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
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
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