TAKING FURTHER AGENCY ACTION ON AI

How Agencies Can Deploy Existing Statutory Authorities To Regulate Artificial Intelligence

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In response to the surge of attention, excitement, and fear surrounding AI developments since the release of OpenAI's ChatGPT in November 2022,[1] governments worldwide[2] have rushed to address the risks and opportunities of AI.[3] In the United States, policymakers have sharply disagreed about the necessity and scope of potential new AI legislation.[4] By contrast, stakeholders ranging from government officials and advocates to academics and companies seem to agree that it is essential for policymakers to utilize existing laws to address the risks and opportunities of AI where possible, especially in the absence of congressional action.[5]

What this means in practice, however, remains murky. What are the statutory authorities and policy levers available to the federal government in the context of AI? And how should policymakers use them? To date, there has been no comprehensive survey to map the federal government's existing ability to impose guardrails on the use of AI across the economy. In 2019, the Trump administration issued Executive Order 13859,[6] which directed agencies to "review their [regulatory] authorities relevant to applications of AI."[7] Subsequent 2020 OMB guidance further required: "The agency plan must identify any statutory authorities specifically governing agency regulation of AI applications, as well as collections of AI-related information from regulated entities."[8] Unfortunately, it appears the U.S. Department of Health and Human Services (HHS) was the only agency to respond in detail.[9]

Since taking office, the Biden administration has taken critical strides to prepare the federal government for the potential proliferation of AI. Its 2023 executive order on AI[10] and the subsequent 2024 OMB memo on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence"[11] (OMB M-24-10 AI guidance) directed agencies to undertake specific AI-related tasks and provided guidance on federal agency use of AI.

The accompanying fact sheets list all of the recommendations detailed in the five chapters of this report:

- The White House and its subordinate agencies
- The Department of Labor
- The Department of Education
- Housing regulators
- Financial regulatory agencies

But what comes next? These Biden administration actions hardly represent the culmination of the federal government's interventions into or involvement with AI. As technologies advance, new AI risks and benefits will emerge, sometimes demanding new federal responses. Agencies must be ready to deploy every tool at their disposal to ensure that the AI revolution benefits everyday Americans, rather than just the tech giants developing new models.

With that in mind, Governing for Impact (GFI) and CAP undertook research to identify existing authorities that can be used to address AI. In the interest of keeping this initial report to a reasonable length, only a sample of federal agencies were selected, including:

- The White House and its subordinate agencies, including the OMB and the Office of Information and Regulatory Affairs (Chapter 1)
- The Department of Labor (Chapter 2)
- The Department of Education (Chapter 3)
- The housing regulators (Chapter 4)
- Financial regulatory agencies (Chapter 5):
    - The Treasury Department
    - The Office of the Comptroller of the Currency
    - The Board of Governors of the Federal Reserve System
    - The Federal Deposit Insurance Corporation
    - The Commodity Futures Trading Commission
    - The National Credit Union Administration
    - The Securities and Exchange Commission
    - The Consumer Financial Protection Bureau
    - The Financial Stability Oversight Council

This report is structured to include a chapter for each of the above agencies, covering:

- An overview of the agency and its intersection with AI
- AI risks and opportunities within the specific agency and its jurisdiction
- The current state of the agency and its efforts to address AI
- The specific relevant authorities the agency could invoke to regulate AI risks
- Recommendations for how the agency could use each identified authority to regulate AI
- A fact sheet to accompany each chapter with a summary of all the recommendations in that chapter for the specific agency or agencies

Recognizing that many readers may only be interested in a specific agency or agencies, each chapter is designed to be read and understood independently of the other chapters. The report is accessible online and in PDF form. Finally, the report includes fact sheets detailing all recommendations from each chapter, available both online and in PDF form.

Background

When OpenAI released its ChatGPT large language model (LLM) generative AI chatbot to the public in November 2022,[12] it quickly became one of the fastest-growing consumer technology applications ever.[13] Generative AI and its ability to generate synthetic text, images, audio, and video represents the most user-accessible form of AI, and new generations of AI are poised to interface with and control our devices and programs directly.[14] Meanwhile, behind the scenes, automated systems increasingly control health care, finance, and housing decisions. In the finance sector, lenders deploy AI-based systems to make lending decisions or depend on third-party models to guide their lending processes. Similarly, in the housing sector, AI is now employed in both public and private housing screening. AI is set to affect almost every sector of our economy. As Bill Gates has suggested, we may well be living in the "Age of AI"—a technological inflection point as momentous as the invention of the personal computer, the internet, and the mobile phone.[15]

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The explosion in growth of this new AI technology raised immediate concern among the public, lawmakers, and regulators about how society and government can and should best respond. The immediate opportunities and challenges of AI are clear to many; however, the solutions to these very real benefits and harms are far less clear, yet critically important, to address as this technology spreads with a rapidity not seen in recent history. It is imperative to examine all the tools in the toolkit to address AI, from legislation that may take years to draft, pass, and implement to existing authorities that can be exercised by agencies now.

Federal government action

Passing new AI legislation, though vital, does not appear to be imminently forthcoming from Congress. In 2023, Senate Majority Leader Chuck Schumer (D-NY) hosted a series of eight closed-door AI insight forums with senators and leading experts[16] that culminated in a May 2024 AI white paper.[17] Sen. Schumer has previously announced to the 118th Congress that his approach to AI legislation will be through the regular order committee process.[18] Meanwhile, the House of Representatives did not announce a bipartisan AI task force until February 2024,[19] with no clear legislative path outlined. To date, the most Congress has done is hold numerous hearings on AI,[20] and the prospects for comprehensive AI legislation in the 118th Congress appear distant.

A crucial task for federal regulators moving forward will be to scope their existing ability to regulate AI in the absence of new AI legislation.

As a result, the primary federal actor in the AI policy space has been and will likely continue to be the executive branch. The Trump administration issued two executive orders on AI[21] and OMB guidance that included requiring agencies with regulatory authorities to "identify any statutory authorities specifically governing agency regulation of AI applications"[22] and submit them to the OMB, with which only HHS complied.[23] In the wake of ChatGPT's release, the Biden administration immediately began to announce a series of steps to address AI—building on its 2022 "Blueprint for an AI Bill of Rights"[24]—which started with voluntary commitments from leading AI companies.[25] This culminated with the October 2023 executive order on AI[26] and the subsequent March 2024 release of the OMB M-24-10 memorandum, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence," for federal government use of AI.[27] A crucial task for federal regulators moving forward will be to scope their existing ability to regulate AI in the absence of new AI legislation.

Support for existing authorities

As the International Association of Privacy Professionals noted, "[A]t least in the short term, AI regulation in the U.S. will consist more of figuring out how existing laws apply to AI technologies, rather than passing and applying new, AI-specific laws."[28] This enforcement of existing laws has been repeated strongly by the administration, enforcement agencies and regulators, and Congress.

As made clear by its 2023 executive order on AI,[29] the unambiguous position of the Biden administration is to "ensure that AI complies with all Federal laws and to promote robust technical evaluations, careful oversight, engagement with affected communities, and rigorous regulation."[30] The order further notes: "The Federal Government will enforce existing consumer protection laws and principles and enact appropriate safeguards against fraud, unintended bias, discrimination, infringements on privacy, and other harms from AI."[31] Additionally, Vice President Kamala Harris stated: "[E]ven now, ahead of congressional action, there are many existing laws and regulations that reflect our nation's longstanding commitment to the principles of privacy, transparency, accountability, and consumer protection. These laws and regulations are enforceable and currently apply to AI companies."[32]

This was echoed early by federal enforcement agencies, including the U.S. Department of Justice (DOJ), Federal Trade Commission (FTC), Consumer Financial Protection Bureau (CFPB), and Equal Employment Opportunity

Commission (EEOC), in an April 2023 joint statement on AI that clearly said: "Existing legal authorities apply to the use of automated systems and innovative new technologies just as they apply to other practices."[33] And in her press statement accompanying the joint statement, FTC Chair Lina Khan said: "There is no AI exemption to the laws on the books."[34] In April 2024, 10 federal enforcement agencies issued the "Joint Statement on Enforcement of Civil Rights, Fair Competition, Consumer Protection, and Equal Opportunity Laws in Automated Systems," which declared: "We also pledge to vigorously use our collective authorities to protect individuals' rights regardless of whether legal violations occur through traditional means or advanced technologies."[35]

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—DOJ, FTC, CFPB, EEOC joint statement on AI

The bipartisan Senate AI Working Group—which was led by Senate Majority Leader Chuck Schumer (D-NY) along with Sens. Mike Rounds (R-SD), Martin Heinrich (D-NM), and Todd Young (R-AK)—noted in its May 2024 AI white paper: "The AI Working Group believes that existing laws, including related to consumer protection and civil rights, need to consistently and effectively apply to AI systems and their developers, deployers, and users."[36]

About this report

Despite consensus around the need to apply existing laws to novel AI applications, more work remains to be done. While it is true that existing statutes may allow agencies to regulate the use of AI, regulations on implementation may still need to be updated accordingly. As a result, a central challenge will be identifying with specificity how agencies may need to adapt or revise their regulatory regimes for an AI era.

Inspired by the HHS response to the 2020 OMB request for a catalog of agencies' existing authorities to address AI[37] and recognizing the need for a deeper examination of existing authorities as they relate to AI, GFI and CAP have undertaken extensive research to outline potential statutory authorities that selected federal agencies could leverage to address the challenges and opportunities presented by AI. This joint report outlines those potential statutory authorities and offers initial recommendations on utilizing those authorities.

About GFI

Governing for Impact is a regulatory policy organization dedicated to ensuring the federal government works on behalf of everyday Americans, not corporate lobbyists. The policies it designs and the legal insights it develops help increase opportunity for those not historically represented in the regulatory policy process: working people.

For additional information about GFI, please visit https://governingforimpact.org/.

GFI and CAP engaged in an intensive effort to canvas existing authorities and identify potential recommendations to address AI. This included extensive analysis of existing statues, consultation with numerous subject matter experts, and review from various stakeholders. This report does not purport to be perfectly comprehensive, even on the agencies selected for consideration. Instead, it aims to highlight the authorities where the strongest intersection exists between existing authority and actionable recommendations.

Initial research revealed that some agencies were already making significant progress. For example, the FTC has led the way among agencies considering applying its existing authorities to address AI.[38] Similarly, the Department of Commerce is actively exploring and utilizing its existing authorities to address AI-related concerns.[39] Of course, there are more federal agencies than those covered in this report, and every state has agencies and authorities that could be leveraged to address AI.[40] A similar analysis of other federal or state agencies' statutory authorities to effectively mitigate AI-related harms via regulation could be valuable. As noted above, GFI and CAP also encourage agencies that have yet to do so to respond to OMB Circular M-21-06 with an inventory of their regulatory authorities applicable to AI.[41]

Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.[42] This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."[43] Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."[44]*

A note on the Supreme Court and Congress

At the time of this report's publication, several pending U.S. Supreme Court cases could affect federal agencies' ability to regulate.[45] *Chevron* deference has served as the foundation of agency rulemaking for nearly 40 years, enshrining the simple but critical legal maxim that federal agencies, because of their expertise, should

be given deference in interpreting and implementing laws passed by Congress. If, as seems likely, the Supreme Court severely limits or overturns *Chevron*, it will be more important than ever for agencies and policy advocates to ground regulatory policy proposals in the sort of statutory analysis that is undertaken throughout this report. The authors have not, however, analyzed the litigation risk associated with each of the policy recommendations included in this report, which is a necessary precursor to action, particularly considering this court's anti-regulatory bent. This report's focus on existing authorities aims to illustrate the tools agencies currently have at their disposal. Understanding the strengths and limitations of these statutes is essential in helping Congress understand what may be needed in future legislation. CAP has advocated for and continues to believe that AI legislation[46] and broader regulation of online services[47] will be necessary to address the growing risks and challenges of technology.

Conclusion

For the past 30 years, Congress has largely failed to take meaningful action on technology policy, with the recent exception of banning a single application.[48] While the authors believe this to be an unsustainable status quo, current congressional dysfunction does not inspire confidence that legislative action is imminent. In the event of continued congressional inaction, existing statutory authorities, executive action, and voluntary measures at the federal level, along with existing state regulations and new state laws, will remain the sole tools for addressing the risks and opportunities of AI in America.

The 2023 executive order on AI was detailed and prescriptive in its initial tasking to agencies, outlining eight policies and principles in an ambitious attempt to direct government action at the challenges and opportunities of AI. This report details more than 80 recommendations that agencies can take using existing authorities to address AI in furtherance of those AI policies and principles, representing a starting point in thinking about a subsequent stage of AI regulation. The goal of this report is not to set a definitive regulatory policy agenda for AI, but rather to put forward a range of potential proposals for consideration that agencies could assemble into a future roadmap. Some may prove especially effective; others may not be worth pursuing. Ultimately, the hope is that feedback from policymakers, academics, civil society groups, and private firms will help to identify the most promising recommendations for more exhaustive research—an important step before the federal government begins adopting any proposal contained in this report. Examining federal agencies' existing authorities and developing regulatory proposals that utilize those authorities is thus essential to address the immediate risks and opportunities of AI. GFI and CAP hope this report helps spur the next phase of discussion by providing initial analysis and recommendations for immediate action on AI.

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TAKING FURTHER AGENCY ACTION ON AI

The White House

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Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.*[1] *This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."*[2] *Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."*[3]

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

The Executive Office of the President (the White House), including its subordinate agencies, can use existing regulations and executive actions—including the administration of federal grants and federal contracts, the Defense Production Act, and the use of emergency powers such as the International Emergency Economic Powers Act (IEEPA)—to potentially address the challenges and opportunities of artificial intelligence (AI). Governing for Impact (GFI) and the Center for American Progress have extensively researched these existing authorities in consultation with numerous subject matter experts. However, the goal is to provoke a generative discussion about the following proposals, rather than outline a definitive executive action agenda. Each potential recommendation will require further vetting before agencies act. Even if additional AI legislation is needed, this menu of potential recommendations to address AI demonstrates that there are more options for agencies to explore beyond their current work and that they cannot and should not wait to utilize existing authorities to address AI.

The White House contains numerous agencies and offices that address issues that intersect with AI, including the Office of Science and Technology Policy (OSTP), the National Economic Council (NEC), the National Security Council, and the Office of the National Cyber Director, among many others. Among the most critical is the Office of Management and Budget (OMB), which is responsible for implementing the president's policies and contains the Office of Information and Regulatory Affairs (OIRA), the government's regulatory review apparatus.

The White House has already taken action on AI, including the 2022 White House "Blueprint for an AI Bill of Rights";[4] the October 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence";[5] new OMB AI guidance for federal agencies finalized in March 2024 on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence" (OMB M-24-10 AI guidance);[6] and the agency inventories and AI use cases[7] required by the Advancing American AI Act.[8] Much of the AI work produced by the White House has focused on broad principles, targeted efforts by agencies, and guiding the federal government's use of AI.

The Office of Management and Budget

As the entity responsible for implementing the president's agenda across the executive branch,[9] the OMB will play a critical role in coordinating federal agencies as they work to mitigate the known risks posed by AI. This section explains how the OMB and the president can continue to protect Americans from the known risks of AI, including by issuing new guidance for agencies in their disbursement of federal funds and through an updated regulatory review process.

AI risks and opportunities

Government spending constituted more than a quarter of the nation's gross domestic product in 2022.[10] It is essential that such spending does not operate at cross purposes with the government's efforts to mitigate the risks associated with AI. The government should avoid inadvertently or intentionally providing federal money to projects that could supercharge the negative consequences of AI. Relatedly, the government should take steps to ensure that its regulatory efforts—whether they are directly or indirectly related to AI—do not produce unintended consequences that amplify AI risks to the public.

The OMB M-24-10 AI guidance implemented a directive from the executive order on AI to guide "required minimum risk-management practices for Government uses of AI that impact people's rights or safety."[11] The OMB M-24-10 AI guidance outlined 28 broad purposes where the federal government's use of AI are "presumed to be safety-impacting" or "rights-impacting."[12] The Biden administration has identified these categories as those that should be subject to heightened scrutiny and required minimum practices.

Of course, as the OMB recognized in its draft AI guidance for federal agencies, responsibly implemented AI has immense potential to improve operations across the federal government.[13] For example, AI could assist citizens and businesses in navigating everyday interactions with federal agencies.[14] Additionally, as the October 2023 executive order notes, AI could help identify and remediate

cybersecurity vulnerabilities or aid in health care research and development.[15] The OMB's approach can appropriately balance the need to mitigate the risks of AI use with the potentially immense upsides.

Current state

The OMB has already incorporated AI risk mitigation into the government's daily operations.[16] In 2020, OMB issued "Circular M-21-06," which directed agencies to, among other things, describe the statutes that direct or authorize the agency to issue regulations related to the development or use of AI.[17] However, with the notable exception of the Department of Health and Human Services (HHS),[18] agencies generally failed to comply with this directive.[19]

Most recently, following President Joe Biden's issuance of the October 2023 executive order on AI, the OMB released new draft AI guidance for federal agencies[20] and finalized that guidance in March 2024 as the OMB M-24-10 AI guidance.[21] This AI guidance established new requirements for agencies' use of AI tools, including "specific minimum risk management practices for uses of AI that impact the rights and safety of the public."[22] These proposed management practices include but are not limited to: completing an AI impact assessment (including the provenance and quality of data used in the AI); testing the AI for performance in a real-world context; independent evaluation; ongoing monitoring and periodic human review; ensuring human decision making is kept in the loop; plain-language documentation; reducing algorithmic bias and using representative data; consulting affected groups; and maintaining opt-out options where practicable.[23] Importantly, this guidance focused primarily on agencies' procurement and use of AI, and not on their regulatory actions to mitigate AI risks created by private actors,[24] although CAP and other groups[25] have urged the OMB to redouble its efforts to collect agencies' inventory of statutory authorities that could apply to AI, as required by Executive Order 13859.[26]

Relevant statutory authorities

The OMB should consider using its statutory authority regarding federal awards, regulatory review, and federal contracting to address key AI issues within its jurisdiction and to direct the federal government's AI efforts.

Uniform guidance for federal awards

As part of its mission to harmonize and improve operations across agencies, the OMB has the authority to issue guidance to federal agencies on how to disburse awards of federal financial assistance.[27]

At 31 U.S.C. § 6307, the U.S. Code authorizes the OMB to "issue supplementary interpretative guidelines to promote consistent and efficient use of procurement contracts, grant agreements, and cooperative agreements."[28] At 31 U.S.C. § 503(a)(2), the OMB is directed to "establish governmentwide financial management policies for executive agencies" and "[p]rovide overall direction and leadership to the executive branch on financial management matters by establishing financial management policies and requirements, and by monitoring the establishment and operation of Federal Government financial management systems."[29]

Under this authority, the OMB issued the "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards," or uniform guidance, in 2014, which is codified at 2 C.F.R. Part 200. The uniform guidance sets forth procedural and substantive guidelines that federal agencies must follow and may consider when disbursing federal awards to nonfederal entities.[30] Among other things, the uniform guidance requires federal agencies to publish a notice of funding opportunity for each award, establish a merit review process for applications, and consider the risks associated with making an award, taking into account the awardee's financial stability, management controls and methods, and history of performance.[31] Importantly, federal agencies may make exceptions to the uniform guidance's requirements in their grant processes, and must do so when required by the federal statute governing a particular award.[32]

In addition to the uniform guidance, the OMB often issues guidance in the form of memoranda and circulars to agencies, advising them on how they should disburse federal financial assistance. For example, the OMB issued a 2020 memorandum to agency heads detailing how they could change and relax administrative requirements for grant recipients during the COVID-19 public health emergency.[33] Additionally, in 2023, it released another memorandum applying the "Buy America" provisions from a 2021 executive order and the Infrastructure Investment and Jobs Act to federal grant awardees and subawardees.[34]

Recommendations

Based on the above-cited authority, the OMB could consider the following actions:

- **Develop guidance that adapts the recent OMB M-24-10 AI guidance[35] to apply to AI use by other recipients of federal funds, including grants, loans, and other forms of financial assistance.** The guidance could establish a similar framework for agencies to assess the safety- and rights-impacting purposes of AI from the OMB M-24-10 AI guidance[36] and mitigate the harmful consequences of the applicable risks thereof, using minimum practices for AI risk management. The guidance could urge agencies to impose conditions on federal funds to the extent the statutory sources of those funds allow such conditions.

- **Update the uniform guidance for federal awards at 2 C.F.R. Part 200, pursuant to 31 U.S.C. §§ 6307 and 503(a)(2), to incorporate AI risk assessment** – and the steps that applicants are taking to mitigate risks – into agencies' consideration of applications for federal funding, as permitted by the statutory sources for such funding. Specifically, the OMB could update 2 C.F.R. § 200.206(b)(2) to include an assessment of AI risk within its risk evaluation requirements; update 2 C.F.R. § 200.204(c) to require or suggest that the full text of funding opportunity announcements include any AI risk evaluation requirements; and update 2 C.F.R. § 200.211 to require or recommend that federal award publications include the results of AI risk analyses produced during the application process. The current risk evaluation section permits a federal agency to consider the "applicant's ability to effectively implement statutory, regulatory, or other requirements imposed on non-Federal entities."[37] A revised uniform guidance could explicitly suggest that federal agencies consider the potential for grantees' use of AI to impact their ability to comply with such requirements and the impact AI use could have on the other categories of risk specified in the current guidance.

These proposals could help prevent federal funds from going toward projects that might accelerate the proliferation of AI harms that affect the safety of the public or the rights of individuals. Further study is needed to determine the exact form that AI risk analysis in federal awards should take.

