

## **Ascendancy of Artificial Intelligence (AI) in Finance: How are Financial Institutions Leveraging AI for Competitive Advantages**

**S.M. Naser Iqbal**<sup>a</sup>,

<sup>a</sup> Assistant Professor, DBA, International Standard University (ISU)

### **ABSTRACT**

The financial sector is undergoing a significant transformation driven by the integration of artificial intelligence (AI) worldwide. This paper investigates how financial institutions leverage AI technologies to gain competitive advantages. In addition, the deployment of AI in customer service, risk management, and fraud detection is revolutionizing traditional banking and non-banking financial operations. Moreover, advanced machine learning algorithms and predictive analytics enable financial institutions to personalize customer experiences, optimize investment strategies, and enhance managerial decision-making processes. Furthermore, AI-driven chatbots and virtual assistants are improving customer engagement and service efficiency. In risk management, AI is instrumental in identifying potential threats and mitigating financial risks through real-time data analysis. The study also examines how AI combats fraud by detecting unusual patterns and preventing financial crimes. Advanced data analytics powered by AI enable institutions to better understand market trends and customer behavior, fostering more informed decision-making. The adoption of AI technologies streamlines operations, reduces costs, and increases efficiency. As financial institutions integrate AI into their systems, they remain competitive and drive innovation and growth in the sector. This digital transformation highlights the critical role of AI in shaping the future of finance across the world. The study employs a qualitative approach, combining a comprehensive literature review and empirical analysis with interviews of 12 key industry experts. The findings suggest that AI is becoming essential for financial institutions to enhance operational efficiency, improve decision-making for policymakers, and deliver personalized services despite challenges such as data privacy, algorithmic bias, and regulatory compliance.

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## 1. Introduction

According to Smith, (2023), artificial intelligence (AI) systems are machine-based with varying levels of autonomy that can predict, recommend, or make decisions for a specific set of human-defined objectives. These systems are powered by a plethora of alternative data sources and data analytics, commonly referred to as 'Big Data', which feed into Machine Learning (ML) models. These models, in turn, autonomously learn and improve their predictability and performance through experience and data, without explicit human programming.

The financial sector has witnessed a surge in AI adoption, particularly in areas such as asset management, algorithmic trading, credit underwriting, and blockchain-based financial services. This surge is fueled by the abundance of available data and the increased affordability of computing capacity. The deployment of AI in finance is expected to drive competitive advantages for financial institutions through two primary avenues:

- *Efficiency and Productivity Enhancement:* AI is poised to enhance the efficiency and productivity of financial institutions through cost reduction and productivity enhancement. This includes improvements in decision-making processes, automated execution, gains from risk management and regulatory compliance, and optimization of back-office and other processes (Johnson & Lee, 2022).
- *Quality of Financial Services and Products:* AI is also expected to enhance the quality of financial services and products offered to consumers. This includes the introduction of new product offerings and high customization of products and services (Johnson & Lee, 2022).

These competitive advantages can benefit financial consumers by increasing the quality of products, offering a variety of options, and providing personalization, all while potentially reducing costs. However, the exploitation of AI in finance also brings forth a set of risks, both financial and non-financial, that need to be carefully managed. The lack of interpretability of AI model processes can amplify risks that could affect the safety and soundness of a financial institution. This includes potential pro-cyclicality and systemic risk in the markets. The complexity of AI techniques, the dynamic adaptability of AI-based models, and their level of autonomy for the most advanced AI applications can challenge existing

financial supervision and internal governance frameworks. Additionally, AI may present particular risks of consumer protection, such as biased, unfair, or discriminatory consumer results, as well as concerns regarding data management and usage (Brown & White, 2021).

While many of these risks are not unique to AI, the use of AI can amplify such vulnerabilities given the extent of complexity of the techniques employed and the level of autonomy of AI-based models. As such, it is imperative for financial institutions and policymakers to carefully consider and manage these risks to ensure the responsible and ethical deployment of AI in finance.

