Switzerland

**Re: MFA Comments on FSB Consultation Report on Sound Practices for
Responsible Adoption of Artificial Intelligence (June 10, 2026)**

Dear Sir or Madam:

MFA¹ appreciates the opportunity to submit comments to the Financial Stability Board (“FSB”) on its consultation report on Sound Practices for Responsible Adoption of Artificial Intelligence, published June 10, 2026 (the “**Consultation Report**” or the “**Proposed Sound Practices**”). We support the FSB's objective of fostering responsible artificial intelligence (“AI”) adoption across the financial sector and welcome the Consultation Report’s recognition that AI presents both significant opportunities and risks that warrant thoughtful governance. We offer the following comments with the goal of helping ensure that the final report is as effective and durable as possible and provides guidance that is calibrated to the actual diversity of institutions and use cases in the financial system.

Central to that goal is preserving the flexible, principles-based character of the Proposed Sound Practices. The FSB has been clear that these practices are not intended to establish an international standard or impose a prescriptive approach. We believe that framing is essential. AI technology is evolving rapidly, the range of institutions adopting it is vast, and the use cases

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vary enormously. We support the FSB's recognition of proportionality given the variety of and sizes of financial institutions. We have concerns, however, that the specificity of the Proposed Sound Practices and case studies is in tension with the report's flexible framing. The Proposed Sound Practices skew heavily toward governance models characteristic of large institutional banks that are neither reflective of current market practice across the sector nor practicable for smaller, less complex, and more nimble organizations. AI is a transformative technology with the potential to democratize sophisticated capabilities across the financial sector. Alternative asset managers already have compelling use cases that demonstrate this potential. However, a one-size-fits-all approach modeled on the infrastructure and organizational capacity of large banking institutions risks slowing this progress, effectively limiting meaningful AI adoption to the largest, most well-resourced institutions. Such an outcome runs counter to the FSB's stated goal of proportionate, responsible AI adoption across a diverse financial system.

Further, in certain areas, the Proposed Sound Practices do not fully reflect the current realities of how AI technology is developed, offered, and deployed in the market today.

Executive Summary

Our comments address five principal concerns:

1. Reinforce the flexible, non-prescriptive intent of the Proposed Sound Practices throughout the body of the final report by revising provisions that imply a single or preferred implementation path and confirming that multiple approaches may satisfy each underlying principle;
2. Revise language throughout the Proposed Sound Practices that implies a governance model or organizational structure that is characteristic of large institutional banks and not reflective of the broader financial sector or proportional for many segments of the industry;
3. Clarify that the case studies included in the final report are illustrative only and do not represent the expected or preferred approach to implementing a given sound practice;
4. Modify the Proposed Sound Practices to reflect current AI market realities, in particular with respect to third-party dependency and concentration risk as well as explainability; and
5. Direct that the Proposed Sound Practices build upon, rather than duplicate, financial institutions' existing model risk management, data governance, and cybersecurity frameworks, and align AI-specific terminology and definitions with existing industry

usage, including through cross-border harmonization, to avoid creating competing standards.

I. The Proposed Sound Practices Should Reinforce Their Flexible, Non-Prescriptive Intent

MFA strongly supports the FSB’s stated intent that the Proposed Sound Practices should serve as a flexible, high-level framework that complements rather than supersedes existing regulatory regimes. We urge the FSB to carry that intent consistently into the body of the final report, ensuring that the text as a whole, not just the framing language in the introduction, reflects the flexibility to which the FSB has committed. As currently written, the Proposed Sound Practices risk effectively imposing mandatory requirements through detailed implementation expectations, granular documentation standards, and language that leaves little room for proportionate application. The cumulative effect is a framework that, while nominally flexible, threatens to carry the weight of binding regulation.

