Growing Asia's Markets

28 November 2024

ASIFMA Response to "Proposed amendments with respect to assigning responsibility for the use of artificial intelligence tools by Market Infrastructure Institutions, Registered Intermediaries and other persons regulated by SEBI".

To be Submitted via *SEBI Portal* in the format prescribed by SEBI (table further below).

SEBI proposal	**Comments: Level of agreement:** **strongly disagree**	**Rationale**
9. a **In the Securities and Exchange Board of India (Intermediaries) Regulations, 2008** -after existing Chapter IIIA, the following Chapter and Regulation thereunder is proposed to be inserted:	**Comment 1: *"Irrespective of the scale and scenario of adoption of such tools"*** We strongly suggest SEBI to take a risk-based approach, and allow Intermediaries to take into account the materiality of the use case. We hope SEBI will adopt the principle of proportionality in their oversight of AI use, and for financial institutions in their development and deployment of AI. AI can potentially be used in a whole range of functions across financial markets, to augment existing activities, to replace them, or to perform complex and intensive tasks that were not	**Rationale in relation to Comment 1: *"Irrespective of the scale and scenario of adoption of such tools"*** A one-size-fits-all approach should therefore be avoided as it risks over-regulating inconsequential low-risk use cases, which would hinder innovation and slow down adoption of a technology that could have a beneficial impact. FIs have been using AI and Machine Learning tools for years. The risks associated with these tools have been evaluated and incorporated into the control framework of FIs. **Rationale in relation to Comment 2: *: "sole responsibility"*** As mentioned, whilst FIs will remain accountable, the responsibility of the various controls in the generative AI lifecycle will depend on the deployment model, and we suggest that responsibility (and liability) should lie with the party who has control over the specific element of the lifecycle. **Rationale in relation to Comment 3: *"if the output . .***

"CHAPTER IIIB ***Usage of artificial intelligence tools*** ***16C. (1)*** *Any person regulated by the Board who uses artificial intelligence tools or technologies specified by the Board as artificial intelligence and machine learning techniques, that are either designed by it or procured from third-party technology service providers, irrespective of the scale and scenario of adoption of such tools for conducting its business and servicing its investors, shall be solely responsible –* ***(a)*** *for the privacy, security and integrity of investors' and stakeholders' data including data maintained by it in a fiduciary capacity throughout the processes involved;* ***(b)*** *if the output arising from the usage of such tools and techniques is relied upon or dealt with; and* ***(c)*** *for the compliance with applicable laws in force.* *(2) The Board may, in case of violation of the provisions of sub-regulation (1), take such action as it may deem fit including action under Chapter V of these regulations.* ***Explanation****: For the purpose of this regulation, -* ***(a)*** *the expression "artificial intelligence tools" may include a application or software programme or executable system o combination thereof, offered by the person regulated by t*	previously feasible. Each use case will have its own risk profile and key stakeholders. Financial institutions should be allowed to adopt a risk-based approach that is proportionate to the risk of the particular use case and its potential impact on stakeholders. Such risks should be measured against the performance of comparable current processes (if existing) or an available human-powered alternative. Further, we believe that Intermediaries already have in place oversight structures dealing with the use of technology which are in line with the regulatory standards which are largely technology-neutral, applying equally to manual processes and to sophisticated technology such as AI systems. Setting a higher bar for processes using AI will hamper innovation and create an asymmetric regulatory framework. (More in ASIFMA's AI paper – principle 2, 3 and 4 on page	***. is relied upon or dealt with."*** An Intermediary cannot be held responsible for any bad decisions by a client or external stakeholder based on the otherwise accurate and fair output of an AI tool. Where correct and fair output of AI tools is used by investors incorrectly/inappropriately with undesired outcomes, this should not inadvertently place bad investor/stakeholder decisions onto the Intermediaries as this is beyond their control. **Rationale in relation to Comment 4: *"throughout the process involved."*** For clarity and calibration of the requirements. **Rationale in relation to Comment 5: Definition of AI tool** A technology-neutral approach will allow the regulatory framework to remain dynamic and future proof and enable India markets to keep pace with new technological developments, encourage innovation and not place unnecessary obstacles on the industry's use of the technology. It is not necessary to define "Artificial Intelligence." At this time, ASIFMA does not endorse a specific definition of AI since it is neither a narrow nor static technology. Additionally, we believe that if regulators utilize a principles-based and outcomes-focused approach by referring to AI characteristics, it may be less necessary to develop a consensus single, specific definition of AI, particularly since many jurisdictions have recently adopted, or are in the process of adopting, region-specific AI

