

International Regulatory Strategy Group response to the Department for Science, Innovation and Technology (DSIT) and Office for Artificial Intelligence (OAI) Policy Paper “A pro-innovation approach to AI regulation” published 29 March 2023 (AI White Paper)

Introduction:

The International Regulatory Strategy Group (**IRSG**) is a joint venture between the City of London Corporation and TheCityUK. Its remit is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services. IRSG welcomes the AI White Paper and the opportunity to comment on the many issues arising to create a framework for responsible AI and innovation in the UK.

The IRSG recently commented on the Joint Bank of England (**BoE**) and Financial Conduct Authority (**FCA**) Discussion Paper on Artificial Intelligence and Machine Learning (DP5/22) (**Discussion Paper**) and many of the issues raised in our response are pertinent to the AI White Paper. You can find our submission on the IRSG website: [IRSG response to BoE / FCA DP5/22 – Artificial Intelligence and Machine Learning | IRSG](#).

The financial services sector has long been a major user of information and communications technology (**ICT**), using it to provide better, faster, more efficient, and more effective products and services for the end customer. In recent years, established financial entities have overhauled their business models to integrate technology and digitise finance. They have also used technology to become more secure and resilient, offering their customers and the wider system novel tools and protections.

Artificial Intelligence (**AI**) is a broad term covering a spectrum of techniques, including machine learning (**ML**) and deep learning, which may be used alone or together as part of a broader process. In any discussion about AI, it is therefore important to be precise, as the level of complexity and risk associated with simple automation or learning tasks will not necessarily be the same as more advanced deep learning techniques, all of which can be captured within the same terminology.

AI and ML are tools increasingly used in financial services and, as noted in the Discussion Paper, may enable financial services firms to offer better products and services to customers, improve operational efficiency, and increase revenue and drive innovation, leading to better outcomes for customers, firms, financial markets and the wider economy.

AI also, however, comes with several risks, including those that impact customers, market integrity, and financial stability. It is therefore vital that AI is managed within a targeted legislative and regulatory structure, to provide appropriate protections to individuals and markets, whilst also ensuring the regulatory approach is flexible and readily implementable for all sizes of organisations.

The IRSG welcomes the recent announcement made by PM Rishi Sunak to push the UK as a global centre for artificial intelligence regulation. We welcome HM Government’s commitment to consider the opportunities and risks the technology poses and discuss how they can be mitigated through

IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

“internationally coordinated action”. The IRSG is keen to support HM Government in this endeavour and is happy to provide further detail on any of the topics raised below.



TheCityUK

Key Recommendations:

In line with our response in the following sections, please find below a summary of IRSG's key recommendations:

- The IRSG welcomes the government proposal **to implement a principles-based framework for regulators to interpret and apply to AI** within their remits, to allow regulatory agility and proportionality. The IRSG considers **that the financial services sector is not currently in need of additional AI-specific legislation.**
- It is the view of the IRSG that **an outcomes-based approach is likely to be the most appropriate in practice, noting the risk that process-focused regulation of AI may stifle innovation.** Technological neutrality to regulation avoids either constraining or skewing the innovative and beneficial ways in which AI is or may be used in financial services.
- It is equally important that, as stated in the White Paper, **regulators issue clear, consistent, and interoperable guidance on how the principles interact with existing legislation and the future approaches to enforcement to be taken by the regulators.** To that end **a clear deadline for the provision of guidance from regulators would be welcomed.** Such guidance should also be regularly reviewed given the speed of technological change.
- **Coordination** across regulators in this space will be crucial. The IRSG is, however, of the opinion that **while effective coordination is critical to achieve the objectives of the AI White Paper, the addition of further regulators, or an AI-specific regulator, is not required at this stage.**
- **The AI White Paper also recognises the importance of technical standards as a way of providing consistent, cross-sectoral assurance that AI has been developed responsibly and safely.** The IRSG would welcome clear deadlines on the creation and publishing of certain standards by organisations.

Detailed Response:

A principles-based approach

The IRSG notes that **the consultation proposes “a principles-based framework for regulators to interpret and apply to AI within their remits”** to allow regulatory agility and proportionality. As a sector already operating under and within a well-established framework of principles-based regulation, **the IRSG welcomes this approach. The IRSG considers that the financial services sector is not currently in need of additional AI-specific legislation** as existing frameworks provide thorough regulatory parameters that can cover the risks arising from AI together with appropriate guidance. Indeed, introducing AI specific law risks is likely to create another barrier to entry and undermine the objective of the AI White Paper to create the best environment for innovation. We agree with a principles based approach which is consistent with the approach evolving in other jurisdictions, notably in the US. The case for more law has not been established, at least not currently.

