POSITION PAPER

DATE: 13 September 2024
SUBJECT: AI IN THE DUTCH PENSION SECTOR

How the Dutch pension sector works at controlled and responsible use of AI

The Dutch pension sector recognizes the great potential of artificial intelligence (AI) for improving service provision in the interest of pension fund members and beneficiaries through efficient pension administration, a personal pension and sustainable returns. We foresee an acceleration in technical development. As the Dutch pension sector, we are developing and applying AI. At the same time, we are aware of the risks of using AI are proponents of using AI in a controlled and responsible manner.

PRINCIPLES FOR THE APPLICATION OF AI

For a controlled and responsible use of AI, it is important to see the application of AI as a means to an end, not an end in itself. Pension providers are fully committed to and involved in developing internal codes of conduct in which the application of AI is embedded in strategic goals, the risk framework and ethical framework. Codes of conduct of pension providers are based on the (draft) Dutch pension sector code of conduct for the ethical application of AI, as well as guidelines by the Dutch Central Bank (DNB).

DNB has established principles for applying AI in the financial sector: soundness, responsibility, accountability, fairness, ethics, skills and transparency (SAFEST). Furthermore, DNB has published an AI risk framework that looks at input risks, throughput risks, output risks and overarching risks. These guidelines provide a good basis for developing codes of conduct. Some important elements are:

- Providing transparency to the user about the application of AI is important because the difference between human action and autonomous actions by AI systems is decreasing.
- In the context of fairness, AI should not inadvertently disadvantage certain groups of people.
- It is necessary to develop board level expertise to oversee the introduction of AI applications.

THE PENSION SECTOR AND THE AI ACT

The AI Act provides a good basis for developing codes of conduct for the application of AI. It is positive that applications with 'unacceptable' and 'high' risk are defined and come with specific provisions. We appreciate the risk-based approach that is taken in the AI Act.

The AI Act does not contain high-risk applications that are specific to the pension sector. In the Dutch pension system, risk-assessments and pricing for pension providers toward (prospective) members and beneficiaries is regulated by law. Price discrimination towards individual members or beneficiaries or subgroups is unlawful under Dutch pension law. Therefore, the risks in the

application of AI models for risk assessment and pricing by insurers and credit rating assessments by banks do not apply to pension providers. Pension providers must of course nevertheless assess and mitigate the risks of their AI applications.

The AI Act's gives freedom to sectors to establish guidelines for the responsible application of AI. This stakeholder-driven approach is important given the diversity within the financial sector. We note that because of divergent labor, social and tax law, the pension sector is very much organized at the national level. National pension sector codes of conduct contribute to controlled and responsible use of AI in pension provision.

The Dutch Federation of Pension Funds has prepared a draft *Code of Conduct on AI and Ethics for the Pension Sector*. The code of conduct does not only look at technology, but it also links to the governance of AI applications and the organization culture in which AI applications are used. The code of conduct was drafted in a technology-neutral manner and is principle-based. It outlines WHAT pension providers should do, but does not prescribe HOW they should implement the principles.

The guideline formulates 21 principles for the ethical use of AI. They are in line with the European High-Level Group on AI's [Ethics Guidelines for Trustworthy AI](#) as well as DNB guidelines. Some important elements are:

- For risk-based application of AI, the pension fund should make a conscious choice regarding the identified risks and measures compared to the application of more traditional technologies.
- Proportionality is applied to risk management. The assessment of potential impacts of AI should be seen as proportional to the level of risk of the AI systems.
- Auditability of AI systems contributes to reliability and members' and beneficiaries' trust. External accountability must be ensured in AI applications that affect fundamental rights.
- In the context of transparency and explainability, pension funds only use AI applications for which they can provide an adequate explanation of the operation (throughput) and outcomes (output) of the AI system.
- Oversight of AI applications can be exercised through governance mechanisms, such a human-in-the-loop, human-on-the-loop or human-in-command approach.
- Pension funds have a dedicated data environment. Pension funds have access to special categories of personal data. Usage must be in accordance with the GDPR and the [Guidelines for Personal Data Processing](#) by the Dutch Federation of Pension Funds.

THE APPLICATION OF AI IN THE DUTCH PENSION SECTOR

Various Dutch pension providers are developing codes of conduct for a controlled and responsible application of AI. In general, it can be said that the pension sector is not a frontrunner when it comes to developing AI applications. Applications in use mostly apply traditional AI, while applications using Generative AI to analyze unstructured data such as video and audio are mostly still under development.

AI is used foremost in the field of pension administration, where there are applications in communication with members and beneficiaries, contact with employers that are enrolled in the pension scheme, and in administrative processes.

AI applications in communication help to make pension communication easier to understand, by providing answers to basic questions in the language of choice and personalized to the level of understanding of the member or beneficiary. When it comes to choices and choice guidance within the pension scheme, a human takes over.

There are potential benefits for AI in pension administration. First, automation and optimization of administrative processes lead to operational excellence. Second, advanced data analysis improves data quality and operational risk monitoring more broadly. Third, more advanced insights from available data can help foster more proactive actions, for example to make sure employers enroll their employees in the pension fund and pay pension premiums on time.

The above AI functions are very similar to functions in others sectors within and beyond the financial sector. For the most part, pension providers observe AI developments elsewhere and use them as building blocks to deploy their own AI applications, only developing internally what is needed to complete a functionality.

In asset management, AI applications are being developed to process large amounts of data to produce insights relevant for investment decisions. Generative AI introduces the possibility to learn from unstructured data. Results include insights into risks, returns and ESG impact of investments. It is relevant to note that such systems are not fully autonomous and humans will still make the investment decisions.

With regards to algorithmic trading, the introduction of AI makes risk identification, monitoring and control of model drift and data drift are extra important. Asset managers test models extensively and build in controls to act upon potential drift. Of course, algorithmic trading is already regulated under MiFID2.

LOOKING AHEAD AT POSSIBLE FURTER EUROPEAN INITIATIVES ON AI IN THE FINANCIAL SECTOR

On the basis of our experience with the responsible and controlled application of AI in pension provision, we provide the following points of interest for possible further European initiative on the application of AI in the financial sector:

- A principle-based, risk-based and stakeholder-driven approach with attention to proportionality is the best way to get to effective controls that are relevant for pension provision.
- AI applications in the pension sector predominantly pertain to functions similar to those of other sectors, such as contact with members, beneficiaries and employers, and automation of administrative processes. Any legislative initiative on the application of AI in the financial sector should focus on sector-specific functions, such as individual risk assessment, pricing and asset management.
- In recent years, EU financial regulation has often taken a horizontal approach. In this case, the same framework applies to globally systemic banks as a single-sponsor pension fund with a few thousand participants. With such an approach it is difficult to sufficiently pay attention to proportionality and the specificities of pension provision. We warn against the introduction of controls and governance requirements for the entire financial sector that are only relevant for a subsection of the sector. Obligations should be tailored to pension providers as much as possible in order to ensure that additional regulatory burdens are commensurate to the real risk of the use of AI systems by pension providers.