Written evidence submitted by KPMG LLP

Thank you for the opportunity to submit evidence to your committee's inquiry into the use of Artificial Intelligence (AI) in Financial Services which I am pleased to do on behalf of KPMG LLP, a UK limited liability partnership and member firm of KPMG, a global organisation of independent professional services firms providing Audit, Legal, Tax and Advisory services.

AI is already transforming the way we live and work. It presents a significant opportunity to improve productivity, boost efficiencies and optimise effectiveness whilst also enhancing the customer experience, including in financial services. The UK has a well-established financial services industry, strong technological and sector expertise, and a respected regulatory framework, positioning it well to make use of AI's potential.

Capitalising on the innovations AI offers so that the City of London – and the wider financial services economic ecosystem across the UK - continues to be a world leader in finance is critically important to bolstering the UK's attractiveness and our position on the world stage. But in seizing that opportunity, it is imperative to consider potential risks, and to ensure that appropriate safeguards and mitigations are implemented.

Financial services and AI are strategic priorities for the government. *Invest 2035: the UK's modern industrial strategy* green paper, launched last October, highlighted both these areas and, in January 2025, the government made clear its ambitions for AI, endorsing Matt Clifford's AI Opportunities Action Plan which outlined a roadmap to leverage AI for growth, productivity, and benefits for UK citizens, describing it as a 'blueprint to turbocharge AI'.

This makes it an opportune moment to explore the implications and the potential of the fusion of these two sectors and we therefore welcome your committee's inquiry.

Our response to your request for evidence is informed by our extensive experience in the financial services sector as well as our work in the field of AI.

KPMG is a leading adviser to the financial services sector, with a global financial service practice comprising around 65,000 dedicated partners and professionals across more than 140 countries and territories working with clients across the industry. This gives us first-hand knowledge and insight into the challenges experienced across the sector.

In AI, industry analysts recognise us as a leader. We are known for our comprehensive Trusted AI Framework and capability, and we continue to embed AI capabilities across the KPMG organisation, investing over US$1.7 billion across the KPMG network in our last financial year, with a specific focus on technology and AI, talent and ESG. Worldwide, our AI delivery capability consists of more than 30,000 people trained across all aspects of AI, from AI strategies, learning and adoption, risk, ethics and responsible AI through to the technology, infrastructure and data. Most importantly, we are our own Client zero; we consume the services we sell to our clients in order to drive innovation, improve quality, gain market position and make our business more efficient and effective. We work closely with our global alliance partner ecosystem[1], including with Microsoft, Google Cloud, Oracle, ServiceNow, SAP, Workday and Salesforce to enhance and evolve our AI service offerings to stay at the forefront of the dynamic AI landscape.

[1] KPMG Global Alliances and Ecosystems

Our detailed response is attached. In summary, our perspective on the matters raised in your call for evidence is as follows:

- **AI presents a significant opportunity to transform the UK financial services sector.** Our research[2] suggests it has the potential to drive productivity improvements of up to 50% in the next five years, improving efficiency, effectiveness, customer experience and value, including for customers in vulnerable situations (which may be temporary or persistent). Crucially, it is freeing up capital and capacity which can be redeployed and reinvested to fuel a wave of innovation.

- **Traditional AI, such as predictive models and machine learning, has been successfully deployed within critical functions of Financial Service organisations for many years. In recent years, Generative AI and more recently Agentic AI are actively being explored and implemented.** It is anticipated that both the methods of application and the extent of utilisation will continue to increase and expand, particularly as AI becomes fully integrated into organisations, agentic AI advances, and new applications emerge.

- **However, whilst the opportunity for AI is clear, some organisations face challenges in scaling AI solutions.** Many of these challenges are driven by the risks and barriers to adoption. At the heart of these risks and barriers is a three-dimensional trust challenge:
    - employees may resist AI tools if they fear job displacement or do not understand how to work effectively with them;
    - customers may reject AI-enabled products or services if they doubt their reliability, fairness, or data-handling practices; and
    - regulatory bodies are increasingly scrutinising AI applications for compliance with emerging standards.

  Many of the specific risks impact one of more of these personas including data quality and integration with legacy technologies, cybersecurity, data privacy, AI model bias, hallucinations, and market concentration. Implementing appropriate mitigations and safeguards is therefore essential to building trust and enabling innovation.

- **AI is set to transform the workforce in the Financial Services sector.** Enhancing training and career progression initiatives to support the development of employees' AI proficiencies will enable the realisation of growth and innovation. It will be crucial to build and preserve expertise within the workforce to meet future needs.

- **The UK's principles-based regulatory framework for financial services, which includes protections for consumers and rules governing critical third parties, is an effective model for overseeing AI in financial services.** However, further guidance on its application and additional resources for supervision will likely be necessary.

