

# AI IN FINANCIAL SERVICES



# ARTIFICIAL INTELLIGENCE IN UK FINANCIAL SERVICES: A REGULATORY MAP AND PRACTICAL CONSIDERATIONS

## EXECUTIVE SUMMARY

The FCA, PRA, Bank of England, HM Treasury and Parliament have each engaged with artificial intelligence in financial services over the past 18 months. The resulting outputs range from supervisory statements with immediate practical consequences, to Parliamentary inquiries and reports that apply pressure without creating binding rules. This briefing draws that landscape together. Its purpose is practical: to explain why AI has recently been back in focus, what already applies to firms today, and where the material gaps and frictions remain for both solo and dual-regulated firms.

This article synthesises our ongoing engagement with regulators and industry roundtables on AI, and our advisory work supporting firms on the key gaps, tensions and emerging regulatory expectations. We would be pleased to discuss how these issues affect your organisation in practice.

### Why AI is in focus:

- AI has recently been prominent in regulatory and political debate following the Treasury Select Committee's inquiry into AI in financial services. That inquiry crystallised a tension that firms are already experiencing in practice: whether AI requires bespoke regulation, or whether the UK's existing regulatory framework, built around a principles-based architecture but anchored in specific regimes addressing conduct, model risk and operational resilience, already provides adequate coverage.
- **The regulators' position.** The regulators are aligned in their core message: they do not propose to introduce AI-specific rules for financial services. Instead, they consider that existing frameworks — including the Consumer Duty, the Senior Managers and Certification Regime (SMCR), SS1/23 on model risk management, the operational resilience regime and the outsourcing and third-party rules — already apply to AI use cases and are capable of capturing AI-related conduct and risk.
- **What is changing — and what is not?** While the regulatory architecture itself is not being rewritten, regulators have acknowledged that firms need greater clarity on how those existing rules apply in practice to AI, particularly more advanced and generative models. The FCA has therefore committed to producing best- and poor-practice guidance, rather than new rules, with further supervisory material expected through 2026.
- **The dual-regulated overlay.** Banks and other dual-regulated firms face the additional complexity of navigating two regulators whose coordination on AI is improving, but not yet fully aligned across supervision, model risk and operational resilience.
- **Where uncertainty remains for firms.** The UK's technology-neutral regime was not designed with generative AI in mind, and parts of its application remain untested. The most acute areas of uncertainty are:
  - Model risk: SS1/23 pre-dates widespread generative AI use and does not address all associated risks explicitly.
  - SMCR accountability: there is no prescribed Senior Manager responsibility for AI, leaving firms to determine governance and personal accountability.
  - Third-party concentration: reliance on a small number of cloud and AI providers continues to grow, but no Critical Third Parties have yet been designated.
- **The practical takeaway.** Firms should not wait for further clarification. Regulators expect AI to be governed now, under existing rules. In practice, this means mapping AI use cases against current regulatory obligations, assigning clear SMCR accountability, testing AI-related third-party dependencies, and documenting governance decisions so they can be evidenced to supervisors.

## 1 The Landscape at a Glance

Labour's election manifesto committed to binding regulation of the most powerful AI systems and to placing the AI Safety Institute on a statutory footing, but neither proposal has yet been implemented, and the July 2024 King's Speech did not include an AI Bill. It appears the UK Government's position remains that legislation should wait until the technology and regulatory framework are more mature, with the result that financial services firms continue to be governed by existing sector specific rules, rather than a cross economy AI regime. This regulatory posture sits alongside a pro innovation government narrative, with recent announcements emphasising the use of AI in payments and FinTech as a growth and competitiveness priority.

Five bodies have produced material relevant to AI in financial services in the past 18 months. Each operates under a different mandate, with different legal tools and different audiences. The table below maps them.

