

The image features a solid red background on the left side, which transitions into a dark blue background on the right. The right side is decorated with several vertical, glowing, curved lines in shades of blue and orange, creating a sense of motion and depth. The word "Cooley" is written in a white, serif font on the red background.

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2025 SEC Annual
Reporting Workshop



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AI Disclosures for Public Companies

attorney advertisement

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Inside-Out Approach to Disclosure: Inside

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Inside-Out Approach to Disclosure

- Evaluate/establish company practices
- Evaluate/establish company plans
- Analyze impacts/materiality
- Analyze risks/materiality
- Disclose

Fact Gathering

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How is AI used?

- **Gathering the facts**

- **WHO**
- **WHAT**
- **WHEN**
- **WHERE**
- **WHY**
- **HOW**

How is AI used?

- **WHO**

- Tech companies that develop AI products
- Any kind of company that uses AI products, e.g.,
 - Employers in HR context
 - Financial Services
 - Insurance
 - Healthcare
 - Fintech
- Which business units within the company use AI?

How is AI used?

- **WHAT**
 - Generative AI
 - Analytical AI

How is AI used?

- **WHEN**

- In development, but not yet used in production
- AI training phase
- AI fine-tuning phase
- Beta version
- Used internally in production
- Sold or made available for third-party use

How is AI used?

- **WHERE**
 - Public instance
 - Private instance, closed system
 - In what country are:
 - Servers
 - Users
 - Subjects
 - Training

How is AI used?

- **WHY**

- To vet employee candidates
- To decide credit terms
- To decide insurance rates
- To generate content
- To make medical decisions
- To make investment decisions
- To produce more efficiently
- To make predictions

How is AI used?

- **HOW**

- Trained using public materials (e.g., web scraped training material)
- Trained using own materials
- Trained using third-party materials entrusted or licensed to you
- Trained using inputs (whose inputs?)
- Fine-tuned along the way

Managing & Overseeing AI Use

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Governance

- Governance of AI requires interdisciplinary approach
 - AI task force or committee - multidisciplinary team that is responsible for AI decisions at the company
 - AI policy/guidelines - policies and procedures for use of AI in the business and by third-party providers
 - Developing and using AI fairly/ethically
 - Mitigation of litigation risk
 - Protection of sensitive information (personal data, proprietary info, IP)
 - Oversight and training

Governance

- Governance Tools
 - Questionnaires/surveys to identify and address AI uses throughout the business
 - Template forms
 - Used by personnel to request approval of AI tool or particular AI use
 - Educate personnel on company policies and how to use AI responsibly

Governance

- Third-parties
 - Allocation of duties/responsibilities/risks - allocate responsibilities and risks with third parties who provide AI solutions to the company or to which the company sells AI solutions
 - Service providers
 - Collaborators
 - Products
 - Customers
- Recourse (contract, insurance)
- Unsanctioned or unintentional use of AI

Materiality Assessment

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Measuring Materiality

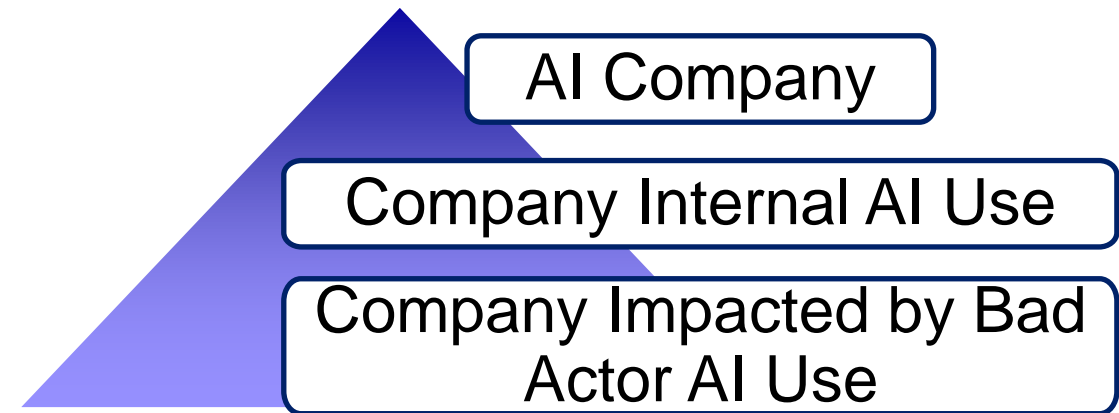
- Importance of AI to the business
 - Significance of business functions utilizing AI
 - Purpose of AI use
- Degree of impact on the business, financial performance or growth, if
 - There were an error in AI-generated output
 - E.g., wrong decision made, incorrect output relied on, hallucinations
 - There were loss of proprietary information
 - E.g., proprietary inputs included in output to another user
- Degree of focus on AI by
 - Board, management, investors

