

# *SEC Targets Investment Firms Over “AI-Washing” Claims*

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On March 18, 2024, the Securities and Exchange Commission (SEC), settled with two investment advisers over alleged “AI Washing,” a colloquial reference to the practice of companies making false, misleading, or exaggerated claims concerning their businesses’ use of artificial intelligence (AI). The announcement from SEC Chairperson Gary Gensler comes as part of a broader regulatory push to increase scrutiny of AI-related statements, as well as to deter any novel risks posed by machine learning, including risks relating to conflicts of interest,<sup>[1]</sup> market manipulation, and deception. These enforcement actions—likely arising from the SEC sweep of investment advisers and their AI-based tools in December 2023<sup>[2]</sup>—underscore the need for public companies and investment firms to scrutinize their AI disclosures, policies, and procedures.<sup>[3]</sup>

Investment advisers Delphia (USA) Inc. and Global Predictions Inc. separately settled with the SEC, with Delphia agreeing to pay a \$225,000 civil penalty, while Global Predictions agreed to pay \$175,000. The SEC alleged that Toronto-based Delphia misled the public in SEC filings, public statements, and on its website over its purported use of AI and machine learning in support of its investment strategy.<sup>[4]</sup> The SEC further alleged that Global Predictions made false statements concerning the use of AI, incorrectly claiming that its platform used “expert AI-driven forecasts” and that the firm promoted itself as the “first regulated AI financial advisor.”<sup>[5]</sup> Although these settlements also concern state of the art technology, they differ in significant ways from the SEC’s previous case against Charles Schwab and its alleged misconduct associated with its robo-advisor, Schwab Intelligent Portfolios (SIP). There, the alleged misconduct concerned omissions regarding Schwab’s mandated disclosures for SIP and its failure to inform clients about potential cash drags on their investments, whereas here, the SEC pursued allegedly overblown or otherwise misleading statements regarding the firms’ AI capabilities.<sup>[6]</sup>

These settlements—the first-ever instances charging violations of the antifraud provisions of federal securities law in connection with AI-related statements—reflect federal agencies’ willingness to pursue potential deceptive representations about AI.[7] In connection with the settlements, SEC Enforcement Director Gurbir Grewal underscored that, “if you claim to use AI in your investment processes, you need to ensure that your representations are not false or misleading. And public issuers making claims about their AI adoption must also remain vigilant about similar misstatements that may be material to individuals’ investing decisions.” Grewal’s admonition tracked closely with a warning the FTC issued last year, “not to overpromise what any algorithm or AI-based tool can deliver. Whatever it can or can’t do, AI is important, and so are the claims you make about it.”[8]

Although AI is a new frontier of regulatory enforcement, this week’s enforcement actions are consistent with other recent regulatory actions to address misstatements on other novel securities issues. In April 2022, the SEC charged Vale, S.A., a publicly traded Brazilian mining company, with “greenwashing”—that is, false, misleading, or exaggerated claims concerning a company’s environmental, social, and governance (ESG) policies or credentials, an allegation which resulted in a \$55.9 million settlement last year.[9]

Whether the subject of the disclosure relates to emergent technologies or traditional accounting, compliance with SEC and FTC rules largely requires compliance with one precept: full, fair, and truthful disclosure. To that end, companies and investment advisors that employ AI should carefully: i) scrutinize their AI systems’ capabilities, including keeping an inventory of what AI technology is being used, assessing whether such use presents any conflicts of interest or violates applicable rules and regulations, and avoiding hypothetical language when describing their AI practices and capabilities; ii) maintain copies of AI-related supervisory policies and procedures; iii) ensure that their compliance and legal departments work with their communications and marketing teams to scrutinize public statements and marketing materials to ensure that they align with the reality of their AI systems’ performance; and, iv) consider training for executive, marketing, sales, and business development personnel on the legal and reputational risks of AI-related misrepresentations

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[1] In July 2023, the SEC proposed rules to address potential conflicts of interest that the SEC believes are posed by the use of predictive data analytics, including AI. The proposed rules would generally require firms to take steps to analyze their predictive data analytics and similar technologies and determine the extent to which they place the interests of the firm above those of its investors. See *SEC Proposes New Requirements to Address Risks to Investors From Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers*, U.S. Sec. & Exch. Comm’n (Jul. 26, 2023), <https://www.sec.gov/news/press-release/2023-140>.

[2] See *SEC Probes Investment Advisers’ Use of AI*, W.S.J. (Dec. 10, 2023), <https://www.wsj.com/articles/sec-probes-investment-advisers-use-of-ai-48485279>.

[3] See, e.g., *FTC Action Leads to Ban for Owners of Automators AI E-Commerce Money-Making Scheme*, Fed. Trade Comm’n (Feb. 27, 2024), <https://www.ftc.gov/news-events/news/press-releases/2024/02/ftc-action-leads-ban-owners-automators-ai-e-commerce-money-making-scheme>; “AI, Finance, Movies, and the Law” Prepared Remarks Before the Yale Law School, U.S. Sec. & Exch. Comm’n (Feb. 13, 2024) (“If a company is raising money from the public, though, it needs to be truthful about its use of AI and associated risk.”).

[4] *SEC Charges Two Investment Advisers with Making False and Misleading Statements About Their Use of Artificial Intelligence*, U.S. Sec. & Exch. Comm’n (Mar. 18, 2024), <https://www.sec.gov/news/press-release/2024-36>

[5] *Id.*

[6] See *Schwab Subsidiaries Misled Robo-Adviser Clients about Absence of Hidden Fees*, U.S. Sec. & Exch. Comm'n (Jun. 13, 2022), <https://sec.gov/news/press-release/2022-104>.

[7] See, e.g., *Keep Your AI Claims in Check*, Fed. Trade Comm'n (Feb. 27, 2023) <https://www.ftc.gov/business-guidance/blog/2023/02/keep-your-ai-claims-check> (warning companies that the Federal Trade Comm would levy its enforcement powers against those making misleading statements concerning their AI).

[8] *Id.*

[9] *SEC Charges Brazilian Mining Company with Misleading Investors about Safety Prior to Deadly Dam Collapse*, U.S. Sec. & Exch. Comm'n (Apr. 28, 2022), <https://www.sec.gov/news/press-release/2022-72>.

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