Sound Practice 3 (Incorporation of AI risks into risk management framework) illustrates the tension between the introduction’s stated flexibility and the prescriptive nature of the Proposed Sound Practices themselves. Its premise, that financial institutions should incorporate AI risk considerations into existing risk management frameworks, is sound and proportionate on its face. In application, however, the practice calls for financial institutions to “track and document their AI use throughout the lifecycle,” with an accompanying list of documentation elements spanning ten separate categories even before noting “enhanced documentation and logging for GenAI and agentic AI use cases.” It further directs institutions to establish bespoke “contractual arrangements for vendors to provide timely information and compensating controls” where logging or rollback capabilities are vendor managed. Large financial institutions may have the internal resources to build and maintain a centralized AI use-case inventory (as the report’s own case study describes) and the negotiating leverage to secure customized contractual terms from AI vendors. Many alternative asset managers, however, cannot readily replicate these expectations, nor would it be necessary or proportionate for use cases that are relatively low risk.

Sound Practice 9 (Performance management) illustrates the same problem from a different angle. Although the practice appropriately calls for performance evaluation “proportionately” to a use case’s “materiality and risk,” it subsequently directs financial institutions to “specify thresholds across all relevant dimensions of performance” and enumerates five factors for performance assessment. This framework assumes an institution is building or materially customizing its own models and has the testing infrastructure and technical staff needed to implement multi-dimensional performance testing. Many smaller alternative asset managers instead deploy off-the-shelf or lightly configured third-party AI tools, where there is no realistic ability or need to run this type of testing.

Taken together, these examples show that the Proposed Sound Practices are not, in practice, the flexible principles institutions can adapt to their own circumstances that the introduction describes. Rather, in these instances they function as prescriptive operational and structural requirements that leave little practical room for institutions to tailor their approach to their businesses.

Notably, asset managers are not operating in a regulatory vacuum with respect to their adoption of AI. As fiduciaries, asset managers are already subject to overarching duties of care and loyalty that require them to act in their clients' and investors' best interests, including in the selection, deployment, and oversight of the technology they use. These duties are principles-based rather than prescriptive, and that flexibility allows asset managers to calibrate their governance and oversight practices to the specific AI tools they use, the specific risks those tools present, and the specific context in which they are deployed. This is particularly well-suited to the current stage of AI adoption given how rapidly it is evolving. A rigid, checklist-style framework imposed at this moment risks becoming obsolete or counterproductive as the technology matures, whereas the existing fiduciary framework is inherently adaptive.

We recommend that the FSB review the body of the Proposed Sound Practices for language that implies a single or preferred implementation path and revise that language to make clearer that multiple approaches may satisfy the underlying principle. The Proposed Sound Practices should consistently reinforce that the relevant risk or governance objective should be achieved by means appropriate to the institution and use case in question.

II. The Proposed Sound Practices Should Reflect the Diversity of the Financial Sector

Our concerns about the lack of flexibility are compounded by the fact that the Proposed Sound Practices, in their substantive requirements, baseline assumptions, and the case studies selected to illustrate them, are oriented heavily toward large, systemically important banking institutions. Despite calling for proportionality, the requirements are often disproportionate to what could or should be expected of the broader range of financial institutions the FSB intends to address. Alternative asset managers and other non-bank financial intermediaries operate under fundamentally different business models, risk profiles, and governance structures than global systemically important banks. References to “size” and “complexity” are insufficient without concrete guidance on how smaller or more specialized firms should adjust their posture.

The FSB correctly acknowledges the importance of proportionality in framing the Proposed Sound Practices:

Proportionality should be considered when applying the sound practices in this report. Each financial institution should consider the relevance and applicability

of these sound practices based on its business model, complexity, role in the financial system, structure, size, and the extent to which AI is used or deployed in their critical (or material) functions. Financial institutions may also refer to or adapt certain sound practices, depending on the materiality and risk of a specific AI use case, impact and outcomes of the use case, and the type of AI being adopted.

The Proposed Sound Practices, however, place the onus on financial institutions to revise and adjust prescriptive requirements that appear crafted with only one type of financial institution in mind.

