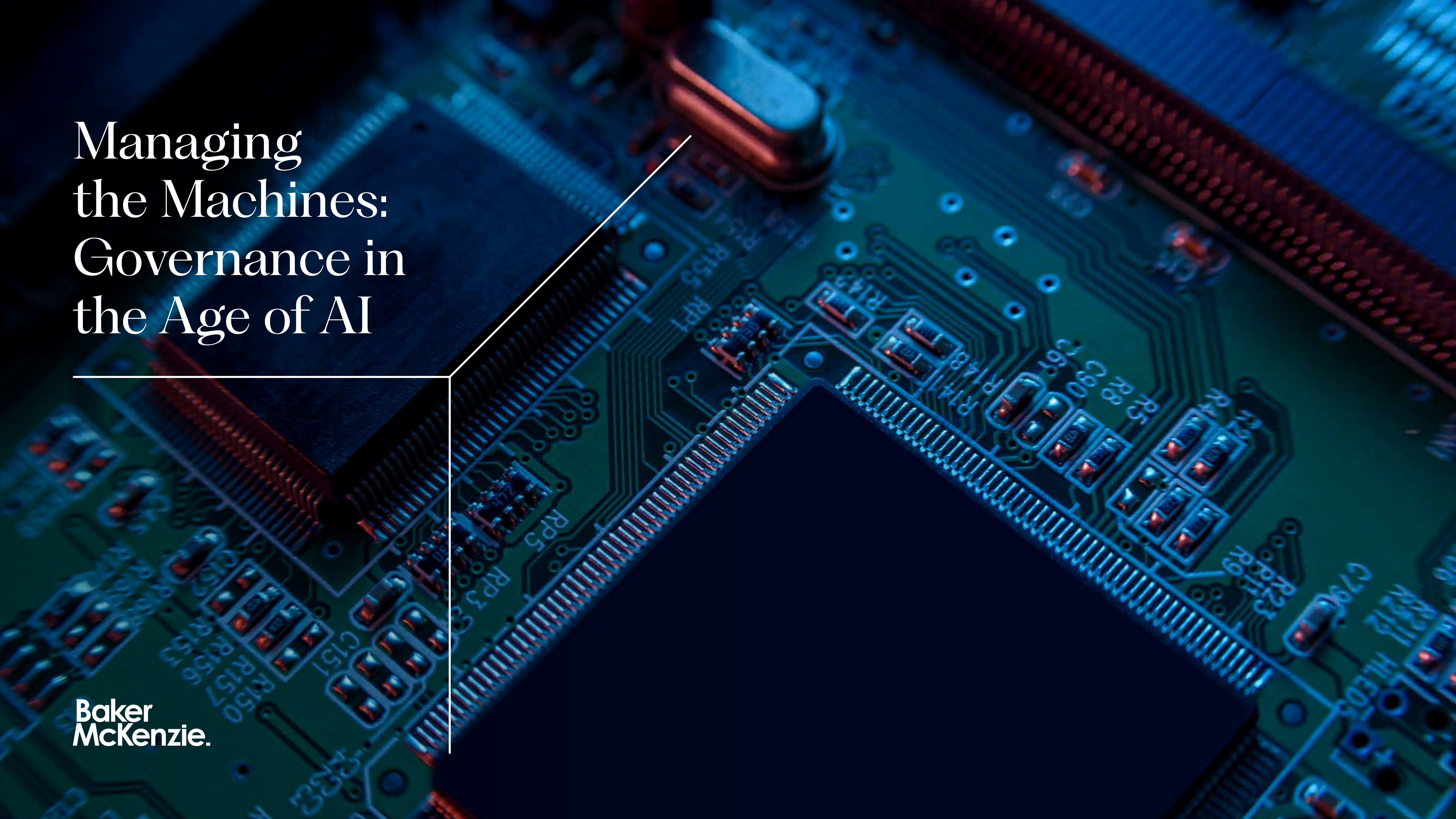
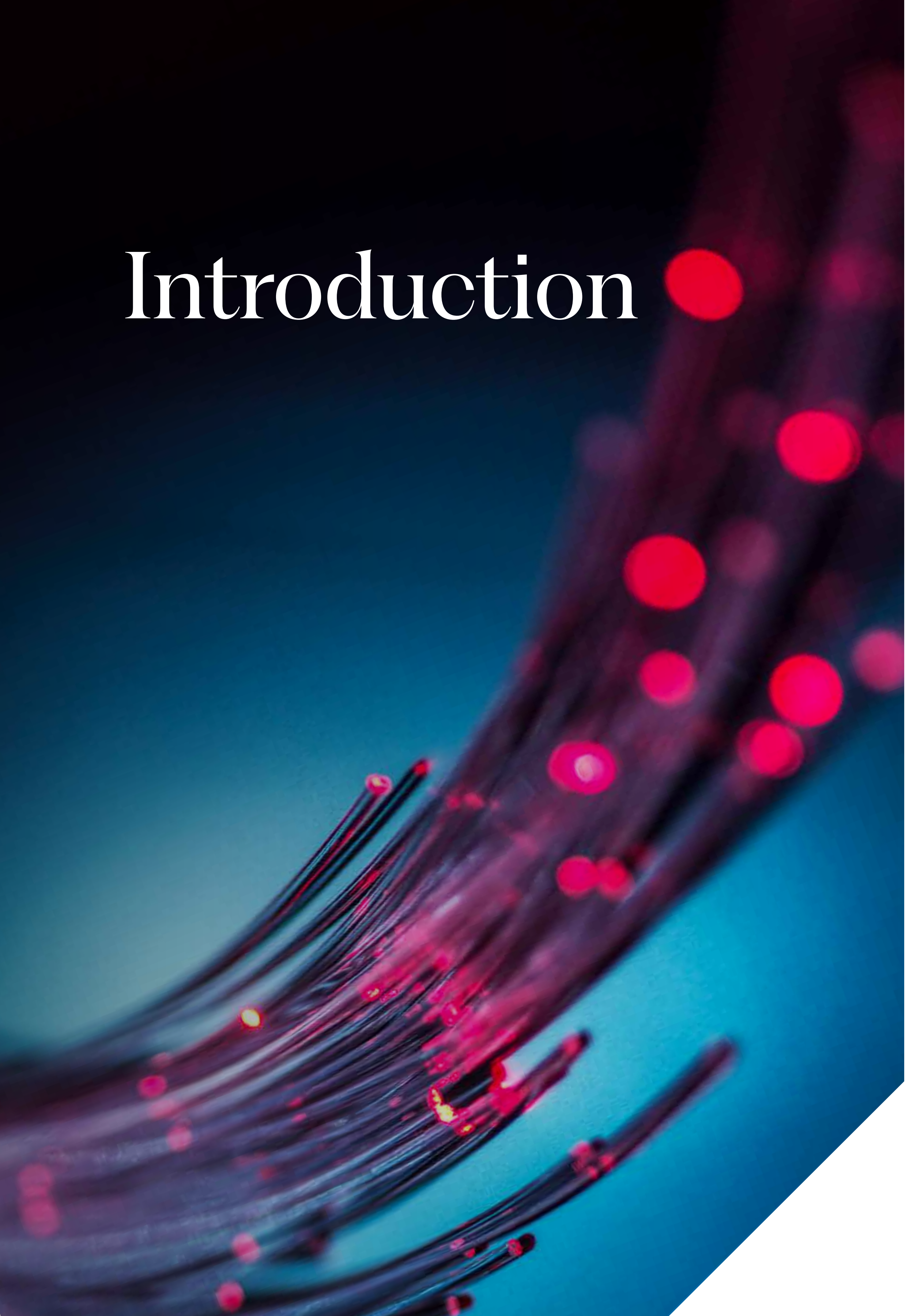


