Artificial Intelligence, Capital Markets and the ESG Agenda

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Recently, generative artificial intelligence, or AI, has become the topic of the hour in many different sectors of society, including the legal and the capital market sectors, and legal issues involving the use of AI have provoked extensive debate.

Some have even suggested that AI is the new ESG, comparing the revolution that the Environmental, Social and Governance agenda has caused in a wide range of markets in the past few years to AI's potential[1]. Although we doubt the comparison is fair – in our view, the revolution brought by AI will be structural, and its impact on the market will therefore be more profound than the effects of the ESG pillars and stakeholder capitalism – the fact is that both AI and ESG have sparked very interesting discussions, often on intertwined issues.

In the capital market, for example, a significant topic of debate arises from the convergence of artificial intelligence and ESG issues: Will AI systems and tools help or hinder the ESG agenda?

Advances in artificial intelligence have automated data processing and analysis, increasing both the volume of data that can be processed and the speed at which it is processed. Algorithms and computer programs can now process and analyze vast amounts of information, a task that would take much longer without AI, if it could be done at all[2].

The use of AI in the capital market has thus allowed investors to collect and analyze a much greater amount of information about their investments, including data related to ESG factors and criteria. The automation of processes for collecting and analyzing ESG-related data has facilitated the decision-making process by investors who wish to invest in assets aligned with ESG principles. From this perspective, AI tools can facilitate and bolster the ESG agenda and sustainable investment[3].

At the same time, the use of AI technologies presents challenges from environmental, social and corporate governance perspectives. On the environmental front, processing data using AI consumes substantial electricity, contributing to greenhouse gas emissions[4]. From the social and corporate governance perspectives, AI technologies can perpetuate biases and inaccuracies present in the individuals who developed them and in the data used to create and train AI systems[5].

Another important issue from a social perspective is the number, which is likely to be enormous, of jobs that will simply cease to exist as AI advances and is applied in a whole gamut of industries and businesses. Some commentators compare the scale of the impact that AI will have on the job market to the transformation brought about by the Industrial Revolution.

To address some of the issues related to the use of AI in the capital markets, in July of this year, the Securities and Exchange Commission (SEC), the US securities market regulator, proposed new requirements for the use of predicative data analysis and AI technologies by broker-dealers and investment advisers. The proposed rules focus on potential conflicts of interest that can arise when the use of complex analytic models (including various types of AI, such as machine learning, deep-learning algorithms, neural networks and natural language processing and large language models) can place the broker-dealer's or investment adviser's interests above those of their investors[6].

In other words, while the use of AI technologies can be beneficial for investors, because they allow access to, and processing of, greater volumes of information on the capital market, there is also the risk that, as the use of these technologies spread, broker-dealers and investment advisers may use them to their own advantage, and potentially to the detriment of investors[7]. Under the rules proposed by the SEC, broker-dealers and investment advisers must adopt measures to deal with conflicts of interest, along with written policies and procedures to comply with the SEC's rules. According to the head of the SEC, Gary Gensler, if adopted, these rules will help protect investors from the conflicts of interest that can arise with the use of artificial intelligence technologies[8].

To date, Brazil's securities commission, the CVM (Comissão de Valores Mobiliários), has not yet adopted rules to address the potential conflicts that can result from the use of AI technologies in the securities market.

To strike a balance between the benefits that AI systems can offer and the risks that these new technologies can pose for the securities market, including the risk of conflict of interests between investors and their agents and advisers, it is essential for companies to adopt AI security measures, such as risk and audit committees formed specifically to deal with issues related to the use of AI technologies[9].

Unfortunately, the number of companies that have actually adopted such measures is small: a recent study by the Collective Impact Coalition for Digital Inclusion[10] revealed that only about 10% of the world's leading companies in AI development have announced commitments on ethical issues related to artificial intelligence[11]. Whether they come from policies imposed by regulators, or from commitments assumed voluntarily by companies that use AI in their activities, measures like those proposed by the SEC are essential if artificial intelligence is to realize its potential as a driver for conscious investing, without jeopardizing investors' interests and the ESG agenda[12].

NOTES:

[1] Financial Times. AI is the new ESG. Available at https://www.ft.com/content/e0c30ebe-8d4d-4c70-9705-0ba73295d2c5. Accessed 25 August 2023.

[2] S&P Global. How can AI help ESG investing? Available at https://www.spglobal.com/en/research-insights/articles/how-can-ai-help-esg-investing. Accessed 25 August 2023.

[3] S&P Global. How can AI help ESG investing? Available at https://www.spglobal.com/en/research-insights/articles/how-can-ai-help-esg-investing. Accessed 25 August 2023.

[4] S&P Global. How can AI help ESG investing? Available at https://www.spglobal.com/en/research-insights/articles/how-can-ai-help-esg-investing. Accessed 25 August 2023.

[5] Thompson Reuters. Artificial intelligence use poses an ESG headache for global financial industry. Available at https://www.thomsonreuters.com/en-us/posts/investigation-fraud-and-risk/artificial-intelligence-esg-headache/. Accessed 25 August 2023.

[6] U.S. Securities and Exchange Commission. SEC Proposes New Requirements to Address Risks to Investors From Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers. Available at https://www.sec.gov/news/press-release/2023-140. Accessed 27 August 2023.

[7] The Washington Post. SEC proposes AI crackdown for Wall Street firms. Available at https://www.washingtonpost.com/business/2023/07/26/sec-artificial-intelligence/. Accessed 25 August 2023.

[8] U.S. Securities and Exchange Commission. SEC Proposes New Requirements to Address Risks to Investors From Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers. Available at https://www.sec.gov/news/press-release/2023-140. Accessed 27 August 2023.

[9] Fidelity. Rise of artificial intelligence underlines role of ESG analysis. Available at https://www.fidelityinternational.com/editorial/article/rise-of-artificial-intelligence-underlines-role-of-esg-analysis-e861ae-en5/. Accessed 26 August 2023.

[10] A coalizão "Collective Impact Coalition for Digital Inclusion" foi criada pela World Benchmarking Alliance (WBA) e é orientada pelo Digital Inclusion Benchmark (DIB).

[11] Fidelity. Rise of artificial intelligence underline role of ESG analysis. Available at https://www.fidelityinternational.com/editorial/article/rise-of-artificial-intelligence-underlines-role-of-esg-analysis-e861ae-en5/. Accessed 26 de agosto de 2023.

[12] Fidelity. Rise of artificial intelligence underline role of ESG analysis. Available at https://www.fidelityinternational.com/editorial/article/rise-of-artificial-intelligence-underlines-role-of-esg-analysis-e861ae-en5/. Accessed 26 de agosto de 2023.

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