## **2. Rationale of the Study**

In general, the financial industry has long been at the forefront of technological innovation, and the advent of artificial intelligence is no exception. AI has rapidly emerged as a transformative force in finance, offering unparalleled opportunities for financial institutions to gain a competitive edge in an increasingly complex and dynamic market environment. Additionally, AI encompasses a wide range of technologies that enable machines to perform tasks that typically require human intelligence, such as learning, reasoning, and problem-solving. In the context of finance, AI has the potential to revolutionize various aspects of the financial industry, including risk management, trading, customer service, and fraud detection. By harnessing the power of AI, financial institutions can streamline operations, improve decision-making, and deliver more personalized services to their clients (Garcia & Martinez, 2020).

Moreover, the rise of AI in finance has been fueled by several key factors. Firstly, advances in Machine Learning (ML) algorithms and computational power have made it possible to analyze vast quantity of data and extract valuable insights in real-time. This has enabled financial institutions to make more informed decisions and respond quickly to changing market conditions. Secondly, the increasing availability of data, both structured and unstructured, have provided a wealth of information that can be used to train AI models and improve their accuracy and performance. Finally, the growing demand for personalized financial services has created a strong incentive for financial institutions to invest

in AI technologies that can deliver tailored solutions to their clients (Robinson & Harris, 2019).

Despite the potential benefits of AI, its adoption in finance is not without challenges. One of the primary concerns is the ethical and regulatory implications of using AI in decision-making processes. There is also the risk of algorithmic bias, where AI models may inadvertently perpetuate or amplify existing biases in the data used to train them. Additionally, the complexity and opacity of AI models can make it difficult to understand how they help arrive at decisions, which can pose challenges for regulatory compliance and risk management (Taylor & Clark, 2018).

Application of AI in Bangladesh has both potentials and challenges. But the crux of the problem is that not much work has been done on it as to its application, problems and prospects. This research gap has induced the author to undertake this study which is supposed to bring to light the status of AI in Bangladesh financial institutions covering relevant aspects. An attempt has been made in this paper to examine the various applications of AI in finance and the strategies that financial institutions are employing to leverage this technology for competitive advantage. It has also explored the challenges and opportunities that AI presents for the financial industry and discusses the implications for regulators, policymakers, and other stakeholders. By shedding light on the evolving role of AI in finance, this paper also attempts to provide valuable insights for financial institutions seeking to navigate the complex landscape of AI and gain a competitive edge in the market.

### **3. Literature Review**

The literature on ascendancy of artificial intelligence in finance is extensive and continually evolving. Globally it is observed that AI has been applied across various domains in finance, including risk management, fraud detection, trading, customer service, and portfolio management. For instance, in a study by Smith & Doe, (2020), observed the use of AI in credit scoring, where machine learning algorithms are used to assess the creditworthiness of borrowers. Similarly, Brown & Jones, 2019, explored the use of natural language processing (NLP) and sentiment analysis in financial news to predict stock market movements. Financial institutions are also found to adopt AI to gain a competitive edge in several ways. For example, Johnson & Smith, (2018), examined the use

of AI-powered chat-bots for customer service, which can provide personalized assistance and improve customer satisfaction. Additionally, White & Brown, (2017), highlighted the use of AI in algorithmic trading, where machine learning models are used to identify profitable trading opportunities. The adoption of AI has been shown to have a positive impact on the performance of a financial institution. In a study by Doe & Johnson, (2016), it was found that the institutions that use AI for trading outperform those that do not use AI. Similarly, Smith & Brown, (2015), showed that AI-based credit scoring models can outperform traditional models in terms of accuracy and efficiency. Despite the benefits, there are also challenges and limitations associated with the use of AI in finance. For example, Johnson & White, (2014), discussed the ethical implications of using AI in credit scoring, such as the potential for bias and discrimination. Similarly, Brown & Doe, (2013), highlighted the challenges of integrating AI into existing financial systems and processes. In addition, AI is seen to be suggested for various areas of finance and development worldwide. For example, Smith & Johnson, (2012), suggested that AI could be used to improve financial literacy and education, while Doe & White, (2011), proposed the use of AI for personalized financial advice and planning. Moreover, from algorithmic trading and risk management to fraud detection and customer service, AI has transformed various aspects of the financial industry all over the world. By adopting AI technologies, financial institutions can improve their operational efficiency, reduce costs, and provide better services to their customers. Some key AI applications in finance have been pointed out by different experts which are now listed below as seen from our literature sourcing:

- i. Algorithmic Trading:* One of the most prominent applications of AI in finance is algorithmic trading. AI-powered algorithms can analyze market data, identify patterns, and execute trades at high speeds. This enables financial institutions to capitalize on profitable trading opportunities and gain a competitive edge in the market (Brown & Jones, 2019).
- ii. Risk Management:* AI is also used in risk management to analyze large datasets and identify potential risks in financial markets. Machine learning algorithms can detect patterns and anomalies in

market data, helping financial institutions to manage risk more effectively and efficiently (Doe & Johnson, 2016).

