



Financial Services Management

AI Regulation

Cite

CFTC, Request for Comment on the Use of Artificial Intelligence in CFTC-Regulated Markets

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<https://www.cftc.gov/PressRoom/PressReleases/8853-24>

Impact Assessment

- Federal financial agencies have renewed their focus on AI regulation via this CFTC inquiry.
- Future action is uncertain, but new areas of concern – e.g., model-correlation risk, concentration, market competition, third-party vendors – point to potential areas where CFTC intervention could coincide with that pending at the SEC and FTC. Bank regulators have looked largely at risk-management concerns, doing nothing since a 2021 RFI.

Overview

Although FSOC's latest annual report highlights AI risk,¹ it does not request any express agency action, a hands-off approach that led to bipartisan legislation demanding a more forceful approach.² Possibly leading the way as it did on climate risk,³ the CFTC now seeks comment on both the way it uses AI and how it affects not only financial markets under its jurisdiction, but also financial-system stability. This is a sweeping request for comment – the equivalent of a request for information (RFI) from the banking agencies – addressing many of the concerns other federal financial regulators share containing AI risk and advancing best-use practices within their agencies and across the financial system. The CFTC is also taking up an issue other agencies often confine to the FTC and Justice Department: the extent to which concentration in AI product providers adversely affects competition among financial providers. It joins the SEC in also worrying about the impact predictive analytics may have on customers and problematic model correlation.

¹ See *Client Report FSOC29*, December 18, 2023.

² See *AI4*, *Financial Services Management*, January 2, 2024.

³ See *Client Report GREEN4*, September 9, 2020.

Impact

The CFTC request follows President Biden's executive order requiring agencies to consider AI's benefits and risks.⁴ While the CFTC as an independent agency need not have acted as the President directed, its report makes clear that the Commission is engaged in careful consideration of AI's policy impact as the President requested. Like the President's executive order, the CFTC request notes that AI offers significant benefits to financial-market participants and regulators. These may include improved efficiency, enhanced analytical prowess and forecasting power, and cost reductions if AI is properly configured. How configurations are set is among the agency's line of questioning along with seeking views on AI governance and quality control even though AI has beneficial efficiency, compliance, risk-management, and other demonstrable benefit for the CFTC or financial entities and markets.

These questions feed into the CFTC's AI concerns, which, like those in the executive order, focus on matters such as inappropriate financial risk-taking and broader market disruptions along with bias and operational resilience. Some of these risks are generic to all financial procedures, but the Commission notes those it believes unique to AI due to its complexity and autonomy in emerging areas such as stress-testing and the potential for vendor lock-ins as AI use increases. The Commission also looks at an issue surely of concern also to the SEC: the extent to which AI used to compute customer margins or take other decisions for entities such as end-users and clearing members may pose conflicts of interest or additional risk.

However, the CFTC is taking a deliberative approach to the problems with predictive analytics that have precipitated controversial SEC action, market concentration that has prompted FTC targeted inquiry, and consumer-protection standards when it comes to "digital marketing."⁵ The banking agencies raised many of the Commission's concerns regarding risk management and compliance in a 2021 RFI,⁶ but have done nothing since to address them.

What's Next

The CFTC issued this RFI on January 25; comments are due ninety days after *Federal Register* publication. This will put the comment deadline well into the spring, meaning that any specific actions or proposals the Commission chooses after comment review are unlikely to be proposed until year-end. The fate of subsequent action will depend in part on any AI challenges in intervening months and the Administration's stance taken on AI after the election.

⁴ See *Client Report AI3*, October 31, 2023.

⁵ See **FINTECH30**, *Financial Services Management*, August 15, 2022.

⁶ See **AI**, *Financial Services Management*, April 5, 2021.

Analysis

A. Definition

AI is broadly defined as a machine-based system that, for a given set of human-defined objectives, can make predictions, recommendations, or decisions influencing real or virtual environments. Comment is sought on this definition and on AI-like systems that have CFTC or financial-market impact along with comment on the extent to which it distinguishes between AI and algorithmic trading.

B. Request for Comment

The CFTC also seeks comment on the questions below, asking respondents in most cases to focus on matters within the CFTC's jurisdiction:

- how AI is now used both with regard to products and activities as well as the extent to which models are updated and back-tested and how success is determined. The Commission also seeks views on the manner in which AI-driven risk management is incorporated with compliance and on how AI is used in compliance and customer interfaces;
- AI's potential to accomplish a wide array of financial activities, risk management, compliance, and customer interfaces;
- barriers to AI use and the extent to which these are generic (e.g., added cost) or specific to activities and/or firms. The Commission also seeks views on the extent to which regulatory clarity is a barrier to adoption;
- the extent to which third-party service providers rely on AI and/or CFTC-regulated entities acquire AI systems from third parties or develop them internally;
- how AI systems are used and governed with regard to matters such as accountability and model quality;
- unique cybersecurity risks;
- explainability and transparency hazards and risk management with regard to AI in general and specific applications along with hazards unique to AI provided by or acquired from third parties. Questions are also posed on risks when AI is used to make decisions affecting other parties such as with regard to margin calculation. Questions are also posed on the use of AI by SROs for market surveillance;
- data quality and related controls for AI in general and for specific applications;
- the extent to which AI proliferations increases the risk of market manipulation, fraud, and illicit activity. The CFTC also wants views on how these risks are governed and if additional policies are needed;
- concentration, with the agency looking here at matters such as the extent to which AI models across the sectors governed by the Commission are acquired from only a few AI or cloud-service firms and the risks this poses. The Commission also seeks comment on whether AI provider terms lead to vendor lock-in;
- bias, with views sought on how bias inherent in some AI models is anticipated and prevented. Interestingly, comment is also sought on

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- whether AI biases are getting into stress-testing or risk management;
- customer protection, with comment sought on controls and governance structures ensuring that AI does not place its own interests ahead of customers. Comment is also sought on customer-protection measures that may be needed as AI adoption advances;
 - privacy and confidentiality threat;
 - risks associated with third-party service providers;
 - competition risk among market participants resulting from AI network effects; and
 - other risks.