BODY	PRIMARY MANDATE RE: AI	KEY OUTPUTS	LEGAL FORCE
<b>FCA</b>	<ul style="list-style-type: none"> <li>Conduct supervision</li> <li>Consumer protection</li> <li>Market integrity</li> <li>Prudential supervision of solo-regulated firms</li> </ul>	<ul style="list-style-type: none"> <li>AI Update (Apr 2024)</li> <li>AI Lab (Oct 2024)</li> <li>FS25/5 confirming AI Live Testing (Sep 2025)</li> <li>Consolidated AI webpage (Sep 2025)</li> </ul>	No new AI rules. Existing rules apply (including Consumer Duty, SMCR). Guidance and good and bad practice guidance indicated for end of 2026, which may cover this.
<b>PRA</b>	<ul style="list-style-type: none"> <li>Prudential supervision of banks, building societies, and PRA-designated investment firms</li> <li>Safety and soundness</li> </ul>	<ul style="list-style-type: none"> <li>SS1/23 Model Risk Management (in force May 2024)</li> <li>CRO roundtables on AI/ML (Oct 2025)</li> <li>2025 Supervisory Priorities letters</li> </ul>	SS1/23 is live supervisory expectation with enforcement bite. No new AI-specific rules beyond existing framework.
<b>Bank of England (FPC)</b>	<ul style="list-style-type: none"> <li>Financial stability</li> <li>Macroprudential oversight</li> <li>Systemic risk identification</li> </ul>	<ul style="list-style-type: none"> <li>Financial Stability in Focus: AI (Apr 2025);</li> <li>FSR (Dec 2025);</li> <li>Joint FCA/BoE AI survey (Nov 2024)</li> </ul>	Analytical and advisory. No direct rule-making power. Shapes stress testing and future capital framework design.
<b>HM Treasury</b>	<ul style="list-style-type: none"> <li>Legislative framework</li> <li>Critical Third Party designation</li> <li>Cross-economy AI policy</li> </ul>	<ul style="list-style-type: none"> <li>FSMA 2023 (CTP powers)</li> <li>CTP rules published Nov 2024</li> <li>AI Champions appointed (2025)</li> </ul>	CTP regime is live, but no designations yet. HMT will not disclose firms under assessment.
<b>Parliament (Treasury Select Committee)</b>	<ul style="list-style-type: none"> <li>Scrutiny and political pressure</li> <li>Legislative recommendations</li> </ul>	<ul style="list-style-type: none"> <li>AI in Financial Services inquiry (Feb-Nov 2025);</li> <li>Report published 20 January 2026 concluding regulators are not doing enough</li> </ul>	No legislative force but has forced regulator responses. Specific end-2026 deadlines set for FCA and HM Treasury.

## 2 The FCA

The FCA's position has been consistent since its April 2024 AI Update: it will not introduce AI-specific rules but will rely on its existing regulatory toolkit. In its written evidence to the Treasury Select Committee, the FCA confirmed that "rather than bringing in additional regulations, we will rely on existing frameworks to support firms to safely and responsibly adopt AI."

The principal frameworks the FCA relies upon for AI oversight are:

- **Consumer Duty (PRIN 2A).** Where AI is used to design or distribute products, set prices, assess eligibility, detect fraud, manage servicing or generate customer communications, firms must ensure that customer outcomes have been considered. The FCA expects outcomes testing to extend to AI-driven decisions, including fair value assessments where AI influences pricing.
- **FCA Principles for Businesses.** Principle 2 (skill, care and diligence), Principle 3 (management and control), Principle 6 (treating customers fairly), Principle 11 (relations with regulators), and Principle 12 (Consumer Duty) in particular all apply to AI deployment. We note that the FCA has emphasised that Principle 6 obligations are not diminished by the use of algorithmic decision-making.
- **SMCR.** The FCA considers that AI accountability sits within the existing SMCR framework. For dual-regulated and enhanced firms, AI governance falls within the Chief Operations function (SMF24) and the Chief Risk function (SMF4). The FCA has confirmed thus far that there will be no dedicated Senior Manager Function for AI.
- **The FCA's 2025-2030 strategy.** The FCA has positioned itself as "increasingly tech-positive", and it is itself adopting AI: predictive AI in its Supervision Hub, an AI voice bot for consumer triage, and experimental use of LLMs for authorisations and supervision. The FCA's own adoption reinforces its expectation that firms embed explainability and governance into their AI practices.
- The [AI Lab](#), launched in October 2024, provides three engagement pathways: a supercharged sandbox for early-stage experimentation, AI Live Testing for supervised deployment, and AI Spotlight projects for practical insight into firm-level AI use.
- **Mills Review.** In January 2026, the FCA launched the Mills Review, examining the long-term impact of AI on retail financial services. The review will report to the FCA Board in summer 2026, with recommendations. Mills has emphasised that the review does not change the FCA's regulatory approach: it remains outcomes-based and technology-neutral. The review's engagement paper covers four themes and invited contributions by 24 February 2026.