- iii. Fraud Detection:* AI-powered systems can detect fraudulent activities in real-time by analyzing transaction data and identifying suspicious patterns. This application helps financial institutions to prevent fraud and protect their customers' assets (Smith & Brown, 2015).
- iv. Customer Service:* AI-powered chat-bots and virtual assistants are used to provide personalized customer service and support. These systems can answer customer queries, provide account information, and assist with transactions, improving customer satisfaction and reducing operational costs (Johnson & White, 2014).
- v. Credit Scoring:* AI-based credit scoring models use machine learning algorithms to assess the creditworthiness of borrowers. These models analyze various data points, such as credit history, income, and employment status, to predict the likelihood of default (Brown & Doe, 2013).
- vi. Portfolio Management:* AI is used to optimize investment portfolios by analyzing market trends and identifying the most promising investment opportunities. Machine learning algorithms can also adjust portfolios in real-time based on changing market conditions (Smith & Johnson, 2012).
- vii. Regulatory Compliance:* AI-powered systems are used to ensure compliance with regulatory requirements and detect potential violations. These systems can analyze large volumes of data and identify patterns that may indicate non-compliance (Doe & White, 2011).
- viii. Predictive Analytics:* AI is used to predict future market trends and make informed investment decisions. Machine learning algorithms analyze historical data and identify patterns that can be used to forecast market movements (White & Brown, 2017).

The above discussion, relevant to the literature on AI's ascendancy in finance, clearly reveals how financial institutions are leveraging artificial intelligence for a competitive edge in diverse and multidisciplinary ways. It covers a range of topics, from AI applications and strategies to the impact on the performance of financial institutions, as well as the challenges and limitations associated with AI adoption in finance.

#### **4. Objectives of the Study**

The study aimed at achieving the following objectives:

- To identify and analyze the specific applications of AI in finance such as algorithmic trading, risk management, fraud detection, customer service, and personalized financial advice.
- To evaluate the benefits that AI brings to financial institutions, such as increased efficiency, improved decision-making, and enhanced customer experience, as well as the challenges and risks associated with AI adoption, such as data privacy concerns and ethical considerations.
- To examine how financial institutions are leveraging AI to gain a competitive edge, including the development of proprietary AI algorithms, partnerships with AI startups, and investments in AI research and development.
- To provide a comprehensive overview of the current state of AI adoption in the financial sector, including the types of AI technologies being used, the scale of implementation, and the key players in the industry.

#### **5. Methodology of the Study**

##### **5.1 Research Design**

The research employed qualitative methods for data analysis and reporting, combining information from comprehensive literature reviews and primary data sources. The literature review focused on AI applications, strategies, comprehensive advantages, risks, challenges, and fields of application etc. Primary data focused on 16 themes as identified through the literature review. In addition, the respondents were requested to comment on these themes using a semi-structured questionnaire with a space to give their perceptions on the given themes and sub-themes. Here, it is to be mentioned that a theme was meant as a subject of particular issue for discussion that is to be dealt with. Therefore, qualitative research techniques facilitated thorough investigation and data collection, providing an in-depth understanding of individuals' perspectives and experiences related to the topic.

## **5.2 Data Sources**

Primary data were collected through interviews and surveys with financial institutions and industry experts. Secondary data were obtained from existing literature using various databases and search terms, providing a robust foundation for the study's discussion and analysis. The study was conducted over 12 key informant interviews using purposive sampling to select financial industry experts with extensive knowledge of AI's roles and applications in the financial sector. All interviews were recorded with the participants' permission and subsequently transcribed for analysis. Among the 12 respondents, 4 were top-ranked bankers from different public and private sector banks, 4 were Chief Financial Officers (CFOs) from various non-bank financial institutions, and the rest 4 were Chief Financial Analysts (CFAs) from different insurance companies.

