

AI washing: The SEC is focused on your AI disclosures

By Mayme Donohue, Esq., and Alexander Abramenko, Esq., Hunton Andrews Kurth LLP*

JULY 11, 2024

The pace of SEC rulemaking has been fast and furious recently and its focus on emerging technology and cybersecurity is sharper than ever. In addition to the SEC's increased enforcement activity in the digital asset space and new disclosure rules related to cybersecurity risks, they have also become increasingly focused on AI washing, both in enforcement actions and public remarks.

"AI washing" (which follows the trendy ESG-related term, "Greenwashing") is the new buzzword to describe a company overexaggerating its use of AI in an attempt to attract investors.

Recent SEC enforcement actions targeting AI washing

In March, the SEC announced the settlement¹ of enforcement actions against two different investment advisers, both of which were charged with making false and misleading statements about their purported use of AI. Civil penalties in these settlements were collectively \$400,000.

In March, the SEC announced the settlement of enforcement actions against two different investment advisers.

In one case,² the SEC targeted statements made on the firm's marketing materials, press releases and website that claimed, for example, that the firm "[p]uts collective data to work to make our artificial intelligence smarter so it can predict which companies and trends are about to make it big and invest in them before everyone else."

The SEC found that this and related statements about the firm's use of AI were false or materially misleading after the firm admitted during the investigation that, "it had not used any of its clients' data and had not created an algorithm to use client data."

In the other case,³ the SEC found that the firm made false and misleading statements on its website and social media about its purported use of AI. For example, the firm falsely claimed to be the "first regulated AI financial advisor" and falsely claimed that its platform provided "[e]xpert AI-driven forecasts."

The SEC's message is clear with these enforcement actions, if you say you are using AI, you better be sure that you are. In a video⁴ released about these enforcement actions, the SEC's Director of the Division of Enforcement, Gurbir S. Grewal said that these,

"enforcement actions should serve notice to the investment industry, that if you claim to use AI in your investment processes, you must ensure that your representations aren't false, they aren't misleading."

SEC's public warnings against AI washing

In a speech⁵ in February, SEC Chair Gary Gensler had AI top of mind and focused almost the entirety of his remarks on AI and the SEC's corresponding regulatory duties.

Chair Gensler was first focused on the risks he sees associated with the use of AI including, the conflicts of interests raised by AI for advisers, the problems presented by AI hallucinations and the threat that AI could pose to the stability of capital markets. According to Chair Gensler, AI washing encompasses not just outright false claims, but also overly generalized disclosures that do not actually help investors.

With AI making the headlines almost daily, companies may feel pressured to reference AI in some way in their public disclosures, even if there is not anything concrete to report. This, Chair Gensler says, is a mistake. In particular, he cautioned against:

- boilerplate AI disclosures not particularized to the company;
- disclosing the use of AI models when the underlying technology is not actually AI-driven; and
- AI-related projections that do not have a reasonable basis.

In no uncertain terms, Chair Gensler makes clear "that AI washing may violate the securities laws."

In March, on the same day that the SEC announced the AI washing settlements discussed above, Chair Gensler released one of his infamous YouTube videos⁶ focused entirely on AI washing.

In the video, while acknowledging that "AI is the most transformative technology of our time," he expresses his concern that, "when new technologies come along, we've also seen time and again false claims to investors by those purporting to use those new technologies." In no uncertain terms, Chair Gensler makes clear "that AI washing may violate the securities laws."

Chair Gensler has been joined in his warnings to the public markets by the SEC's Director of the Division of Enforcement, Gurbir S. Grewal. In public remarks⁷ in April, Director Grewal focused on his perceived problematic disclosures by investment firms on their use of AI as well as disclosures by public companies. Director Grewal cautioned investment firms to pause before making claims about their use of AI in the investment process to attract new investors.

Take a step back, and ask yourselves: do these representations accurately reflect what we are doing or are they simply aspirational? If it's the latter, your actions may constitute the type of "AI-washing" that violates the federal securities laws.

Director Grewal also encouraged "proactive compliance" as a tool to avoid violating disclosures rules when it comes to AI washing, suggesting that companies and their counsel should focus "education, engagement, and execution."

- Individuals responsible for a company's disclosures should first educate themselves on emerging and heightened AI risks by reviewing the SEC's enforcement actions, reading Chair Gensler's remarks on AI, staying updated on how AI-related issues are actually impacting companies in practice.
- After educating themselves, individuals responsible for public disclosure should engage stakeholders inside their company's different business units to learn how AI intersects with their activities, strategies, risks, financial incentives, etc.
- Finally, companies should then execute a plan to ensure their internal policies, procedures and disclosure controls appropriately reflect how the company is actually using AI and the related risks.

About the authors



Mayme Donohue (L) is a Richmond, Virginia-based partner in **Hunton Andrews Kurth LLP's** capital markets group. She counsels clients on securities law matters, capital markets transactions, mergers and acquisitions, and corporate governance issues. She is also a leader of the firm's AI, metaverse and emerging technologies practice, a member of the firm's blockchain working group, and associate editor of the Blockchain Legal Resource blog. She can be reached at mdonohue@HuntonAK.com. **Alexander Abramenko (R)** is an associate in the firm's capital markets group in Washington, D.C. He focuses on capital markets transactions, securities law reporting and disclosures, corporate governance, and general corporate law. He

can be reached at aabramenko@HuntonAK.com. This article was originally published May 9, 2024, on the firm's website. Republished with permission.

This article was published on Westlaw Today on July 11, 2024.

* © 2024 Mayme Donohue, Esq., and Alexander Abramenko, Esq., Hunton Andrews Kurth LLP

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.

Takeaways

If you are a public company that is either using AI, thinking about using AI or in an industry that AI has the potential to impact, now is the time to critically think about your public disclosures. It is a public company's responsibility to be able to articulate to investors how the company is using AI without crossing the line into aspirational uses that are not yet viable or deployed.

At the same time, the risks of using, or not using AI, must also be analyzed and disclosed to the extent material to the business. For example, saying nothing about AI if your company is exposed to AI-related risks is also potentially a problem.

As we have seen with other emerging technologies, it is more important than ever for the legal department to be working closely with product and strategy teams to really understand how a company is using AI. If the risks of AI washing are properly managed, how a company describes its use of AI and the related risks presents an opportunity to successfully engage with investors in the space.

Notes:

¹ <https://bit.ly/3WcrbuW>

² <https://bit.ly/3XXE9y0>

³ <https://bit.ly/3zwBQHT>

⁴ <https://bit.ly/4eRAAPH>

⁵ <https://bit.ly/3zAN7H8>

⁶ <https://bit.ly/3We6wq6>

⁷ <https://bit.ly/3RWIJZm>