

Answers of the European Financial Congress¹ in relation to the International Association of Insurance Supervisors' consultation on draft Application Paper on the supervision of artificial intelligence ²

Methodology for preparing the answers

The answers were prepared in the following stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They received selected extracts of the IAIS's consultation document and the consultation questions translated into Polish. The experts were guaranteed anonymity.

Stage 2

Responses were obtained from experts representing:

- insurance firms
- insurance distributors
- regulators
- consulting firms,
- the academia.

Stage 3

All the responses were collected, anonymised and the survey project coordinators prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to propose modifications and additions as well as marking the passages they did not agree with.

Step 4

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared. The final version of the answers was translated into English and submitted to the IAIS.

¹ The European Financial Congress www.efcongress.com is an independent think tank focusing on economic and financial issues. Its goal is to engage in debate on the security and stability of the financial systems as well as sustainable economic growth of the European Union and Poland. The EFC is run by the Centrum Myśli Strategicznych. The EFC Project dedicated to insurance is EFC Insurance: Sales, Innovations, Risks <https://www.efcongress.com/usir/>

² <https://www.iais.org/uploads/2024/11/Draft-Application-Paper-on-the-supervision-of-artificial-intelligence.pdf>

Answers of the European Financial Congress to consultation questions

1. General comments on draft Application Paper on the supervision of artificial intelligence

Regulatory Alignment:

There is a need for the IAIS document to align with existing European regulations, particularly the AI Act and DORA. The document does not adequately reference these regulations, leading to uncertainty about compliance and potential overlaps in requirements or additional burden placed on the insurers on top of the AI Act or DORA, which would impact insurers competitive position vs other market participants.

Addressing Third Party Risk:

The document should take into account the regulatory obligations of technology providers, who play a significant role in the deployment of AI in insurance. There is a concern that the current framework may impose excessive burdens on insurers while overlooking the accountability of technology firms.

Importance of Proportionality:

The principle of proportionality is highlighted as crucial, given the varying levels of AI integration among market participants. The application of human oversight should be guided by predefined logic, particularly for high-risk AI systems, rather than being uniformly mandated independently from the level risk associated with AI systems.

Comprehensive Recommendations:

The document is recognized for presenting a comprehensive set of recommendations on AI supervision, which are generally positive and based on a risk-based approach. While the flexibility is appreciated, it also raises concerns about interpretative inconsistencies across jurisdictions.

Consumer Protection and Transparency:

There is a need for further development in consumer education regarding their rights and the transparency of AI decision-making processes.

2. Comments on specific sections of draft Application Paper on the supervision of artificial intelligence

Re: Section 2.2 AI system definition

The definition of AI systems is currently too general and should be elaborated to improve standardization and cooperation within the sector. It is advisable to include various levels of classification, such as AI system, AI model (particularly in relation to the use of standard statistical models widely applied in the sector by insurers), and context of use

Re : Section 2.3 Scope and structure

The governance framework needs to clearly outline responsibilities across different organizational levels, especially in relation to existing risk management practices.

Re: Section 3.4 Human oversight and allocation of management responsibilities

Paragraph 41: There is a highlighted need in the document for enhanced AI skills within business areas, the shift in responsibility may necessitate organizations to bolster their capabilities in monitoring complex AI solutions.

Re: Section 3.5 Use of third-party AI systems and data

The document should address the risks associated with using AI models provided by third parties, particularly concerning data security and the potential for uncontrolled data sharing across sectors due to data aggregation within the models build by external vendors.

Re: Section 5.2 Explaining AI system outcomes

The discussion on explainability is deemed insufficient, as the suggested methods (such as LIME and SHAP) are inadequate for complex AI models, including GenAI solutions. There is a necessity for more robust standards and mechanisms to ensure explainability.

Re: Section 6.2 Fairness by design

The document requires insurance companies to provide appeal mechanisms for clients, but there are no details on how such mechanisms would function in practice. This requirement may be pose practical issues.

Re: Section 6.3 Data management in the context of fairness

Paragraph 82: This section states that elasticity models cannot utilize behavioral attributes. It emphasizes that the insurer's data management processes should prevent the unfair use of customer data (ICP 19.12.7), particularly regarding non-risk-based pricing practices that exploit consumers' willingness to pay or their low propensity to shop around.

EIOPA's "Supervisory statement on differential pricing practices in non-life insurance lines of business," published on 22 February 2023, also highlights that pricing practices should not result in unfair treatment of customers. It suggests that adequate measures should be implemented, including defining appropriate thresholds or guardrails for premium differences among customers with similar underwriting risk profiles and service costs. This paragraph implies that some differentiation in pricing is permissible, which may not be as restrictive as the interpretation derived from paragraph 82.

