EU AI AND DATA FRAMEWORKS

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The AI Act and its impacts on the European financial sector

With the adoption of the Artificial Intelligence (AI) Act, the European Union has positioned itself at the forefront of AI regulation from a global perspective. While the AI Act is an important milestone, much remains to be done to implement it, to promote the responsible use of AI in the financial sector, and to enable European citizens to harness the benefits of AI and the data economy.

The AI Act will impact the financial sector in a number of ways. On the one hand, AI-based creditworthiness assessments by banks, as well as pricing and risk assessments in life and health insurance are considered high-risk AI use cases and will therefore have to comply with heightened requirements for such AI applications.

These requirements are expected to be further developed by European standardisation bodies. Subsequently, national competent authorities (NCAs) will need to ensure that financial institutions comply with the new AI governance and risk management requirements and standards, while assessing the extent to which more detailed sectoral guidance may be required for these AI use cases.

The AI Act will also introduce new requirements for so-called general purpose AI systems, including large language models and generative AI applications. Working closely with service providers such as Bigtechs, financial institutions are already experimenting with these new tools and assessing how they can take advantage of the significant opportunities they offer. The expectation is that these tools will become mainstream rather soon.

The European Commission's new AI Office, which will be responsible for enforcing and overseeing the new rules for general-purpose AI systems, should ensure that service providers fulfil their responsibilities and assist users in implementing these systems. Under sectorial legislation financial institutions remain ultimately responsible for the tools and services they outsource. The oversight framework set out in the Digital Operational Resilience Act (DORA) for so-called "critical third-party service providers" could be useful here.

Balancing innovation, risks, and consumer control is fundamental to responsible AI adoption.

The remaining uses of AI in the financial services sector would largely be developed and used in accordance with existing legislation, without additional legal obligations arising from the AI Act. Given that the use of AI in use cases such as claims management, anti-money laundering or fraud detection in the financial services industry is already quite extensive, supervisors need to assess the extent to which existing rules are sufficient and where additional guidance may be needed for specific use cases. This would take into account considerations such as proportionality, fairness, explainability and accountability.

From another perspective, the European data strategy, which includes legislation such as the Data Act and the Data Governance Act, also plays a key role in shaping the landscape for the use of AI in the European financial sector. It facilitates the re-use of public sector databases or access to private datasets from connected devices, such as health wearables or connected cars, which could enable financial institutions to develop more innovative and tailored products and services, thereby making broadening competition in access to and use of data.

This is also the aim of the proposed Financial Data Access (FiDA) regulation, which will open consumers' data held by financial institutions to third parties. In the insurance sector FIDA could facilitate the development of insurance dashboards, where consumers can access information about their insurance products from different providers on a single platform. This could potentially increase competition and enable consumers to make more informed choices.

Open questions remain about what data should be made available, how it is used, and on consumer protection. These will need to be addressed during the legislative process. Financial institutions should not be disadvantaged compared to non-financial ones, and consumer should always remain in effective control of where their data goes and how it is used.

NCAs will need to ensure that they integrate these new frameworks into their day-to-day supervisory activities. To this end, initiatives such as the ESA's Digital Finance Supervisory Academy can bring economies of scale and support more agile up-skilling. In addition, NCAs should also progressively embrace the use of new technologies for supervisory purposes (Suptech), for instance deriving actionable insights from large datasets through AI.

Finally, it is also important to promote convergence, taking into account emergent European regulation, at the international level, as the International Association of Insurance Supervisors (IAIS) expects to do with the development of an AI application paper in the course of 2024.

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AI Act and European data strategy - Supporting the uptake of AI in finance

In the ever-evolving landscape of technology, data has emerged as a pivotal resource capable of driving value creation, fostering innovation, and reshaping entire industries. The financial services sector, in particular, stands to benefit significantly from harnessing the power of data. As financial institutions collect and analyse customer data, opportunities arise for the creation of innovative products and services, streamlining internal processes, and reducing operational costs. With the increasing migration of socio-economic activities to the digital realm, the EU has responded with legislative initiatives such as the AI Act and the European data strategy to provide a comprehensive framework for supporting the uptake of AI in finance.

Financial services companies are increasingly relying on data to develop innovative products and services, thereby boosting revenue streams. Moreover, data-driven optimisation enables these institutions to streamline internal processes, leading to lower operational costs. The exploitation of data promises to create value across various operations, from optimising global manufacturing value chains to enhancing energy and resource efficiency through smart technologies.

The EU recognises the transformative power of data-driven innovation in fostering growth, resource efficiency, economic competitiveness, and social well-being. It is a crucial component for achieving the goals of the twin transition. As we grapple with global challenges, such as energy efficiency and economic competitiveness, the EU sees data-driven innovation as a driving force towards solutions.

