# Consultation Response

DP5/22 – Artificial Intelligence and Machine Learning

February 2023

Law Society of Scotland

## Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Competition, Banking, Company & Insolvency Law and Privacy Law sub-committees welcome the opportunity to respond to Discussion Paper 5/22 from the Bank of England, Prudential Regulation Authority and the Financial Conduct Authority[1].

We have the following comments to put forward for consideration. We have only commented on questions 1 to 3.

## Consultation questions

### Supervisory authorities' objectives and remits

### Question 1. Would a sectoral regulatory definition of AI, included in the supervisory authorities' rulebooks to underpin specific rules and regulatory requirements, help UK financial services firms adopt AI safely and responsibly? If so, what should the definition be?

We believe that a sectoral definition of AI could be contemplated to help inform industry understanding of technical programmes and software that may be appropriately characterised as AI. However, given possible prospective technological advancements, we consider that such a definition would need to be sufficiently adaptable / malleable to accommodate the prevailing state-of-the-art.

A threshold technical definition of AI could, nonetheless, be combined with a sectoral scoping condition. While there are manifold applications of AI-based technology, not all applications may be of significance or present a risk to the effective functioning of the financial markets and allied regulatory objectives. Certain (generic) AI integrations may provide use cases that could benefit both the financial

[1] DP5/22 - Artificial Intelligence and Machine Learning | Bank of England

service markets or other unrelated industries, and which, notwithstanding the AI inherence, may not pose any substantive risks to the financial markets or related regulatory considerations. Such use cases could, by example, include general AI-based human resource or office management tools that may yield efficiencies, but which have no direct or manifest impact upon the performance of regulated activities, market integrity, customer interests or relevant competitive considerations.

A rulebook-based AI definition may therefore benefit from sectoral circumscription, to ensure emphasis on technologies and integrations, which might jeopardise regulatory- and market-related interests, are subject to suitable regulatory safeguards, supported by appropriate regulatory oversight. A definition framed on such a basis could centre on activities, performed using AI-based technology, that would be undertaken by or are directly relevant to the regulated activities, products or services fulfilled by the authorised firm. In the setting of regulated outsourcing arrangements, the Guidelines on Outsourcing (EBA/GL/2019/02) promulgated by the European Banking Authority prescribe a similar approach in terms of outsourcing:

'… means an arrangement of any form between an institution, a payment institution or an electronic money institution and a service provider by which that service provider performs a process, a service or an activity that would otherwise be undertaken by the institution, the payment institution or the electronic money institution itself.'

Analogous outsourcing definitions may also be found within both the Financial Conduct Authority's Handbook of Rules and Guidance, and the Prudential Regulation Authority's Rulebook, promoting a clearer and common understanding of the contours of the relevant regulated outsourcing regimes. In tandem with a bespoke sectoral consideration, overlaying regulatory guidance could also be provided to delineate any specific or de minimis AI integrations that would not ordinarily be characterised as areas of regulatory sensitivity. Similarly, such an approach would be consistent with the existing Guidelines on Outsourcing, which enumerate several arrangements that should not, generally, be recognised as creating a regulated outsourcing relationship (at paragraph 28 (page 26)).

Therefore, it is anticipated that an appropriately calibrated sectoral AI definition could help promote the safe and responsible adoption of AI-based technology amongst authorised firms. As AI technology providers become more prolific and sophisticated, early adoption of a sectoral AI definition and development of associated rulebook provisions, may also help foster a greater appreciation of financial regulatory considerations relevant to the adoption of technologies amongst such providers.

## Question 2. Are there equally effective approaches to support the safe and responsible adoption of AI that do not rely on a definition? If so, what are they and which approaches are most suitable for UK financial services?

There are several pre-existing pertinent regulatory requirements that may already be significant to the deployment of AI-based tools by authorised firms. As cited within the discussion paper, the 'consumer duty' will introduce a further principle and rules to safeguard consumers of retail financial services, which will have a conceivable impact on the integration of AI technologies within the consumer product and service lifecycle.  Operational continuity and resilience also remain areas of pervasive risk consideration that could, conceivably, be applied to AI integrations.  Other pre-existing regulatory tenets – including legal, regulatory, Handbook- and non-Handbook-based requirements and guidance – may be similarly used or clarified to cater for growing adoption of AI.  As a consequence, while there may remain reasonable scope for the adoption of an AI-centric definition and attendant requirements, a tempered approach to prospective rule-making may be appropriate in light of broader and prevailing operational and conduct obligations that are also significant to AI integrations.