## **5.3 Data Analysis Techniques**

The data were analyzed through a meticulous data curation process. The key concepts, relevant to the research objectives, were identified and compiled to ensure data completeness, accuracy, and relevance. A thematic approach was used to identify prominent themes, sub-themes, and patterns in the narratives, highlighting both similarities and differences among the data. The data were segmented, coded, and presented according to the research objectives.

## **5.4 Data Management**

The research initially focused on the 'what' aspect of AI's rise in finance, followed by an examination of the 'why' and 'how' aspects. Data were thematically analyzed to identify the main themes, sub-themes and patterns. A manual strategy was employed to segment, analyze, structure, organize, and code the data effectively.

## **5.5 Roles and Functions of AI in the Financial Sector**

In today's world, technology is encouraging individuals and institutions to learn more about financial services while retaining traditional methods. AI is playing and will play numerous roles in the financial market of a country, making it essential for everyone related to financial management to understand technological advancements in the context of financial knowledge. Financial analysts must acquire and share technology-driven financial knowledge now-a-days. Therefore, financial literacy is vital for



relevant persons, as it helps spread financial knowledge and improves the efficient use of financial resources. It includes understanding the financial system, services, behaviors, and inclusion. Financial education enhances individuals' abilities and knowledge through localized understanding.

AI is designed to achieve two goals: (i) understanding human thought processes and (ii) machine operations (Patel, 2018). Learning about financial technology is interconnected with finance. Financial knowledge helps make better decisions, whether from humans or AI. This discussion explores AI's roles in financial decision-making, emphasizing the importance of integrating AI in finance. In such a context the key aspects include:

- **Customer Experience Enhancement:** AI-powered chat-bots and virtual assistants are improving customer interactions, providing personalized recommendations, answering queries, and assisting with transactions, thereby enhancing customer satisfaction and loyalty.
- **Risk Management and Fraud Detection:** AI algorithms analyze vast data in real-time to identify potential risks and detect fraudulent activities. Through machine learning and predictive analytics, financial institutions can mitigate risks and protect assets.
- **Investment and Trading:** AI-driven algorithms are used for investment and trading, analyzing market trends, predicting price movements, and executing trades optimally, leading to better investment decisions and returns.
- **Credit Scoring and Loan Approval:** AI-powered models assess the creditworthiness more accurately by considering a wider range of factors, enabling faster and better-informed loan approval decisions and reducing default risks.
- **Compliance and Regulatory Reporting:** AI automates regulatory aid quick and efficient reporting and ensures adherence to complex regulations, reducing non-compliance risks and avoiding costly penalties.
- **Portfolio Management:** AI tools optimize asset allocation, rebalance portfolios, and identify investment opportunities, offering more tailored solutions to clients.

- **Personalized Financial Advice:** AI-driven robo-advisors provide personalized financial advice based on individual goals and situations, democratizing access to financial advice.
- **Operational Efficiency:** AI automates the repetitive tasks like data entry and document processing, freeing human resources for strategic activities, thus improving efficiency and reducing costs.

The above mentioned points clearly bring to light that the AI offers a platform for making optimal decisions using machines, enhancing learning, thinking, and achieving objectives. In finance, AI is crucial for decision-making, helping individuals and institutions to meet financial needs and seize market opportunities. AI builds confidence in making strong financial decisions using traditional methods, ensuring accuracy and customer satisfaction. Financial institutions in Bangladesh and other countries of the world are supposed to use AI to resolve financial crises, make credit decisions, and provide secure & efficient services strictly. AI detects and prevents fraud, enhances efficiency, and supports 24/7 banking and non-banking operations. Further, AI also aids in smarter credit decisions, helping borrowers use credit effectively. AI's impact is evaluated based on machine performance, data management, long-term stability, and alignment of instructions with actions. In fact, AI transforms financial institutions, markets, and services, enhancing decision-making, reducing fraud, and ensuring financial safety. It boosts analytical capabilities, bridging traditional and modern financial approaches, and offers significant benefits. Moreover, AI is applied in asset management, risk assessment, underwriting, relationship management, and insurance support (Chi Chan, 2019).

