AIFS0028

Written evidence submitted by UK Sustainable Investment and Finance Association (UKSIF)

About UKSIF and our membership

1.1 The UK Sustainable Investment and Finance Association (UKSIF) is the UK's leading membership organisation for sustainable finance, committed to promoting a financial system that works for the benefit of the environment, society, and us all. UKSIF represents a diverse range of financial services institutions and investors committed to these aims, and our more than 300 members, representing over £19trn of global assets under management (AUM), include investment managers, pension funds, banks, financial advisers, ESG data and research providers and NGOs, among other groups. For more details, please visit our website: uksif.org.

1.2 In our response to the Committee's call for evidence, we outline some of the main benefits, potential risks, and use-cases of artificial intelligence (AI), from our perspective, in relation to institutional investors' sustainable and responsible investing practices, drawing on perspectives from our investor members that are now increasingly considering AI's role within their investment decision-making, strategies, and the use of AI by their investee companies. While climate change risk has typically been a core topic of investor focus within sustainability, we are now seeing AI rise further up this agenda as part of investors' consideration and investment analysis of material ESG factors.[1]

How is AI currently used in different sectors of financial services and how is this likely to change over the next ten years?

2.1. Artificial intelligence (AI) is increasingly being adopted across different areas of the financial services and investment industries, including in regards to assessing material climate change and sustainability-related risks and opportunities. While AI continues to have considerable potential in driving benefits and sustainable economic growth globally and the UK, it also brings with it new risks and ethical dilemmas for companies and investors that increasingly need to be addressed and taken into account.

2.2 Long-term responsible investors are becoming more and more mindful of the risks arising from the improper use of AI and are regularly applying these considerations carefully across their investment portfolios to maximise value creation for their clients and beneficiaries. In terms of some of the use-cases among investors in regards specifically to sustainability issues, these include the following:

- Supporting traditional investment analysis and engagement by investors with their investee companies and assets. For example, with natural language processing helping firms more quickly process and analyse larger volumes of financial and non-financial information on companies such as their quarterly earnings results, annual reports, and other corporate reporting.
- Improving the consistency of ESG data to support more effective investment decision-making and other areas (e.g. risk management). For example, with AI algorithms having potential to help provide new, improved data sets on a company's environmental impacts and conduct, including in relation to their supply chain emissions. Data on biodiversity and nature could benefit in particular with this data less consistent generally compared with climate data for investors, e.g. opportunities

[1]Please note that UKSIF's response is informed by our membership, though this does not necessarily reflect the views and perspectives of our entire membership, either individually or collectively.

with new biodiversity data measuring corporates' impacts on deforestation through satellite imagery.

- Assisting in the development of new internal models to help predict and anticipate future climate risks and the assessment of climate impacts (e.g. extreme weather and natural disasters) on companies' assets and activities.
- Reducing the reporting burden posed by a range of regulatory and investment industry-wide reporting initiatives- e.g. the EU's Corporate Sustainability Reporting Directive (CSRD) and Task Force on Climate-related Financial Disclosures (TCFD)- in the process freeing up more resource on other activities supporting value creation.

2.3. These use-cases of AI, among others, could help enhance future profitability for investors and companies- if deployed appropriately- though they will also carry risks, especially should there be over-reliance on certain AI tools and techniques. With investors now considering the investment risks from AI to their portfolios and assets, they will generally be considering a range of risks and opportunities relating to the use of AI among their portfolio companies.

2.4 This can include from a climate and environmental perspective alongside a social lens as well. To support investors in addressing the range of risks, new industry-wide frameworks and guidelines are beginning to emerge, including: the CFA Institute's 'Ethics and Artificial Intelligence in Investment Management', the OECD's AI Principles, which were updated in 2024 to capture emerging risks introduced by generative tools such as ChatGPT and Gemini (formerly Google Bard), and the World Economic Forum's Responsible AI Playbook for Investors.[2]

2.5 Separately, we know that financial regulators (e.g. FRC, PRA, FRC) are increasingly using AI tools and models to inform the ways in which they regulate authorised financial services firms. This includes helping monitor emerging risks in financial markets, and in terms of relevance to sustainable investing this could include assessing companies' approaches to disclosure of sustainability-related financial risks and other non-financial reporting. Going forward, regulators will need to be conscious of possible bias and flaws in some AI models and continue to assess their digital capabilities to mitigate these risks.

What are the benefits and risks to consumers arising from AI, particularly for vulnerable consumers?