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[2] AI set to add £35bn to financial and professional services sector by 2030

I hope you find our evidence helpful. We look forward to following the progress of your inquiry as it develops, and we would be happy to answer any questions you may have.

DETAILED RESPONSE

1 Artificial Intelligence adoption in the UK financial services sector

1.1 Artificial Intelligence (AI) has long been an integral part of the financial services sector, with traditional techniques like machine learning being successfully implemented across various critical business functions. For example, machine learning algorithms have been pivotal in enhancing fraud detection systems and credit scoring. As the sector continues to evolve, there is a growing embrace of newer AI technologies, such as generative AI and agentic AI, which promise to unlock further potential and drive innovation across the industry. This is evidenced by the Bank of England's November 2024 report[3] and supported by KPMG's global research[4] which found that 81% of banking and insurance Chief Executive Officers (CEOs) and 75% of asset management CEOs prioritise generative AI as a key investment, with 92% of financial services companies reporting profits from AI investments in the past 24 months. Such data demonstrates a robust adoption rate, positioning financial services as a leader in AI integration.

1.2 The UK Government recognises the potential of the sector and AI. Its Industrial Strategy – *Invest 2035* green paper identified eight growth-driving sectors, including financial services, digital, and technologies. Notably, financial services account for £208.2 billion[5], or 8.8% of total UK economic output, with the UK's digital sector estimated to account for around £153bn[6] or around 6.5% of UK output. The fusion of these sectors through technological and AI adoption is thus strategically significant for the UK.

1.3 For the purpose of this response, we will focus on Generative AI and Agentic AI solutions due to their rapid expansion and adoption across various sectors. Horizontal Agentic solutions include general productivity tools such as Microsoft365 Copilot, while vertical Agentic solutions provide sector and domain-specific AI solutions e.g. fraud detection.

1.4 In our firm, we categorise AI adoption into three stages: Enable, Embed, and Evolve. These stages provide a framework for understanding the likely progression of AI usage. We define these waves as follows:

- **Enable:** focuses predominantly on personal productivity tools such as Microsoft Copilot and includes horizontal Agentic solutions that empower the workforce to be

[3] Artificial intelligence in UK financial services - 2024 | Bank of England

more efficient in their daily activities. Typical administrative tasks are augmented or automated, freeing up time for the workforce to focus on more creative and critical thinking/decision-making activities. This wave is widely being adopted across sectors.

- **Embed:** focuses on re-engineering processes and examining how AI can augment and automate processes end-to-end. This typically involves embedding vertical (sector and domain-specific) AI agents to support existing business processes, thereby driving increased efficiencies and effectiveness.
- **Evolve:** the third wave, focuses on reimagining business models. A significant trend post-2025 is likely to be the rapid increase in the adoption and embedding of Agentic AI solutions, which are capable of autonomous decision-making and learning, fundamentally reshaping sector value chains.

Current use of AI in Financial Services

1.5 We are seeing varying levels of risk appetite set for AI across the sector. This is determining where and how AI is deployed across organisations. Primarily, we are seeing widespread roll out within the Enable wave, with the greatest focus on personal productivity tooling and lower risk AI use cases being deployed, for example to support back-office function tasks and digital assistants, or chatbots, with a 'human in the loop' to monitor the model and its outputs.

1.6 However, although AI implementation is progressing, according to our global research[7] cited above only 32% of companies report generating returns at scale. Larger firms have made the most progress to date through focusing on building infrastructure to scale vertical solutions in specific domains whilst embedding enhanced responsible AI and ethical frameworks.

1.7 Key applications of AI across financial services include:

Front Office (typically customer and client facing, revenue generating functions)

Banking:

- **Customer Service and Engagement:** AI-powered virtual assistants can provide instant support, handling routine enquiries, transactions and, increasingly, more complex interactions with growing levels of empathy. They can also assist in identifying and addressing the potential that a customer may be in a vulnerable situation, offering tailored support.

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[4] KPMG global tech report: Financial services insights
[5] Commons Library Research Briefing, 18 November 2024, Financial services in the UK: SN06193.pdf
[6] Economic Estimates: Digital Sector Annual Gross Value Added (2019 to 2023) - GOV.UK
[7] KPMG global tech report: Financial services insights

- **Personalised Banking Services:** AI can analyse sentiment within both customer transactional and engagement data, and open source data (such as social media), to offer more personalised financial services, enhancing customer experience satisfaction and loyalty.

Insurance:

- **Customer Fulfilment:** AI-driven virtual assistants can support underwriting and quotes, provide policy information and initiate claims notification and handling enquiries efficiently, for certain products using technologies such as visual recognition (e.g. using car damage photographic inputs).
- **Sales and Marketing:** AI helps in segmenting customers and personalising marketing campaigns, improving customer acquisition and retention across product groups.

