Lessons From The SEC's 2024 Crackdown On AI Washing

By **Keith Miller and Stephen Hogan-Mitchell** (January 2, 2025)

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As artificial intelligence technology continues to reshape business operations, some companies and advisers have overstated or misrepresented their AI capabilities to attract investors or retain their competitive edge.

This practice, referred to as AI washing — a nod to greenwashing, whereby corporations make misleading claims about the environmental impact of their products, services or business — was the subject of increased scrutiny from the U.S. Securities and Exchange Commission in 2024 following a surge in the commercial adoption of generative AI technologies in 2023.[1]

In this article, we discuss the SEC's 2024 crackdown on AI washing, highlighting the cases arising last year that underscore the SEC's focus, and offer practical strategies businesses can implement in 2025 to reduce the risk of SEC scrutiny over their AI-related claims moving forward.

Taking Aim at AI Washing

In early December 2023, SEC Chair Gary Gensler publicly warned companies against AI washing. Around the same time, news spread that the SEC had begun to investigate companies falsely touting the AI capabilities of their products.[2] Reports also emerged that the SEC was probing the use and governance of AI among investment advisers.[3]

On Jan. 25, 2024, the agency took further action, issuing an investor alert cautioning the public about scams involving "[f]alse claims about a public company's products and services relating to AI."[4]

Just a week later, the SEC demonstrated its commitment to enforcing these warnings when it announced a settlement involving fraud charges against Brian Sewell and his firm, Rockwell Capital Management, tied to misleading and deceptive AI claims aimed at students enrolled in Sewell's online crypto trading course, the American Bitcoin Academy.[5]

The SEC claimed that from early 2018 to mid-2019, Sewell solicited hundreds of students who enrolled in his online crypto-asset trading course to invest in the Rockwell Fund, a hedge fund Sewell claimed he was forming to invest in crypto-assets using specific investment strategies. The SEC alleged that the students received a pitch deck that falsely claimed that Sewell utilized cutting-edge technologies, including artificial intelligence, machine learning and machine algorithms, to generate significant returns.

However, according to the SEC, neither the AI technology nor the fund itself ever materialized. When announcing the settlement, Gurbir S. Grewal, former director of the SEC's Division of Enforcement, warned: "Whether it's AI, crypto, DeFi or some other buzzword, the SEC will continue to hold accountable those who claim to use attention-grabbing technologies to attract and defraud investors."

The SEC continued its crackdown in March, when it simultaneously announced two additional settlements with investment advisers Delphia (USA) Inc. and Global Predictions Inc. related to false and misleading statements regarding their use of AI.[6]

In Delphia's case, the SEC alleged that the robo-adviser misrepresented the capabilities of its "predictive algorithmic model," misleading clients about its functionality and effectiveness. According to the SEC, in Delphia's Form ADV filings to the SEC, in a press release and on its website, Delphia misled the public when it claimed that it used AI and machine learning that incorporated client data during its investment process.

For example, the SEC alleged that Delphia falsely claimed that it "put 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 SEC also claimed that Delphia falsely promoted itself as "the first investment adviser to convert personal data into a renewable source of investable capital ... that will allow consumers to invest in the stock market using their personal data."[7]

In reality, according to the SEC, Delphia never actually integrated AI or machine learning into its algorithm, making its claims both false and misleading. These misrepresentations, the SEC contended, violated Sections 206(2) and 206(4) of the Advisers Act, as well as the SEC's Marketing Rule 206(4)(1).

Similarly, the SEC claimed that Global Predictions made false and misleading statements in 2023 on its website and on social media about its purported use of AI, its status as the "first regulated AI financial advisor" and the services that it offered.

According to the SEC, Global Predictions falsely claimed that its technology incorporated "expert AI-driven forecasts," when in fact it did not. Global Predictions also inaccurately advertised itself as the "first regulated AI financial advisor" on its public website, in emails to current and prospective clients, and on various social media sites.[8]

However, the SEC claimed these representations were false and unsupported, and charged the company with violating numerous federal securities laws, including Section 206(2) of the Advisers Act.

SEC's Continued Crackdown Against AI-Related Misrepresentations

The SEC ramped up its AI-related enforcement throughout the summer of 2024.

On June 11, it filed charges against Ilit Raz, the founder and CEO of Joonko Diversity Inc., an AI hiring startup. According to the SEC, Raz falsely claimed to use AI to help clients find diverse and underrepresented candidates to fulfill their diversity, equity and inclusion goals.[9] Specifically, the SEC claimed that Raz falsely told investors that Joonko's technology was based on seven different AI algorithms that used "natural language processing and computer vision to scan public data on the candidates that are referred to [Joonko]," and that the "matching of candidates was automated from end to end."[10]

In August, the SEC announced charges against QZ Asset Management Limited, a China-based investment adviser, along with its U.S.-based holding company, QZ Global Limited, and CEO Blake Yeung Pu Lei. The charges included, among other things, allegations that QZ Asset Management fraudulently claimed it would use proprietary AI-based technology to generate extraordinary weekly returns — between 2.5% and 7% — while promising 100% protection for client funds.[11] According to the SEC, these statements were completely false, and QZ Asset and its CEO vanished, misappropriating at least $6 million of client funds.

