REGULATORY INTELLIGENCE

How the EU artificial intelligence draft regulation could affect your business

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The European Commission published a draft of its ground-breaking Regulation on Artificial Intelligence (AI) on April 21. The overall broad scope of the draft regulation, from definition of AI through actors in the AI value chain to its extra-territorial reach, means that the law is expected to have a significant impact on financial services firms in all aspects of their practice, from the prevention of financial crime, to investment algorithms and recruitment procedures.

In what will likely be the world's first piece of legislation exclusively governing the use of AI, the draft regulation may very well set the standard worldwide, in a similar way the General Data Protection Regulation (GDPR) did for data protection, privacy and cybersecurity matters.

Risk-based approach

The draft regulation adopts a risk-based approach, identifying four levels of risk. It will be for businesses to identify what AI systems they use or provide, and which risk group each falls into.

Unacceptable risk

Applications at the highest "unacceptable risk" level are prohibited. Included in this general ban are systems that may materially distort the behaviour of a person in a manner that causes (or is likely to cause) physical or psychological harm, as well as the use of AI systems by public authorities designed to evaluate the trustworthiness of natural persons, resulting in unfair treatment of those persons. Real-time remote biometric identification systems for law enforcement are also banned, unless limited exceptions apply.

High-risk

Systems classified as "high risk" are not forbidden but will be subject to multiple regulatory requirements, some applicable to users and other provisions to providers of AI. High-risk AI includes systems to evaluate the creditworthiness of natural persons (and other systems relating to access of essential private and public services); recruitment and workforce management such as monitoring or evaluating performance of employees; real-time remote biometric identification; and products covered by a suite of existing European Union legislation (machinery, medical devices, vehicles, etc.,).

Limited-risk

"Low/limited" risk applications include those AI systems that interact with people (such as chatbots), as well emotion recognition systems. They will face new regulatory requirements, aimed at promoting enhanced transparency for individuals.

Minimal-risk

Only those AI systems considered a "minimal" risk escape mandatory new obligations (for those the draft regulation includes, however, the option to adhere to voluntary codes of conduct fostering adherence to the rules applicable to high-risk AI).

Broad scope of applications and wide range of participants affected

Achieving compliance with the proposed law may be a high bar in light of the wide definition of "AI systems". Aiming to be technologically neutral and future proof, it includes software developed with supervised, unsupervised and reinforcement machine learning; and with statistical approaches, search and optimisation methods.

The draft regulation imposes different requirements on a variety of participants in the AI value chain, and there may be scope for some uncertainty and fluidity as to which category particular businesses fall into.

The bulk of the proposed obligations are imposed on "providers" and "users" of AI, both defined broadly. "Providers" include those who develop an AI system or put it into service under their own name. If any user, distributor, importer or other third party modifies (for example) the intended purpose of a high-risk AI system, they may be considered a "provider" too. "Users" are any entities or individuals who use an "AI system".

Some concessions are made for Small and Medium-Sized Enterprises and start-ups, including by setting up AI regulatory "sandboxes" (i.e., controlled environments to test innovative technologies for a limited time).

Extra-territorial scope

The draft regulation applies to users of AI in the EU, and to any provider placing AI on the market or putting AI into service in the EU, regardless of where that provider is established. Further, it applies to any providers and users of AI that are located outside the EU, "where the output produced by the AI system is used in the EU".

Requirements for "high-risk" AI systems on users and providers

The draft regulation will impose a raft of mandatory requirements for high-risk AI systems and related obligations on providers and users as well as other key participants in the AI value chain.

For providers, these obligations include: establishing a risk management system for the lifecycle of high-risk AI; meeting the specified quality criteria in the training and testing data; creating ex-ante technical documentation; enabling AI systems to automatically record events (logs); ensuring transparency in the design and development of the systems; enabling AI to be overseen by natural persons; and achieving accuracy, robustness and cybersecurity. Providers will also need to ensure that high-risk AI systems undergo a conformity assessment and are registered in a public EU database.

For users, the obligations include implementing the human oversight; carrying out post-market monitoring of the AI's operations; ensuring input data is relevant; reporting risks and "serious incidents" to the providers and/or the regulators; and continuing to comply with other relevant laws, such as carrying out a data protection impact assessment under the GDPR.

Requirements for "low risk" AI systems on users and providers

Users of low risk AI such as emotion recognition systems and 'deep fakes' (i.e. AI systems that generate or manipulate certain images, audio or video content to falsely appear authentic) will need to inform individuals that such AI systems are in operation.

AI systems that interact with natural people, like chatbots, will need to be designed in such a way as to inform people that they are interacting with a machine.

Enforcement

Each EU member state will have to designate at least one competent national authority to implement and supervise the regulation's application. At EU level, a newly established European Artificial Intelligence Board will take care of effective implementation throughout the EU.

The proposed fines for non-compliance are significant: breach of certain provisions may result in fines of up to 6% of annual global turnover (or 30 million euros, whichever is higher), with other breaches carrying a penalty of up to 4% of annual global turnover (or 20 million euros, whichever is higher).

Specific impact on financial services firms

The draft regulation is sector-agnostic. However, it states that it seeks to ensure "coherent application and enforcement" of the new rules it imposes and existing European Union financial services legislation. It envisages that the authorities responsible for the supervision and enforcement of the current financial services laws will be designated by member states as the "competent national authority" for compliance with this draft AI law by regulated financial services firms.

The draft also states that for certain financial services firms that use or provide AI, it would be appropriate to integrate some of the AI providers' obligations (such as in relation to conformity assessment and risk management systems) and some of the AI users' obligations (such as post market monitoring) into existing obligations and procedures under Directive 2013/36/EU[1].

In the light of the wide scope of the proposed new law, financial services firms will soon have to consider the use of which AI system falls into which risk category and how in practice they can implement compliance with the extensive new obligations.

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[1] Directive 2013/36/EU of the European Parliament and of the Council of June 26, 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Complaints Procedure

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