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2 February 2023

## **AFM Response to PRA Discussion Paper 5/22, Artificial Intelligence and Machine Learning**

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
  - Comment on the proposals, and their consequences for members of AFM and their customers.

### About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 32 million people in the UK and Ireland, collect annual premium income of over £22 billion, and employ nearly 30,000 staff<sup>1</sup>.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses<sup>2</sup> and to take account of corporate diversity<sup>3</sup>.

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<sup>1</sup> ICMIF and AFM, 2022: <https://financialmutuals.org/wp-content/uploads/2022/10/UK-Market-Insights-2022.pdf>

<sup>2</sup> Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

<sup>3</sup> <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

## AFM comments on the proposals

4. We welcome the Discussion Paper and the opportunity to comment. The increasing adoption of Artificial Intelligence and Machine Learning (AI and ML) in the UK financial services industry is having an effect on all insurers, large and small. We have responded against the three main categories of questions posed in the discussion paper.

### Supervisory authorities' objectives and remits

5. We consider it is vital that the supervisory authorities are actively engaged in the development of AI in the UK; it is consistent with their objectives, and with the role of protecting consumers. There is a range of definitions of AI, and whatever final definition the PRA and FCA adopt, it is important that this is future-proofed, or capable of adaptation over time, as the implications of AI adoption become clearer.

### Potential benefits and risks

6. Amongst some of the most often touted benefits of AI to insurance are individualising cover, assessing risk, detecting fraud, enhancing standards of service and claims-handling, and reducing error. AI and ML are also helping to transform operations in many insurers, to reduce costs and streamline policy administration. ChatGPT offers the opportunity to create enhanced Chat facilities for customers, and to generate engaging material for marketing and education purposes for customers.
7. Also, the increasing amount of data available to insurers has the potential to facilitate improvements in decision-making in firms, to advance innovation in product design and to heighten customer satisfaction. For example, AI is at the core of plans by some health insurers to focus on helping customers stay well, rather than on supporting them when they're ill. During the height of the pandemic, AI was used to predict high-risk Covid patients<sup>4</sup>, demonstrating the relevance and breadth of its applications in the insurance and healthcare sectors.
8. In Sweden, the mutual insurer AMF was able to reduce complexity and lower costs on eight million pension policies, across many generations of platform, by adopting a single, AI-enabled platform. That resulted in increased transparency and reduced charges for customers as a result of the firm's mutual business model<sup>5</sup>. In the UK, Babylon Health works

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<sup>4</sup> [https://www.thelancet.com/journals/landig/article/PIIS2589-7500\(22\)00093-0/fulltext](https://www.thelancet.com/journals/landig/article/PIIS2589-7500(22)00093-0/fulltext), August 2022

<sup>5</sup> <https://www.lumera.com/en/customers/amf/>

with a range of insurers, and seeks to add value through its AI, “from attracting and engaging customers through to improving clinical pathways, lowering claims costs and capturing invaluable insights<sup>6</sup>”.

9. The consequences of AI may be positive on the whole in achieving good outcomes for consumers, alongside enhanced business efficiencies for firms, but there are also risks and potential downsides. In particular, the inappropriate use of AI, or ineffective controls on its adoption, will cause a range of ethical problems, including the risks of (unintended) bias and discrimination. This might result in further disenfranchising of vulnerable consumers, for whom data is lacking or implies a greater degree of risk. As a result, it becomes crucial to ensure that the data used to build AI systems is diverse and representative of the target population. Additionally, these systems' outputs must be continuously monitored and audited, since they might become biased or invalid, as the data they use changes.

### Regulation

10. Inevitably therefore, and as recognised in the Government’s policy work on ‘establishing a pro-innovation approach to regulating AI’, the ambition for the UK to ‘remain a global AI superpower’ over the next 10 years, encourages a regulatory approach which supports innovation, and is proportionate, but which also safeguards the rights to privacy and the needs of the individual<sup>7</sup>.
11. Smaller businesses, including many of the firms that AFM represents, may be less likely to adopt new technology directly, due to the high cost and complexity of bespoke systems, and limited knowledge of off-the-shelf AI systems. Additionally, the inexorable threat of cybercrime, and similar, often has a greater impact on smaller businesses, including for mutuals who have no shareholders to shoulder the cost. These factors may exacerbate the correlation between an enterprise’s size and its competitiveness, which could lead to a few large AI-driven corporates dominating the markets alongside significant losses for those small and medium-sized enterprises (SME) unable to leverage this technology.
12. Moreover, the nature of some digital solutions means that AI capacity might be part of a packaged purchase, potentially without the firm knowing it<sup>8</sup>. In such cases, if the firm is unaware of the AI capabilities

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<sup>6</sup> <https://www.babylonhealth.com/en-gb/business-hub/babylon-for-business>

<sup>7</sup> <https://www.gov.uk/government/publications/establishing-a-pro-innovation-approach-to-regulating-ai/establishing-a-pro-innovation-approach-to-regulating-ai-policy-statement>

<sup>8</sup> For example, see the telephony-based case study on page 9 of a recent report on AI Governance: <https://financialmutuals.org/wp-content/uploads/2022/12/2022-AI-Governance-Report-c.pdf>, December 2022

within a system, it will not be able to adequately assess the risks, or the ethics of the usage.

