AIFS0014

Written evidence submitted by Dr Virág Blazsek

Chief proposal: The UK should hold a referendum on the fundamental questions of AI.

I. Relevant background and the reason for this submission

I am a Lecturer in Commercial, Corporate and Banking Law at the University of Leeds School of Law in Yorkshire, England. My research is focused on banking law, financial regulation, and financial stability-related issues from a comparative perspective. I am submitting this evidence as part of my scholarly activities. Beyond my role at Leeds, I have also been an external examiner at King's College London since 2022.

I am listing below my relevant background.

1. Legal education (first law degree, master's and PhD degrees):
    a. LLM and SJD in International Business Law, Central European University
    b. LLM in Business and Finance Law, George Washington University Law School
    c. LLM in US and Global Business Law, Suffolk University School of Law
    d. Juris Doctor and PhD in Law (recognition of S.J.D.), Eötvös Loránd University Faculty of Law
2. 11-year law practice, including:
    a. 7 years as an in-house legal counsel and manager at Hungary's market-leading financial institution, OTP Bank Plc in 2007-2014, and
    b. 2 years as an attorney at the United Nations Joint Staff Pension Fund's Office of Investment Management in New York, NY in 2019-2020.
3. Publications:
    a. Monograph, *Banking Bailout Law: A Comparative Study of the United States, United Kingdom, and the European Union (Routledge, 2021)*, which is available in 600 libraries globally (WorldCat.Org).
    b. Scholarly articles on financial stability and financial regulation (see here).
    c. Impact article: Regulators' rhetoric about bank failures doesn't match their actions, American Banker (May 3, 2024).
4. Scholarship: 4 years of full-time (post-PhD) teaching and research experience in banking law and financial regulation as Lecturer in Commercial, Corporate and Banking Law at the University of Leeds School of Law in 2021-present (see my faculty profile).
5. A recently completed one-month course and obtained professional education certificate in 'Applied Generative AI for Digital Transformation' from the Massachusetts Institute of Technology (MIT) (July-August 2024).

II. Responses to selected questions

Re 'How the UK financial services can take advantage of the opportunities in AI while mitigating any threats to financial stability and safeguarding financial consumers, particularly vulnerable consumers?'

The risks related to artificial intelligence (AI), and in particular Generative AI (GenAI) should be taken extremely seriously. A major issue is that very fundamental (philosophical) questions of AI and

GenAI remain open. And how can we develop a regulatory framework that would be capable of mitigating the related risks without first addressing those fundamental questions? The scope of this issue goes beyond financial regulation. Different answers to those fundamental questions lead to fundamentally different regulatory approaches and solutions. Therefore, in line with the principle of democratic authorisation, it would be logical, and in multiple ways beneficial for the United Kingdom (UK), to hold a referendum on questions of this magnitude, capable of reshaping our economy and society, having a most fundamental impact on people's lives and livelihoods. Yet, there has not been a discussion on such a referendum in the UK; a referendum has not been part of the AI-related discussion in other jurisdictions either.[1] Further, lack of a global authority, the above-mentioned fundamental questions will be addressed jurisdiction by jurisdiction, if at all. The advantage of that will be a compartmentalisation of potentially bad regulatory decisions of any single jurisdiction. But this regulatory risk-compartmentalisation will be limited due to the cross-border implications of those potentially bad regulatory decisions. Also, due to international policymakers, like the Bank for International Settlements (BIS), the International Monetary Fund (IMF), and the G20 Financial Stability Board (FSB), there has been significant harmonisation in financial regulations following the 2008 Global Financial Crisis.

One of the consequences (or perhaps indicators) of the above-mentioned issue with regard to the unanswered fundamental questions of AI is the political dividedness as to new technologies and AI. Most recently, this has been exemplified by a series of January 2025 executive orders in the United States (US), by the previous and the current administrations representing very different approaches as to new technologies.[2] While the new administration's executive order includes some firm prohibitions (for example, as to central bank digital currencies in the US, a technology that might include embedded AI algorithms as well), in line with US constitutional principles, that does not prevent Congress from passing a relevant legislation in the future. -- And that is what most probably will happen.

The recent EU AI Act represents a good approach in that it identifies some prohibited AI activities.[3] But see also the earlier 'open letter' by major AI-developers urging a pause and re-thinking of the role of AI – which request has remained largely ineffective to date.[4]

There is a delicate balance between letting new technologies develop while protecting the interests of the public (such as financial stability) and the interests of financial services customers and consumers. But this is very challenging because new technologies need data and users in order to develop. Therefore, while pilot programmes are very helpful, they limitedly promote the development of AI.

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[1] But see (in the US-context) Kevin Frazier, A National Advisory Referendum on AI? (June 27, 2024), https://www.lawfaremedia.org/article/a-national-advisory-referendum-on-ai (accessed 13 March 2025).

