

## Slaughter and May

### Regulating AI - AI in Financial Services - Facing the future

<b>Selmin Hakki</b>	<p>Hello, my name is Selmin Hakki and I'm a lawyer in the financial regulation team at Slaughter and May. I'm joined today by my colleague Tim Fosh to talk about the regulation of AI in financial services, which is the subject of wide ranging debate in the UK and internationally and also the topic of a recent discussion paper that was published jointly by the Bank of England and the FCA.</p> <p>This video forms part of a series of regulating AI thought pieces that cover a range of topics from a competition law consideration when using algorithms to IP, data and employment issues linked to AI use. You can find all those pieces on the Slaughter and May website.</p> <p>But Tim, turning to today, and the regulation of AI in financial services. The deployment of AI in financial services has accelerated rapidly in recent years, can you talk us through some of the common areas of deployment.</p>
<b>Tim Fosh</b>	<p>Sure, I mean as with anything in this area, it depends what you mean by AI. It's a broad, water front of term that has a multitude of different options and potential products and deployments. Just quickly, things like algorithmic training, high-frequency trading go back a number of years now, customer KYC and due diligence, credit monitoring and credit scoring in the financial services lending sector. Things like robo-advice has become bigger over the last few years. Capital and credit modelling and capital risk modelling, really its increasing all the time, you can't really stick a pin in it in it at any one particular moment. As you say it's developing and there isn't an area of financial services that isn't deploying it and isn't thinking of further deployments.</p>
<b>Selmin Hakki</b>	<p>And there's quite a comprehensive overview of deployment isn't there, in the joint survey that has been conducted by the Bank of England and the FCA back in 2019.</p>
<b>Tim Fosh</b>	<p>Indeed, but as with anything that's only good at a point of time and it's never going to get everything, even then.</p>
<b>Selmin Hakki</b>	<p>And now looking at regulation, the UK government put out a policy paper in July, in which it set out its emerging thinking and we know from that paper that it plans to set out a framework that it plans to create a framework that is pro-innovation, adaptable and context specific. Now there's no set regulatory specific framework for the use of AI by financial institutions at the moment, and yet the discussion paper that I mentioned sort of canters through a myriad of requirements that seem to apply, so how is the use of AI governed for financial services firms at the moment?</p>
<b>Tim Fosh</b>	<p>Well it's often described as 'technology neutral' which essentially means there aren't specific rules for AI. If you are a financial services firm deploying AI you</p>

	<p>need to apply the same rules and principles as you do in your business more widely, so that's things like treating your customers fairly, product governance and design, governance more widely, systems and controls, outsourcing – I mean the list is almost endless, as many as there are regulatory requirements.</p> <p>But that then is obviously far easier said than done when these are novel products, they're novel technologies and a lot of the time firms have found difficulty actually applying those principles which weren't designed for purpose to these new concepts. So one of the things the industry has been calling out for, for a while now, is greater clarity on exactly what it means to apply those principles and those rules, one of the things the discussion paper suggests might be happening in the future is more of a development of specific guidance as to what it means in reality to implement those rules in a fit for purpose way in the AI space.</p>
<b>Selmin Hakki</b>	<p>And we, I guess, tend to suggest to clients that they might be better off looking at AI as, well as much of a business issue as a technology issue, so not just isolated to the IT department. With that in mind, what do you think the governance implications are for firms deploying AI?</p>
<b>Tim Fosh</b>	<p>I mean I think they're similar to governance issues which arise sort of in respect to any product, but they're complicated by the fact AI sort of goes across multiple different areas. And also by definition AI often excludes a lot of human factor which would otherwise be involved.</p> <p>I think the most important thing is that those in charge and those at the top of the governance and indeed in the levels in between, actually understand the risks, opportunities and operation of the AI they've got. That doesn't necessarily mean they have to understand the intricacies of all of the different algorithms, but they need to understand what good results look like and what they need to guard against, and that's going to require education of the people at the top of the business and the levels in between. If they don't understand what they're trying to guard against then the risk is that they don't guard against it and then you have negative outcomes both for customers and ultimately for the firm. There's a need to be able to explain all of those elements to the various stakeholders, not only internally but also externally, particularly regulators and potentially to a lesser extent customers, depending on what the particular firm thinks about transparency in the context of their AI products.</p>
<b>Selmin Hakki</b>	<p>And there's no dedicated SMF for AI at present is there?</p>
<b>Tim Fosh</b>	<p>No there isn't. I mean AI probably falls within a number of different places, it could fall under SMF24 potentially or SMF4, but also the responsibility for particular business units that might rely heavily on AI or that might have products that do, and therefore are particularly revenue generative. So it's not that any particular senior manager can now, or probably even in the future, just abscond themselves of responsibility for AI, it's important that as a level of</p>

