AIFS0037

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Executive Summary:

- Various technologies, including automation tools and AI, have been in use by the financial services industry for many years. The sector is well-placed to take advantage of the latest technological innovations which have the potential to further drive growth and productivity.
- The financial services sector is currently in a state of cautious adoption of AI technologies albeit industry feedback is that there is widespread adoption of AI within the pensions industry. There are some key sector specific barriers to be resolved parior to transformational change being driven in those areas where AI can be identified as appropriate for deployment.
- The financial services sector is heavily regulated and sanctions for non-compliance can be significant. The regulatory environment may limit braver adoption until overlaps and inconsistencies in laws and/or regulation can be resolved, and until industry participants can find the confidence to take bolder steps. The regulators have an important role to play in achieving this going forward.
- It is unlikely that changes to financial services law and/or regulation will keep pace with or be sufficiently agile to provide a framework for safe deployment of AI given the pace of technological change. In the shorter term, clarity and consistency around how the regulators will apply current law and/or regulation to AI, is likely to provide some confidence to the sector. This could be achieved by guidance, best practice guides, and/or codes on critical matters such as ethics, conduct, values, accountability and governance.
- Concerns relating to data, third party dependencies, the interconnectedness of systems relevant to the financial services ecosystem, skills gaps, and the proximity of AI output in this space to the consumers of financial products and services, are other potential barriers to adoption that the sector needs to address.
- Regulatory initiatives focused on addressing the harms that could arise from AI adoption could encourage financial services firms to implement the infrastructure required in governance, accountability, resourcing, skills, and training, etc. that will safeguard against the key risks while encouraging the adoption of important technological advances.
- Several regulatory initiatives including sprints, sandboxes, hubs, and consortiums have evolved and deepened the sector's understanding of the risks and opportunities of AI. These initiatives have helped to inform the regulatory approach, support innovative technology reach the market, and assist the development of responsible and ethical technology to move from theory to the real world[i]. These initiatives should continue to have a critical role going forward.
- The UK will need to foster international relations to ensure the UK's

competitiveness. International bodies like UNESCO[ii] and IOSCO[iii] are developing important global understandings which the UK needs to consider given inconsistencies in approach between the EU and the US.

How is AI currently used in different sectors of financial services and how is this likely to change over the next ten years?

Current uses: The most common applications of AI in financial services are presently in low impact areas which do not utilise customer data and which do not have direct consumer interfaces. Many of these applications are aimed at optimising back-office operational efficiencies and desk-top productivity and relate to the automation of repetitive compliance tasks such as due diligence and the production of draft documentation[iv]. The use of AI in capital markets is well established with use cases relating to monitoring market risks, trading strategies and assisting portfolio management[v] and in private equity, with use cases in lead sourcing, customer template generation, and the delivery of market insights.

There are also use cases in fraud and financial crime where the pattern detection abilities of AI are being utilised to enable proactive rather than reactive responses to anomalous behaviours in the markets.

There are some consumer-facing AI tools in use including AI chat bots, virtual assistants, and technology which transforms long and generic documents into short and personalised videos presented by personalised avatars. However, these are not yet commonplace and are often limited to being able to answer specific questions and provide specific answers.

In addition, the regulators are actively using AI. The Bank of England[vi] and the FCA[vii] have been testing and using AI for a number of years, looking to become more efficient and more data led, and TPR has confirmed its plans to use AI to "*deliver new insights and trends, and to focus on more strategic and analytical work, thereby increasing overall productivity*"[viii] and "*to anticipate the future needs of regulation, policy formation and sharpening our decision-making*"[ix].

The next decade: While it is not possible to predict, it seems likely that the financial services industry will see a steady incremental adoption of AI. As the impact of AI becomes clearer, as the industry learns how to manage and govern the risks, it will likely make confident step-by-step strides forward in areas where it identifies that AI can make a difference.

