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# Navigating New Frontiers in Regulatory Enforcement: the SEC Increases Scrutiny of Artificial Intelligence

The SEC is Keeping a Watchful Eye on Companies' Claims about their AI Capabilities and Issued a Recent Warning: Don't "AI-Wash"

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In July 2023, the SEC proposed new rules that would require broker-dealers and investment advisers to take certain actions to address potential conflicts of interest that could arise through the use of predictive data analytics and other technologies powered by AI.

On December 5, 2023, during remarks at The Messenger AI Summit, SEC Chair Gary Gensler warned public companies against "AI washing"—or misrepresenting their AI capabilities or making misleading statements about the role of AI in their businesses—and compared this act to "greenwashing" in the ESG context, which has come under increasing SEC scrutiny over the past few years.<sup>1</sup> Chair Gensler noted that public statements made by reporting companies about their AI capabilities fall squarely within the ambit of securities law and must be "full, fair and truthful." On December 14, in remarks before the Financial Stability Oversight Council, Chair Gensler hailed AI as "the most transformative technology of our time, on par with the internet and mass production of automobiles."<sup>2</sup> Yet he cautioned that, while AI can "create great efficiencies across the economy," it has the potential to be used to deceive investors and could lead to a "monoculture" caused by the dominance of a small number of platforms. And the DOJ has taken notice as well, joining other regulators' efforts to prevent bias and discrimination from the use of AI and monitoring AI tools for anticompetition effects.

It is clear that, as was witnessed with the rising use of cryptocurrency, transformative technology can and does pose regulatory difficulties. Maintaining knowledge of the underlying product and how it is understood in the marketplace is critical to regulation—and defense—in these contexts. When prosecuting and defending so-called AI washing allegations, regulators, defense counsel and companies will have to get up to speed on the technical aspects of AI in order to determine full, fair and truthful disclosure has been achieved. Before asking whether a company misrepresented its AI capabilities, regulators will have to arrive at an understanding of what AI is, how it is understood by developers and investors, and what makes a statement misleading, rather than simply misunderstood by the market. Mounting a successful defense will require similar knowledge on the part of companies and their counsel.

In light of Chair Gensler's remarks, companies should expect heightened scrutiny of public statements about their AI capabilities. Regulators will be pursuing these cases not only to send a message, but also to develop an understanding of how AI washing can be prosecuted and regulated. Companies should consider whether they are accurately representing the role of AI in their businesses and engage counsel that can draw from a broad range of expertise to help regulators contextualize what AI really is in various scenarios and how it figures into the delivery of goods and services by companies. White & Case's Global Technology Industry Group draws from various disciplines and is prepared to address these issues—and is doing so for clients already.

1 Enforcement Task Force Focused on Climate and ESG Issues.

2 Remarks before the Financial Stability Oversight Council: 2023 Annual Report.

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