

UK regulators explore Artificial Intelligence and Machine Learning

AT A GLANCE

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What's new?

- The Bank of England (BoE), PRA and FCA ('the regulators') published a [discussion paper](#) (DP) on the use of artificial intelligence (AI) and machine learning (ML) on 11 October.
- In 2020, the BoE and FCA launched the AI Public-Private Forum (AIPPF) to bring together experts from across financial services, the technology sector and academia. The AIPPF published its [final report](#) in February 2022.
- The discussion paper aims to respond to the AIPPF's final report and gather further feedback on the risks and benefits of the use of AI and ML, how the current regulatory framework applies and explores how it may need to evolve in the future.

What does this mean?

- The DP is a direct response to the AIPPF final report and addresses two main questions: why AI falls within the remit of the regulators and which particular objectives are relevant to the risks related to AI, and how the current regulatory framework applies to AI.
- The regulators set out the rules that apply to AI in relation to three of their key objectives:
 - consumer protection;
 - competition;
 - safety and soundness.
- **Consumer protection** - A key priority for the regulators is that AI does not create bias or discrimination. The regulators' approach, based on principles and high level rules, already applies to AI. The [New Consumer Duty](#) does not prevent firms from adopting business models with different pricing by groups, but they should ensure the price charged is reasonable, relative to the expected benefits.
- The FCA also has the power to enforce the consumer protection requirements in the Consumer Protection from Unfair Trading Regulations, which involves the prohibition of unfair commercial practices.
- The DP confirms that the discriminatory decisions made through using AI systems could also be a breach of the Equality Act.
- **Competition** - The FCA may use its existing functions, derived from the the Competition Act, the Financial Services and Markets Act and the Enterprise Act, to ensure effective competition. This includes the introduction of market-wide remedies or firm-specific measures. The FCA could also make a market investigation reference to the Competition and Markets Authority for an in-depth market investigation.

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- **Safety and soundness** - The DP focuses on the impact on data, models, governance, resilience and third party dependencies.
- To ensure quality throughout the lifecycle of data, the regulators note that existing legislation such as the UK GDPR and Basel Committee on Banking Supervision's principles apply to AI applications.
- The current scope of model risk management (MRM) regulation is limited but the PRA's [consultation](#) on MRM covers AI and includes questions on the adequacy of the principles to mitigate the risks related to AI models.
- Whilst regulators take a principles-based approach to governance, they indicate that the use of AI may require changes to the way firms are applying the Senior Managers and Certification Regime (SM&CR). A dedicated AI Senior Management Function (SMF) and/or a Prescribed Responsibility could potentially be added under the SM&CR.
- Regulators also note that certain third parties providing AI models could emerge as future potential critical third parties as a result of the increasing use of these data and models.

What does this mean for firms?

- Firms need to assess the impact of the current regulatory framework on their use of AI. The potential risks of AI throughout its lifecycle need to be identified, as well as the actions firms have taken to meet the expectations set out in regulation, and referenced in this DP.
- Firms need to look into their decision-making and governance processes and frameworks. The expectations regarding governance and resilience must be met whether the AI is developed in-house, or by third parties.
- Firms are also encouraged to consider how the SM&CR may address challenges around the governance of AI models from their development to their deployment.
- The PRA also expects banks to give consideration to what factors would constitute a model. MRM may act as the primary framework for firms to manage and mitigate potential AI-related risks.
- The DP will help inform the regulators' thinking and any future policy proposals. Both financial services firms and third parties will be affected and need to be aware of the current expectations they need to meet as well as potential new developments.

Next steps

The consultation period for the discussion paper on the use of AI and ML closes on 10 February 2023. The PRA's consultation on model risk management principles for banks will close on 21 October 2022.

DCMS is set to publish a cross-sectoral White Paper on AI later this year.

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