Inside-Out Approach to Disclosure: Outside

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Inside-Out Approach to Disclosure

- Translating practices on the ground to disclosure
- What should be disclosed based on fact gathering (practices, impacts, risks, materiality)
- Public disclosures
 - SEC filings, e.g., registration statements, securities offering documents, annual reports, quarterly reports, current reports, proxy statements
 - Business section, MD&A, governance, risk factors
 - Don't forget to consider company/industry experiences that have driven practices and plans
 - Other disclosures, e.g., ESG/sustainability reports, website, social media, press releases, investor presentations



Inside-Out Approach to Disclosure

- Considerations in formulating disclosure
 - Clarity and specificity
 - Beware of AI-washing in disclosures
 - Beware of under/over-disclosure
 - What is the right level of disclosure?
 - Supportable statements (current state and aspirations)
 - Benchmarking peers
 - Stakeholder expectations
 - Investors
 - Proxy advisory firms
 - Regulators

Disclosure Considerations

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Illustrative Business Uses

- Use of AI to make important decisions about individuals (e.g., employment decisions, credit decisions, insurance decisions, housing decisions)
- Use of personal information to train or fine tune AI
- Use of third-party data or content to train or fine tune AI
- Use of data scraped from the Internet to train or fine-tune AI
- Use of AI for biometric identification of humans (e.g., to determine identity, age, gender, other characteristics)
- Use of likeness or voice of humans to train AI
- Use of third-party content to generate new content using generative AI
- Use of AI in regulated areas

Illustrative Primary Risks

- AI could produce biased results due to the data that it is trained on
- AI could hallucinate, causing erroneous or inaccurate output
- AI could re-identify personal information that had been deidentified
- AI could be used by, or compromised in, a cyber security attack
- Despite monitoring AI usage within the business, the company may not know about all AI that is used within the company or by third-party service providers
- Increased market competition as a result of the use of AI
- Potential obsolescence of products or services

Illustrative Secondary Risks

- AI laws have been, and may continue to be, enacted that require disclosure of proprietary information about AI development and training, which could be a competitive disadvantage
- AI related laws and regulations are in flux and being enacted in various jurisdictions - changes in laws and regulations could inhibit the company's business model, limit or prohibit use of data, or may prevent doing business in certain jurisdictions
- Both AI legislation and litigation is rapidly evolving, which creates uncertainty with respect to rules applicable to the company
- Utilization of AI could lead to claims of misappropriation of publicity rights
- Could suffer claims that company's public statements regarding use of AI, and/or the capabilities of the AI, are overstated and therefore deceptive
- AI bias could lead to claims of resulting negative impacts, which may lead to litigation or regulatory action

Three AI Perspectives

- AI companies (developers, providers of AI)
- Companies that use AI tools
- Bad actor use of AI affecting companies

AI Company (Developer/Provider)

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AI Company

- AI itself is company's main/primary product
- AI is substantial component of primary product
 - i.e., algorithms
- AI is driving force in industry
 - i.e., search engines, semiconductor

Example – AI Software Developer

- **Company develops AI software for customers to enhance their efficiency by automating tasks for data analysis**
- What are potential disclosures relating to the company's business, operations and financial performance?

