AI Act impact for Insurers

7 August 2024

The European Union's Artificial Intelligence Act (**AI Act**) entered into force on 1 August 2024 and will become effective in phases over the next 24 to 36 months. As has been widely reported, it will have an enormous impact on a whole range of sectors, but arguably few more so than the insurance sector.

In this article, we have considered how the AI Act will impact insurers and what needs to be done now to prepare for gradual implementation.

What's special about insurers?

To compete successfully, insurers are constantly innovating and tailoring product offerings in response to customer needs and behaviours. A recent EIOPA report[1] indicated that 50% of non-life and 24% of life insurers who responded to an EU market wide survey, use some form of AI in their business. A look at many insurers' public statements on their use of AI would tend to suggest that those percentages may be understated. Even if they are not, those figures will have increased in the last few months and will continue to increase significantly as months and years pass.

The Central Bank of Ireland (**CBI**) is monitoring insurers' (and other financial institutions') approaches to the use of AI. In its recently published draft Guidance on Securing Customers' Interests[2], it has made it clear that it will intervene where firms seek to unfairly exploit or take advantage of consumer behaviours, habits, preferences, or biases to benefit the firm in a way that causes customer detriment. This separate regulatory dimension to the need to mitigate AI-related risks gives increased impetus to insurers' planning for AI Act compliance.

What's new?

In our December 2023 update, we highlighted some key insurer-related dimensions of the then proposed AI Act. Very little (beyond minor drafting corrections) has changed since, beyond the timelines for its application now being set in stone.

Insurers carrying out "high risk" AI activities

Life and health insurers are called out in the AI Act as potentially in-scope for wide ranging technical and governance measures in how they carry out those activities. High risk activities include the use of AI systems intended to be used for risk assessment and pricing in relation to natural persons in the case of life and health insurance. However, in light of Ireland's community rated[3] domestic health insurance market, it seems more likely that only life insurers will have obligations in this particular context.

Where an insurer is engaging in a high risk AI activity, it will be required to comply with a wide range of technical and governance measures. An insurer's obligations can stem from it being treated as:

a) a provider of AI (i.e. where it develops a piece of AI software internally)

b) as a deployer of AI (where it uses an externally developed AI system for business functions, which is more typically the case)

High risk AI systems will be subject to strict requirements before being deployed on the market. These will include:

- ensuring adequate risk assessment and mitigation systems are in place
- ensuring that activity is logged to ensure traceability of results
- ensuring detailed documentation is available providing all necessary information on the system and its purpose to enable relevant supervisory authorities to assess its compliance
- building in appropriate human oversight measures to minimise risk
- ensuring a high level of robustness, security and accuracy.

Certain of these requirements overlap heavily with existing and anticipated consumer protection requirements; for example the anticipated digitalisation-related requirements of the revised Consumer Protection Code and related Standards. Insurers may consider progressing steps for compliance with both, in tandem.

The European Commission is also due to release further guidance on high risk AI systems by 2 February 2026, including a list of examples of uses that are high risk and those which are not.

Insurers using high risk AI systems will be required to implement a robust risk management framework; or more likely, adapt their existing risk management frameworks to ensure full compliance. This will involve risk assessments both before and after the AI system is put into use and will include a risk assessment of the system's potential impact on the health, safety and fundamental rights of any person impacted by the system. Insurers will have to document any risk management measures taken in relation to high risk AI systems to reduce any risks identified.

Human oversight measures are also a key focus of the AI Act in relation to high risk AI systems. Insurers that deploy a high risk AI system must ensure that a natural person can appropriately monitor the system and be capable of identifying and addressing any dysfunctions that arise. Aside from AI Act consequences (see below) of failing to do this, Solvency II (oversight, governance and risk) and separate consumer-related breaches may occur where this does not happen. This particular obligation may therefore be a focus of the CBI.

Where any person is affected by a decision of a high risk AI system, that person has a right to have a "clear and meaningful" explanation of the role of the AI system in the making of that decision. As a result, insurers will need to ensure that their use of AI systems is carefully logged.