[2] The White House, Strengthening American Leadership in Digital Financial Technology, Executive Order (23 January 2025) https://www.whitehouse.gov/presidential-actions/2025/01/strengthening-american-leadership-in-digital-financial-technology/ (accessed 13 March 2025); The White House, Advancing United States Leadership in Artificial Intelligence Infrastructure, Executive Order (14 January 2025) https://bidenwhitehouse.archives.gov/briefing-room/presidential-actions/2025/01/14/executive-order-on-advancing-united-states-leadership-in-artificial-intelligence-infrastructure/ (accessed 13 March 2025); The White House, Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence, Executive Order (30 October 2023) https://www.federalregister.gov/documents/2023/11/01/2023-24283/safe-secure-and-trustworthy-development-and-use-of-artificial-intelligence (accessed 13 March 2025).

[3] Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence and amending Regulations (EC) No 300/2008, (EU) No 167/2013, (EU) No 168/2013, (EU) 2018/858, (EU) 2018/1139 and (EU) 2019/2144 and Directives 2014/90/EU, (EU) 2016/797 and (EU) 2020/1828 (Artificial Intelligence Act) ('EU AI Act').

[4] Pause Giant AI Experiments: An Open Letter (22 March 2023), https://futureoflife.org/open-letter/pause-giant-ai-experiments/ (accessed 13 March 2025).

This means that, as long as jurisdictions allow AI to develop, the financial system cannot be fully protected against the risks that technology might mean for the financial system and society.

At the current stage of technological development, and with all the unanswered, fundamental questions, only human controlled AI should be used as to financial services. This control is the main method of mitigating some of the risks. This is supported by the findings of a 2024 survey according to which 'most AI processes remain reliant on human intervention, reflecting the current role of AI as a supportive "tool" rather than a direct replacement for humans in the investment process.'[5] The promises of AI are jaw-dropping, but as a user and a scholar, my experience has been that currently, AI frequently involves errors.

According to a 2024 survey, currently, 'nine out of 10 managers are (…) using (54%) or planning to use (37%) AI within their investment strategies or asset class research.'[6] This illustrates that, in just about 3-5 years, AI-based solutions have increased significantly across sectors of the economy. In this respect, it is important to mention that one of the important elements of the financial stability-related regulatory framework is the separation of commercial and investment banking activities. They are very different in nature and, from time to time, ideas of the elimination of this separation emerge. However, historic evidence (see, for example, the consequences of the repeal of the Glass-Steagall Act in the US about a decade prior to the 2008 Global Financial Crisis) and related scholarly works show that this fundamental compartmentalisation of risks, a separation of commercial and investment banking, is a fundamental building block of financial regulation.[7] With the emergence of AI, risks will increase in the financial sector and so the above separation of commercial and investment activities will become even more important.

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

Whether AI will be deployed increasingly in financial services will depend on the policy and regulatory approach taken in the UK. Financial services are one of the most regulated sectors of the economy, together with the energy sector and some other highly regulated sectors. Who can enter the market as financial service provider, what types of services are provided, and to whom, at many instances, under what contractual conditions, are all defined by the legislator and the regulator in the UK. This puts them in a difficult position with a lot of responsibility. This means that if the legislator and regulator make a mistake in terms of their AI-related strategy, it will have enormous consequences. The UK does not stand alone in this respect. Therefore, one of the chief responsibility of regulators is to push back against sectoral pressure to make rushed decisions.[8]

Re 'Are financial services adopting AI at a faster rate than other sectors in the economy?'
Yes, and I think that this is due to various factors, such as the significant size of the financial sector within the economy as a whole, and the fact that this sector started to digitalise first among the sectors of the economy. Also, the nature of financial services makes is particularly apt for digitalisation.

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[5] AI integration in investment management, 2024 global manager survey by Mercer Investments, page 29, https://www.mercer.com/assets/global/en/shared-assets/global/attachments/pdf-2024-Mercer-AI-integration-in-investment-management-2024-global-manager-survey-report-03212024.pdf (accessed on 13 March 2025).
[6] AI integration in investment management, 2024 global manager survey by Mercer Investments, page 5, https://www.mercer.com/assets/global/en/shared-assets/global/attachments/pdf-2024-Mercer-AI-integration-in-investment-management-2024-global-manager-survey-report-03212024.pdf (accessed on 13 March 2025).
[7] Arthur E. Wilmarth Jr., *Taming the Megabanks: Why We Need a New Glass-Steagall Act* (OUP, 2020).
[8] Ferran E, 'International Competitiveness and Financial Regulators' Mandates: Coming Around Again in the UK' (2023) 9 Journal of Financial Regulation.