Updates to regulatory review

Presidents since Richard Nixon have implemented systematic reviews of rulemakings to ensure consistency with statutes and presidential priorities.[38] President Ronald Reagan's Executive Order 12291 centralized regulatory review in the OIRA, a suboffice of OMB, and required that agencies conduct detailed benefit-cost analyses of proposed regulatory actions.[39] And President Bill Clinton's Executive Order 12866 reduced the scope of regulatory review to only those regulatory actions deemed "significant."[40]

President Biden most recently revised Executive Order 12866 in April 2023.[41] Among other changes, the revision increased the threshold for "significance," directed federal agencies to engage underrepresented communities during rulemaking processes, and directed the OMB to make corresponding changes to Circular A-4, which implements the regulatory review process.[42]

AI has the potential to impact every aspect of our economy, government, and society—as evidenced by the expansive scope of the October 2023 executive order on AI,[43] the myriad safety-impacting and rights-impacting government uses of AI in the OMB M-24-10 AI guidance,[44] and the wide range of topics contemplated

in the 2023 OSTP request for information for a national AI strategy.[45] It is thus reasonable that all regulatory agencies should start to consider the impact of AI on their existing and future abilities to carry out their regulatory requirements.

Recommendations

Based on the above-cited authority, the president, OMB, and OIRA could consider the following actions:

- **Issue a new requirement in the regulatory review process that would require agencies to include a brief assessment of 1) the potential effects of significant regulatory actions on AI development, risks, harms, and benefits, and 2) an assessment of the current and anticipated use of AI by regulated entities and how that use is likely to affect the ability of any proposed or final rule to meet its stated objectives.** This requirement could follow the format of the benefit-cost analysis required by the current Executive Order 12866. The modification to the regulatory review process could take the form of a new executive order, a presidential memorandum,[46] or an amendment to Executive Order 12866 that adds a subsection to §1(b) and/or §6(a).

- **Issue a presidential memorandum directing agencies and encouraging independent agencies to review their existing statutory authorities to address known AI risks** and consider whether addressing AI use by regulated entities through new or ongoing rulemakings would help ensure that this use does not undermine core regulatory or statutory goals. Such a presidential memorandum would primarily give general direction, similar to the Obama administration's behavioral sciences action,[47] rather than require a specific analysis on every regulation.

  The presidential memorandum could direct executive departments and agencies, or perhaps even the chief AI officer established in the 2023 executive order on AI and further detailed in the OMB M-24-10 AI guidance,[48] to:

  - Identify whether their policies, programs, or operations could be undermined or impaired by the private sector use of AI tools.
  - Comprehensively complete the inventory of statutory authorities first requested in OMB Circular M-21-06,[49] which directed agencies to evaluate their existing authorities to regulate AI applications in the private sector.
  - Outline strategies for deploying such statutory authorities to achieve agency goals in the face of identified private sector AI applications.

Federal contracting

Among its recent AI initiatives, the Biden administration has taken steps to address AI in federal contracting. The October 2023 executive order on AI encouraged the U.S. Department of Labor (DOL) to develop nonbinding nondiscrimination guidance for federal contractors using AI in their hiring processes,[50] which the DOL issued in April 2024.[51] Additionally, the OMB M-24-10 AI guidance both offers and anticipates additional guidance concerning a distinct issue: agencies' procurement of AI tools.[52]

This section proposes more forceful action. Through the Federal Property and Administrative Services Act (FPASA),[53] the federal government retains the authority to impose binding conditions that promote economy and efficiency in federal procurement[54] on federal contractors,[55] who collectively employ 1 in 5 U.S. workers.[56] This section explains why and how the administration could issue binding regulations to protect the federal contracting workforce from nefarious or poorly developed AI management tools, including but not limited to preventing discrimination in hiring. It also explains why the logic underpinning recent adverse FPASA court decisions would not apply to FPASA conditions on using AI management tools.

AI risks and opportunities

AI harms in the workplace are well documented,[57] and government contractors are not immune to these common problems. Many of these harms are explored in more depth in Chapter V, which discusses AI harms affecting all workers. These include discrimination, safety and health, wage and hour compliance, misclassification of employee roles, worker power and datafication, and workforce training and displacement.[58] In the federal contracting context, several harms present unique challenges:

- **Discrimination:** For example, as highlighted in the AI Bill of Rights, automated workplace algorithms, which often rely on AI models, have been shown to produce biases in hiring, retention, and firing processes.[59] The OMB M-24-10 AI guidance highlighted that government use of AI to "[d]etermin[e] the terms or conditions of employment, including pre-employment screening, reasonable accommodation, pay or promotion, performance management, hiring or termination," should be presumed rights-impacting.[60] For example, a now-discontinued hiring tool built and used by Amazon was reported to reject women applicants by penalizing resumes that included the word "women's" in their candidate ranking.[61]

- **Physical and mental health harms:** Automated management increases worker physical and mental health risks[62] and has dire implications for employee privacy.[63] The OMB M-24-10 AI guidance highlighted that government use of AI

to incorporate “time-on-task tracking; or conducting workplace surveillance or automated personnel management” should be presumed rights-impacting.[64]

- **Privacy breaches:** Of particular importance to government contracting, AI technologies may increase government vulnerability to privacy breaches when contractors are tasked with handling sensitive data or tasks.[65]

- **Wage and hour compliance:** As technology blurs the line between work and nonwork time, it may become more difficult to assess what time is compensable and therefore should be considered in producing pay determinations. Other risks include opacity and manipulation in algorithmic wage-setting technologies[66] and digital wage theft enabled by timesheet rounding.[67]

Of course, AI offers opportunities to promote the interests of the federal contracting workforce as well. For example, AI tools could potentially allow compliance officers to better identify violations of preexisting FPASA standards.

Current state

The executive order on AI required the DOL to issue guidance for federal contractors regarding nondiscrimination in hiring involving AI and other technology-based hiring systems.[68] The DOL has recently finalized that guidance.[69] The guidance explains how federal contractors and subcontractors who use AI, algorithms, and automated systems may be at risk of violating the Equal Employment Opportunity Act and provides examples of how contractors can meet their compliance obligations.[70] Importantly, the guidance states that federal contractors cannot delegate compliance responsibilities to outside entities, including vendors, and provides several promising practices to maintain compliance.[71]

Separately, the OMB M-24-10 AI guidance has proposed standards for agencies’ procurement of AI technology and promises to “develop an initial means to ensure that Federal contracts for the acquisition of an AI system or service align with the guidance in this memorandum”[72] in accordance with the Advancing American AI Act,[73] which was signed into law in December 2022,[74] and the 2023 executive order on AI.[75] On March 29, 2023, the OMB posted a request for information on “Responsible Procurement of Artificial Intelligence in Government” to help develop that guidance.[76]

Despite these important steps, neither the executive order on AI, the OMB M-24-10 AI guidance, nor future AI procurement guidance announced in the OMB M-24-10 AI guidance appears likely to cover the AI tools federal contractors may be using to manage their workforces outside of hiring.

Relevant statutory authority

The FPASA authorizes the president to "prescribe policies and directives that the President considers necessary to carry out this subtitle," namely the FPASA's goal of promoting economy or efficiency in federal procurement.[77]

Past administrations have invoked the FPASA to regulate federal contracting in various ways. In the 1970s, courts held that the FPASA authorized the federal government to require contractors to abide by certain anti-discrimination policies.[78] Other administrations have invoked the FPASA to require federal contractors to comply with certain workplace standards, including wage and price standards,[79] regulations concerning project labor agreements,[80] and requirements that contractors provide employees notice of their rights to opt out of joining a union or paying mandatory dues outside of representational activities.[81] The federal government has also promulgated FPASA rules requiring contractors to provide disclosures of known violations of federal criminal laws or of the civil False Claims Act,[82] creating business ethics awareness and compliance programs,[83] and mandating the use of the E-Verify system to confirm employment eligibility of workers.[84] In 2011, the Obama administration used the FPASA to mandate that contractors implement screening systems to prevent employee conflicts of interest.[85] And in 2016, the Obama administration relied on its FPASA authority to require federal contractors to receive paid sick leave.[86]

More recently, the Biden administration has deployed its FPASA authority in two high-profile cases: 1) to impose a vaccine or test mandate on the federal contracting workforce and 2) to raise the minimum wage for federal contractors' employees to $15 per hour in 2022.[87] Challengers have successfully won injunctions against both rules in federal courts—although, as explained below, for reasons that do not apply to this proposal.[88]

Recommendations

As the OMB prepares the forthcoming procurement guidance mentioned in OMB M-24-10 AI guidance,[89] it may also want to consider whether it can include standards that:

- **Ensure baseline levels of competition and interoperability,** such that agencies do not get locked into using the services of a single AI firm.

Under its FPASA authority, the Federal Acquisition Regulatory Council,[90] which is chaired by OMB's administrator for federal procurement policy, can promulgate a rule that outlines protections for all employees at firms that hold a federal contract as it relates to AI, including potentially through the following actions:

- **Incorporate the presumed safety-impacting and rights-impacting uses of AI** from the OMB M-24-10 AI guidance to apply to federal contractors and their use of AI systems for workplace management.[91]
- **Require federal contractors employing automated systems to use predeployment testing and ongoing monitoring** to ensure safety and that workers are paid for all compensable time and to mitigate other harmful impacts.
- **Establish specific requirements regarding pace of work, quotas, and worker input** to reduce the safety and health impacts of electronic surveillance and automated management.
- **Mandate disclosure requirements** when employees are subject to automation or other AI tools.
- **Provide discrimination protections** related to algorithmic tools, including ensuring that automated management tools can be adjusted to make reasonable accommodations for workers with disabilities.
- **Ensure privacy protections** for employees and users of AI.

Many of these recommendations follow from the executive order on AI,[92] the OMB M-24-10 AI guidance,[93] the AI Bill of Rights,[94] and the National Institute of Standards and Technology (NIST) AI Risk Management Framework;[95] other standards from these documents may also be worth considering.

Regulating the use of AI in government contracts advances the FPASA's statutory goals of economy and efficiency in several ways. For example, AI hiring tools often rely on data that already suffers from bias,[96] and relying on AI tools may bake in this data and mask it from potential employers. These biases may increase employee turnover and make contractors vulnerable to legal risks, leading to increased costs for contractors and the government. Furthermore, AI models such as algorithmic management have been linked to safety issues, including increased stress for workers under employer surveillance.[97] Worker stress can lead to increased mistakes and safety issues, creating added costs for the government down the line.

These justifications find close analogs in the reasoning that past administrations have used to impose new FPASA obligations that have been upheld in federal court. For example, in *Chamber of Commerce v. Napolitano*, a federal district court upheld a requirement that contractors ascertain the immigration status of certain new hires using E-Verify, finding that a reasonably close nexus exists so long as the "President's explanation for how an Executive Order promotes efficiency

and economy [is] reasonable and rational."[98] In that case, the court found that President George W. Bush's conclusion that the E-Verify system would result in fewer immigration enforcement actions, fewer undocumented workers—and "therefore generally more efficient and dependable procurement sources"—was sufficient to meet the nexus requirement.[99] The court also held that "[t]here is no requirement … for the President to base his findings on evidence included in a record."[100] Similarly, in this context, regulating the use of AI in government contracts would also lead to a more "dependable procurement" workforce since AI technologies would be tested to root out possible bias or other automation harms. Additionally, some of the earliest exercises of modern presidential procurement power concerned anti-discrimination measures.[101]

Finally, it is important to note that two high-profile efforts by the Biden administration to impose laudable requirements on federal contractors have suffered setbacks in court. One was an order,[102] enjoined by the 5th, 6th, and 11th U.S. Circuit Courts of Appeals,[103] obligating contract recipients to require their employees to wear face masks at work and be vaccinated against COVID-19. Another order increased the hourly minimum wage paid by parties who contract with the federal government for workers on or in connection with a federal government contract.[104] Despite favorable district court rulings in Arizona and Colorado,[105] a court in the Southern District of Texas enjoined the application of the minimum wage rule in three Southern states.[106] Recently, however, the 10th U.S. Circuit Court of Appeals upheld the minimum wage rule as applied to seasonal recreational workers, finding that the standard for finding a nexus between the rule and FPASA's goal of "economy and efficiency" is lenient.[107]

However, this proposed rule is distinguishable from the minimum wage and COVID-19 rules in several ways. In the COVID-19 case, the 5th Circuit, citing the major questions doctrine, found the FPASA did not clearly authorize the president to impose requirements concerning the conduct of the employees of federal contractors, as opposed to regulating the contractor-employers themselves.[108] A rule regulating the use of AI in government contracts would not impose any requirements on employee conduct, even indirectly. Hence, this decision is largely irrelevant to the proposed action.

Even according to the flawed reasoning of the Texas district court's opinion enjoining the minimum wage rule in three states, the administration could distinguish a rule regulating the use of AI under several theories. For one, regulating the use of AI would not have nearly the same economic ramifications for contractors since it would not require immediate wage increases across the workforce. The proposed rule's focus would be quality assurance for the use of AI systems, leading to likely savings for the government—the kind of purchasing considerations that fit squarely within the court's framing of the FPASA as primarily concerned with the "supervisory role of buying and selling of goods."[109]

Defense Production Act

The Defense Production Act (DPA) includes a powerful and underutilized subpoena power that may offer the best opportunity for the federal government to get a look inside certain AI models.[110]

Current state

The executive order on AI laudably invokes the DPA to impose a limited disclosure obligation on the developers of certain new AI models.[111] Specifically, the executive order directs the U.S. Department of Commerce to require companies "developing or demonstrating an intent to develop potential dual-use foundation models" to report—on an ongoing basis—training parameters, model weights, and "red-teaming" testing results based on forthcoming NIST guidance.[112] According to a news report, these requirements will apply to "all future commercial AI models in the US, but not apply to AI models that have already been launched."[113] The executive order also directs the Department of Commerce to require that people or companies that acquire, develop, or possess "a potential large-scale computing cluster" report the existence and location of those clusters.[114]

Relevant statutory authority

The executive order's disclosure directive is well-grounded in statutory authority, as illustrated below. This section seeks to underscore that the president's DPA authority plausibly extends beyond what the proposal laid out in the executive order.

When it comes to subpoenas, the DPA holds:

> *The president shall be entitled … to obtain such information from, require such reports and the keeping of such records by, make such inspection of the books, records, and other writings, premises or property of … any person as may be necessary or appropriate, in [the President's] discretion, to the enforcement or the administration of this chapter and the regulations or orders issued thereunder … [and] to obtain information in order to perform industry studies assessing the capabilities of the United States industrial base to support the national defense.*[115]

This language is quite broad, particularly in the first grant of authority. The second, more qualified grant for industry studies, at least references the terms "industrial base," which is not defined in the statute, and "national defense," which is statutorily defined in part as "critical infrastructure protection and restoration."[116] "Critical infrastructure" is defined, in turn, as "any systems and assets, whether physical or cyber-based, so vital to the United States that the degradation or destruction of such systems and assets would have a debilitating

impact on national security, including, but not limited to, national economic security and national public health or safety."[117] There exists a presumption, waivable by the president, of confidentiality if the company so attests, per 50 U.S.C. §4555(d).[118]

Beyond military applications, then, the DPA's subpoena power appears to extend, at minimum, to any AI application that poses a serious threat to basic services—for example, the energy grid or water system—the broader economy, or public health. Notably, the executive order's definition of dual-use foundation models appears to be somewhat coextensive with the DPA's definition of "critical infrastructure."[119]

However, it is worth emphasizing that the DPA empowers the president to take additional action if necessary. For example, nothing in the statute prevents the administration from applying its reporting requirements to existing AI applications, rather than future ones, as reporting indicates is the current plan.[120] Indeed, while the executive order envisions creating an ongoing notification and reporting system, the president still retains the statutory authority to demand, on a one-off basis, a broad array of information from companies that own AI applications capable of threatening the statute's capacious definition of "national defense." This authority similarly would allow the president to seek relevant information beyond training parameters, model weights, and red-teaming test results.

Emergency powers

As the nation's chief executive, the president has a constitutional obligation to respond to exigent national security threats and national emergencies.[121] Additionally, Congress has enacted specific statutory schemes endowing the president with enhanced powers under certain emergent circumstances.[122] This section explains several potential applications of the president's emergency powers that are relevant to known risks of AI. It suggests that the White House define the criteria that would lead the president to use these authorities. It also proposes drafting an emergency response plan the government can follow once those criteria are met.

AI risks and opportunities

It is possible that some future AI application may suddenly pose risks that demand an exigent response. Examples of such circumstances might include:

- **Financial chaos:** AI used in stock prediction and financial decision-making may raise the risk of stock market collapse by increasing the homogeneity of stock trading. As Securities and Exchange Commission (SEC) Chair Gary Gensler warned in a 2020 paper, if trading algorithms all make a simultaneous decision to

sell the same asset, it could tank the stock market.[123] Sens. Mark Warner (D-VA) and John Kennedy (R-LA) have introduced legislation to address threats to financial markets from AI, with Sen. Warner noting, "AI has tremendous potential but also enormous disruptive power across a variety of fields and industries – perhaps none more so than our financial markets."[124]

- **National security and biodefense:** Some of the same features that make AI revolutionary technology with great potential for good—for instance, reducing cost and complexity of scientific endeavors—may also pose national security threats. AI may make it easier for foreign governments and nonstate actors to achieve breakthroughs in areas such as autonomous weaponry, biological warfare, and mass manipulation through high-quality mis-/dis-/mal-information. Any or all the above could threaten the nation's security.[125] The 2023 executive order on AI outlined numerous taskings related to addressing AI's impact on cybersecurity and biosecurity.[126]

- **Corrupted information and weaponized communications:** The 2022 National Science and Technology Council (NSTC) report, "Roadmap for Researchers on Priorities Related to Information Integrity Research and Development," noted four main categories of harms from corrupted information: harms to consumers and companies, individuals and families, national security, and society and the democratic process.[127] In particular, experts repeatedly cite rapidly disseminated and weaponized information campaigns as a key threat of greatly expanded AI. AI allows bad actors to create and publish enormous amounts of mis-/dis-/mal-information that are difficult to distinguish from truth.[128] Increasingly sophisticated AI will exploit "cognitive fluency bias," which refers to humans' tendency to give more weight to information conveyed in well-written text content or compelling visuals.[129] This kind of misinformation is already a key strategy of nonstate and state actors in Russia, China, and Iran, among other countries.[130] For instance, a crude version of this "deepfake" strategy was deployed in the Russian war against Ukraine, wherein the Russian government published an AI-generated video of Ukrainian President Volodymyr Zelenskyy calling on Ukrainians to lay down their arms.[131] In May 2024, before the U.S. Senate Select Committee on Intelligence, Director of National Intelligence Avril Haines testified:

  > *For example, innovations in AI have enabled foreign influence actors to produce seemingly-authentic and tailored messaging more efficiently, at greater scale, and with content adapted for different languages and cultures. In fact, we have already seen generative AI being used in the context of foreign elections.*[132]

Current state

The national security apparatus has begun to react to the potential threats of AI proliferation. Officials at the U.S. Department of Defense have taken steps to better defend the country's information ecosystem from rapidly proliferating dis-/mis-/mal-information,[133] issued the 2022 "Responsible Artificial Intelligence Strategy and Implementation Pathway" report,[134] and spoken publicly about the U.S. military's AI strategy.[135]

In August 2023, President Biden signed Executive Order 14105, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern."[136] This executive order declared a national emergency based on advances made by "countries of concern" in "sensitive technologies and products critical for the military, intelligence, [and] surveillance."[137] The president issued the executive order pursuant to the International Emergency Economic Powers Act (IEEPA). The executive order included AI in its list of sensitive technologies and directed the U.S. Treasury Department to prohibit outbound investments into those countries of concern and to establish strict regulatory requirements in other countries.[138] Relatedly, the Commerce Department initiated export controls in October 2022 that restrict the ability of companies to sell certain advanced computing semiconductors or related manufacturing equipment to China.[139] The Commerce Department expanded its AI export controls in October 2023.[140]

The 2023 executive order on AI also recognized the potential national security implications of the spread of AI, and directed agency actions to mitigate AI risks in critical infrastructure and cybersecurity.[141] The order highlighted the potential for AI to increase biosecurity risks and directed various stakeholders to produce a study of those risks and potential mitigation options.[142] The executive order also tasked the national security adviser with delivering an additional "National Security Memorandum" on AI to the president in 2024.[143]

As noted above, President Biden declared a national emergency pursuant to the IEEPA in August 2023 with Executive Order 14105,[144] which joined other emergencies involving technology declared via executive order. This includes a national emergency declared in President Donald Trump's May 2019 Executive Order 13873, "Securing the Information and Communications Technology and Services Supply Chain";[145] it was further expanded by President Biden's June 2021 Executive Order 14034, "Protecting Americans' Sensitive Data From Foreign Adversaries,"[146] and again in his February 2024 Executive Order 14117, "Preventing Access to Americans' Bulk Sensitive Personal Data and United States Government-Related Data by Countries of Concern."[147] Executive Order 14117 directed various federal agencies to issue regulations prohibiting data transfers—through data brokers, employment agreements, investment agreements, and otherwise—to "countries of concern."[148]

Relevant authorities

This section identifies ways that the president could exercise their authority in the event of—and in anticipation of—AI systems that may pose a threat to the safety of the American people. Upon the president's declaration of a national emergency, several authorities throughout the U.S. Code become available.[149] These include economic tools such as the IEEPA,[150] which authorizes the president to regulate or prohibit international transactions in the event of a national emergency. Since the law's enactment, presidents have declared 69 emergencies pursuant to the IEEPA.[151] At 50 U.S.C. § 1701, the IEEPA authorizes the president to use the statute's authorities "to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such threat."[152] Subject to some exceptions,[153] upon declaration of a national emergency, 50 U.S.C. § 1702 provides the president with authority to take extensive action to "investigate, regulate, or prohibit" a wide range of international transactions and freeze assets of foreign actors.[154] At 50 U.S.C. § 1708(b), the IEEPA authorizes the president to "block and prohibit all transactions in all property and interests in property of" foreign persons or entities engaged in or benefiting from "economic or industrial espionage in cyberspace, of technologies or proprietary information developed by United States persons."[155]

