

Regulators assess AI discussion paper feedback

AT A GLANCE

October 2023

What's new?

- The BoE, FCA and PRA ('the regulators') published a [feedback statement](#) (FS) on 26 October 2023 assessing the responses they received on a [discussion paper](#) (DP5/22) regarding use of artificial intelligence (AI) in financial services, released in October 2022.
- Key points discussed in the FS include the definition of AI, domestic and international regulatory alignment on aspects of the regulatory framework and issues such as consumer outcomes, data, model risk management and third-party risk.
- The feedback statement is part of a broader initiative to engage with the industry and understand the implications of AI on the financial sector. The statement does not present new policy proposals or guidance for firms.

What does this mean?

- The FS provides analysis of the 54 responses received to DP5/22.
- The regulators received feedback from a diverse range of stakeholders including industry bodies, banks, technology providers, consumer associations, insurance and financial market infrastructure. They indicate that there was no significant divergence of opinion between sectors.
- The regulators note a number of key points that most respondents made, including:
- **Sectoral AI definition:** Respondents suggested that a technology-neutral, outcomes-based, and principles-based approach would be effective in supporting the safe and responsible adoption of AI in financial services.
- The FS notes that defining AI for regulatory purposes would be challenging due to rapid evolution in the technology, the risk of overly broad or narrow definitions, potential

encouragement of regulatory arbitrage, and a clash with the technology-neutral regulatory approach.

- **Regulatory coordination and alignment:** Respondents called for a more harmonised approach to AI regulation at both domestic and international levels.
- Respondents highlighted challenges related to the fragmentation of data regulation and insufficient regulation covering data access, data protection, and data privacy (which, for example, impacts monitoring bias). The FS notes that many respondents would find value in an alignment of data definitions/taxonomies and greater harmonisation among sectoral regulators.
- **Consumer outcomes focus:** A majority of respondents cited consumer protection as an area for the regulators to prioritise.
- They also indicated that the focus of regulation and supervision should be on consumer outcomes, especially with respect to ensuring fairness and other ethical dimensions.

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- Respondents suggested that the regulators could release guidance to clarify regulatory expectations. For example, how the FCA will assess the use of AI in the context of the expectations in the Consumer Duty.
- **Third-party models:** The rising use of third-party models and data is an area of focus, with calls for more regulatory guidance.
- Respondents noted the link with operational resilience and outsourcing rules. This includes the upcoming critical third parties regime, being developed to manage systemic risks posed by some third parties.
- Respondents suggested that third-party providers of AI solutions should provide evidence to support the responsible development, independent validation, and ongoing governance of their AI products. This would provide firms with sufficient information to make their own risk assessments.
- **Model risk management principles:** While respondents welcomed the PRA's expectations set out in [SS1/23](#), they pointed to areas where further clarification would be useful. For example, with wider access to 'off-the-shelf models', respondents suggested that there is a risk of a lack of understanding on the risks associated with the models and increased reliance on third-party providers.
- **Existing governance structures:** The regulators note that respondents believe that governance structures are either already sufficient to cover AI or are being adapted by firms to make them sufficient and to comply with existing regulatory requirements.
- Most respondents favor practical guidance on how Senior Managers (SM) should take 'reasonable steps' under the Senior Manager & Certification Regime (SM&CR) for clearer compliance and governance. The FS also found that

firms would oppose a new AI-specific Prescribed Responsibility under a Senior Management Function (SMF), given the vast applications of AI and that it could overburden the Chief Operations Officer (SMF24).

What do firms need to do?

- Whilst the feedback statement does not include policy proposals, it provides insights into the regulators' priorities in this area.
- As an essential first step, firms should ensure that they understand and comply with existing regulation when deploying AI.
- Regulators expect firms to have robust risk management frameworks, including to ensure adequate data governance for AI models. Firms also need to ensure there is adequate explainability and understanding of the functioning and outputs of models. This is the case whether AI models are developed in-house or are outsourced.
- Firms must adhere to regulations like the SM&CR and the Consumer Duty. Under SM&CR, SMFs should reflect AI use in their responsibility statements, showing 'reasonable steps' in governance. Under the Consumer Duty, ensuring AI integration and outputs meet higher standards for good retail customer outcomes is essential.
- There is a clear call for broader cross-sectoral and international collaboration on AI-related topics. Consequently, firms should monitor regulatory efforts outside financial services and the outputs from international forums/organisations.
- A few key areas discussed in the FS could prompt regulators to delve deeper in some areas. These encompass meeting consumer duty expectations with AI deployment, addressing bias and fairness, data regulation, SM&CR, and managing third-party risks.

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Next steps

The themes in the FS may guide the regulators future priorities. The Government's response to its [AI white paper](#), expected by the end of the year, may also impact the regulators' next steps.

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