Navigating the AI Revolution: Imperatives for Board Success in a Shifting Regulatory Landscape

An increasing number of boards are now identifying Artificial Intelligence (AI) and in particular, so-called generative AI as both a major opportunity and potential risk. The use of AI is already actively applied in boardrooms and corporate decision-making processes, such as enhancing M&A due diligence, profiling investors, auditing annual reports, validating new business opportunities, and analyzing and optimizing procurement, sales, and marketing. Rapid and widespread AI development has attracted billions of investment dollars. The opportunities are endless, but so is the potential for risk.

Boards bear legal and ethical responsibilities for the use of AI within their companies, impacting employees, customers, and shareholders including third-party products that may embed AI technologies including reputational, security, and financial risks. Another risk is that many companies already have traditional AI forms like machine learning, and generative AI running, formally or informally without directors' or even C-suite knowledge or oversight. The challenge lies in implementing effective strategies that not only leverage the benefits but also mitigate risks and align with upcoming regulatory challenges. Taking proactive steps now can set the stage for future AI adoption and the establishment of a robust framework for governing your investment in research and development.

The overwhelming majority of companies who have looked at how to address trust concerns with AI have published principles that have been externally marketed in a *"don't worry, we've got this covered"* brochure or web page. Principles are of zero value to stakeholders as they do not offer guidance as to what to do, or how to do it. Instead of merely stating broad principles, what's needed are concrete protocols or governance structures. These protocols should provide specific guidance on how to implement ethical AI practices and address trust concerns effectively. Protocols lead to pronouncements, which are specific decisions based on internal or external challenges. It is the corpus of decisions that evidence whether the governance is working. Failure to take proactive steps in implementing robust governance measures can result in reputational harm and a breakdown of customer trust, ultimately leading to significant consequences for the company.

Directors who don't actively learn and lead AI advancement and governance within their companies, risk losing control to shareholders and regulators. This can distract the company from the pursuit of its strategic goals and increase the likelihood of missed opportunities. It's crucial for directors to deepen their understanding of AI, including generative AI, to govern its use effectively within their organizations – and that includes both an impetus to innovate and use the technology as well as to manage its downsides. But how well-equipped are most board directors to tackle this challenge? If your directors were each asked to write a short definition of AI, how similar would they be – let alone to mention an accurate definition.

In its broadest sense, AI encompasses a wide array of advanced technologies seeking to replicate human-like intelligence. Generative AI, a subset of AI, specifically focuses on generating new content and handling various data synthesis tasks. Understanding the distinction between these categories is pivotal for directors to navigate AI governance successfully.

A key feature that sets AI apart from other technologies is its life cycle. Humans build AI systems, which then operate on their own. As these systems are deployed, they start a new cycle of use and application in different areas and essentially take over.

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While governing such a technology can seem overwhelming, especially for those not familiar with the technology, directors cannot afford to be complacent or leave this to management. The experience with equally complex governance-related issues, such as climate change, cybersecurity, and diversity, indicates a clear pattern where in the absence of leadership from corporate Canada, shareholders and regulators assume a more prominent role. We feel strongly that directors need to be on the front foot and provide leadership rather than waiting to respond to regulation after the fact or pressure from shareholders. Where possible the goal should be to provide the right amount of oversight and risk management, without adding more work and red tape as we saw with climate reporting. Boards should be proactive in creating and developing AI governance policies that seamlessly integrate with the company's environmental, social, and governance (ESG) strategy, enhancing accountability and ethical behaviour as both seek to address risk in the broadest sense and proactively approach its mitigation.

So far in the 2024 AGM season, we have observed that shareholders are slowly but steadily increasing demands for AI transparency and board accountability, with an immediate focus on the entertainment, tech, and financial sectors, such as Walt Disney, Apple, and others. We see this as a growing trend that cannot be ignored, similar to the early days of climate and diversity proposals. While Institutional Shareholder Services (ISS) and Glass Lewis (GL) lack specific guidelines related to AI, many investors have issued AI expectations for investees aligned with ESG criteria, such as HSBC, Fidelity International, Federated Hermes, Ethos, and others. For example, the largest sovereign wealth fund in the world, Norges Bank Investment Management (NBIM) considers key elements of responsible AI to include: i) board accountability, ii) transparency and explainability, and iii) robust risk management processes that look beyond traditional business risks and address privacy, security, non-discrimination, and human oversight and control.

