Written evidence submitted by the Financial Conduct Authority

The FCA regulates financial services firms and financial markets in the UK. Our strategic objective is to ensure financial services markets function well.

Our operational objectives are to:

- secure an appropriate degree of protection for consumers,
- protect and enhance the integrity of the UK financial system, and
- promote effective competition in the interests of consumers.

We have a secondary objective to facilitate the growth and competitiveness of the UK economy and we have an important role in the continued success of the UK financial services markets, as London closes the gap to be the world's highest rated financial centre.[1]

Our approach to innovation in financial services is world leading. The services we offer which allow innovative firms to test propositions have been replicated around the world.

Our approach to regulation is principles-based and outcomes-focused, regardless of the underlying technology firms use to provide services. Key initiatives like our Regulatory and Digital Sandboxes, our TechSprint services, use of synthetic data, and our new AI Lab are ensuring that we keep pace as industry considers how to use new technologies is safe and responsible ways.

We welcome the launch of the Treasury Committee's inquiry into AI in financial services and are grateful for the opportunity to contribute to this call for evidence.

1. Executive Summary

1.1. The FCA aims to enable the safe and responsible use of AI within financial services, realising the potential benefits of AI for markets and consumers while balancing the risks. Our approach is principles-based and outcomes focused. Our approach to firms' use of AI is no different. This ensures firms know what is expected of them and supports UK growth and competitiveness by enabling firms to realise the benefits of fast-moving technology like AI.

1.2. In April 2024, we published our AI Update. This set out how our existing regulatory frameworks apply to firms' use of AI. This includes, for example, the Consumer Duty and Senior Managers & Certification Regime. As set out in our January 2025 letter to the Prime Minister, we will continue to rely on these existing frameworks and avoid introducing additional regulations for AI.

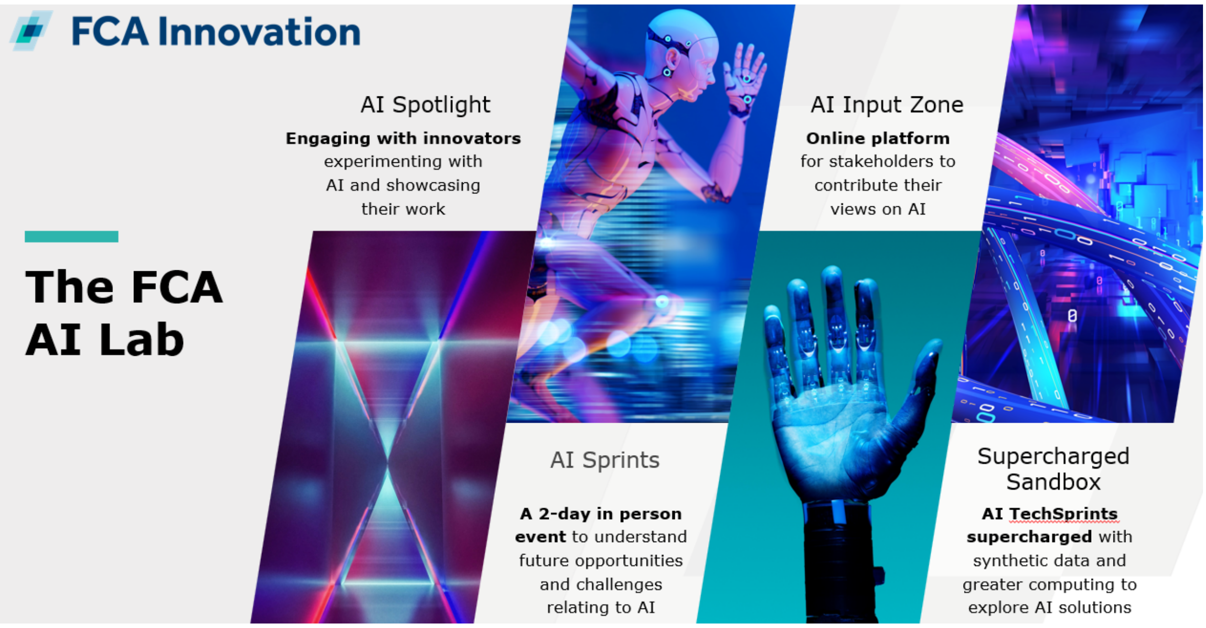
1.3. As the financial industry looks to increase AI adoption across the UK, a collaborative and agile approach is needed to harness the ability of AI to boost

[1] In Z/Yen's most recent Global Financial Centres Index, published in September, London retained its spot as the 2nd highest rated centre and closed the gap slightly with 1st ranked New York.

economic growth in a way that benefits both consumers and markets. The UK Government's recent AI Opportunities Action Plan reinforces how important this is.