A principles-based framework, if applied as intended, should not stifle innovation in business, as it will allow for business-specific implementation of compliance and governance frameworks, resulting in the development of sector-wide best practices. We welcome the recommendation that guidance is issued to regulators as to the establishment and incorporation of principles. Regulatory expectations on AI need to be sufficiently precise and consistent for firms to understand which of their activities and processes are within scope and for firms that fall within the remit of more than one regulator to be operating within a consistently applied and interpreted framework.

The financial services sector and regulators provide useful and relevant experience in the application of principles-based regulation. The IRSG considers that careful consideration in development of the UK’s approach should be given as to how principles are established and applied consistently by regulators in the context of existing regulatory frameworks. We consider that the establishment of AI related principles should operate as part of existing principles, with AI-specific clarification as appropriate. The FCA’s ‘Consumer Duty’ is a current example of the introduction of principles and outcomes-based regulation which, while certainly not without its challenges in terms of the practicalities of implementation, is relevant for AI deployment in FCA-regulated business. The IRSG agrees with the proposal to leverage existing regimes. The IRSG would anticipate that in many cases existing FCA principles such as fairness, transparency, and governance, already provide an effective framework for AI-specific considerations, given the alignment with the same considerations flagged in the consultation.

The IRSG considers that Government and regulators should carefully consider how regulators implement principles and welcome proposals to co-ordinate and issue guidance to regulators. The IRSG agrees with the proposed approach of proportionality and context-specific, technology neutral regulation but notes that firms may well be subject to compliance with more than one regulator’s requirements, such as the FCA, ASA and ICO. Consistency and clarity of approach will therefore be paramount and while we anticipate that the Digital Regulation Cooperation Forum (**DRCF**) will have an important role to play, it will be important to ensure that all sectoral guidance is consistent some

of which may fall outside of the auspices of the DRCF. Data, including but not limited to personal data, is at the heart of the development, training and use of AI so a cross sectoral and holistic approach to the role of data in AI will also be essential to ensure consistency. Inconsistency could be a serious impediment to innovation and effective oversight.

Looking overseas can also give some useful insight into the challenges of implementing hard regulation of AI, in a fast-moving technology environment. The first draft of the AI Act in the EU was released in April 2021 and has changed quite significantly to its current form. By way of example, the definition of AI, has evolved from a broad definition that risked capturing technologies with little autonomy (such as those with pre-determined decision paths) to a definition which now requires a level of autonomy to be classified as AI – a characteristic recognised in the AI White Paper. The public perception and awareness of AI changed quite dramatically during the various different drafting phases of the AI Act, driven in large part by the rapid mass adoption of large language models, such as Chat GPT. First the EU moved to regulate “general purpose AI” and then further refined this to regulate general purpose AI in a lighter way, whilst placing more stringent obligations on foundation models – a type of general purpose AI that can be used as the basis for other AI systems. Given that the EU AI Act is not yet finalised, the EU has been able to adjust its response to the fast pace of change. However, this will be more challenging once the Act has passed into law. As the rate of AI development continues to accelerate, regulation by “hard law” will become more challenging still, whereas principles based regulation does offer the opportunity to accommodate technology change more readily and without the need to find space in the crowded parliamentary schedule.

Regulating the use – outcomes-based regulation

It is the view of the IRSG that **an outcomes-based approach is likely to be the most appropriate in practice, noting the risk that process-focused regulation of AI may stifle innovation by forcing AI applications and processes into static regulatory categories** which are less adaptable to new innovations. Technological neutrality to regulation avoids either constraining or skewing the innovative and beneficial ways in which AI is or may be used in financial services.

Outcomes-based regulation also future-proofs regulatory approaches in a rapidly evolving space. In order to do so, however, the approach must be sufficiently clear and consistent across regulators, so that regulation does not in practice lead to:

- differences in the types of AI processes and techniques that can be developed and deployed by firms subject to parallel regulatory frameworks or more than one regulator’s overview, resulting in uneven competition and a risk of regulatory arbitrage;
- either an under-capture or over-capture of processes and techniques which may be of legitimate supervisory interest, but which may inhibit the regulators in discharging their statutory responsibilities, either by requiring them to police processes that do not give rise to the principal risks associated with the use of AI, or by failing to capture processes that do give rise to a legitimate supervisory interest; and

- in the longer term, rules that may restrict innovation as processes need to be modified either to come within (or fall outside the scope of) technology-based rules.

