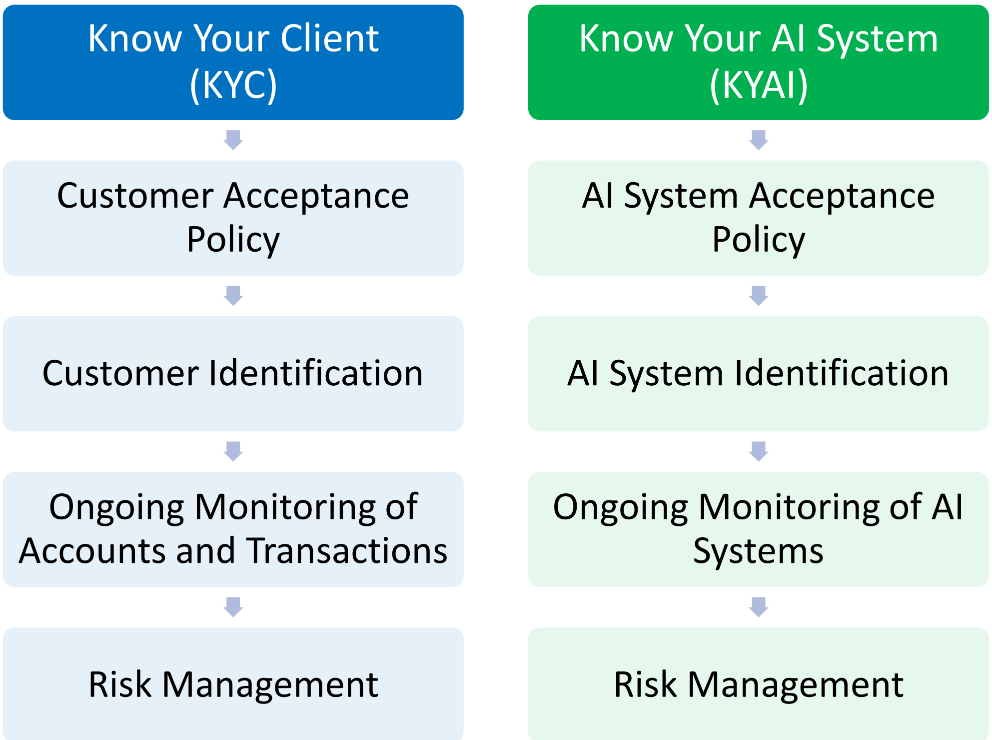
Know Your Client vs Know Your AI (KYAI)

Regulatory guidance on Know Your Client ("KYC") has been contained in various papers across the year and they reflect the evolution of the supervisory thinking over time. For example, the Prevention of Criminal Use of the Banking System for the Purpose of Money-Laundering issued in 1988 stipulates the basic ethical principles and encourages banks to put in place effective procedures to identify customers, decline suspicious transactions and cooperate with law enforcement agencies (e.g. customer identification and record-keeping). With the proposed European Union ("EU") artificial intelligence ("AI") act (the "EU AI Act"), firms have to apply a similar approach to understand the risks posed by its AI system. A process known as, Know Your AI System ("KYAI").

From a KYC standpoint, all banks should be required to "have in place adequate policies, practices and procedures that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, by criminal elements". Certain key elements should be included by in the design of KYC programmes. In this sense, KYC should be a core feature of banks' risk management and control procedures, and be complemented by regular compliance reviews and internal audit. The intensity of KYC programmes beyond these essential elements should be tailored to the degree of risk. From a KYAI standpoint, a similar process can be adopted under a risk-based approach (see table below).

Figure 1: Know Your Client (KYC) vs Know Your AI System (KYAI)



Know Your Client vs Know Your AI

Know Your Client (KYC)	Know Your AI System (KYAI)
Customer Acceptance Policy: Banks should develop clear customer acceptance policies and procedures, including a description of the types of customer that are likely to pose a higher than average risk to a bank.	**AI System Acceptance Policy**: Firms should develop clear AI system acceptance policies and procedures, including a description of the types of AI systems that are likely to pose a higher than average risk to a firm.
Customer Identification: Customer identification is an essential element of KYC standards. For this purposes, a customer includes: (a) (the person or entity that maintains an account with the bank or those on whose behalf an account is maintained (i.e. beneficial owners); (b) the beneficiaries of transactions conducted by professional intermediaries; and (c) any person or entity connected with a financial transaction who can pose a significant reputational or other risk to the bank.	**AI System Identification**: AI system identification is an essential element of KYAI standards. For this purposes, a AI system means a machine-based system that is designed to operate with varying levels of autonomy and that can, for explicit or implicit objectives, generate outputs such as predictions, recommendations, or decisions, that influence physical or virtual environment.
Ongoing Monitoring of Accounts and Transactions: On-going monitoring is an essential aspect of effective KYC procedures. Banks can only effectively control and reduce their risk if they have an understanding of normal and reasonable account activity of their customers so that they have a means of identifying transactions which fall outside the regular pattern of an account's activity.	**Ongoing Monitoring of AI Systems**: On-going monitoring is an essential aspect of effective KYAI procedures. Firms can only effectively control and reduce their risk if they have an understanding of normal and reasonable activity of their AI systems so that they have a means of identifying incidents or serious incidents which may require to be reported to regulators.
Risk Management: Effective KYC procedures embrace routines for proper management oversight, systems and controls, segregation of duties, training and other related policies. The board of directors of the bank should be fully committed to an effective KYC programme by establishing appropriate procedures and ensuring their effectiveness.	**Risk Management**: Effective KYAI procedures embrace routines for proper management oversight, systems and controls, segregation of duties, training and other related policies. The board of directors of the firm should be fully committed to an effective KYAI programme by establishing appropriate procedures and ensuring their effectiveness.