Managing the Machines: Governance in the Age of AI

Baker McKenzie.

Introduction

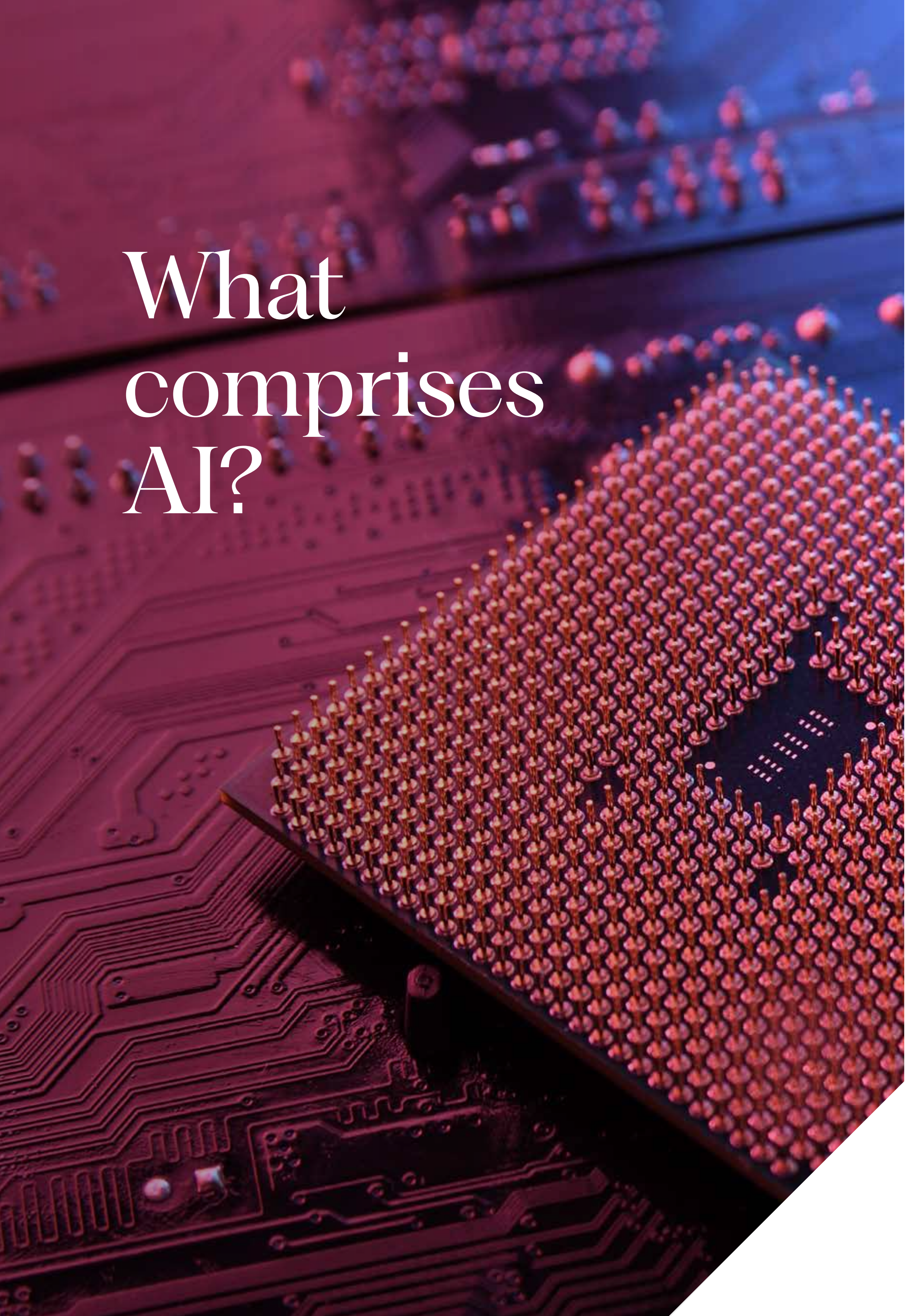


Artificial Intelligence ("AI") is increasingly being used by large companies to enhance decision-making, increase efficiency, optimise supply chains and uncover new growth opportunities. As technology continues to evolve, it is no longer "if" businesses should adopt AI but which AI models are best to deploy and how quickly they can be utilised. This pressure is particularly acute with the emergence of "AI first" delivery models in certain markets. For listed companies, it is important to understand how managing AI fits into existing corporate governance, reporting and corporate responsibility frameworks, as well as helping boards to take steps to understand the associated risks and opportunities.