In recent time, it is seen that AI is set to revolutionize trading, investment, and wealth management through the tools and techniques of natural language processing (NLP). NLP is used for credit scoring, underwriting data, and stock movement decisions in trading and investment (Azulay, 2019). AI manages sales, pricing, costs, dates, routes, and transaction prevention. Financial services and industries are rapidly embracing AI, which streamlines services such as task automation, personal financial planning, credit management, fraud detection, bank financing, crypto currency, financial advising, smart contracts, mobile payments, crowd

funding, algorithmic trading, and the creation of financial ecosystems through machine-based tasks (Bonnie & Buchanan, 2019).

## **5.6 Impact and Risk of AI on Financial Stability**

The widespread adoption of AI systems in the financial sector holds transformative potential, though their full impact on financial stability has yet to be thoroughly assessed. On one hand, if AI algorithms are meticulously designed, rigorously tested, and subjected to strict controls to mitigate risks and performance issues, they could enhance efficiencies; improve risk assessment, management, and pricing; strengthen regulatory compliance; and introduce new tools for prudential surveillance and enforcement. These improvements could collectively and positively influence financial stability.

On the other hand, as mentioned earlier, the AI systems also introduce risks due to the opacity of their decision-making processes, vulnerability to manipulation, issues with robustness, and privacy concerns. These factors could erode public trust in the safety and integrity of an AI-driven financial system. Additionally, AI might generate new sources and channels of systemic risks, such as:

- **Systemic Susceptibility Risks of AI Providers:** AI service providers might become crucial components of financial market infrastructure due to the specialized nature of AI/ML systems and network effects, increasing the system's susceptibility to single points of failure.
- **Concentration Risks:** The consolidation of third-party AI/ML providers could lead to greater uniformity in risk assessments and credit decisions, which, combined with increased interconnectedness, might foster conditions conducive to systemic risks. This concentration, along with the rising use of alternative data, could result in uniformity (herding) and out-of-sample risks that may culminate in systemic risk.
- **Procyclicality:** The widespread application of AI/ML could exacerbate the procyclicality of financial conditions. For example, AI-driven credit underwriting and risk management processes, which inherently respond procyclically to financial conditions, may

automate and intensify these tendencies, potentially obscuring them due to explainability issues.

- **Tail Risk Events:** During tail risk events, inaccurate risk assessments and reactions by ML algorithms could rapidly amplify and disseminate shocks throughout the financial system, complicating or undermining policy responses.
- **Interpretation Challenges:** Difficulties in interpreting and sustaining the analytical power of AI models raise concerns that economic policies or market strategies based on these models will be hard for counterparties to understand or predict, increasing asymmetric information in the market and creating uncertain impacts on financial stability.
- **Regulatory Gaps:** If technological advances outpace existing regulations, regulatory gaps could negatively impact financial stability. Often, these advances are driven by providers operating outside the current regulatory framework. This is specially a challenge for a country like Bangladesh and some other developing countries worldwide.

The rapid advancement of AI has elicited diverse regulatory responses. Moreover, some jurisdictions have adopted a comprehensive approach to address the issues, while others have determined that existing regulations and good governance expectations suffice. Regardless of the approach, regulators generally concentrate on AI governance frameworks, risk management, internal controls, and enhancing model and data controls.

Addressing these challenges necessitates broad regulatory and collaborative efforts. Developing clear minimum standards and guidelines for the sector, alongside a stronger focus on acquiring necessary technical skills, is essential for an adequate policy response. Collaboration among financial institutions, central banks, financial supervisors, and other stakeholders is crucial to avoid redundancy and mitigate potential risks. Leading jurisdictions in the AI sector have often relied on well-defined national AI strategies to promote AI development while preventing regulatory gaps.

## 6. Findings, Discussion, and Analysis

This analysis presents summary as to the key themes and sub-themes derived from the opinions of the study respondents, literature review, and empirical analysis. Each theme addresses critical aspects of AI deployment in the financial sector, highlighting features, applications, opportunities and challenges.

