AIFS0088

Written evidence submitted by the Association of British Insurers (ABI)

Executive summary

1. We welcome the opportunity to respond to the Committee's Call for Evidence on AI in financial services. Please note that this response is limited to AI in the insurance sector. We are also mindful that AI can be defined in very broad terms. Consequently, our response aligns with the government's 2023 AI policy paper which uses the term to mean technology that is defined by its: adaptivity (AI systems are trained and, through such training, develop the ability to perform new forms of inference), and autonomy (some AI systems can make decisions without the express intent or ongoing control of a human).

2. As the trade association for the insurance and long-term savings sector, an international, innovative industry with data at its heart, we are focused on ensuring the significant opportunities to innovate with AI are harnessed responsibly.

3. We support the UK's current approach to AI, which is pro-innovation, technology-agnostic, risk-and outcomes-based, and integrates existing legal and regulatory frameworks. We believe it is important that the UK government and regulators continue to engage closely with each other, their international counterparts and other relevant stakeholders. This will ensure that developers and deployers of AI can operate within a pro-innovation, proportionate, clear, consistent and coherent regulatory environment, which integrates existing legal and regulatory frameworks and is interoperable across borders.

4. We support this approach to enable our sector to innovate with AI and to ensure that good customer outcomes are at the heart of innovations and that technological advancements enhance customer experiences.

5. We have engaged with the UK government and regulators on the developing legal and regulatory framework for AI. The ABI's AI Guide, published in February 2024, and developed in close collaboration with a group of member experts across roles including data science, actuarial, data protection, legal and compliance, provided a practical approach to applying the 5 principles underpinning responsible AI, as set out in the UK's AI Policy Paper: "AI regulation: a pro-innovation approach". Some insurance firms have commented to us that they are currently using this as a practical guide alongside regulatory guidance to assist with their implementation of AI governance and processes.

6. We are keen to continue to engage closely with the government and regulators as the legal, regulatory, technological and wider ecosystem affected by AI evolves.

Question 1: How is AI currently used in different sectors of financial services and how is this likely to change over the next ten years?

This may include:

- **Are there particular areas of financial services that are adopting AI more quickly and at higher rates of penetration than others?**
- **Are Fintech firms better suited to adopting AI?**
- **What percentage of trading is driven by algorithms/artificial intelligence?**

7. The insurance and long-term savings industry is a highly innovative, international and data-centric sector. As such, advanced data applications have been integral to the industry for years, across all key functions, e.g. underwriting, pricing, claims, prudential and risk management, and across international borders

8. AI in the form of Generative AI is in use currently to a lesser extent with individual firms having different risk appetites and therefore the degree to which it is used. This approach ensures that its implementation is both safe and beneficial to good customer outcomes and aligns with high governance standards.

9. The pace of technological development in AI is extremely fast, so ten years ahead is perhaps too far to predict. We would note that insurers are developing AI strategies and governance, to ensure its use is safe and delivers good outcomes for consumers. Insurers want to innovate responsibly, use AI carefully and seek to achieve this by deploying at appropriate pace and with due care and consideration for customer outcomes. As a highly regulated and well-established (bringing with it legacy IT systems) industry, this may mean that the insurance industry is not able to deploy as quickly as other parts of the financial services industry or indeed as fast as technology providers themselves.

10. We expect AI developments to provide greater depth of insight to insurers, including from smart product data and internet of things technology, e.g. wearable technology and telematics devices, contributing to insights into life/health and motor insurance. We expect this to enhance insurers' understanding and management of risk, enable them to provide more tailored products and services for customers, and help customers to take steps to understand better how to reduce their exposure to risk, e.g. by exercising more to improve their health, or driving more carefully to reduce their risk of car accident or damage.

11. As AI tools have become more readily available and uses continue to expand, we are seeking greater clarity and consistency of legal and regulatory requirements across all parts of the AI supply chain, as well as international interoperability. As insurance operates across borders it is important to have coherence and interoperability with strong accountability and governance frameworks across the whole ecosystem. This will protect organisations and consumers with exposure to AI, especially where it has a direct or indirect effect ondecision-making.