This paper sets out:

- key governance considerations for large groups and listed companies relating to the use and implementation of AI;
- an overview of the existing framework of legislation and guidance in the UK to regulate AI;
- relevant market commentary for Boards on adopting and managing AI; and
- insights on market practice amongst the largest listed companies in the UK when reporting on AI.

Whilst the content below is primarily focused at UK listed companies, it will in many ways be applicable to large privately held companies and multinationals listed elsewhere.



What comprises AI?

The Organisation for Economic Co-operation and Development (the "OECD") defines AI as "a machine-based system that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments. Different AI systems vary in their levels of autonomy and adaptiveness after deployment".

The UK Government's paper [Establishing a pro-innovation approach to regulating AI] suggests that these systems are 'adaptable' because they can find new ways to meet the objectives set by humans, and 'autonomous' because, once programmed, they can operate, to varying extents without human control.

AI comprises a complex and evolving set of fields and is not a singular piece of technology. AI models include a broad, interconnected range of algorithms, models and processes. The key terms which are often referred to as AI include:

- **Machine learning:** This refers to a particular artificial intelligence technique which can be used to enable computers to learn and adapt without following explicit instructions, by using algorithms and statistical models to analyse and draw inferences from patterns in data.
- **Large Language Models:** This refers to a particular artificial intelligence technique which can be used to allow computers to create new content (such as text, code, images), including for example, Generative AI or "GenAI".
- **Agents:** This refers to artificial intelligence systems that can operate autonomously, set goals, and take action with minimal human intervention to achieve those goals. Unlike other AI which primarily responds to commands, agentic AI can plan and execute tasks, and adapt its behaviour based on changing conditions and real-time data.

Other key models include Text Analytics, Chatbots, Speech Recognition, Supervised Learning, Deep Learning, Robotics, and Transformer Architecture, amongst others.

Together, these components form the backbone of modern AI, driving innovation across industries and reshaping how businesses and individuals interact with technology.

"AI" therefore acts as an all-encompassing umbrella term describing a wide range of technologies that enable machines to engage in tasks that would otherwise require human input.

Existing Framework of Legislation and Guidance for AI Governance in the UK

The UK Government continues to adopt a decentralised approach to regulating AI. Existing legislation and reporting frameworks already provide a robust foundation governing Boards' oversight of novel technologies such as AI and the impact thereof on companies and their stakeholders.

The key existing reporting requirements include the following:

- **Section 172 Statement:** Directors are required to publicly report on how they have considered each year, amongst other things, (i) the likely consequences of any decision in the long term, including an explanation of the effect on the company's decisions and strategies during the year, (ii) the issues, factors and stakeholders that the Directors consider relevant in complying with section 172, and (iii) the main methods used by the Directors to engage with stakeholders and understand the issues to which the Directors should have regard. As companies adopt AI, we expect that disclosures detailing that adoption will become increasingly relevant for Section 172 statements.

- **Description of Principal Risks and Uncertainties under Companies Act 2006 and UK Corporate Governance Code:** Pursuant to the Companies Act 2006, the annual report must contain a description of the principal risks and uncertainties facing the company, which in practice includes risks that might threaten the company's business model, future performance or result in significant value erosion. Provision 28 of the UK Corporate Governance Code (the "Code") also requires the Board to confirm in the company's annual report that it has carried out a robust assessment of the emerging and principal risks facing the company, which procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated. For many companies AI may be an emerging rather than a principal risk and/or opportunity.