Available emergency authorities also include infrastructural powers such as those the president possesses over the nation's communications infrastructure. For example, under the Communications Act at 47 U.S.C. § 606(c), upon "proclamation by the President that there exists war or a threat of war, or a state of public peril or disaster or other national emergency, or in order to preserve the neutrality of the United States," the president may suspend or amend regulations applicable to any or all stations or devices capable of emitting electromagnetic radiation and may cause the closing of any radio station.[156]

The president also possesses emergency powers to modify federal contracts. At 41 U.S.C. § 3304, the U.S. Code authorizes executive agencies to use noncompetitive procurement procedures if "it is necessary to award the contract to a particular source to maintain a facility, producer, manufacturer, or other supplier available for furnishing property or services in case of a national emergency or to achieve industrial mobilization."[157]

In addition to these and more specific statutory authorities, the president also possesses inherent Article II authority to protect the country from immediate threats in other ways.[158] As the U.S. Supreme Court has long recognized, circumstances may arise that demand presidential action in the absence of congressional delegation—particularly, during emergency situations.[159] CAP has

previously highlighted the need for the administration to prepare to address AI systems that may threaten the safety of the American people.[160]

Recommendations

To prepare the government to use the above powers in the event of an AI system posing emergency threats to the United States, the White House could consider the following actions:

- **Direct the National Security Council to develop a memorandum that outlines scenarios wherein AI applications could pose an emergency threat to the country and identifies actions that the president could take through existing statutory schemes and their inherent executive authority under Article II of the Constitution to resolve the threat.** The memorandum should study the landscape of imaginable AI applications and devise criteria that would trigger emergency governmental action. Such a memorandum could complement or be incorporated as part of the National Security Memorandum required by the October 2023 executive order on AI.[161] The memorandum's design could echo the National Response Plan, originally developed after 9/11 to formalize rapid government response to terrorist attacks and other emergency scenarios.[162] The memorandum could consider authorities:
    - **Inherent to the president's constitutional prerogative to protect the nation:** For example, the memorandum could identify when it could be appropriate for the president to take military or humanitarian action without prior congressional authorization when immediate action is required to prevent imminent loss of life or property damage.[163]
    - **Under the IEEPA:** For example, the memorandum could consider the administration's authority to expand the policies established in the August 2023 IEEPA executive order, using the statute to freeze assets associated with AI technologies and countries of concern that contribute to the crisis at hand.[164] Follow-up executive action could identify new countries of concern as they arise. As another example, the memorandum could identify triggers for pursuing sanctions under 50 U.S.C. § 1708(b) on foreign persons that support the use of proprietary data to train AI systems or who steal proprietary AI source code from sources in the United States. The memorandum could also explore the president's authority to investigate, regulate, or prohibit certain transactions or payments related to run away or dangerous AI models in cases where the models are trained or operate on foreign-made semiconductors and the president determines that such action is necessary to "deal with" a national security threat. Even if that model is deployed domestically or developed by a domestic entity, it may still fall within reach of the IEEPA's potent §1702 authorities if, per 50 U.S.C. §1701, the model: 1) poses an "unusual or extraordinary threat," and 2) "has its source in whole or substantial part outside the United States." The administration can explore whether AI models' dependence on foreign-made semiconductors for training

and continued operation meets this second requirement. Indeed, scholars have previously argued that the interconnectedness of the global economy likely subjects an array of domestic entities to IEEPA in the event sufficiently exigent conditions arise.[165]

- **Under the Communications Act:** For example, the memorandum could identify scenarios in which the president could consider suspending or amending regulations under 47 U.S.C. § 606(c) regarding wireless devices to respond to a national security threat.[166] The bounds of this authority are quite broad, covering an enormous number of everyday devices, including smartphones that can emit electromagnetic radiation.[167]
- **To modify federal contracts:** For example, the memorandum could identify possibilities for waiving procurement requirements in a national emergency if quickly making a federal contract with a particular entity would help develop capabilities to combat a rapidly deploying and destructive AI.[168]
- **To take other statutorily or constitutionally authorized actions:** The memorandum could organize a process through which the White House and national security apparatus would, upon the presence of the criteria outlined in the memorandum, assess an emergent AI-related threat, develop a potential response, implement that response, and notify Congress and the public of such a response.[169] It could also request a published opinion from the Office of Legal Counsel on the legality of the various response scenarios and decision-making processes drawn up pursuant to the recommendations above. This will help ensure that the president can act swiftly but responsibly in an AI-related emergency.

- **Share emergency AI plans with the public:** The administration should share such emergency processes and memoranda they develop with Congress, relevant committees, and the public where possible.

Conclusion

The White House and its subordinate agencies, including the OMB and OIRA, have taken important steps to begin safeguarding government operations and the public from the potential harms of AI. Yet as this section illustrates, policymakers nonetheless retain a number of untapped tools at their disposal that should be further considered to address AI. As AI control technologies and protocols cohere in the coming years, GFI and CAP hope that the preceding recommendations empower officials to think broadly about how executive action could help build a safe and productive AI ecosystem.

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

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169 The president could also consider action under the Trade Expansion Act. For example, the president could restrict—via tariffs or otherwise—imports of inputs to AI applications, such as semiconductors, when doing so would protect national security. Subject to certain preconditions, the act allows the president to "determine the nature and duration of the action that, in the judgment of the President, must be taken to adjust the imports of the article and its derivatives so that such imports will not threaten to impair the national security" and, in some cases, "take such other actions as the President deems necessary to adjust the imports" of certain articles if the commerce secretary finds that the quantity or manner in which they are imported impairs national security. See Legal Information Institute, "19 U.S.C. § 1862(b)-(c) - Safeguarding national security," available at https://www.law.cornell.edu/uscode/text/19/1862 (last accessed May 2024).

TAKING FURTHER AGENCY ACTION ON AI

Department of Labor

By Reed Shaw

Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.*[1] *This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."*[2] *Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."*[3]

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

The U.S. Department of Labor (DOL) oversees numerous statutes, from the Fair Labor Standards Act (FLSA) to the Family and Medical Leave Act (FMLA), that can potentially help address the challenges and opportunities of artificial intelligence (AI) as it affects workers. Governing for Impact (GFI) and the Center for American Progress have extensively researched these existing authorities in consultation with numerous subject matter experts. However, the goal is to provoke a generative discussion about the following proposals, rather than outline a definitive executive action agenda. Each potential recommendation will require further vetting before agencies act. Even if additional AI legislation is needed, this menu of potential recommendations to address AI demonstrates that there are more options for agencies to explore beyond their current work and that agencies should immediately utilize existing authorities to address AI.

The proliferation of AI and automated algorithmic technologies poses both macro and micro challenges for workers. At one extreme, sufficiently advanced AI may displace entire occupation categories, putting thousands or millions of Americans out of work. But such dramatic predictions can also overshadow how AI and automated technologies already play a role in shifting worker power to employers and denying workers statutory protections.

While the ultimate scale of workplace disruption remains unknown, the DOL is responsible for implementation and enforcement of several statutes that protect and empower workers.[4] As President Joe Biden acknowledged in his 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence," automated systems and other technology deployed in the workplace hold great potential to improve working conditions.[5] But they can also pose grave risks to workers' rights and safety if not used carefully or implemented without worker input.[6] This section explains some of the known risks of AI in the workplace and identifies DOL-enforced statutes that could be used to address them through regulations, subregulatory guidance, and enforcement practices. Among other authorities, the DOL could use these statutes to ameliorate known harms by updating wage and hour regulations, guarding workers' safety and health against the negative impacts of automated management, and ensuring that automated benefits administration is transparent and fair.

AI risks and opportunities

AI may cause harm to American workers in several known and unknown ways. Although certainly not exhaustive, the known risks can be roughly grouped into seven categories:

- **Discrimination:** Algorithmic bias refers to an algorithm's tendency toward replicating or amplifying human biases due to unrepresentative or incomplete training data or reliance on information that reflects historical inequalities.[7] As one of the eight primary policies and principles of the Biden administration's approach to AI, the 2023 executive order on AI noted:

  > *From hiring to housing to healthcare, we have seen what happens when AI use deepens discrimination and bias, rather than improving quality of life. Artificial Intelligence systems deployed irresponsibly have reproduced and intensified existing inequities, caused new types of harmful discrimination, and exacerbated online and physical harms.*[8]

  The May 2024 DOL "Artificial Intelligence and Worker Well-being: Principles for Developers and Employers" lists as a priority that "AI systems should not violate or undermine workers' … anti-discrimination and anti-retaliation protections."[9] As the Equal Employment Opportunity Commission has identified,[10] algorithmic bias can be embedded in technologies that employers increasingly use to make hiring and retention decisions. Such bias can surreptitiously disadvantage workers or applicants based on any number of protected characteristics by shaping recruitment efforts toward "relevant" job seekers and narrowing the candidate pool through automated interview technology or based on historical employment data.[11] For example, there is ample evidence that AI-driven interview software, which

films interview responses and assesses candidates' performance, is "definitionally discriminatory"[12] against individuals with disabilities.[13]

- **Access to benefits:** An increased use of AI in evaluating claims for benefits such as health insurance and unemployment compensation or making investment decisions in employer-sponsored retirement accounts could pose significant risk to workers' well-being.[14] This could occur because, for example, an algorithmic system denies claims at a higher rate than a human,[15] or because an AI-enabled investment allocation technology could prioritize investments that trigger payment of transaction fees and commissions to a brokerage over investments that would maximize an employee's retirement savings.[16]

- **Safety and health:** As GFI has documented in its prior regulatory advocacy work, electronic surveillance and automated management (ESAM) can pose risks to workers' physical and mental safety and health.[17] Employers' unrestrained use of ESAM can result in an unsustainable pace of work that increases accident rates and musculoskeletal strain.[18] The Office of Management and Budget (OMB) M-24-10 memorandum on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence" specifically identified AI used to "control or significantly influence the outcomes of … physical movements of robots or robotic appendages within a workplace, school, housing, transportation, medical, or law enforcement setting" as presumed to be safety-impacting.[19] ESAM can also heighten mental health stress for workers as they labor under extreme pressure with little privacy.[20] As ESAM technologies become more sophisticated, they create even more risks to mental health—for instance, by increasing pressure on workers via technology that detects and measures emotions and thoughts. This particular risk was cited as an AI purpose presumed to be rights-impacting by the OMB M-24-10 AI memo.[21] The May 2024 DOL AI principles prioritize that "AI systems should not violate or undermine workers' … health and safety rights."[22]

- **Wage and hour compliance:** AI and the remote, on-demand work that it can enable raise thorny questions about employers' obligations under wage and hour laws. As technology blurs the line between work and nonwork time, it may become more difficult to assess what time is compensable, and it therefore should be taken into account in assessing compliance with minimum wage and overtime laws.[23] Additionally, if AI takes over tasks that involve discretion, creativity, and supervision, or if automated timekeeping software automatically reduces wages for time spent off-task, workers who previously were not eligible for overtime compensation may become eligible.[24] Other risks include opacity and manipulation in algorithmic wage-setting technologies[25] and digital wage theft enabled by an outdated regulatory regime.[26] The May 2024 DOL AI principles highlight as a priority that "AI systems should not violate or undermine workers' … wage and hour rights."[27]

- **Misclassification:** Most federal laws that set labor standards apply only to employees, rather than independent contractors.[28] Whether a worker is an employee or an independent contractor, as well as whether an indirect employer—for example, a parent company—counts as an employer for statutory purposes, is largely determined based on the amount of control an entity possesses over the worker.[29] AI-enabled, always-on ESAM makes it easier for companies to exert control over workers while avoiding the traditional hallmarks of employer control, such as on-site, human supervision.[30] If companies are able to avoid being classified as a joint employer of a worker or retain independent contractor status for their workers by supplanting traditional modes of control with virtual control enabled by ESAM, they may skirt their obligations under a host of employment laws.[31] For example, McDonald's has long argued that it is not the joint employer of employees in franchised stores despite the tight control that headquarters exerts over franchise employees by tracking their productivity through point-of-sale technology.[32]

- **Worker power and datafication:** AI can disempower workers by disrupting organizing efforts[33] through, for example, surveillance and scheduling tricks and by accelerating "worker datafication." This refers to employers' ravenous collection, use, and resale of workers' data without regard for workers' ownership of, privacy regarding, or ability to benefit from the data.[34] The May 2024 DOL AI principles prioritize that "AI systems should not violate or undermine workers' right to organize" and that "Workers' data collected, used, or created by AI systems should be limited in scope and location, used only to support legitimate business aims, and protected and handled responsibly."[35]

- **Workforce training and displacement:** When people think about AI's impact on workers, a common first thought is the potential for mass layoffs and job displacement. According to one estimate, activities that account for up to 30 percent of the hours currently worked across the U.S. economy could be automated.[36] Of course, the automation of existing jobs is only part of the story, as experts expect AI to create a new wave of jobs associated with the technological revolution, for which American workers must be prepared. The World Economic Forum estimated in 2020 that while AI would displace 85 million jobs worldwide by 2025, the technology would also create 97 million new roles.[37] However, even if the net impact on jobs is positive, there is still the potential for significant point-in-time job losses or net losses in particular geographies, possibly at a more rapid pace than the United States has experienced before.[38] The DOL AI principles note the "risks that workers will be displaced entirely from their jobs by AI" and highlight "Supporting Workers Impacted by AI" as a principle, saying that "[e]mployers should support or upskill workers during job transitions related to AI."[39]

The application of AI in the realm of employment law is not all bad for workers. The technology holds great promise for federal agencies, including the DOL, to augment

their enforcement capabilities. For instance, it could be used to analyze reams of wage and hour data, trace patterns, and help identify employers for further investigation of potential statutory violations—for example, failure to report expenditures on union avoidance consultants—and to ensure payment of prevailing, minimum, or overtime wages. In particular, the use of AI for analyzing, investigating, and auditing prevailing wage enforcement represents an early opportunity, given the existing data on wages and benefits. Rapid data collection and analysis fueled by AI could help occupational safety and health experts draw conclusions about workplace characteristics and job conditions that are most likely to lead to injury and illness.[40] New research highlights how AI-aided enforcement strategies could dramatically reduce workplace injuries.[41] AI could also be used to spotlight further review instances where investment decisions and employee benefit determinations may be rigged against workers.

Current state

The DOL has already taken promising action on AI and plans to take more. For example, it published a blog post explaining what the White House's AI Bill of Rights means for workers.[42] The Office of Federal Contract Compliance Programs (OFCCP) collects information from federal contractors about their use of AI in recruitment, screening, and hiring.[43] The Office of Disability Employment Policy funds various projects related to AI in employment, such as the Partnership on Employment and Accessible Technology's "AI & Disability Inclusion Toolkit."[44]

The 2023 executive order on AI also directed the DOL to take several steps, including preparing reports for the president and publishing guidance about wage and hour and health and safety risks related to AI.[45] In response, the DOL issued a field assistance bulletin in April 2024 that describes how various federal labor standards apply to employers who use AI to manage their workforces.[46] For example, the guidance document addresses how AI-enabled employee monitoring tools that track keystrokes and other activities could unlawfully deprive workers of compensation for working time spent on noncomputer tasks.[47] Additionally, the bulletin highlights the potential danger of embedding errors in automated employment tools because of the potential to affect a large group of workers quickly.[48]

In response to the 2023 executive order on AI, the Department of Labor' published "Artificial Intelligence and Worker Well-being: Principles for Developers and Employers" in May 2024.[49] These eight principles include a North Star of "Centering Worker Empowerment," along with priorities that include ethical AI development, transparency, and protection of labor and employment rights.[50]

The executive order also directed the DOL to issue guidance for "[f]ederal contractors regarding nondiscrimination in hiring involving AI and other technology-based hiring systems,"[51] which the DOL released in May 2024 as the "Artificial Intelligence and Equal Employment Opportunity for Federal Contractors."[52] The guidance includes a discussion of the types of bias that can be embedded in algorithmic decision-making processes and explains how federal contractors are responsible for compliance with nondiscrimination statutes regardless of whether their hiring decisions involve automation.[53] Additionally, the guidance explicitly states that federal contractors cannot delegate compliance responsibilities to outside entities—including vendors—and provides several promising practices to maintain compliance.[54]

Finally, the OMB M-24-10 AI memo—primarily applicable to agencies' procurement of AI software—focused on AI use cases that are rights-impacting, including:

> … [*d*]*etermining the terms or conditions of employment, including pre-employment screening, reasonable accommodation, pay or promotion, performance management, hiring or termination, or recommending disciplinary action; performing time-on-task tracking; or conducting workplace surveillance or automated personnel management.*[55]

The jurisdiction of the DOL in enforcing an array of statutes is limited, at least in part, by the department's interpretation of the statutes' definitions of "employee" and "employer."[56] By the DOL's terms, the laws typically do not protect individuals working as independent contractors and instead only apply to employees. Additionally, an employer can only be held accountable concerning the statutory rights of an employee if they are found to be in an employment relationship with a particular worker.[57] This distinction comes into play particularly when a lead firm contracts parts of its workforce to subcontractors or franchisees. While statutes vary, a key factor in determining whether a worker is an independent contractor or an employee and whether a lead firm is a joint employer of a subcontractor's employee is the amount of control that the employer exercises or has the authority to exercise over the worker.[58]

The preamble to the DOL's rule defining "employee" under the FLSA, and therefore also the FMLA,[59] recognizes this connection. It explicitly states that "whether the employer uses technological means of supervision (such as by means of a device or electronically)" is a "[fact] relevant to the employer's control over the worker."[60] The preamble to the rule also discussed the role that electronic monitoring plays in a control analysis.[61] The DOL could also consider explicitly recognizing the use of ESAM as an indicator of control for joint employer recognition under employment statutes.[62] As GFI explained in a comment to the National Labor Relations Board (NLRB) in 2023, surveillance practices allow lead firms to tightly control their subcontractors' or franchisees' employees with

whom the companies disclaim having an employment relationship.[63] Ensuring that control exerted and reserved by ESAM systems is considered in joint employer analyses, even in the absence of traditional hallmarks of employer control—such as on-site, real-time, human supervision—will ensure workers can hold entities that control them accountable for the entities' obligations under employment law.

Relevant statutory authorities

This section explains how some statutes currently enforced by the DOL could apply to AI. As explained in the introduction to this report, this list is by no means exhaustive, and each potential proposal would benefit from additional research and vetting.

Fair Labor Standards Act: Recordkeeping and reporting

At 29 U.S.C. § 211(c), the FLSA requires employers to "make, keep, and preserve" records of "wages, hours, and other conditions and practices of employment" and submit reports to the Wage and Hour Division (WHD) administrator "as he shall prescribe by regulation … as necessary or appropriate for the enforcement" of the statute.[64] The DOL has used this authority to issue regulations at 29 C.F.R. Part 516 that, among other things, require employers to keep records that include regular hourly rates of pay, records of retroactive payments of wages, and documentation demonstrating whether the employee qualifies for any exemptions under the FLSA.[65]

At 29 U.S.C. § 211(a), the FLSA states:

> *The [WHD] Administrator or his designated representatives may investigate and gather data regarding the wages, hours, and other conditions and practices of employment in any industry subject to this chapter, and may enter and inspect such places and such records (and make such transcriptions thereof), question such employees, and investigate such facts, conditions, practices, or matters as he may deem necessary or appropriate to determine whether any person has violated any provision of [the FLSA], or which may aid in the enforcement of the provisions of [the FLSA.]*[66]

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Issue new recordkeeping and reporting rules**, pursuant to 29 U.S.C. § 211(c), to require employer records to ensure legibility and transparency of wage determinations made by automated systems and to require periodic reports to the WHD of those records from employers using AI-driven wage and scheduling technology. Such regulations would help combat black-box wage determination and discrimination[67] that can make workers' wages unpredictable and irregular,[68] as well as ensure that such wage determinations satisfy the minimum wage and overtime requirements of the FLSA. As documented by Veena Dubal, professor of law at the University of California, Irvine, many workers are subject to algorithmic management and wage setting that withholds or reduces compensation for work when doing so benefits the company.[69] This can make it difficult for workers to appreciate the connection between time spent working and amount of income generated, or to understand and correct errors in their compensation, and can also result in opaque wage setting that violates minimum wage or overtime laws.[70] The DOL contemplated a similar rulemaking in the early 2010s that would have required recordkeeping and disclosure to workers about their status as employees or independent contractors and detailed information about how their pay is computed, but a regulation was never proposed.[71]

- **Launch investigations**, pursuant to its administrative subpoena power in 29 U.S.C. § 211(a),[72] of employers to ensure compliance with minimum wage and overtime provisions. The WHD could prioritize investigation of employers that are noncompliant with the reporting rules mentioned, are in industries with large numbers of employee complaints, or are in industries with high penetration of automated wage and scheduling technologies. These investigations could produce valuable information about the characteristics of automated systems that make minimum wage and overtime violations more likely to occur and encourage employers' compliance with their legal obligations under the FLSA.

