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Dr Eamonn Cahill

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Department of Enterprise, Trade and Employment

Dublin

Ireland

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Dear Mr Cahill,

In light of your recent Public Consultation on the National Implementation of EU Harmonised Rules on Artificial Intelligence (AI Act), we would like to take this opportunity to advise that the Central Bank of Ireland (the Central Bank) is supportive of this consultation and welcomes the development of a harmonised approach to the national implementation of the AI Act.

We provide in what follows some focussed comments relating to areas of relevance to the Central Bank's mandate. This letter sets out the Central Bank's views on the four consultation questions. The Central Bank is also drawing the Department's attention to cross-cutting issues that we had previously discussed at working level. In our response, we highlight the importance of designating the Market Surveillance Authorities as soon as possible given the provisions of the AI Act on Prohibited AI Practices come into effect in February 2025.

We would be very pleased to engage further with you or your officials on any of the issues raised here.

Best regards,

Gerry Cross,
Director
Financial Regulation - Policy & Risk

Q1- What considerations should the Department have regard to when devising the configuration of national competent authorities for implementation?

This question considers different approaches to the designation of competent authorities, ranging from a centralised model to a more distributed, sector-based approach. By national competent authority, the AI Act means (i) Market Surveillance Authority (MSA) or (ii) notifying authority.

The AI Act is complex and while it is new, it will need to align with existing regulations, powers, practices and mandates at national and EU authorities. The AI Act is wide-ranging providing a framework for the development, deployment and the use of AI systems. At the same time, mitigating various types of risks to health and safety and breaches of fundamental rights across many sectors – including financial services – means that vastly different AI systems in very different industries are covered by one EU regulation.

As such, AI systems use and risk is context-dependent. Within financial services, there is a significant body of existing regulations and standards covering the types of activity identified under the AI Act as high-risk. Therefore, there are inherent links with the role of sectoral and any horizontal supervisory authorities (domestic or EU level).

In a sector-based model the co-ordination, and the roles and responsibilities of the national competent authorities should be clear and transparent, with an understanding of how they fit within each other's existing remit. For example, there needs to be clear distinctions between co-ordination at national and EU level and supervision as per the AI Act, the former should not affect the latter as the overall accountability for supervisory tasks remain with the relevant supervisor. Coordinating authorities will need to take this into account both at a national and EU level.

The Central Bank regulates financial institutions and markets through risk-based supervision, which is underpinned by credible enforcement deterrents. The Central Bank is part of the European System of Financial Supervision, and the ECB Single Supervisory Mechanism for supervising large banks (significant institutions). These provide mechanisms to co-ordinate on implementation at EU level within financial services.

The Department may wish to consider how to best organise co-ordination at a national level. As part of this co-ordination, the Department may wish to consider how information would flow between sector specific national MSAs. This includes adequate information 'gateways' to exchange information, that takes into account existing sector or MSA/institution specific legislative requirements regarding confidentiality, and ensures the effective implementation of the AI Act and facilitates the sharing of supervisory intelligence and information related to incident reporting as envisaged under the AI Act.

Regarding the MSA for the financial sector, according to recital 158[1] of the AI Act, the Central Bank should be designated as competent authority for the purpose of supervising the implementation of the AI Act, unless this is designated to another authority. This description in the AI Act implies a sector-based approach when it comes to the supervision of the financial sector. Accordingly, we support the designation of the Central Bank as MSA for the financial sector. We highlight the importance of designating the Market Surveillance Authorities as soon as possible given the provisions of the AI Act on Prohibited AI Practices come into effect in February 2025.

Q2 - Are there potential synergies between the implementation of AI Act and the implementation of other EU Regulations applying to Digital markets, services, and infrastructure?