1.4. The 2025 launch of our AI Lab is an example of how the FCA is working to bring regulators, firms and wider stakeholders together to better understand the strategic, regulatory and practical implications of AI, and to support innovation.

1.5. The AI Lab includes 4 zones: AI Spotlight, Supercharged Sandbox, AI Input Zone, and AI Sprints.



1.6. The AI Lab includes a "Supercharged Sandbox" which will enable authorised firms to test generative AI models with consumers, getting supervision feedback along the way. This will allow firms to experiment with innovative products or services in a safe environment (using General Data Protection Regulation - GDPR - compliant datasets) to support testing in a real-world environment. It also supports our own understanding of new and emerging use cases.

1.7. We continue to engage closely with industry to ensure they have the clarity they need and that we adapt to the speed, scale and complexity of AI. The AI Lab enables a dynamic "Input Zone" where firms can raise questions with us as they seek to adopt AI directly.

1.8. The AI Spotlight supports Innovators by featuring innovative solutions, such as novel approaches to Consumer Financial Inclusion, that enable the FinTech community to learn from others.

1.9. We are committed to maintaining our strong track record of helping firms to launch innovative financial products and services because positive innovation is a major contributor to economic growth.

2. Our regulatory framework & AI

2.1. Our regulatory framework is anchored around our statutory responsibilities, which we set out at the start of this response. This regulatory framework is principles-based and outcomes-focused.

2.2. In practice, this means we do not have a specific regulatory regime for AI, instead we are rely on our existing framework and standards to support the safe and responsible use of AI within financial services.

2.3. We have sought feedback and tested this approach regularly with external stakeholders and market participants. We have also carried out work to understand how financial services are adopting AI, and the risks that may exist.

2.4. In October 2023, in a joint discussion paper on AI, the FCA and the PRA initiated a discussion with industry and stakeholders to understand our role in supporting the safe and responsible adoption of AI in financial services.

2.5. In April 2024, the FCA published an AI Update which set out how our existing framework helps protect consumers and markets, addressing many of the potential risks and harms associated with AI, without the need for an AI specific regulatory regime. This also provided certainty for firms looking to adopt AI, to help them realise the potential benefits of AI. For example, this covers key aspects of our framework relating to:

- Consumer Protection, including the **Consumer Duty** – which already requires firms to design products and services that meet the needs of their target customers and provide fair value, as well as requiring firms to communicate in a way that meets the information needs of customers, and provide support that meets their needs.

- We also noted that firms using AI technologies in a way that embeds or amplifies **bias**, leading to worse outcomes for some groups of consumers, might not be acting in good faith for their consumers (and therefore not consistent with the Consumer Duty), unless differences in outcome can be justified objectively.

- Accountability and governance, including the **Senior Managers and Certification Regime** (SM&CR) which emphasises senior management accountability and is relevant to the safe and responsible use of AI.

2.6. In our January 2025 response to the Prime Minister on our role in supporting growth, we explained that rather than bringing in additional regulations, we will rely on existing frameworks to support firms to safely and responsibly adopt AI.

2.7. We believe that with a fast-moving technology like AI, this is the best way of supporting beneficial and responsible innovation, fostering UK growth and competitiveness.

2.8. But we recognise this is a fast-evolving area. We continue an open dialogue with the financial services industry, consumer groups, academics and others to understand what they need and considering where we can further elaborate on our framework. This includes supporting firms by enabling safe testing and experimenting through the AI Lab.

3. How AI is being used across financial services

3.1. Our research and ongoing engagement with industry suggests that at present, where firms are adopting AI, many are approaching adoption cautiously. Our 2024 AI/Machine Learning Survey (jointly published with the Bank of England) indicated 75% of 118 firms responding to the survey are already using AI, with a further 10% planning to use AI over the next three years.