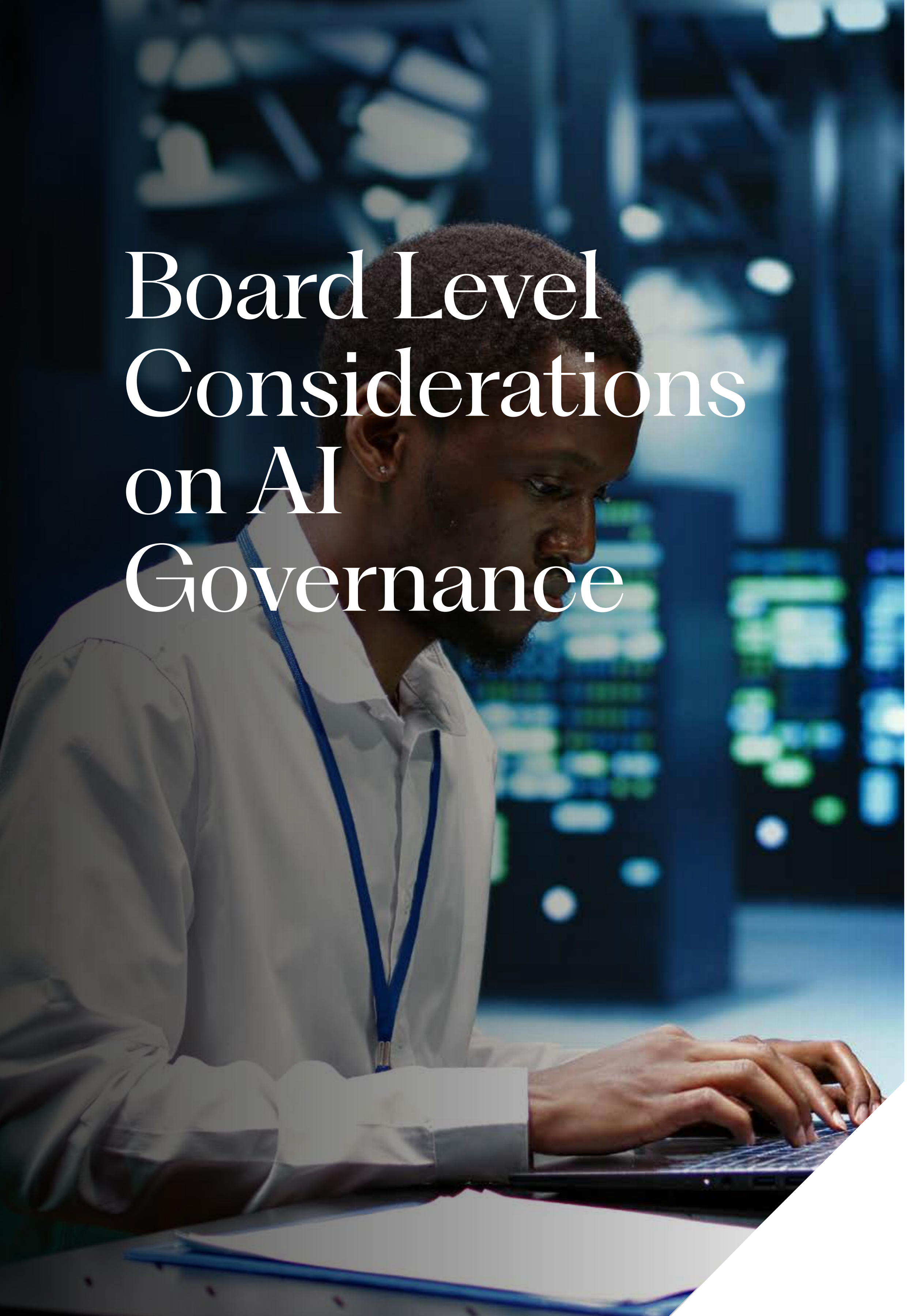
- **Disclosure of Material Controls under UK Corporate Governance Code:** Provision 29 of the Code (applicable for reporting periods beginning on or after 1 January

2026) requires that, when monitoring and reviewing the effectiveness of the company's risk and internal control framework, the Board should ensure this covers all material controls, including financial, operational, reporting and compliance controls. The 2024 Corporate Governance Code Guidance (the "Code Guidance") describes "material controls" as including "information and technology risks, including cybersecurity, data protection and new technologies such as artificial intelligence". The Code Guidance also sets out an expectation that Boards will at least consider whether controls over emerging technologies like AI are material and therefore should be monitored, reviewed and reported on under the Code. The above has also been echoed by the Financial Reporting Council (the "FRC") which notes in its Insight report: AI, Emerging Tech and Governance that "[e]xisting aspects of the Corporate Governance code and S172 regulations provide the framework for considering the implications of new technologies, including AI".

In its Annual Review of Corporate Governance Reporting published in November 2024, the FRC commented on AI-related reporting, noting as follows:

> "It is important that Boards have a clear view of the responsible development and use of AI within the company and the governance around it"

To do so, Boards may need to upskill, improve access to training or draw on the expertise of management and specific company knowledge.



Board Level Considerations on AI Governance

Due to the all-encompassing nature of AI technologies, Boards are encouraged to holistically consider AI alongside wider business and governance considerations, whereby AI governance and due diligence procedures should be proportionate to the potential impacts of companies' AI-related activities.

The International Corporate Governance Network (the "ICGN") notes in its AI Engagement Guide that companies should articulate their approach to AI in an overarching statement or set of principles, and embed responsible AI in existing company policies such as their Code of Conduct, Information Security, and Data Privacy policies. The ICGN also recommends that Boards ensure that company management implement existing regulation and relevant standards on responsible AI. These may include, amongst others, the OECD's AI Principles, which form a global framework for responsible AI and promote innovative, trustworthy AI that respects human rights and democratic values.

Boards may consider the implications of AI on other aspects of the governance of their organisations as well as corporate reporting more generally, including the following:

- **Role of AI in ESG Reporting:** Integrating AI into companies' ESG practice can help to enhance efficiencies in reporting processes by streamlining the workflow and generating quality information. Companies are increasingly using AI solutions to streamline their data analysis for ESG reporting, with data and analytics companies using AI to analyse various sources of data from companies, including sustainability reports, to produce assessments on the extent of a company's commitment to ESG topics and insights on company performance in real-time.

  Based on a review of annual reporting for FY2025 of 30 of the largest UK listed companies (see further below), a fifth of companies considered the interaction of AI with ESG considerations. Three companies detailed investments into AI-driven tools and sustainability technology to enhance agricultural analysis, assess client transition plans or combat food waste, with one further company describing AI as a tool for its drive to net zero. Another company surveyed described employing AI software as part of assistive technology support for employees.