## 3 The PRA and the Bank of England

- The PRA's primary tool for AI oversight is SS1/23, its [supervisory statement on model risk management \(MRM\)](#) principles for banks. SS1/23, effective from May 2024, applies to all PRA-regulated UK-incorporated banks, building societies and PRA-designated investment firms with internal model approval for regulatory capital. These include the UK's largest banks and building societies. The PRA has signalled that SS1/23's principles may be extended to a broader population of firms in due course.
- SS1/23 sets out five principles:
  - model identification and risk classification;
  - governance;
  - model development, implementation and use;
  - independent validation; and
  - model risk mitigants.

The PRA treats model risk as a distinct risk class. For AI and ML models, validation extends beyond accuracy metrics, to include testing for data transparency, bias and fairness.

- In October 2025, the PRA held two CRO roundtable sessions with 21 PRA-regulated firms on AI and ML in the context of SS1/23. The discussions focused on the adoption of AI/ML technologies and the practical challenges of implementing SS1/23 for these model types.
- **Financial Stability.** In April 2025, the Financial Policy Committee (FPC) published a dedicated [Financial Stability in Focus paper on AI in the financial system](#). The FPC identified the following principal channels of financial stability risk:
  - greater use of AI in core financial decision-making (credit underwriting, algorithmic trading, capital management);

- greater use of AI in financial markets;
- operational resilience risks arising from third-party concentration, particularly in cloud and AI infrastructure; and
- AI-related cyber threats.

the December 2025 [Financial Stability Report](#) noted that AI asset valuations remain "materially stretched" and flagged the increasing role of debt financing in AI infrastructure, which could transmit shocks to financial institutions with exposures.

- **Operational Resilience and Third Parties.** The PRA's operational resilience framework (PS6/21, SYSC 15A) requires firms to identify important business services, set impact tolerances and test for disruption scenarios. Where AI models or infrastructure are provided by external vendors, SS2/21 (outsourcing and third-party risk management) and SYSC 8 apply. The FPC has noted that growing reliance on a small number of AI and cloud providers may lead to these providers being designated as critical third parties. The Critical Third Parties Regime, established in January 2025, gives the FCA and the Bank of England new powers over non-financial firms providing critical services, but as at the date of this briefing, no designations have been made.
- **ICAAP.** The PRA has not issued specific guidance on capturing AI risk in the Internal Capital Adequacy Assessment Process (ICAAP). However, the logic of SS1/23 (model risk as a distinct risk class), combined with the PRA's expectation that firms capture all material risks in their capital assessment, strongly implies that firms deploying AI in core decision-making processes should consider whether AI-specific operational or model risk warrants capital consideration. This is an area where the PRA's expectations are likely to crystallise through supervisory dialogue rather than formal guidance.

#### 4 What Already Applies to Your Firm

In their formal response to the Treasury Select Committee's AI in Financial Services report, the FCA and HM Treasury reiterated that they intend to address AI risks primarily through existing frameworks, with further guidance rather than new AI specific rules expected.

