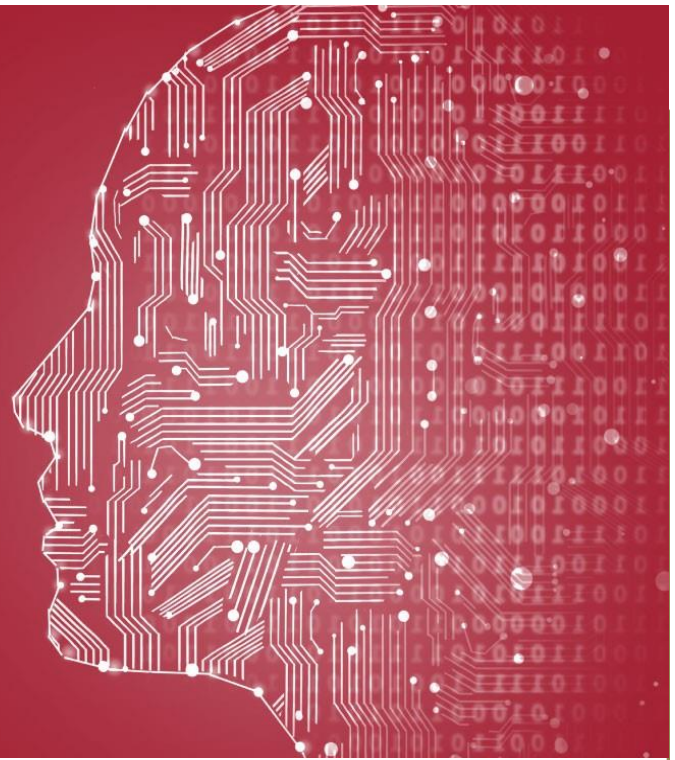# A Further Step Towards Innovation

THE FSC ISSUES NEW RULES ON ROBOTIC AND AI ENABLED ADVISORY SERVICES

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In line with the objective of positioning Mauritius as a reputable FinTech hub, the Ministry of Finance announced a proposed legislation for the establishment of "a regime for Robotics and Artificial Intelligence Enabled Financial Advisory Services."

Taking the cue in October 2020, the Financial Services Commission (the "**FSC**") issued a consultation paper (the "**Consultation Paper**") seeking views on the proposal to introduce a regulatory framework for services providers of Robotic and Artificial Intelligence Enabled Advisory Services.

Finally, in June 2021, the FSC issued the Financial Services (Robotic and Artificial Intelligence Enabled Advisory Services) Rules 2021 (the "**Rules**") to govern this innovative area of the financial services sector.

In this paper, we attempt to provide a brief summary of the Rules, by addressing its basis, the key points which it has laid out, and our analysis of these changes.

1 What has been the basis for the development of the Rules?

International Organization of Securities Commissions[1]

As mentioned in the Consultation Paper, IOSCO provided the basis which was used by the FSC to develop the Rules. The IOSCO released in 2020 a consultation report on the use of artificial intelligence and machine learning by market intermediaries and asset managers.[2]

The IOSCO report explains that market intermediaries in different jurisdictions mostly used Artificial Intelligence and Machine Learning in:

(a)   Advisory and support services;

(b)   Risk management;

(c)   Client identification and monitoring;

(d)   Selection of trading algorithm; and

(e)   Asset management/ Portfolio management.

The report also identified the need for regulators to adopt stringent measures to ensure that there was sufficient oversight in the use of these automated services, as well as consumer protection by ensuring that the operators of these systems have enough expertise and knowledge in the field.

2 Why were the Rules issued by the FSC?

The Consultation Paper mentions that technology enablers such as robotic and artificial intelligence are indeed transforming the financial advisory landscape worldwide. The prominence of client-facing tools is particularly expanding amongst the tech-savvy client segment, whereby financial advice is being provided in a more efficient and cost-effective manner.

The objective of the Rules is to provide a regulatory framework aimed at promoting the adoption of new and emerging technologies by licensed service providers in Mauritius.

3 What are Robotics and AI Enabled Advisory Services?

The Rules define 'Robotics and AI Enabled Advisory Services' as the provision of digital and personalised advisory services through a computer program and/or artificial intelligence enabled algorithms with limited human intervention.

More specifically, the 'advisory services' include discretionary and non-discretionary investment and portfolio management services provided by the licensee to its clients.

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[1] The International Organization of Securities Commissions (IOSCO) is an international body acts as the global standard setter for the securities sector by developing, implementing and promoting adherence to internationally recognized standards for securities regulation.
[2] The Consultation Report issued by the IOSCO in June 2020 is available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD658.pdf

4   What is the application process under the Rules?

Any person who provides financial advisory services with the use of computer programs and AI enabled algorithms which would fall under 'Robotics and AI Enabled Advisory Services' would be required to apply for a licence under the Rules.

An application for a License should made in accordance with Part IV of the Financial Services Act 2007 ("**FSA**").

In particular, application for a licence shall be made in such form and manner as may be specified by the FSC, and shall be accompanied by:

(a)   a business plan or feasibility study outlining the proposed business activity of the applicant;

(b)   particulars and information relating to customer due diligence of promoters, beneficial owners, controllers, and proposed directors in the form specified by FSC Rules;

(c)   such other information as may be specified in FSC Rules or otherwise required by the Commission to determine the application.