The FSB's treatment of board and senior management oversight in Sound Practice 1 (Strategic direction and oversight) illustrates this concern. Many financial institutions outside the large bank sector do not have a board of directors in the traditional sense, and even where senior leadership bodies exist, it is neither practical nor effective for day-to-day AI oversight to rest with the most senior people or governance bodies within an organization. Instead, we typically observe that senior leadership appropriately sets AI strategy, articulates risk appetite, and weighs in on key decisions, but ongoing oversight responsibility is delegated to individuals, working groups, or committees, as makes sense for the size and organizational structure of the asset manager, with clear accountability and appropriate expertise.

Sound Practice 2 (Governance and accountability) presents a related concern. The practice begins uncontroversially with the notion that financial institutions should "define clear roles and responsibilities and maintain an appropriate governance framework." However, it then directs institutions toward the three lines of defense model as the reference structure, going so far as to state that it is "essential" that audit, evaluation, risk management, and testing functions remain independent and functionally separate from development teams. This may be a reasonable articulation for large financial institutions with the staff and organizational depth to support fully separated first-, second-, and third-line functions. For many alternative asset managers, however, this level of functional separation is neither practical nor achievable, and mandating it as "essential" deprives institutions of the optionality to devise organizational structures and reporting lines proportionate to their size and complexity.

This orientation carries through to the case studies, which are drawn almost exclusively from large, internationally active banks, G-SIBs, and similarly large insurers. None features an alternative asset manager or comparably-scaled nonbank financial institution. Because the Proposed Sound Practices are meant to be illustrated "in practice" through these examples, the effect is to implicitly frame large-bank infrastructure as the reference model for responsible AI adoption, rather than as one proportionate approach among several.

The lack of proportionality in the Proposed Sound Practices is further exacerbated by the fact that they seem not to meaningfully differentiate among levels of risk, instead crafted for very high risk use cases. By contrast, other regulatory frameworks, such as the EU AI Act, distinguish among unacceptable, high, limited, and minimal risk uses of AI and calibrate obligations accordingly. The Consultation Report states that “authorities . . . stress the importance of responsible AI adoption via strong governance, clear accountability, and sound risk management practices especially in high materiality and high risk use cases”, but the Consultation Report never defines or otherwise elaborates on what constitutes a “high risk” use case for these purposes. Nor do the Proposed Sound Practices themselves give concrete guidance or illustrations of adjustments for lower risk use cases. Expressly limiting the application of certain Proposed Sound Practices to higher-risk use cases would better align the framework with its own stated proportionality principle.

Sound Practice 10 (Human oversight) presents a related concern. Its core requirement, that institutions implement human oversight calibrated to the materiality, risk, autonomy, complexity, and explainability of each AI use case, is, on its face, appropriately proportionate. However, the Consultation Report’s own discussion of agentic AI acknowledges that the impracticality of real-time human monitoring grows as agent use scales and suggests that effective monitoring and detection may “require augmentation with another AI agent or other forms of AI.” For a large institution, standing up a second AI system to oversee a first may be a viable option. For most alternative asset managers, however, building or procuring a supplementary layer of AI purely to monitor another AI system is neither proportionate nor, in many cases, feasible, particularly for use cases that are neither highly material nor high risk.

In light of the foregoing, we recommend that the FSB revise the Proposed Sound Practices to more consistently reflect the diversity of institutions operating in the financial sector. First, the FSB should revise language throughout the Consultation Report that assumes a particular organizational structure, such as a traditional board of directors or a fully segregated three lines of defense model, and replace it with objective-based language that identifies the governance outcome sought while leaving institutions latitude to determine the structure, personnel, and reporting lines appropriate to their size and complexity. Second, the FSB should apply the proportionality principle within the body of each sound practice itself, rather than relying on the introduction to do that work; a brief proportionality caveat accompanying each practice would go a long way toward ensuring the framework functions as guidance rather than as a checklist. Third, the FSB should clarify prominently, both in the introduction and immediately preceding each case study, that the case studies are illustrative examples of one approach among several and not a reference implementation or benchmark, and should soften language within the case studies themselves that may otherwise be read as suggesting a single

correct way to implement the sound practices. These revisions would allow the final report to be more applicable to the full range of institutions operating in today's financial sector.