3.2. Our survey found the area with the highest percentage of respondents using AI is optimisation of internal processes (41%), followed by cybersecurity (37%) and fraud detection (33%). Over the next three years, an additional 36% of respondents expect to use AI for customer support (including chatbots), 32% for regulatory compliance and reporting, 31% for fraud detection, and 31% for optimisation of internal processes[2].

3.3. The survey also asked firms to rate use cases by level of materiality, where 62% were rated as low materiality. This supports findings from our broader firm engagement that AI is primarily being used for back-office functions such as operations and IT, with the exception of cybersecurity and fraud detection.

3.4. The highest perceived current benefits of AI, according to firms responding to our survey, are in

- data and analytical insights,
- anti-money laundering & combating fraud, and
- cybersecurity

The areas with the largest expected increase in benefits over the next 3 years are

- operational efficiency
- productivity
- cost base

3.5. Some firms are using simple technology like algorithms, while others are using technologies like Machine Learning (ML) and Large Language Models (LLMs). 17% of firms that responded to our survey are already using foundation models (commonly used models include LLMs like ChatGPT from OpenAI and Claude from Anthropic).

[2] See section 2.4: Range of use cases & Chart 6 within the survey report

3.6. As well as seeking to understand how financial services firms are adopting AI through our survey, we have also seen firms test AI use cases through the FCA's innovation services. In broad terms, business models applying to our innovation services (outlined below) include risk management tools and anti-money laundering (AML) propositions, credit lending related propositions, consumer duty and financial inclusion propositions and policies and data-handling propositions.

3.7. We have also observed firms exploring how AI can help to automate front-end processes such as robo-advice (a type of automated financial adviser providing algorithm-driven wealth management services with little to no human involvement), debt management, switching insurance and savings accounts. Firms are also exploring greater use in backend processes such as underwriting, and some elements of financial planning or on-boarding.

3.8. On the path to AI adoption, there is a significant difference between AI supporting a part of the process versus fully automated decision-making. We know from our survey that 55% of AI use cases have some automated decision-making but only 2% are fully autonomous, reflecting the cautious approach we have seen.

3.9. Our survey also explored potential barriers to AI adoption in financial services, differentiating between regulatory and non-regulatory barriers.

3.10. Data protection and privacy were noted by respondents as the greatest regulatory constraints, with operational resilience and cybersecurity rules also highlighted.

3.11. Non-regulatory constraints mentioned by firms included safety, security and robustness, insufficient talent/access to skills, and appropriate transparency and explainability. We are engaging with industry to understand where regulators can help to mitigate or overcome these barriers, including through the FCA's AI Lab.

4. The FCA's work on AI

4.1. Acknowledging the cautious approach that many firms are taking to AI adoption and use, we remain committed to supporting industry to experiment in a safe and responsible way. As part of this, in January 2025, we launched our AI Lab, adding a new AI focus to our long-running Innovation services. This aims to support innovators as they develop new AI models and solutions.

4.2. The kick-off events brought together industry professionals, academics, regulators, technologists and consumer representatives to explore future policy and regulatory considerations for AI in financial services with a focus on the next five years.

4.3. Topics explored included (1) Bias and Fairness, (2) Explainability, Governance, and Transparency, (3) Data Quality and Integration, and (4) Compliance and Automation. Innovators applied to feature on a Digital Spotlight platform, which acts as a repository of AI use cases and capabilities. Selected innovators also presented their solutions at the Spotlight Showcase, held at our offices, to foster industry-wide learning and collaboration.

4.4. Key highlights from this Showcase included:

- AI being developed to assess biometric verification systems for bias and improve fairness in identity verification
- Agentic AI financial assistants providing personalised guidance to consumers, and explainability tools that offer real-time transparency in AI decision-making
- Compliance automation solutions demonstrating how AI can streamline regulatory reporting and risk assessments
- Synthetic data innovations showcasing privacy-preserving techniques for training models without real consumer data.

These practical applications illustrated how AI is could transform financial services and provided insights into the future trends around AI adoption.

4.5. One specific area of uncertainty that was raised during the AI Lab discussions was around data protection and privacy; a theme that also featured in our 2024 AI Survey results. Having heard the concerns raised, our CEO has written jointly with the Information Commissioner asking firms to highlight the data protection barriers to the safe adoption of AI, such that we can understand them better and consider what regulatory support might be needed to allow firms to innovate.