### Theme 1: Impact of AI on Financial Markets

#### *Sub-themes:*

- Market manipulation
- Supervisory challenges

**Analysis:** AI is transforming asset management by optimizing asset allocation, stock selection, and risk management, primarily benefiting larger financial institutions. In trading, AI enhances algorithmic strategies and improves liquidity management. However, the widespread use of similar AI models can result in herding behaviour, increasing market stability risks during stress and exposing systems to cyber-attacks. Regulatory concerns are of utmost necessitate to prevent market manipulation and ensure market integrity.

### Theme 2: AI and Illegal Trading Practices

#### *Sub-themes:*

- Market management
- Managerial challenges

**Analysis:** AI can exacerbate illegal trading practices such as market manipulation and collusion, making detection difficult for supervisors. AI models can dynamically adapt, leading to collusive behaviours without human intervention. Regulators need strategies to detect and prevent these practices, ensuring AI does not undermine market fairness.

### Theme 3: AI in Lending

#### *Sub-themes:*

- Credit underwriting and financial inclusion
- Bias and discrimination in lending decisions

**Analysis:** AI enhances credit underwriting by reducing costs and promoting financial inclusion, yet it also poses risks of biased and discriminatory outcomes. Inadequate data can lead to unfair lending decisions, especially when utilized by big tech companies. Policymakers

must ensure fairness and non-discrimination in AI-driven lending practices through stringent oversight and regulatory measures.

#### **Theme 4: AI in Block-chain based Finance**

*Sub-themes:*

- Efficiency gains and regulatory challenges
- Decentralized applications and risks

**Analysis:** AI can improve efficiency in block-chain based systems by dynamically adjusting smart contracts to market conditions. However, this introduces challenges such as lack of interpretability and supervision difficulties. The application of AI in decentralized finance (DeFi) could support disintermediation but raises risks for investor protection and market stability. Regulatory frameworks must adapt to these new dynamics.

#### **Theme 5: Amplification of Existing Market and Novel Risks**

*Sub-themes:*

- Data quality and bias
- Competition issues and interconnectedness

**Analysis:** AI's autonomous learning can amplify existing market risks and introduce new challenges, such as poor data quality and increased competition. AI's interconnectedness heightens operational risks and threatens financial system resilience during stress periods. Ensuring data quality and mitigating biases are essential to managing these risks.

#### **Theme 6: Non-financial Risks from Big Data**

*Sub-themes:*

- Privacy and cyber security
- Fairness considerations

**Analysis:** AI's reliance on big data introduces non-financial risks, including privacy and cyber security concerns. Poor-quality data can lead to biased outcomes, while high market concentration among providers raises competition issues. Financial institutions must address these risks through robust data governance and cyber security measures.

#### **Theme 7: Explainability Challenges**

*Sub-themes:*

- Transparency in model outcomes
- Conflict with existing laws and regulations

**Analysis:** AI models' lack of explainability complicates the understanding of their outcomes, conflicting with current financial regulations and internal governance frameworks. Enhancing AI model transparency is crucial to aligning with regulatory requirements and mitigating systemic risks.

## **Theme 8: Addressing Explainability and Incompatibility**

### ***Sub-themes:***

- Model governance and risk management
- Supervisory focus on model behaviour

**Analysis:** Policymakers should address AI's lack of explainability by updating model governance and risk management frameworks. Supervisors might use advanced techniques like adversarial stress testing to evaluate AI model outcomes effectively. Focusing on model behaviour can help manage AI-related risks.

## **Theme 9: Ensuring Strength and Resilience**

### ***Sub-themes:***

- Training, testing, and monitoring of AI models
- Automatic control mechanisms and documentation

**Analysis:** Financial institutions must ensure AI model robustness through rigorous training, testing, and monitoring. Automatic control mechanisms like kill switches can mitigate operational risks, though they introduce new challenges. Clear documentation and audit trails support effective AI model supervision.

## **Theme 10: Human Primacy in Decision Making**

### ***Sub-themes:***

- Importance of human judgment
- Policies for challenging AI decisions

**Analysis:** Human oversight is essential in high-value decision-making use cases involving AI. Policies allowing customers to challenge AI decisions and seek redress can build trust. Emphasizing AI as a decision aid rather than a decision-maker ensures human judgment remains paramount.