III. The Proposed Sound Practices Should Be Revised to Reflect Current AI Market Realities

Several of the Proposed Sound Practices reflect assumptions about how AI is built, delivered, and governed that do not accurately describe the AI market as it exists today. Financial institutions of all types and sizes are increasingly reliant on a small number of large technology companies for foundation models, cloud infrastructure, and application-layer AI products. The commercial, technical, and contractual realities of that market bear little resemblance to the framework the Proposed Sound Practices appear to contemplate in certain areas, in particular with respect to third-party dependency and concentration risk as well as explainability.

A related, fundamental gap is the Proposed Sound Practices' lack of differentiation between "developers" and "deployers" of AI. Other regulatory frameworks distinguish between entities that build or substantially customize an AI model or system and those that procure and use a model or system largely as offered by a third party, and calibrate obligations accordingly. The Proposed Sound Practices do not draw this distinction in any comparable way. This omission is particularly consequential because most financial institutions, including the great majority of alternative asset managers, are deployers rather than developers of the AI models and systems they use at this stage. Proposed Sound Practices premised on the assumption that an institution controls or can meaningfully influence a model's underlying architecture, training data, or ongoing development, are difficult or impossible for a deployer to satisfy in the same way. Sound Practice 8's expectation that institutions "build explainability into model development" and Sound Practice 12's expectations regarding negotiated contractual protections and substitutability are both illustrative of requirements that are premised on a level of access, control, or negotiating leverage that most deploying institutions simply do not have.

Sound Practice 12 (Third-party AI risk management) expects financial institutions to manage AI supply chain risk, negotiate contractual protections, and maintain substitutability arrangements with key AI providers. In practice, the foundation model and cloud infrastructure market is highly concentrated, terms of service are often standardized and non-negotiable for all but the very largest institutions, and genuine substitutability (i.e., the ability to switch from one leading AI provider to another) is not commercially feasible for many institutions. Concentration in this market is a structural feature of the current technology landscape, not a consequence of inadequate procurement practices by individual financial institutions.

Sound Practice 8 (Explainability and transparency) states that where compensating controls cannot adequately mitigate explainability risk, institutions must consider "deploying a

more explainable AI or non-AI model or system, even if performance is inferior.” This provision effectively prescribes reverting to a less capable system rather than leaving institutions to determine the appropriate risk management response within their own governance frameworks. It creates potential limitations on AI adoption by requiring institutions to forgo best-available tools where full explainability cannot be achieved.

We urge the FSB to review the Consultation Report carefully and align the assumptions and recommendations more closely with the realities of the current AI landscape.

IV. The Final Report Should Build on Existing Governance Frameworks Rather Than Create Competing Definitions and Standards

The Proposed Sound Practices largely proceed as though AI governance is a novel discipline requiring an entirely new compliance architecture, rather than an extension of governance frameworks financial institutions have refined over decades. As such, they risk creating competing and duplicative standards. The same dynamic operates across borders. Many alternative asset managers and other financial institutions operate across multiple jurisdictions and are therefore subject to a range of overlapping, and at times inconsistent, AI-related regulatory standards. Global firms must comply with various standards across borders, and the risk of competing definitions and frameworks described throughout this section is magnified as individual jurisdictions adopt their own AI-specific requirements.

To promote consistent implementation and reduce regulatory fragmentation across jurisdictions, the FSB could further clarify key terminology and definitions related to AI in the Proposed Sound Practices. For example, terms such as "AI," "traditional AI," "machine learning," "generative AI," "agentic AI," "foundation models," and "AI models" could be defined more precisely and distinguished from one another, as vague or overlapping terminology may lead to inconsistent application both within and across jurisdictions.