Asset Management:

- **Client Advisory Services:** Robo-advice platforms can offer automated, tailored, algorithm-driven financial planning services, providing clients with investment advice based on their risk profile and financial goals.
- **Portfolio Management:** AI assists can provide personalised investment strategies and recommendations, enhancing client engagement and satisfaction.

Middle Office (supporting services which bridge front and back-office functions, typically focussed on risk, technology support)

Banking:

- **Risk Management and Compliance:** AI can continuously monitor financial controls and detect anomalies in transactions, enhancing fraud detection and regulatory compliance.
- **Credit Scoring and Underwriting:** AI models can assess credit risk more accurately by analysing a broader range of data, improving loan approval processes.

Insurance:

- **Underwriting and Risk Assessment:** AI can enhance underwriting processes by analysing large datasets to assess risk more accurately and efficiently.
- **Claims Management:** AI can streamline claims processing by automating routine tasks and detecting fraudulent claims through pattern recognition.

Asset Management:

- **Risk Analysis and Management:** AI tools can analyse market data to identify potential risks and opportunities, supporting portfolio managers in making informed decisions.

- **Regulatory Compliance:** AI can assist in scanning regulations and monitoring compliance controls, ensuring adherence to industry standards.

Back Office (typically corporate and business services which underpin the core operations)

Banking:

- **Operational Efficiency:** AI can automate routine back-office tasks, such as data entry and reconciliation, reducing errors and operational costs.
- **Fraud Detection:** AI systems can analyse transaction patterns to identify and prevent fraudulent activities, safeguarding financial assets.

Insurance:

- **Policy Administration:** AI can automate policy management tasks, improving efficiency and accuracy in policy updates and renewals.
- **Data Management:** AI can enhance data processing and analysis, supporting better decision-making and operational efficiency.

Asset Management:

- **Trade Processing and Settlement:** AI can optimise trade processing and settlement operations, reducing processing times and errors.
- **Data Analytics and Reporting:** AI can automate data analysis and reporting, providing insights into portfolio performance and market trends.

1.8 AI is being adopted as core functionality within Fintech driving the same range of benefits mentioned above across efficiencies, reducing risk and enhancing customer experience. Examples include AI powered fraud detection, robo-advisors, AI powered payment authentication and alternative credit scoring and loan approval processes. The barriers to adoption are, in some respects, lower in Fintech due to their agile nature, modern technology stacks and fewer regulatory requirements. Larger and longer-established financial institutions may be comparatively less agile in AI adoption, but might have an advantage in that they are able to draw on vast datasets that enable more sophisticated innovation and model training.

Future trends

1.9 Within the next five years, we expect financial institutions will increasingly focus on the Embed wave of AI and move into the Evolve phase for complex decision-making processes, enhancing high-risk areas such as credit risk assessment, regulatory compliance, and personalised customer experiences.

1.10 We anticipate this transformation will be driven by a shift from tool-specific AI applications to an integrated ecosystem, transforming end-to-end value chains and optimising service delivery models. We will also see a continued rise in agentic AI with "AI agents" capable of acting as 24/7 virtual advisors, providing tailored financial guidance, further automating routine transactions and proactively managing customer needs based on real-time data and predictive insights and, in operations, streamlining back-office processes across their full end-to-end life cycle such as fraud-detection, compliance monitoring and risk assessment by analysing huge volumes and amounts of data with unmatched speed and precision.

1.11 Example applications include autonomous banking with AI managing finances and investments in real-time and predictive maintenance in insurance which is where AI transforms risk management into a predictive process, reducing claims and enhancing safety.

1.12 Looking further than five years out, post 2030, AI is expected to further integrate into the physical world, influencing financial services in various ways. In banking this might include using AI-enabled physical security systems and fraud detection over physical transactions, such as using facial recognition and behavioural analysis in branches and ATMs; in payments, using AI-powered autonomous payments to facilitate seamless in-person transactions in walk-in, walk-out retail experiences; and, in insurance, AI-powered autonomous drones might become mainstream for property assessments and risk profiles.

2 Potential productivity improvements and workforce implications

Productivity

2.1 AI has the potential to significantly improve productivity in financial services. The UK, with its robust financial sector, strong regulatory framework and technology ecosystem, is in a good position to harness its potential. Joint research[8] between KPMG and the City of London Corporation in 2024 indicated that, under a maximum scenario, AI could add £35bn to the financial and professional services (FPS) sector over the next five years driven by enhanced productivity, new market opportunities, and product development.

2.2 The study, which analysed a profile of roles across insurance, asset management, investment banking, retail banking, challenger banks, fintech, and legal services—

projected a potential productivity increase of up to 12% in the short term (one year) and up to 50% over a longer (five year) timeframe, provided AI is fully integrated and put to maximum advantage. This is likely to be most focussed on support functions, followed by control functions and to a slightly lesser extent revenue functions which have a more critical human component.

