THE RISE OF ARTIFICIAL INTELLIGENCE IN CORPORATE GOVERNANCE IN INDIA

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Introduction

It has become a common saying among people these days that Artificial Intelligence or AI, as it is commonly called, is soon going to take over humanity. While this may be a blatant exaggeration stemming out of insecurities of many, it is not untrue that AI is swiftly capturing several industries, including those where one could not have imagined smooth operation by anything or anyone other than a human being himself. Today, AI is everywhere. From our bedrooms to corporate boardrooms, it is hard to deny, or even ignore, the role that AI is playing in making lives more feasible. It is in this very same way that AI is now being used to facilitate and regulate corporate governance mechanisms in the working of corporations. And while it may have taken some time (and while it might still take more), India is fast catching on to the current worldwide trend of relying on artificial intelligence to enforce corporate governance mechanisms that ensure the healthy and ethical functioning of a corporation, although there is a need for stronger legal and statutory framework. This paper will try to analyse the ways in which AI is being used for Corporate Governance and the pivotal roles played by regulatory bodies such as the Ministry of Corporate Affairs and more importantly, the Securities and Exchange Board of India. This paper will also try to provide certain suggestions on how AI can be incorporated to make Corporate Governance regimes more efficient.

A Brief Context on the usage of AI in the Domain of Corporate Governance

Before going into how AI made its way into the domain of Corporate Governance, it would be more helpful to first understand what Corporate Governance really stands for. In the simplest form, it refers to the system used to direct and control companies or corporations, the system itself being made up of "ownership, boards, incentives, company law, and other mechanisms"[1]. Artificial Intelligence, on the hand, can be most simply described as the field which combines computer science and strong datasets to make machines more intelligent which enables problem solving[2].

So, in the most basic sense, the use of AI in Corporate Governance regimes refers to the use of the technology that facilitates decision making by entities like the Board of Directors in a corporation to help control and direct the way in which the company should go ahead. Therefore, it can be safe to say that AI aids the Board of Directors in their decision-making process, bringing such decisions in line with ethical and legal considerations in the neo-institutional setup[3] of corporations, among other things.

AI has become an integral part of our lives. Whether it be the unlocking of our smartphones or even doing spell checks on our documents – the role of AI cannot be ignored. It is of significant value in implementing healthy corporate governance regime.

Some of the ways in which AI can be incorporated in the Corporate Governance regimes of companies to make the legal framework around them stronger and better enforceable can be in the form of Compliance Monitoring wherein AI algorithms work efficiently in analysing data, especially financial, and detecting different kinds of fraudulent activities to facilitate compliance with legal and regulatory requirements. Where human errors can leave scope for a company to default at complying with regulations, AI can make this task more efficient and streamlined[4]. This will help both the regulators as well as those running the company to keep a check on the compliance regime. Besides this, in large corporate transactions such as mergers and acquisitions, proper Due Diligence becomes one of the most important factors in fixing liability in case

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[1] Michael Hilb, *Toward artificial governance? The role of artificial intelligence in shaping the future of corporate governance*, J MANAG GOV 24, 851–870 (2020), https://doi.org/10.1007/s10997-020-09519-9.

[2] *What is artificial intelligence?,* IBM, (Apr. 15, 2023, 8:57am), https://www.ibm.com/in-en/topics/artificial-intelligence. https://www.ibm.com/in-en/topics/artificial-intelligence#:~:text=At%20its%20simplest%20form%2C%20artificial,in%20conjunction%20with%20artificial%20intelligence.

[3] Michael Hilb, *Toward artificial governance? The role of artificial intelligence in shaping the future of corporate governance*, J MANAG GOV 24, 851–870 (2020), https://doi.org/10.1007/s10997-020-09519-9.

[4] MCO Marketing, *How Artificial Intelligence Can Assist Compliance*, MYCOMPLIANCEOFFICE, (Apr. 15, 10:00am), https://mco.mycomplianceoffice.com/blog/how-ai-can-assist-compliance.

something goes wrong. AI based analytical tools can facilitate such transactions and make them faster with better decision-making[5]. Moreover, AI algorithms can be used in the analysis of important legal documents to identify areas of conflict and other issues and offer mechanism for Dispute Resolution. Parties to such a conflict can reach a mutually agreeable resolution after making a more informed decision that incorporates the research and analysis provided by AI algorithms.