4.6. We will continue to utilise the AI Lab throughout 2025 to perform live testing with firms as they adopt and scale AI solutions in their businesses. This will help us understand how firms are adapting their business models, and will help us continue to test whether any regulatory changes are needed to support the safe and responsible use of AI to support innovation and growth.

The FCA's internal use of AI

4.7. Recognising the positive impact AI is already having across financial services, we have been undertaking work internally to expand our use of AI to enhance our efficiency and productivity.

4.8. We have been implementing advanced analytics and technology-driven solutions, particularly to support the effort against financial crime. One such example is through sanctions screening where the FCA has built an analytics tool to objectively assess how well firms identify and respond to sanctions risks. The tool has assessed the sanctions controls for more than 90 firms across a range of sectors and helped us target our supervisory work against firms that demonstrated weaknesses. Where we identified weaknesses in firms' systems, we provided tailored feedback and actionable remedies to help prevent these firms from being exploited to breach or evade sanctions.

4.9. The FCA has also developed an advanced network intelligence tool that can identify harmful, coordinated networks of cross-platform social media users in various domains. The model enabled the FCA to issue 38 alerts against social media personalities who breached sections 19 and 21 of FSMA by using their platforms to promote financial products inappropriately. This use of advanced analytics helps us act faster to issue consumer warnings.

4.10. We are have a new capability that links FCA, open source and intelligence data into a single regulatory and corporate network. We are using sophisticated techniques to present the network data to those making authorisation and supervisory decisions about firms. This is proving particularly useful for understanding relationships between firms or individuals and any connected risks, past or present.

4.11. We have recently launched an Anti-Money Laundering (AML) and Synthetic Data project in partnership with The Alan Turing Institute and Plenitude Consulting to improve money laundering detection, using real anonymised financial transactions from high street banks augmented with a wide range of money laundering typologies to create a fully synthetic dataset which mimics the characteristics of real-world data. The project will address the current barriers to innovation in money-laundering detection by making the data set available to firms through the FCA's Digital Sandbox. It is part of a greater effort by the FCA to find new ways to use analytics and data science to improve efforts to tackle financial crime and supports both the UK Economic Crime and FCA's Business Plan.

We have been successful in introducing AI into our contact centre (Supervision Hub) where we introduced predictive AI in December 2023, reducing administrative burden whilst delivering operational efficiencies this included automated call transcription alongside real-time knowledge and case categorisation recommendations. The Supervision Hub is currently piloting a voice bot, which directs the consumer to the correct Agency; FOS, FSCS, etc, on first contact, rather than the call potentially being double handled. We continue to expand our use of AI in platforms like Salesforce, Workday, and ServiceNow to improve operational efficiency and effectiveness. We are piloting Microsoft Co-pilot across various operational teams to increase efficiency and reduce administrative burden.

4.12. The FCA receives thousands of documents monthly, mostly unstructured text, as part of our Authorisations and Supervisory work. We are experimenting with the use of Large Language Models (LLMs) to identify risks presented within those documents. LLMs extract and summarise facts for staff verification, creating efficiencies by presenting some top risks before document reviews begin. Our people remain integral, using their expertise for judgement, while AI focuses on fact extraction and synthesis. Our goal is to respond, decide, and raise concerns faster without compromising quality

4.13. In addition to targeted use of LLMs, we are also exploring the delivery of operational efficiencies through the use of off-the-shelf AI tools such as Microsoft Co-pilot.

4.14. We continue to see significant value from our investments in data and digital tooling. In the wake of the Gloster report, we implemented a system to bring together data from multiple sources - data reported by firms, information from regulatory partners, and data received from consumers - into one place. We've continued to invest in and develop that system, and now use advanced statistical techniques to highlight outlier firms which may present a higher level of risk based on those data points.

4.15. Looking forwards, we will continue to work with tech providers, academia and other public sector agencies including the governments AI incubator. We are preparing our workforce by updating training for data, digital, and AI skills. Additionally, we are establishing a framework for responsible AI use within our governance processes to manage risks and ensure accountability within the organisation.

Our work with others

4.16. We are also working with domestic and international partners to support safe and responsible AI adoption. This includes domestically with the Bank of England and through the Digital Regulation Cooperation Forum (DRCF), as well as supporting industry-led initiatives. And internationally with the International Organisation of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), the Financial Stability Board (FSB) and the Global Financial Innovation Network (GFIN)).