Re: Section 6.5 Monitoring the outcomes of AI systems

Paragraph 89 Local Regulations vs. IAIS Guidelines: Clarity is needed on how local regulations, such as the AI Act, interact with IAIS guidelines, especially regarding the maintenance of AI model inventories and the implications for insurers.

3. What further work could the IAIS undertake on artificial intelligence?

Incorporation and alignment to other regulations, standards, guidelines related to Governance AI by other entities

IASA should draw from materials developed by other bodies and organizations publishing in the field of Responsible AI, and incorporate established best practices into its guidelines, as many industries face similar threats. In particular, from European perspective the IAIS documentation could be expanded to map its guidelines against the requirements of the AI Act, ensuring comprehensive no additional burden being imposed on insurance industry. This should include addressing issues related to third-party rights, cybersecurity, and data privacy.

It is suggested that IAIS clarify frameworks and standards for risk stratification and distinguishing between high-risk and low-risk AI systems (in a similar way that it is stated in AI Act that indicates definition of high-risk systems).

There is a risk that the upgrading of generative AI models by global companies may lead to practices prohibited by the AI Act and/or necessitate the discontinuation of the use of these models by the insurance sector. IAIS should propose an adaptation and rapid response/monitoring model to mitigate the negative impacts of such changes.

Governance framework and risk assessment guidelines

IAIS could propose a reference governance model that outlines roles and responsibilities in the development and maintenance of AI solutions.

In addition, IAIS could give further considerations towards establishing universal ethical standards that would generally guide the safe use of AI. Emphasis should be placed on adapting to new challenges emerging in the rapid development in the AI field that will create new risks not identified in the existing risk management standards.

A more precise guidelines on how the fairness is defined is required as there are many ways to quantify that by insurers. This poses a risk of inconsistencies in the market, especially between how supervisors view it and approach used by insurance companies to monitor fairness.

Further consideration could be given towards issues related to copyrights (for instance AI processing data on insurance products via web scraping) and the balance between data retention and the use of data for training AI models need to be addressed.

Clear standards for security to protect against abuses and manipulation in the sales of insurance products facilitated by AI engines could also be considered.

Third party accountability

Establishing accountability for AI decisions, is crucial. There is a need for clarity regarding who is responsible for AI decisions, particularly in cases of algorithmic errors especially in the context of third party solutions. As mentioned in general comments there is a concern that the current framework may impose excessive burdens on insurers while overlooking the accountability of technology firms.

Tools for supervisors

IAIS could develop standardized tools, such as audit question and risk assessment frameworks, to assist supervisors in their oversight roles.

IASA could emphasize the importance of the consumer education programs eg recommending local supervisors to create educational materials for consumers

regarding their rights in interactions with AI systems.

4. Are there risks not effectively captured by the IAIS' work on artificial intelligence?

Fundamental risks affecting the insurance market:

1. **Systemic Risks:** Experts warn of systemic risks associated with widespread AI failures or errors in commonly used models, which could have global repercussions for the insurance market. The introduction of flawed assumptions by AI that affect financial stability is a significant concern.
2. **Regulatory Arbitrage:** Concerns exist regarding regulatory arbitrage, where technology companies may exploit gaps in oversight, leading to the use of AI systems trained in ways that are prohibited in other contexts. Developing general guidelines to address these issues is necessary.
3. **Market Concentration:** The development of AI in insurance may lead to market concentration among a few large players with access to extensive data resources, potentially stifling competition and innovation. This could result in the exclusion of certain customer groups deemed "too risky" for insurance coverage.
4. **Unpredictability of AI:** The adaptive nature of AI means that its decision-making can become unpredictable over time, raising concerns about the long-term implications for the insurance sector.
5. **Reputational Risks:** Changes in insurance distribution models due to AI could pose reputational risks for the industry, necessitating careful management of these transitions.
6. **Predictive Decision-Making:** AI's ability to predict customer behavior could lead to preemptive denial strategies, such as raising premiums for clients likely to cancel policies. There is also a risk of mass erroneous decisions due to similar algorithms being used across companies.

Other risks:

7. **AI impact on employment:** There are concerns about the potential for AI to influence employment levels in the insurance sector, leading to social tensions.
8. **Client Awareness and Transparency:** It is crucial to ensure that clients understand they are interacting with AI rather than a human to manage expectations and risks effectively.