Re 'To what extent can AI improve productivity in financial services?'
AI can save money and time for both financial service providers and their customers and consumers. This is exactly what predominantly drives innovation in financial services in my view. According to a 2024 survey, on average, 47% of companies' digital budgets is spent on GenAI in the financial services sector.[9]

Re 'What are the key barriers to adoption of AI in financial services?'
I think that a key barrier to adoption of AI in financial services is that the technology is not sufficiently developed at this stage. Also, I am concerned about the fact that AI is man-made and there are biases in the system already at this stage, and it is hard to predict the long-term consequences of those man-made biases. If we consider AI as an assistant and not as a manager, we can keep this issue under more control.

While many organizations may be interested in implementing AI, they can face obstacles with execution. A shortage of data science talent, for example, is the primary barrier (39%) to AI adoption to help address and mitigate fraud and money laundering. Another obstacle for this use case is time for implementation (35%).[10]

Re 'Are there areas where the financial services should be adopting GenAI with little or no risk?'
GenAI, based on my experience as a user, is not very reliable at this point, even though it has been developing exponentially in the past couple of years. It can be used by financial service providers in any areas as an advisor, an assistant, as long as the user is knowledgeable and there is 100% human control over GenAI (it does not make decisions without human supervision). This approach means that any error would fall within the risk of the financial service provider and not the customer and consumer. This will guarantee that financial service providers will employ GenAI (and AI) in a responsible manner. On the other hand, this might lead to lobbying by financial service providers who might want to distribute the risk between them and their customers including consumers. Regulators should push back against such initiatives.

In sum, GenAI should be used by financial service providers, but not by their customers and consumers. Financial service providers should be transparent about the usage of AI (always flagging it), and always using it in a way that the final decision maker is a human being.

The above approach is supported by recent findings that show that most economic value creation takes place in human resources, operations, and marketing and sales (quote, 'For the first time, our latest survey explored the value created by gen AI use by business function. The function in which the largest share of respondents report seeing cost decreases is human resources. (…) For analytical AI, respondents most often report seeing cost benefits in service operations—in line with what we found last year—as well as meaningful revenue increases from AI use in marketing and sales').[11]

A year later, a similar survey indicates the exponential growth of reliance on GenAI in the financial services sector (with rapid growth in the areas of risk, legal, and compliance besides the above-

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[9] The state of AI in early 2024: Gen AI adoption spikes and starts to generate value, Survey, McKinsey (May 30, 2024), Exhibit 5, https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai-2024 (accessed on 13 March 2025).
[10] Daniel Wolfe, 7 ways gen AI is disrupting financial services jobs, American Banker, https://www.americanbanker.com/payments/list/7-ways-gen-ai-is-disrupting-financial-services-jobs (accessed on 13 March 2025).
[11] The state of AI in early 2024: Gen AI adoption spikes and starts to generate value, Survey, McKinsey (May 30, 2024), Exhibit 6, https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai-2024 (accessed on 13 March 2025).

mentioned areas of application in the sector).[12] This economic value creation will drive financial service providers to continue investing in GenAI. Also, this indicates that most GenAI-related activities in the financial sector are not directly related to financial services but rather to operations and human resources. However, the World Economic Forum predicts that AI will expand 'from operational gains to strategic value creation' within the next 5 years (by 2030).[13]

Regulators should not rush to financial sector-specific GenAI regulation. GenAI started to make a difference only in 2023, so just two years ago. It is important to monitor the development of this technology, but perhaps regulatory needs mostly fall outside financial regulation.

Re 'Are there likely to be job losses arising from AI in financial services and if so, where?'

According to the most recent studies, this will not be the case for a while, but AI might cause long-term changes in employment.[14] This is mostly because financial services are related to the most important aspects of human life, such as the management of personal income, getting a mortgage or other type of loan, and making payments. 'According to American Banker's Predictions 2024 survey (…), 75% of finance industry professionals think AI will change the nature of some jobs, but won't replace human workers. Twenty-one percent say AI will replace jobs in the banking industry, while just 4% say it will have little impact on these jobs. While most banks are still researching the technology, major banks like JPMorgan Chase, Wells Fargo and Goldman Sachs are already rolling out some AI-powered programs. JPMorgan Chase is using large language models to detect fraud by looking at patterns in emails. Goldman Sachs is using generative AI to help software engineers in code development. And Ally Bank has an AI-powered program that transcribes and summarizes customer service calls. As interest in AI grows, financial service industry professionals are rapidly figuring out where and how to use it. According to 26% of respondents, customer service is the top use case/strategic business initiative for AI, mostly for customer support functions. Other key uses include fraud prevention and detection, analytics and marketing. In what is a somewhat surprising finding, 14% of respondents say they see no use cases for AI or that it is not applicable. (…) While many organizations may be interested in implementing AI, they can face obstacles with execution. A shortage of data science talent, for example, is the primary barrier (39%) to AI adoption to help address and mitigate fraud and money laundering. Another obstacle for this use case is time for implementation (35%).[15]

Re 'Is the UK's financial sector well-placed to take advantage of AI in financial services compared to other countries?'

