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LMA Position on the IOSCO Consultation Report on Artificial Intelligence in Capital Markets: Use Cases, Risks, and Challenges

On behalf of the Loan Market Association (the **LMA**), we welcome the opportunity to respond to the International Organization of Securities Commissions (**IOSCO**) consultation report into AI in Capital Markets. IOSCO's engagement with industry in beginning to form its views into the use of AI is both well-timed and balanced.

As transformative as AI is, it introduces both opportunities and risks that need to be considered to enable its successful deployments in financial markets. At the LMA, we are uniquely placed to scan these risks and opportunities for the loan markets across Europe, the Middle East and Africa (**EMEA**). Our high-level observations are set out below. We stand ready to offer further contributions to IOSCO but we wanted to provide our initial high-level views at this stage.

- **A nuanced approach is required to AI:** There are various forms of AI technologies, some based on more simplistic algorithms which are already being deployed across the sector and which, in our view, do not pose systemic risks given the closed and non-generative nature of these AI technologies. New and emerging forms of AI will bring new potential use cases, and with these new opportunities and risks. As such, a nuanced approach is required when looking at the opportunities, risks and challenges associated with AI and this approach will also need to take into account jurisdictional differences.

- **AI has already made significant inroads into loan operations:** This is the case particularly in areas such as fraud detection, regulatory compliance, and customer service. These applications illustrate AI's ability to consume vast quantities of data and in some cases, such as in pattern detection, these technologies can be used to identify patterns at speeds far beyond human capacity. There are clear benefits to the utilisation of AI in loan operations, including cost savings, process enhancement, consistency of understanding and reduction of risk.

- **AI as a tool for research and diligence**: AI has the potential to assist with research and diligence in the loan markets. AI allows for quicker assessments and diligence, which can help supplement human processes in loan markets. While machine learning models can flag potential breaches or risks, lender oversight and legal expertise remain critical in assessing more complex structures, reducing concentration risk and ensuring that AI is deployed correctly.

- **The integrity of data is key**: The integrity of data lies at the heart of AI's effectiveness and is necessarily a key risk in its deployment. Inaccurate or deliberately manipulated data can undermine AI outputs, impacting decisions across interconnected systems. The risk of

hallucinations—when AI generates inaccurate or misleading results due to deficient training data, incorrect assumptions, bias or general lack of real-world knowledge – is another key risk to be considered in deploying AI technologies.

- **Availability and structure of data:** While AI can already assist with predictive modelling, the effectiveness of AI tools depends on the availability of sufficient data. The private nature of loan markets and confidentiality provisions may therefore limit AI's use cases in loan markets. Furthermore, from an operational perspective, the multitude of unstructured data across the loan market has historically made technological interoperability problematic. Successfully integrating AI with existing systems will require market participants to overcome this challenge. Ethical issues also come into focus with the use of AI - while open-source AI can democratise access and drive innovation, it also increases exposure to potential risks of misuse.

- **Quality of data:** In addition to the availability of data, the quality of data also impacts on the ability to deploy AI solutions in the loan markets. By way of example, valuations as they stand today often lack standardised, high-frequency data, making it difficult to deploy AI models to provide fully automated assessments. In these types of scenarios, AI is currently more effective when used alongside traditional models rather than as a standalone solution.

- **Data security:** Balancing openness with data security is an ongoing challenge for both the financial and tech industries. Addressing these vulnerabilities requires robust data governance and frameworks that ensure transparency and accountability wherever AI is deployed. Nonetheless, AI offers exciting opportunities for positive disruption across our market.

The LMA is working with members to understand the long-term impacts of AI and we would welcome the opportunity to discuss with you and provide a further update of our future work to ensure the loan market is well considered in the process of furthering your work in AI in capital markets. The LMA would equally be pleased to provide additional information on the loan market's views following the closure of this consultation.

We would like to be further involved in any follow up processes IOSCO take forward. We therefore request that you keep Hannah Vanstone of the LMA updated (hannah.vanstone@lma.eu.com) of any opportunities for further engagement.

Yours faithfully

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About us: The LMA was established in 1996 and is headquartered in London. Our key objective is improving liquidity, efficiency and transparency for the loan markets in EMEA. By establishing sound, widely accepted market practice, we seek to promote loans as one of the key debt products available to borrowers across the region. Our membership has grown steadily and currently stands at over 880 organisations covering 69 jurisdictions, and comprising commercial and investment banks, institutional investors, law firms, service providers, rating agencies and regulatory and governmental bodies. The LMA's overall mission is to act as the authoritative voice of the EMEA loan markets vis à vis lenders, borrowers, regulators and other members of the loan ecosystem.