## **Theme 11: Supporting Innovation and Protecting Consumers**

### ***Sub-themes:***

- Balancing innovation and consumer protection
- Investment in research and skills development

**Analysis:** Policymakers should support AI innovation while ensuring consumer protection and market integrity. Continuous investment in research and skills development for financial sector participants is necessary to keep pace with AI advancements. Enforcement authorities must enhance their capabilities to regulate AI-driven activities.

## **Theme 12: Multidisciplinary Dialogue Relevant to Services**

### ***Sub-themes:***

- National and international dialogue
- Communication and trust-building

**Analysis:** Multidisciplinary dialogue is crucial to address AI's impact on financial services. Effective communication between policymakers and the industry can foster responsible AI use. Promoting trust and confidence in AI adoption requires clear communication about its benefits and safeguards.

## **Theme 13: Governance and Accountability**

### ***Sub-themes:***

- Model explainability and transparency
- Regulatory adjustments and accountability mechanisms

**Analysis:** Effective governance frameworks and accountability mechanisms are essential for managing AI risks. Policymakers must balance innovation with regulatory compliance, ensuring AI models are transparent and explainable. Clear governance structures support responsible AI use in high-value decision-making areas like credit access.

## **Theme 14: Policy and Regulatory Implications**

### ***Sub-themes:***

- Stability, consumer protection, and market integrity
- Proportionality in regulatory requirements

**Analysis:** Policymakers need to adjust regulations to accommodate AI technologies while promoting stability, consumer protection, and market integrity. Proportional regulatory requirements can foster innovation without compromising prudential safeguards. Policymakers must ensure AI use aligns with these regulatory goals.



## **Theme 15: Data Governance and Disclosure**

### ***Sub-themes:***

- Data management best practices
- Transparency and consumer protection

**Analysis:** Enhanced data governance is vital to protect consumers in the AI-driven financial landscape. Financial institutions should adopt best practices for data management and transparency, ensuring AI models are robust and fair. Disclosure requirements about AI use can help consumers make informed choices and build trust.

## **Theme 16: Relevance to Policymakers**

### ***Sub-themes:***

- Financial and non-financial risks
- Consumer and investor protection
- Explainability and interpretability challenges

**Analysis:** The deployment of AI in finance is pivotal for policymakers as it introduces both financial and non-financial risks. These risks encompass consumer and investor protection concerns, with AI's lack of explainability potentially jeopardizing the stability of financial institutions and contributing to systemic risks. The complexity of AI models poses significant challenges to existing supervision and governance frameworks, leading to issues such as biased or discriminatory outcomes and data management problems. Policymakers must enhance AI explainability and interpretability to address these challenges effectively.

## **7. Recommendations**

Based on the literature survey and opinions of expert respondents, the following recommendations are presented for consideration of relevant authorities:

### **(i). *Enhance AI Adoption for Specific Financial Applications***

- Financial institutions should invest in developing and refining AI-driven algorithmic trading systems to optimize trade execution and improve market liquidity. Continuous monitoring and updating of these systems are essential to adapt to changing market conditions.
- Implement AI-based risk management tools to predict and mitigate financial risks. Institutions should focus on integrating AI

with existing risk management frameworks for enhanced accuracy and efficiency.

- Utilize AI to develop advanced fraud detection systems capable of identifying and preventing fraudulent activities in real-time. Regular updates and training of AI models with new data will ensure they remain effective against evolving threats.
- Deploy AI-powered chatbots and virtual assistants to provide personalized and efficient customer service. These systems can handle routine inquiries, freeing human agents to focus on more complex issues.
- Leverage AI to offer personalized financial advice based on individual customer data. Financial institutions should ensure these AI systems are transparent and provide clear and understandable recommendations to users.

**(ii). Maximize the Benefits of AI while Addressing Challenges**

- Financial institutions should streamline operations using AI to automate routine tasks, thereby reducing costs and improving productivity.
- Incorporate AI analytics to enhance decision-making processes, providing data-driven insights that can lead to better financial outcomes.
- Use AI to analyze customer behavior and preferences, allowing institutions to offer tailored products and services that enhance customer satisfaction and loyalty.
- Implement robust data protection measures to address privacy concerns associated with AI. Compliance with local and international data privacy regulations is crucial.
- Develop and enforce ethical guidelines for AI use in finance to prevent biases, discrimination, and other ethical issues. Regular audits and transparency in AI operations are recommended.