2.3 Today, as organisations focus on the Enable and Embed phases of AI transformation, existing processes will increasingly be accelerated using AI, driving an initial phase of productivity improvement. As organisations successfully reach the 'Evolve' phase and implement completely re-imagined agentic processes, we may see organisations productivity increase by an order of magnitude. This may create a period of 'winners' and 'losers' where the first organisations to reach 'Evolve' undergo a 'great leap forwards' and significantly outperform those left behind. This may cause a bandwagon effect where some laggards invest heavily in agentic systems in order to catch up and others are outcompeted from the marketplace.

2.4 There are two dimensions to how productivity improvements to existing processes can be derived: Efficiency, the amount of time it takes to perform a task or complete a process (for example, AI driven automation at a global bank effectively doubled efficiency by reducing loan underwriting times from 30 to 16 days[9]) and Effectiveness, the performance of process, such as accuracy or customer satisfaction (for example, a major credit card company thwarted 80 million fraudulent transactions worth $40 billion globally, a success it attributed to substantial investments in AI technology[10]).

2.5 Whilst AI undoubtedly has the potential to save costs and, with pressure on financial services firms to reduce overheads, some may feel inclined to 'bank' the potential savings. However, the real driver for AI to boost productivity will be how the freed-up capital and capacity is reinvested and redeployed as this can potentially fuel a wave of innovation in products and services, create new revenue streams and support sustainable growth.

Workforce implications

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[8] AI set to add £35bn to financial and professional services sector by 2030
[9] Intelligent banking
[10] Intelligent banking

2.6 As financial services firms recognise AI's potential to improve productivity, they have four strategic options regarding their workforce: 1) reallocate employee time to higher-value tasks that foster growth, 2) redeploy talent to areas of expansion, 3) maintain current organisational structures while reducing stress to achieve long-term productivity gains through decreased staff burnout and lower attrition rates, or 4) implement redundancies in roles where AI can automate and replace tasks.

2.7 Although reducing headcount might seem attractive to cost-sensitive firms, it could be short-sighted given the comparative costs of reskilling versus hiring new employees. According to the Financial Services Skills Commission[11], financial services firms could save up to £49,100 per employee by reskilling staff rather than hiring new employees. Instead of viewing AI solely as a cost-cutting tool, proactively upskilling and reskilling colleagues in higher-value activities and growth areas, together with providing training and career progression to support the development of AI proficiencies to equip them to work effectively with this technology, can lead to long-term cost savings and financial gains.

2.8 But with the financial services sector accounting for over 3%[12] of the UK workforce, and it being geographically dispersed across the country, concerns around the potential impact on jobs as a result of AI-enabled cost efficiencies are understandable.

2.9 We anticipate that in the short-term (1-3 years approximately) AI will transform the workforce by changing existing roles through the augmentation and automation of tasks. It may also replace some roles, particularly affecting administrative positions and those involving repetitive manual tasks. However, in the longer term, we foresee new job opportunities as discussed below.

2.10 Predicting the precise impact is, of course, challenging. Firms will not achieve *every* potential AI opportunity available to them and, as mentioned above, firms may choose to redeploy freed up capacity in the workforce on improving their customer offering by, for example reducing call centre waiting times. A potential contraction may happen organically as firms slow down hiring and choose not to replace leavers, rather than as a result of redundancy programmes. The jobs market in the UK banking sector has sustained a 40% drop from Covid-driven highs seen in 2022[13] and shown a further 1% drop over 2023-2024, which might support the beginnings of an organic decline.

2.11 We estimate that from around 2027 onwards, the increased adoption and implementation of agentic systems will give rise to a new set of jobs. These may include new roles such as Bias Controller, Agent Cluster Manager, Cognitive System Architect, Orchestration Specialist, AI Performance Analyst, AI Learning Manager

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[11] Reskilling-A-business-case-FINAL-Jan-2022.pdf
[12] Financial Services in the UK, House of Commons Library: SN06193.pdf
[13] AI and Investment Trends Reshape UK Financial Job Market- Morgan McKinley

together with an increase in roles over the governance and ethics of AI, which is a field that is already emerging. Additionally, because a critical success factor for high-performing agentic systems is establishing systems of human accountability (in which humans remain responsible and accountable if those systems fail) the UK financial services workforce must include individuals with the specialist skills and expertise needed to manage complex and oversee appropriate controls over complex risk concepts such as herd behaviour, insider trading, and market manipulation to fulfil likely demand for these essential roles.