Guidance

It is equally important that, as stated in the White Paper, **regulators issue clear, consistent, and interoperable guidance on how the principles interact with existing legislation and the future approaches to enforcement to be taken by the regulators.** We welcome the approach already being implemented by the Bank of England and FCA in DP5/22 of clarifying how certain existing legal requirements and supervisory expectations apply to the use of AI. We agree that there is a need to clarify the expectations across the different regulators when enforcing existing laws applicable to AI and we also agree that there is no pressing case for the introduction of yet more law for AI. We also note that while guidance is technically not legally binding, for all practical purposes it is treated as such within the financial services sector both by regulators and regulated firms given that regulators state that they will enforce in accordance with published guidance. In the context of international interoperability, this approach is in keeping with many of the overseas initiatives from financial services regulators referenced in DP5/22 which, when read together, reflect a general preference amongst regulators globally for guidance and clarifications on the use of AI over the introduction of new process-focused requirements with the force of hard rules. This approach also allows for the regulatory approach to AI to evolve in line with innovation, without the need for wholesale review of rules in response to technological evolution.

As the FCA and PRA rightly point out in DP5/22, there are a range of systems, controls, governance, and operational and management rules that already apply to the deployment of AI by regulated firms. Focusing on the overall adequacy and outcomes of firms' governance is appropriate for the development of an AI framework. As noted above, the FCA is already in the process of introducing detailed outcomes-focused rules that are applicable to consumers in the form of the FCA Consumer Duty, which may provide additional safeguards against inappropriate use of AI where end consumer outcomes may be impacted. This again comes with the caveat that any guidance produced by regulators in relation to AI needs to be precise enough for firms to understand which of their activities are within scope of the regulators' expectations and of what these expectations actually consist.

In time, as the use of AI in financial services develops, there may be some specific areas where further guidance could be helpful. A notable example of this is the additional guidance on the application of certain existing rules to AI, building on the commentary already set out in DP5/22 and in the final report of the AI Public-Private Forum published in February 2022.

The IRSG considers that guidance should be developed and published in good time alongside the principles in advance of regulatory launch, to give firms time to deploy these requirements and work with regulators to identify considerations where enhanced clarity would benefit business and regulatory clarity. To that end **a clear deadline for the provision of guidance from regulators would be welcomed.** Given the pace of evolution and adoption of AI, there is a risk that guidance will quickly become outdated so the IRSG would propose that **a regular review of guidance is timetabled**

and to ensure that guidance is relevant, industry consultation is built into each review cycle. We anticipate that guidance will necessarily need to be iterative to keep pace with the rapid evolution of AI.

The coordination layer

The IRSG considers that **effective coordination is critical to achieve the objectives of the AI White Paper**, including in particular:

- ongoing oversight of the effectiveness of the de-centralised regulatory framework, including a commitment to remain responsive and adapt the framework if necessary (and promptly) including obtaining regular feedback from industry;
- central monitoring of AI risks arising in the UK;
- public education and awareness raising around AI and what responsible AI use means in practice for customers and consumers including how they can raise concerns and exercise their rights; and
- testbeds and sandbox initiatives for the development of new AI-based technologies.

Coordination is a paramount consideration and we welcome the recognition of its importance by the Government. Given the breadth of sectors and regulators which will need to engage with AI and regulate its use, careful thought will need to be given as to how best to implement effective coordination. The DRCF will have a role to play but not all AI use cases and regulators fall within its remit. The risks of a) AI use cases falling between the gaps of vertical sectoral guidance; and b) sectoral guidance failing to keep pace with the rapid evolution of AI adoption, will also need to be regularly reviewed and managed by the coordination layer. As we have proposed in relation to guidance and standards, regular industry consultation could help to inform Government and regulators where gaps and inconsistencies are arising and how to prioritise their remediation.

The IRSG is, however, of the opinion that **while effective coordination is critical to achieve the objectives of the AI White Paper, the addition of further regulators, or an AI-specific regulator, is not required at this stage.**

International considerations and the importance of domestic and international interoperability

The IRSG welcomes the AI White Paper's recognition of the importance of working closely with international partners to both learn from, and influence, regulatory and non-regulatory developments. It is agreed that the promotion of interoperability and coherence between different international (and domestic) approaches is important to deliver the objectives of the AI White Paper, notably to create the optimum environment for innovation and responsible AI use. The UK needs to tread the line between an advantageous regulatory regime and isolation through development of a unique regime. The latter would leave the UK as a reluctant follower of larger trading blocs. **As such, working with and taking account of the developments within the OECD, Council of Europe, and the**

EU AI Act itself, will be essential for multinational organisations seeking to navigate the global regulatory picture.

The legal and regulatory landscape for AI is evolving rapidly across multiple jurisdictions with some favouring a more prescriptive rule-based approach (such as the proposed EU AI Act) and others favouring a principles, outcomes-based, approach such as the proposed Canadian Artificial Intelligence and Data Act.

For the proposed UK principles-based regime to be effective, interoperability domestically across sectors and internationally across multiple different jurisdictions by benchmarking and through international regulatory forums will be essential to delivering a pro-innovation approach and to ensure effective regulation for responsible AI use.