In 2020, the European Commission's (Commission) digital finance package set out its strategy and legislative proposals for a competitive EU financial sector that would give consumers access to innovative financial products, while ensuring consumer protection and financial stability. As a result, the Markets in Crypto Assets Regulation (MiCA), the Digital Operational Resilience Act (DORA) framework and the Distributed Ledger Technology (DLT) pilot regime have been finalised and are in the process of being implemented. In broad terms, these are examples of where new regulations aim to provide an environment where new technologies can be applied safely and at a high standard. That being said, the scope of the regulations mentioned above cover specific sectors/activities within financial services and are framed differently to the AI Act. Therefore,

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[1] Recital 158: *(…) the competent authorities for the supervision and enforcement of those legal acts, in particular (…), should be designated, within their respective competences, as competent authorities for the purpose of supervising the implementation of this Regulation, including for market surveillance activities, as regards AI systems provided or used by regulated and supervised financial institutions unless Member States decide to designate another authority to fulfil these market surveillance tasks. (…)*

synergies regarding implementation and guidance based on previous sector specific regulations are somewhat limited in comparison to the cross-sector product-safety approach under the AI Act.

Q3 How can Ireland's implementation of the AI Act bolster Ireland's position as a leading Digital Economy, increasing investment and accelerating innovation in AI? What would excellence in AI regulation look like?

The AI Act can support Ireland's position in being a leading digital economy by providing a clear system of outcomes-focused regulation and supervision that is proportionate, transparent and predictable and with innovation approached as a key aspect of a well-functioning economy and subject to an appropriately risk-based regulatory framework. This includes clarifying the scope and organising the national and EU co-ordination across sectors.

This includes identification of relevant stakeholders to provide further guidance/clarification on some of the scope and cross-cutting issues mentioned in the Annex to this letter. In particular, being clear about the scope of the regulation (what AI is covered by the AI Act), and why there are particular exclusions. There are several cross-cutting issues that remain to be clarified by the Commission/AI Office or other authorities, and have remained unclear for the past number of years while the AI Act was being drafted.

In terms of organisation, this includes how best to give effect to regulation. From the perspective of the Central Bank as a potential MSA, it is important to be clear about how supervision of high-risk use cases and of the use of prohibited AI practices will be organised nationally and at EU level, including how authorities responsible for cross-cutting implementation issues and issues related to protecting fundamental rights will be identified.

In the AI Act implementation, the Commission has a role to develop guidelines regarding implementation taking into account existing financial services regulation (as part of existing Union law). The European Supervisory Authorities (ESAs) have commenced plans to explore gaps and overlaps between the AI Act and existing sectoral legislations. However, it is unclear at present what the Commission or other EU bodies (ESAs, ENISA) will be taking forward and what will be left to Member States, and within Member States what will fall to central banks and regulatory authorities.

We need clarity on how the requirements of the AI Act will apply with existing regulations such as the DORA framework. For example, there are specific links to DORA, operational resilience and oversight of outsourcing including providers of AI systems and their end use by financial services firms. It is unclear, at present, where oversight of third party providers to financial services firms sits between the AI Act and DORA, including if providers are critical third party providers as there are additional supervisory requirements under DORA. There are requirements related to General-purpose AI models (GPAIs; Chapter V), where it is the AI Office that may be directly responsible. However, further clarity would be welcomed on the role of MSAs in relation to the requirements on GPAIs, including their application within financial services.

The Central Bank has actively contributed to the work of EIOPA and the International Association of Insurance Supervisors (IAIS) in the areas of digitalisation, innovation and AI. EIOPA has published a report[2] on digital ethics setting out AI governance principles for ethical and trustworthy AI in the European insurance sector. In 2020, the Central Bank co-chaired the EBA Task Force that produced the main EU Loan Origination Guidelines on credit risk and credit worthiness assessment, covering some key aspects of the high-risk use case related to credit worthiness assessment under the AI Act.

At the national level, in the context of AI and the AI Act, we have provided technical observations to the Department of Enterprise, Trade and Employment (DETE) throughout the AI Act's development at technical/working level. In 2023, the Central Bank undertook a research project, the Data Ethics Within Insurance Project, which aimed to further develop the Central Bank's understanding of the nature and extent of the use of Big Data and Related Technologies generally and across the insurance value chain and the consideration of ethics as part of that.

