AGENDA

From ‘Destroying Humanity’ to Product Obsolescence, AI Risks Rise for Boards

Risks stem from ethical to cybersecurity concerns

By Lindsay Frost | July 24, 2023

Companies are increasingly weighing the risks surrounding artificial intelligence, based on separate reviews of 10-Qs and 10-Ks by public company intelligence provider MyLogIQ and AlphaSense. Similarly, research company TipRanks recently noted a 646% increase in risk disclosures mentioning AI since 2018.

Such risks range from privacy concerns to intellectual property use to compliance and reputational issues, as well as the risk that AI could make a company’s product or services obsolete. And these risks are likely to evolve and become more severe as the adoption of generative and other forms of AI by businesses increases, sources told Agenda.

Companies including Electronic Arts, Meta Platforms, Doordash, Getty Images, Oracle, Rent the Runway, Salesforce and others have made AI-related risk factor disclosures this year.

For boards, it’s important to practice active oversight of AI risks, sources said. Although most (95%) of the 328 directors recently surveyed by the National Association of Corporate Directors said the increasing adoption of AI tools would impact their businesses, only 28% said AI is a regular discussion point in boardroom conversations. Experts told Agenda that the risks and opportunities associated with AI should start to become an ongoing conversation point in boardrooms.

“From a board standpoint, the risks can go from an administrative glitch to something reputational or fundamental to the company, depending on the outset of where, what and how AI is being used,” said Randy Wang, senior counsel at law firm Bryan Cave. “Everyone is trying to come to grips with what the implications are.”

Looking ahead, investors are beginning to push companies to address AI as well. Just this month, Arjuna Capital filed a shareholder proposal at Microsoft probing “the material risks of [the company’s] generative artificial intelligence technology facilitating misinformation and disinformation, as well as assessing the effectiveness of Microsoft's efforts to remediate those harms."

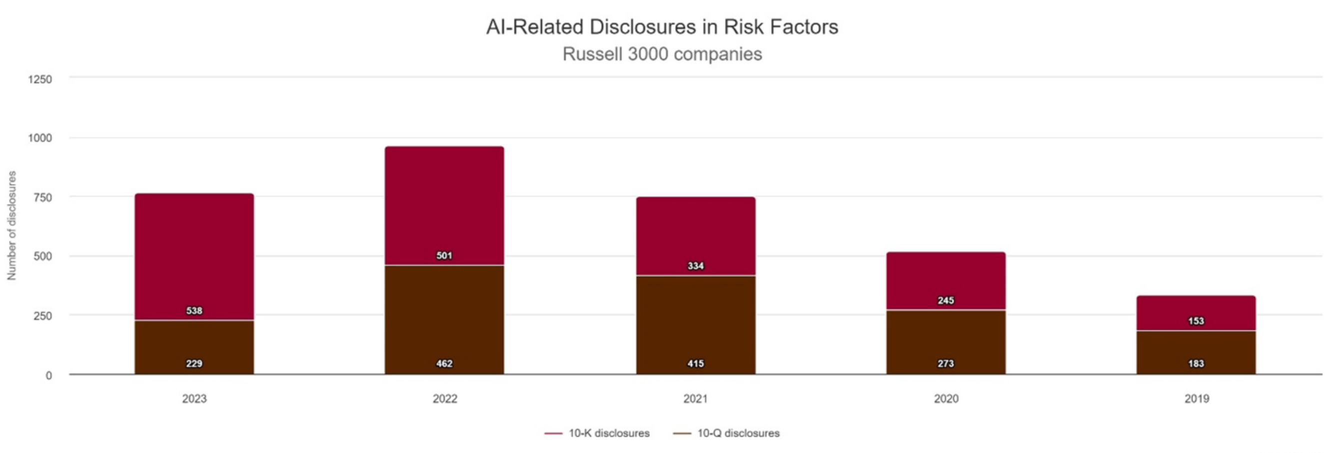
"The responsibility of the board is to be informed and identify areas of development and learning they need to get themselves or add through board persons or capabilities. And engage with management of active oversight of AI in the context of ERM and audit and assessment functions associated with that," said John Gilluly, partner and vice chair of the U.S. transactional practice at law firm DLA Piper.

"Of course, there's also a disclosure responsibility for public companies where they review the periodic reports, current reports and registration statements to ensure compliance securities laws on all material information, including AI if relevant."

'Destroying Humanity' and Other Risks

Between Jan. 1 and June 30 of this year, 541 public companies included AI or artificial intelligence in risk factors disclosed in 10-Qs and 10-Ks, according to AlphaSense, up from 392 over the same period last year and 278 companies in 2021.