Another significant usage of AI in Corporate governance has been realised in the realm of the corporate boardroom. AI has had a profound impact in promoting boardroom diversity, evaluation of the board, providing support in decision making processes as well as reviewing and analysing large volumes of corporate data, reducing the risk of human error. AI's role in the boardroom will be discussed at length in the subsequent section of the paper.

The Indian Scenario

The advent of AI in India has been rather promising. It can date back to the 1960s. The permeation of AI in the various industries has been quite radical and has impacted several areas. The advent of AI has similarly made a significant impact on corporations in the way that the management functions and internal discipline is maintained. Now some of the core areas in which the role of AI unfolds in the domain of Corporate Governance include boardroom support in decision-making, prevention of insider trading, disclosure regulations, compliance monitoring, and shareholder voting among other techniques. Certain regulatory bodies have taken notice of AI's advent and mandated its regulation in certain ways.

AI in the Corporate Boardroom

In the simplest sense, an example of AI's usage with respect to the boardroom in India will take us back to the Covid-19 Pandemic era, where the Ministry of Corporate Affairs laid down guidelines on how Board Meetings were to be conducted online to comply with one of the most crucial tools of Corporate Governance. But it is pertinent to know that AI is capable of much more. The BOD's decision-making process depends on several considerations. These can be with respect

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[5] *How Mergers and Acquisitions can be transformed using Artificial Intelligence*, M & A WORLDWIDE, (Apr. 15, 10:30am),
https://m-a-worldwide.com/how-mergers-and-acquisitions-can-be-transformed-using-artificial-intelligence/.

to innovation, collaboration, optimization etc.; or target achievements, legal compliances, ethical compliances etc., or decisions on board composition, executive development, executive compensation etc[6]. At present, there are no specific laws in India which help in monitoring and regulating Artificial intelligence[7]. However, a robust and strict legal mechanism, if put in place, will help enforcing the various duties of directors as enumerated under the Companies Act, 2013. It is well known that one of the most important duties of a director is to keep the sensitive data of the corporation confidential and protect it from any kind of leaks. A director is also supposed to maintain the highest standard of diligence while working with utmost care and in good faith to avoid any conflict of interest between the shareholders and themselves. The role of AI unfolds here, wherein AI works on company information and other sensitive and confidential data (say, of consumers) and helps secure it from any threats that might affect the company. The role further extends to the task of decision making. Such decisions are based on large quantities of data (often known as Big Data)[8], which when supplied to an AI tool, can lead to objective and effective decision-making, removing the scope of human biases by relying on set algorithms. However, in the absence of a legal and regulatory framework that allows for delegation of work of the directors, it is hard to tell how much of it can be delegated to AI tools. In the case of Dairy Containers v NZI Bank, a New Zealand court held that it was the fundamental duty of the directors to manage the business of the company, and that they could delegate work so far as it related to day-to-day management of the company, but they cannot delegate the management function itself[9]. Similarly, in the US, directors cannot delegate the duties which lie at the heart of management of the corporation[10]. And even the duties that might have been delegated must be supervised by the directors themselves. So, in India, in case there is a breach of duty or leak of sensitive information by AI tools, the liability would still ideally fall up on the directors under Sections 166 and 134 of

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[6] Michael Hilb, *Toward artificial governance? The role of artificial intelligence in shaping the future of corporate governance*, J MANAG GOV 24, 851–870 (2020), https://doi.org/10.1007/s10997-020-09519-9.

[7] Khushboo Luthra, *Assessing the Intelligence of the Artificial Intelligence in Law: Prospects in India*, SINGHANIA AND PARTNERS, (Apr. 15, 03:05pm), https://singhania.in/blog/assessing-the-intelligence-of-the-artificial-intelligence-in-law-prospects-in-india-.

[8] Florian Möslein, *Robots in the boardroom: artificial intelligence and corporate law*, RESEARCH HANDBOOK ON THE LAW OF ARTIFICIAL INTELLIGENCE, pp. 649–670, (2018), https://doi.org/10.4337/9781786439055.00039.

[9] Dairy Containers Ltd v NZI Bank Ltd [1995] 2 NZLR 30, at p. 79 et seq.

[10] Florian Möslein, *Robots in the boardroom: artificial intelligence and corporate law*, RESEARCH HANDBOOK ON THE LAW OF ARTIFICIAL INTELLIGENCE, pp. 649–670, (2018), https://doi.org/10.4337/9781786439055.00039.

the Companies Act, 2013, as well as for the breach of Section 85 (Offences of Companies) of the Information Technology Act, 2000[11]. Moreover, AI can facilitate better governance by helping directors remain informed on business updates and the identification of potential risks as well as opportunities. AI can also be used to evaluate the performance of the BOD by analysing data on the participation, attendance and decision-making of individual directors. It can promote Board Diversity since its selection criteria will be based on algorithms far removed from human biases.