	10: https://www.asifma.org/wp-content/uploads/2021/06/enabling-an-efficient-regulatory-environment-for-ai-report_june-2021.pdf) **<u>Comment 2: *"sole responsibility"*</u>** We suggest that a differentiation should be made between responsibility and accountability. And we advocate for SEBI to support a shared responsibility framework. There is a distinction between accountability and responsibility, where FIs must remain accountable, but third parties may be responsible for certain parts of the AI value chain. "Providers" and "deployer/users" share the responsibility for risk management associated with the use of generative AI. This establishes accountability and ensures responsibilities of the generative AI service provider and its consumers	definitions. We equally caution authorities from producing specific and prescriptive definitions. However, we understand that in order to comment on considerations relating to this topic, it may be necessary to refer to a common definition. For this reason, we suggest to utilize the OECD definition of AI systems The OECD definition is not overly broad as to capture systems that are not considered AI today. Additionally, definitions in many major jurisdictions have followed the OECD definition or have proposed similar definitions based upon the one developed by the OECD. Notably, in May 2024, the OECD Ministerial Council Meeting adopted the latest revisions to the OECD Principles on Artificial Intelligence, which include 47 state adherents and continues to reference this definition of AI systems. The European Union's AI Act also utilizes this definition. **<u>Rational in relation to Comment 6: collaboration among authorities</u>** For consistency.

	with regard to responsible use of generative AI. When understanding the risks associated with the use of generative AI, it is critical to note that the allocation of risk responsibilities is contingent upon the particular AI application scenario that could originate from the generative AI service provider or the user of the generative AI service and such allocation should be contractually agreed between the involved parties, where it is not specified by the regulators. **Comment 3:*“if the output . . . is relied upon or dealt with.”*** It is unclear from the current language whether SEBI is referring to reliance/dealings by the Intermediary, or by the client/external stakeholders/ or both. The way this requirement currently reads is as if when a client or stakeholder is using accurate and fair output from an AI tool, but then takes	

	his/her own bad decision, this would be the responsibility of the RE. If that is indeed SEBI's intention, we are very concerned that this would be significant overreach and would be an outlier as compared to requirements and guidelines in other jurisdictions. In relation to clients' or external stakeholders' reliance on the output of the AI tool, we strongly suggest that the onus should be on the Intermediary to have the governance and controls in place for the AI tool to provide an accurate and fair output in line with the expected regulatory outcomes for a specific activity. The reliance by the client/external stakeholder on that fair and accurate output is beyond the control of the Intermediary. There do not appear to be any boundaries limiting our	

	responsibility to the accuracy of the data or the compliance of the AI product to our Responsible AI principles / an equivalent industry standard. **<u>Comment 4: "throughout the process involved."</u>** The AI "process" is fluid and it is unclear what is meant by "the process involved" and it would be a clear material risk for Intermediaries to be solely responsible for all data throughout that process. Additionally, generative and/or predictive AI processes may vary based on the use case. For certain use cases, developers may be responsible for a significant portion of the AI process while for other use cases, Intermediaries may most if not all be part of the process. **<u>Comment 5: Definition of AI tool</u>** We submit that the proposed definition of AI tool is too broad. We recommend that SEBI adopts a technology-neutral, risk-based and principles-	

	focused regulatory approach to markets and intermediation activities in India. The focus should be on activities and outcomes, rather than seeking to regulate any particular technology use. If SEBI must include specific reference to AI, then we suggest using the **OECD AI System definition: "***An AI system is a machine-based system that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments. Different AI systems vary in their levels of autonomy and adaptiveness after deployment."*	

Board, to investors/stakeholders or used internally by it to facilitate investing and trading or to disseminate investment strategies and advice, carry out its activities including compliance requirements and the same is portrayed as part of the public product offering or under usage for compliance or management or other business purposes; ***(b)*** *the expression "person regulated by the Board" shall have the same meaning as provided under Explanation 1 to regulation 16A."* [4]	**Comment 6: collaboration among authorities** We understand that the Digital India Act includes a specific reference to the "regulation of high-risk AI systems". We hope that the various authorities will coordinate so as to ensure a consistent, safe and supportive regulatory approach to AI in India.	
9. b. **In the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018** - after existing regulation 39A in Chapter VI (General Obligations), the following regulation is proposed to be inserted: "***Usage of artificial intelligence tools*** ***39B.*** *A recognized stock exchange and a recognized clearin corporation which uses artificial intelligence tools or technologie specified by the Board as artificial intelligence and machin learning techniques, that are either designed by it or procure from third-party technology service providers, irrespective of th scale and scenario of adoption of such tools for conducting i business and servicing its clients or constituents, shall be sole responsible–*	NA	NA