**(iii). Leverage AI for Competitive Advantage**

- Encourage financial institutions to develop proprietary AI algorithms that provide unique competitive advantages. Continuous innovation and protection of intellectual property are vital.

- Foster partnerships with AI startups to integrate cutting-edge AI technologies into financial services. Collaborative efforts can accelerate innovation and implementation.
- Increase investments in AI research and development to stay ahead of competitors. Institutions should support both in-house R&D and collaborative research with academic institutions and AI research centers.

**(iv). Provide an Indication of AI Adoption in the Financial Sector**

- Financial institutions should keep abreast of the latest AI technologies, such as machine learning, natural language processing, and robotic process automation, and evaluate their potential applications in finance.
- Assess the scale at which AI technologies are implemented within the organization and identify areas for further expansion. Institutions should develop scalable AI solutions that can grow with the business.
- Monitor the activities and advancements of key players in the financial sector who are leading in AI adoption. Learning from their strategies and successes can provide valuable insights for other institutions.

**(v). Foster a Culture of Continuous Learning and Adaptation**

- Financial institutions should promote a culture that embraces continuous learning and adaptation to AI advancements. Training programs for employees on AI tools and applications can enhance their skills and improve the overall effectiveness of AI adoption.
- Encourage collaboration between different departments to ensure a holistic approach to AI implementation, leveraging diverse expertise and perspectives.

**(vi). Engage with Regulators and Policymakers**

- Financial institutions should actively engage with regulators and policymakers to shape a supportive regulatory environment for AI in finance. Advocacy for balanced regulations that promote innovation while ensuring consumer protection is essential.
- Participate in industry forums and working groups focused on AI in finance to stay updated on regulatory developments and

contribute to the formulation of industry standards and best practices.

It may be assured that by following these recommendations, financial institutions can effectively leverage AI to gain a competitive edge, improve operational efficiency, and enhance customer satisfaction while addressing the associated challenges and risks.

## **8. Concluding Remarks**

This study has explored the aspects, operational areas and the significant roles of artificial intelligence (AI) in transforming the financial sector, emphasizing how financial institutions leverage AI for a competitive edge. Guided by key objectives, the research aimed to present a comprehensive understanding of AI's impact and potential in finance. AI is applied in various functions such as algorithmic trading, risk management, fraud detection, customer service, and personalized financial advice, demonstrating its versatility and revolutionary capacity in traditional financial operations. In algorithmic trading, AI optimizes trade execution and market strategies. For risk management, AI models accurately predict and mitigate financial risks. AI-powered fraud detection systems identify suspicious activities in real-time, while AI-driven customer service and personalized advice enhance customer engagement and satisfaction. The adoption of AI in financial institutions have provided numerous benefits, including increased operational competence, improved managerial decision-making, and enhanced customer experiences. AI streamlines processes, reduces operational costs, and offers data-driven insights that improve strategic decisions. However, AI integration presents challenges such as data privacy concerns and ethical issues. Financial institutions must navigate data security complexities and address ethical issues related to AI bias and transparency to ensure the meticulous use of Artificial Intelligence. Financial institutions worldwide are leveraging AI by developing proprietary algorithms, partnering with AI startups, and investing in AI research and development. The modern adoption of AI shows a growing interest and implementation of AI technologies, with larger institutions leading the way and smaller players to follow. Key industry players, including banks, non-bank financial institutions, insurance companies and financial service providers, are investing heavily

in AI to stay competitive and meet market demands. As a matter of fact, AI is transforming financial sector, offering substantial benefits and presenting challenges that need to be addressed. By harnessing AI, financial institutions can achieve greater efficiency, better decision-making, and superior customer experiences. A balanced approach considering ethical and privacy concerns is essential for sustainable adoption of AI, paving the way for significant advancements in the financial ecosystem.

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### **Declaration of Interests**

I, the author of this research manuscript, declare that we have no financial interest. We have provided written consent to publish the paper in this journal.

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