AI in Compliance Monitoring and Risk Management

Artificial Intelligence can help Indian companies in compliance with statutory regulations more effectively, thereby avoiding legal liability. This can be done using AI algorithms that identify potential violations of legal provisions and indicate a pattern of illegal and fraudulent activity. AI can also keep a track of the forever changing legal regulations and reporting processes of different authorities. Furthermore, AI can be used to improve Blockchain technologies. Any risks associated with individual transactions and accounts can be identified by such technologies[12]. This can further reduce the risk of fraudulent transactions taking place. Again, the advent of blockchain technologies is new in India but looks promising. There are several blockchain analytical companies in India that can partner up with corporations to provide them with effective solutions. For example, Chainalysis, one of world’s largest transaction monitoring solutions companies, can be outsourced work by companies to keep track of how funds are moving across different blockchains to avoid the risk of fraudulent transactions[13].

AI and Regulatory Bodies

AI is gaining momentum in the legal world in India. In a first, the Punjab and Haryana High Court

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[11] Komal Singh, *Inception of AI in the Boardroom: A New Dimension in Corporate Governance*, MANUPATRA, (Apr 18, 2023 12:06pm), https://articles.manupatra.com/article-details/Inception-of-AI-in-the-Boardroom-A-New-Dimension-in-Corporate-Governance.

[12] Daniel B., *The Use of AI in Blockchain Analytics: Improving the Detection and Prevention of Fraud and Money Laundering*, LINKEDIN, (Apr 18, 2023, 09:18pm), https://www.linkedin.com/pulse/use-ai-blockchain-analytics-improving-detection-prevention-bron/?trk=pulse-article_more-articles_related-content-card

[13] Vishal Chawla, *Top Blockchain Analytics Companies and What They Do*, ANALYTICS INDIA MAG, (Apr 18, 2023, 09:30pm), https://analyticsindiamag.com/top-blockchain-analytics-companies-and-what-they-do/

decided a bail plea using ChatGPT, an AI chatbot[14]. Similarly, AI has been fast penetrating into the corporate realm in India. So how could it have escaped the notice of regulatory bodies. In early 2019, the Securities and Exchange Board of India issued a circular on reporting of Artificial Intelligence (AI) and Machine Learning (ML) applications and systems offered and used by market intermediaries[15]. This could be termed as the advent of AI in the Indian financial market. In doing so, SEBI recognised the potential benefits of AI based technologies managing risk and detecting fraudulent transactions. SEBI also took cognizance of the fact that AI did not lead to increase in any further risks in this domain. Moreover, SEBI also envisions the usage of AI for surveillance, investigation as well as inspections in the day-to-day processes of the capital markets. This is important for corporate governance as it can prevent incidences of insider trading if implemented and used properly by SEBI.

Moreover, as per the SEBI (LODR) 2015 rules, the Bombay Stock Exchange has mandated filing of announcements under Listing agreements in XBRL format starting in 2023[16]. Structured XBRL data is extremely useful for training AI and machine learning tools[17]. These AI tools can be used to analyse the XBRL data. Similarly, AI tools are being used for e-voting for shareholder resolutions, as mandated by SEBI for listed companies.[18]. AI can be trusted to provide greater transparency as well as accuracy in the voting process, with less chances of rigging and human bias. Additionally, the Ministry of Corporate Affairs has played a pivotal role in encouraging the use AI based technologies in financial reporting and compliances to ensure greater degree of corporate governance.

AI in the Corporate – Indian groups using AI for Corporate Governance

[14] *In a first, Punjab and Haryana high court uses Chat GPT to decide bail plea*, THE TIMES OF INDIA, (Apr 18, 2023, 09:45pm),
https://timesofindia.indiatimes.com/india/in-a-first-punjab-and-haryana-high-court-uses-chat-gpt-for-deciding-upon-bail-plea/articleshow/99070238.cms?from=mdr.

[15] Circular: Reporting for Artificial Intelligence (AI) and Machine Learning (ML) applications and systems offered and used by market intermediaries, (Jan 04, 2019), SEBI.

