EU AI Act –
Unravelling AI in
Financial Services

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In this article, the writers examine how the potential legal and regulatory touchpoints of the EU AI Act to financial services and why this is of note to firms.

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Key Points

• AI drives innovation agendas in financial services.
• Competent use and adequate human oversight stops negative outcomes.
• AI causes multiple consumer protection harms (e.g. unsuitable advice).
• Transparency provides a solution to the problem of opacity with AI systems.

Introduction

Artificial intelligence (“AI”) takes a primary role in current processes of technological transformation in financial services. Its primary place on innovation agendas alludes to the array of significant benefits that AI technologies can provide for firms, consumers, and markets. Equally, AI systems have the ability to cause significant harm. In view of this, recent years have involved a growing acknowledgement of the importance of AI adoption – together with its use and development - being guided by appropriate laws and regulations as a key consideration of responsible innovation. The field of AI has a long-standing history and substantial links to statistical methods with extensive applications in financial services. The adoption of AI in financial services is supported by three specific elements of innovation:

• machine learning (“ML”).
• non-traditional data.
• automation.

AI systems can aggregate all three elements or a subset of them. A particular AI use requires distinguishing between these three elements of innovation and examining their respective role. This allows for an appropriate understanding of AI-related risk, given that each element can result in distinct challenges. The development and uptake of AI systems in financial services generally takes place where innovation is required. A sound legal framework underpinning the use of AI systems in financial services goes some way to ensuring the protection of fundamental rights, product safety, services or liability issues. To this end, it is necessary to understand how financial services firms are influenced by the European Union (“EU”) AI Act.
Challenges Posed by AI for Responsible Innovation

Some say that the use of ML, non-traditional data, and automation holds significant promise, but may also contribute to challenges in managing the trustworthiness and responsible use of AI systems. Accordingly, these challenges have generated a growth of publications on trustworthy and responsible AI. These two elements are at the core of what the EU AI Act aims to satisfy. That is, creating the right conditions for its growth and development.

Challenges posed by AI can be segmented into certain background considerations that are at the root of many of the concerns that firms encounter in AI innovation. Within these, specific areas of concern arise and are not limited to one consideration in particular. Rather, they are multi-faceted, both in terms of their application and substance.

Of the primary concerns, use and human oversight constitutes a key touchpoint for the EU AI Act. How AI is deployed and their level of interaction with human decisions leads to the issue of using AI systems competently use with adequate human oversight. To guarantee competent use, AI system users need to be equipped with an adequate level of understanding that extends to aspects relating to the system’s development and deployment, such as the system’s intended purpose, design, underlying data, performance.
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Without these pre-conditions for the informed exercise of human discretion or intervention in relation to system outputs human beings can end up over-relying on or placing undue trust in AI systems’ output. At the other end of the continuum, people could result in distrusting AI systems excessively, e.g. as a result of their conviction that human judgement and reasoning are superior. Awareness of an AI system’s intended purpose and operational limitations are crucial to prevent inappropriate repurposing (i.e. the use of the system in ways that deviate from its intended purpose and for which the system is unfit). Both of these go against the stated objectives of the EU AI Act, namely:

- ensure that AI systems placed on the market and used are safe and respect existing law on fundamental rights and Union values.
- ensure legal certainty to facilitate investment and innovation in AI.

Human oversight is extremely relevant to all AI systems. A paucity of adequate oversight may mean that performance problems go unnoticed and interventions that are required to prevent detrimental outcomes fail to occur. Inadequate oversight can take two forms:

- the absence of human overseers.
- human overseers being present but failing to exercise their role effectively.

On top of this, the use of ML, non-traditional data, and automation may result in increased difficulties in ensuring competent use and human oversight. These difficulties are encountered when understanding and managing data quality, navigating system complexity, opacity, and adaptivity, or adapting to increases in the complexity of technology supply chains. Each of these factors may add to the difficulty for system users and overseers to gain the understanding they need to ensure competent use and effective oversight.

Additionally, the adoption of more sophisticated AI systems raises concerns about system users and overseers’ skills and attitudes. Given the passing of time, relying on increasingly capable and high-performing systems can result in de-skilling and unduly unresponsive attitudes among users and overseers. Nonetheless, increases in system complexity and the use of automation often require the opposite: higher levels of technical skills + a more attentive approach to the exercise of oversight. With reference to recital (48) of the draft EU AI Act, high-risk AI systems should be ‘designed and developed in such a way that natural persons can oversee their functioning’. For this purpose, these concerns surrounding appropriate human oversight measures should be addressed – and identified - by the provider of the system before its placing on the market or putting into service.
Use of AI in Financial Services Leads to Significant Harms

The use of AI in financial services can result in substantial benefits for firms, customers, and markets. Such benefits may arise from AI-enabled increases in effectiveness or efficiency. Equally, AI can also lead to significant harms. Of those most often cited in financial services, the use of AI can have implications for a range of consumer protection issues.

It is worth noting that there can be trade-offs between the occurrence of some of the positive and negative impacts. As an example, using non-traditional forms of data for risk profiling can bring benefits in terms of financial inclusion, but also be connected with invasions of privacy. This provides evidence that managing impacts can require value judgments to weigh up competing considerations. In the context of the EU AI Act, these harms have contextual application where they align with the harms that AI systems pose – health and safety and fundamental rights.
Importance of Transparency

Transparency is key to responsible AI innovation. Transparency is crucial to ensuring and demonstrating that AI systems are both trustworthy and used responsibly. The principle of transparency concerns disclosing information about AI systems. Transparency involves gathering and sharing information about an AI system’s logic (also known as ‘explainability’) together with how the AI system was designed, developed, and deployed.

External stakeholders, such as customers, regulators, or businesses, have an interest in various types of information about an AI system. As do internal stakeholders, such as participants of different business units involved in designing, developing, and deploying AI systems.

The principles of transparency and accountability are closely related and support each other. Firstly, transparency is a prerequisite for accountability, since accountability mechanisms depend on the availability of information about an AI system. In a mutually supportive fashion, accountability operates as a prerequisite for transparency. Without accountability, commitments to transparent practices would remain unmotivated, unsupervised, and arbitrary.

The principle of transparency plays a fundamental role in solving common problems linked to specific characteristics of AI. Most notably is opacity – a limited ability of human mind to understand how certain AI systems operate.

In this regard, a lack of transparency in AI (due to complexity or how the algorithm was realized in code or how the application is realised) makes it difficult to monitor, identify and prove possible breaches of laws, including legal provisions that protect fundamental rights. Having greater levels of transparency provides a solution to the problem of opacity.
Conclusion

For final remarks, the wide array of products and services delivered by the financial services sector means market participants can expect to be significantly affected by the EU AI Act. How and to what extent depends on the size, complexity and nature of the business. Innovation agendas as a result will be constrained by the imposed obligations. In no uncertain terms should innovation be stymied by regulation, yet the latter can reinforce the former both in terms of rigour and credibility, amongst other things. Key things to note are:

- **Transparency**: communicate clearly with stakeholders to arrive at suitable solutions.
- **Preparation**: start the identification process to determine which parts of the business may be affected and why.

How AI & Partners can help

Once published, the EU AI Act would lay down the first landmark regime governing the artificial intelligence space in a comprehensive and harmonised manner; thus, its breadth would affect the artificial intelligence industry and could represent a blueprint for other jurisdictions to follow. Therefore, now is a good time to prepare for the main disruptive changes the EU AI Act is on the point of introducing and AI & Partners would be happy to assist you in this process.

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