It is also likely that across all kinds of industries progress will be made with AI technologies and that we will evolve ways of tackling problems like bias and hallucination, we will have the ability to retrain and improve models, and we will gain clarity on the protections needed around key issues such as the sharing of sensitive and private data.

It is also probable that consumers will evolve their understanding of and use of AI technologies both generally and in relation to their engagement with financial services and products. Increased engagement will likely stimulate further evolution particularly if consumers trust in the system.

Technologies that currently sit in test environments, but which could bring transformational change should they reach the market, might include digital IDs that could make account opening quicker, smoother and less dependent upon paper copies of supporting documents. They could also create robust forms of secure proof of identity which could help with safe ways of identity sharing, onboarding and the development of trusted means for the transfer of the data upon which the financial system depends.

To what extent can AI improve productivity in financial services?

What are the best use cases for AI? Which particular transactions may benefit from AI?

Productivity: Current use applications appear focused on improving productivity by streamlining manual and time-consuming processes. Examples of AI introducing these efficiencies in financial services can be found in the automation of research, information extraction, drafting, data searching and in first draft report writing, all with the intention of liberating the time of skilled and experienced humans for other tasks.

Best use cases: The best cases are perhaps those where AI is improving on what humans can do. One good example is the use of AI to detect fraudulent and other unwanted behaviours, where it is quicker and more effective than humans at spotting patterns of behaviour in market data. This is enabling better detection of financial crime and fraud and could enable pro-active rather than reactive responses to unusual activity or red flags.

In the pensions space, AI is expected to drive up levels of consumer engagement and inclusion in an area where traditionally consumers have not had a good understanding of relevant financial products. The use of AI is helping to improve understanding for members to manage their pensions. An example of how some professional service firms are already doing this is by transforming long and generic documents into short and personalised videos presented by personalised avatars. However, such steps are not without regulatory risk for firms who take them, particularly in the absence of guidance on key questions such as whether engaging with consumers in this way may be seen as providing advice to customers. It may also be that some members, particularly older members, do not trust the technology, with a recent study finding that "45% of over-65s say they either don't fully trust AI or don't trust it at all to provide accurate financial guidance"[x]. Trustees may need to factor this distrust into decisions as to whether to invest in and use consumer-facing AI tools, including with reference to the demographic of their members.

What are the key barriers to adoption of AI in financial services?

Some of the key barriers to the adoption of AI in financial services include:

Regulatory uncertainty: A combination of regulatory uncertainty and potentially severe penalties for regulatory transgressions are key current barriers to the adoption of AI in financial services. The regulators have wide powers, which include criminal and regulatory sanctions[xi], and these significant regulatory risks may outweigh the benefits of using AI.

There are many complex legal questions to resolve with an AI overlay, pending regulatory clarity to assist the progress of these debates, many of them are likely to

continue without conclusion until the focus changes to whether the greater risk lies in not using the benefits of AI. Regulatory certainty would likely assist these debates and could result in pro-AI decisions being taken with more confidence.

Skills and literacy gaps[xii]: There is a recognised need to re-skill and up-skill throughout the financial services sector. Addressing this skills gap will assist the sector to overcome job loss related fears and prepare the workforce for the roles of the future. It will also enable the financial services sector to deploy relevant skills from board to ground level which will be essential for good governance, and for trust in and the stability of the financial system. There are collaborations evolving between the industry and the universities which could help to increase the talent pool and drive talent into the sector.

Data: Good AI outcomes depend on good source data and the financial services sector has some significant legacy issues including high volumes of siloed data, and data bias, which need to be overcome as a foundational step.

Assurance: It is likely that the financial services sector will need to foster collaborations between the large, traditional financial institutions and newer, often smaller companies (fintechs) which are using technology to deliver and implement innovative financial services and products. There are a number of issues acting as impediments to progress in this space including the regulatory perimeter which technology companies generally exist outside of, the attribution of responsibility for regulatory risk as between regulated financial institutions and technology providers, and a lack of a combination of credibility, certification, reputation and funding behind start-ups. The FCA continues to be instrumental in bringing suitable start-ups to market via its sandbox initiatives and more could be done in this space to stimulate innovation and resolve some of the barriers to success.