Question 2: To what extent can AI improve productivity in financial services?

This may include:

- **Where are the best use cases for AI? Which particular transactions may benefit from AI? What are the key barriers to adoption of AI in financial services? Are there areas where financial services should be adopting GenAI with little or no risk? Are there likely to be job losses arising from AI in financial services and if so, where? Is the UK's financial sector well-placed to take advantage of AI in financial services compared to other countries?**

12. AI presents opportunities to improve productivity by enabling firms to automate and accelerate some data processing processes throughout the typical lifecycle of insurance and long-term savings. This helps to increase efficiency, reliability and decision-making. It also helps reduce costs, the ability to operate with economies of scale and drive growth. For example:
    - Product design: AI can identify patterns within underwriting portfolios, align with patterns in claims and identify areas where opportunities exist to rebalance exposure.
    - Claims automation: to automate claims processing and approvals by reading and validating claims against policy wordings and reading, analysing and validating photographic images of damage. This reduces the time taken to disburse funds to policyholders. Personalised, customisable services, for example to analyse an individual's data to offer bespoke insurance premiums based on their risk profile.
    - Predictive underwriting, for example to assess potential risk to policyholders and offer more accurate and tailored policies.

- Fraud detection for example to assist by analysing patterns and identifying suspicious activities, thereby mitigating potential losses.
- To unlock, extract, manage and derive more insights from data, and structure it in a more organised, consistent and accurate manner. To better utilise and interpret unstructured data such as voice, pdfs, word documents and excel spreadsheets relating to insurance contracts, claims submissions, and complaints.
- To interrogate large datasets more closely and quickly, such as The Environment Agency national LIDAR (Light Detection and Ranging) data, to derive insights and assess risk such as those relating to the unique risks that tall buildings can present, especially in fire or windstorm insurance.
- To enhance customer service through AI-powered chatbots and virtual assistants that provide instant support and handle enquiries, improving overall customer experience.
- In marketing segmentation, for example, to group customers based on behavioural and/or attributional data, for more effective communications.

13. Key barriers to AI adoption include:
    - **Regulatory complexity:** The insurance industry is highly regulated so faces more regulatory requirements than other participants in the AI environment, e.g. technology sector. This increases compliance costs (and is hence an opportunity cost where resources could be spent on innovation) to the financial services sector. A lack of certainty also leads to a more cautious approach to innovation, and investment into the technology, processes and people necessary to support its implementation. Regulators including the FCA are already working to address duplication and the high cost and compliance burden within the regulatory system, and the government is reviewing the redress system (government review of FOS, and FCA/FOS joint review of the redress system) These initiatives can help reduce regulatory complexity and encourage faster AI adoption.
    - **Infrastructure and operational readiness:** Firms need to identify potential integration challenges between existing legacy systems and AI and invest in necessary upgrades to ensure AI tools and systems work with existing systems and technologies.
    - **Data readiness**: Firms need to ensure the data on which AI systems are trained are accessible and available, accurate and relevant, transparent and explainable.
    - **Skills and training:** Firms need to train their staff to ensure they have the skills and awareness of ways in which AI is different to other technologies. This is key to help staff to develop, interpret, explain, manage, monitor and innovate with AI responsibly and safely, and benefit fully from technology developments.
    - **Third party standards:** The UK Critical Third Parties (CTP) regime is designed to manage risks to the stability of, or confidence in, the UK financial system by overseeing critical third parties that provide essential services to financial services firms. This regime includes third parties that offer both existing and emerging technology services, which can encompass AI solutions. While the regulatory landscape for third party providers offering AI solutions is evolving, further development is needed to enhance assurances and legal certainty for firms purchasing or utilising AI as part of a package or service. This would also streamline due diligence processes, reducing costs and resource expenditure for multiple firms.

14. The industry aims to support its workforce as technology develops, ensuring they are equipped to use it to improve their roles and to deliver good customer outcomes, rather than reducing the number of roles. The ABI's AI Guide includes a number of points relating to using AI responsibly. These include points on the need to ensure accountability and governance with appropriate levels of human oversight.