2.12 With potential role changes for lower grade jobs concentrated in administrative and repetitive manual tasks, traditional career progression pathways could be threatened. This risk is compounded by the loss of knowledge as experienced senior professionals—including those who possess the skills necessary to ensure effective accountability over agentic systems—exit the job market. Approaches such as shadowing, senior apprenticeships, and subsidisation (keeping people in roles to help them acquire critical skills even if the role itself is no longer economically viable) may be necessary to maintain the flow of essential skills through the ranks of the UK financial services sector.

2.13 The UK financial services sector must prepare for the workforce of the future by shifting its skills profile from those suited for roles likely to be automated by AI to those suited for roles in the age of agentic AI and human-AI collaboration. And firms will need to reshape and reskill their workforces and adapt their organisational structures to maximise the potential growth benefits that AI can offer as they implement agentic systems and beyond.

2.14 There is substantial future growth potential in the financial services workforce, but if a shorter-term impact on jobs is not managed appropriately, and adjacent skills and capacity that firms come to rely on later are lost from the financial services workforce, the upside will be under threat.

3 Barriers and risks to adoption

Barriers to AI Adoption

3.1 Despite the transformative potential of AI, several barriers hinder its adoption in financial services:

- **Data and infrastructure:** AI initiatives require clean, accessible data and robust infrastructure. Many financial institutions face challenges with outdated systems and technical debt, limiting their ability to innovate and adapt to new technologies including AI. Nearly 40% of financial services executives surveyed globally by KPMG[14] in 2023 reported that their IT/digital infrastructure was at a low or medium level of development.

- **Regulatory and compliance:** The regulatory landscape for AI is complex and evolving, and can be challenging for financial institutions to navigate. The rapid pace of AI development may outstrip regulatory frameworks, and regulatory uncertainty may slow or limit the adoption of transformative AI applications. Firms tend not to want additional regulation but they do want further guidance on the application of responsible AI principles.
- **Cybersecurity and data privacy:** Increasing AI adoption can amplify cybersecurity risks as AI systems, especially those using generative AI, expand the attack surface for hackers. Financial institutions are also concerned about privacy and data risks arising from the use of AI. Advanced security measures, including vulnerability scanning, real-time monitoring and robust encryption, are essential.
- **Skills, cultural and organisational resistance:** To harness AI effectively, financial institutions need teams that are both technologically proficient and ethically aware. There is a significant gap between the AI skills available and those required. Over half of executives in our Global AI in Finance[15] report cited this lack of skills as a major challenge.
- **ROI uncertainty:** High implementation costs, lack of aligned strategy and uncertain return on investment (ROI) are significant barriers, with many organisations struggling to identify and measure the value of AI.
- **Strategy:** A flooded landscape of third-party Agentic AI solutions, the pace of advancements of AI and long lists of use cases coupled with the fear of missing out and need for speed are hindering progress. AI strategies need to align to business strategies and use cases be prioritised to focus on value and suitable measurement of success.
- **Sustainability & ESG:** The energy consumption of Large Language Models (LLMs) is a growing concern, necessitating strategies like efficient prompt engineering, green data centres, and smaller language models. While there have been improvements in the energy efficiency of training and running LLMs, addressing major energy challenges requires a multifaceted approach to mitigate carbon emissions.

3.2 A key overarching barrier to adoption is trust. Customers need to be comfortable using AI-enabled services, employees need to trust AI outputs, and management must be confident in its understanding of the solutions and the responsible and ethical use.

Broader risks in AI adoption and use

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[14] the-gen-ai-advantages-in-financial-services.pdf
[15] KPMG global AI in finance report

3.3 Beyond the barriers to AI adoption, several broader risks could pose challenges including to the fair treatment of consumers and to financial stability:

- **Embedded bias:** AI systems can inadvertently perpetuate or amplify existing biases if not properly managed. This can occur through historical societal biases present in training data or limitations in data diversity. Ensuring diverse and representative datasets, along with transparent model governance, is crucial to mitigating this risk. Bias in AI systems can lead to unfair treatment or exclusion of consumers from financial services, exacerbating existing inequalities.
- **Data sharing and ethics:** Effective AI implementation requires comprehensive and high-quality data access. However, this necessitates careful consideration of data sharing practices to ensure consumer privacy and protection. Customers who have limited understanding of data rights or are less digitally literate may be more susceptible to data misuse or breaches. AI systems should be designed and deployed with ethical considerations front of mind to prevent misuse and ensure fairness. This includes avoiding discrimination, ensuring transparency in AI decision-making processes, and maintaining accountability for AI-driven outcomes. Financial institutions must establish ethical guidelines and governance frameworks to oversee AI deployment, so that AI systems are used responsibly and do not exploit or disadvantage vulnerable individuals.
- **Opacity, hallucinations and monitoring challenges**: AI systems, particularly those employing complex machine learning models, can exhibit behaviours that are difficult to predict or understand. This opacity in AI decision-making processes (the 'black box' issue) can pose difficulty for firms in understanding how outputs have been generated and in explaining resulting decisions to senior management or consumers (e.g. credit approvals). Generative AI also has the potential to be used to create realistic but false information, "hallucinations", which could lead to market distortion, hindering regulators' ability to anticipate and mitigate systemic risks. The need for greater transparency and enhanced monitoring tools and frameworks could increase as AI activities increasingly migrate to nonbank financial intermediaries (NBFIs), which may not be subject to the same regulatory scrutiny as traditional financial institutions.
- **Data, model, or concept drift:** Data drift refers to changes in data inputs that were not part of initial training, model drift refers to a reduction in performance due to changes in the relationship between input and output variables, and concept drift refers to changes in the statistical properties of the target variables. Any form of drift—data, model, or concept—can lead to unexpected model outcomes, potentially harming consumers or leading to trading strategies that could lead to market volatility possibly undermining financial stability. Regular audits, updates, and recalibrations of AI models are necessary to manage these risks effectively.
- **Market volatility and herding behaviours**: AI-driven trading strategies can significantly increase market speed and volatility. These algorithms can execute trades at a pace far beyond human capability, potentially leading to rapid market movements. Under stress, if multiple AI systems react similarly to market signals, this can result in highly correlated trading behaviours (herding behaviours), amplifying market volatility and potentially triggering flash crashes or other

destabilising events. This could be manifest as an ‘AI powered’ meme stock moment, if retail investors use AI agents with related underpinnings. The challenge lies in ensuring that AI systems are designed with safeguards to prevent such correlated behaviours and that they can respond appropriately to market anomalies. Potential mitigations include implementing rigorous validation and testing processes, ensuring diverse and representative training datasets, kill-switches, and maintaining human oversight to provide a check on AI outputs.

- **Third-party dependencies and concentration:** Increasing reliance on external AI providers may introduce operational resilience and financial stability risks where the providers experience disruption or security breaches. The concentration of AI tools among a few large tech companies may exacerbate these risks. According to the Bank of England[16], one-third of AI implementations now depend on external providers, up from 17% in 2022. Mitigation strategies include conducting thorough vendor due diligence, establishing robust contractual safeguards and contingencies, implementing continuous monitoring, and, where possible diversifying AI providers.

[16] Artificial intelligence in UK financial services - 2024 | Bank of England

3.4 Financial services firms can mitigate these risks at a micro level by implementing a robust AI risk and control framework, proportionate to the organisation's size and risk appetite, including comprehensive risk assessments, continuous monitoring and adaptive strategies to respond to emerging threats.

3.5 Policymakers and regulators have started to monitor these risks at a macro level. The IMF recently produced a report[17] on the possible impacts of AI on financial stability and the Bank of England's Financial Policy Committee has published its assessment[18] of AI's impact on financial stability and how it plans to monitor the evolution of those risks. The issue is that AI could both increase the interconnectedness of financial services firms and increase the probability that existing levels of interconnectedness threaten financial stability. The Bank of England is considering whether it could use stress tests to understand how AI models used for trading, whether by banks or non-banks, could interact with each other. This could help the Bank to understand reaction functions better, identify where elements of objective functions might cause them to evolve in ways which actively amplify shocks and undermine financial stability, and use results to inform where intervention is required.

4 Benefits and risks to consumers – in particular vulnerable consumers – and potential to enhance financial inclusion

4.1 The ways in which AI can benefit customers have been covered in section 1. Principally they relate to improved customer service and enhanced products and services, which could be personalised and tailored to customer needs.

4.2 In addition to these, the enhanced capabilities that AI can offer create a huge opportunity to broaden financial inclusion by opening up financial services to new demographics in the UK and globally that have not traditionally been consumers of financial services.

4.3 Segments with lower wealth, lower financial literacy, and cultural barriers (including language and dialect) have either not participated in the market for more advanced financial services such as equities and fixed income, or not been commercially viable customers. AI's ability to manage risk and offer personalised investment portfolios could make it commercially viable to offer less affluent customers investment services that are personalised, as well as offer new channels for consumers to enter the market place due to better tools to break down language barriers, raise levels of financial literacy, and support micro-investments. This is a significant opportunity both for the sector and for UK society as a whole.

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[17] Global Financial Stability Report, October 2024 - Steadying the Course: Uncertainty, Artificial Intelligence, and Financial Stability

[18] Financial Stability in Focus: Artificial intelligence in the financial system | Bank of England

Customer vulnerability

4.4 Customer vulnerability is a critical and well-recognised issue within the financial services sector. Firms are actively responding to regulatory guidance, such as FG21/1[19], to proactively identify and address the unique needs of customers in vulnerable situations. The Financial Conduct Authority (FCA) has recently published findings from a study[20] across firms, highlighting progress and best practices in this area. Firms may appoint Senior Responsible Officers to oversee the vulnerability agenda, integrated into Consumer Duty reviews, product design, and transformation initiatives.

