

INSIGHTS

Compliance Isn't the Only 'AI Washing' Risk

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Companies are rapidly adopting artificial intelligence technologies, and both regulators and private plaintiffs have set their sights on “AI washing,” where businesses tout AI capabilities that do not exist.

The term “AI washing” originates from green washing, where firms make false or misleading statements regarding their environmental or sustainability initiatives. At a conference late last year, SEC Chair Gary Gensler announced that the commission was focused on AI washing, and reminded attendees that securities laws require “full, fair and truthful” disclosures. “Don’t do it,” Gensler said, reiterating that “one shouldn’t greenwash, and one shouldn’t AI wash. I don’t know how else to say it.”

Not surprisingly given Gensler’s warning, the SEC last month [announced the settlement](#) of two enforcement actions involving misleading AI claims, both against registered investment advisers. Those advisers, according to the SEC, represented to the market that they used artificial intelligence when, in fact, they did not. In both cases, the investment advisers agreed to pay a fine and cease and desist from further violations.

There is little doubt that additional SEC enforcement actions will follow, not to mention actions by other regulators, such as the Federal Trade Commission and the Commodities Futures Trading Commission, seeking to curb AI-related misrepresentations by industry participants. Indeed, most federal regulators have launched AI task forces, seemingly consistent with President Joe Biden’s October 2022 [executive order on AI](#), which warned that the “[u]se of new technologies, such as AI, does not excuse organizations from their legal obligations, and hard-won consumer protections are more important than ever in moments of technological change.”

But risks do not end with regulators, as companies engaged in AI washing are also exposed to private lawsuits brought by shareholders claiming an exaggeration of AI capabilities. In February, for example, software company Innodata Inc. [was sued in federal court](#) by a proposed class of investors alleging its stock price dropped more than 30% after a financial research firm, Wolfpack Research, published a report saying Innodata’s artificial intelligence technology was “smoke and mirrors,” and that its marketing claims were akin to “putting lipstick on a pig.”

Given the proliferation of AI — or supposed AI — across industries, more lawsuits like this can be expected, and even if such cases are found ultimately to be without merit, they can expose a

firm to serious financial and reputational harm.

To avoid enforcement and litigation risk related to AI washing, companies should take steps now to ensure their public statements about artificial intelligence capabilities are not false or misleading. In this regard, it is important for companies to understand what AI is, and what it is not. Technology generally qualifies as AI only if it exhibits some level of learning, adapting and autonomy. On the other hand, technologies merely providing advanced automation and statistical analysis are not necessarily considered AI.

These AI washing considerations, as well as the numerous other risks associated with AI — such as privacy, data security, and data “hallucinations” — must become part of the compliance “playbook” for any company using artificial intelligence.

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