Question 3: What are the risks to financial stability arising from AI and how can they be mitigated?

This may include:

- **Does AI increase the risks relating to cybersecurity? What are the risks around third-party dependencies, model complexity, and embedded or 'hidden' models? How significant are the risks of GenAI hallucination and herding behaviour? Are the risks of having AI tools used in the financial sector concentrated in the hands of a few large tech companies? To what extent do the AI financial market tools rely on social media outlets? E.g. trading algorithms using social media posts?**

15. AI can be used as a tool to help cyber security, but the same characteristics also make it a powerful weapon in the hands of malicious actors. AI can be leveraged to help cyber security by:
    - **Enhancing threat detection and response:** AI can leverage machine learning algorithms to analyse vast amounts of data and identify patterns that signal potential threats.
    - **Automating responses to cyber incidents**, reducing the time it takes to react and minimising potential damage.
    - **Predicting future threats** based on historical data, allowing firms to develop proactive countermeasures.

16. However, it creates risks to cybersecurity, for example by:
    - **Lowering the barrier to entry** enabling criminals to act with a relatively low level of expertise.
    - Enabling the ability to **automate cyberattacks** on a wide scale, find and exploit vulnerabilities and learn how to avoid detection by security systems, such as antivirus software.
    - Enabling the ability to create deepfake voices, images and videos and assist in more sophisticated **phishing campaigns:** AI makes it easier to research targets and create believable social engineering content, exploiting human trust of the real person it is faking. Used in conjunction with genuine names and internal communication styles, these can deceive employees and circumvent security measures, leaving firms and their customers vulnerable to significant disruption.
    - Enabling **prompt injections**: Hackers can take advantage of a core feature of generative AI systems, i.e. the ability to respond to users' natural language instructions, to override developer instructions to manipulate or alter the training or input data of large language model for malicious purposes, e.g. to steal or leak sensitive data, spread malware, mislead, commit fraud or take over systems and devices.

17. **Concentration risk**: The European Central Bank (ECB) has highlighted that widespread AI adoption in financial services could increase market concentration, with a few dominant AI vendors/providers posing systemic risks.

18. **Procurement processes**: AI is increasingly being embedded in hardware and software packages and not going through standard procurement processes that require oversight and governance. Firms are also noticing the introduction of AI tooling into parts of the business that have not previously used machine learning or AI, without actively opting to use it. As a consequence, this increases associated risks, including relating to cyber security.

19. **Oversight & accountability**: There are risks that the lines of accountability, responsibility and liability are unclear, that 3rd parties act on firms' behalf, resulting in regulatory exposure, that third parties' reliance on AI technologies and services impact service quality, reliability and continuity.

20. **Environmental risk**: Increased use of AI increases demand for critical resources, including power, water, natural minerals, and land. Detrimental effects may include reduced availability and access to critical

resources, higher levels of uninsurability, higher insurance premiums, and reduced access to insurance cover, and hence lower resilience.

Question 4: What are the benefits and risks to consumers arising from AI, particularly for vulnerable consumers?

This may include:

- **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? What is the risk of AI increasing embedded bias? Is AI likely to be more biased than humans? What data sharing would be needed to make AI more effective in financial services, and will there be a need for legislative change to achieve that? Are there any current or future concerns around data protection and AI in financial services? What sort of safeguards need to be in place to protect customer data and prevent bias?**