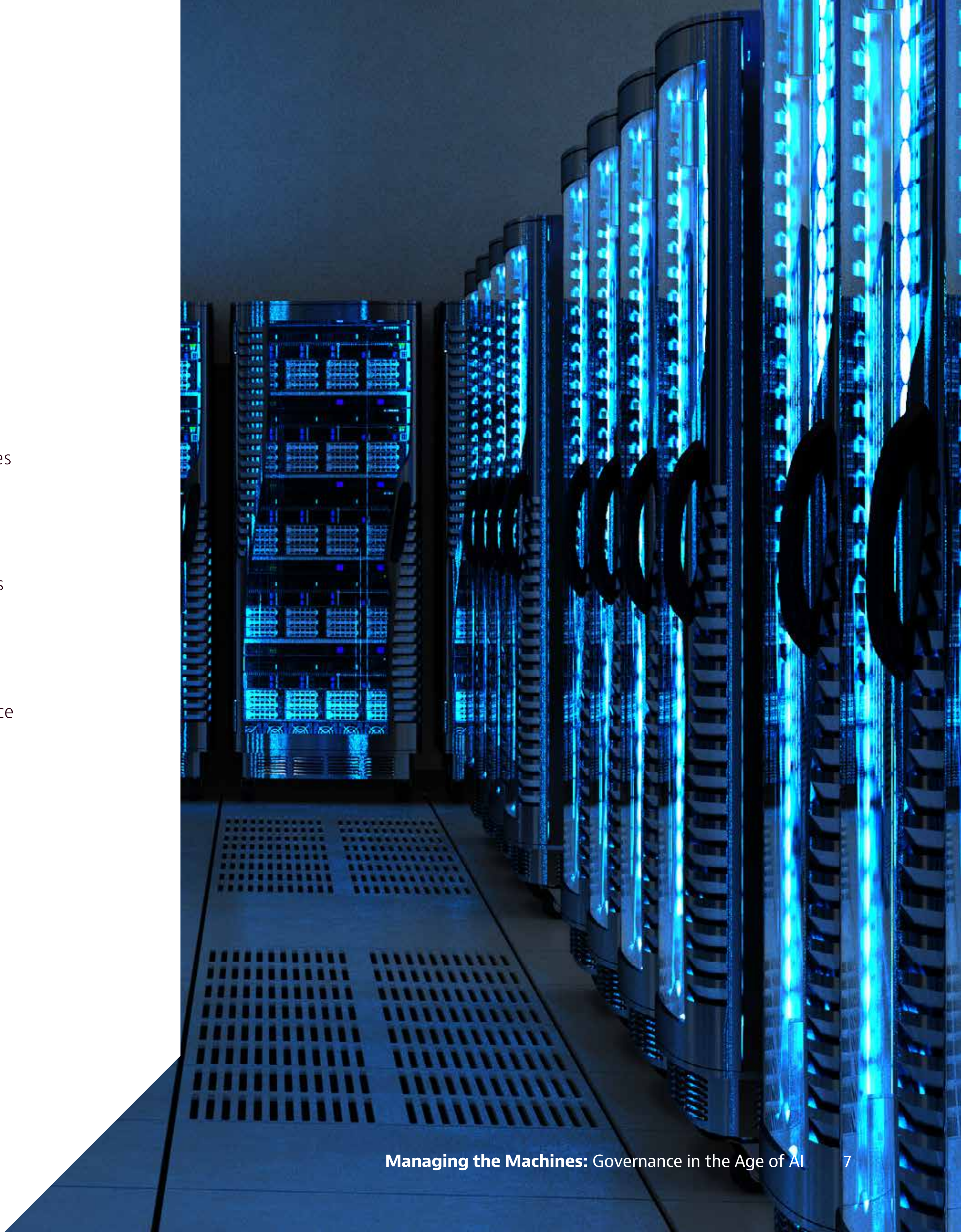
- **Data Privacy and Protection:** AI technologies can exacerbate surveillance risks by increasing the amount of personal data (such as, for example, end-users' online behavioural data) being collected. Moreover, risks can also arise from the processing, use, analysis and storage of personal data, including from forecasting individuals' behaviours or making inferences about individuals' attributes beyond the information explicitly captured in the various data points collected (so-called 'aggregation risks').

  As noted by the ICGN in its AI Engagement Guide (see further below), understanding the implications of the use of AI for human rights to privacy and data protection, equality and non-discrimination is a fundamental element of AI governance. The Information Commissioner's Office (the "ICO") echoes this, noting that companies should be transparent about how their AI systems collect, use, and store personal data. In the UK and EU, this includes adhering to (i) the General Data Protection Regulation ("GDPR") (including lawfulness, fairness, transparency, data minimisation, and accountability), (ii) the Data Protection Act 2018, and (iii) sector-specific guidance from regulators such as the ICO.

- The ICO's Guidance on Governance and accountability in AI lists a number of control measures it expects companies to put in place, including, amongst others, a documented and embedded privacy management framework endorsed by senior management which supports the AI system's development, use and oversight. Putting in place an accountability mechanism for AI governance supplemented by guidelines that consider appropriate use and ethical implications of AI as well as clear reporting lines and regular training programmes may be useful to guide companies' conduct and allow Boards to retain oversight of AI-based decision making.

  The ICO in its report on Agentic AI, AI'll get that! Agentic commerce could signal the dawn of personal shopping 'AI-gents' also makes clear that "technological advancements must not come at the cost of data privacy" and emphasises that poorly implemented Agentic AI could lead to data protection harms. Therefore, the connection between AI and data protection laws, guidance and enforcement remain closely linked and reinforces the need for strong AI governance that addresses the intersection and dependencies of data protection.

- **Accounting Considerations – ISO/IEC 42001:2023:** To ensure responsible development and use of AI system, companies providing or utilising AI-based products or services are encouraged to consider ISO/IEC 42001 (Information technology - Artificial intelligence - Management system). ISO/IEC 42001:2023 is an international accounting standard that specifies requirements for establishing, implementing, maintaining, and continually improving an Artificial Intelligence Management System (AIMS) within organisations. It includes guidance on matters including, amongst others, (i) setting an acceptable use AI policy governed at board level, (ii) AI risk and impact management and accountability, (iii) performance evaluation and continuous improvement, (iv) documentation and transparency, and (v) embedding ethical principles into governance processes.