## Benefits, risks, and harms of AI

### Question 3. Which potential benefits and risks should supervisory authorities prioritise?

There are already certain existing legislative and regulatory requirements which may safeguard against or provide readily enlargeable bases to support or mitigate against the identified risks and benefits.  We believe that areas perhaps requiring greater focus may include data governance and resilience of market competitiveness.

There are numerous and diverse AI applications, some of which may involve consumption of customer or commercially sensitive data.  Both the integrity of such application processes together with the outputs of these processes could have a material impact on authorised firm behaviours, customer outcomes and market integrity.  From a data governance perspective, while there are existing threshold data protection, privacy and allied competition requirements that will remain relevant in this setting, AI integrations may still create additional challenges and opportunities within the financial markets.

For example, technology providers may collate and house significant amounts of commercial or customer data, resulting from the adoption of their AI applications.  Such applications may be hosted on-cloud and hence outwith authorised firms' integral infrastructure, meaning an unregulated provider may host material quantities and categories of sensitive data across different and competing authorised firms, subject to autonomous AI-based oversight.  Whether by AI or human error, the concentration of high volumes of sensitive data sets creates an amplified risk of data contamination.  This might risk strategic data (such as pricing information) being inadvertently leaked amongst rival authorised firms or distorting customer-centric outputs (e.g., insurance underwriting criteria and policy premia).  While these risks are not novel, the reliance upon AI-based technology provisioned by third and likely unregulated providers does amplify the relevant considerations and may merit greater oversight.

AI is presently a growing area of interest and represents an opportunity for both authorised firms (as consumers) and technology developers (as providers).  In future, however, it is conceivable there will be significant consolidation within the AI industry.  This will inevitably result in a diminution in the number and diversity of AI providers, and a correspondingly greater reliance amongst authorised firms upon a limited set of providers.  Future consideration may therefore need to be given to the systemic impact such providers may have upon authorised firms and the wider financial services industry, correlating with existing regulatory consideration of oversight measures for critical third parties (via DP22/3: Operational Resilience: Critical Third Parties to the UK Financial Sector).

### Question 4. How are the benefits and risks likely to change as the technology evolves?

We have no comment to make.

### Question 5. Are there any novel challenges specific to the use of AI within financial services that are not covered in this DP?

We have no comment to make.

### Question 6. How could the use of AI impact groups sharing protected characteristics? Also, how can any such impacts be mitigated by either firms and/or the supervisory authorities?

We have no comment to make.

### Question 7. What metrics are most relevant when assessing the benefits and risks of AI in financial services, including as part of an approach that focuses on outcomes?

We have no comment to make.

## Regulation

### Question 8. Are there any other legal requirements or guidance that you consider to be relevant to AI?

We have no comment to make.

### Question 9. Are there any regulatory barriers to the safe and responsible adoption of AI in UK financial services that the supervisory authorities should be aware of, particularly in relation to rules and guidance for which the supervisory authorities have primary responsibility?

We have no comment to make.

### Question 10. How could current regulation be clarified with respect to AI?

We have no comment to make.

### Question 11. How could current regulation be simplified, strengthened and/or extended to better encompass AI and address potential risks and harms?

We have no comment to make.

### Question 12. Are existing firm governance structures sufficient to encompass AI, and if not, how could they be changed or adapted?

We have no comment to make.

### Question 13. Could creating a new Prescribed Responsibility for AI to be allocated to a Senior Management Function (SMF) be helpful to enhancing effective governance of AI, and why?

We have no comment to make.

### Question 14. Would further guidance on how to interpret the 'reasonable steps' element of the SM&CR in an AI context be helpful?

We have no comment to make.

### Question 15. Are there any components of data regulation that are not sufficient to identify, manage, monitor and control the risks associated with AI models? Would

**there be value in a unified approach to data governance and/or risk management or improvements to the supervisory authorities' data definitions or taxonomies?**

We have no comment to make.

**Question 16. In relation to the risks identified in Chapter 3, is there more that the supervisory authorities can do to promote safe and beneficial innovation in AI?**

We have no comment to make.

**Question 17. Which existing industry standards (if any) are useful when developing, deploying, and/or using AI? Could any particular standards support the safe and responsible adoption of AI in UK financial services?**

We have no comment to make.

**Question 18. Are there approaches to AI regulation elsewhere or elements of approaches elsewhere that you think would be worth replicating in the UK to support the supervisory authorities' objectives?**

We have no comment to make.

**Question 19. Are there any specific elements or approaches to apply or avoid to facilitate effective competition in the UK financial services sector?**

We have no comment to make.

**For further information, please contact:**

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