21. **Potential benefits to consumers include:**
    - **Accessibility:** Personalised pricing based on individual risk profile can improve access to customised insurance products personalised to consumers including vulnerable customers and those with pre-existing conditions.
    - **Faster & More Efficient Claims Processing:** AI can automate claim evaluations using advanced technologies like image recognition and natural language processing. This reduces processing time, ensuring prompt payouts for individuals in urgent situations, such as medical emergencies or natural disasters.
    - **Enhanced Fraud Detection & Prevention:** AI can identify fraudulent claims more accurately, minimising unnecessary costs that contribute to higher premiums. This ensures that legitimate claims are processed quickly and fairly.
    - **24/7 Customer Support & Accessibility:** AI-powered chatbots can provide round-the-clock assistance with policy inquiries, claims filing, and explanations of complex terms. This can be especially beneficial for elderly individuals, people with disabilities, and those unfamiliar with insurance processes.
    - **Proactive Risk Management & Prevention:** AI can leverage data from wearable devices and smart home technology to detect early warning signs of potential risks, such as health concerns or property maintenance issues. By offering personalised advice, AI can help consumers prevent claims before they arise.
    - **Financial Support & Policy Adjustments:** AI can identify early indicators of financial hardship and recommends policy modifications to help consumers maintain coverage. This proactive approach prevents policy lapses due to missed payments.
    - **Tailored Insurance Solutions:** AI can customise policy recommendations based on individual needs, ensuring that vulnerable consumers receive appropriate and adequate coverage for their unique circumstances.

22. AI has the potential to amplify biases that may be present in historical or human decision-making. As AI systems produce statistical analysis at scale, its outputs can amplify embedded bias in its training data which may lead to unintended consequences, including potential unfair treatment of certain groups or individuals. It is important to recognise that this is a risk associated with AI in general, and not specific to the insurers' use of AI.

Question 5: 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?

This may include:

- **Are new regulations needed or do existing regulations need to be modified because of AI?**
- **Will Government and regulators need additional information, resources or expertise to help monitor, support and regulate, AI implementation in financial services?**

23. We believe the Government and regulators should continue to take a proportionate, technology-neutral, risk-based and outcomes-based approach to AI regulation, interoperable with relevant existing international regulatory frameworks. This approach should remain flexible enough to adapt to the rapid technological evolution of AI. The FCA's, Bank of England's, and PRA's outcomes-focused approach to regulation is a strength, as it allows regulatory expectations to keep pace with emerging risks and technological advancements. Excessive regulations stifle innovation, increase costs for end customers, and add legal uncertainty due to potentially overlapping requirements.

24. To support AI innovation while ensuring consumer protection and financial stability, we would welcome:
    - **International coherence and consistency:** Many insurers operate across borders and so have to comply with the EU AI Act as well as UK requirements. We are seeking a streamlined, tech-neutral, regulatory approach, structured in a way that allows firms to build and use AI safely and without unnecessary restrictions, and which applies to all developers and users of AI.
    - **National coherence and consistency:** As AI is a cross-cutting technology, we welcome continued close engagement between UK regulators to ensure coherence and consistency of regulations, to ensure firms and their consumers have clarity and confidence in the way AI is used and regulated.
    - **Clear regulatory requirements applicable across the supply chain:** AI is increasingly being embedded in hardware and software packages and not going through standard governance processes applicable to procurement. Firms are also noticing the introduction of AI tooling into parts of the business that have not previously used machine learning or AI, without actively opting to use it. We are seeking a regulatory environment where all parts of the supply chain are equally regulated. This would also help reduce duplication and burden around homogenous activities such as due diligence and assurance actions where they relate to the same vendors, and reduce the risks associated with arbitrage, where vendors might prefer users with lower risk and governance standards.
    - **International regulatory engagement and coordination:** We believe it is important for the UK government and regulators to continue to engage closely with their international counterparts to ensure that the UK's regulatory approach to AI is consistent with global standards.

About us

The ABI is the voice of the UK's world-leading insurance and long-term savings industry, which is the largest sector in Europe and the third largest in the world. We represent more than 300 firms within our membership, including most household names and specialist providers, providing peace of mind to customers across the UK.

We are a purpose-led organisation: Together, driving change to protect and build a thriving society. On behalf of our members, we work closely with the UK's governments, HM Treasury, regulators, consumer organisations and NGOs, to help ensure that our industry is trusted by customers, is invested in people and planet, and can drive growth and innovation through an effective market.

A productive and inclusive sector, our industry supports towns and cities across Britain in building a balanced and innovative economy, employing over 300,000 individuals in high-skilled, lifelong careers, two-thirds of whom are outside of London. Our members manage investments of £1.4 trillion, contribute £18.5 billion in taxes to the Government and support communities and businesses across the UK.

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