Fair Labor Standards Act: Minimum wage and overtime

At 29 U.S.C. § 206(a), the FLSA requires most employers to pay most employees a minimum wage for all hours worked.[73] At 29 U.S.C. § 207(a)(1), the FLSA requires most employers to pay most employees 1.5 times their regular rate of pay for all hours worked in excess of 40 hours per week.[74] At 29 U.S.C. § 254(a), the Portal-to-Portal Act amended the FLSA to exempt from "hours worked" time spent commuting and time spent on "activities which are preliminary to or postliminary to" an employee's principal activities of work.[75]

In addition to the statutory amendments' attempted clarification of what time is considered compensable for minimum wage and overtime purposes, the WHD has issued several interpretive regulations, organized at 29 C.F.R. Part 785, and pieces of guidance, field assistance bulletins,[76] on the subject. At 29 C.F.R. § 781.11–13, for example, the WHD explains that an employee's time is compensable if the employer knows or has reason to know that the employee is engaged in work, and that principle applies to work completed away from the job site "or even at home."[77] Citing administrative ease, at 29 C.F.R. § 785.47, the regulations draw on judicial precedent to set forth the WHD's de minimis rule, which exempts "insubstantial or insignificant periods of time beyond the scheduled working hours" from compensability.[78] Similarly, based on administrability rationales, current regulations permit employers to round timesheets to the nearest quarter-hour.[79]

Besides bona fide meal breaks,[80] which are not compensable, most time in a day between an employee's first performance of a "principal" activity and when the employee ceases such activity is compensable.[81] Activities that are "principal" are those that a worker is "employed to perform," rather than those that are preliminary or postliminary, such as commuting.[82]

Recommendation

Based on the above-cited authority, the DOL could consider the following action:

- **Issue updated interpretive regulations at 29 C.F.R. Part 785,** pursuant to 29 U.S.C. § 211(c), that allow only employers who track time manually through analog methods to engage in timesheet rounding[83] and establish a presumption against application of the de minimis rule in cases where employers use highly precise timekeeping technology.[84] These changes would eliminate an outdated regulatory regime that allows companies to use sophisticated timekeeping technology to facilitate wage theft by exploiting rules meant to minimize the burden of pen-and-paper wage and hour calculations. Given the ubiquity and ease of digital timekeeping, there is no longer a compelling justification for allowing practices such as rounding employees' hours to the nearest quarter-hour or failing to treat short periods of working time as compensable for minimum wage and overtime compliance.[85]

Unemployment compensation

The unemployment compensation system is a joint federal-state scheme that provides support through individual benefit payments.[86] The federal statute establishes broad requirements for the program, but the specifics are determined by state laws, which are administered with DOL oversight.[87]

At 42 U.S.C. § 503(a)(1), the federal unemployment compensation statute requires states implementing laws to include "[s]uch methods of administration … as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due."[88] If the DOL determines that a state violates §503(a)(1), the statute directs the DOL, at 42 U.S.C. § 503(b), to stop payment to the state unemployment agency.[89] To ensure compliance, at 42 U.S.C. § 503(a)(6), the statute requires states to make reports "in such form and containing such information, as the Secretary of Labor may from time to time require, and compliance with such provisions as the Secretary of Labor may from time to time find necessary to assure the correctness and verification of such reports."[90] 42 U.S.C. § 1302 directs the secretary of labor to "make and publish such rules and regulations … as may be necessary to the efficient administration of" several social welfare programs, including unemployment compensation.[91]

The 2023 executive order on AI specifically directs the secretary of labor to assess how unemployment insurance "could be used to respond to possible future AI-related disruptions."[92] The OMB M-24-10 AI memo specifically declares AI used for:

> *Making decisions regarding access to, eligibility for, or revocation of critical government resources or services; allowing or denying access—through biometrics or other means (e.g., signature matching)—to IT systems for accessing services for benefits; detecting fraudulent use or attempted use of government services; assigning penalties in the context of government benefits [to be presumptively rights-impacting and subject to specific minimum risk management practices.]*[93]

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Update quality control program regulations at 20 CFR § 602.21,** pursuant to 42 U.S.C. §§ 503(a)(1) and 1302, to require states to undertake audits and submit their results to the DOL for any automated or AI-driven benefits determination system. This could help ensure that states provide unemployment compensation to individuals consistent with federal law, provide for human in-the-loop review of any algorithmic denial of benefits, and ensure fair human adjudication for appeals of those denials. The current quality control program regulations were promulgated based on this same statutory authority.[94] These regulations would guard against states' use of automated systems to deny coverage to eligible individuals (or worse, wrongfully accuse them of fraud),[95] a use case cited by the OMB as presumptively rights-impacting, and therefore it should be subject to heightened scrutiny.[96] This proposal is closely related to the actions directed in Section 7.2(b) of the president's 2023 executive order on AI, which aims to ensure the equitable

distribution of public benefits. For example, the executive order directs the U.S. Department of Agriculture to issue guidance to state, local, and Tribal governments that address the use of AI systems in benefits distribution. It requires such guidance to ensure that such systems, among other things, maximize program access; require governments to notify the Department of Agriculture of AI use; create opt-out opportunities for benefit denial appeal; and enable auditing to ensure equitable outcomes.[97]

- **Issue a new unemployment insurance program letter (UIPL)** to guide states specifically on where and how AI can and should be implemented for unemployment insurance administration. This new UIPL should incorporate the minimum risk management practices for the presumed rights-impacting use of AI from the OMB M-24-10 AI memo[98] and any subsequent guidance. For example, utilizing AI to flag potential fraud must be accompanied by the minimum risk practices from the OMB M-24-10 AI memo, such as carrying out AI impact assessments, testing the systems in the real world before widespread deployment, and ongoing monitoring to ensure equity.[99] The DOL should clarify that these requirements extend to any vendor a state unemployment insurance system contracts with to provide services.

Occupational Safety and Health Act

Congress enacted the Occupational Safety and Health (OSH) Act with the purpose of "[assuring] so far as possible every working man and woman in the Nation safe and healthful working conditions."[100] An examination of the congressional record makes clear that Congress established the Occupational Safety and Health Administration (OSHA) because the field of occupational safety and health was changing quickly.[101] Congress decided that it needed to empower a federal agency with the authority to keep up with changes in the organization of work and establish rules to protect workers. As a congressional report explained, "technological advances and new processes in American industry have brought numerous new hazards to the workplace."[102] New "processes are being introduced into industry at a much faster rate than the present meager resources of occupational health can keep up with."[103]

At 29 U.S.C. § 654(a)(2), the OSH Act requires employers to comply with "occupational safety and health standards promulgated under" the law.[104] At 29 U.S.C. § 652(8), the statute defines "occupational safety and health standard" as "a standard which requires conditions, or the adoption or use of one or more practices, means, methods, operations, or processes, reasonably necessary or appropriate to provide safe or healthful employment and places of employment."[105] At 29 U.S.C. § 655(b), the statute establishes how OSHA may prescribe such standards.[106] OSHA has used this authority repeatedly to issue regulations at 29 C.F.R. Part 1910 that protect workers from workplace exposure to lead, ergonomic risk,[107] and many other

hazards. OSHA also has experience regulating and issuing guidance about mental health hazards that threaten workers.[108]

In addition to the law's substantive requirements, the OSH Act requires employers to record and report information, including about workplace injuries, to OSHA. At 29 U.S.C. § 657(c)(1), the statute mandates that employers "make, keep and preserve, and make available to the Secretary [of Labor] … such records regarding his activities relating to this Act as the Secretary . . . may prescribe by regulation as necessary or appropriate for the enforcement of this Act or for developing information regarding the causes and prevention of occupational accidents and illnesses."[109] At 29 U.S.C. § 657(c)(2), the statute directs the secretary of labor to prescribe regulations "requiring employers to maintain accurate records of, and to make periodic reports on, work-related deaths, injuries and illnesses other than minor injuries."[110]

At 29 U.S.C. § 671(d), the statute directs the National Institute for Occupational Safety and Health (NIOSH) to conduct, upon its own initiative or "upon the request of the Secretary" of labor or health and human services, research "necessary for the development of criteria for new and improved occupational safety and health standards."[111]

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Begin the standard-setting process**, pursuant to 29 U.S.C. § 655(b), to regulate the use of ESAM in the workplace to the extent that it creates hazards to workers' physical and mental safety and health. Such regulation could mitigate the increasingly unsustainable pace of work enforced by these systems, which leads to ergonomic injury and increased risk of accidents. For example, the Washington State Department of Labor and Industries has fined Amazon repeatedly for forcing its warehouse workers to work at punishing speeds that exacerbate the risk of injury.[112] The state's citations specifically reference the "direct connection" between Amazon's ESAM and workplace musculoskeletal disorders.[113] A standard on ESAM would also reduce the harmful effects that these systems can have on workers' mental health. As early as 1987, the now-defunct U.S. Office of Technology Assessment recognized that ESAM increases employee stress, heightening job strain risk.[114]

Of course, OSHA's standard-setting process is uniquely slow and resource intensive for the agency,[115] and the process would need to be informed by additional research to design an effective policy. So, in the meantime, the following recommendations should be considered:

- **Issue new subregulatory guidance and bring general duty clause enforcement** actions related to companies' use of ESAM in ways that harm worker safety and health. As GFI has urged in past advocacy efforts, OSHA should follow the lead of Washington state by more directly tying ESAM use to physical and mental health hazards.[116] Enforcement actions based on unsafe ESAM use could be taken because of the already ongoing DOL investigation into high injury rates at Amazon warehouses.[117]

- **Update existing subregulatory guidance about sector-specific ergonomic risks** to include a discussion of how ESAM can increase musculoskeletal injury risk. As described in a GFI report in 2023, OSHA could update the ergonomics guidance documents for poultry processing and grocery warehousing and create a new ESAM-conscious ergonomic risks guidance document for the warehousing industry.[118] The guidance could describe best practices to prevent ergonomic injuries – such as quota transparency, worker involvement in quota setting, and rest breaks – and how ESAM systems should be adjusted to accommodate those best practices.

- **Update injury reporting regulations at 29 C.F.R. Part 1904,** pursuant to 29 U.S.C. § 657, revising OSHA's log of work-related injuries and illnesses (Form 300) to collect information about automated systems used in the tasks, job roles, or workplaces in which the worker was working at the time of injury or illness. Additionally, OSHA could update Form 300 to include a column identifying when injuries are musculoskeletal.[119] This would allow OSHA to develop a better understanding of the precise causal mechanisms between ESAM and these injuries and inform the substantive policymaking described above.

- **Request research from NIOSH,** pursuant to 29 U.S.C. § 671(d), to fund and conduct further research to study ESAM's effect on job strain and physical injury.[120]

While all policies that affect workers should benefit from workers' input, these workplace safety recommendations should take into account the views of labor unions and other worker advocates who have been involved in regulating workplace technology for decades and have notched important wins through, for example, contract negotiations.

Employee Retirement Income Security Act: Adverse benefits determination and disclosure

Congress enacted the Employee Retirement Income Security Act (ERISA) to establish a comprehensive regulatory scheme for employee pension and welfare benefit plans, including group health insurance plans, offered by private sector employers.[121] The act creates protections for plan participants and beneficiaries

by setting requirements related to disclosure and reporting about decisions regarding benefit eligibility, benefit accrual, investing and plan administration, and plan funding.[122]

At 29 U.S.C. § 1133, the statute requires:

> *In accordance with regulations of the Secretary [of Labor], every employee benefit plan shall—(1) provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, setting forth the specific reasons for such denial, written in a manner calculated to be understood by the participant, and (2) afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim.*[123]

At 29 U.S.C. § 1022, the statute requires that a "summary plan description of any employee benefit plan shall be furnished to participants and beneficiaries," which shall include a description of the "circumstances which may result in disqualification, ineligibility, or denial or loss of benefits."[124] At 29 U.S.C. § 1029(c), the statute authorizes the secretary of labor to "prescribe the format and content of the summary plan description."[125]

At 29 U.S.C. § 1135, the statute permits the secretary of labor to "prescribe such regulations as he finds necessary or appropriate to carry out" ERISA's requirements.

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Update regulations at 29 C.F.R. § 2560.503-1,** which implement the denial-of-claims disclosure and appeal requirements at 29 U.S.C. § 1133. The current regulations state, for example, that in the case of an adverse benefit determination by a group health plan, a participant is entitled to request a copy of any "internal rule, guideline, protocol, or other similar criterion" that was relied on in making the adverse determination.[126] An updated regulation could require affirmative disclosure of a plain-language description of any algorithmic determination involved in a benefits determination, as well as the results of an equity audit conducted in a manner similar to that recommended in the OMB M-24-10 AI memo.[127] Additionally, the updated regulations could clarify that the appeal process authorized by 29 U.S.C. § 1133(2) and outlined at 29 C.F.R. § 2560.503-1(h) requires that appeals of benefits denials be heard by a human. This update could come as part of the DOL's announced review of ERISA disclosures pursuant to the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0.[128]

- **Update regulations at 29 C.F.R. § 2520.102-3(l)** to amend the summary of plan description to include a plain language description of any automated and algorithmic systems that the plan uses to make determinations that could "result in disqualification, ineligibility, or denial or loss of benefits,"[129] as well as whether the system has been externally audited or the administrator has instituted safeguards such as opt-out mechanisms for participants who would prefer human-made determinations. This would provide some transparency to workers and advocates about the decisions that plan administrators make with the help of AI-driven systems. This update could also come as part of the DOL's announced review of ERISA disclosures pursuant to the SECURE Act 2.0.[130]

Employee Retirement Income Security Act: Investment advice

At 29 U.S.C. § 1104, ERISA imposes responsibilities on plan fiduciaries, who are individuals that are responsible for plan management and operations.[131] Among them are the duties of prudence and loyalty.[132] At 29 U.S.C. § 1104(c)(5), the statute requires default investment allocations for retirement savings plans to be "invested by the plan in accordance with regulations prescribed by the Secretary."[133] The DOL recently issued a proposed rule to revise the scope of ERISA's coverage of investment advice fiduciaries to keep pace with the modern economy.[134]

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Update regulations at 29 C.F.R. § 2550.404a-1(c),** pursuant to 29 U.S.C. § 1104, to revise the investment duty of loyalty in light of the risks that AI-driven investment allocation technologies can create and potential conflicts of interest. The updated regulation could be similar to the Securities and Exchange Commission's rulemaking proceedings that seek to prevent investment advisers from using algorithms that create conflicts of interest between the adviser and the investor's retirement goals.[135] Importantly, plan fiduciaries should be required to ensure that AI-driven investment advice or allocations are not improperly weighted toward decisions that maximize fees and commissions at the expense of retirement savers. Such regulations could also require an audit of any AI-driven or otherwise automated investment allocation technologies for the potential for conflicts of interest.

- **Issue new regulations,** pursuant to 29 U.S.C. § 1104(c)(5), requiring algorithmic transparency and legibility to plan participants and beneficiaries for default asset allocations.[136]

- **Update the statutory transactions exemption at 29 C.F.R. § 2550.408g-1(b)(4),** "Arrangements that use computer models," to strengthen the existing auditing requirements and institute other AI-specific requirements, taking into account the DOL's approach in the proposed revisions to the Prohibited Transaction Exemption 2020-02.[137] Alternatively, or in addition to updating the exemption, the DOL could issue guidance that more fully describes the term "computer model" and identifies AI applications to which this exemption may apply.

Labor Management Reporting and Disclosure Act

Congress passed the Labor Management Reporting and Disclosure Act (LMRDA) to level the playing field between management and labor by providing transparency for workers, government, and advocates into the complex anti-union persuasion industry.[138] The law requires a series of disclosures from unions, employers, and union-avoidance consultants and law firms to ensure that workers know the sources of the huge sums of money that go into urging them one way or another on unionization.[139]

At 29 U.S.C. § 433(a)(3), the LMRDA requires employers to file a report to DOL "in a form prescribed by" the secretary of labor if the employer makes "any expenditure, during the fiscal year, where an object thereof, directly or indirectly, is to interfere with, restrain, or coerce employees in the exercise of the right to organize and bargain collectively through representatives of their own choosing, or is to obtain information concerning the activities of employees or a labor organization in connection with a labor dispute involving such employer."[140] The DOL has used this authority to specify what information employers must report in LM-10 forms, including, most recently, the DOL's proposed rule requiring employers to identify themselves as federal contractors.[141] Additionally, the LM-10 form instructions identify what types of transactions employers must report.[142]

Recommendation

Based on the above-cited authority, the DOL could consider the following action:

- **Issue a regulation or subregulatory guidance,** in the form of independent guidance documents or in the LM-10 form instructions, that explains how forms of ESAM can chill workers' exercise of their Section 7 rights under the National Labor Relations Act and when they must be reported in employers' LM-10 forms. The use of worker surveillance to thwart organizing activities is well documented.[143] The regulation or guidance could explain how that might require employers to report their expenditures on such technologies. They could reference the memo issued by the NLRB's general counsel on the subject,[144]

as well as prior guidance from the DOL on surveillance reporting.[145] Additional guidance may empower workers, unions, and labor watchdogs to report employer noncompliance to the DOL.

Worker Adjustment and Retraining Notification Act

Congress enacted the Worker Adjustment and Retraining Notification (WARN) Act to help workers and communities prepare for economic dislocation caused by mass job losses.[146] At 29 U.S.C. § 2102, the WARN Act requires prior worker and governmental notification in the event of a plant closing or mass layoff.[147] 29 U.S.C § 2101(a) defines plant closing and mass layoffs to include, during any 30-day period, a plant closing resulting in employment losses of at least 50 employees; a mass layoff of at least 50 employees where the employment loss consists of at least 33 percent of employment at the site; or a mass layoff with an employment loss of 500 or more at a single site of employment, regardless of its proportion of total employment at the site or if the employment loss is part of a plant closing.[148] Sixty days prior to a termination event that triggers the WARN Act, 29 U.S.C. § 2102(a) requires the employer to give written notice of the planned terminations: "(1) to each representative of the affected employees as of the time of the notice or, if there is no such representative at that time, to each affected employee; and (2) to the State or entity designated by the State to carry out rapid response activities under [the Workforce Innovation and Opportunity Act], and the chief elected official of the unit of local government within which such closing or layoff is to occur."[149]

At 29 U.S.C. § 2107(a), the statute provides the DOL with the authority to "prescribe such regulations as may be necessary to carry out" the act.[150] The DOL recently announced its intention to revise its implementing regulations at 20 C.F.R. Part 639 to update the definition of "single site of employment" as it relates to remote and telecommuting workers.[151]

Recommendation

Based on the above-cited authority, the DOL could consider the following action:

- **Update regulations at 20 C.F.R. § 639.3(i),** pursuant to 29 U.S.C. § 2107(a), to explain that, in the case of a completely or primarily remote workforce, the term "single site of employment" applies to the employer's entire workforce. In the case of algorithmic management, the DOL should clarify that all workers subject to the same or similar algorithm are considered one single site of employment. Updated regulations could also ensure that workers subject to intermittent deplatforming caused by algorithmic optimization have maximal protections possible under the WARN Act.

Family and Medical Leave Act

The Family and Medical Leave Act (FMLA) at 29 U.S.C. § 2612(a)(1)1 *et seq.*, requires covered employers to offer most employees 12 weeks of unpaid, job-protected leave for the birth and care of a child; to care for an adopted or foster child; to care for a spouse, a child under age 18, or a parent with a serious health condition; or because the employee is unable to work due to a serious health condition.[152]

29 U.S.C. § 2615(a)(1) makes it unlawful for an "employer to interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided" under the act.[153] 29 U.S.C. § 265 authorizes the DOL to issue regulations "as are necessary to carry out" the act.[154]

Recommendations

Based on the above-cited authority, the DOL could consider the following actions:

- **Update regulations at 29 C.F.R. Part 825,** pursuant to 29 U.S.C. §§ 2615(a)(1) and 2654, to require legibility and transparency of automated systems[155] that make any determinations bearing on the allocation or approval of FMLA leave, along with any other applicable minimum practices for rights-impacting AI from the OMB M-24-10 AI memo.[156] This would implement the transparency protections recommended by the White House's AI Bill of Rights and ensure that employers' use of automated systems does not unlawfully restrain workers' exercise of their rights under the FMLA. Because FMLA determination algorithms are likely bound up in other human resource management systems, this proposal could also provide transparency of those benefits processes as well. Specifically, these updated regulations should require:
  - At 29 C.F.R. § 825.301, legibility and transparency around use of automated systems to make FMLA designations
  - Legibility and transparency around use of automated systems to review, request, or otherwise process certifications under 29 U.S.C. § 2613
  - Legibility and transparency around use of automated systems to provide eligibility notices, at 29 C.F.R § 825.300(b); rights and responsibilities notices, at 29 C.F.R. § 825.300(c); and designation notices, at 29 C.F.R. § 825.300(d)
  - At 29 C.F.R. § 825.302, legibility and transparency around use of automated systems for employees to provide notice of the use of leave or to transmit information around scheduling of intermittent leave under 9 U.S.C. § 2612(b) and (e)
- **Update regulations by modifying 29 C.F.R. § 825.220,** pursuant to 29 U.S.C. §§ 2615(a)(1) and 2654, to prohibit employers from using FMLA data as inputs to any automated management system that may make an employment decision based, in part, on an employee's use or nonuse of FMLA leave. This would reduce employers' ability to weaponize employees' data against

them to retaliate for using FMLA leave. Under these recommended updated regulations, the automated management system must strictly segregate and keep confidential any information provided for FMLA certification pursuant to 29 C.F.R. § 825.500(g).

- **Update subregulatory guidance under 29 C.F.R. § 825.301(a)** prohibiting automated systems from using information other than that received from the employee or the employee's authorized spokesperson in designating FMLA leave pursuant to 29 C.F.R. § 825.301(a). Existing regulation already prohibits the conduct for employers and would also apply to automated systems used by employers, but additional clarification is essential to restrict automated systems that would improperly combine data sources.

Conclusion

Firms already rely on automated systems to manage workforces, a trend that seems likely to accelerate given the proliferation of new AI technologies. But technological innovation does not exempt employers from preexisting statutory obligations. Several statutes empower the DOL to address certain AI issues. GFI and CAP hope this chapter offers inspiration to worker advocates and policymakers interested in how the federal government could update regulatory regimes to account for the ways in which new developments in AI may affect the American workforce.

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

Endnotes

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TAKING FURTHER AGENCY ACTION ON AI

Department of Education

By Anna Rodriguez

Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.*[1] *This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."*[2] *Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."*[3]

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

The U.S. Department of Education has several existing statutory authorities to consider in addressing the challenges and opportunities of artificial intelligence (AI). Governing for Impact (GFI) and the Center for American Progress have extensively researched these existing authorities in consultation with numerous subject matter experts. However, the goal is to provoke a generative discussion about the following proposals, rather than outline a definitive executive action agenda. Each potential recommendation will require further vetting before agencies act. Even if additional AI legislation is needed, this menu of potential recommendations to address AI demonstrates that there are more options for agencies to explore beyond their current work and that agencies should immediately utilize existing authorities to address AI.