Market Commentary on Listed Company Boards' Role regarding AI

Many private and public stakeholders are showing a growing interest in how companies are addressing the challenges and leveraging the opportunities arising from the deployment of AI. The predominant concerns relate to companies using AI in a safe, ethical, and sustainable manner as well as to companies' ability to effectively manoeuvre AI-related challenges whilst maximising the benefits of its integration.

Highlighted below are the views and expectations of key stakeholders in the UK corporate environment which Boards may wish to consider to anticipate areas of interest and concern of investors and public bodies alike, and to assess the robustness of their AI oversight.

- **UK Government's AI Opportunities Action Plan and Code of Practice:** In January 2025, the UK Government published its national AI Action Plan, setting out a need to (i) invest in the foundations of AI, (ii) push hard on cross-economy AI adoption and encouraging the private sector to rapidly pilot and scale AI products and services, and (iii) position the UK to be an "AI maker" rather than an "AI taker", with the aim being to foster national champions at critical layers of the AI stack.

  This was supplemented by a voluntary Code of Practice for the Cyber Security of AI aimed at various stakeholder groups forming the AI supply chain. Such stakeholders include organisations responsible for embedding / deploying AI models within their infrastructure as well as end users such as employees who use AI models for any purpose, including to support their work and day-to-day activities. The Code of Practice sets out twelve Principles to address the cyber security risks arising from the use of AI, which include, amongst others, (i) raising awareness of AI security threats and risks, (ii) maintaining regular security updates, patches and mitigations, and (iii) enabling human responsibility for AI systems.

- **Glass Lewis UK Benchmark Policy 2026:** According to Glass Lewis' UK Benchmark Policy, companies should consider adopting strong internal frameworks that include ethical considerations and ensure they have provided a sufficient level of oversight of AI. Boards may seek to ensure effective oversight and address skills gaps by engaging in continued board education and / or appointing directors with AI expertise. They should provide clear disclosure concerning the role of the Board in overseeing issues related to AI, including how companies are ensuring Directors are fully versed on this issue. Oversight may be effectively conducted by specific directors, the entire Board, a separate committee, or combined with the responsibilities of a key committee. In the absence of material incidents, Glass Lewis has not issued any general voting recommendations.

- **ISS Global Benchmark Policy Survey:** The ISS Proxy Voting Guidelines and Benchmark Policy Recommendations do not currently refer to AI or any related voting recommendations. However, as part of its 2025 Global Benchmark Policy Survey, ISS asked whether companies should publicly share how their Boards oversee AI business or AI implementation systems with the goal of managing AI-related risks. A majority of respondents, which included investor and non-investor from various countries including the UK and the US, indicated that they would consider this necessary "only in cases where AI plays a significant role in the business or business strategy (where businesses already have or plan to implement significant AI use)". These findings are in line with the position of the FRC which has reiterated in its latest Review of Annual Corporate Reporting that companies should generally include only "material and relevant information", noting that good quality reporting does not necessarily require a greater volume of disclosure.
- **Pensions UK's Stewardship and Voting Guidelines 2025:** According to Pensions UK's Stewardship and Voting Guidelines 2025, investors should consider voting against the re-election of a director where there is evidence of "egregious conduct" around the development and deployment of AI. Pensions UK recommends that companies should have a governance framework for the acceptable use of AI, implement robust data anonymisation techniques and adopt a "zero-trust" approach when selecting AI tools and third-party services. Investors should assess whether companies have board-level accountability for AI, disclose responsible use frameworks, and align with emerging standards on transparency and fairness.

The growing interest and scrutiny from investors and proxy bodies of companies' AI risk assessment and governance procedures is a direct reflection of the increasing prevalence of AI-related disclosures and reporting. Indeed, market insights indicate a clear consensus that AI is becoming a permanent consideration for Boardroom discussions and companies' strategic outlook, as is explored in the following section.

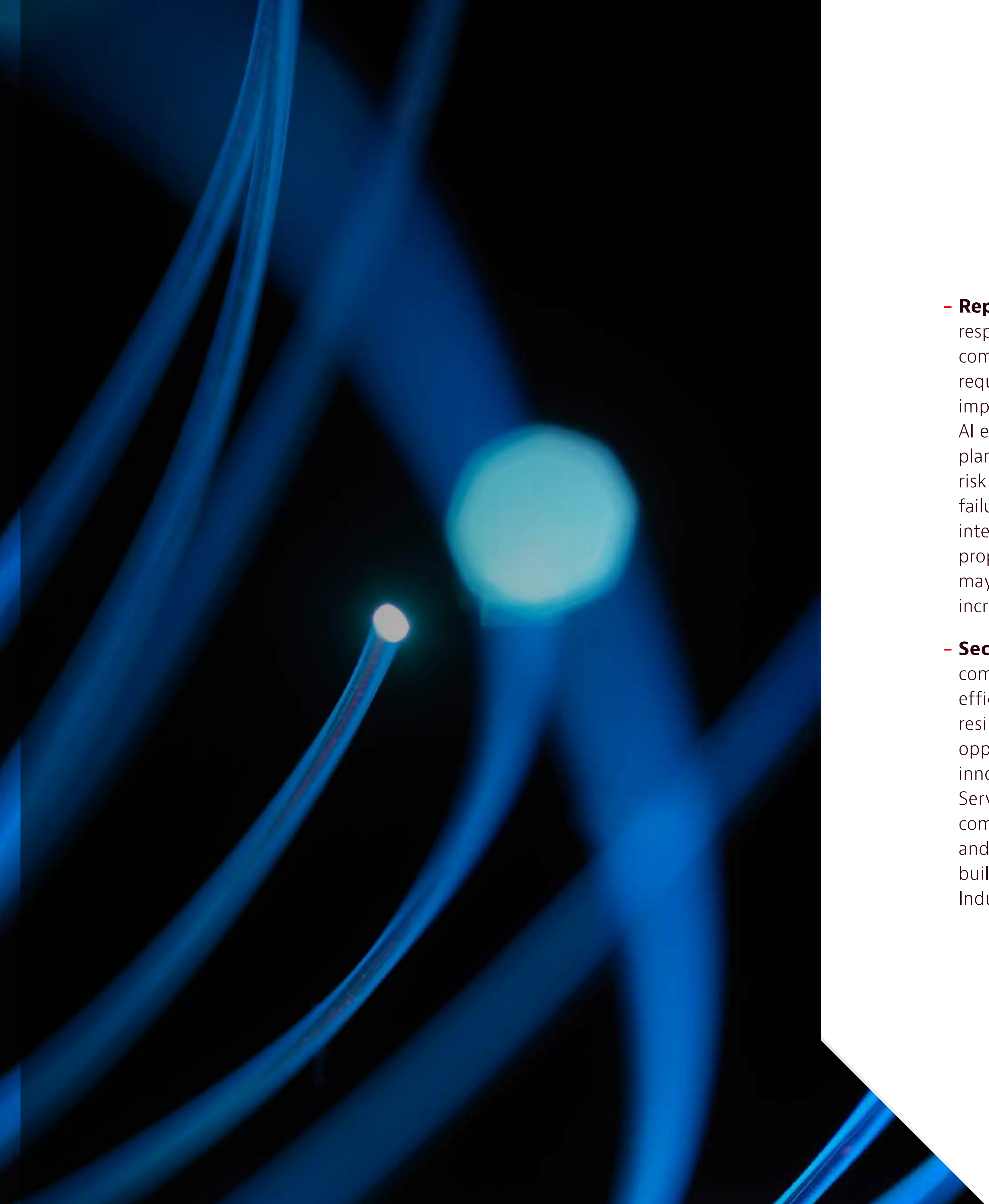
Emerging Themes from Listed UK Company Annual Reporting