	<p>senior management there is a collective amount of experience and understanding and knowledge of how these things work such that collectively there is an understanding of the risks as I was saying arising from it.</p>
<b>Selmin Hakki</b>	<p>You touched briefly on transparency and I have a trickier question – how much do you think firms need to tell their customers about the use of AI?</p>
<b>Tim Fosh</b>	<p>Yes, that is a tricky question thank you Selmin. I'll give it a slightly weasely answer which is, it depends. I think it depends on a number of different things: what your product is, how the AI is used in that, how complicated it is, but also who your customers are. There are a number of different rules and principles you can apply in this area, so the Principle Seven requirement to consider the information needs of your customers and communicate with them in a way that is clear, fair and not misleading. And also increasingly in the future, the consumer duty, which includes all sorts of requirements around communicating with the customers.</p> <p>But I think you need to be mindful of the fact that transparency is not necessarily a goal in of itself. You need to consider what it is that your customers are going to get out of any transparency, so in most circumstances it is unlikely probably to give complete transparency to the code and inner workings of the various bits of the AI because that's only going to confuse customers more.</p> <p>I don't think there is any one answer here, you need to consider it in the round as to a number of different factors and that will often lead to different results and different circumstances. But it is incumbent on the management and going back to the governance to actually consider all of the relevant factors in coming to that decision.</p>
<b>Selmin Hakki</b>	<p>Now we've spoken about the discussion paper, it looks at the pros and cons of different policy approaches to the regulation of AI, but it doesn't actually set out any concrete regulatory measures does it? So how do you see the regulators supervisory approach evolving in the future?</p>
<b>Tim Fosh</b>	<p>I mean I think we're going to continue with the technology neutral approach. I think everything we've seen suggests that's the way we're going, we're going with maybe a loose framework of a principles based approach but based on current rules and current guidance, no specific rules for AI. But I think we'll increasingly see guidance and I think the discussion paper suggests that's potentially where we're going, the regulators will give more worked examples of what is good and bad practice, potentially harking back to things like the cloud outsourcing guidance which they've given in the past, to show firms how they might apply the rules and guidance in particular different areas. It might even be the case that we see some guidance developing in respect, or coming out of, enforcement action, although I don't think that's the way the regulators ideally want it to happen. I think it's going to be more formalised guidance and firms</p>

	then having a slightly clearer view of what it means to apply the existing and wider rules in this narrower context.
<b>Selmin Hakki</b>	Yes, and it certainly seems like it's something the industry wants. I think it was one of the points that was raised in the 'Artificial Intelligence Public-Private Forum'. The final report said that one of the challenges to adoption at the moment in the UK by firms, is the perceived lack of clarity about how firms should actually apply existing requirements at a practical level.
<b>Selmin Hakki</b>	So Tim, do you have any final words of wisdom for firms that are looking to deploy an AI programme?
<b>Tim Fosh</b>	I think firms really need to think about why they're doing it and what it means to deploy AI. It's not enough to deploy it just to do it and to be seen to do it, they need to identify the benefits both to themselves and to their customers in designing the product and designing what the outcomes should be. They also need to be able to monitor those outcomes and ideally tweak the AI in order to achieve better outcomes if things aren't going well. Also to have the courage, potentially, to have the courage to stop relying on AI if indeed it is not bringing those benefits which they initially identified.
<b>Selmin Hakki</b>	Great, thank you for joining me today,
<b>Tim Fosh</b>	Thanks, Selmin.