Of broader application: General purpose AI

There will also be obligations stemming from the use of general-purpose AI (**GPAI**). GPAI is AI that can be used in and adapted to a wide range of applications, and which can handle many different tasks (for

example, image and speech recognition, audio and video generation, question answering and many others). Examples of GPAI that may be used by many insurers include dialogue generation for virtual assistants (i.e. chatbots), pricing (through analysing historical data) and marketing / sales content generation.

GPAI will be regulated on a two-tier system – low impact and high impact. For low impact GPAI models, various transparency requirements will apply, including drawing up technical documentation, complying with EU copyright law and disseminating detailed summaries about the content used for training. For high impact GPAI models (which involve extremely high levels of computing power with the potential to cause systemic risk), more onerous obligations will apply, including model evaluations, assessment and mitigation measures, adversarial testing requirements and cybersecurity protections / reports.

In each case, an insurer deploying GPAI must inform any users of the GPAI system that they are engaging with an AI system and must ensure that staff interacting with the system must have sufficient literacy and training. These customer communication and staff competency obligations are unsurprising and as a theme will resonate with most insurers.

AI Act penalties

The AI Act provides for the potential of significant fines where in-scope businesses fall short. The precise circumstances in which fines will be imposed will be set out in national implementing legislation. For now, the following broad principles are set out in the AI Act:

- non-compliance with the provisions of the AI Act prohibiting practices with unacceptable risk may result in fines of up to €35m, or 7% of the worldwide annual turnover of the preceding financial year, whichever is higher

- non-compliance with additional obligations (including obligations relating to the use of high risk AI systems) may be subject to fines of up to €15m, or 3% of the worldwide annual turnover for the preceding financial year, whichever is higher

As already highlighted, where an insurer breaches the AI Act, it is likely that it will also breach other existing financial services-related regulation and bring itself in scope for CBI sanction as a result.

AI Act Timeline

The AI Act will become applicable on a phased basis:

- uses of AI with unacceptable risk will be prohibited from **2 February 2025** (this includes the use of AI for purposes of social scoring or exploiting people's vulnerabilities)
- the provisions relating to GPAI and provisions in relation to the responsibilities of national competent authorities, as well as the provisions relating to penalties, apply from **2 August 2025**
- the provisions relating to high risk AI systems apply from **2 August 2027**

While the AI Act has direct effect as an EU regulation, it also requires individual member states to legislate for supervision and enforcement of the AI Act at a national level. These measures will include the selection of a national competent authority to ensure compliance with the AI Act.

Next Steps for Insurers

Insurers have many significant regulation-driven projects underway and pending (DORA, CPC, IAF and climate-risk related projects, to name a few). The AI Act must now feature too.

We suggest that the following are some key steps that insurers can take now to prepare for the gradual application of their obligations under the AI Act over the next three years:

- Identify and review all uses of AI within the business to map them against the risk categories set out in the AI Act; in particular identifying any "high risk" AI activities. In this regard, insurers should note that the definition of an AI system in the AI Act is extremely broad and will include many systems that are used to interpret data.
- Life and (if applicable – see our comments above on this) health insurers should, in particular, establish if they are engaging in any high risk AI activities and ensure that appropriate risk monitoring is in place (including human oversight of the relevant AI systems).
- Establish an AI governance framework including policies in relation to the acceptable use of AI, the development of AI tools, and the assessment and approval of any external AI tools for use within the business.

For a more detailed breakdown of the provisions of the AI Act, please see the detailed guide to the AI Act prepared by our Technology group who are experts in all aspects of AI regulation.

For advice on any aspect of this article, please contact Laura Mulleady, Partner, Sinéad Lynch, Partner, Niall Guinan, Associate or any member of ALG's Insurance & Reinsurance team.

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[1] *EIOPA-BoS-24/139 - Report on the Digitalisation of the European Insurance Sector – 30 April 2024*

[2] *Published in March 2024*

[3] *Everyone pays the same premium for a particular level of health insurance coverage, regardless of individual factors like age, health or gender.*