On Oct. 10, the SEC settled charges with Rimar Capital USA Inc., Rimar Capital LLC, CEO Itai Liptz and board member Clifford Boro.[12] Rimar Capital had raised nearly $4 million from investors by promoting an AI-driven trading application that promised superior returns. However, the SEC alleged that Rimar Capital had no such AI-based trading application.[13] The settling defendants agreed to pay $310,000 in civil penalties. In announcing the settlement, Andrew Dean, co-chief of the SEC's Asset Management Unit, emphasized that "[a]s AI becomes more popular in the investing space, we will continue to be vigilant and pursue those who lie about their firms' technological capabilities and engage in 'AI washing.'"[14]

The SEC filed another set of charges shortly after the announcement of the Rimar Capital action — this time against Destiny Robotics Corp. and its CEO and sole officer and board member, Megi Kavtaradze. The startup had promoted itself on social media as the creator of a "socially intelligent" humanoid hologram and a robot to serve as an at-home personal assistant and companion.

According to the SEC, the defendants represented that Destiny Robotics' robot would use cutting-edge technology and AI and be "capable of understanding and responding to human emotions, allowing for personalized interactions and companionship ultimately reducing loneliness and promoting mental well-being."[15] While the startup's public statements touted the technological breakthroughs underlying the development of the robot, the SEC alleged that the company had made no such advances in technology and that the AI in the prototype was limited to AI and facial recognition software that the company purchased.[16]

As part of the settlement, the defendants agreed to judgments that permanently enjoined them from violating the securities laws and required them to pay disgorgement and civil penalties totaling approximately $65,000.[17]

How Companies Can Mitigate Risk

While the incoming Trump administration may bring about an overall less aggressive enforcement approach, the risk of continued enforcement actions in the AI area remains.[18] In addition, the increase in SEC enforcement actions in 2024 was accompanied by a continued stream of private actions brought by investors seeking damages associated with misleading AI claims, including a recent securities class action transferred to the U.S. District Court for the Southern District of New York against public company Oddity Tech Ltd. and a number of its executives.[19]

Companies can consider the following actions to mitigate the risks of claims of AI washing.

Ensure accuracy when making representations about AI capabilities.

The most fundamental takeaway from these enforcement actions is the importance of making truthful and well-supported statements about AI capabilities.

While the technologies may be cutting-edge, the regulatory claims themselves are nothing novel. The SEC's scrutiny of AI claims is just the latest area of focus on misleading or inaccurate statements made by firms.

To stay compliant, companies should avoid exaggerating the features, functionality or potential impact of their AI technologies, and ensure that all public statements are reasonable and verifiable with supporting evidence.

Establish robust compliance procedures.

As AI becomes more integral to business operations, companies may benefit from having in place robust compliance processes to carefully review all public statements related to AI. This includes vetting marketing materials, investor presentations, social media posts and press releases to ensure they accurately reflect the company's AI capabilities. A well-structured compliance framework can help prevent misstatements that could trigger regulatory scrutiny.

Promote transparency with investors.

Open and honest communication is essential when discussing emerging technologies such as AI. Companies should be candid about both the strengths and limitations of their AI systems. Overpromising or making vague, unsubstantiated claims can lead to trouble with regulators. Providing investors with a balanced, realistic view of the technology ensures trust and mitigates risk.

Prepare for heightened scrutiny.

If the SEC's focus on AI continues, companies across all sectors will need to be prepared to demonstrate that statements about their AI capabilities are accurate and backed by actual performance data. Preparing for this scrutiny in advance will help companies avoid compliance pitfalls.

Looking Ahead to 2025

AI washing involves more than just flashy marketing — it encompasses making material misstatements about a company's technology and misleading investors about its potential to affect growth, efficiency or market share. As seen in recent enforcement actions, the SEC has emphasized that investors were misled by buzzwords and promises of cutting-edge AI technology that, in reality, either did not exist or was far less robust than advertised and described.

As AI technology continues to proliferate, businesses must exercise greater caution in how they present their capabilities to investors. While exaggerating AI potential might seem immaterial, the long-term risks — such as fines, reputational harm and even criminal charges — are far more severe.

The message to companies looking ahead to 2025 is clear: Transparency, accuracy and accountability are essential when communicating about AI.

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[1] https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai.

[2] https://www.wsj.com/articles/sec-head-warns-against-ai-washing-the-high-tech-version-of-greenwashing-6ff60da9?mod=article_inline.

[3] https://www.wsj.com/articles/sec-probes-investment-advisers-use-of-ai-48485279.

[4] https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/artificial-intelligence-fraud.

[5] https://www.sec.gov/newsroom/press-releases/2024-13.

[6] https://www.sec.gov/newsroom/press-releases/2024-36.

[7] https://www.sec.gov/files/litigation/admin/2024/ia-6573.pdf.

[8] https://www.sec.gov/files/litigation/admin/2024/ia-6574.pdf.

[9] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26020.

[10] https://www.sec.gov/files/litigation/complaints/2024/comp26020.pdf. On July 31, 2024, the United States District Court for the Southern District of New York issued an order staying the case in its entirety pending the conclusion of a parallel criminal case.

[11] https://www.sec.gov/newsroom/press-releases/2024-109; https://www.sec.gov/files/litigation/complaints/2024/comp-pr2024-109.pdf.

[12] https://www.sec.gov/newsroom/press-releases/2024-167?utm_medium=email&utm_source=govdelivery.

[13] https://www.sec.gov/files/litigation/admin/2024/33-11316.pdf.

[14] https://www.sec.gov/newsroom/press-releases/2024-167?utm_medium=email&utm_source=govdelivery.

[15] https://www.sec.gov/files/litigation/complaints/2024/comp26157.pdf.

[16] https://www.sec.gov/files/litigation/complaints/2024/comp26157.pdf.

[17] https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26157.

[18] https://news.bloomberglaw.com/securities-law/sec-to-increase-scrutiny-of-ai-tools-used-by-brokers-advisers.

[19] https://dockets.justia.com/docket/new-york/nysdce/1:2024cv06571/627543.