4.17. For example:

- We are working closely with the National Cyber Security Centre (NCSC) and Ofcom to combat the use of AI-generated fraud in financial services.
- We have supported the Investment Association's recent work on how AI is being considered within the investment management sector.
- We co-led a report, working with GFIN and the Dubai Financial Services Authority (DFSA), entitled 'Key insights on the use of consumer-facing AI in global financial services'.
- We have been an active participant in the GFIN AI Project, including participating in a series of discussions, along with over 32 regulators, central banks and international organisations. This included discussions on robo-advice, personalised finance, and consumer education & information and how these are being adopted within jurisdictions across the world.
- We are actively contributing to the IOSCO AI working group looking at use cases, risks and challenges that AI may bring for capital markets. The report setting out the findings from this research was published in March 2025. We are an active member of relevant workstreams at the FSB and IAIS.

5. Protecting and enhancing the integrity of the UK financial system

5.1. AI presents risks that could impact financial stability, including:

- Market integrity risks: intentional or unintentional collusion between AI algorithms, market manipulation (e.g., spreading of misinformation), and herding behaviour (where models take the same actions without centralised direction) were all noted as risks in response to our joint Discussion Paper with the Bank. This could cause or amplify market disruptions (e.g., 'flash crashes'), as well as make collusion more difficult to identify.

- Cybersecurity threats: AI could be used by bad actors for more sophisticated and frequent attacks on financial services, impacting the resilience of firms and their services, and market stability.
- Third-party risks: AI presents a challenge to monitor operations and activities that are outsourced by a firm to a third party (we discuss this risk further in paragraphs 5.5 – 5.10).

5.2. There is a clear link between our market integrity remit and the Bank of England's financial stability remit which lead us to work closely together. We have collaborated and jointly explored the impact of AI in financial services including focusing on the potential financial stability impacts. This includes through our AI Discussion Paper and the joint AI survey, which we discussed earlier in our response. We are also jointly chairing the Bank of England's AI Consortium.

5.3. The AI Consortium, which will launch later this year, will provide a platform for public-private engagement on AI. The Consortium will be looking to:

1. identify how AI is or could be used in UK financial services, for example, by considering new capabilities, deployments and use cases as well as technical developments,
2. discuss the benefits, risks and challenges arising from the use of AI, and
3. inform the FCA's and Bank's ongoing approach to addressing identified risks and challenges in promoting the safe adoption of AI.

5.4. At an international level, the FCA participates in relevant international workstreams including co-chairing the Financial Stability Board's Financial Innovation Network (FSB FIN) and participating in IOSCO's AI working Group, accountable to G20. The 2024 FSB report on the financial stability implications of AI presented key developments and challenges. The objective for this year is to examine vulnerabilities associated with AI-related third-party dependencies and service provider concentration, and monitoring of AI adoption and their vulnerabilities. IOSCO also published a report on Artificial Intelligence in Capital Markets: Use Cases, Risks, and Challenges on 12 March this year which the FCA was actively involved in and which looks at AI impact on financial markets. We are also involved in the IAIS's AI Forum.

Wider ecosystem risks: third parties

5.5. A key challenge for firms lies in their ability to monitor operations and risk management activities that take place outside their organisations within third parties.

5.6. Our 2024 AI Survey indicated, for example, that 33% of firms' AI use cases are from third parties. Increased reliance on third parties, often outside our regulatory perimeter, for datasets and other IT outsourcing (such as cloud computing), may amplify systemic risks.

5.7. In November 2024 we, alongside the Bank and PRA, published our final policy and rules for critical third parties (CTPs) to the UK financial sector, which came into force in January 2025. HM Treasury is responsible for designating these CTPs and has power to do so broadly where it considers failure or disruption in the third party's services to firms or Financial Market Infrastructure (FMI's) could threaten the stability of, or confidence in, the UK financial system. The adoption of AI may lead to the emergence of third-party providers of AI services who are critical to the financial sector. If that were to be the case, these systemic AI providers could come within scope of CTP regime, if they were designated by HM Treasury.

