Next Move:
Regulatory and policy developments in tech

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1. Making AI ethical and responsible

The issue

Artificial intelligence (AI) is already being used to create better products, remarkable efficiency, and superior customer experiences. Part of its power comes from machines' ability to quickly learn patterns in business from massive data sets. For example, an AI deployed for recruiting, trained to learn from past hiring patterns, can quickly screen thousands of resumes to find candidates similar to those successfully hired in the past.

But those learned patterns may reflect natural human faults and biases, which automated decision systems can replicate or even amplify. In industries or at companies where diversity has been lacking, AI can, with great efficiency, perpetuate the pernicious cycle of human bias and make it difficult for new voices and types of candidates to break through.

The regulators' take

Regulatory activity has picked up since 2017 to create guardrails around AI practices. Both business leaders and policymakers are beginning to understand the array of risks and unintended consequences. Is AI making accurate, bias-aware decisions? Is it violating anyone's privacy? How can you govern and monitor this powerful technology?

Regulatory and policy developments are moving at different speeds depending on jurisdiction and specificity. Two recent developments relate to automated decision tools. Two others cover more sweeping developments — the first (almost) global agreement on the ethics of AI and the European Union (EU) AI Act.

- **Automated hiring tools.** On November 10, the New York City Council voted to enact a law that would ban the use of AI in recruiting, unless the software vendor undergoes a yearly independent audit to check for gender or race bias. The legislation, pending the signature of Mayor Bill de Blasio, would mandate companies to disclose to applicants that they are being screened via machine and give candidates an alternate method if requested. The measure aims to shine a light into the complex algorithms that rank the skills and personalities of job applicants based on how they speak or write.

- **Automated decision systems in public contracting.** California's AB 13 Automated Decision Systems Accountability Act, if passed, encourages transparency in the state agencies' procurement and contracting for goods and services that include the use, licensing, or development of an automated decision system. For example, a prospective contractor is to submit an impact assessment report on steps it has taken to conduct testing to assess (1) any risks posed to the privacy or security of personal information and (2) any risks that may result in inaccurate, unfair, biased, or discriminatory decisions impacting natural persons.

- **Global agreement on the ethics of AI.** On November 25, 193 nations adopted a UNESCO global agreement, the most comprehensive global agreement on the ethics of artificial intelligence. It includes an explicit ban on the use of AI systems for social scoring and mass surveillance. Notably, the United States was not a signatory given the withdrawal from UNESCO in 2019.

- **EU AI Act.** The EU has also undertaken a sweeping regulatory framework proposal, launched in April, in an effort to hold the use of AI to "EU values and fundamental rights." The 108-page document provides a taxonomy that classifies the use of AI into four levels of risk — unacceptable, high, minimal or low. Degrees of regulation would follow within this risk-based approach, which would apply not only to European companies but also to companies located outside the region that provide the software within the EU. The proposed risk mitigation measures include extensive testing, documentation and reporting for higher risk AI activities, and no regulation for lower-risk activities such as spam blockers and video games. The details of this Act are being hotly debated in the EU.

Your next move

The message coming from regulators, globally, is clear: Rules will be put in place to counter AI's risks, and companies will need to get ready.

- **Take stock**. Company leaders can take a look around to see what AI and advanced analytics are already running. Many executives are truly unaware of the use and development of AI across various functions, whether it be supplied by vendors or homegrown. Stock taking should include an understanding of the data collection, sourcing and processing that are used for creating AI models, as well as what oversight mechanisms are currently engaged.

- **Reflect on alignment of uses to company values.** A company-wide inventory of the uses of AI will help leadership ascertain if the use cases align with company values and if they are in the path of imminent policy. In some cases, existing laws can provide clear guardrails, such as employment law on potential discrimination. But within the rules, there is room for discernment. Concepts such as fairness, sustainability and bias can be subjective, human constructs. Many issues will need to be considered within the context of a company's own ideals, values, and unique view on risk.

- **Monitor developments**. Company leaders should watch the policy and regulatory space to understand the specific activities identified as risky where regulation is likely to develop. Company leaders should also monitor whether there is anything within the company's tech stack or values or strategy that could be on a collision course with coming regulation. It could even mean that executives should join the conversation, providing policymakers with input on how the rules will impact them.

