

**Consultation paper on “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”.**

**Objective:**

1. This Consultation Paper solicits comments and inputs from the public on the proposed amendments to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 and the Securities and Exchange Board of India (Intermediaries) Regulations, 2008, with respect to assigning responsibility for the use of artificial intelligence (“AI”) tools by Market Infrastructure Institutions, Registered Intermediaries and other persons regulated by SEBI.

**Background:**

2. The expression “Artificial Intelligence” is understood to focus on executable programmes in machines and computers that can learn, reason and act in ways that would normally require human intelligence. AI techniques are designed to learn from analysing data sets and perform on the basis of minimal or without any human assistance. AI uses ‘Machine Learning’ techniques including natural language processing (voice to text, text to systems, robo chat bots, etc), neural networks, statistical heuristics, feedback mechanism, etc, including a combination thereof to analyse large amounts of data, learning from such data and performing tasks without explicit instructions.

3. In view of the increased usage of AI and Machine Learning (“ML”) tools in investor facing products and in order to create an inventory of AI/ML landscape to gain an understanding of the adoption of such technologies in the securities

market and to also ensure preparedness for any AL/ML issues that may arise in the future, SEBI specified requirements for reporting of AI and Machine Learning (ML) application and systems offered and used by -

- i. Stock Brokers and Depository Participants - through issuance of a Circular dated January 4, 2019<sup>1</sup>,
- ii. MIs (Stock Exchanges, Depositories and Clearing Corporation) - through issuance of a Circular dated January, 31, 2019<sup>2</sup>, and
- iii. Mutual Funds, Asset Management Companies, Trustee Companies, Board of Trustees of Mutual Funds - through issuance of a Circular dated May 9, 2019<sup>3</sup>.

The provisions of the said circulars have been suitably incorporated in the respective Master Circulars accessible at the link <https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&sid=6&smid=0> .

4. Any set of applications / software / programs / executable / systems (computer systems) – cumulatively called application and systems that are offered to investors (individuals and institutions) by market intermediaries/institutions (to facilitate investing and trading OR to disseminate investments strategies and advice OR to carry out compliance operations / activities; where AI / ML is portrayed as a part of the public product offering or under usage for compliance or management purposes), were inter alia included within the ambit and scope of the Circulars (mentioned in paragraph 3) issued by SEBI.

**Concerns and issue for consideration:**

5. The use of AI/ML systems/tools are on the rise including in the financial markets to enable stakeholders to make informed decisions and thus may play

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<sup>1</sup> SEBI/HO/MIRSD/DOS2/CIR/P/2019/10.

<sup>2</sup> SEBI/HO/MRD/DOP1/CIR/P/2019/24

<sup>3</sup> SEBI/HO/IMD/DF5/CIR/P/2019/63

an increasingly significant role in market analysis, stock selection, investment strategies and in building a portfolio in their invested securities.

6. AI prompted trading or operations including compliance mechanism in the securities markets may have inherent benefits like increased efficiency, accuracy in decision making, risk management, catering to a wide category of investors, timely reporting, etc and may have ensured ease of doing business for securities market institutions and intermediaries or such tools extended to investors by intermediaries may have afforded the investors with necessary ease in respect of carrying out their transactions in the securities market. However, while recognizing the need for intermediaries to embrace such latest techniques and AI tools, it is equally important to ensure the protection of investors with the usage of such tools.

7. Hence, while SEBI has already mandated reporting requirements in respect of the usage of AI/ML systems under its Circulars/Master Circulars, there is also a pressing need to assign responsibility on the Market Infrastructure Institutions (MIIs), intermediaries and persons regulated by SEBI that use AI/ML, in the conduct of their business and related activities or while servicing their clients so as to bring in more seriousness to such users while deploying AI/ML tools and at the same time ensure investors' protection.

**Recommendation:**

8. It is envisaged that every person regulated by SEBI that uses such artificial intelligence tools and techniques while conducting its activities in the securities markets and for servicing its clients, regardless of the scope and size of adoption of such tools, shall apart from complying with all applicable laws in force be solely responsible for all the consequences of such use including ensuring the privacy, security and integrity of the investors' and stakeholders' data especially the data maintained by it in a fiduciary capacity, throughout the processes involved and shall be responsible if the output arising from the usage of such tools and techniques is relied upon or dealt with.

**Proposal:**

9. In view of the forgoing, the following amendments are proposed-

- 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:

***“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 any application or software programme or executable system or a combination thereof, offered by the person regulated by the***

*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.”<sup>4</sup>*

- 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 clearing corporation 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—*

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<sup>4</sup> Explanation 1 of regulation 16A of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 specifies as under-

*“Explanation 1.—For the purposes of this regulation, the expression “person regulated by the Board” shall mean –*

*(a) a person registered with the Board under section 12 of the Act;*

*(b) an asset management company of a mutual fund registered with the Board;*

*(c) investment manager of an alternative investment fund or infrastructure investment trust registered with the Board;*

*(d) manager of a real estate investment trust registered with the Board.”*

- (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.*

***Explanation:*** *For the purpose of this regulation, the expression "artificial intelligence tools" may include any application or software programme or executable system or a combination thereof, offered by a recognized stock exchange or a recognized clearing corporation to investors/stakeholders or used internally by it to facilitate trading and settlement, 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."*

- 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:

***"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 and 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 expression “artificial intelligence tools” may include any application or software programme or executable system or a combination thereof, offered by the depository to investors/stakeholders or used internally by it to facilitate trading and settlement, carry out its activities including for 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.”

**Public Comments:**

10. Comments are therefore sought from the public on the aforementioned proposal including on the suggested amendments to the Regulations mentioned above. The comments/suggestions in this regard may be submitted latest by **November 28, 2024** through the link [<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>]

11. In case of any technical issue while submitting the comments through the web-based public consultation form, the comments with the subject “Proposed amendments with respect to assigning responsibility for the use of artificial intelligence tools” may be sent by e-mail to [consultadv1@sebi.gov.in](mailto:consultadv1@sebi.gov.in) with a copy to:

- a) T. Vinay Rajneesh, GM at [tvrajneesh@sebi.gov.in](mailto:tvrajneesh@sebi.gov.in)
- b) Rohan Ahluwalia, AM at [rohana@sebi.gov.in](mailto:rohana@sebi.gov.in)

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