(a) *for the privacy, security and integrity of investors' and stakeholders' da including data maintained by it in a fiduciary capacity throughout tl processes involved;* ***(b)*** *if the output arising from the usage of such tools and techniques is relie upon or dealt with, and* ***(c)*** *for the compliance with applicable laws in force.* ***Explanation****: For the purpose of this regulation, the expression "artifici intelligence tools" may include any application or software programme c executable system or a combination thereof, offered by a recognized stoc exchange or a recognized clearing corporation to investors/stakeholders c used internally by it to facilitate trading and settlement, carry out its activiti including compliance requirements and the same is portrayed as part of tl public product offering or under usage for compliance or management c other business purposes."*		
9. c In the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018-after existing regulation 82A in Chapter VII (inter alia dealing with obligations of depositories), the following regulation is proposed to be inserted:	**<u>Comment 1: *"Irrespective of the scale and scenario of adoption of such tools"*</u>** We strongly suggest SEBI to take a risk-based approach, and allow Depository Participants to take into account the materiality of the use case. We hope SEBI will adopt the principle of proportionality in their oversight of AI use, and for financial institutions in their development and deployment of AI. AI can	**<u>Rationale in relation to Comment 1: *"Irrespective of the scale and scenario of adoption of such tools"*</u>** A one-size-fits-all approach should therefore be avoided as it risks over-regulating inconsequential low-risk use cases, which would hinder innovation and slow down adoption of a technology that could have a beneficial impact. FIs have been using AI and Machine Learning tools for years. The risks associated with these tools have been evaluated and incorporated into the control framework of FIs. **<u>Rationale in relation to Comment 2: *: "sole responsibility"*</u>** As mentioned, whilst FIs will remain accountable, the responsibility of the various controls in the generative AI lifecycle will depend on the

"***Usage of artificial intelligence tools*** ***82B.*** *A depository which uses artificial intelligence tools or technologies specified by the Board as artificial intelligence and machine learning techniques, that are either designed by it or procured from third-party technology service providers, irrespective of the scale and scenario of adoption of such tools for conducting its business and servicing its clients or constituents, shall be solely responsible–* ***(a)*** *for the privacy, security and integrity of investors' and stakeholders' data including data maintained by it in a fiduciary capacity throughout the processes involved;* ***(b)*** *if the output arising from the usage of such tools an techniques is relied upon or dealt with; and* ***(c)*** *for the compliance with applicable laws in force.* ***Explanation****: For the purpose of this regulation, the expressio "artificial intelligence tools" may include any application o software programme or executable system or a combinatio thereof, offered by the depository to investors/stakeholders or use internally by it to facilitate trading and settlement, carry out i activities including for compliance requirements and the same portrayed as part of the public product offering or under usage fo compliance or management or other business purposes."*	potentially be used in a whole range of functions across financial markets, to augment existing activities, to replace them, or to perform complex and intensive tasks that were not previously feasible. Each use case will have its own risk profile and key stakeholders. Financial institutions should be allowed to adopt a risk-based approach that is proportionate to the risk of the particular use case and its potential impact on stakeholders. Such risks should be measured against the performance of comparable current processes (if existing) or an available human-powered alternative. Further, we believe that Intermediaries already have in place oversight structures dealing with the use of technology which are in line with the regulatory standards which are largely technology-neutral, applying equally to manual processes and to sophisticated technology such as AI	deployment model, and we suggest that responsibility (and liability) should lie with the party who has control over the specific element of the lifecycle. **Rationale in relation to Comment 3: *"if the output . . . is relied upon or dealt with."*** Depository Participants cannot be held responsible for any bad decisions by a client or external stakeholder based on the otherwise accurate and fair output of an AI tool. Where correct and fair output of AI tools is used by investors incorrectly/inappropriately with undesired outcomes, this should not inadvertently place bad investor/stakeholder decisions onto the Depository Participants as this is beyond their control. **Rationale in relation to Comment 4: *"throughout the process involved."*** For clarity and calibration of the requirements. **Rationale in relation to Comment 5: Definition of AI tool** A technology-neutral approach will allow the regulatory framework to remain dynamic and future proof and enable India markets to keep pace with new technological developments, encourage innovation and not place unnecessary obstacles on the industry's use of the technology. It is not necessary to define "Artificial Intelligence." At this time, ASIFMA does not endorse a specific definition of AI since it is neither a narrow nor static technology. Additionally, we believe that if