What are the risks to financial stability arising from AI and how can they be mitigated?

There are several ways in which AI could threaten the stability of the financial system and these include:

Malicious use: The threat landscape has evolved from simple viruses to sophisticated attacks which deploy AI, and which increase known risks around data, third parties, and cyber risks, and which make it likely that AI could be used by bad actors to deploy better scams, steal data and steal monies.

Black-box: There are significant risks for financial services around the interpretability and explainability of AI models relative to key regulatory principles such as sound governance as fundamental to the stability of the financial system and to the need to ensure good financial outcomes for consumers.

Herding: There are risks around the ability of AI models to drive consistent decision making or co-ordinate behaviours in response, for example to market events, and the potential for this to cause unintended market events such as crashes.

Are there risks of having AI tools used in the financial sector concentrated in the hands of a few large tech companies?

The regulators have been concerned for many years about growing reliance on a small number of service providers[xiii]. This concentration of risk is likely to increase with the deployment of AI technologies where the expertise and financial ability to produce fit-for-purpose AI technologies will likely be limited to a few companies. The potential for widespread consequences from this risk has been indicated by recent IT outages where customers have been unable to access their money from retail banks and, in pensions, where a cyber-attack affected multiple schemes. These risks are likely to heighten as the interconnectedness of the financial services system increases and where reliance placed by the sector on limited sources of data, technology, infrastructure and software, exacerbate the risks that the actions or vulnerabilities of one component could create systemic issues and instabilities.

There is progress to be made in related areas including the development of appropriate and standardised risk management processes, due diligence exercise, certified quality standards and warranties, and third-party accountability.

What are the benefits and risks to consumers arising from AI, particularly for vulnerable consumers?

What benefits to consumers might arise from using AI in financial services? For example, could AI be used to identify and provide greater assistance to vulnerable consumers?

The benefits specific to consumers relate largely to the potential for AI to make financial services smarter and faster and therefore able to bring more financial services and products to more consumers at lower cost. This could mean, specifically for under-represented and vulnerable consumers, access to financial services where this may not have previously been possible.

There are a number of general risks to all consumers arising from the use of AI starting with the likelihood that if poor data has gone into AI then poor results will likely come out of AI. There are well rehearsed concerns around the many issues with the data held by the financial services industry and resolving this will be essential to ensuring that consumers get good outcomes in cases where AI has been deployed. There are other general risks that have been noted including, hallucinations, unexplainable outcomes, improved and more numerous scams and frauds, and financial system instability.

There are a range of issues to be resolved, and which are specific to the interface between AI and consumers. These include literacy and skills gap issues, the possibility for misunderstanding of the AI and/or the related financial information in respect of which the AI has been deployed, the inability for consumers to discern whether AI

output is real or not, and the likelihood of more and more successful consumer facing scams.

Vulnerable customers: The treatment of vulnerable customers is currently a problematic area for the financial services sector, and it has been the subject of recent enforcement decisions by the FCA. This, like many of the other issues discussed, is double edged. In terms of a risk, if the source data contains unresolved factors relevant to vulnerability, such as bias about financial means, then it is likely that AI output based on that source data could exacerbate problems relevant to that vulnerability. This highlights the need for the financial services sector to address issues related to vulnerability that could be embedded in legacy financial services data. In terms of a benefit, AI is good at spotting patterns of behaviour and may be better at spotting patterns of behaviour that flag vulnerability concerns than humans are. This could result in more vulnerable consumers receiving better outcomes than is presently the case.

Are there any current or future concerns around data protection and AI in financial services?

There is some regulatory uncertainty around the use of protected data contained within the broader mass of financial services data with AI. The FCA and the ICO are working to resolve these uncertainties, and the outcome of their ongoing collaboration will likely be instrumental in enabling the financial services sector to be more confident in adopting AI technologies[xiv]. The FCA is making ongoing efforts to stimulate innovation using synthetic data and safe testing environments where financial services firms can experiment with technology without the risks associated with actual deployment[xv].