As stated in the Central Bank's Regulatory and Supervisory Outlook Report[3], over 2024/25, the Central Bank will be undertaking policy work and developing its supervisory expectations of regulated entities related to the use of AI in financial services. This includes preparing for the

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[2]https://www.eiopa.europa.eu/eiopa-publishes-report-artificial-intelligence-governance-principles-2021-06-17_en

[3]https://www.centralbank.ie/docs/default-source/publications/regulatory-and-supervisory-outlook-reports/regulatory-supervisory-outlook-report-2024.pdf

implementation of the AI Act. This will build on our previous relevant experience, and we continue to seek clarification on the cross-cutting issues we have identified to foster a proactive implementation of the AI Act.

Q4 How can Ireland's implementation of the AI Act drive support and accelerate progress from each of these perspectives while meeting our regulatory obligations?

The National AI Strategy is founded on three core principles: adopting a human-centric approach to the application of AI; staying open and adaptable to new innovations; and ensuring good governance to build trust and confidence for innovation to flourish. These principles resonate with the Central Bank's approach of supporting innovation in the financial sector.

As mentioned in our response to Q2 and Q3, there are cross-cutting issues that remain to be clarified to ensure that a human-centric approach to AI is followed, as well as appropriate governance that can lead to trustworthy AI, both of which can enable innovation.

The Central Bank has enhanced the functioning of our Innovation Hub which seeks to help innovators to gain a deeper understanding of our regulatory and supervisory expectations by sharing our perspective on innovation – including AI – within financial services including with our subject matter experts.

We are establishing an Innovation Sandbox Programme in Quarter 4, 2024. This new facility will be outcomes-focused, providing regulatory advice and support for participants while adopting a thematic approach in relation to innovative technology, including but not limited to AI. It aims to enhance and support innovative technology outcomes in line with the public interest, to facilitate the mutual understanding and development of new ventures, innovative business models, and new ways of serving customers and potentially expedite the deployment of substantially new technologies, new products, or new services across the ecosystem. We will consider AI solutions where these suit the thematic programme.

Annex – Cross-cutting issues that require further clarification to successfully implement and supervise the EU AI Act

There are several related cross-cutting issues that remain to be clarified by the Commission, EU AI Office, ESAs and domestic authorities/legislators. These relate to scope (application of the definition of AI system), implementation of explicit or implicit concepts under the AI Act (bias, explanations, fairness, robustness) and links with new EU/national regulation like the DORA framework and the Individual Accountability Framework (IAF). These are being shared with DETE to constructively engage with this consultation. These are based on a preliminary identification of potential issues, drawing on the Central Bank's initial assessment and interpretation of the AI Act as well as on relevant research.

Application of the Definition of 'AI System': The scope of the AI Act application in financial services hinges on this definition in Article 3 and recital 12, as it informs the application of the AI Act to high-risk use cases for both banking and insurance. The Commission per Article 96(1) (f) of the AI Act shall develop guidelines on the application of the definition of an "AI system". There is not yet a timeline for when these guidelines will be developed. They are crucial to help clearly delineate the scope of the AI Act for financial services providers and consumers.

AI Bias and Fairness:
- *AI bias* refers to AI systems that produce biased results that are systematic and consistent deviation of an algorithm's output from the true value or from what would be expected in the absence of bias. This can happen in the training data used initially, the algorithm, or the predictions the algorithm produces. **Article 10 (Data and data governance) covers data related bias explicitly.** There are requirements for risk management approaches/systems for high-risk use cases (Article 9, recital 65). The requirements of this and related articles mean – in theory – appropriate feedback loops to minimise biases once deployed.

- *Fairness* is related to bias in that one way it could be defined in general as the absence of bias/discrimination in AI systems. The AI Act has attempted to build-in *prospective fairness*

at data/modelling stage compared to *retrospective individual fairness* in EU non-discrimination law.[4]

However, despite the explicit objective of the AI Act to prevent discrimination, it does not provide a clear standard for determining when unequal treatment is illegal discrimination compared to traditional non-discrimination law. It remains to be seen how this will be implemented in practice, how expectations or relevant decisions by national and EU authorities, including courts, will be taken into account.[5]

Transparency, Explanations, and Interpretability:

These are a group of inter-related issues:

- *Transparency* in provision of information to users (Article 13, recital 171) means affected persons should have the right to obtain an explanation when *a decision is based mainly on the output from certain high-risk systems* and *significantly affects their health, safety or fundamental rights*.