4.5 The fundamental premise of the guidance and market trends is that any customer or UK citizen can experience moments of vulnerability. These challenges can be persistent and permanent, or they may be periodic, temporary, or even a one-off occurrence. This understanding does not diminish the severe and persistent challenges faced by individuals with significant mental or physical disabilities but underscores the reality that vulnerability can affect anyone at different times in their lives.

4.6 Vulnerability can arise from various drivers, including health issues (such as severe illness affecting the individual or a close family member), challenging life events (like bereavement, relationship breakdown, or job loss), socio-economic factors and as a result of increased cost of living challenges. These situations can impact financial resilience, increasing the risk of poor financial decisions that may exacerbate personal or health challenges. Additionally, physical accessibility issues, cognitive health matters, and communication barriers can create further difficulties in managing financial affairs.

AI as an Accelerator of Outcomes

4.7 AI plays a pivotal role as an accelerator of outcomes for vulnerable customers, capable of influencing these outcomes in either direction. On the positive side, AI can enhance the identification and support of vulnerable individuals by analysing data to predict and respond to their needs more effectively. However, there is also a significant risk that AI could be misused to exploit vulnerabilities, potentially causing harm. Malicious use of AI could target individuals in vulnerable situations, exacerbating their challenges.

Utilising AI to Strengthen Customer Resilience, Protection, and Support

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[19] Guidance for firms on the fair treatment of vulnerable customers | FCA
[20] Firms' treatment of customers in vulnerable circumstances – review | FCA

4.8 In the evolving landscape of customer vulnerability, AI offers substantial opportunities to enhance resilience, protection, and support for consumers in the financial services sector.

4.9 AI can play a crucial role in bolstering support by proactively identifying or predicting vulnerable situations and offering customised assistance tailored to their unique needs.

4.10 Many leading institutions in the financial services sector are currently using AI to achieve objectives related to communication and transparency. AI can be applied to adapt communications suitable for the literacy level of adults in the UK, typically around the reading age of an 11–12-year-old.

4.11 In addition, AI is being utilised to enhance customer service by reducing wait times and improving accessibility for those needing extra assistance. For vulnerable consumers, this facilitates access to financial services and support, potentially decreasing financial exclusion.

4.12 These techniques enable effective communication with individuals who have neurodiversity or other health challenges. For example, conversational AI (chatbots) can adjust their communication pace to accommodate customers with severe challenges, providing a consistent and effective interaction that might be challenging for human agents to deliver.

4.13 The more advanced institutions are exploring the use of AI to identify customers with different types of vulnerabilities. However, ethical challenges are causing delays as firms work towards determining and executing appropriate support actions. For instance, AI can analyse spending patterns to notify consumers about potential overdrafts or suggest budgeting strategies. It is necessary to maintain a balance between providing guidance and making personal recommendations, which may be seen as intrusive.

4.14 AI is also being explored for identifying potential health or life events by analysing transactional data to detect purchases associated with illnesses or bereavement. This raises ethical considerations, as customers may not have disclosed such matters or consented to firms knowing this information, especially when special category data is involved. Firms must balance their obligation to prevent poor outcomes with respecting customer privacy.

5 Regulation - striking the right balance

5.1 In terms of striking the right balance between seizing the opportunities of AI but at the same protecting consumers and mitigating against threats to financial stability, overall,

KPMG supports the government and financial regulators' current plans to oversee the use of AI using existing principles-based frameworks and toolkits (e.g., Data Protection regime Consumer Duty, Critical Third Parties regime). These should provide sufficient agility to adjust to changes in the technology while still offering appropriate protection to consumers and the wider economy. We agree that utilising existing regulators to oversee the adoption of AI has its merits but consider that it is vital that those regulators are able to articulate and define their roles clearly. These regulators must also be suitably funded to ensure they have the capacity to take on these new roles against their existing well-established responsibilities.

5.2 That said, as the onus is then on individual firms to navigate the practicalities of incorporating these principles into their risk management processes, the provision of supplementary AI-specific guidance would be useful to ensure consistent outcomes. Whilst we appreciate some has already been provided, for example by the Information Commissioner[21], we find that clients are still confused as to how they will be regulated, who will regulate, and against what standards.

5.3 Effective monitoring and supervision of the use of AI will also require enhanced government and regulatory expertise – an upskilling which is already underway.