Whilst the laws surrounding data protection are robust, AI is a rapidly evolving technology which means the risks are constantly changing. In this context, bad actors are becoming increasingly more sophisticated in their cybersecurity attacks, including by using AI, and these risks present opportunities for bad actors to obtain and compromise financial services data. It is vital for financial services firms to keep cyber security and resilience at the top of their risk agendas, be willing to respond quickly, and adapt their practices to respond to evolving cyber security risks. Financial services firms may need to exceed the requirements of the data protection legislation to ensure that their cyber risk is not increased by reason of AI.

How can Government and financial regulators strike the right balance between seizing the opportunities of AI but at the same time protecting consumers and mitigating against any threats to financial stability?

Are new regulations needed or do existing regulations need to be modified because of AI?

The rapid nature of technological change makes this an area potentially unsuitable for a prescriptive approach which could take a significant time to implement and which could stifle innovation.

It is possible that by identifying and addressing the main risks and harms, and by using the benefit of existing embedded and robust regulatory principles, the regulators can remove regulatory inconsistencies and strengthen and clarify the guidance as to what 'good' looks like. In so doing, the regulators could increase the confidence levels throughout the financial services industry relative to where there exist strong arguments for the implementation of AI driven solutions.

This approach could be a route to fostering innovation while ensuring that adoption is safe and reliable so that the markets remain stable, and consumers are enabled to reach good financial outcomes.

The successful regulatory sandboxes could continue to be utilised to enhance the process of getting suitable startups on the path to success, closing the knowledge gaps that exist between the financial services industry and the technology industry, and forging collaborations that can genuinely bring instrumental change to the financial services industry.

It would be useful to have engagement and dialogue around key legal and regulatory questions, such as whether, in the pensions context, as a matter of trusts law, AI could act as a prudent person, how the use of AI might interplay with the FCA's senior managers regime and what the application of the consumer duty looks like in the context of AI deployment. Open discussion and clarity around such questions could address the concerns of industry participants to a sufficient degree to move the dial and generate the confidence needed to move AI experimentation from proof of concept to commercial adoption.

All of this could be driven forward by collaborative focus on an agreed roadmap for the successful deployment of solutions driven AI throughout the financial services industry, underpinned by clear goals, clear standards, quality data, and consistent, iterative progress where safe and reliable technology driven solutions can be confidently adopted and trusted.

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[i] Potential bias in firms' use of consumer data | FCA / AI and Digital Hub | DRCF / AI Lab | FCA / About Us - FSSC

[ii] Ethics of Artificial Intelligence | UNESCO

[iii] IOSCO publishes new Consultation Report on Artificial Intelligence in Capital Markets: Use Cases, Risks, and Challenges / The Financial Stability Implications of Artificial Intelligence - Financial Stability Board

[iv] AI - hot off the press from the Bank of England and FCA - how is it being used across the financial services industry and what are the risks? - Burges Salmon

[v] Would you like to know more about how AI is being deployed in capital markets around the world? - Burges Salmon

[vi] TRUSTED AI: Ethical, safe, and effective application of artificial intelligence at the Bank of England − speech by James Benford | Bank of England

[vii] AI Update

[viii] Data Strategy, March 2025

[ix] Digital, Data and Technology strategy, October 2024

[x] Age vs. AI: stark differences in attitudes towards AI

[xi] For example, section 58B of the Pensions Act 2004 and see Chapter 6 of the "Decision Procedure and Penalties manual" for the FCA's powers to impose penalties

[xii] Home - FSSC

[xiii] FCA's Business Plan series – the commitment to minimising the impact of operational disruptions and the proposed regime for critical third parties - Burges Salmon

[xiv] FCA and ICO letter: Supporting AI, innovation and growth in financial services

[xv] AI Update, Regulatory Sandbox | FCA, AI Lab | FCA