- **Prepare to comply.** More immediately, the New York City law, if it comes into effect as planned in 2023, will mean any company that targets New York City residents for recruitment will need to get systems in compliance. This includes not only checking that any software vendor used to screen applicants undertake yearly audits, but also considering how to accommodate applicants who ask to have an alternate resume review. The same will be true for any company doing business in the European Union once the EU AI Act is implemented.

For more on how to evaluate your existing practices or prepare for future regulation, please see PwC's responsible AI perspectives.

2. Stablecoins: preventing a weak link from emerging in the financial system

The issue

Stablecoins which are pegged to fiat currency such as the dollar are a new asset class in the banking system, with the potential to create frictionless, low-cost transactions. An estimated $130 billion of stablecoins is currently in circulation, and they're tradeable into traditional currencies and other digital assets.

Stablecoins are not governed by the same rules as traditional currency. So a pressing question for regulators today is this: Could stablecoin assets be a weak link that can threaten the safety and soundness of the financial system?

For example, regulators and law enforcement are concerned about the adequacy of dollar reserves and the liquidity of other assets that a stablecoin issuer depends on to cover coins in circulation. The potential for a "run" on stablecoins could create a liquidity crisis if assets are not collateralized. To guard against that risk, notably, both the Commodities Futures Trading Commission and the New York Attorney General have issued penalties.

The regulators' take

To mitigate risks, expect two paths — proposed new laws and stronger enforcement of existing rules.

Proposed legislation covering stablecoin issuers as banks. The President's Working Group on Financial Markets suggested that Congress enact legislation requiring that stablecoin issuers become insured depository institutions in a November 1 report. This would subject them to a bank-like regulatory regime that includes capital and liquidity requirements, examination by federal banking regulators, and a suite of risk management and consumer protection requirements. It would also require that they are insured by the Federal Deposit Insurance Corporation (FDIC), providing a government backstop in the event of a crisis.

The report recommends two additional pieces of legislation. One would create risk management standards for custodial wallets and other third parties. The other would require that stablecoin issuers limit their affiliation with commercial entities.

Members of Congress and regulators have begun to act following the report. Senator Sherrod Brown (D-OH) recently sent letters to large stablecoin issuers asking about their operations, risks and controls. FDIC Chair Jelena McWilliams recently explained that the agency is exploring how it can apply its existing deposit insurance framework to different stablecoin arrangements. She acknowledged that figuring out the best path forward for regulating these arrangements will be an interagency effort.

Designating some stablecoin-related activities as systemically important. In the absence of Congressional action, the report calls for the Financial Stability Oversight Council (FSOC) to consider designating certain stablecoin-related activities as systemically important, which would subject them to enhanced risk management standards and additional oversight.

Your next move

It could take years for stablecoin legislation to get through Congress — if it ever does. Those who issue, manage or transact in stablecoins should not expect immediate legislation reclassifying these entities as banks.

But all participants in this market — including issuers, trading platforms and banks that hold reserves — should consider the following.

Familiarize yourself with the existing regulatory toolkit. The absence of immediate legislation does not mean that scrutiny will not increase. Regulators will likely use existing rules and authorities to mitigate risks that concern them. For example, the federal banking regulators have authority to examine banks that hold stablecoin issuers' fiat currency reserves. Also, most stablecoin issuers are already subject to anti-money laundering requirements due to their FinCEN registration and are supervised as money transmitters or trust companies by state banking authorities. These states have significant licensing, enforcement and regulatory authority over stablecoin issuers — and for those supervised by New York State, that includes the DFS specific cybersecurity and AML regulations.

Consider pursuing a bank charter. Certain larger issuers have already announced their intention to pursue a bank charter that would allow them to offer a broader range of products and services, and qualify them for streamlined oversight instead of the 50-state licensing requirements for payments institutions.

Adopt best practices in areas attracting heightened scrutiny. All parties that participate in this market should familiarize themselves with the evolving patchwork of regulatory expectations. Developing best practices around liquidity management, AML, cybersecurity and consumer protection can position them well for the inevitable additional scrutiny.

Additional information

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