The Department of Education has already started to consider the risks and opportunities of AI, resulting in its 2023 "Artificial Intelligence and the Future of Teaching and Learning" report[4] and its various taskings in the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."[5] Artificial intelligence may be able to provide new kinds of education opportunities,[6] but it also comes with risks, including those related to student surveillance and discipline, biased plagiarism detection, student loan misinformation, and discrimination in admissions.

The Department of Education's authorities to address AI include titles VI and IX of the Civil Rights Act, the Americans with Disabilities Act (ADA), and the Higher Education Act (HEA).[7] These statutes can be used to address impermissible discrimination using AI technology and provide various requirements for contractors servicing student loans.

AI risks and opportunities

Equal access to education is paramount to social and economic advancement,[8] and educators increasingly rely on AI and related technologies to advance access to education.[9] However, the use of AI in education may also cause unintended harm.[10]

There are several areas of potential concern in using AI in education, including:

- **Student surveillance and discipline:** School software and online systems track various school interactions, performance, and other information.[11] In many cases, AI tools, which may train on datasets with racial bias,[12] are then deployed to "predict" future misconduct, track academic performance, and develop personalized learning programs.[13] The May 2023 Department of Education report, "Artificial Intelligence and the Future of Teaching and Learning," notes: "Examples of discrimination from algorithmic bias are on the public's mind, such as … an exam monitoring system that may unfairly identify some groups of students for disciplinary action."[14] The finalized Office of Management and Budget (OMB) AI guidance issued for federal agencies in March 2024—the OMB M-24-10 memorandum on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence"—lists "monitoring students online or in virtual-reality," "recommending disciplinary interventions," and "facilitating surveillance (whether online or in-person)" as uses of AI by federal agencies that should be presumed to be rights-impacting.[15] The Center for Democracy and Technology (CDT) found that 88 percent of teachers report their schools use AI-powered software to monitor student activity online, and two-thirds of those teachers report these data are being used to discipline students.[16] The same study found that 40 percent of schools monitor students' personal devices.[17]

  Alarmingly, this surveillance is even more harmful to LGBTQ+, Black, and brown students, who are already overrepresented in incidents of school discipline and law enforcement involvement.[18] Additionally, Black and Latinx students are more likely to use school-issued devices than their peers and, therefore, are more likely to be subjected to increased monitoring and related negative consequences, such as discipline.[19]

- **Plagiarism detection:** Many schools use online platforms or software that purport to detect plagiarism in work submitted by students.[20] However, these programs—equipped with AI-detecting capabilities—have been found to falsely conclude that students have used AI tools or otherwise plagiarized their work.[21] Even when these tools work as intended, they fail to consider the many reasons why students may use assistance when submitting written work, especially as an accommodation for students with disabilities or those for whom English is a second language.[22] The OMB M-24-10 AI memo lists "detecting student cheating or plagiarism" as an AI use by federal agencies that should be presumed to be rights-impacting.[23]

- **Federal student loan misinformation:** As the Consumer Financial Protection Bureau (CFPB) has reported, banking institutions increasingly rely on AI-generated chatbots to provide consumers with important information about their products and services.[24] Given the changing nature of federal student loan repayment and the on-ramp period for resuming repayment,[25] loan servicers' usage of chatbots, especially any chatbots that utilize generative AI, could expose consumers to misleading information about their federal student loans due to their unreliability from hallucinations.[26] Hallucinations are described by the National Institute of Standards and Technology (NIST) as "the production of confidently stated but erroneous or false content."[27]

- **Undergraduate admissions and scholarship awards:** Half of the higher education institutions currently use AI technology to review incoming applications, including initial screenings of transcripts and recommendation letters.[28] The OMB M-24-10 AI memo lists "influencing admissions processes," "determining access to educational resources or programs," and "determining eligibility for student aid" as uses of AI by federal agencies that should be presumed to be rights-impacting.[29] Advocates have highlighted that the unrestrained use of AI in school admissions may replicate and favor past prejudices, as AI programs may take into account the demographics and characteristics of past students and give those same groups preferential treatment, often to the detriment of students whose communities have historically been pushed out of higher education.[30] This is especially troublesome given the U.S. Supreme Court's decisions in *Students for Fair Admissions v. Harvard* and *Students for Fair Admissions v. University of North Carolina*, which prohibited the use of race as a factor in college admissions outside of narrow circumstances.[31]

Current state

The Department of Education has a unique opportunity to regulate and place safeguards around the responsible use of AI in the classroom. The recent 2023 executive order on AI directs the department to develop policies that will ensure "safe, responsible, and nondiscriminatory" uses of AI in the education context,

including by providing for human review of AI determinations where possible and developing an "AI toolkit" for education leaders.[32] In May 2023, the department released its "Artificial Intelligence and the Future of Teaching and Learning" report.[33]

Notably, the OMB M-24-10 AI memo for agencies identifies several rights-impacting AI use cases in education, including: "detecting student cheating or plagiarism; influencing admissions processes; monitoring students online or in virtual-reality; projecting student progress or outcomes; recommending disciplinary interventions; determining access to educational resources or programs; determining eligibility for student aid or Federal education; or facilitating surveillance (whether online or in-person)."[34] It also warns that AI-related "[decisions] blocking, removing, hiding, or limiting the reach of protected speech" may infringe on protected rights.[35]

Additional ongoing and existing agency initiatives are also likely to protect students and consumers from the potential harms of misaligned or inaccurate AI.[36] For example, the Department of Education's existing guidance relating to the Family Educational Rights and Privacy Act applies if protected records or information are collected, analyzed, or distributed using automated technologies.[37] Moreover, a proposed rule to restrict misinformation in the advertising market for secondary degrees should also apply when institutions deploy automated algorithms to target those deceptive ads.[38]

Relevant statutory authorities

The Department of Education has already proposed several protections for students that target AI harms, including the many recommendations in the "Artificial Intelligence and the Future of Teaching and Learning" report.[39] It has also taken on extensive litigation to enforce its existing protections.[40] However, the department can take additional actions under its existing statutory authority to address the unique threats to students posed by AI technologies.

Title VI of the Civil Rights Act of 1964

Title VI protects individuals from discrimination based on race, color, or national origin in programs or activities that receive federal financial assistance.
Title VI states:

> *No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.*[41]

Title VI applies to all the operations of a school district or college that receives federal funding, including its admissions, financial aid, recruiting, academic programs, student discipline, grading, class assignment, physical education, athletics, and housing.[42] Past guidance has clarified that Title VI also covers national origin-minority groups, including when students cannot speak or understand English because of that identity.[43]

Recommendation

Given this authority, the Department of Education could take the following action:

- **Issue guidance under Title VI explaining that 34 C.F.R. Part 100 applies to discrimination enabled by AI or other generative technology.** Specifically, this guidance would include examples of impermissible discrimination using AI technology, including disproportionate discipline for students of color, students with disabilities, or students for whom English is not their first language.

Title IX

Title IX protects individuals from discrimination based on sex in education programs or activities that receive federal financial assistance. Title IX states:

> *No person in the United States shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or activity receiving Federal financial assistance.*[44]

Title IX includes protections from sex discrimination, including: "sexual harassment; the failure to provide equal athletic opportunity; sex-based discrimination in a school's science, technology, engineering, and math (STEM) courses and programs; and discrimination based on pregnancy."[45] An interpretative notice has explicitly recognized sexual orientation and gender identity as a protected class under Title IX.[46]

Recommendation

Given this authority, the Department of Education should consider the following action:

- **Issue guidance specifying that, under 34 C.F.R. 106.31(b), using AI or other automated technologies, including generative AI, may violate Title IX if it results in sex discrimination.** This includes discriminatory surveillance of students because of their sex, disparate discipline resulting from that surveillance, or the filtering out of appropriate internet content because of discriminatory or imprecise AI internet monitoring.

Americans with Disabilities Act, Section 504 of the Rehabilitation Act, and the Individuals with Disabilities Education Act

Section 504 prohibits the discrimination of individuals with disabilities in programs and activities that receive federal financial assistance from the Department of Education. Section 504 provides:

> *No otherwise qualified individual with a disability in the United States … shall, solely by reason of her or his disability, be excluded from the participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.*[47]

The Americans with Disabilities Act, as amended, expanded the definition of covered disabilities under Section 504, emphasizing its wide applicability.[48]

The Individuals with Disabilities Education Act (IDEA) provides federal funds to educational agencies to assist students with disabilities.[49] Each participating school must identify and evaluate students with disabilities and develop individualized educational programs (IEPs), including a statement of the services the school is providing the student.[50] The IDEA grants the department the authority to promulgate regulations and guidance that govern participating schools.[51]

Under Section 504 of the ADA and the IDEA authority, the department has issued several guidance documents, including "dear colleague" letters and technical assistance documents, and has implemented regulations.[52]

Recommendation

Given this authority, the department could take the following action:

- **Issue guidance explaining the ADA's application to AI's discriminatory effects in surveillance and discipline,** including specific examples of possible discriminatory effects of programs that detect AI-generated work or cheating. The guidance could also address how some students may benefit from AI-assisted programs, which can constitute an accommodation in certain circumstances.

Higher Education Act

Under 20 U.S.C. § 1087(f), the Department of Education is authorized to enter into contracts with qualified institutions for loan servicers as long as they meet certain criteria, which the secretary can set.[53] The department has promulgated several servicing-related regulations under its rulemaking authority under Title IV of the HEA[54] and has published several guidance documents.[55]

Recommendation

Given this authority, the Department of Education can take the following action:

- **Require that contracted servicers using AI-generated chatbots ensure that borrowers are receiving accurate information about their individual loans.** This includes an option to speak with a human within a reasonable amount of time and incorporating any of the relevant minimum risk management practices for rights-impacting purposes developed through the OMB M-24-10 AI memo.[56]

Conclusion

Education is at the front lines of the AI revolution, and the Department of Education is already engaged in examining the challenges and opportunities of AI. Its existing statutory authority across various education levels provides a variety of options to address the potential challenges and opportunities of AI. GFI and CAP hope this chapter will offer thoughtful options to educators, administrators, and, ultimately, students as AI becomes commonplace in the education system.

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

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TAKING FURTHER AGENCY ACTION ON AI

Housing Regulators

By Anna Rodriguez

[Read the fact sheet](#)

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.*[1] *This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."*[2] *Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."*[3]

The U.S. Department of Housing and Urban Development (HUD) and other housing regulators should consider addressing potential artificial intelligence (AI) risks to housing fairness and discrimination using existing statutory authorities in the Fair Housing Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act. While Governing for Impact (GFI) and the Center for American Progress have extensively researched these existing authorities in consultation with numerous subject matter experts, the goal is to provoke a generative discussion about the following proposals, rather than outline a definitive executive action agenda. Each potential recommendation will require further vetting before agencies act. Even if additional AI legislation is needed, this menu of potential recommendations to address AI demonstrates that there are more options for agencies to explore beyond their current work and that agencies should immediately utilize existing authorities to address AI.

While the use of AI in housing decisions is not the primary perpetrator of discrimination, it has augmented existing historical inequalities and further obscured housing providers' decision-making metrics. As Lisa Rice, president and CEO of the National Fair Housing Alliance, stated in a Senate AI insight forum:

> *These systems are still performing their originally-intended function: perpetuating disparate outcomes and generating tainted, bias-laden data that serve as the building blocks for automated systems like tenant screening selection, credit scoring, insurance underwriting, insurance rating, risk-based pricing, and digital marketing technologies. The ability of automated systems to scale can lead to, reinforce, or perpetuate discriminatory outcomes if they are not controlled.*[4]

While the administration should address these underlying inequities, the 2023 AI executive order has specifically tasked HUD with at least addressing the harms caused by AI in housing,[5] and many of the recommendations below build on this directive.

AI risks and opportunities

Access to housing is imperative to overall well-being, economic and social advancement, and safety. As the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence" highlights, AI has the potential to exacerbate unlawful discrimination in housing, including by automated or algorithmic tools used to make decisions about access to housing and in other real estate transactions.[6]

A note on terminology

In this section, the authors define "AI" expansively to refer not just to technologies incorporating recent advances in machine learning but also to algorithmic and automated decision-making technologies that have enabled discrimination in the housing context for many years now, especially with the prolific use of tenant screening tools.[7]

Specifically, the 2023 executive order on AI requires the Department of Housing and Urban Development and the Consumer Financial Protection Bureau (CFPB) to issue guidance targeting tenant screening systems and detailing how the Fair Housing Act (FHA), Consumer Financial Protection Act, and Equal Credit Opportunity Act (ECOA) apply to the discriminatory effects of AI in housing advertising, credit, or other real estate transactions[8]—ECOA proposals are included in chapter 5 of this report. Furthermore, the Office of Management and Budget (OMB) M-24-10 memorandum on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence" identifies minimum risk management practices that must be applied when using AI for rights-impacting purposes, including: "Screening tenants; monitoring tenants in the context of public housing; providing valuations for homes; underwriting mortgages; or determining access to or terms of home insurance."[9] The AI section on HUD's own website identifies "potential risks associated with AI systems, such as fairness, bias, privacy concerns, and security vulnerabilities."[10]

From the authors' perspective, several kinds of AI applications could further entrench harms to consumers and tenants, including:

- **Surveillance in public housing:** Facial recognition and other biometric data are being used in public housing to evict residents for minor infractions as part of a broader surveillance network, another example of automated and machine learning technologies enabling and exacerbating long-standing harmful activities.[11] Types of facial recognition are also identified in the OMB M-24-10 AI memo as presumed rights-impacting uses of AI.[12] Reports indicate that HUD grant money has been used to install surveillance cameras, some of which are equipped with AI technology.[13] In the wake of these reports, HUD has said that it will not fund future grants that use facial recognition.[14]

- **Tenant screening:** AI and adjacent tools—including automated processes that compound existing discriminatory assessments—can be used in public and private housing screening contexts, further perpetuating discrimination. Automated tenant screening programs often conceal factors that result in a negative recommendation, sometimes including years-old eviction notices.[15] "Screening tenants" is cited in the OMB M-24-10 AI memo as an AI use by federal agencies that is presumed to be rights-impacting.[16]

- **Allocation of subsidized housing:** Relatedly, AI tools may be used by federal and state agencies to determine the allocation of subsidized housing or other federal programs. A 2019 report that analyzed common screening and prioritization programs used by federal housing agencies, including the Vulnerability Index – Service Prioritization Decision Assistance Tool (VI-SPDAT), found that communities of color received lower prioritization scores than their white counterparts and that individual white applicants were more likely to be prioritized for permanent supportive housing than people of color.[17]

- **Appraisal:** As HUD has recognized in recent proposed rulemaking, home appraisal programs have negatively affected marginalized communities:

  > *While AVMs [automated valuation models] have the potential, if properly used, to reduce human bias and improve consistency in decision-making, they are not immune from the risk of discrimination. For example, the models may rely upon biased data that could replicate past discrimination or even data that could include protected characteristics, such as race, or very close proxies for them. Moreover, if an algorithm were to generate discriminatory results, the harm could be widespread because of an AVM's scale.*[18]

  Undervalued homes and entire neighborhoods can help fuel generational wealth gaps.[19] A report from the Terner Center for Housing Innovation at the University of California, Berkeley, found that home valuations lower than the contract price are more common for households of color and significantly diminish a homeowner's overall wealth.[20]

- **Online advertising:** Online advertising is a critical component of many industries today, including housing. In 2019, Facebook (now Meta) settled with various civil rights groups and private parties over allegations of discriminatory ad targeting practices.[21] Later in 2019, HUD filed suit against Facebook alleging violations of the Fair Housing Act, which resulted in a settlement in 2022.[22] As HUD's suit against Facebook alleged, online platforms may perpetuate racial discrimination in access to housing opportunities by targeting ads that exclude certain protected classes or other characteristics.[23] AI and algorithms that target advertisements could cause similar harms and violations of the Fair Housing Act. As HUD noted in recent guidance, this can be both deliberate or unintentional but is illegal either way.[24]

- **Privacy:** Online advertisements for housing and housing applications may be predicated on private or confidential information about potential consumers.[25] Beyond data collection, housing providers and screening companies can misuse sensitive and personal information, especially in the context of eligibility determinations.[26] This risk is amplified when AI-driven systems make automated decisions without transparency, leading to possible exclusion from housing opportunities based on obscure or inaccurate data.[27] Aggregation and analysis of sensitive and personal data by AI can also result in profiling and discrimination, further exacerbating existing inequalities in the housing market.[28]

Current state

The Biden administration has already taken steps to address housing discrimination writ large, which can be exacerbated by the unregulated use of AI and adjacent tools. For example, the Action Plan to Advance Property Appraisal and Valuation Equity (PAVE) specifies several actions to bring AVMs into compliance with existing anti-discrimination laws.[29] As a part of the PAVE plan, agencies are currently engaging in rulemaking under Section 1473(q) of the Dodd-Frank Act to address potential bias by including nondiscrimination quality control standards in the proposed rule.[30] According to the PAVE plan, CFPB, the Department of Justice (DOJ), the Department of Veterans Affairs (VA), and HUD will issue guidance on the Fair Housing Act and ECOA's application to the appraisal industry.[31] HUD has already issued a letter informing all FHA participants that appraisals must comply with the Fair Housing Act.[32]

HUD also recently issued two guidance documents—one on tenant screening, "Guidance on Application of the Fair Housing Act to the Screening of Applicants for Rental Housing," and one on advertising, "Guidance on Application of the Fair Housing Act to the Advertising of Housing, Credit, and Other Real Estate-Related Transactions through Digital Platforms"—that explain how the FHA protects certain rights when housing providers use AI technologies.[33]

The new HUD screening guidance outlines liability for housing providers and screening companies under the FHA, explaining how intentional and unintentional discrimination facilitated by AI technology may violate the FHA.[34] Furthermore, the guidance highlights important considerations for both housing providers and tenant screening companies when using AI technologies, including choosing relevant screening criteria; ensuring the accuracy of records; providing transparency to applicants; allowing applicants to challenge negative information; and designing and testing models for FHA compliance.[35] The guidance points specifically to credit history, eviction history, and criminal records as underlying information that is susceptible to recreating bias.[36]

The HUD guidance on advertising through digital platforms describes the responsibilities and liability for advertisers and ad platforms under the FHA.[37] Specifically, the guidance illustrates several ways advertisers and ad platforms may violate the FHA, including by segmenting and selecting audiences based in part on protected characteristics or proxies, including via custom or mirror audience tools; limiting protected class groups' access to housing-related ads; reverse redlining; and showing different content or pricing to different groups based on protected characteristics.[38] Lastly, the guidance recommends that advertisers use platforms that manage the risk of discriminatory delivery, follow ad platform instructions, carefully consider the source of audience datasets, and monitor the outcomes of advertising campaigns.[39] The guidance recommends that ad platforms should run housing-related ads in a separate process with a specialized interface designed to avoid discrimination in audience selection and delivery, avoid providing targeting options that directly or indirectly relate to protected characteristics, conduct regular testing, identify and adopt less discriminatory alternatives for AI models and algorithmic systems, ensure that algorithms are similarly predictive across protected groups, ensure that ad delivery systems are not resulting in differential pricing, and document information about ad targeting functions and internal auditing.[40]

HUD has also appointed a chief artificial intelligence officer (CAIO) in accordance with the taskings from the 2023 executive order on AI and the OMB M-24-10 AI memo.[41]

In 2013, the Obama administration implemented the discriminatory effect rule, formalizing HUD's long-held interpretation of the FHA prohibiting discriminatory effects, regardless of intent to discriminate.[42] In 2020, however, the Trump administration issued a revised rule, which purported to create defenses to disparate impact claims for entities relying on algorithms and other automated technologies.[43] Of note, the 2020 rule allowed defendants to show that "predictive analysis accurately assessed risk" as a defense to a challenged policy.[44] The 2020 rule never took effect and was rescinded by the Biden administration's HUD in 2021, which finalized a rule mainly returning to the 2013 paradigm—and eliminating the Trump rule's defenses related to algorithmic technologies.[45]

Relevant statutory authorities

This section explains how some statutes currently enforced by housing regulators could apply to AI. As explained in the introduction to this report, this list is by no means exhaustive, and each potential proposal would benefit from additional research and vetting.