Moreover, the fees with regards to this license are as follows:

(a)   Application fee – MUR 20,000 (USD500)

(b)   Fixed annual fee – MUR 76,000 (USD1,900).

5   What are the main obligations of a licensee under the Rules?

5.1   General Obligations

A licensee must, inter alia,

(a)   have its principal bank account in Mauritius;

(b)   implement adequate internal controls, risk management, business continuity and disaster recovery plan;

(c)   be managed by a board of directors consisting of a minimum of three directors, one of whom shall be an independent director and a resident of Mauritius.

5.2   Minimum Capital Requirements

A licensee is required to keep a minimum unimpaired stated capital of MUR 600,000 or its equivalent in another currency.

5.3   Insurance Requirements

A licensee is required to have professional indemnity insurance to indemnify the company, employees and any person acting on its behalf, against liability for the sum of at least MUR 2 million or a higher amount.

5.4   Due Diligence Requirements

A licensee is required to conduct due diligence in line with the requirements under

(a)   Financial Intelligence and Anti-Money Laundering Act;

(b)   Financial Intelligence and Anti-Money Laundering Regulations 2018 or any similar Regulations made under the Financial Intelligence and Anti-Money Laundering Act; and

(c)   Financial Prohibitions against Listed Parties under the United Nations (Financial Prohibitions, Arms Embargo and Travel Ban) Sanctions Act.

5.5   Service Level Agreements ("**SLA**")

A licensee is required to enter into SLAs with its clients prior to providing any services which must contain:

(a)   any exclusivity agreements which may have been entered between the licensee and any particular services provider; and

(b)   any specific conditions or triggers which could resulting discontinuation of its services and possible use or replacement of human judgment.

5.6   Further onus on the Board of Directors

It is noteworthy that the Rules specify that the Board of the licensee must ensure that the licensee has adequate policies, processes, framework for designing, monitoring and testing algorithms through reviews.

Moreover, a licensee is not allowed to outsource key processes and management of their client-facing tools.

5.7   Record Keeping Obligations

In addition to section 29 of the FSA[3], a licensee should also maintain:

(a)   a copy of the advice provided to the client through the Robotic and Artificial Intelligence Enabled Advisory Services and the output of the investment;

(b)   information received from the client that was relied on to generate the advice; and

(c)   details of all algorithms and software used by the holder of a Robotic and Artificial Intelligence Enabled Advisory Services licence.

Also, independent evaluation reports of its algorithms and software systems must be submitted to FSC:

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[3] Section 29 of the FSA addresses the need for licensees to keep and maintain records of the identity of its customers, and a full and true written record of every transaction of analysis undertaken.

(a)   at least once every two years from the date of its licence; and

(b)   following any material changes, thereto.

5.8   <u>Transitional Provisions</u>

Any person who was carrying out Robotic and Artificial Intelligence Enabled Advisory Services before the commencement of the Rules should, <u>within 3 months</u> of the commencement of the Rules (i.e. 12 June 2021), apply for a licence.

6   How are other countries doing it?

In the UK, from a report published in 2019[4], it was noted that Machine Learning (which is defined as the development of models for prediction and pattern recognition from data, with limited human intervention) is most commonly used in anti-money laundering and fraud detection as well as in customer-facing applications (e.g. customer services and marketing). Some firms also use Machine Learning in areas such as credit risk management, trade pricing and execution, as well as general insurance pricing and underwriting.

Moreover, in the UK, the Financial Conduct Authority and the Bank of England have established an Artificial Intelligence Public-Private Forum[5] (AIPPF) to bring together stakeholders from governmental and non-governmental organisations to understand the impact and challenges in the use of Artificial Intelligence in the financial services sector.

It was identified, by the AIPPF, that transparency and the regulations surrounding data collection needed to remain stringent, as well as highlighting the importance of human oversight in checking for potential bias by the algorithms used.

7   Do the Rules provide an extensive enough regulatory framework for licensees?

It appears that the use of automated services providers in the financial services sector has increased over the years and the more so since the start of the Covid-19 pandemic. Therefore, the development of the Rules was undoubtedly necessary since this area requires a stricter regulatory framework and more oversight from regulators having the relevant expertise.

The same key words arise in the IOSCO Principles, the Consultation Paper and in the discussions of the AIPPF in the UK; transparency and a rigorous system of checks and balances are primordial in the development of AI enabled financial advisory services.

However, it still seems, from the Rules, that the proposed regime does not place that many additional restrictions on the services providers, which could therefore lead to

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[4] Research Note: Machine learning in UK financial services, FCA and BoE, October 2019, available at https://www.fca.org.uk/publication/research/research-note-on-machine-learning-in-uk-financial-services.pdf
[5] For additional information, more information on AIPPF is available at https://www.bankofengland.co.uk/events/2020/october/fintech-ai-public-private-forum

enforcement issues in the future, if this area keeps growing but the legislative framework lags behind.

It is often said that technology moves forward, and the law follows. While the Rules provide a step in the right direction, it would be beneficial, for the organic development of this area of financial services, that further guidance be provided by the FSC so as to supplement the Rules in the future.