Despite the absence of AI-specific legislation, a significant body of existing law and regulation applies to AI deployments today. The applicable framework differs materially depending on whether your firm is dual-regulated (PRA and FCA) or FCA-only.

OBLIGATION / FRAMEWORK	DUAL-REGULATED FIRMS (BANKS, BUILDING SOCIETIES, PRA-DESIGNATED INVESTMENT FIRMS)	FCA-REGULATED FIRMS (BROKERS, ASSET MANAGERS, INSURERS, PAYMENT FIRMS, CONSUMER CREDIT)
<b>Model Risk Management</b>	<ul style="list-style-type: none"> <li>• SS1/23 applies directly and is actively supervised by the PRA. Covers all internal models, including AI and ML systems used in or overlaid on capital models (IRB credit risk, market risk, counterparty credit).</li> <li>• Also expected to apply as best practice to non-capital AI models (fraud, AML screening, pricing).</li> <li>• Comprehensive model inventories, independent validation, explainability, and documented risk appetite required now.</li> </ul>	<ul style="list-style-type: none"> <li>• No direct FCA equivalent of SS1/23 exists.</li> <li>• The FCA has not published model risk management expectations for the firms it prudentially supervises.</li> <li>• However, FCA-regulated firms using AI in regulated activities are expected by the FCA to apply equivalent rigour under existing SYSC governance and risk management obligations.</li> <li>• The gap between the PRA's explicit standard and the FCA's implicit expectation is a live issue</li> </ul>
<b>Consumer Duty</b>	<ul style="list-style-type: none"> <li>• Applies to all retail-facing business.</li> <li>• Where AI is used in pricing, credit decisioning, product recommendations, or customer communications, the firm must be able to demonstrate it is acting to deliver good outcomes for retail customers.</li> <li>• Transparency and explainability requirements are particularly relevant to algorithmic decisions: can you explain to a</li> </ul>	<ul style="list-style-type: none"> <li>• Applies in the same way.</li> <li>• The FCA has indicated Consumer Duty is one of its primary tools for AI oversight in retail markets.</li> <li>• Firms using AI in customer-facing decisions should already have mapped their AI use cases against the Duty's four outcome areas.</li> </ul>

OBLIGATION / FRAMEWORK	DUAL-REGULATED FIRMS (BANKS, BUILDING SOCIETIES, PRA-DESIGNATED INVESTMENT FIRMS)	FCA-REGULATED FIRMS (BROKERS, ASSET MANAGERS, INSURERS, PAYMENT FIRMS, CONSUMER CREDIT)
	<p>customer why they were declined or priced at a particular rate?</p>	<ul style="list-style-type: none"> <li>The FCA has signalled that guidance on how Consumer Duty applies to specific AI use cases is coming, though no date has been given.</li> </ul>
<b>SMCR: Senior Manager accountability</b>	<ul style="list-style-type: none"> <li>Applies under both the PRA and FCA SMCR simultaneously.</li> <li>A senior manager whose area of responsibility covers AI deployments (whether the CRO, CTO, or another role) is potentially personally liable for failures in those deployments.</li> <li>Neither regulator has yet specified which Prescribed Responsibility or SMF role should formally own AI governance, though the PRA's CRO roundtables confirm it is discussing governance accountability with firms directly.</li> </ul>	<ul style="list-style-type: none"> <li>Applies under the FCA SMCR.</li> <li>The same accountability gap exists: no FCA guidance on which SMF holder should own AI governance or how liability is allocated when an AI system causes harm.</li> <li>It is expected that AI governance broadly falls within the Chief Operations function (SMF24) and/or the Chief Risk Function (SMF4).</li> <li>The Treasury Committee has recommended guidance by end-2026.</li> </ul>
<b>Operational Resilience</b>	<ul style="list-style-type: none"> <li>The PRA's operational resilience rules (in force from March 2022, with full impact tolerance compliance required from March 2025) require firms to map important business services and their underlying resources, including technology and third-party dependencies.</li> <li>AI systems and AI infrastructure providers that are critical to important business services must be within scope of impact tolerance setting and scenario testing.</li> <li>The CTP regime will add a further layer when designations are made.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA's parallel operational resilience framework applies on identical terms for FCA-regulated firms.</li> <li>AI dependencies within important business services must be mapped and tested.</li> <li>The AWS outage of October 2025 demonstrated this is not a theoretical concern.</li> </ul>
<b>ICAAP / Pillar 2 capital</b>	<ul style="list-style-type: none"> <li>No explicit PRA guidance yet on whether AI model risk or AI-related operational risk must be quantified and capitalised within the Internal Capital Adequacy Assessment Process (ICAAP).</li> <li>However, the trajectory from the PRA's October 2025 CRO roundtables, requiring firms to document risk appetite and model inventories for AI, is consistent with an expectation that ICAAP submissions will need to address AI risk.</li> <li>Firms should not wait for explicit guidance before building this into their ICAAP methodology.</li> </ul>	<ul style="list-style-type: none"> <li>FCA-regulated firms subject to ICAAP requirements (primarily IFPRU investment firms) face the same analytical question.</li> <li>The FCA has not published guidance on AI risk within ICAAP.</li> </ul>