Fair Housing Act

The Fair Housing Act makes it unlawful for "any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction" based on any protected class under the statute.[46] The statute specifically prohibits discrimination in advertising, appraisal, public housing, and tenant screening.[47] The act gives HUD the authority to conduct formal adjudications of complaints and to promulgate rules to interpret and carry out the act.[48] Under this authority, HUD recently promulgated a rule reinstating HUD's discriminatory effect standard, which clarifies that discriminatory effect—facially neutral practices that cause unjustified discrimination—is sufficient to violate the act's prohibition on discrimination.[49]

Regarding advertising, Section 804(c) of the Fair Housing Act, 42 U.S.C. 3604(c), as amended, states:

> *It shall be unlawful to make, print, or publish, or cause to be made, printed, or published, any notice, statement, or advertisement, with respect to the sale or rental of a dwelling, that indicates any preference, limitation, or discrimination because of race, color, religion, sex, handicap, familial status, or national origin, or an intention to make any such preference, limitation, or discrimination.*[50]

HUD has implemented this provision through rulemaking,[51] and subsequent rulemaking expanded the definition of prohibited discrimination to include discriminatory effect.[52] As highlighted above, the 2023 discriminatory effect rule determined that the 2020 rule's third-party and outcome prediction defenses—both making it easier for AI-based discrimination—were unnecessary.[53] HUD has since provided general guidelines for advertising and marketing and investigation procedures.[54]

The FHA covers tenant screening that results in discrimination.[55] For example, a 2016 guidance document outlined that housing providers violate the FHA when the provider's "policy or practice has an unjustified discriminatory effect, even when the provider had no intent to discriminate."[56] The guidance explains circumstances under which utilizing criminal records, which are inherently biased due to the criminal justice system's disproportionate targeting of African American and Hispanic communities,[57] may subject housing providers to liability under the FHA.[58]

Advocacy groups and the DOJ, in a statement of interest,[59] have also argued that the same logic should similarly apply to other screening factors, such as credit, and rental and eviction records.[60]

The FHA also covers residential appraisal. The term "residential real estate-related transaction" is defined in the statute to include the "appraising of residential real property."[61] Courts have also relied on other provisions of the Fair Housing Act, including 42 U.S.C.A. § 3605, which prohibits real estate discrimination because of "race, color, religion, sex, handicap, familial status, or national origin" to prohibit discrimination in the appraisal industry.[62] This prohibition includes real estate businesses that provide housing-related services that "otherwise make unavailable or deny."[63] Courts have observed that "an appraisal sufficient to support a loan request is a necessary condition precedent to a lending institution making a home loan."[64] Moreover, HUD has updated its general appraiser requirements to include nondiscrimination principles[65] and has begun rulemaking on automated valuation models—which is discussed below.[66]

Under 42 U.S.C.A. § 3608, HUD must administer public housing programs in a "manner [that] affirmatively [furthers] the purpose of [the FHA],"[67] including its nondiscrimination provisions. HUD has promulgated several rules under this authority, known as the Affirmatively Furthering Fair Housing (AFFH) rules.[68] The AFFH rules apply to all federally funded housing programs, which must not only abide by nondiscrimination principles but also "take meaningful actions to overcome patterns of segregation and foster inclusive communities."[69] In 2015, the Obama administration promulgated an AFFH rule under FHA's mandate for affirmatively advancing fair housing.[70] In 2020, the Trump administration effectively eliminated the AAFH rule, leaving only a general statement of what constitutes a fair housing approach, with few policy requirements for local governments.[71] In 2023, HUD proposed a new AFFH rule, largely restoring the 2015 rule and developing several key provisions, including requiring localities to develop equity plans, track their process in fair housing goals, and increase accountability through direct public complaints.[72]

Recommendation

Based on the aforementioned authorities, HUD could take the following action:

- **Update the "Fair Housing Advertising" guidelines – a separate document from the newly released advertising guidance – elucidating Section 804(c)'s prohibition against discrimination in the advertisement of housing opportunities in the context of online advertising that relies on algorithmic tools or data**, as required by the 2023 executive order on AI and consistent with the recent HUD guidance on advertising through digital platforms.[73] Such guidance would be consistent with the DOJ's settlement with Facebook, which

targeted similar practices,[74] and can specifically highlight practices that lead to housing advertisements being steered away from protected communities.[75] Furthermore, the guidance should specify that companies providing advertising services using AI technologies are liable. The guidelines should mirror the responsibilities and liabilities outlined in HUD's recent guidance.[76]

Dodd-Frank Act

Section 1473(q) of the Dodd-Frank Act amended Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI) to add a new section, 1125, requiring automated valuation models to adhere to certain quality standards.[77] Under this authority, the Federal Housing Finance Agency (FHFA) and other agencies have proposed a rule to improve the quality control standards for AVMs.[78] The proposed rule applies to AVMs in making credit decisions or covered securitization determinations regarding a mortgage but does not mandate specific policies institutions must follow or cover nonbank entities.[79] Key provisions in the rule require AVMs to "ensure a high level of confidence in the estimates produced; protect against the manipulation of data; seek to avoid conflicts of interest; and require random sample testing and reviews."[80]

Recommendations

Based on this authority, the FHFA should take the following actions:

- **Continue the rulemaking process on the proposed AVM rule but also include its application to all mortgage lenders** – specifically nonbanks, given that more than half of annual residential real estate loans were made by nonbanks in 2022.[81] Furthermore, the rule should include specific minimum standards for each proposed goal, potentially incorporating the National Institute of Standards and Technology (NIST) AI guidelines[82] or relevant minimum standards developed in response to the minimum risk management practices anticipated by the OMB M-24-10 AI memo.[83]

- **Specify, through the proposed AVM rule or additional rulemaking, that companies using AVMs must disclose their use to customers and allow customers to request nonautomated appraisals or seek valuation from alternative AVMs**. The FHFA can do so using its broad authority in Section 1125 to "account for any other such factor that the agencies … determine to be appropriate."[84] This would align with the statute's purpose to "ensure a high level of confidence in [AVMs]," "protect against the manipulation of data," and "avoid conflict of interest."[85]

Fair Credit Reporting Act

While HUD does not administer the Fair Credit Reporting Act (FCRA), it can help the Consumer Financial Protection Bureau and the Federal Trade Commission communicate statutory and regulatory obligations to affected entities in the housing space. Especially if the FCRA's primary regulators update regulations and guidance to account for novel AI development, as the authors recommend in Chapter 5,[86] HUD can collaborate on guidance explaining entities' obligations in the context of AI. For example, under some of the recommendations the authors propose in Chapter 5, credit reporting agencies, such as certain tenant screening firms,[87] would need to disclose their use of AI technologies; periodically assess whether their machine learning or other automated technologies result in discriminatory outcomes or take into account information prohibited by statute; and provide for human review of reinvestigation requests, which, in practice, would require individual traceability and legibility.[88] Furthermore, users of credit reports, including landlords and property managers, may eventually need to disclose information about the use of AI or related technologies in adverse decision notices.[89]

Conclusion

The Department of Housing and Urban Development and other housing regulators play a critical role in ensuring fairness in housing and contemplating how to address the potential challenges AI creates. HUD's AI work directed by the AI executive order is a critical start, and further utilizing its existing authorities, as outlined in this chapter, is essential. GFI and CAP hope this chapter will inspire regulators, advocates, and policymakers interested in how the federal government could update regulatory regimes to account for this new AI moment as it affects housing.

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

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86 For a more fulsome analysis of the FCRA's history and authority, see “Fair Credit Reporting Act” section of Todd Phillips and Adam Conner, “Financial Regulatory Agencies,” in Will Dobbs-Allsopp and others, *Taking Further Agency Action on AI* (Washington: Center for American Progress, 2024), available at https://www.americanprogress.org/article/financial-regulatory-agencies-chapter/.

87 Consumer Financial Protection Bureau, “CFPB Reports Highlight Problems with Tenant Background Checks.” The CFPB has already recognized that tenant screening reports often rely on untrustworthy data, creating barriers to housing.

88 “Fair Credit Reporting Act” section of Phillips and Conner, “Financial Regulatory Agencies”; Legal Information Institute, “15 U.S.C. § 1681c - Requirements relating to information contained in consumer reports,” available at https://www.law.cornell.edu/uscode/text/15/1681c (last accessed May 2024).

89 “Fair Credit Reporting Act” section of Phillips and Conner, “Financial Regulatory Agencies.”

TAKING FURTHER AGENCY ACTION ON AI

Financial Regulatory Agencies

By Todd Phillips and Adam Conner

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

Authors' note: *For this report, the authors use the definition of artificial intelligence (AI) from the 2020 National Defense Authorization Act, which established the National Artificial Intelligence Initiative.*[1] *This definition was also used by the 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence."*[2] *Similarly, this report makes repeated reference to "Appendix I: Purposes for Which AI is Presumed to be Safety-Impacting and Rights-Impacting" of the 2024 OMB M-24-10 memo, "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."*[3]

Artificial intelligence (AI) is poised to affect every aspect of the U.S. economy and play a significant role in the U.S. financial system, leading financial regulators to take various steps to address the impact of AI on their areas of responsibility. The economic risks of AI to the U.S. financial system include everything from the potential for consumer and institutional fraud to algorithmic discrimination and AI-enabled cybersecurity risks. The impacts of AI on consumers, banks, nonbank financial institutions, and the financial system's stability are all concerns to be investigated and potentially addressed by regulators. While Governing for Impact (GFI) and the Center for American Progress have extensively researched these existing authorities in consultation with numerous subject matter experts, the goal is to provoke a generative discussion about the following proposals, rather than outline a definitive executive action agenda. Each potential recommendation will require further vetting before agencies act. Even if additional AI legislation is needed, this menu of potential recommendations to address AI demonstrates that there are more options for agencies to explore beyond their current work and that agencies cannot and should not wait to utilize existing authorities to address AI.

The October 2023 "Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence" assigned executive branch financial regulators AI-related tasks[4] and specifically encouraged independent regulatory agencies, which cannot be directly tasked by the president, to address the risks of AI:

> *Independent regulatory agencies are encouraged, as they deem appropriate, to consider using their full range of authorities to protect American consumers from fraud, discrimination, and threats to privacy and to address other risks that may arise from the use of AI, including risks to financial stability, and to consider rulemaking,*

as well as emphasizing or clarifying where existing regulations and guidance apply to AI, including clarifying the responsibility of regulated entities to conduct due diligence on and monitor any third-party AI services they use, and emphasizing or clarifying requirements and expectations related to the transparency of AI models and regulated entities' ability to explain their use of AI models.[5]

In March 2024, the U.S. Treasury Department issued a report on AI specific cybersecurity risks in financial services that included the following summary of the AI regulatory landscape:

Financial regulatory agencies generally do not issue regulations or guidance on specific technologies, but instead address the importance of effective risk management, governance, and controls regarding the use of technology, including AI, and the business activities that those technologies support. Regulators have emphasized that it is important that financial institutions and critical infrastructure organizations manage the use of AI in a safe, sound, and fair manner, in accordance with applicable laws and regulations, including those related to consumer and investor protection. Controls and oversight over the use of AI should be commensurate with the risk of the business processes supported by AI. Regulators have noted that it is important for financial institutions to identify, measure, monitor, and manage risks arising from the use of AI, as they would for the use of any other technology. Advances in technology do not render existing risk management and compliance requirements or expectations inapplicable. Various existing laws, regulations, and supervisory guidance are applicable to financial institutions' use of AI. Although existing laws, regulations, and supervisory guidance may not expressly address AI, the principles contained therein can help promote safe, sound, and fair implementation of AI.[6]

As noted in the Treasury Department's report, existing laws and regulations clearly apply to the use of AI in the financial services sector. This report for financial regulators highlights 11 relevant existing authorities and the numerous agencies that oversee them in detail below, along with recommendations on how to potentially utilize those authorities to address AI. It should be noted that there is some repetition and overlap in the recommendations for financial services regulators due to the multiple parallel existing statutory authorities. Additionally, these recommendations align with or draw from the AI best practices recommended by the Biden administration's AI Bill of Rights, the National Institute of Standards and Technology (NIST) AI Risk Management Framework, the 2023 AI executive order, and the Office of Management and Budget (OMB) M-24-10 memorandum on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence" issued in March 2024.[7]

In this report, the term "**U.S. financial regulatory agencies**" includes the federal banking and credit union agencies, financial markets regulators, and executive branch agencies. Specifically, in this report, these agencies include the Treasury Department, the Office of the Comptroller of the Currency, the Board

of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the National Credit Union Administration, the Securities and Exchange Commission (SEC), the Consumer Financial Protection Bureau, the Financial Stability Oversight Council, which is chaired by the secretary of the treasury, and, to some extent, the Financial Industry Regulatory Authority, the self-regulatory organization for securities brokers, which is overseen by the SEC. It should be noted that other federal agencies not listed in this report also have financial regulation responsibilities and authorities that could potentially be used to address AI.

AI risks and opportunities

AI may affect financial services consumers and the U.S. and international banking and financial systems in various known and unknown ways.[8] The risks and opportunities of AI for financial services start with similar broad concerns as other areas discussed in this report, including the need for safe and secure systems with clear safeguards to address and mitigate risk, the potential for algorithmic discrimination that perpetuates or exacerbates existing historical inequalities, the potential for fraud and harm to consumers, and the possibility of affecting essential systems.

Several areas of concern are detailed below:

- **Prevention of access to financial services:** AI-powered systems may prevent consumers from accessing critical financial services[9] by illegally discriminating against customers, generating incorrect information for their credit reports, or using faulty AI systems to execute transactions. The OMB M-24-10 AI guidance lists AI used by federal agencies for "[a]llocating loans; determining financial-system access; credit scoring; determining who is subject to a financial audit; making insurance determinations and risk assessments; determining interest rates; or determining financial penalties" as potentially rights-impacting.[10]

- **Algorithmic discrimination that may exacerbate historical inequalities:** Massive amounts of data are required to train and run AI-powered systems.[11] In the financial services world, such historical data may dangerously reflect long-embedded systemic inequalities, such as redlining, unfair credit denials, and other discriminatory practices. AI systems trained on these historic data run the substantial risk of incorporating these inequities if not addressed proactively.

- **AI-enabled fraud:** AI is already embraced as a tool to enable advanced fraud against consumers and financial institutions. The use of AI voice cloning[12] and AI-generated fake accounts[13] are just the tip of the iceberg when it comes to future AI-enabled financial fraud.

- **Failure to comply with anti-money laundering requirements:** The Bank Secrecy Act and Treasury Department regulations require institutions to submit suspicious activity reports (SARs) whenever customers engage in activity that may be money laundering.[14] Black-box AI systems may fail to report otherwise suspicious activities, leaving banks in violation of the Bank Secrecy Act.

- **Threats to safe, secure, and stable financial systems:** Integrating AI systems into financial services may pose a risk to the operation of these critical systems, as their sophistication grows along with the lack of transparency into proprietary black-box AI systems and algorithms that provide essential services and upkeep. The 2008 financial crisis proved how important the stability of the broader financial system is for a growing economy; yet AI and the commercial cloud computing that provides advanced AI pose risks that could negatively affect financial stability. Indeed, the Financial Stability Oversight Council has identified AI as a "vulnerability" within the U.S. financial system.[15] For example, a bank's use of the same or similar data for AI-based risk management models, AI-enabled network effects, or unregulated AI service providers may pose systemic risks.[16]

Although certainly not exhaustive, these known risks affect at least three main categories of stakeholders in the financial sector:

1. **Customers:** Banks and other financial services providers may illegally discriminate against customers when making lending decisions with unknowingly biased AI systems.[17] Banks' and lenders' retail and institutional customers are also at risk of faulty AI systems that fail to accurately respond to their inquiries, accurately assess their credit worthiness, or execute transactions.[18] Similarly, brokers' customers face losses from transactions that AI systems fail to execute.[19] Financial institutions also serve as a wealth of information about customers, which is necessary for AI systems to operate, and may be liable for customer losses stemming from AI-enabled fraud.[20]
2. **Banks:** The core purpose of bank regulation is to ensure banks' safety and soundness,[21] and AI could put this at risk. Banks face potential operational failures from AI-enabled cyberattacks that can evade their information technology (IT) defenses,[22] runs from depositors' use of AI for treasury management,[23] and losses from banks' own opaque and faulty AI-based risk management systems.[24]
3. **Securities brokers and futures commission merchants, securities and derivatives exchanges, and other market intermediaries:** In addition to banks, the nonbank financial institutions that comprise the capital markets are also poised to use AI systems that may pose risks to firms' financial health and that of markets overall. Brokers may be liable for trades that AI systems failed to execute or misexecuted, and investment advisers and brokers may be liable for AI systems that fail to offer conflict-free advice or advice in the clients' best interests.[25] Exchanges may face operational failures from their AI-based

matching software or experience flash crashes stemming from erroneous high-frequency trading.[26] Additionally, clearinghouses relying on AI systems that fail may be unable to novate trades, putting the markets at risk of requiring bailouts.[27]

Current state

The 2022 White House AI Bill of Rights, which was the basis of much of the 2023 executive order on AI, noted that AI or automated systems could "have the potential to meaningfully impact the American public's rights, opportunities, or access to critical resources or services" and that critical resources or services included financial services.[28]

The 2023 AI executive order outlines eight policies and principles for AI for the Biden administration's approach to AI, including that AI must be "safe and secure," "[promote] responsible innovation, competition, and collaboration," and "[advance] equity and civil rights," as AI "systems deployed irresponsibly have reproduced and intensified existing inequities, caused new types of harmful discrimination, and exacerbated online and physical harms." The guidance specifically highlights the need to "enforce existing consumer protection laws and principles and enact appropriate safeguards against fraud, unintended bias, discrimination, infringements on privacy, and other harms from AI," emphasizing the need for protections in "financial services."[29]

The executive order also required the secretary of the treasury to "issue a public report on best practices for financial institutions to manage AI-specific cybersecurity risks" and provides financial services and housing directives for the CFPB.[30] Finally, the order highlights the direction it hopes independent regulatory agencies not under the direct authority of the president will take on AI, noting:

> *Independent regulatory agencies are encouraged, as they deem appropriate, to consider using their full range of authorities to protect American consumers from fraud, discrimination, and threats to privacy and to address other risks that may arise from the use of AI, including risks to financial stability, and to consider rulemaking, as well as emphasizing or clarifying where existing regulations and guidance apply to AI, including clarifying the responsibility of regulated entities to conduct due diligence on and monitor any third-party AI services they use, and emphasizing or clarifying requirements and expectations related to the transparency of AI models and regulated entities' ability to explain their use of AI models.*[31]

The OMB M-24-10 AI guidance notes that AI used by federal agencies should be automatically presumed rights-impacting if used for "[a]llocating loans; determining financial-system access; credit scoring; determining who is subject to a financial audit; making insurance determinations and risk assessments; determining interest rates; or determining financial penalties (e.g., garnishing wages or withholding tax returns)."[32]

The financial regulatory agencies have been working on addressing AI in a variety of ways.

The Consumer Financial Protection Bureau (CFPB) has been one of the most proactive federal agencies on the issue.[33] Director Rohit Chopra has made statements warning about the myriad risks of AI, including that its need for large datasets and computing power could result in a natural oligopoly: "There could be a handful of firms, and just to be honest, a handful of individuals who ultimately have enormous control over decisions made throughout the world."[34] Chopra has also expressed concern that AI "magnifies disruptions in a market that turn tremors into earthquakes"[35] and that AI could be used for illegal and discriminatory lending decisions.[36]

Accordingly, the CFPB has provided market participants with various guidance about how AI may and may not be used. The CFPB explained that federal law does "not permit creditors to use complex algorithms when doing so means they cannot provide the specific and accurate reasons for adverse actions."[37] It has also warned that creditors may not "rely on overly broad or vague reasons to the extent that they obscure the specific and accurate reasons relied upon."[38] The CFPB has criticized credit reporting agencies' use of AI screening tools.[39] In conjunction with the U.S. Department of Justice, Equal Employment Opportunity Commission, and Federal Trade Commission, the CFPB warned that AI systems "have the potential to produce outcomes that result in unlawful discrimination" and that "[e]xisting legal authorities apply to the use of [AI] just as they apply to other practices."[40] The CFPB has also penalized firms for relying on faulty automated compliance systems. The bureau ordered Wells Fargo to pay $3.7 billion for compliance failures that resulted in wrongful home foreclosures, car repossessions, and lost benefit payments[41] and ordered Hello Digit to pay a $2.7 million fine for causing users to be charged overdraft fees.[42] It is reportedly increasing examinations of AI systems.[43]

At the Treasury Department, Graham Steele, while serving as assistant secretary for financial institutions in October 2023, gave a speech detailing how AI can affect banking, consumer finance, and insurance markets and emphasizing the importance of AI providers engaging in responsible innovation.[44] In addition, the Treasury Department appointed a chief artificial intelligence officer as required by the 2023 executive order on AI.[45] The Financial Stability Oversight Council (FSOC), which is chaired by the treasury secretary, has identified AI as a potential risk to the financial system and has issued recommendations to the other regulators to monitor AI's development in their respective jurisdictions.[46] In a February 2024 testimony before the U.S. House Committee on Financial Services, Treasury Secretary Janet Yellen noted that the FSOC was "closely monitoring the increasing use of artificial intelligence in financial services, which brings potential benefits such as reducing costs and improving efficiencies and potential risks like cyber and model risk."[47] And in March 2024, the Department of the Treasury's Office of Cybersecurity and Critical Infrastructure Protection issued a report in response to requirements

from the 2023 executive order on AI, entitled "Managing Artificial Intelligence-Specific Cybersecurity Risks in the Financial Services Sector."[48] While focusing on the AI-specific risk of cybersecurity, the "Next Steps: Challenges & Opportunities" chapter contains a small section that notes "Regulation of AI in Financial Services Remains an Open Question" according to those interviewed for the report.[49]

The federal banking agencies have also begun tackling AI, albeit at a slower pace.[50] The Office of the Comptroller of the Currency (OCC) formed an Office of Financial Technology.[51] The Federal Deposit Insurance Corporation (FDIC) created FDITech, a tech lab, though it recently reduced its public-facing role.[52] Four federal reserve banks—San Francisco, New York, Atlanta, and Boston—have also set up offices to study financial innovation and AI.[53] These efforts are intended to focus, in part, on how regulators can use AI to assist in regulating financial institutions as well as to better understand how banks are using AI in their activities. These agencies have also jointly issued a request for information on financial institutions' uses of AI[54] and have proposed a rule to impose heightened standards for the use of home appraisals conducted using algorithms.[55]

The Securities and Exchange Commission (SEC) is quickly evaluating how regulated institutions use AI in capital markets. Chairman Gary Gensler has given a plethora of speeches discussing the possible harms of AI,[56] including in a March 2024 interview with Politico in which he warned of a potential financial crisis caused in part by AI.[57] In addition, the agency has launched a Strategic Hub for Innovation and Financial Technology (FinHub) that focuses, in part, on AI generally in the securities markets.[58] The SEC proposed a rule to address risks posed to investors from conflicts of interest associated with using predictive data analytics.[59] With regard to investment advisers, the SEC's examinations division has begun soliciting information about advisers' uses of AI.[60] SEC staff have issued guidance[61] and a risk alert[62] addressing robo-advisers that use algorithms to make investment recommendations.