AI is already increasingly considered in the annual reports of listed UK companies, with key themes emerging on how listed companies report on AI and what is included in these reports:

- **Strategic report and stakeholder involvement:** Almost all FTSE 30 companies mentioned AI in the FY2025 reporting year, showcasing its importance in the market at present, with 28 companies referencing AI in their strategic reports:
  - **Board Strategy:** AI is increasingly a strategic priority for boards, reflected in Board discussions and deep-dive sessions on generative AI, with companies reporting that they plan to integrate AI training into Board training programmes, to understand the risks associated with AI and what responsible AI use is in the context of the future success of their company and informing strategic decisions for growth opportunities.
  - **GenAI and Machine Learning:** Some companies make reference to extensive AI activities, applying "advanced algorithms such as machine learning and natural language processing to provide professional customers with the actionable insights they need to do their jobs, for example, in the form of extractive AI insights to help them make speedy and accurate decisions, or generative AI output to reduce or automate their workload".
  - **Pilot Initiatives:** At least one company launched pilot AI initiatives with a global network of specialists to monitor restoration efforts with the objective of collecting primary data through drones, audio sensors and artificial intelligence.
  - **Strategic Opportunities:** Opportunities have been identified by large and listed companies in relation to transforming manufacturing processes, brand-building, increasing efficiencies and even increasing responsiveness to cyber, IT and data privacy risks.

- **Strategic Partnerships**: It is clear that listed and large companies in the UK are actively engaging in AI-driven partnerships to drive product development and industry initiatives to enhance technology solutions with aims to improve operational efficiency, and address ethical considerations. Companies have been collaborating and are seeking to collaborate with AI technology providers to invest, develop and acquire AI tools to improve administrative efficiency, create tools to assist with document and biometric verification and are using AI to improve safety and reporting.
- **Regulatory Development**: Some organisations are actively participating in global regulatory initiatives on AI and collaborating with other organisations to gain insight into developments into future regulation and AI governance strategies.

- **Risk:** A key emerging theme is the risk profile associated with AI, with AI mentioned as a risk factor consistently in annual reports of UK listed companies and across other large company reporting. AI is consistently identified as an emerging and material risk, with companies coining AI as an "emerging risk factor". There were several key risk factors which underpinned the reporting:
  - **Cybersecurity:** Companies highlight the risk of cybersecurity threats, AI-enabled cyber-attacks and social engineering, including the weaponisation of AI by cyber threat actors, geopolitics and "hacktivism" research practices.
  - **Regulatory Uncertainty:** It is anticipated that EU and global AI regulations may create compliance challenges in the future. As is discussed later in this section, many companies suggest that this risk can be mitigated by implementing internal AI regulatory and governance frameworks now ahead of any future proposed regulation. The implementation of AI governance policies has been suggested by certain companies in order to ensure they are protecting against risk of internal misuse, leading to operational, reputational and ethical risks as outlined below.
  - **Operational Disruption:** Risks associated with failing to adopt or integrate AI effectively into business models are also front of mind, with organisations reporting that recruiting and retaining AI talent is a focus to maintain product quality. AI has been identified as a potentially "disruptive technology" which is being actively monitored as an operational risk and a "trend" that may result in market volatility and change, credit risk, increased cyber-attacks, increased risk of IT challenges posing a threat and disruption of company's key operations.



- **Reputational and Ethical Risks:** Misuse of AI and responsible AI practices are key themes throughout listed company reporting. Certain companies note that AI will require investment, with risks associated to failure to implement, setting up plans to ensure responsible use of AI ensuring that AI governance is included in internal audit plan engagement. AI has also been linked as a key execution risk factor among companies, which have highlighted failures "to successfully design, implement and sustain an integrated framework and operating model for AI". Without proper oversight, many companies report that misuse of AI may open the company up to reputational challenges and increased scrutiny.
- **Sectoral Themes**: However, whilst AI is seen as a risk, companies also recognise the transformative potential in efficiency gains in operations and manufacturing, enhanced resilience in technology and information security and opportunities for personalised customer engagement and innovation. Identified risks differ by sector, with Financial Services institutions focused on model risk, regulatory compliance and cybercrime mitigation; Consumer Goods and Retail focusing on risks related to AI's role in brand building and supply chain transformation; Energy and Industrial firms focused on AI-driven load forecasting and resource competition risks; and Healthcare and Pharmaceuticals looking at talent acquisition, research integrity and patient engagement.