Yes, the UK is very well-placed due to its globally strong position as a significant jurisdiction for financial services, dispute resolution, legal services, insolvency, and commercial law. As long as London remains a globally significant financial centre, the UK will remain well-placed on a global scale in this particular area. Also, based on my recent research project on FinTech centres, the UK is globally strong in FinTech innovation.[16] I think that one of the main objectives of the UK should be to

[12] The state of AI: How organizations are rewiring to capture value, Survey, McKinsey (March 12, 2025), Exhibit 10, https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai (accessed on 13 March 2025).
[13] How AI can redefine investment strategy and generate value for financial firms, World Economic Forum, (February 4, 2025), https://www.weforum.org/stories/2025/02/ai-redefine-investment-strategy-generate-value-financial-firms/ (accessed on 13 March 2025).
[14] Daniel Wolfe, 7 ways gen AI is disrupting financial services jobs, American Banker, https://www.americanbanker.com/payments/list/7-ways-gen-ai-is-disrupting-financial-services-jobs (accessed on 13 March 2025).
[15] Daniel Wolfe, 7 ways gen AI is disrupting financial services jobs, American Banker, https://www.americanbanker.com/payments/list/7-ways-gen-ai-is-disrupting-financial-services-jobs (accessed on 13 March 2025).

offer high level data security. This is a chief concern for financial service-providers ('Data privacy and security [is] a primary concern for banks').[17] A major challenge is that currently, if a FinTech company is successful, after a certain size, it tends to relocate to the US. This is hard to fight as the US is a much bigger market than the UK. But the UK could remain a globally competitive jurisdiction with a high quality and reliable data security, cybersecurity, and privacy framework.

Re 'What are the risks to financial stability arising from AI and how can they be mitigated?'
The financial sector runs on trust; therefore, a loss of trust might undermine trust and result in panic and systemic instabilities. I agree with some of the findings of a recent article that regulatory efforts should focus on 'eliminating bias in algorithms and enhancing the explainability of AI's decision-making processes, which are essential to maintaining public trust and transparency.'[18]

The risks to financial stability arising from AI are mostly unknown and related to the possible abuse of the system. This puts regulators in a very challenging position. Most of the risks of GenAI can be dealt with outside financial regulation (they are not financial services-specific). The financial sector-specific aspect of GenAI-related risks is rather the fact that the harm can be greater in this sector due to the nature of financial services. The key regulatory areas tackling these issues should include data security, privacy laws, as well as education of the general population (increasing financial literacy and GenAI-related knowledge).

Re 'Are the risks of having AI tools used in the financial sector concentrated in the hands of a few large tech companies?'
Yes, see also the open letter on AI.[19] It will be very challenging to artificially induce more competition among large tech companies (some argue that they are bigger because they are better).[20]

Also, there has been an increasing market concentration in financial services on both sides of the Atlantic. Some blame the post-2008 financial regulatory framework (increased compliance costs not affordable by smaller banks). I am of the view that the above market concentration has primarily been caused by the fact that 'the heart and brains' of banks has increasingly been their IT systems. As technology and digitalisation have been advancing, those IT systems represent increasing costs for banks, and that results in increasing market concentration, fewer and bigger banks. The 2008 bank bailouts (and related regulatory measures) might have speeded up but did not cause market concentration in financial services.[21]

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[16] Dr Virág Blazsek, Leeds Financial and FinTech Hub Research Project Conference Video, https://www.youtube.com/watch?v=L0lkCrbYlpA (accessed on 13 March 2025).
[17] Dr. Kostis Chlouverakis, How artificial intelligence is reshaping the financial services industry, EY (26 April 2024), https://www.ey.com/en_gr/insights/financial-services/how-artificial-intelligence-is-reshaping-the-financial-services-industry (accessed on 13 March 2025).
[18] Dr. Kostis Chlouverakis, How artificial intelligence is reshaping the financial services industry, EY (26 April 2024), https://www.ey.com/en_gr/insights/financial-services/how-artificial-intelligence-is-reshaping-the-financial-services-industry (accessed on 13 March 2025).
[19] Pause Giant AI Experiments: An Open Letter (22 March 2023), https://futureoflife.org/open-letter/pause-giant-ai-experiments/ (accessed 13 March 2025).
[20] Pinar Akman, Intelligence Squared debate on "Break up the Tech Giants" (17 January 2018), https://www.youtube.com/watch?v=ay4bKauK-UU (accessed 13 March 2025).
[21] Virág Blazsek, Banking Bailout Law: A Comparative Study of the United States, United Kingdom, and the European Union (Routledge, 2021),