Aligning Product Regulation and Corporate Governance

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Regulating new technologies

- New technologies/applications bring new risks
  - Some are foreseen and can be managed *ex ante*
  - Others are unforeseen – ***emergent risks***
- How to manage emergent risks?
  - Precautionary principle: restrict deployment until tested, regulate w.r.t. safety
  - Proportionality: permit deployment subject to close monitoring and reassessment on emergence of issues

The AI Regulation

- Some AI use-cases prohibited: *unacceptable risks*
- Minimum standards for *high-risk* AI systems
  - Including credit assessment of natural persons
  - Covering e.g. data requirements, transparency, oversight by natural persons, robustness, cybersecurity, etc.
  - Conformity assessment before deployment → CE marking
- Providers encouraged to apply these standards voluntarily to *low-risk* systems as well
- Sandboxes to facilitate controlled experimentation

Oversight and Enforcement

- For financial services, devolved to financial services supervisors (inc ECB)
- Conformity to be certified *by firms* utilising existing risk management and governance processes

Regulating financial products

- Product regulation
  - Minimum standards for products established by regulators
  - Regulators must understand risks and calibrate rules effectively
    - Difficult in the face of fast-moving product innovation
- Product governance
  - Firms must establish processes for design and marketing of products that focus on user benefit
  - Must be able to demonstrate case for user benefit based on internal analysis
  - Harnesses information / data available to firms

Structure of internal processes

- Important to link AI compliance / data governance with product governance
- Ensure an overarching approach focusing on consumer benefit
  - Not just a ‘tick-box’ list of generic minimum requirements
  - Product governance should ensure focus on deploying AI to deliver clear benefit for consumers

Challenges with compliance

- Short-termism
  - Corporate penalties (even very high ones) insufficient to ensure compliance
  - Adequacy of compliance is hard for investors to assess: unlikely to be priced into stocks
  - Non-compliance creates long-tail risks (takes time to be discovered by supervisors)
  - Stock-based pay creates incentives to skimp (Armour et al, 2020)
  - Longer minimum vesting periods + Regulatory duty of care/responsibility (eg FCA Senior Managers Regime) can counteract this