[16] *BSE issued a Circular regarding the filing of announcements in XBRL Format on the BSE Listing Centre*, TEAMLEASE REGTECH, (April 19, 2023, 12:09am),
https://teamleaseregtech.com/legalupdates/article/21339/bse-issued-a-circular-regarding-the-filing-of-announcements-in-xbrl-format-on-the-bse-listing-centre/.

[17] *How can XBRL and AI work together?,* XBRL, (April 19, 2023, 01:47am),
https://www.xbrl.org/news/how-can-xbrl-and-ai-work-together/.

[18] Circular: e-Voting Facility Provided by Listed Entities, (December 09, 2020), SEBI.

Indian Corporates are slowly but steadily incorporating various AI powered tools to streamline regulatory compliance monitoring and risk management to make governance better. While this is still new for most corporations, some are becoming a major game-changer in the field. Among such corporations, Infosys, a global tech giant and consulting company, has paved the way in this regard. It has identified the need for AI in a digitizing world and is providing third party solutions to many corporations with its IT Governance, Risk and Compliance framework[19]. This framework allows an AI driven framework to keep track of legal as well as contractual requirements, facilitates strategy-driven risk management along with compliance and regulatory management.

Way forward – An Analysis

Statutory guidelines around the use of AI within any industry in India is still a grey area in law. In the absence of s strong legal framework, use of AI becomes difficult. This is especially true in the arena of Corporate Governance. One of the main reasons for the existence of corporate governance is to fix liability on corporate characters like directors or managerial personnel etc. When AI is introduced into this equation, it becomes a little tricky as to how liability must be fixed for breach of any obligations. Introducing the concept of product liability wherein AI is treated as the product can also be used to fix distributive liability on the corporation using the AI, along with the software developers and manufacturers of the AI[20]. However, this approach can lead to several legal complications as it would become difficult to determine which part of AI defaulted and whose fault it exactly was. How else can liability be fixed then is a question that needs to be worked up on in the Indian Context.

AI can be granted the status of personhood similar to how a corporate is given recognition as a legal fiction and a juristic person. Giving AI legal rights and duties can come in handy in fixing liability. In such an equation, an agent-principal relationship between those using AI and the AI tool itself must be established. AI based decisions must go through a process of screening and ratification by human directors and managerial personnel. Furthermore, a concept like 'piecing the

[19] Governance, Risk and Compliance, Infosys, (April 19, 2023, 2:34am), https://www.infosys.com/services/cyber-security/insights/governance-risk-compliance-overview.html.

[20] Rakshit Sharma, *Legal Paradigm Shift in Corporate Governance with the Introduction of Artificial Intelligence*, RGNUL STUDENT RESEARCH REVIEW (RSRR), (Apr 20, 03:45am), https://rsrr.in/2021/06/11/artificial-intelligence-in-corporate-governance/.

corporate veil' can be used to determine specifically whose fault it was that lead to a breach of duty or obligation.

More importantly, laws must be formulated to regulate the usage of AI in India. Four committees were recently established by Ministry of Electronics and Information Technology (MeitY), the executive agency for AI-related initiatives, to develop an AI policy framework[21]. This committee has also suggested vesting the status of a legal juristic person to AI; however, no regulatory framework has been formulated yet. In this fast-changing world where AI is increasingly becoming prominent in all industries, a strong legal framework is the need of the hour. Legislators and other statutory bodies must act on bringing in a legislation on the same as soon as possible.

Conclusion

The role played by AI can neither be ignored nor taken for granted in today's world. It has taken several industries by storm and eased business operations. Similarly, usage of AI for maintaining a standard of Corporate Governance is gaining momentum worldwide, and to quite an extent, in India as well. However, to maintain such a momentum, a strong legal framework is the need of the hour. Along with this, a practical idea on how liability can be fixed is required. Not to mention, there is always a risk of AI algorithmic bias in making corporate decisions. In such a scenario, it becomes extremely important for regulators to take all of this into consideration while drafting any new policies or legislations to govern AI that will in turn drive Corporate Governance. Inspiration can also be taken from how regulations have been drafted in the West while incorporating our own native understanding of how laws should be enacted in this regard. But one thing that is for sure is that AI is here to stay and the opportunities that come with it must be exploited and put to good use.

[21] Khushboo Luthra, *Assessing the Intelligence of the Artificial Intelligence in Law: Prospects in India*, SINGHANIA AND PARTNERS, (Apr. 15, 03:05pm), https://singhania.in/blog/assessing-the-intelligence-of-the-artificial-intelligence-in-law-prospects-in-india-.