

Regulatory and Enforcement Alert

SEC Fines Two Investment Advisers for “AI Washing”

March 19, 2024

On March 18, 2024, the SEC [announced](#) settled charges against two investment advisers for making false and misleading statements about their use of artificial intelligence (“AI”), which the SEC refers to as “AI washing.” By analogy, the SEC has pursued “[greenwashing](#)” cases in connection with false and misleading statements about ESG, which has been anticipated to provide a playbook for the SEC to pursue AI-related perceived disclosure failures.

In yesterday’s settlements, the advisers settled anti-fraud charges (Sections 206(2) and 206(4) of the Advisers Act), violations of the Marketing Rule (Rule 206(4)-1), and policy violations (Rule 206(4)-7). The advisers paid combined civil penalties of \$400,000.

One settlement involved a registered investment adviser that provided robo-advisory services to retail accounts and also managed pooled investment vehicles. The [Order](#) found that the adviser made false and misleading statements in its Form ADV Part 2A brochures, in a press release, and on its website, a sampling of which is as follows:

- That the adviser’s advice was “powered by the insights it makes when individuals . . . connect their social media, banking, and other accounts . . . or respond to [adviser] questionnaires” which make its investment decisions “more robust and accurate”;
- That client data was used in “a predictive algorithmic model” for the selection of investments;
- That the adviser “uses machine learning to analyze the collective data shared by its members to make intelligent investment decisions”; and
- That the adviser puts “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 Order alleged that the adviser had not developed the stated capabilities and noted that the adviser conceded during an examination that it had not created an algorithm to use client data nor otherwise used the client data. The Order detailed post-examination remediation undertaken by the adviser, including corrective disclosure, onboarding a Compliance Manager, and retaining compliance consultants. However, the Order found that the adviser continued to make false and misleading statements in email communications, on social media, and in a press release, as follows:

- That client data was helping train the adviser’s “algorithm for pursuing ever better returns” and was pooled “to power [the adviser’s] algorithm”;
- That the adviser’s “proprietary algorithm uses the data being invested by our members, so we can make stock selections across thousands of publicly traded companies up to seven financial quarters in the future”; and
- That the adviser’s “proprietary algorithms combine the data invested by its members with commercially available data, to make predictions across thousands of publicly traded companies up to two years into the future.”

The second settlement involved a registered investment adviser that was an internet investment adviser to retail clients, on similar conduct (as well as other conduct unrelated to statements concerning AI). The [Order](#) found that the adviser made false and misleading statements on social media, on its website, and in emails to current and prospective clients, with certain AI-related statements as follows:

- That the adviser’s technology incorporated “expert AI-driven forecasts”; and
- That the adviser was the “first regulated AI financial advisor.”

The Order found that these statements were inaccurate.

In the SEC press release accompanying the two settlements, SEC Chair Gary Gensler commented that the two advisers “marketed to their clients and prospective clients that they were using AI in certain ways when, in fact, they were not. We’ve seen time and again that when new technologies come along, they can create buzz from investors as well as false claims by those purporting to use those new technologies. Investment advisers should not mislead the public by saying they are using an AI model when they are not. Such AI washing hurts investors.” Enforcement Director Gurbir Grewal gave a similar warning in the press release: “[I]f you claim to use AI in your investment processes, you need to ensure that your representations are not false and misleading.”

Broader Context of SEC Scrutiny of AI-Related Disclosures

Yesterday’s settlements come on the heels of public remarks by Chair Gensler about concerns over AI washing. For instance, [last month](#), Gensler, in addition to making comments in connection with public company AI washing, stated the following with respect to investment advisers and broker-dealers: “Investment advisers or broker-dealers also should not mislead the public by saying they are using an AI model when they are not, nor say they are using an AI model in a particular way but not do so. Such AI washing, whether it’s by companies raising money or financial intermediaries, such as investment advisers and broker-dealers, may violate the securities laws.” Gensler acknowledged, as he has [before](#) in other contexts, that the SEC is a “merit neutral” agency and stressed the importance of “full, fair, and truthful disclosure” concerning AI.

While yesterday’s settlements involved retail investors, and focused on fairly straightforward disclosure failures, the SEC’s current focus on AI is expansive and extends beyond advisers to retail clients. SEC officials have stated

publicly that they are scraping registrants' publicly available statements (*e.g.*, Form ADVs, websites) about their use of AI and that AI is going to be a larger part of the examination program this year—and such commentary is not limited to advisers to retail clients. Also, notably, though these settlements did not involve public issuers, Director Grewal's press release comments included a warning to those entities: "And public issuers making claims about their AI adoption must also remain vigilant about similar misstatements that may be material to individuals' investing decisions."

Takeaways

- Advisers need not avoid contemplating or using AI; but disclosures must accurately reflect actual uses of AI.
- Advisers should consider whether their advertisement review processes incorporate review for AI-related statements.
- Advisers should consider whether their websites and social media sites are being monitored for AI-related statements.
- Advisers should consider inventorying all uses of AI at the sponsor level, including across different investment teams and offices, and ensure that policies are sufficiently tailored and applied uniformly.

Conclusion

The settled Orders serve as a good reminder to ensure that an adviser's disclosures are consistent with policy and practice—including in the AI space as here, but also in other areas (such as in the ESG space). The settled Orders also demonstrate that the SEC has existing tools to enforce AI-related misconduct even in advance of, or without, adoption of an AI-specific SEC rule.

Finally, while yesterday's settlements were focused on disclosures and AI washing, sponsors should be mindful of other potential risks related to AI (such as conflicts; improper use of confidential data; allocation of AI-related expenses; etc.) and develop appropriate controls.

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