13. Transparency is key in ensuring that a regulated firms' governance structure and controls are adequate. And transparency of decision-making that relies on AI is important for a customer who, for example, might find their insurance application is rated, or their claim is rejected. To address this, a certain level of AI explain-ability may be necessary, including that consumers are afforded the "right to explanation", i.e. to receive an explanation of how AI systems made a decision that affects them, and to challenge it if unfair.
14. Regulation also needs to be balanced to ensure that the measures imposed are proportionate to the risk and impact. It also needs to ensure that the rulebook treats different businesses equitably. In recent years there has been a pronounced focus in PRA and FCA in supporting the development of new fintech solutions, whilst retaining high barriers to entry for more traditional businesses. We consider this creates a systemic risk in financial services, similar to that overseen by Ofgem, who championed new tech-based energy providers, only to find that when market conditions deteriorated, they lacked the capital reserves, management experience and commitment to customers necessary to survive. Regulation therefore needs to find the right balance, both in supporting innovation and managing risks, as well as in nurturing new solutions and avoiding harm to traditional business models.
15. To support a proportionate regulatory regime, the supervisory authorities must ensure that they engage with a wide and relevant representation of firms. In the recent past, initiatives like the AI Public-Private Forum, or the Climate Financial Risk Forum (Innovations workstream) have focused on fintech providers and the largest banks and insurers. That has an impact on how readily proposals for regulation recognise and are adaptable to the different AI uses of small businesses, and that they are proportionate.
16. In our response to PRA on their recent consultation on operational resilience, we made the point that in order to achieve proportionality it is also important to avoid placing extra burdens on product providers, where new regulations are pitched at technology providers<sup>9</sup>. That is equally valid here, where small businesses are most likely to buy-in AI-based services.

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<sup>9</sup> <https://financialmutuals.org/wp-content/uploads/2022/01/AFM-response-to-PRA-on-operational-resilience.pdf>, December 2022

17. The first principle in EIOPA's 'governance principles for an ethical and trustworthy AI' is on proportionality<sup>10</sup>. This assumes insurers conduct an AI use case impact assessment, to identify what governance measures are necessary, and that these are proportionate to the potential impact of the AI use case. An as yet unpublished White Paper from AI-specialists Lumera, responding to societal concerns, states:

*“A zero-tolerance approach to avoiding these causes of anxiety is likely to prohibit the use of AI altogether. AI models are valued by businesses today for their predictive powers and ability to identify meaningful patterns and differences. As they learn from new data, they need to operate without constant human intervention, otherwise there is less value in deploying them.”*

18. In the US, the National Institute of Science and Technology has now released the initial version of its AI Risk Management Framework<sup>11</sup>. We think this is a very helpful approach, both in setting out seven key characteristics of trustworthy AI systems, as well as a Playbook, setting out the actions and outcomes that firms should adopt via four risk management functions (govern, map, measure, and manage).

19. Given such initiatives in the EU and US, we consider that for the UK to assume leadership in AI, it is important to press ahead with regulations early, to give certainty and clarity to businesses, and to achieve an early consensus on standards of transparency and ethics. As stated by WTW<sup>12</sup>:

*“although various pieces of legislation are being prepared, grey areas still remain with companies having to rely on high-level guidelines that could leave significant room for interpretation. Therefore, for the time being at least, responsibility primarily rests with companies, organisations and society to ensure AI is used ethically.”*

20. Large AI image-making (e.g. DALL-E-2) and language models (such as GitHub Copilot and ChatGPT), trained on vast amounts of public data, can raise questions about copyright infringement. In November, tech companies GitHub, Microsoft and OpenAI were sued for training GitHub Copilot- a code generating tool- on open source code repositories, essentially plagiarising the work of human software developers in a way that violates their licenses<sup>13</sup>. The case, still open, launched a debate

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<sup>10</sup> <https://www.eiopa.europa.eu/sites/default/files/publications/reports/eiopa-ai-governance-principles-june-2021.pdf>

<sup>11</sup> <https://www.engage.hoganlovells.com/knowledgeservices/news/nist-publishes-artificial-intelligence-risk-management-framework-and-resources>, February 2023

<sup>12</sup> 'The rise of AI in insurance: a double-edged sword', November 2022

<sup>13</sup> <https://www.bloomberg.com/news/articles/2023-01-09/github-s-openai-powered-copilot-sparks-legal-debate?leadSource=uverify%20wall>, January 2023

around AI, circling on the concepts of authorship, ownership and authenticity, which regulation will need to reflect.

21. A key responsibility for new regulation of AI and ML is that it safeguards and protects consumers, and ensures industry adopts an ethical approach. As a recent and thought-provoking article from the Institute for Ethics in AI at University of Oxford stated<sup>14</sup>:

*“These predictive analytics are conquering more and more spheres of life. And yet no one has asked your permission to make such forecasts. No governmental agency is supervising them. No one is informing you about the prophecies that determine your fate. Even worse, a search through academic literature for the ethics of prediction shows it is an underexplored field of knowledge. As a society, we haven’t thought through the ethical implications of making predictions about people - beings who are supposed to be infused with agency and free will.”*

22. An early priority will be ensuring that there is an effective control and governance environment for the use of AI. The Discussion Paper draws on the requirements in SS5/16 ‘Corporate governance: Board responsibilities’, which states firms should pay close attention to the skills of its members. However, in practical terms, recent research by AI Governance indicates most organisations have no AI expertise on their Board, and over 90% have no structures and processes in place to control the use of AI<sup>15</sup>.

23. Additionally, educating consumers on usage, limitations and potential risks of AI, as well as on their rights in this domain, may help mitigate some unfair or potentially unlawful uses of AI emerging from gaps in the current regulation.

24. We would welcome the opportunity to discuss further the issues raised by our response, and we give permission to PRA to list AFM as a responder to this paper.

Yours sincerely,



Martin Shaw  
Chief Executive  
Association of Financial Mutuals

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<sup>14</sup> [‘If AI is predicting your future, are you still free?’](#), December 2021

<sup>15</sup> [Are leaders ready to control the use of AI in their organisations?](#), December 2022