AI operates globally and the IRSG agrees with the AI White Paper and the Discussion Paper that the UK continues to have an important role to play to co-ordinate the discussion of how AI should be regulated and to facilitate the interoperability of evolving laws and standards. To achieve that goal, clarity when articulating the UK approach will be key. In particular, explaining the benefits of any differences in the UK approach versus that taken in other jurisdictions and keeping this narrative up to date as AI and the UK oversight of AI continue to evolve. This will help to drive certainty and will also help to ensure that the UK continues to maintain influence over the development of AI laws and regulations as a global leader in the field, rather than becoming a reluctant follower as other jurisdictions and trading blocs (notably the EU) fill the legal void with their own laws and regulations.

It is also relevant to consider from a UK and international business perspective the context of organisations that operate different business lines and activities which fall into different verticals of regulation (or none at all). For example, offering certain types of loans (and associated credit checking) may fall within the financial services regulated perimeter and within evolving definitions of high risk AI across a number of different jurisdictions' AI specific laws, whereas operating staff recruitment and performance management will (largely) not be regulated in the UK from a purely AI perspective, with the exception of the extension of principles in sectors with existing governance and oversight regulation (such as the UK's Senior Managers regime and broader sectoral conduct and governance requirements), but *will* be regulated as high risk AI under a number of different jurisdictions' AI specific laws. Cases where personal data is processed would fall under the jurisdiction of the ICO. Cases where there is unlawful discrimination by AI would fall under the jurisdiction of the Equalities and Human Rights Commission. It is therefore clear that care is needed to ensure consistency and cohesion around sectoral regulatory guidance issued on AI. Care around a sector-specific regulatory framework is also needed to minimise the potential conflicts of markedly different regulatory frameworks applying to different parts of the same entity, whether in the UK or abroad.

The importance of standards

The AI White Paper also recognises the likely importance of technical standards as a way of providing consistent, cross-sectoral assurance that AI has been developed responsibly and safely.

To this end, the Government will continue to invest in the AI Standards Hub, formed in 2022, whose role is to lead the UK's contribution to the development of international standards for the development of AI systems.

This standards-based approach is welcomed by the IRSG and may prove particularly useful for those deploying AI in multiple jurisdictions. It has already been recognised within the EU AIA, which anticipates compliance being established by reference to common technical standards published by recognised standards bodies. It seems likely that over time this route (use of commonly recognised technical standards) will become the de facto default route to securing practical compliance to the emerging regulatory regimes.

This approach would certainly help address the concerns many (particularly smaller organisations) will have about the challenge of meeting competing regulatory regimes across national boundaries. As such the IRSG recommends the AI Standards Hub be encouraged to develop a set of standards that set a minimal level of technical and operational competence on which organisations can base their compliance with regimes domestically and, ideally, globally and that existing, and already published, AI standards such as ISO/IEC 23053:2022 (Framework for Artificial Intelligence (AI) Systems Using Machine Learning (ML)) and ISO/IEC 23894 (A new standard for risk management of AI), be considered together with the developing work of the British Standards Institute (through initiatives such as their ART/1 artificial intelligence committee) in the development of standards.

As in the case of guidance, **the IRSG would welcome clear deadlines on the creation and publishing of certain standards by organisations**, such as the British Standards Institute and the Alan Turing Institute, **to encourage the continued development of frameworks for organisations to follow**. Recognising that the process for reviewing and updating standards, once set, is necessarily more involved than the process to review and update guidance, like guidance there is a risk that standards will become outdated given the pace of evolution of AI. Consideration should be given as to how best to ensure that standards remain up-to-date with evolving AI and AI laws.

Need for effective enforcement of existing laws

While effective management and oversight of AI risk across regulated financial services sector firms is laudable, the deliberate use of AI for nefarious purposes is much more likely to be undertaken by bad actors in the criminal fraternity. Such use of AI for bad purposes is likely to add to the growing public concerns and adverse media coverage of AI and may in turn put pressure on the Government to apply stricter laws and regulation to *all* AI, whether good or bad. Effective enforcement of existing laws against bad actors intent on using AI for nefarious purposes is therefore essential first and foremost to protect the public but equally importantly to ensure that “good” AI is allowed to continue to thrive. Innovative AI requires a safe space to flourish.

Concluding comments and membership

We stand ready and willing to continue to engage with the Department for Science, Innovation and Technology and the Office for Artificial Intelligence on this important project and look forward to opportunities to exchange more detail in the future.

The IRSG organised a workshop on the AI White Paper in May 2023 with interested Members and has conducted several follow-up discussions with members to discuss and collate their feedback. The IRSG wishes to thank those who have overseen production of this response, in particular DLA Piper UK LLP.

We thank you for considering this submission.

Contact address:

IRSGSecretariat@cityoflondon.gov.uk