Thus, the deployment of artificial intelligence in finance holds the promise of driving competitive advantages for the entire financial sector through new finance solutions. However, the adoption of these technologies introduces potential risks, both financial and non-financial, as well as concerns related to consumer trust.

Recognising the transformative potential of AI and the associated risks, the EU has introduced legislative frameworks, most notably through the AI Act and the European data strategy. These frameworks aim to ensure transparency, accessibility, and human oversight in the development and deployment of AI systems in the financial sector. By fostering a secure and customer-friendly environment, EU legislation strives to strike a balance between promoting innovation and growth and minimising associated risks.

The EU recognises the transformative power of data-driven innovation in fostering growth.

The AI Act plays a pivotal role in facilitating and encouraging the use of AI in the financial sector. By mandating transparency, it seeks to build a foundation for responsible AI deployment. The act addresses concerns related to ethical AI use, data privacy, and security, emphasising the importance of balancing automation with human expertise. In doing so, it not only supports the growth of the financial sector but also ensures the minimisation of associated risks.

In tandem with the AI Act, the Data strategy is poised to unlock even more data, fostering increased competition in the data market. This not only benefits established financial institutions but also creates opportunities for smaller players and newcomers to thrive in the financial landscape. The broader access to data encourages innovation and ensures that a wider array of market participants can contribute to the evolving financial ecosystem.

The AI Act and the European data strategy represent critical steps in providing a comprehensive framework for the responsible adoption of AI in finance. These legislative frameworks aim to build trust among consumers and foster an environment conducive to innovation and growth.

As we navigate the future, these regulatory measures position the EU at the forefront of shaping a digital financial landscape that balances technological advancement with ethical considerations.

CAROLINE CASEY

General Manager Customer Experience and Innovation - Moody's Analytics

Balancing act: navigating AI deployment in financial services and beyond

Rules for AI deployment

Artificial intelligence (AI) has continually evolved since its origins in the 1950s, with big advances in fields such as machine learning, deep learning, and more recently generative AI (GenAI)

GenAI can generate content such as text, images, code, video, audio or synthetic data. OpenAI's ChatGPT was released in November 2022 and changed the game by making GenAI accessible to a broad audience thanks to a chat-based interface with GPT3.5. It garnered 100 million users within two months, making it the fastest growing application in history.

Limitless applications

The highly engaging and user-friendly interface [of ChatGPT/GenAI] significantly democratizes access to AI technology.

Any individual, even with minimal technical skills, can harness its power, facilitating its rapid adoption. This has led to the discovery of innovative ways to streamline existing workflows and develop solutions that were not previously feasible.

There are limitless use cases for GenAI in the financial sector, particularly due to its ability to analyse and interpret large data sets. There are also use cases that are relevant across sectors, these include streamlining customer service efforts and directly interfacing with customers in new ways with highly tailored responses, augmenting developer workflows with coding assistants, enhancing sales efforts by identifying leads and tailoring pitches, and devising marketing materials including images, video and audio.

Moody's Annual Innovation Survey 2023 identified key finance sector use cases as the following: loan origination and underwriting, risk assessment and management, along with compliance and reporting.

GenAI has immense potential in finance due to its ability to analyse and interpret large datasets.

GenAI has immense potential in finance, but it also presents certain risks, including the possibility of algorithmic bias and concerns about data privacy. This means a regulatory framework is needed that balances the need for innovation with risk mitigation. The European Union's proposed AI Act is a significant step in this direction. It aligns with Europe's Single Digital Market and aims to provide a safe and unified environment for businesses to navigate AI technologies.

Evolving regulations

The AI Act aims to ensure a human-centric and ethical development of AI and provides for certain transparency and risk-management rules for AI-systems in the EU, with a focus on AI systems used by big tech companies. However, the dynamic nature of AI necessitates a future-proof regulatory framework. The AI Act provides a good starting point but, it will need to evolve continuously to keep pace with technological advancements.

This will require an ongoing dialogue between policymakers, industry stakeholders, and technology partners. Importantly, organizations will need to ensure their tech partners are actively aligning with the AI Act, similar to requirements for GDPR or DORA.

Financial firms should also devise their own guardrails. This includes the need for putting in place controls around intellectual property and ensuring datasets are not inappropriately or inadvertently used to train large language models. Furthermore, financial institutions should be vigilant to prevent AI-generated hallucinations that could potentially mislead customers. This involves implementing measures to identify and mitigate any instances where the AI system might produce inaccurate or misleading information, especially when clients are relying on GenAI solutions. By setting clear guidelines and controls, financial firms can enhance the responsible and ethical use of AI, fostering trust and reliability in their AI-driven processes. Approaches like Retrieval Augmented Generation can be leveraged to reduce these risks.

