

PROPERTY & CASUALTY

AI Washing The New Frontier of Corporate Scrutiny

By, Christopher Hughes, *Managing Director*
and Vincent Filippini, *Claims Advocate*



The emergence of artificial intelligence (AI) technology is transforming industries and enabling businesses to enhance decision-making, optimize processes and deliver innovative products and services. AI is undeniably changing how businesses operate and people live their daily lives. In today's competitive business landscape, many companies are pushing the boundaries of this technology, openly charting AI strategies to save time and improve bottom lines. However, companies often encounter familiar challenges as they seek to capitalize on this transformative technology.

What is AI Washing?

While AI continues to be a popular topic at dining room tables and in boardrooms, it is also becoming a significant focus for the U.S. Securities and Exchange Commission (SEC). In March 2024, former SEC Chair Gary Gensler released a video coining the term “AI Washing.”¹ This term describes the practice of companies exaggerating or misrepresenting their AI products or services to gain a competitive advantage or appeal to investors. The SEC stated that AI washing may violate securities laws and have taken enforcement actions against companies they believe have engaged in this practice.

Regulatory Action

The same day the SEC released its statement on AI Washing, they announced that Delphia and Global Predictions settled SEC charges and agreed to pay

\$400,000 in civil penalties.² Delphia claimed it “put[s] 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.” However, the SEC found that Delphia did not possess the AI and machine learning capabilities it claimed and had disseminated an untrue statement of material fact. Similarly, Global Predictions, which claimed to be the “first regulated AI financial advisor,” was accused of misrepresenting its AI capabilities.

More recently, the SEC charged Iliot Raz, the founder of Joonko, with fraud for making false and misleading statements about the quantity and quality of Joonko's customers, the number of candidates on its platform and the company's revenue.³ While this case involves other accusations of fraud, it is alleged that Raz used AI washing to defraud investors of at least \$21 million. The SEC's press release stated that they “will continue to police the markets against AI-washing,” indicating their ongoing commitment to monitoring and addressing AI-washing occurrences.

1. [SEC.gov | Chair Gary Gensler on AI Washing](#)

2. [SEC.gov | SEC Charges Two Investment Advisers with Making False and Misleading Statements About Their Use of Artificial Intelligence](#)

3. [SEC.gov | SEC Charges Founder of AI Hiring Startup Joonko with Fraud](#)

4. [FTC Announces Crackdown on Deceptive AI Claims and Schemes | Federal Trade Commission](#)



EU Legislation and US States On the Way

In March 2024, the European Union passed the EU AI Act, becoming the world's first regulator of AI.¹² While the timeline for enforcement extends years into the future for some aspects of the act, organizations utilizing AI or selling AI-based products will need to consider this regulation to operate in the EU. Key considerations include the technology's classification, development and use requirements, transparency mandates, ethical considerations and an outright ban on certain use cases.

While the EU passed a comprehensive AI Act, the United States has various sources regulating AI. In 2024, at least 45 states proposed AI-related legislation, with Utah, California and Colorado enacting laws governing the private sector. Although the federal government has not passed comprehensive AI legislation, existing laws have limited application to AI, and some frameworks and guidelines have been released as executive orders. How the new administration will view AI and its regulation remains to be seen.

The former Federal Trade Commission (FTC) Chair, Lina Khan, entered the fray on September 25, 2024, with a new law enforcement action called Operation AI Comply.⁴ The FTC has agreed to proposed orders with DoNotPay⁵ and Rytr⁶. Additionally, the commission has filed claims against Ascend Ecom⁷ and Ecommerce Empire Builders⁸ and obtained a federal court order related to its case against FBA Machine.⁹

Class Action Claims

Beyond enforcement actions, AI-related securities class action claims are also becoming more common. The Stanford Law School Securities Class Action Clearinghouse has been tracking AI-related security class action filings since the first case in March 2020.¹⁰ Since then, they have tracked 41 filings related to AI, including 15 in 2024.

One notable case involves GitLab Inc.¹¹ Similar to the AI-washing cases brought by regulators, the plaintiffs allege that GitLab made misleading statements about its AI capabilities, claiming it could optimize its product and increase market share. The plaintiffs assert that "the truth emerged" in a later earnings report, which showed weak demand for AI features. The complaint includes transcripts of various earnings calls, arguing that the company overstated its abilities and has had to revise its 2025 earnings projections. While this lawsuit and others like it are still pending, it highlights the significant potential legal and monetary risks.

Limiting Exposure with D&O Coverage

The continuous flow of media attention and regulatory scrutiny surrounding corporate use of AI has inevitably led to several securities class action claims against Directors and Officers, alleging fraudulent statements or disclosures about the benefits of AI to a corporation's business. By all accounts, the AI revolution is in its early days, and we can expect years of corporate adoption and investments in AI. With this increasing exposure and threat of lawsuits against Directors and Officers, it is crucial for companies to understand the current risks and how to protect themselves in case of a securities class action or other AI-related litigation. (See [Artificial Intelligence](#), [Hiring Practices & EPLI](#)) When new risks emerge, it is a good time to review your insurance programs, specifically your D&O insurance, to help ensure you have the necessary coverage and appropriate limits to handle any potential exposure to AI litigation.

5. [Agreement Containing Consent Order \(ftc.gov\)](#)

6. [Rytr: Agreement Containing Consent Order \(ftc.gov\)](#)

7. [Ascend Ecom: Complaint \(ftc.gov\)](#)

8. [ECommerce Empire Builders: Complaint \(ftc.gov\)](#)

9. [Temporary Restraining Order with Asset Freeze, Appointment of a Temporary Receiver, and Other Equitable Relief, and Order to Show Cause Why a Preliminary Injunction Should Not Issue \(ftc.gov\)](#)

10. [Securities Class Action Clearinghouse: Filings Database \(stanford.edu\)](#)

11. [GitLab-complaint-2.pdf \(dandodiciary.com\)](#)

12. [EU AI Act: first regulation on artificial intelligence | News | European Parliament \(europa.eu\)](#)



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