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Artificial Intelligence in the Financial Sector – Interim Report for Public Comments

November 24, 2024

On November 5, an interim report on the use of artificial intelligence in the financial sector was published for public consultation. The report was the outcome of the collaborative efforts of an inter-ministerial team, which included representatives from the Ministry of Justice, Ministry of Finance, the Competition Authority, the Securities Authority, the Supervisor of Capital Markets, Insurance and Savings, and the Banking Supervision Department of the Bank of Israel.

The interim report provides an analysis of key issues associated with the use of AI, with a particular focus on its application in investment advisory services and portfolio management, credit in the banking industry, and insurance underwriting. A central theme in the report's recommendations is the preference for utilizing the existing regulatory powers of various authorities (including directives, opinions, and guidelines) to address the challenges posed by AI, rather than the making of amendments to existing legislation. Additionally, the recommendations emphasize the applicability of current legal frameworks to activities conducted using AI.

The interim report also addressed the following issues:

- **"Explainability Obligation":** Due to the complexity of AI systems, it can be difficult to explain how certain decisions are reached. The interim report

recommends not to impose a broad obligation to provide explanations for each decision. Instead, the report suggests that the focus should be on significant decisions affecting individuals or financial institutions (e.g., medium to high-risk decisions and decisions that negatively impact a client, such as the rejection of a credit application).

- **Human Involvement:** A common solution proposed to address the challenges of AI operations is for there to be human oversight and involvement in algorithmic decision-making. The interim report recommends that real-time human involvement (as opposed to post-factum review) be required only for critical decisions affecting individuals, provided that the technology significantly influences the decision. It also recommends considering the need for human involvement during appeal or review stages.
- **Notification and Disclosure:** The report recommends a requirement to provide notice of the use of AI systems, at least in the initial phase of technology implementation. Additionally, it recommends considering mandatory disclosure obligations regarding the characteristics of the AI system and its implications (e.g., the extent of AI involvement in decision-making, system limitations, existence of alternative services, etc.) within existing disclosure requirements.
- **Privacy and Personal Data Protection:**
 - **Re-identification of Data:** Privacy laws apply to identifiable personal data or data that can be identified with reasonable effort. The development of AI systems has enhanced re-identification capabilities of previously anonymous data, posing significant risks to privacy and personal data protection. The report recommends that financial regulators require supervised entities to conduct risk assessments concerning the re-identification of personal data and implement information security measures for "anonymous" data as well (personal data that has been rendered anonymous by removing identifiable elements).
 - **Inferred Data:** AI systems significantly enhance the ability to infer new information about individuals based on existing data, including predictions about future behavior (inferred data). The interim report assumes that outputs from AI systems related to or targeting a specific individual, including inferred data, are considered personal information under current privacy laws and are protected accordingly. **The report seeks public input on whether it is appropriate to apply specific obligations or rights concerning inferred data, such as establishing a right to reasonable inference in contexts characterized by heightened duties of good faith and fairness (e.g., in the financial services sector).**
- **Discrimination:** Decision-making through AI systems increases the risk of discrimination, partly due to the use of biased data attributes (e.g., nationality,

ethnicity, race, etc.) or "proxy" data correlated with biased attributes. Due to concerns about hidden and unconscious discrimination, the report recommends that supervised entities be required to implement measures to identify and prevent discrimination. **Additionally, the report seeks public feedback on the application of the U.S. "disparate impact" doctrine, which assesses the existence of discrimination based on whether the outcome results in prohibited discrimination against protected groups.**

- **Liability:** The report recommends maintaining the established principle that legal liability lies with the supervised entity, without deviating from rules that impose specific liability on executives and other officials within the financial institution under certain circumstances. It also proposes to generally prohibit financial institutions from disclaiming or limiting their liability for services provided to clients via AI systems or shifting that liability to another party.
- **Competition:** The report recommends that the competition authority consider concerns about market power or competitive barriers resulting from AI in the context of merger reviews. **It also proposes permitting financial entities access to data from credit information databases or data that can be made accessible under the open banking reform. The Bank of Israel opposes this recommendation.**

Comments on the interim report can be submitted by no later than December 15, 2024. If any of you wish to submit comments, we would be happy to assist you.

For the Report (Hebrew), click [here](#).

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