This is apparent, in particular, in areas that closely track long-standing model risk management practices, including those governing quantitative and algorithmic trading models, which already provide mature approaches to model validation, testing, benchmarking, and ongoing performance monitoring. Notably, the FSB itself recognizes elsewhere in the Consultation Report that AI risk assessment can build on "financial authorities' respective regulations or guidance on AI risk management, model risk management, operational resilience, and third-party risk management." Left as is, the current approach risks producing parallel, and at times competing, definitions and frameworks that address substantially the same underlying risks as existing regimes, without reference to or reconciliation with them.

This risk is evident in Sound Practices 8 and 9. Financial institutions, and quantitative investment managers in particular, already validate and monitor proprietary models using well-

established model risk management concepts such as conceptual soundness, outcomes analysis, benchmarking, challenger models, and sensitivity and stress testing. Sound Practice 9's dimensions of performance (accuracy, range of output, robustness, stability, and sensitivity testing) and Sound Practice 8's explainability methods (including "post-hoc explainability," "triangulation," and the distinction between "global" and "local" explainability) describe substantially the same discipline using new, AI-specific terminology. Where these concepts diverge from or only partially overlap with the model risk management vocabulary institutions already use, financial institutions are left maintaining two parallel taxonomies, and in some instances two parallel validation processes, for what is fundamentally a single underlying activity.

A related concern arises under Sound Practice 7 (Data governance). While the Proposed Sound Practices acknowledge that data governance frameworks "may be pre-existing," the AI-specific elements that follow, including new data classification and labelling schemes, a formal "data lineage" concept, and "policy aware" metadata instructions, are introduced without reference to the data governance, data mapping, and recordkeeping frameworks financial institutions already maintain for other regulatory purposes. As a result, Sound Practice 7 risks functioning as a new, parallel data governance taxonomy layered on top of institutions' existing frameworks, rather than as guidance on how to extend those existing frameworks to cover AI-specific data uses.

The same concern applies to Sound Practice 11 (Cyber and ICT risk management). MFA and its members recognize that AI introduces genuine, AI-specific cybersecurity risks, and we welcome the FSB's attention to them. However, cybersecurity and operational resilience are already heavily regulated, with mature frameworks addressing technology risk, third-party and supply chain risk, incident detection and reporting, and business continuity. Without careful coordination, Sound Practice 11 risks becoming a competing standard that runs alongside, rather than within, those existing frameworks, creating duplicative compliance burdens and, potentially, conflicting definitions of common cyber and ICT risk concepts.

We urge the FSB to revise the final report to make clearer that the Proposed Sound Practices, in many respects, can be extensions of existing model risk management, data governance, and cybersecurity and operational resilience frameworks, rather than as freestanding, AI-specific structures. Where existing frameworks already address a risk present in an AI context, compliance with those existing requirements should satisfy the relevant Sound Practice without the need for duplicative AI-specific measures or divergent AI-specific definitions.

V. Conclusion

MFA appreciates the FSB's work on this important initiative and the opportunity to provide these comments. We strongly support the goal of responsible AI adoption across the financial sector and believe that well-calibrated, genuinely flexible guidance will do more to advance that goal than prescriptive requirements that do not reflect the diversity of the institutions, markets, and technologies they are intended to address. We urge the FSB to consider the recommendations set forth above as it finalizes the Proposed Sound Practices, and we welcome the opportunity to discuss any of these points further. If the FSB has questions or comments, please do not hesitate to contact Jill R. Whitelaw at JWhitelaw@mfaalts.org or the undersigned at JFlores@mfaalts.org with any questions regarding this letter.

Respectfully submitted,

/s/ Jillien Flores

Jillien Flores

Chief Advocacy Officer

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

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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.*

* * *

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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