For directors looking to kickstart responsible AI governance at their company, here are [5] key things you can do starting today:

a) AI Inventory:

Inventory is the # 1 priority that directors and accountable executives for AI need to get their heads around: first inventory, then opportunity. Regardless of whether a company is developing and training new AI models, using them in HR processes, or simply automating daily tasks, directors should consult experts working with AI technology, regulation, and governance to develop and implement foundational policies. All companies should compile and monitor a complete inventory of their models and how they are being used. Start with legal requirements, what's involved in managing risks, and how AI can be harnessed for strategic imperatives, and conduct regular inventory to have a timely and comprehensive oversight. The inventory should include information on ID, name, strategic goal alignment, cost per annum, value per annum, stage gate, accountable executive, project owner, and vendor/ internal procurement processes.

b) AI Strategic Integration:

AI governance is about corporate governance. It should be a part of the corporate strategy as it is commercially driven, builds transformative value, and should evolve beyond mere compliance. AI initiatives must align with the company's strategic goals and risk management protocols and the approach to oversight should be holistic; encompassing all levels of the organization, clarifying roles and responsibilities, and defining risk appetites. Key principles include transparency, accountability, security, and fairness. Leaders need to start with small-scale AI experiments and data-focused initiatives to make sure these efforts support the company's goals while not creating unnecessary risk. It's important to plan how to use AI in a way that's both ethical and clear to everyone, to keep up responsibility and trust with all stakeholders.

c) AI Continuous Education and AI On-Going Assessment

Recognizing AI's rapid and transformative potential, directors should cultivate a culture of continuous education to stay abreast of the latest developments, risks, and opportunities. Proactive learning initiatives will empower boards to make informed decisions and undertake a comprehensive assessment of how AI and generative AI are used within the company. This includes identifying AI applications, assessing their impacts on various facets of the business and procurement processes, and understanding the ethical considerations surrounding AI adoption. Privacy considerations must also be integrated into the ethical framework with a focus on protecting sensitive data and ensuring compliance with relevant regulations. It is imperative to undertake ongoing assessments to ensure that AI applications are used without discriminatory practices. Regular evaluations are necessary to identify and rectify biases that may emerge over time and safeguard the company's integrity. Without regular and ongoing assessments, directors risk overlooking critical aspects of AI integration and use and creating a reputational risk to the company.

d) Navigating current Regulatory Frameworks:

In Canada, several upcoming federal and provincial privacy law reforms will affect the use of AI in business operations. If passed, the proposed federal Bill C-27, also known as the *Digital Charter Implementation Act*, 2022, would include implementing Canada's first artificial intelligence legislation - the Artificial Intelligence and Data Act (AIDA) and could come into effect in 2025. Canada and the EU are beginning to work on implementing the EU-Canada Digital Partnership which will help address new challenges in digital transformation that impact research, industry, society, and the broader economy. The European Union Parliament recently approved the AI Act that will be implemented over the next few years, and in the U.S., President Biden introduced the Executive Order on Safe, Secure, and Trustworthy Artificial Intelligence last year. All these regulations will have an impact on Canadian companies, and both directors and C-suite executives should be familiar with the potential implications for their firms. The question to be asked is 'how we can use AI strategically to advance our priorities to create value for our company while in compliance with upcoming regulations'.

e) Guidelines for AI Accountability and Risk Level Oversight:

AI accountability and risk oversight should consist of several key components including; who is in charge of AI-related development, procurement and/or deployment, what are the risk management policies to be followed and how both process and outcomes should be disclosed. An effective approach to risk involves the development of guidelines that span ethical considerations (e.g. explainability, fairness and privacy) as well as traditional performance measures (e.g. accuracy, security and safety) and requirements for regulatory compliance. It is paramount to clearly define the board's responsibilities, the executive in charge, and to conduct periodic controls to reduce risks. Whether through centralized AI centers of excellence or decentralized business units, companies should establish risk management policies, principles, and protocols and at the same time endeavour to foster a culture of innovation and data-driven problem-solving. The potential for bureaucratic process to overwhelm the stimulus for innovation is a common theme, and it is generally agreed that AI governance requirements should distinguish use cases

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on the basis of impact, with a view to unfettering all but the higher impact cases. Reporting or disclosing the information to investors and stakeholders should be done in a transparent and timely manner as they need to be reassured that somebody is overseeing how this technology gets deployed both from a risk and data-driven problem–solving standpoint and from an innovation and opportunity standpoint.

Companies need to define AI risk level and what use cases can AI and generate AI be applied to and distinguish between high risk for high-impact cases and lower risk where impact is usually determined by whether something has a severe potential impact but the duration of the impact is of the reverse ability. The risk of AI tools not being error-free and potentially causing harm to companies is a valid concern. AI hallucinations, where AI systems generate inaccurate or nonexistent outputs, can indeed lead to misleading information and legal liabilities. As companies continue to automate their services and use generative AI, the boards will need to assess their legal and financial exposure and mitigate the risks.

Ultimately, managing AI is about choosing to lead rather than follow. Boards that don't actively embrace and lead with AI risk falling behind, facing problems with regulators and unhappy shareholders. Successfully integrating AI means completely rethinking how to add value and manage risks, not just fitting AI into existing strategies. It requires bold vision and action. Will boards guide their companies to growth and innovation, or will they be forced to catch up under pressure from outside forces?

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