Narrowing this down, 433 Russell 3000 companies made 767 such disclosures as of July 10, compared to the 377 companies that made some 963 disclosures for the full year in 2022, according to MyLogIQ. MyLogIQ tracked 312 companies making 749 disclosures in 2021.



"Boards are learning the right questions to ask and getting education on the scopes of the opportunity and risk. It's now recognized that AI presents as large an enterprise risk, and larger, than traditional categories like privacy and cybersecurity," said Danny Tobey, partner at DLA Piper. "AI has elements of those, frankly, and a whole laundry list of unique risks. We are going to see an increasing recognition by boards that leadership needs to have a plan to manage these risks."

Indeed, almost half (42%) of 119 CEOs surveyed at the Yale University CEO Summit last month said they fear AI could "destroy humanity" in five to 10 years, as reported by CNN Business.

The specific risks Gilluly saw disclosed in 10-Qs and 10-Ks span several distinctive categories: bias and discrimination, reputational harm, data limitations, unpredictable and autonomous decisions, lack of transparency, reliance on third parties for data and the complexity and R&D dollars involved in AI.

For example, Wang notes there is a strong focus on using AI for hiring, although the "risk of bias is pretty pronounced." Indeed, New York City recently passed a bill requiring that any use of AI in hiring be audited by a neutral third party the year before it is used.

Generative AI — which produces new content based on data models — in particular "is a newer field, and some of the big risks that have been shared, and very public examples you have to recognize, is that not everything they respond with is necessarily truthful," said Christine Livingston, managing director focusing on emerging technology innovation and the Internet of Things at Protiviti.

Getty Images, for one, disclosed in a risk factor in its March 14 10-K regarding the "legal, social and ethical issues" related to the use of AI, while Salesforce said the social and ethical issues related to using its own AI offerings "may result in reputational harm and liability," according to its March 8 10-K.

Oracle disclosed in its 10-K filed last month that if AI and machine learning "fail[s] to operate as anticipated or our other products do not perform as promised, our business and reputation may be harmed."

Dell noted in a risk factor filed in its March 30 10-K that "[t]he rapid evolution and increased adoption of artificial intelligence ("AI") technologies and our obligations to comply with emerging AI laws and regulations may require us to develop additional AI-specific governance programs."

So far, the risk disclosures are pronounced in certain industries, sources said. Indeed, more than half (53%) of the risk factor disclosures made so far this year came from technology and communications companies, according to MyLogIQ, while the second-largest segment of disclosures came from the financial industry.

It's important that boards discuss the risks and how their companies plan to mitigate them as a part of their overall risk oversight duties in addition to pressure testing the company's enterprise risk management, internal audit and control functions, Gilluly said.

Livingston said that for most companies, "governance and risk management doesn't account for generative AI, and they need to adapt frameworks and processes accordingly."

“Boards should all be setting up information reporting systems so they can be apprised of the risks and opportunities [from AI],” Wang said. “Just as boards need to be informed and have system monitoring with something like cybersecurity, it’s appropriate to do the same to the extent AI is material to them. They should be similarly looped in through reporting systems on what is going on with AI.”

For example, Tobey suggested that companies follow the National Institute of Standards and Technology’s artificial intelligence risk management framework, published in 2021.

“This was a wake-up call to leaders and directors because NIST came out and said, ‘This is an enterprise-level risk and key stakeholders include the boards and senior leadership,’” Tobey said. “And NIST referred to these risks as affecting the sustainability of the organizations, so I think the executive branch really set the bar high.”

It’s the board’s job to make sure management is up to speed on the issues, sources said. Some 10% of directors surveyed by the NACD said their management teams are very or extremely proficient on AI issues.

Opportunities

However, companies also need to consider the opportunities that AI can bring to businesses, sources said. Revenue growth, addressing talent and skill shortages as well as sustainability goals, cost savings, improvement in IT and better customer experiences are all ways companies are taking advantage of AI. Indeed, some 79% of 200 corporate strategy leaders surveyed by Gartner said AI and analytics are critical to business success.

As of 2022, 35% of more than 7,500 global businesses reported using AI in their business, according to IBM’s Global AI Adoption Index. Some 42% reported that they are exploring the use of AI.

For example, some companies in the biopharmaceutical industry are using AI for drug discovery and medicine development through expediting the review of scientific literature and identifying drug targets and potential clinical trials, Wang said. Automobile companies are also exploring vehicle automation technology, Wang added, while financial institutions are using AI to identify money laundering.

“My sense is that companies that are using AI are being prudent about how they use it,” Wang said. “AI for most companies is just one tool in the toolkit.”

Overall, boards need to understand that “you’re not going to be a data scientist, but you need to understand some fundamental concepts that dramatically change how you use and govern AI,” Livingston said.