The Financial Industry Regulatory Authority (FINRA), the self-regulatory organization for securities brokers,[63] formed an Office of Financial Innovation to coordinate fintech efforts that include AI[64] and published a white paper on AI in the securities industry.[65]

The Commodity Futures Trading Commission (CFTC) issued "A Primer on Artificial Intelligence in Financial Markets" in 2019 that discusses, among other things, how the CFTC could leverage AI to better regulate its markets.[66] More recently, the agency created an enforcement division task force focused on emerging technologies, including AI,[67] and its Technology Advisory Committee created a panel to evaluate "responsible artificial intelligence."[68] The CFTC's commissioners have given speeches on the need for the agency to regulate AI.[69]

The Biden administration's work on AI is ongoing, but the AI Bill of Rights, the NIST AI Risk Management Framework, the 2023 executive order on AI, and the OMB M-24-10 AI guidance have highlighted key AI risk mitigation practices to be further developed.[70] Due to parallel statutory authorities across multiple agencies, many of these recommendations are referenced repeatedly in the sections below.

These efforts include, but are not limited to, the following:

- **Required minimum risk management practices for AI use that is deemed safety-impacting or rights-impacting:** The OMB M-24-10 AI guidance requires minimum risk management practices for federal agencies that utilize AI for certain purposes presumed to be safety-impacting or rights-impacting.[71] These steps, including AI impact assessments and other requirements, could be repurposed for use beyond federal agencies, such as at banks or financial services institutions.

- **AI audits:** The development of an independent third-party AI auditing ecosystem is being explored to ensure effective risk management and compliance with AI systems.[72] AI audits in this context can include both the data used to train AI systems and the AI systems themselves, including their source code. The audits would also include third parties utilizing AI for banks or other financial institutions as vendors or contractors. In all cases, regulators should set out guidelines for appropriate conflict checks and firewall protocols for auditors.

- **Explainability and legibility:** The 2022 AI Bill of Rights[73] made "notice and explanation" a key principle for the safe use of AI, noting that people "should know that an automated system is being used and understand how and why it contributes to outcomes that impact you" and that automated systems should "provide clear, timely, understandable, and accessible notice of use and explanations."[74] The 2023 AI executive order noted that "requirements and expectations related to the transparency of AI models and regulated entities' ability to explain their use of AI models" should be a priority for independent agencies, including independent financial regulators.[75] This expectation for explainability and legibility is also reflected in the OMB M-24-10 AI guidance for federal agencies using or procuring AI, which notes:

  > *Explanations might include, for example, how and why the AI-driven decision or action was taken. This does not mean that agencies must provide a perfect breakdown of how a machine learning system came to a conclusion, as exact explanations of AI decisions may not be technically feasible. However, agencies should still characterize the general nature of such AI decisions through context such as the data that the decision relied upon, the design of the AI, and the broader decision-making context in which the system operates. Such explanations should be technologically valid, meaningful, useful, and as simply stated as possible, and higher-risk decisions should be accompanied by more comprehensive explanations.*[76]

Financial regulators should collaborate with others in the public and private sector as they develop best practices for explanation and legibility.

- **AI red-teaming:** The 2023 AI executive order defined AI "red-teaming" as "a structured testing effort to find flaws and vulnerabilities in an AI system, often in a controlled environment and in collaboration with developers of AI."[77] Red-teaming has emerged as a method to test AI that is embraced by leading generative AI companies[78] and has been a focus of the White House in voluntary commitments,[79] the executive order, and the OMB M-24-10 AI guidance.[80] This can also include red team/blue team exercises, whereby the blue team defends the systems against the simulated penetrations,[81] or "violet-teaming," which attempts to address broader systemic societal issues in adversarial testing.[82]

- **Cybersecurity and AI risk management:** The Biden administration has made cybersecurity a key focus, with efforts that include the 2023 National Cybersecurity Strategy.[83] The 2023 executive order on AI also prominently mentions cybersecurity throughout. Similarly, AI risk management has been an early focus of voluntary and mandated AI efforts from the U.S. government, including the NIST AI Risk Management Framework and the OMB M-24-10 AI guidance.[84]

Relevant statutory authorities

This section explains how various statutes enforced by the federal financial regulators could be used to regulate AI. This list is by no means exhaustive.

Bank Secrecy Act

Relevant agencies: *Treasury Department, Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration, Securities and Exchange Commission, Commodity Futures Trading Commission*

The Bank Secrecy Act (BSA), enacted in 1970, is designed to combat money laundering and financial crimes.[85] The BSA and regulations promulgated thereunder require financial institutions to maintain records and report certain transactions indicative of money laundering or other illicit activities.[86] Under these regulations, banks and other financial institutions must verify the identity of all customers, keep detailed records of cash transactions exceeding $10,000, and report suspicious transactions to the Financial Crimes Enforcement Network (FinCEN).[87] By mandating these reporting requirements, the BSA aims to enhance transparency in financial dealings, detect potential illegal activities, and safeguard the financial system's integrity.[88]

The broad statutory authority allows the treasury secretary and banking and financial regulators to promulgate regulations requiring institutions to create and implement a wide variety of anti-money laundering programs.[89]

Recommendations

Using these authorities, the Federal Reserve, OCC, FDIC, SEC, and CFTC could consider the following actions:

- **Regulate how institutions' customer identification and suspicious activity reporting programs use AI.** As AI becomes more integrated into financial systems, it can help institutions monitor and analyze transactions for BSA compliance more effectively, detecting anomalies or patterns indicative of illicit activities. However, regulators must be cognizant of the harms of offloading such an important law enforcement task to AI systems and should outline best practices for implementing AI systems and require institutions to develop standards for how they use AI to automate anti-money laundering tasks.

- **Require banks to periodically review their BSA systems to ensure accuracy and explainability.** Accurate and timely reports of suspicious activities must be balanced against financial privacy and FinCEN's ability to review the reports it receives. Regulators must ensure the AI institutions' BSA systems use is accurate and can explain why activities are suspicious and therefore flagged. Regulators should require institutions to periodically review their AI – perhaps by hiring outside reviewers – to ensure continued accuracy and explainability to expert and lay audiences. Examiners must be able to review source code and dataset acquisition protocols.

Gramm-Leach-Bliley Act: Disclosure of nonpublic personal information

Relevant agencies: *Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration, Securities and Exchange Commission, Commodity Futures Trading Commission, Consumer Financial Protection Bureau*

Enacted in 1999, the Gramm-Leach-Bliley Act (GLBA) proclaimed it "the policy of the Congress that each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' nonpublic personal information."[90] Accordingly, 15 U.S.C. § 6802 provides that "a financial institution may not … disclose to a nonaffiliated third party any nonpublic personal information" unless it has first provided consumers notice.[91]

The GLBA requires the banking and financial regulators to "establish appropriate … administrative, technical, and physical safeguards" for institutions that 1) "insure the security and confidentiality of customer records and information"; 2) "protect against any anticipated threats or hazards to the security or integrity of such records"; and 3) "protect against unauthorized access to or use of [customer information]."[92] Under this authority, the federal banking regulators have implemented interagency guidelines for establishing information security standards[93] and issued IT and cybersecurity risk management guidance.[94]

Recommendations

The regulators should make further use of this authority to ensure resiliency against AI-designed cyber threats, including the following actions:

- **Require third-party AI audits for all institutions.** AI audits should be required for all institutions. Larger institutions can bring this practice in-house, depending on the ecosystem that develops around AI audits. However, smaller financial institutions may lack the staff and funding for in-house expertise or AI red-teaming but still need to mitigate against AI risk. Accordingly, small institutions should undergo AI security audits by qualified outside consultants to determine where vulnerabilities lie. These audits help identify and address any vulnerabilities in AI systems that might be exploited by cyber threats, thus enhancing overall cybersecurity measures. This includes risks that cybercriminals could use AI to impersonate clients such that institutions inadvertently release customer information erroneously, believing that they are interacting with their clients. Regulators should set out guidelines for appropriate conflict checks and firewall protocols for auditors.

- **Require red-teaming of AI for the largest institutions.** AI red-teaming is defined as "a structured testing effort to find flaws and vulnerabilities in an AI system, often in a controlled environment and in collaboration with developers of AI."[95] The largest firms should already be utilizing red-teaming for their AI products. In addition, they should be running red team/blue team exercises, and the agencies should require the teams to incorporate AI into their efforts. Using AI can significantly increase the speed at which red teams can find and exploit vulnerabilities, leaving blue teams at a significant disadvantage.[96] Firms must know how malicious actors can use AI to attack their infrastructure to defend against it effectively. Banks and other financial institutions must conduct AI red-teaming to fortify their cyber defenses and proactively identify vulnerabilities.

- **Require disclosure of annual resources on AI cybersecurity and AI risk management and compliance.** Financial institutions must disclose their annual resources dedicated to cybersecurity and AI risk management and compliance, which is crucial for transparency and accountability. Given the

escalating reliance on AI-driven technologies in banking operations, the potential vulnerabilities and risks associated with cyber threats amplify significantly. By mandating such disclosures, stakeholders, including customers, regulators, and investors, gain valuable insights into a bank's commitment to mitigating cyber risks through AI.

Equal Credit Opportunity Act

Relevant agency: *Consumer Financial Protection Bureau*

The Equal Credit Opportunity Act (ECOA) was enacted to prevent discrimination in credit granting. The ECOA makes it "unlawful for any creditor to discriminate against any applicant" for credit "on the basis of race, color, religion, national origin, sex or marital status, or age" or "because all or part of the applicant's income derives from any public assistance program."[97] The ECOA requires creditors to provide reasons for credit denials and grants applicants the right to challenge any decision perceived as discriminatory. Its fundamental goal is to promote fair and equal access to credit for all qualified individuals, fostering a more inclusive and equitable financial landscape.

The ECOA allows the Consumer Financial Protection Bureau to "prescribe regulations to carry out the purposes of [the act]," including those it believes "are necessary or proper to effectuate [the ECOA's purposes], to prevent circumvention or evasion thereof, or to facilitate or substantiate compliance therewith."[98] It also requires firms to provide "[e]ach applicant against whom adverse action is taken [with] a statement of reasons for such action."[99]

Recommendations

Using these authorities, the CFPB could consider the following actions:

- **Require lenders to periodically review their lending systems to ensure explainability and that no new discriminatory activity applies.** Research suggests that AI-based systems may result in lending decisions that have a disparate impact,[100] which is a violation of the ECOA.[101] The CFPB has already indicated in guidance that AI-based lending systems cannot be used when those systems "cannot provide the specific and accurate reasons for adverse actions."[102] Nevertheless, the CFPB should require lenders making lending decisions using AI to periodically review those systems – perhaps by hiring outside reviewers – to ensure explainability to expert and lay audiences and to confirm that discrimination does not inadvertently creep in as new data are used. Examiners must review source code and dataset acquisition protocols.

- **Prohibit lenders from using third-party credit scores and models developed with unexplainable AI.** Many lenders use credit scores or other sources of information from third parties, which themselves may use AI to create those ratings.[103] The CFPB should prohibit lenders from using unexplainable scores or models to avoid fair lending requirements and require all lenders subject to the ECOA to obtain information about the explainability of their third-party service providers' AI.

- **Require lenders to employ staff with AI expertise.** As described above, many lenders rely on third-party models for lending decisions. Given the pitfalls of algorithmic lending decisions, these firms must maintain diverse teams that include individuals with AI expertise to understand how such models operate and can introduce bias into firms' lending decisions. These experts are necessary to identify and mitigate potential biases or unintended consequences of algorithmic decision-making. The 2023 executive order on AI required federal agencies to appoint chief artificial intelligence officers (CAIOs),[104] whose duties were further outlined in the OMB M-24-10 AI guidance.[105] The CFPB should follow that model to require firms to similarly designate a CAIO or designate an existing official to assume the duties of a CAIO.

Fair Credit Reporting Act

Relevant agency: *Consumer Financial Protection Bureau*

Recognizing that "the banking system is dependent upon fair and accurate credit reporting" and that "inaccurate credit reports directly impair the efficiency of the banking system," Congress enacted the Fair Credit Reporting Act (FCRA) in 1970.[106] The FCRA generally covers all entities that help create, provide, and use consumer reports and allows the Consumer Financial Protection Bureau to regulate those activities. For example, the FCRA prohibits entities that furnish information to consumer reporting agencies (CRAs) from reporting information that they know have errors, mandating they correct and update false information, and allows the CFPB to craft regulations prescribing policies and procedures that must be followed.[107] For CRAs themselves, the FCRA excludes particular information from reports and requires agencies to describe to users the key factor in credit score information.[108] And for users of consumer reports—which include lenders, employers, and landlords—the FCRA prescribes responsibilities if they take adverse actions based on report information and allows the CFPB to regulate how users provide consumers with credit decision notices and the information contained in such notices.[109] The CFPB may also regulate the procedures for instances where consumers wish to dispute the accuracy of information in reports.[110] The Federal Trade Commission, CFPB, and other agencies have administrative enforcement authority.[111]

Using this regulatory authority, the CFPB has issued regulations creating and requiring firms to use model forms and disclosures,[112] requiring furnishers of information to "establish and implement reasonable written policies and procedures regarding the accuracy and integrity of the information [provided to credit reporting agencies],"[113] and requiring users of credit reports to disclose to consumers when their credit report has been used as a means for determining their risk.[114]

Recommendations

As it relates to AI, the CFPB should consider using these authorities to take the following actions:

- **Require credit reporting agencies to describe whether and to what extent AI was involved in formulating reports and scores.** Although the CFPB has issued guidance making clear that the ECOA requires lenders to make their AI systems explainable,[115] it has yet to do the same with credit reporting agencies. Given that AI-based systems may result in the creation of credit scores that will result in a disparate impact, the CFPB should use its authority over credit reporting agencies to make clear that the AI used to generate credit scores should describe the extent to which AI was used and ensure the scores are explainable.

- **Require credit reporting agencies to periodically review their AI systems to ensure explainability and that no new discriminatory activity applies.** Beyond simply requiring credit reporting agencies' AI systems to be explainable to expert and lay audiences, the CFPB should also require the agencies to periodically review their systems to ensure continued explainability as new data are introduced. CFPB examiners must be able to review source code and dataset acquisition protocols.

- **Require credit reporting agencies to provide for human review of information that consumers contest as inaccurate.** As part of U.S.C. § 1681i "reasonable reinvestigation" mandate, credit reporting agencies should be required to have a human conduct the reinvestigation of AI systems' determinations and inputs.[116] Since AI-based systems may use black-box algorithms to determine credit scores or inputs that create credit scores, individually traceable data are required for adequate human review. As noted above, general explainability is important but would not be sufficient to allow human reviewers to correct potentially erroneous information under the FCRA.

- Given the preceding recommendation, **require users of credit reports to inform consumers of their right to human review of inaccuracies in AI-generated reports in adverse action notices**, per 15 U.S.C. § 1681(m)(4)(B).

- **Update model forms and disclosures to incorporate disclosure of AI usage.** Given the CFPB's mandate that credit reporting agencies and users of credit reports use model forms and disclosures, the CFPB should update those forms to include spaces for model form users to describe their AI usage.

Importantly, "consumer reports" under the FCRA include those that provide information used "in establishing the consumer's eligibility for … employment purposes."[117] "Employment purposes" includes the "purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee."[118] The CFPB should consider several policy changes to explicitly address electronic surveillance and automated management (ESAM) used by employers:

- **Require purveyors of workplace surveillance technologies to comply with the FCRA.** As AI firms become increasingly used to mine data provided by employers, it is important that ESAM software companies be considered credit reporting agencies and comply with the corresponding restrictions. The CFPB should consider adding such companies to its list of credit reporting agencies[119] and issue supervisory guidance explaining the circumstances under which ESAM companies act as CRAs and the corresponding responsibilities that they entail for ESAM companies and employers.

- **Ensure ESAM technologies used by employers comply with the FCRA.** If the CFPB provides that these technology providers are CRAs, the CFPB must also make clear that users of their software comply with the FCRA. Accordingly, it should consider modifying the "Summary of Consumer Rights" issued by the CFPB to include information about employee FCRA rights concerning employers' use of ESAM technologies.[120] It should also consider modifying "Appendix E to Part 1022" to identify how employers furnishing employee data to ESAM technology companies and data brokers must ensure the accuracy of their furnished information.[121]

Community Reinvestment Act

Relevant agencies: *Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation*

Enacted to undo the pernicious effects of redlining,[122] the Community Reinvestment Act (CRA) encourages banks to meet the credit needs of the communities in which they operate, particularly low- and moderate-income neighborhoods. The CRA requires banks to actively engage in lending, investment, and service activities in these underserved communities by mandating periodic evaluations of banks' performance in meeting the community's credit needs.[123] The CRA grants federal banking regulators the authority to regulate banks' compliance with the law.[124]

The CRA does not allow regulators to change banks' lending decisions, only to decide how it will evaluate whether banks comply with the act. The regulators' rules allow banks to submit strategic plans for complying with the CRA[125] and establish assessment areas for determining compliance.[126]

Recommendation

The federal banking regulators should consider using their authority to:

- **Require banks to indicate whether they use AI to comply with CRA regulations and, if so, require those systems to be explainable.** Given AI systems' abilities to wade through mountains of information and identify the most profitable outcomes, banks may use them to game CRA regulations. For example, banks may use AI to help determine the most optimal assessment areas for profitability purposes. Regulators should require banks to disclose if they use AI to comply with the CRA or with regulations promulgated thereunder. In addition, these AI systems should be required to be explainable to expert and lay audiences to ensure that designated assessment areas are logical. Examiners must be able to review source code and dataset acquisition protocols.

Consumer Financial Protection Act: UDAAP authority

Relevant agency: *Consumer Financial Protection Bureau*

Following the great financial crisis of 2007–2008, Congress enacted the Consumer Financial Protection Act (CFPA) as Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010. Among other things, the CFPA created the Consumer Financial Protection Bureau to ensure fairness, transparency, and accountability in providing consumer financial products and services by regulating those products and services and enforcing the nation's consumer financial protection laws.[127] The Consumer Financial Protection Bureau regulates various financial sectors, including banks, credit unions, mortgage servicers, payday lenders, and debt collectors, striving to educate consumers and monitor financial practices.

One of the most potent authorities provided to the CFPB is its authority to "take any action authorized ... to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service."[128] Under this so-called UDAAP authority, the CFPB may also write regulations "identifying as unlawful" particular acts or practices and "may include requirements for the purpose of preventing such acts or practices."[129] In other words, the CFPB can regulate consumer financial service providers to ensure their activities are not unfair, deceptive, or abusive.

Recommendations

Using this authority, the CFPB should consider the following actions:

- **Require financial institutions' consumer-facing AI systems to accurately respond to customer inquiries and execute transactions subject to strict consumer protection standards, periodically reviewing consumer-facing AI systems to ensure accuracy and explainability.** As institutions begin using AI chatbots to communicate with customers, these systems must provide consumers with accurate information about their accounts, their firms' policies and procedures, and the law. In addition, as these AI systems begin to be used for more than simply providing information – such as executing customers' money transfers or asset purchases – it is imperative that they accurately and effectively execute transactions according to customers' wishes and execute only transactions that are legal and comply with firms' policies. The CFPB must ensure that institutions' consumer-facing AI systems are accurate in all respects and require, through rulemaking, periodic review of their systems to ensure accuracy.

- **Require AI red-teaming and red team/blue team exercises for the largest institutions.** The CFPB's UDAAP authority can be used to prohibit the inadvertent disclosure of consumers' information at institutions not subject to the GLBA.[130] Nonbank consumer financial service providers hold a wealth of information about customers that malicious AI systems feed off, and they may be liable for customer losses stemming from AI-enabled fraud.[131] With AI red-teaming[132] or red team/blue team exercises, the red team attempts to attack a company's information technology infrastructure while the blue team defends against such hacks. The largest firms should already be utilizing AI red-teaming and red team/blue team exercises, but given that real-world attackers have AI at their disposal, the agencies should require this. Having teams use AI can significantly increase the speed with which red teams can find and exploit vulnerabilities, leaving blue teams at a significant disadvantage.[133] Firms must understand how malicious actors can use AI to attack their infrastructure and defend against it. Institutions must conduct AI red-teaming and red team/blue team exercises leveraging AI to fortify their cyber defenses and proactively identify vulnerabilities.

- **Require third-party AI audits for all institutions.** AI audits should be required by all institutions. Larger institutions can bring this practice in-house, depending on the ecosystem that develops around AI audits. However, smaller financial institutions may lack the staff and funding for in-house expertise or AI red-teaming or red team/blue team exercises[134] but still need to mitigate against AI risk. Accordingly, small institutions should be required to undergo AI security audits by outside consultants to determine where vulnerabilities lie. These audits help identify and address any vulnerabilities in AI systems

that might be exploited by cyber threats, thus enhancing overall cybersecurity measures. The CFPB may require such audits because failure to do so while claiming accurate and secure systems is unfair. Regulators should set guidelines for appropriate conflict checks and firewall protocols for auditors.

- **Require disclosure of annual resources dedicated to cybersecurity and AI risk management and compliance.** Requiring nonbank consumer financial service providers to disclose their annual resources dedicated to cybersecurity and AI risk management and compliance is crucial for transparency and accountability. Given the escalating reliance on AI-driven technologies in financial institution operations,[135] the potential vulnerabilities and risks associated with cyber threats amplify significantly. The CFPB could enact regulations mandating such resource disclosures for spending on cybersecurity and AI risk management and compliance. By mandating such disclosures, stakeholders, including customers, regulators, and investors, would gain valuable insights into the extent of an institution's commitment to mitigating cyber risks through AI.