- *Explanations* are the degree to which a system or a set of governance practices and tools support a person's ability to understand the rationale underlying the behaviour of the system. These are covered in Articles 13, 52 and recital 171 amongst others. Recital 171 deals with the *right to an explanation*. Having a right to an explanation implies for it be useful, it must be understandable or interpretable by its receiver.

- *Interpretability of an AI system is the ability for human to know how and why a model performed the way it did in a specific context*.[6] That is, the ability to understand the rationale behind its decision or behaviour, and therefore is related to explanations. While the AI Act does not set specific transparent-by-design models, mandatory use of interpretable AI or explanation tools, providers are free to do so.

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[4] See Colmenarejo et al. (2022), Fairness in Agreement With European Values: An Interdisciplinary Perspective on AI Regulation; Panguitti et al. (2023), The Role of Explainable AI in the Context of the EU AI Act.

[5] See EDPS (2023) for various perspectives across sectors and link between these topics, fundamental rights, and data protection. There are a range of perspectives about how this can be implemented in practice.

[6] As it relates to this submission, depending on the field (computer science, law, psychology), the term 'comprehensibility' or 'explainability' are often used interchangeably with interpretability. This is the reason why we have defined the terms we use in the main text of this submission.

Practical implementation of transparency, interpretability, and explainability will require an approach for implementing these related concepts. To note, there are <u>various policy proposals</u> that illustrate what such an approach could consist of. It is important to have consistent standards for similar contexts, particularly for high-risk use cases including those in financial services.

Robustness of AI systems, their security, and outsourced providers oversight:
Robustness means AI performs consistently through an operationally resilient life-cycle. There are requirements for appropriate cybersecurity measures and standards in place (Article 15 and recitals 76 and 77). These include mitigation of the specific ways that AI can be attacked that are different to standard cyber risk such as data, algorithm poisoning, adversarial input and privacy attacks. There are specific requirements for security and management of outsourcing risks including in Article 25 (Responsibilities along the AI value chain).

There are parallels with requirements under DORA, national authorities Operational Resilience Frameworks including oversight of outsourcing. It is unclear at present, where responsibility for oversight of third party providers to financial services firms falls between the AI Act and DORA, including in relation to the provision of critical services. Finally, there are links to the IAF via responsible persons for provision/deployment of AI along the AI value chain (Article 25, recital 66, 79).

While some of the work may be carried out at EU level, it is unclear at the stage what the Commission or other EU bodies (ESAs, ENISA etc.) will be taking forward and what will be left to Member States, and between Member States what will fall to central banks and regulatory authorities. Clarifying timelines and allocation of responsibilities would be a productive step for the AI Board and Commission to take in the near future.

Other issues
Timeline for the Guidelines from the Commission: Apart from issuing the Guidelines on the high-risk AI systems (within 18 months), the AI Act does not provide a timeline for the other six guidelines in Article 96. It would be useful to have the associated expected time frames for delivery of these. **In particular, on Prohibited AI Practices (Article 5),** it is unclear when the Commission's Guidelines can be expected, given the short period by when these requirements apply (February 2025).

Union Financial Services Law Relationship with AI Act: the term "Union financial services law" is mentioned multiple times in the AI Act. Earlier iterations of the AI Act proposal made specific references to the Capital Requirements Directive (CRD) but, with the exception of in recital 158, no references to specific pieces of Union financial services law are included in the published AI Act. Article 74(6) refers to "high-risk AI systems placed on the market, put into service, or used by financial institutions regulated by Union financial services law" but the scope of the application of this term is unclear. The Commission per Article 96(1) (e) are to provide guidelines to explain the relationship between the AI Act and relevant Union law, including as regards consistency in their enforcement. It is unclear whether this will include details of what is meant by the term "Union financial services law" and if so it would be useful to have a timeline from the Commission on the delivery of these guidelines.

AI literacy requirements (Article 4): these requirements apply by February 2025 for providers and deployers of AI systems. It is not clear what sufficient level of AI literacy means in practice or how that would be reasonably demonstrated.