Creating guardrails

In the process of developing AI solutions, organizations should be attentive to comparing their outputs against traditional or classical approaches. This entails employing techniques like "red teaming," a practice where external experts critically assess and challenge the system, and engaging in continuous testing. This iterative evaluation is essential, especially as technology evolves, to ensure that the AI system's performance is measured against established benchmarks and validated against established methodologies or industry standards.

Moody's has long been a pioneer in using AI, natural language processing and machine learning to build advanced credit risk models and extra data that delivers value and impact for our customers, and we've embedded the best guardrails above in our own principles for using AI responsibly.

Overall, it will be a fine balance for policymakers to provide an appropriate framework which instils confidence in AI for consumers and corporations, whilst avoiding stifling innovation or the ability of smaller players to enter the space.

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It's been a hectic year for AI. It's only the beginning.

The buzz around Artificial Intelligence is impossible to ignore. It's everywhere, and at times, it feels like the hype is spiraling out of control. But here's the catch: despite the noise, the rapid pace of AI advancements points to real, profound changes in the financial industry. This isn't just talk; it's a reality unfolding before us.

At BBVA, we recognize AI's transformative potential and have integrated it as an essential part of our strategy. We're, effectively, on a journey where the road ahead is paved with algorithmic intelligence. From client identification and onboarding to sophisticated marketing strategies, AI has become indispensable. It enhances our fraud detection capabilities, sharpens our market-making strategies, and refines financial forecasting. It plays a pivotal role in augmenting the financial health of our clients and strengthening our anti-money laundering measures. Not everything relies on ultra sophisticated algorithms necessarily but the trend is clear and the trend will not stop.

The advent of Large Language Models (LLMs)

2023 has certainly been a strange year for us. Exciting and, at times, surreal. No matter how you look at it, the introduction of LLMs is a game-changer. The ability of LLMs to understand and interpret human language, paves the way for many revolutionary applications in customer interaction and internal process optimization. The speed at which these innovations are happening is breathtaking and, given that the pace is maintained, one can easily see the rise of a very different financial industry in the not so distant future.

In this context, the task of regulating and controlling AI, particularly following the advent of LLMs, becomes crucial. It's about striking the right balance – ensuring innovation isn't stifled while keeping a tight rein on the potential risks.

The AI Act: balancing innovation and control

We consider the European AI Act to be a significant advancement. Regulating AI presents inherent challenges, especially in light of the ongoing debate regarding its definition. Nonetheless, the AI Act's risk-based approach seems balanced, in principle. It aims to create trust and legal certainty and enable its practical implementation. It rightly focuses on the applications of AI, ensuring that any potentially hazardous use is either prohibited or subject to stringent controls.

Having said that, there is a long road ahead. On the one hand, authorities will play a key role in the implementation of the regulation and its real impact on the development and adoption of AI by companies. On the other hand, the regulation of LLMs under the AI Act requires particular attention. These models, due to their inherent complexity and wide-ranging applications, necessitate a nuanced regulatory approach. While the Act makes strides in promoting reinforced transparency –which we certainly welcome–, its practical application would be subject to the scrutiny of bodies with no background in this field . This could lead to implementation challenges that could hinder the development of the technology in the continent.

Data accessibility: The Key to Unlocking AI's Potential

Regulating and controlling AI is not the only area that deserves political attention. Another crucial aspect of leveraging AI is the access to client data, which is essential for training models and applying data analytics. In this context, policies on data portability and third-party access to user data must adopt a cross-sectoral approach. Such an approach prevents competitive asymmetries and acknowledges the blurring boundaries between different sectors in a digital world.

Looking Ahead: priorities for the next political cycle

As we navigate this landscape, policymakers should focus on the following priorities:

- ***Clarification and implementation:*** We need further clarity on the nuances of the AI Act and its implementation, ensuring that it is consistent with existing financial regulations and is implemented homogeneously across the EU.
- ***Promoting AI as a growth driver:*** Europe must not only lead in regulating AI but also in its development and application. This requires a balanced approach that fosters innovation while ensuring responsible use.
- ***Cross-sectoral data policies:*** Emphasizing the need for cross-sectoral data policies will be crucial.
- ***Strengthening AI literacy:*** Building a workforce that is AI-literate and capable of adapting to new technologies will be essential for the banking sector and Europe as a whole.

We need to ensure that the AI Act is consistent with existing financial regulations.

In conclusion, at BBVA, while we celebrate our achievements in integrating AI, we acknowledge the long road ahead. The transformative effect of AI is undeniable, and navigating this journey requires a collaborative approach between the banking sector, regulators, and policymakers. Together, we can ensure that AI not only drives growth but also upholds the highest standards of security, ethics, and equity in the European banking sector.