Federal Deposit Insurance Act, Federal Credit Union Act, and Bank Holding Company Act

Relevant agencies: *Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration*

The Federal Deposit Insurance Act (FDIA) and the Federal Credit Union Act (FCUA) are two of the core statutes that permit banking and credit union regulators to ensure the safety and soundness of institutions under their respective jurisdictions.[136] The Bank Holding Company Act (BHCA) similarly provides the Federal Reserve with many of the same authorities for bank holding companies. Under these statutes, banking regulators are required to prescribe standards relating to "internal controls, information systems, and internal audit systems" as well as any "other operational and managerial standards as the agency determines to be appropriate."[137] The National Credit Union Administration (NCUA) is required to "promulgate rules establishing minimum standards … of security devices and procedures."[138] Regulators may also enforce prohibitions against activities that are unsafe or unsound.[139]

Pursuant to these authorities, regulators have issued a wide array of regulations and guidance designed to ensure financial institutions adhere to the highest operational standards. For example, they have issued guidelines establishing standards for safety and soundness covering loan documentation, credit underwriting, and asset quality.[140] They have also issued information security standards "for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information."[141] Regulators

routinely examine institutions to ensure adherence to heightened standards and to identify unsafe or unsound activities and issue a host of guidance identifying risky acts and practices that institutions may consider addressing.[142]

Recommendations

Using these authorities, the Federal Reserve, FDIC, OCC, and NCUA should consider the following actions:

- **Require financial institutions' customer-facing AI systems to accurately respond to customer inquiries and execute transactions subject to strict standards and require those institutions to periodically review their customer-facing AI systems to ensure accuracy and explainability.** As institutions begin using AI chatbots to communicate with customers, these systems provide customers with accurate information about their accounts, their firms' policies and procedures, and the law. In addition, as these AI systems begin to be used for more than simply providing information – such as executing customers' money transfers or asset purchases – it is imperative that they accurately and effectively execute transactions according to customers' wishes and execute only transactions that are legal and within firms' policies. Regulators must ensure that institutions' customer-facing AI systems are accurate and require periodic reviews of their systems to ensure accuracy.

- **Ensure banks' capital structures can withstand sudden and deep withdrawals of customer deposits or losses from banks' risk management processes.** Banks' corporate clients are likely to begin using AI systems for treasury management – including bank deposits – and there are likely to be only a small number of providers of such systems, given the large computing power necessary for effective AI.[143] AI-based treasury management systems may automatically move all firms' cash, simultaneously creating significant movements of cash between financial institutions in short periods of time that result in sudden and significant drops in customer deposits. Regulators must ensure that banks maintain sufficient shareholder capital and high-quality liquid assets that enable them to withstand such shifts without failing.

- **Require that AI systems that are parts of banks' capital, investment, and other risk management models be explainable.** Banks today use various systems to automate their capital management strategies, evaluate investment opportunities, and otherwise mitigate risk. They will inevitably use AI for these and other purposes that have significant effects on their profitability and stability. The banking agencies already review firms' risk management practices regarding the various models they use, and regulators should do the same with AI. Specifically, all AI systems must be explainable to expert and lay audiences. Examiners must be allowed to review source code and dataset acquisition protocols.

- **Ensure firms may move between different AI systems before they contract for one system.** The sheer amount of computing power involved in generative AI means that most financial institutions will not develop their own systems in-house; instead, they will license software from a few competing nonfinancial institutions.[144] Financial firms must be able to move between different and competing AI systems to avoid lock-in. Accordingly, regulators should make it a prerequisite for using AI that any system adopted from a third-party service provider allows for easy transition to a competing system upon the contract's expiration. Regulators must ensure that there are many – for example, at least five – providers of AI software for banks that provide for base interoperability, so that not all institutions are using the same one or two pieces of software.

- **Require disclosure of annual resources dedicated to cybersecurity and AI risk management and compliance.** Financial institutions must disclose their annual resources dedicated to cybersecurity and AI risk management and compliance, which is crucial for transparency and accountability. Given the escalating reliance on AI-driven technologies in banking operations, the potential vulnerabilities and risks associated with cyber threats amplify significantly. By mandating such disclosures, stakeholders, including customers, regulators, and investors, gain valuable insights into the extent of a bank's commitment to mitigating cyber risks through AI. Bank and credit union annual disclosures could provide these disclosures.

Dodd-Frank Act: Systemic risk designation

Relevant agency: *Financial Stability Oversight Council*

The Dodd-Frank Act (DFA), enacted following the great financial crisis of 2007–2008, created the Financial Stability Oversight Council to "identify risks to the financial stability of the United States" and "respond to emerging threats to the stability of the United States financial system."[145] Among the authorities the DFA granted to the FSOC is the ability to designate financial market utilities (FMUs) as systemically important and subject to supervision and regulation by the Federal Reserve. Under statute, FMUs are "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."[146]

To designate FMUs, the FSOC can merely determine that they "are, or are likely to become, systemically important."[147] To make this determination, the FSOC is statutorily required to consider five factors: 1) "the aggregate monetary value of transactions processed by the financial market utility"; 2) "the aggregate exposure of the financial market utility … to its counterparties"; 3) "the relationship, interdependencies, or other interactions of the financial market utility … with other financial

market utilities or payment, clearing, or settlement activities"; 4) "the effect that the failure of or a disruption to the financial market utility ... would have on critical markets, financial institutions, or the broader financial system"; and 5) "any other factors that the Council deems appropriate."[148] In the FSOC's rules detailing its process for designating FMUs, it provides that it makes "two critical determinations" in deciding whether to act: first, "whether the failure of or a disruption to the functioning of the FMU now or in the future could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets"; second, "whether the spread of such liquidity or credit problems among financial institutions or markets could threaten the stability of the financial system of the United States."[149] Using this authority, the FSOC has designated eight FMUs, all clearinghouses.[150]

In a March 2024 interview with Politico, SEC Chair Gary Gensler warned about the dangers of concentration with AI and financial systems: "We have set up a lot of our systems of oversight and rules around regulating individual entities or activities, whether it's bank regulators, insurance regulators, securities regulators, commodities regulators." Gensler added that it was important to be "thinking about [AI] across all the entities — are they potentially all using the same base model or base data?"[151] He also noted the threat of AI concentration in the financial system, saying: "I would be quite surprised if in the next 10 or 20 years a financial crisis happens and there wasn't somewhere in the mix some overreliance on one single data set or single base model somewhere."[152]

While AI usage has yet to reach levels that justify designation as FMUs, if AI has the impact and widespread adoption predicted by some, then that future designation may be warranted.

Recommendations

Using this FMU designation authority, the FSOC should consider the following actions in the event that major providers of AI services reach a level of systemic importance to warrant oversight under these authorities:

- **Designate major providers of AI services to financial institutions as systemically important if they reach an adoption level that creates vulnerability.** It may appear incongruous at first glance to designate AI service providers as not only systemically important but also as systemically important FMUs. They do not facilitate payments, are not clearinghouses, do not provide for settlement of financial transactions, nor do they engage in significant financial transactions with counterparties. However, providers of AI services to the largest and most systemically important financial institutions could still meet the FSOC's two determinations if they become so important to traders and market makers that, if the AI systems stop working for those firms, it "could create, or increase, the risk of significant liquidity or credit problems [in the markets]."[153]

Consider, for example, that market makers such as investment banks use AI systems to facilitate trades. If those systems stop working or execute faulty trades, significant liquidity could be removed from the markets, causing asset prices to drop precipitously along with financial instability. Similar arguments may be made for brokers using AI to manage their funding needs: If AI systems stop working, those brokers could lose access to funding sources, causing them to collapse. And the same is potentially true for high-frequency traders using AI to manage their trades – as faulty AI systems could result in flash crashes. Accordingly, the FSOC should monitor which AI systems are relied on by significant players in the markets and consider designating them as systemically important if their failure could threaten the stability of the U.S. financial system.

- **Designate the cloud service providers to those firms designated as systemically important.** AI systems rely on cloud service providers, such as Amazon Web Services or Microsoft Azure, to operate; thus, if these cloud providers fail, AI systems also fail.[154] Indeed, AI programs run on cloud providers' servers and require cloud providers' computing power to conduct the large-scale language processing required for AI. To the extent that AI software is of systemic importance to the financial system and may pose systemic risks if it fails, the fact that AI software cannot operate without cloud providers means that cloud providers are also of systemic importance to the financial system and may pose systemic risks themselves. This is not a new idea; members of Congress and advocacy organizations have previously called for such designation.[155] However, the rise of AI gives this proposal new urgency. Accordingly, once the FSOC identifies which AI systems are systemically important, it should determine the cloud providers on which they rely and consider designating them as systemically important.

Securities Exchange Act of 1934

Relevant agency: *Securities and Exchange Commission*

The Securities Exchange Act of 1934, or "1934 Act," is a cornerstone of securities regulation in the United States, enacted to ensure transparency, integrity, and fairness within the securities markets.[156] The 1934 Act created the Securities and Exchange Commission to regulate the markets and enacted rules governing the secondary trading of securities. It aims to protect investors by mandating the disclosure of crucial financial information, preventing fraudulent practices such as insider trading and market manipulation, and overseeing the operations of securities exchanges.

The 1934 Act governs, and allows the SEC to regulate, brokers, exchanges and alternative trading systems, and clearinghouses, among other institutions. It broadly enables the SEC "to make such rules and regulations as may be necessary or appropriate to implement [the act]."[157] In addition, the 1934 Act provides the SEC with

authority to enact regulations specific to different market participants or registered entities. For example, Section 15 of the act, permits the SEC to "establish minimum financial responsibility requirements" and "standards of operational capability" for brokers,[158] which it has used to enact net capital requirements,[159] risk management practices,[160] and an array of information technology standards.[161] Furthermore, the combination of sections 6, 11A, 15A, and 17A permits the SEC to "facilitate the establishment of a national market system for securities" by allowing it to enact rules requiring exchanges and clearinghouses to "[have] the capacity to . . . carry out the purposes of [the act]."[162] Under these authorities, the SEC enacted Regulation Systems Compliance and Integrity, a comprehensive information technology regulation that requires these entities to "establish written policies and procedures" that "ensure that their systems have levels of capacity, integrity, resiliency, availability, and security" and "[create] business continuity and disaster recovery plans."[163]

Recommendations

Using these authorities, the SEC should consider the following actions:

- **Require that AI systems that are parts of brokers' capital, investment, and other risk management models be explainable.** Brokers use a variety of systems to automate their capital management strategies, evaluate investment opportunities, and mitigate risk. They will inevitably use AI for these and other purposes that significantly affect their profitability and stability. The SEC already regulates brokers' risk management models,[164] and it should do the same with AI. Specifically, all AI systems must be explainable to expert and lay audiences. The SEC should also ensure that it and FINRA's examiners may review source code and dataset acquisition protocols.

- **Require brokers' customer-facing AI systems to accurately respond to customer inquiries and execute transactions subject to strict investor protection standards, with those brokers periodically reviewing their customer-facing AI systems to ensure accuracy and explainability.** As institutions begin using AI chatbots to communicate with customers, these systems must provide clients with accurate information about their accounts, their policies and procedures, and the law. In addition, as these AI systems are used for more than simply providing information – such as executing customer trades – it is critical that they accurately and effectively execute transactions according to customers' wishes and execute only transactions that are legal and within firms' policies. The SEC must ensure that brokers' customer-facing AI systems undergo periodic review to ensure accuracy through third-party audits.

- **Require brokers using AI systems to make investment recommendations to ensure those systems are explainable and operate in clients' best interests.** There may come a day when AI systems are used to make investment recommendations. Before that occurs, the SEC must make clear that any AI systems used for that purpose must comply with existing rules that require investment recommendations to be in clients' best interests.[165] Among other things, AI systems must be explainable to expert and lay audiences. Brokers must also be able to explain why their recommendations are not provided based on conflicts of interest. Furthermore, the SEC should require brokers using AI to make investment recommendations to periodically review those systems and ensure that examiners may review source code and dataset acquisition protocols.

- **Require red-teaming of AI for exchanges, alternative trading systems, and clearinghouses.** AI red-teaming is defined as "a structured testing effort to find flaws and vulnerabilities in an AI system, often in a controlled environment and in collaboration with developers of AI."[166] The largest firms should already be utilizing red teaming for their AI products. In addition, they should be running red team/blue team exercises, and the agencies should require the teams to incorporate AI into their efforts. Using AI can significantly increase the speed with which red teams can find and exploit vulnerabilities, leaving blue teams at a significant disadvantage.[167] Firms must be aware of how malicious actors can use AI to attack their infrastructure to be able to defend against it. Banks and other financial institutions must conduct AI red-teaming to fortify their cyber defenses and proactively identify vulnerabilities. Given the systemic importance of these firms, the SEC should not allow third-party audits to suffice, but rather deploy multiple steps to ensure security and protection.

- **Ensure firms may move between different AI systems before they contract for one system.** The sheer amount of computing power involved in generative AI means that most financial institutions will not develop their own systems in-house; instead, they will license software from a few competing nonfinancial institutions.[168] It will be imperative that financial firms be able to move between different and competing AI systems to avoid lock-in. Accordingly, the SEC should make it a prerequisite of using AI that any system adopted from a third-party service provider allows for easy transition to a competing system upon the contract's expiration. The SEC could require that brokers, exchanges, alternative trading systems, and clearinghouses ensure that there are many – for example, at least five – providers of AI software that provide for base interoperability before entering contracts, so that not all institutions are using the same one or two pieces of software.

- **Require disclosure of annual resources dedicated to cybersecurity spending and AI risk management and compliance.** Financial institutions must disclose their annual resources dedicated to cybersecurity and AI risk management and compliance for transparency and accountability. Given the escalating reliance on AI-driven technologies in financial services, the potential vulnerabilities and risks associated with cyber threats amplify significantly. The SEC should, accordingly, mandate brokers, exchanges, and clearinghouses to disclose their annual expenditures on cybersecurity and AI risk management and compliance. By mandating such disclosures, the SEC can gain valuable insights into the extent of a firm's commitment to mitigating AI risk management.

Investment Advisers Act of 1940

Relevant agency: *Securities and Exchange Commission*

The Investment Advisers Act (IAA) regulates the activities of firms providing investment advice to clients. Under the IAA, investment advisers must register with the Securities and Exchange Commission if they manage assets above certain thresholds, becoming registered investment advisers (RIAs); comply with SEC regulations; and adhere to a fiduciary duty vis-à-vis their clients. Under the IAA, the SEC may regulate how firms safeguard client assets over which they have custody[169] and may "promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors."[170]

Recommendations

Accordingly, the SEC should consider the following actions:

- **Require that RIAs' AI systems used to make investment recommendations are explainable and operate in clients' best interests.** There may come a day when AI systems are used to make investment recommendations. Before that occurs, the SEC must make clear that any AI systems used for that purpose must comply with existing rules that require investment recommendations to be in clients' best interests. Among other things, RIAs' AI systems must be explainable to both expert and lay audiences and explain why their recommendations are not provided based on conflicts of interest. Furthermore, the SEC should require RIAs that use AI to make investment recommendations to periodically review those systems and ensure that examiners may review source code and dataset acquisition protocols.

- **Require RIAs' customer-facing AI systems to accurately respond to customer inquiries and execute transactions subject to strict investor protection standards, with RIAs periodically reviewing their customer-facing AI systems to ensure accuracy and explainability.** As institutions begin using AI chatbots to communicate with customers, these systems provide clients with accurate information about their accounts, their firms' policies and procedures, and the law in a manner that is not misleading. In addition, as these AI systems begin to be used for more than simply providing information – such as executing customer trades – it is imperative that they accurately and effectively execute transactions according to customers' wishes and execute only legal transactions within firms' policies. The SEC must ensure that RIAs' customer-facing AI systems are accurate and require periodic reviews of their systems to ensure accuracy.

- **Ensure RIAs may move between different AI systems before they contract for one system.** The sheer amount of computing power involved in generative AI means that most financial institutions will not be developing their systems in-house; instead, they will license software from a small number of competing nonfinancial institutions.[171] It is imperative that RIAs are able to move between different and competing AI systems to avoid lock-in. Accordingly, the SEC should make it a prerequisite for using AI that any system adopted from a third-party service provider allows for easy transition to a competing system upon the contract's expiration. The SEC must require that RIAs ensure that there are many – for example, at least five – providers of AI software that provide for base interoperability before entering contracts, so that not all institutions are using the same one or two pieces of software.

Commodity Exchange Act

Relevant agency: *Commodity Futures Trading Commission*

The Commodity Exchange Act (CEA) regulates the trading of commodity futures and other derivatives to ensure fair and efficient markets while preventing fraud and manipulation. The CEA created the Commodity Futures Trading Commission to oversee these markets, which requires the registration and regulation of various registrants, trading platforms, and clearinghouses. Originally enacted to protect farmers and ranchers in hedging their risks, the CEA now also covers trades worth trillions of dollars of value.

The CEA allows the CFTC to "make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the act]."[172] In addition, the CFTC has specific grants of regulatory authority over different market participants.

For example, the CFTC may “prescribe rules applicable to swap dealers and major swap participants,” including rules explicitly related to “business conduct standards” and “minimum capital requirements.”[173] For futures commission merchants (FCMs), the CFTC may enact “minimum financial requirements”[174] and regulations governing how these entities handle customer assets.[175] Exchanges must comply with acceptable business practices;[176] “have adequate financial, operational, and managerial resources”; “[create risk management programs] to identify and minimize sources of operational risk”; and “establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery”—and the CFTC may prescribe rules governing all of these activities.[177] Similar requirements apply to clearinghouses, which the CFTC can regulate similarly.[178] With these authorities, the CFTC has enacted various regulations, including the first rules on algorithmic trading.[179] The agency has also recently proposed a rule for cyber and operational resilience.[180]

Recommendations

Using these myriad authorities, the CFTC should consider the following actions:

- **Require AI systems that are parts of futures commission merchants’, swap dealers’, or major swap participants’ capital, investment, or other risk management models to be explainable.** Today, these entities use a variety of systems to automate their capital management strategies, evaluate investment opportunities, and mitigate risk. They will inevitably begin using AI for these and other purposes that significantly affect their profitability and stability. The CFTC should regulate its AI models and ensure that all AI systems are explainable to expert and lay audiences. The CFTC should also ensure that it and the National Futures Association’s examiners may review source code and dataset acquisition protocols.

- **Require futures commission merchants’ customer-facing AI systems to accurately respond to customer inquiries and execute transactions subject to strict investor protection standards.** As institutions begin using AI chatbots to communicate with customers, these systems provide clients with accurate information about their accounts, their firms’ policies and procedures, and the law. In addition, as these AI systems begin to be used for more than simply providing information – such as executing customer trades – it is imperative that they accurately and effectively execute transactions according to customers’ wishes and execute only transactions that are legal and within firms’ policies. The CFTC must ensure that FCMs’ customer-facing AI systems are accurate in all respects and require periodic reviews of those systems to ensure accuracy and explainability.

- **Require that FCMs' AI systems used to make investment recommendations be explainable and operate in clients' best interests.** There may come a day when AI systems are used to make investment recommendations. Before that occurs, the CFTC must make clear that any AI systems used for that purpose must comply with existing rules that require investment recommendations to be in clients' best interests. Among other things, AI systems must be explainable to expert and lay audiences and explain why recommendations are not provided based on conflicts of interest. Furthermore, the CFTC should require FCMs using AI to make investment recommendations, to periodically review those systems, and to ensure that examiners can review source code and dataset acquisition protocols.

- **Require red-teaming of AI for swap dealers, exchanges, and clearinghouses.** AI red-teaming is defined as "a structured testing effort to find flaws and vulnerabilities in an AI system, often in a controlled environment and in collaboration with developers of AI."[181] The largest firms should use red-teaming for their AI products. In addition, they should run red team/blue team exercises and require the teams to incorporate AI into their efforts. Using AI can significantly increase the speed with which red teams can find and exploit vulnerabilities, leaving blue teams at a significant disadvantage.[182] Firms must be aware of how malicious actors can use AI to attack their infrastructure to be able to defend against it. Banks and other financial institutions must conduct AI red-teaming to fortify their cyber defenses and proactively identify vulnerabilities.

- **Require third-party AI audits for all institutions.** All institutions should require AI audits. Larger institutions can bring this practice in-house, depending on the ecosystem that develops around AI audits. However, smaller financial institutions may lack the staff and funding for in-house expertise or AI red-teaming but still need to mitigate against AI risk. Accordingly, small institutions should be required to undergo AI security audits by outside consultants to determine where vulnerabilities lie. These audits help identify and address any vulnerabilities in AI systems that might be exploited by cyber threats, thus enhancing overall cybersecurity measures. Regulators should set out guidelines for appropriate conflict checks and firewall protocols for auditors.

- **Ensure firms can move between different AI systems before they contract for one system.** The sheer amount of computing power involved in generative AI means that most financial institutions will not be developing their systems in-house; instead, they will license software from a few competing nonfinancial institutions.[183] It is imperative that financial firms are able to move between different and competing AI systems to avoid lock-in. Accordingly, the CFTC should make it a prerequisite for using AI that any system adopted from a third-party service provider allows for an easy transition to a competing

system upon the contract's expiration. The CFTC must require that all registrants and registered entities ensure that there are many – for example, at least five – providers of AI software that provide for base interoperability before entering contracts, so that not all institutions use the same one or two pieces of software.

- **Require disclosure of annual resources dedicated to cybersecurity and AI risk management and compliance.** Financial institutions must disclose their annual resources dedicated to cybersecurity and AI risk management and compliance, which is crucial for transparency and accountability. Given the escalating reliance on AI-driven technologies in financial services, the potential vulnerabilities and risks associated with cyber threats amplify significantly. Accordingly, the CFTC should mandate that registrants and registered entities disclose their annual expenditures on cybersecurity and AI risk management and compliance. By mandating such disclosures, the CFTC can gain valuable insights into the extent of a firm's commitment to mitigating AI risks.

Conclusion

The numerous U.S. financial regulators have ample statutory authority to address concerns AI may pose to customers, banks, securities brokers and futures commission merchants, securities and derivatives exchanges, and other market intermediaries. U.S. financial regulators must begin to address these challenges now with their existing authorities and tools to ensure the success and stability of the U.S. financial system in the AI age. GFI and CAP hope this chapter will offer thoughtful options to regulators as they undertake their AI work.

Read the fact sheet

The accompanying fact sheet lists all of the recommendations detailed in this chapter of the report.

Endnotes

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