PAYMENTS
COMPLIANCE

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AI Proposal Unlikely To Hit Payments, Fintech

- **Legal certainty will bring investment in AI**
- **Culture, not regulation, to blame for lack of EU tech**

The EU's proposal for an Artificial Intelligence (AI) regulation is unlikely to be a problem for the financial services, experts have said, as those in the industry welcome the prospect of an EU-wide rulebook.

The Artificial Intelligence Act, which was published on April 21, outlines the European Commission's ambition for greater AI investment and innovation in Europe, while safeguarding the safety and fundamental rights of citizens.

The EU has introduced this proposal so it can see what kind of innovations are coming and how AI tools could be abused in the future, said Antonio Lanotte, Italy-based counsel at Loconte & Partners. "This proposal will ensure that it is regulated and that the risks are reduced before any fundamental rights breaches."

"They are creating a legal framework by which the EU will have sufficient space to regulate and manage something which, otherwise, will be completely out of control," he continued.

Within the proposal, the commission has committed to outlawing what it deems as an unacceptable risk, for example, social scoring undertaken by governments.

Meanwhile, credit scores feature in the following category and are regarded as high risk. Beyond high risk, there is also a limited risk category that focuses on chatbots and simple machinery operations, as well as a minimal risk category accounting for simple tools that will remain unregulated.

The legislation is also flexible and allows for the risk categories to be adjusted over time.

Payments services, unlike credit institutions, are not referred to directly in the regulation, which contrasts with other recent regulatory proposals such as the Digital Markets Act, which directly suggests that payment services could come into the scope of the rules.

The legislation will allow for more concrete oversight, said Emre Kazim, co-founder of Holistic AI, a risk management start-up. "I expect that it will be revised, but it is a good first move by a regulatory body."

The draft has been developed after significant consultation — and the fact that the proposal is risk-based and context-dependent is a strength, according to Tom Whittaker, senior associate at

Burges Salmon. "The proposed requirements recognise the different stakeholders, taking account of their different needs and interests," he said.

In addition, it provides businesses with a better understanding of the direction of travel in the EU, including greater scrutiny of certain types of AI such as biometrics, he added. "Companies, including those in the UK and US, need to consider the proposals now and the potential impact it would have on their development and deployment of AI."

It is unlikely that the proposal will be an issue for fintech innovation, suggested Kazim.

“Instead, the focus is on high-risk cases that touch on civil liberties and due process, which aren't really present in the fintech sector bar things such as credit scoring. The focus here will be on operational risk instead,” he added.

This has already been the case for fintech companies in Europe. For example, the Digital Operational Resilience Act (DORA), which was announced as part of the Digital Finance Package last autumn, will introduce new rules regarding cybersecurity and information communication technology outsourcing for the financial services sector.

The financial sector will be paying attention to the AI proposal, Whittaker suggested. In particular, this is because significant fines of up to €30m or 6 percent of the global turnover will focus attention.

However, by providing legislation now, and ahead of other jurisdictions, the EU is offering legal certainty to companies that want to invest in AI, in terms of what they can, cannot and should do, he said.

In addition, the proposal advises national competent authorities to set up regulatory sandboxes for companies to use, with priority given to small and medium-sized enterprises.

An increase in regulatory oversight that will come once the regulation is in force, however, could drive innovation away from the EU, Kazim suggested. “There is a question when it comes to companies weighing up if they will risk setting up shop in Europe,” he said, acknowledging that the trading bloc tends to have more stringent regulation.

Too much regulation could lead to a lack of investment opportunities, and the EU not being a leader in the AI industry, he argued.

However, this could also be a question of culture, Kazim pointed out, asking: “Why haven't we produced companies like Amazon or Google?”

“It is a bigger question than just putting it down to GDPR [General Data Protection Regulation] and other regulation. It might be due to the risk appetite in our society,” he suggested.

In contrast, others suggested that bringing in new rules on AI could also bring new players on board, due to trust the regulation will instil.

“It makes sense to regulate AI at a European level,” said Nicolas Kipp, managing director at German software company Banxware. “Some legacy players in the industry do wonder why we don't yet have any high-level regulatory framework on the boundaries of AI implementation," he said.

Regulation could have a halo effect, providing legitimacy to industries and market practices, agreed Whittaker. "The regulations are intended to build users' trust in AI, further boosting its use."

Nearly 60 percent of financial-services sector respondents to a report by the consultancy McKinsey in 2020 acknowledged that their companies have embedded at least one AI capability, with 36 percent using robotic process automation for structured operational tasks, while 25 percent are using machine learning techniques to detect fraud.

From a regulatory perspective, there are not as many rules regarding payments and AI, especially in comparison with more regulated industries such as banking or lending, Kipp continued.

"Currently, most applications of AI in the payments industry focus on fraud prevention. One reason for this is that payments have become a lot faster in the last decade," Kipp said, pointing out that the use of AI capabilities is a lot quicker and can differentiate between what is and what isn't fraud.

"The same goes for money-laundering prevention, but I haven't seen this develop into a bigger trend yet," he said.

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