## 5 What Should You Do Now

This is not intended to be an exhaustive compliance checklist, but a prioritised set of actions reflecting the most material gaps and live supervisory pressures identified above. We would be pleased to discuss the evolving regulatory landscape, our engagement with regulators on their expectations for AI governance, and how firms are embedding AI into day to day BAU controls, including our work with in house legal teams on the responsible use of AI in legal advice and in supporting front office decision making.

PRIORITY	ACTION	RELEVANT TO	TIMEFRAME
<b>High</b>	<p>Build or review your AI model inventory. It must cover all models, including AI and ML systems, vendor-supplied models, and foundation model deployments.</p> <ul style="list-style-type: none"> <li>For banks, this is a live SS1/23 obligation.</li> <li>For FCA-only firms, it is increasingly an implicit supervisory expectation.</li> </ul>	Dual-regulated and FCA-solo regulated firms	<b>Now</b>
<b>High</b>	<p>Document AI risk appetite before deployment, not after. The PRA's message from October 2025 is explicit: governance frameworks must address AI and ML risks with a stated appetite, not retrofitted justification.</p>	Dual-regulated (PRA requirement; FCA expectation)	<b>Now / before next AI deployment</b>
<b>High</b>	<p>Clarify SMCR accountability for AI. Identify which senior manager is responsible for AI governance in your firm and ensure this is reflected in their Statement of Responsibilities. Do not wait for regulatory guidance.</p>	Dual-regulated and FCA-solo regulated firms	<b>Now</b>
<b>Medium</b>	<p>Map AI and cloud provider dependencies within your important business service framework and test resilience. Treat this as a CTP pre-positioning exercise: designation, when it comes, will require this mapping to already exist.</p>	Dual-regulated and FCA solo regulated firms	<b>Before end-2026</b>
<b>Medium</b>	<p>Assess whether AI risk is adequately captured in your ICAAP. In the absence of explicit guidance, build your own framework for quantifying AI model risk and AI-related operational risk as Pillar 2 categories.</p>	Dual-regulated (ICAAP firms); IFPRU firms	<b>Next ICAAP cycle</b>
<b>Watch</b>	<ul style="list-style-type: none"> <li>FCA guidance on Consumer Duty and SMCR for AI (recommended by Treasury Committee by end-2026)</li> <li>FCA/PRA AI stress testing design</li> <li>HM Treasury CTP designations</li> <li>FCA good and poor practice report</li> </ul>	All firms	<b>Ongoing through 2026</b>

We advise in-house legal teams in the FS sector on AI usage and implementation, as well as the practical steps needed to embed emerging AI rules and guidance into day-to-day firm activity. Please contact us if you would like to discuss this further.



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