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Article

Between a rock and a hard place

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“If you are rushing to make claims about using AI in your investment processes to capitalise on growing investor interest, stop.”

These were the words of Gurbir S. Grewal, Former Director of the Securities and Exchange Commission’s (SEC) Division of Enforcement, delivered at a compliance and enforcement conference on 15 April 20241. This warning is not limited to AI washing2. Rather the sentiment extends to Environmental, Social and Governance (ESG) and Diversity, Equity and Inclusion (DEI) and the myriad of other means by which businesses may now seek to burnish their credentials and investment cases in the eyes of current and prospective shareholders.

The SEC’s director’s unequivocal missive reflects the growing regulatory scrutiny, investor focus and, by extension, Directors’ & Officers’ liability (D&O) risks which now accompany corporate communications and marketing efforts.

However, companies may also be viewed negatively or suffer a commercial disadvantage if they do not use AI, if they are not deemed to be sufficiently environmentally conscious or if they are not taking steps to improve the diversity of their boards.

Creating an increasingly complex balancing act for executives who are grappling with the threat of not articulating their positions on one hand, and the risk of doing so on the other. Our Risk & Resilience research3 found that a fifth (20%) of global executives surveyed cited boardroom reputation risk as the biggest threat they face this year, rising to 25% among executives in the financial and professional services industry.

The risky twenties

For much of this century, D&O liability and claims focused on governance. The Enron scandal in 2001 broke the seal4 and the 2008 financial crisis opened the floodgates. Directors and officers faced a torrent of new regulation and litigation. These risks persist and have been joined by a plethora of new challenges. Few of which have easy answers.

In 2023, 230 climate litigation cases were filed globally5. While many of these cases were filed against those perceived to be having a negative climate impact, 47 were for ESG washing6, against businesses perceived to have exaggerated or embellished their green credentials. The landscape is further complicated by the rise of anti-ESG litigation leaving insureds in a quandary “to ESG or not to ESG.”

Previously, businesses looking to go public or complete a major transaction may have looked to showcase their attributes and ESG credentials to receive positive profile and support, however, now this must be balanced, understanding how to be ESG friendly without attracting the attention of investors or regulators seeking to curtail companies from engaging in ESG puffery or the overstatement of one’s ESG posture.

Public perception – and the risk of getting it wrong

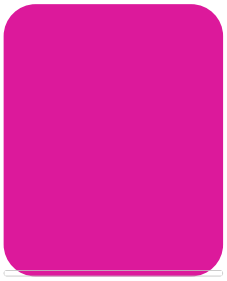
Executives can no longer just consider the financial or operational impact of decisions, but also need to be cognisant of how these decisions may be perceived and how their customer base will respond on social media.

In 2023, a popular beverage company, provided the cautionary tale. In an effort to broaden its appeal, the company partnered with a series of social media personalities across different demographics, including a transgender influencer. The backlash was immediate and intense, with some state officials even threatening legal action against the company for alleged violations of their fiduciary obligations towards shareholders. The company lost significant market value as well as significant US market share.

An evolving D&O threat

D&O litigation traditionally focused on businesses overestimating their performance and prospects. However, it is no longer just the numbers, but rather anything which can be said to be reducing the value of a brand. Executives globally should take note. Whether it is AI, ESG or DEI, their marketing and communications efforts will face scrutiny and potentially risk placing them between a rock and a hard place.

Back to the **Spotlight on Boardroom Risk report**



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1-https://www.wilmerhale.com/en/insights/blogs/keeping-current-disclosure-and-governance-developments/20240424-sec-enforcement-director-warns-against-ai-washing

2- What is 'AI washing' and why is it a problem? - BBC News

3- beazley.com/en-US/news-and-events/spotlight-on-boardroom-risk-2024/methodology/

4- Enron: what happened and what we can learn from it - ScienceDirect

5- https://www.lse.ac.uk/granthaminstitute/publication/global-trends-in-climate-change-litigation-2024-snapshot/
6- https://www.lse.ac.uk/granthaminstitute/publication/global-trends-in-climate-change-litigation-2024-snapshot/

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