AI Company – Illustrative Risk Disclosures

- **Competitive risk**
 - Attracting and retaining skilled AI developer talent in competitive space
 - Risk of obsolescence of product/services due to AI tools
 - Impact on absolute costs or relative costs
 - Competitors' adoption of AI
- **Business risk**
 - Overbroad, insufficient, or biased datasets
 - AI “hallucinations”
 - Offensive or harmful content
 - Lack of adoption of AI by consumers

AI Company – Illustrative Risk Disclosures

- Regulatory/legal risk
 - Rapidly evolving regulatory landscape
 - Costs of compliance with evolving law
 - New requirements may require change to product/services
 - Risk of noncompliance
 - IP risk
 - Misappropriation of company's IP
 - Infringement of another company's IP
 - Data protection
 - Improper handling or abuse of sensitive personal or proprietary data

Company AI Use

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Company Internal Use of AI

- AI is used by the company
- AI is used by employees or contractors, whether sanctioned or not
- AI is used in third-party software/tools used by the company

Example – Employee Use of Generative AI

- **Employee uses generative AI tools to create advertising campaigns for the company**
- What are potential disclosures relating to the company's business, operations and financial performance?

Company AI Use— Illustrative Risk Disclosures

- Competitive risk
 - Over-reliance on single or small group of service providers
 - Ethical concerns or potential loss of customer trust due to AI-generated content
- Business risk
 - Lack of oversight into AI platform
- Regulatory/legal risk
 - Safety, ethics, or legality of employee/third party AI usage
 - Protection of internal and user data
 - Potential infringement of copyrighted content

Company Impacted by Bad Actor AI Use

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Company Impacted Bad Actor AI Use

- Bad actor uses AI to...
 - Exploit a company's cybersecurity vulnerabilities
 - Create deepfakes and misinformation to tarnish a company's reputation
 - Use another company's IP/data for AI training
- Inadvertent data misappropriation

Example – Company Impacted by Bad Actor AI Use

- **Bad actor uses AI to spread false information on social media about a company, featuring manipulated quotes and deepfake images**
- What are potential disclosures relating to the company's business, operations and financial performance?

Company Impacted by Bad Actor AI Use – Illustrative Risk Disclosures

- Competitive and reputational risks
 - Negative publicity from fake stories/comments generated by AI
- Business risk
 - Financial burden of protecting company from AI attacks
- Legal and regulatory risks
 - Exposure of customer or company data to cyberattacks or data breaches
 - Potential copying or stealing of company IP and/or processes

Industry Trends

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Risk Disclosure: Industry Trends

- **BPO**

- Risk of obsolescence, reduced demand for services
- Competitive risks from companies that more effectively deploy AI-driven solutions

- **Consumer Goods & Retail**

- Risk of obsolescence, reduced demand for services
- Reputational damage from AI-generated fictitious content on social media

- **Financial Services**

- Exposure to fraud and misinformation
- Vulnerabilities in third-party services

- **Industrial & Manufacturing**

- Competition from AI-driven manufacturing processes
- Cybersecurity and data privacy threats to supply chain operations

- **Life Sciences & Healthcare**

- Cybersecurity and data privacy threats to patient and proprietary research data
- Competition from superior AI-driven solutions
- Employee misuse and abuse of AI tools

- **Technology**

- Risk of obsolescence, reduced demand for services
- Competition from superior AI-driven solutions
- Employee misuse and abuse of AI tools

Questions?

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Resources

- Public Company Resource Hub
- AI Talks: Webinars and Shorts
- Cooley's Artificial Intelligence/ Machine Learning Medical Device Regulatory Handbook
- cyber/data/privacy insights blog
- Cooley PubCo blog
- The Governance Beat

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Thank You

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