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AI Disclosures Under the Spotlight: SEC Expectations for Year-End Filings

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The Securities and Exchange Commission (SEC) is increasing its scrutiny on artificial intelligence (AI)-related disclosures; therefore, companies must tread carefully as year-end reporting season approaches. Specifically, they have expressed a keen interest in how companies disclose their AI usage, business strategy, and risk. Below, is a summary of the SEC's expectations for disclosures, as well as recent enforcement actions that underscore the importance of compliance.

What Do Effective AI Disclosures Look Like?

The SEC has recognized the transformative impact that AI has on industries and financial markets but has made clear that it will require companies to explain how AI shapes their business strategies and operations, how they rely on the technology, and its potential risks and impacts.

Effective AI disclosures should therefore be tailored to address key questions, such as:

- **What is AI?** Define what the company means by "artificial intelligence." For instance, is it referring to machine learning algorithms, predictive models, or other forms of AI?
- **Where is AI used?** Clarify how and where AI is being applied within the organization. Is it being used in operations, customer interactions, investment decisions, or otherwise?
- **Who developed the AI?** Specify whether the AI technology is proprietary or sourced from third-party vendors. These details provide important context for assessing risks and dependencies.

The SEC also underscored that companies must be careful not to overstate their use of AI or mislead investors about its application. Companies should not say they use an AI model when in reality they do not and should not exaggerate AI's performance or capabilities. According to the SEC, such misrepresentations not only undermine investor trust but also invite regulatory scrutiny and potential enforcement actions.

Building on the SEC's guidance, companies should adopt a proactive approach to their AI disclosures by:

1. Providing Contextualized Details: Avoid simply listing AI as a capability or buzzword. Instead, explain specific applications and how AI contributes to strategic objectives or operations.

2. Disclosing Material Risks: Highlight risks associated with AI, such as operational reliance on third-party providers, potential algorithmic biases, discrimination risk, or compliance with emerging regulations.

3. Ensuring Accuracy: Avoid "AI-washing," or the overstatement of AI's capabilities, as this can mislead investors. Verify that all statements about AI usage are truthful and supported by evidence. This includes avoiding speculative claims about future capabilities or outcomes.

These tailored disclosures not only comply with the SEC's current expectations but also enhance transparency, potentially providing a competitive advantage by enabling investors to better understand how AI is integrated into the company's business and the associated risks and opportunities. Transparent AI disclosures not only comply with SEC expectations but can also build both trust and a stronger foundation for future growth, as well as ensure companies stay ahead in a fast-evolving market.

Recent Enforcement Actions Highlighting AI Risks

Recent SEC enforcement actions underscore its zero-tolerance approach to misleading claims and exaggerated portrayals of AI capabilities in investor communications, signaling a clear warning to companies to prioritize truth over hype. Below are recent notable examples:

1. Global Predictions, Inc.

Global Predictions claimed to use "expert AI-driven forecasts" and promoted itself as the "first regulated AI financial advisor" – without substantiating these statements. The SEC found that Global Predictions misled investors by advertising hypothetical performance metrics not based on actual data and overstating the capabilities of its AI models.

2. Delphia (USA) Inc.

Delphia claimed that it used AI and machine learning to analyze client data, such as client spending and social media data for improved investment decisions. In reality, Delphia never developed these promised capabilities. This case highlights the risks of using AI in your marketing strategy without delivering on such promises.

3. AI Investment Claims in Fundraising

The SEC has also targeted several companies that exaggerated their AI capabilities during fundraising rounds. For example, leveraging "AI" as a buzzword to attract investments while failing to substantiate those claims with verifiable data. Such actions have been described as "old school fraud using new school buzzwords like 'artificial intelligence' and 'automation.'"

These enforcement actions serve as a stark reminder: AI-related claims must be truthful, specific, and backed by evidence. Overhyping or misrepresenting AI can shatter investor trust and unleash significant regulatory and reputational fallout.

Conclusion

Navigating the SEC's evolving expectations for AI disclosures can be challenging, but compliance is critical to maintaining investor trust and avoiding regulatory pitfalls. With the year-end reporting season upon us, ensuring your company's disclosures are accurate, comprehensive, and aligned with SEC guidance is critical.

Should you have any questions, need assistance with AI disclosures, or want to discuss ways to protect your business and position it for long-term success in these areas, please reach out to the authors: Matt White, Justin Daniels, Javier Becerra, or any member of Baker Donelson's team of experienced Artificial Intelligence attorneys.