3.1 As highlighted in our inquiry response, there are a number of risks to business and consumers arising from the improper use of AI by businesses, including the following: the potential of discriminatory employment and hiring practices, the displacement of jobs and jobs losses in some cases[3]; privacy and data protection concerns; copyright issues and potential legal risks; impacts on the energy market and prices owing partially to the consumption of energy from AI data centres; and uncertainty over the reliability of actual outputs and judgements provided by AI models in some instances.[4]

3.2 In recent years, we have seen increased interest from the investment community in particular on the carbon emissions and water usage of AI data centres and their value

[2] https://rpc.cfainstitute.org/research/reports/2022/ethics-and-artificial-intelligence-in-investment-management-a-framework-for-professionals; https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0449; https://www3.weforum.org/docs/WEF_Responsible_AI_Playbook_for_Investors_2024.pdf

[3] According to the OCED, 27% of jobs are in occupations at high risk of automation. This includes non-routine high-skilled roles in finance, medicine and law, among other professions https://www.oecd.org/en/publications/2023/07/oecd-employment-outlook-2023_904bcef3.html?appId=aemshell#ai-jobs

[4] A University of Massachusetts study has found that creating a single AI model requires approximately 284,000 kg of CO2, the same as 62 cars driven continuously for a year. University of Massachusetts Amherst, *Energy and Policy Considerations for Deep Learning in NLP* https://arxiv.org/pdf/1906.02243

chains' (e.g. companies involved with the production of chips and semiconductors).[5] These are financially materially to investors' financial returns in the long term and therefore many firms are promoting the more responsible use of AI from companies, including through their stewardship activities. In terms of carbon emissions specifically, some large technology companies have seen their emissions rise exponentially due to their investments in AI, with Microsoft and Google's emissions for example rising just below 30% and 50% respectively, in spite of their net-zero targets.[6]

3.3 A number of UKSIF's investor members have been taking active steps in response to this broad range of AI-related risks; for example, setting clearer expectations of investee companies when it comes to their use of AI. This is especially important given the lack of clear regulatory frameworks globally- and in the UK- on the use and development of AI, and our expectation that regulation may struggle to evolve in line with AI technologies' rapid evolution.

3.4 Investor expectations can cover some of the following areas among others:

- Companies' governance and oversight arrangements relating to their practices- particularly important with board-level understanding remaining relatively low still.[7]
- Due diligence processes to address a range of risks and support sustainable value creation
- Disclosure and reporting practices (e.g. on potential harms to workers from use of AI and environmental impacts, including in terms of energy consumption and water usage).
- Policies to respond to AI's impacts on the workforce and upskill employees (e.g. consideration of new labour policies and training).
- Transparency relating to companies' products and services (e.g. to mitigate risks of bias and discriminatory practice relating to gender and ethnicity).

3.5 Investors will raise these issues with the aim of helping support and collaborate with their investee companies to assist them in harnessing the benefits of AI and responding to risks as AI continues to evolve. Some specific recommendations made by investors on companies' AI risk management processes, policies, and governance include the following which we would recommend all companies consider: a dedicated board member or board-level committee with responsibility for AI oversight and AI policies, annual disclosure of governance policies, and regular employee training to provide upskilling on use of AI systems and corporate policies. We would very much welcome the Committee considering these specific recommendations for companies in its inquiry, and how these could be gradually implemented for larger companies based in the UK or with a significant presence in the UK.

3.6 We have also started to see the first shareholder resolutions tabled on AI over the last several years- both with the technology sector, and also wider sectors too (e.g. entertainment industry). Some of these resolutions have centred on companies' environmental impacts through their use of AI and data centres, with the objective of ensuring that companies sufficiently disclose their management of AI-related risks and have consistent policies in place to help safeguard workers from harms related to AI use. A recent example is shareholder proposals relating to Alphabet's use of AI and environmental

[5]AI data centres overall are estimated to contribute 2%–3% of global greenhouse gas emissions.https://hbr.org/2023/07/how-to-make-generative-ai-greener

[6]Google and Microsoft report growing emissions as they double-down on AI : NPR

[7]A study from one of our service provider members- MSCI- last year estimated that just over 2% of company directors within the MSCI ACWI Index could be considered to have direct expertise on AI, though transferable AI expertise was assessed as more common https://www.msci.com/www/blog-posts/gpt-4-write-a-blog-post-about/04805263912?utm_source=chatgpt.com

impacts. The shareholder resolution highlighted that Alphabet should disclose further information relating to how the company will meet its 2030 climate targets in light of growing GHG emissions, due to increase in data centre energy consumption and supply chain emissions.[8]

3.7. Separately, the World Benchmarking Alliance published a collaborative investor statement last year- on behalf of responsible investors managing over $8.5 trillion in AUM- highlighting the importance of more inclusive practices from companies and trust in order to realise the benefits of AI and other digital technologies, alongside “respect for human rights” as companies implement new policies to promote the application of AI. A number of UKSIF’s investor members are part of the WBA’s coalition alongside other collaborative initiatives, and we continue to see a powerful, positive role for investor stewardship in supporting companies’ effective and ethical use of AI and their ability to maximise the benefits.

3.8 We know that increasingly many consumers and wider society want to see more transparency and clarity from companies over their AI policies and efforts in mitigating negative impacts from AI, and we believe the global and UK investment community can play a prominent role in responding to this and helping promote much-needed transparency from all companies’ use of AI tools and models. We would welcome the Committee further exploring the role of investors and financial services firms in delivering this transparency on the use of AI and the ways in its benefits could be effectively harnessed to drive long-term, sustainable economic growth.

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[8] https://archive.trilliuminvest.com/shareholder-proposal/alphabet-inc-ai-principles-and-board-oversight-2024/