- **Director experience:** In the previous reporting year, a small number of companies also looked at AI-experience and board composition, with some companies reporting on numbers of non-executive and independent non-executive directors who are knowledgeable in AI and can provide input on AI matters. It is expected that this may become an increasing trend in the next reporting year.

- **Governance and Training:** Many organisations are moving beyond simply identifying AI-related risk factors to implementing formal governance structures to address AI concerns:
  - **AI Governance Frameworks:** Many companies have already introduced "Responsible AI frameworks" which apply globally to guard against misuse of AI internally and ensure AI use is compliant with internal policy. Other companies have reported on their inclusion of AI in risk management and ethics programmes as a key goal for the next financial year, with companies currently developing principles-based rules, AI codes of conduct and planning to publish "AI Standard Operating Procedures".

- **Board Training and Meeting Agendas:** Certain companies plan to hold Board training sessions and expert-led discussions to understand responsible use of AI in the next financial year, planning deep-dive sessions on GenAI to leverage technological capabilities, including digital, data and AI in order to achieve a competitive advantage. Some listed companies already include AI as a standing item for Board meetings, with AI strategy meetings also being a key agenda item on Board "strategy days".
- **Employee Training:** Several companies are prioritising AI capability within their organisations through employee education including structured training programmes, learning hubs and AI awareness initiatives, with one company reporting its AI training hub has been established to "democratise AI awareness and knowledge building by providing access to all colleagues to immersive learning opportunities, interactive simulations and practical case studies".

  There is a clear concerted effort for both listed and large companies to ensure that the AI technologies used are "fair, safe, transparent, explainable, accountable and sustainable, and that they comply with existing legislation and any emerging legislation".

- **Committee work:** A number of organisations have established, or are seeking to establish, specialised committees and/or governance councils to oversee matters related to AI. This reflects AI's growing importance in ethical, operational and strategic contexts. These committees monitor and review AI adoption and strategic direction in areas such as R&D, Technology, Innovation and Audit, balancing the exploitation of AI opportunities against responsible use by reference to internal and governance frameworks. Certain organisations are also using committees to acquire AI and machine learning modelling tools for research purposes.
- **Director and employee performance and AI:** AI has been reported by certain companies as forming part of Board evaluation and employee performance reviews, with use of AI reported as a justification for director and employee bonuses. Certain organisations are using AI to build career frameworks for employees, identifying skills gaps and offering personalised career paths and learning opportunities. Other organisations have provided AI coaches to provide personalised and professional guidance to employees.

Looking ahead

Recognising that AI governance is crucial for long-term value creation and risk mitigation, it is becoming central to Boards' governance and oversight responsibilities. Effective Board oversight enables AI adoption to enhance companies' resilience and performance whilst ensuring its implementation aligns with applicable regulation and ethical standards and policies.

This has been echoed by the Institute of Directors (the "IoD") which has published a Business Paper on AI Governance in Boardrooms setting out 12 Principles of how Boards should manage and oversee AI.

Please see the infographic on the next page for details.

01.
Monitor the evolving regulatory and (geo)political environment

02.
Continually audit and measure what AI is in use, along with principles, processes and controls

03.
Undertake impact and risk assessments that consider the business and its wider stakeholder community

04.
Establish board accountability and management responsibilities for AI governance

05.
Set high-level strategic goals for AI adoption aligned with the organisation's values and business objectives

06.
Empower a cross-functional, operational independent review committee

07.
Validate, document and secure data sources, and assess data assets

08.
Train and upskill people to use AI effectively and responsibly, and embed in the culture

09.
Comply with privacy requirements, including those set out in relevant data protection legislation

10.
Comply with security-by-design requirements to ensure systems are cyber resilient

11.
Test and evaluate systems and remove from use if unintended impacts or harms are discovered

12.
Review systems, policies and governance practices regularly

As is clear from the growing interest and scrutiny of both public and private stakeholders as well as indicative market trends on reporting, AI technologies are at the forefront of companies' strategy and are being firmly – and permanently – placed on Boards' agendas. As companies adjust to the intensifying speed of development and adoption of AI and explore its potential for long-term value creation, corporate reporting is increasingly reflective of these trends and highlight the crucial role AI has assumed in the corporate landscape and beyond.

January 2026

Key Contacts

Baker McKenzie
Tier 1 Corporate Governance
Legal 500

Tom Quincey
Partner, Corporate Finance

+44 20 7919 1219
tom.quincey@bakermckenzie.com

Jo Hewitt
Partner, Corporate Reorganisations

+44 20 7919 1597
jo.hewitt@bakermckenzie.com

James Thompson
Partner, Corporate Finance

+44 20 7919 1954
james.thompson@bakermckenzie.com

Nick Bryans
Partner, Corporate Finance

+44 20 7072 5627
nicholas.bryans@bakermckenzie.com

Charlotte Nolan
Partner, Corporate Reorganisations

+44 20 7919 1050
charlotte.nolan@bakermckenzie.com

Vinod Bange
Partner, Commercial

+44 20 7919 1480
vin.bange@bakermckenzie.com

Adele Harrison
Partner, Commercial

+44 20 7919 1249
adele.harrison@bakermckenzie.com

Robert Adam
Partner, Corporate Finance

+44 20 7919 1863
robert.adam@bakermckenzie.com

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