HYMANS ROBERTSON

Artificial intelligence, real risks:

what AI means for asset owners

AI's growth is a much-discussed topic, with news and information available daily – both good and bad. But how does it apply to you as an asset owner? And what should you be doing about it?

There are three angles from which asset owners are likely to encounter AI:

INVESTMENT DECISIONS	RESPONSIBLE INVESTMENT	LIABILITIES/LONGEVITY
What risks and opportunities will be presented as AI develops?	**What new RI considerations will AI introduce, and how will it interact with current considerations such as climate change and nature?**	**How will AI eventually impact individuals' health?**
	CONSIDERATIONS	
Are your assets well placed to take advantage of opportunities that arise?	Will the massive amount of energy required for AI exaggerate climate and nature risk concerns?	Might AI accelerate medical advances, increasing liabilities for a pension scheme?
Is your exposure to AI well diversified, and how might different assets or sectors be impacted over time?	Or will the extra energy demand actually support the transition towards electrification?	For other asset owners (eg charities), could AI affect the problems their objectives are designed to tackle?

Actions that asset owners can take include:

- ✓ Scenario analysis across economic environments to enable better risk management.
- ✓ Early, consistent engagement with your asset managers to ensure they are managing AI risks effectively.

Asking the right questions and taking the right actions are essential to maintaining a resilient portfolio.

A good starting point would be a **dedicated session to talk through the areas outlined in this article,** establishing your level of existing knowledge about each and their relative importance to you.

Please reach out to your consultant to learn more and find out how we can help.

Investment decisions

The rapid adoption of AI and its knock-on impacts have drawn attention to AI hyperscalers and companies focused on the development of AI tech. But these companies are only part of the picture: AI affects everything from upstream infrastructure (data centres, energy, hardware) to downstream adopters across different sectors.

As AI develops, there will be clear winners and losers across all sectors and asset classes, but predicting these today is not something asset owners should be aiming to do.

For example, there could be winners and losers within sectors, as firms that chose the better AI strategy win out. Also, assuming substantial improvements in AI capability, entire sectors may become redundant, while others may benefit from being complementary to the new AI-driven economy. Meanwhile, yet more new sectors may be created. And the businesses that drive AI (data centres, energy, chips/computing) may do well – or, if AI disappoints, look overvalued in retrospect.

Asset owners can take three key actions:

Engaging with asset managers
To understand where key exposures to AI lie and what steps your managers are taking to manage them. Similarly, engaging with managers to understand how they're assessing and potentially investing in the opportunities that AI-related changes provide.

Maintaining a diversified portfolio
In times of volatility, diversification is the most important tool in building a resilient portfolio. Diversifying by sectors, assets classes and regions is important to protecting portfolio returns. And diversifying across AI-related exposures is no different. For example, asset owners should be diversified not only across businesses that do well if AI grows in capability, but also assets that are resilient if AI disappoints. Asset owners should also be diversified across different parts of the AI value chain, including exposure to energy companies, companies involved in chip/computing supply, data centres, AI labs and companies that deploy AI.

Considering how your portfolio might fare under different outcomes
The impacts of AI should be considered in the context of all other systemic changes/risks that can impact portfolios, including the low-carbon transition and geopolitical uncertainty. All of these forces can impact the economic environment, in terms of growth, inflation and interest rates over the medium term. Testing your portfolio's resilience to different economic environments is an important element of risk management.

To navigate AI's growing influence, investors need diversification, a portfolio-wide perspective and strong engagement with their investment managers.

Responsible investment

AI could change for the better the way we all live and work, improving efficiency and productivity while providing access to new information and experiences. However, as with any developing systemic change, this comes with risks. The growth of AI and how it's used will have implications for environmental, social, and governance (ESG) considerations. For example:

Environmental
AI is highly resource intensive, driving significant energy and water use, yet it also offers the potential to improve climate modelling, support mitigation and adaptation solutions, and increase demand for renewable energy.

Social
AI can deliver social benefits such as improved education, but it also introduces risks including job displacement, bias, security and privacy breaches, disinformation, loss of control, and harmful misuse.

Governance
Strong regulation and good governance will be essential to ensure AI is developed and deployed safely, ethically and in line with societal values. Certain AI companies have investor-unfriendly governance, which must be addressed if AI is to have the systemic effects that AI's proponents claim.

For asset owners, the key actions are:

- **Maintaining understanding** of key ESG issues and how AI, and other global changes, impact them.
- **Engaging with asset managers** to understand managers' approach to assessing companies' governance and ability to navigate these ESG issues. Companies with strong governance systems and policies will be best placed to manage them.

Responsible investment considerations go hand in hand with considering AI's risks and opportunities. Good governance and effective manager engagement will be critical.

Liabilities and longevity

Asset portfolios exist to meet a need, whether it's a pension scheme paying funds to members or a foundation seeking to address a social issue. Any of those 'liabilities' could be affected by AI – for example, by AI helping or harming the need your charity is there to address, or because it affects the longevity of your pension scheme members.

Some leaders in the AI sector argue that its advances could significantly accelerate medical research and health outcomes. Examples already cited include AlphaFold, which has improved understanding of protein structures and could shorten drug-discovery timelines. More ambitious claims include that AI progress could materially increase life expectancy over a relatively short period.

Whether these forecasts play out is hard to predict, but the key issue will be how potential changes feed into the assumptions used to value liabilities or by insurers who are pricing those liabilities.

To date, in the pensions space, we've seen no impact on the valuations being placed on liabilities. But this is an evolving space that we'll be watching closely.

Longevity risk is already one of the most significant uncertainties for pension schemes, and AI could be a new and potentially faster-moving driver of that risk.

Whether your liabilities are affected by longevity risk or other societal factors, AI could have an impact. Ensuring governance and monitoring arrangements can respond to unexpected changes is a sensible and proportionate first step, while staying up to speed with the latest thinking.

At Hymans Robertson, we can support asset owners with these issues by:

- **Supporting manager engagement efforts –** helping you understand your exposure via structured, targeted engagement with your investment managers.
- **Testing resilience –** examining how your portfolio would fare in different future scenarios, considering the range of systemic risks that could lead us into different economic environments.

To find out more, get in touch.

Sanjay Joshi
Responsible Investment Consultant
sanjay.joshi@hymans.co.uk