	systems. Setting a higher bar for processes using AI will hamper innovation and create an asymmetric regulatory framework. (More in ASIFMA's AI paper – principle 2, 3 and 4 on page 10: https://www.asifma.org/wp-content/uploads/2021/06/enabling-an-efficient-regulatory-environment-for-ai-report_june-2021.pdf) **Comment 2*: "sole responsibility"*** We suggest that a differentiation should be made between responsibility and accountability. And we advocate for SEBI to support a shared responsibility framework. There is a distinction between accountability and responsibility, where FIs must remain accountable, but third parties may be responsible for certain parts of the AI value chain. "Providers" and "deployer/users" share the	regulators utilize a principles-based and outcomes-focused approach by referring to AI characteristics, it may be less necessary to develop a consensus single, specific definition of AI, particularly since many jurisdictions have recently adopted, or are in the process of adopting, region-specific AI definitions. We equally caution authorities from producing specific and prescriptive definitions. However, we understand that in order to comment on considerations relating to this topic, it may be necessary to refer to a common definition. For this reason, we suggest to utilize the OECD definition of AI systems The OECD definition is not overly broad as to capture systems that are not considered AI today. Additionally, definitions in many major jurisdictions have followed the OECD definition or have proposed similar definitions based upon the one developed by the OECD. Notably, in May 2024, the OECD Ministerial Council Meeting adopted the latest revisions to the OECD Principles on Artificial Intelligence, which include 47 state adherents and continues to reference this definition of AI systems. The European Union's AI Act also utilizes this definition. **Rational in relation to Comment 6: collaboration among authorities** For consistency.

	responsibility for risk management associated with the use of generative AI. This establishes accountability and ensures responsibilities of the generative AI service provider and its consumers with regard to responsible use of generative AI. When understanding the risks associated with the use of generative AI, it is critical to note that the allocation of risk responsibilities is contingent upon the particular AI application scenario that could originate from the generative AI service provider or the user of the generative AI service and such allocation should be contractually agreed between the involved parties, where it is not specified by the regulators. **Comment 3:*"if the output . . . is relied upon or dealt with."*** It is unclear from the current language whether SEBI is referring to reliance/dealings by the Depository Participants, or by the	

	client/external stakeholders/ or both. The way this requirement currently reads is as if when a client or stakeholder is using accurate and fair output from an AI tool, but then takes his/her own bad decision, this would be the responsibility of the RE. If that is indeed SEBI's intention, we are very concerned that this would be significant overreach and would be an outlier as compared to requirements and guidelines in other jurisdictions. In relation to clients' or external stakeholders' reliance on the output of the AI tool, we strongly suggest that the onus should be on the Depository Participants to have the governance and controls in place for the AI tool to provide an accurate and fair output in line with the expected regulatory outcomes for a specific activity.	

	The reliance by the client/external stakeholder on that fair and accurate output is beyond the control of the Depository Participants. There do not appear to be any boundaries limiting our responsibility to the accuracy of the data or the compliance of the AI product to our Responsible AI principles / an equivalent industry standard. **<u>Comment 4: "throughout the process involved</u>."** The AI "process" is fluid and it is unclear what is meant by "the process involved" and it would be a clear material risk for Depository Participants to be solely responsible for all data throughout that process. Additionally, generative and/or predictive AI processes may vary based on the use case. For certain use cases, developers may be responsible for a significant portion of the AI process while for other use cases, Intermediaries may most if not all be part of the process.	

	<u>Comment 5: Definition of AI tool</u> We submit that the proposed definition of AI tool is too broad. We recommend that SEBI adopts a technology-neutral, risk-based and principles-focused regulatory approach to markets and depository activities in India. The focus should be on activities and outcomes, rather than seeking to regulate any particular technology use. If SEBI must include specific reference to AI, then we suggest using the **OECD AI System definition: "***An AI system is a machine-based system that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments. Different AI systems vary in their levels of autonomy and adaptiveness after deployment."*	