5.8. Together with the Bank and PRA, we have developed a proportionate and targeted regime which focuses on the operational resilience of those services provided by CTPs most essential to the functioning of the UK financial system. Under the rules, we will not oversee CTP entities as a whole, rather, the services CTPs provide to the financial sector, focusing on the most systemically important services. The regime is a significant milestone in helping to bolster the financial sector's resilience, which in turn will promote stability and enhance the UK's competitiveness.

5.9. The FCA also has rules on operational resilience and outsourcing that apply to authorised firms. We explain how these apply to firms' use of AI, in our 2024 AI Update. But we know these risks cannot be tackled in isolation, and we continue to work with industry and key stakeholders to help mitigate the perceived and emerging risks that AI poses.

6. Benefits and risk to consumers arising from AI

6.1. The benefits to consumers arising from firms' use of AI are wide-ranging. As are the risks, especially for vulnerable groups.

6.2. To give a specific example; if automation increases in the consumer facing space, including the use of chatbots, this could benefit many consumers by giving them more efficient and effective information or services. But this might not be the right type of engagement for all consumers, including those with accessibility needs.

6.3. The Consumer Duty requires firms to play a greater and more proactive role in delivering good outcomes for retail customers. Firms are required to act in good faith, avoid causing foreseeable harm, and enable and support retail customers to pursue their financial objectives. The Duty also addresses discrimination harms by requiring firms to take account of the different needs of their customers, including those with characteristics of vulnerability and those with protected characteristics.

6.4. We reminded firms of their responsibilities under the Consumer Duty when using AI, through our 2024 AI Update. But we are also actively engaging industry around this topic and have seen examples of where AI can be used to better support consumers, including those in vulnerable circumstances.

6.5. Within the theme of consumer support and improving consumer outcomes, through our AI Lab we saw AI-driven financial assistants providing personalised guidance designed to improve accessibility and improve consumer decision-making. We also saw solutions focused on enhancing explainability, aiming to improve transparency in AI-driven decision-making and helping consumers better understand financial recommendations.

6.6. Tools designed to identify bias and combat fairness within financial services were also shared through our AI Lab. We saw compliance automation tools, for example, that may help improve consumer outcomes by quickly identifying unfair practices and supporting firms in meeting compliance standards. Bias is also prevalent in biometric verification systems, and we saw innovators exploring AI's application in identifying bias within these systems, encouraging fairness in financial services access.

6.7. Crucially, we also saw solutions that indicated a potential role for AI in analysing financial behaviours and detecting patterns associated with financial crime. These solutions were AI-powered fraud detection tools and risk monitoring solutions, although the effectiveness of such systems depends on ongoing validation and risk mitigation.

6.8. We have several workstreams ongoing, in addition to our work on the AI Lab, that are seeking to ensure the potential risks to consumers are being appropriately managed and mitigated by firms, while also understanding the potential benefits of AI.

<u>AI and bias: research note series</u>

6.9. Given the potential risk of bias impacting consumers of financial services, we have used a series of research notes to explore this. This series seeks to spark debate, contribute to academic discussion, and encourage innovation on issues around inclusive and transparent AI for financial services, as well as filling evidence gaps that firms have noted to us they might struggle to do on their own.

6.10. We have considered differences in pricing for demographic groups across financial markets and what drives them as well as bias in language models.

6.11. As an example of this research, we looked at bias in language models and found evidence of bias on the basis of gender, disability, and ethnicity. There is potential for further innovation in this area to create inclusive and trustworthy AI, as current methods do reduce but not remove bias.

6.12. Similarly, in the published literature review, we reviewed existing literature on bias in machine learning and found that more complex models can make biases against minority ethnic groups worse. However, we note that there are innovative methods that firms can use to mitigate these risks and increase consumer trust. We are clear that firms using AI technologies in a way that embeds or amplifies bias, leading to worse outcomes for groups of consumers, might not be acting in good faith for their consumers (and therefore not compliant with the Consumer Duty), unless differences in outcome can be justified objectively.

6.13. Finally, we are undertaking work to look at potential bias in pricing in different markets and have recently published findings in relation to the mortgage market. In this research, we found that there were no significant pricing differences between mortgages for women, different sexual orientations, health conditions, or minority ethnic groups after accounting for risk factors. Although the research did find that different groups often take out different types of mortgage products. For example, those with a health condition appear to have mortgages with higher initial gross rates of interest on average, but lower upfront lender fees, lower property values and lower household incomes.

April 2025