5.4 In more general terms, beyond the financial services sector, we welcome the government's endorsement of the AI Opportunities Action plan earlier this year as signalling a strong commitment to not just support but actively enhance the AI ecosystem. In principle, we also support the government's plan, as confirmed in the 2024 King's speech, to eventually introduce highly targeted binding rules on developers of the "most powerful" AI systems. We consider many organisations are still seeking to understand their responsibilities around AI adoption, so clear guidance as to what is expected will be welcomed.

Reassessing Financial Services frameworks

[21] Guidance on AI and data protection | ICO

5.5 The EU's AI Act, which entered into force in August 2024, classifies AI applications into risk levels, introducing stringent requirements for high-risk areas. Although this logic is sensible, the prescriptive nature of the Act reduces its ability to remain agile in the face of fast-moving technology. Even during the negotiation period, the underlying risk classification system of the Act had to be substantially amended to account for the emergence of general-purpose AI.

5.6 The UK has instead opted for a more flexible and principles-based approach, where new AI-specific regulation is not currently needed. Instead, the government has proposed to build on existing regimes and empower sectoral regulators to apply five cross-cutting principles:

- Safety, security and robustness
- Appropriate transparency and explainability
- Fairness
- Accountability and governance
- Contestability and redress

5.7 In financial services, the BoE/PRA[22] and FCA[23] have determined that existing policies (e.g., Consumer Duty, SMCR, Model Risk Management Principles) remain sufficient to address the risks posed by AI, as these risks are 'not unique'.

5.8 The FCA's Principles for Business and PRA's Fundamental Rules already require authorised firms to conduct their business with due skill, care and diligence and take reasonable care to organise and control their affairs responsibly, effectively and with adequate risk management systems The PRA and FCA operational resilience policies that have been in place since 2022 further require financial services firms to respond to, recover, learn from and prevent future operational disruptions.

5.9 In addition, the large technology firms that provide models to the financial services sector could fall within scope of financial services regulation under the new Critical Third Parties (CTP) Regime. The third-party provider of any model where a disruption could pose systemic risk to financial services, could be designated as a CTP by HMT. That firm would then need to comply with six fundamental rules, including conducting its business with integrity, due skill, care and diligence and having effective risk management services when providing the systemic service. The technology firm would also need to comply with eight operational risk and resilience requirements.

5.10 It is important to note that the BoE/PRA and FCA have emphasised that their technology-agnostic approach does not mean that they are 'technology blind', and they

will continue to monitor firm deployment to determine whether any amendments to their frameworks become necessary. In fact, the Financial Policy Committee's aforementioned report[24] has noted that additional policy action could be needed if firms begin adopting AI for core decision-making or if AI-driven trading strategies cause amplified shocks.

5.11 We agree the principles-based approach is right - at least for now - as any new prescriptive regulation could rapidly become out of date given the speed at which AI technology is evolving. That said, issuing additional lower level supporting guidance would support firms in navigating their implementation of AI in compliance with these existing policies. For example, last year ESMA issued a statement[25] providing guidance to firms on ensuring their use of AI was complaint with MiFID II requirements.

Enhancing government and regulatory expertise

[22] The Bank and the PRA's response to DSIT/HMT: update on our approach to AI | Bank of England
[23] AI Update
[24] Financial Stability in Focus: Artificial intelligence in the financial system | Bank of England
[25] ESMA35-335435667-5924__Public_Statement_on_AI_and_investment_services.pdf

5.12 We support the regulators' position that financial services firms should be accountable for the responsible and ethical use of AI in their operations. However, for this accountability to be effective in preventing harm, there needs to be strong and focused supervision.

5.13 To achieve this, governments and regulators may need to enhance their expertise and resources. This includes investing in AI literacy and training for staff and leveraging partnerships with technology experts. The government has already committed to all these elements in their recent AI Opportunities Action Plan. Some regulators have already questioned whether they have appropriate funding, capacity and skillsets to regulate AI effectively, and we agree that all these issues need to be addressed to ensure an effective regulatory regime.

5.14 We welcome the establishment of dedicated AI units, such as the FCA's AI lab, which aims to support innovators as they develop new solutions in financial services and is due to include an AI sandbox with access to synthetic data sets. We also welcome ongoing work with public-private partnerships, such as the AI Public-Private Forum[26] and the AI Consortium[27], which facilitates knowledge sharing and allows regulators to stay abreast of technological advancements. These initiatives will enable regulators to determine whether more regulation will be needed in the future.

5.15 We also support the regulators' use of AI to make supervision more efficient and effective, especially given the vast data sets they have access to through regulatory reporting. The FCA has detailed how it is developing new tools to protect consumers and markets e.g., sanctions screening testing, identifying online scams etc. And the PRA is aiming to use the latest cloud AI technology, with humans in the loop, to gain supervisory insights into vast quantities of unstructured data.

April 2025

[26] The AI Public-Private Forum: Final report | Bank of England
[27] Artificial Intelligence Consortium | Bank of England