

## Client Alert | December 1, 2022

### ESG Continues To Be Under Fire by SEC



On Nov. 22, 2022, the Securities and Exchange Commission (Commission) entered into a settlement order (the Order) with Goldman Sachs Asset Management, L.P. (GSAM) for alleged violations of Section 206(4) of the Investment Advisers Act of 1940 (Advisers Act), as amended and Rule 206(4)-7, the compliance rule, for failure to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act.<sup>1</sup> GSAM agreed to cease and desist from violating the Advisers Act, a censure and to pay a \$4 million fine to the Commission. In the Order, the Commission noted the failure by GSAM to adopt, and subsequently, the failure to implement, written policies and procedures concerning GSAM's ESG investment processes in providing services to an ESG separately managed account and two ESG mutual funds (the ESG investment products).

According to the Order, in 2017, GSAM developed a common framework for its ESG investment processes that included a proprietary ESG questionnaire, the responses to which generated a numerical score to inform decisions regarding the inclusion of an issuer in its ESG investment products. Despite this framework, GSAM did not have written policies and procedures concerning its ESG investment process. In 2018, GSAM adopted written policies and procedures to formalize its ESG investment processes. These policies and procedures required GSAM to complete the ESG questionnaire before including an issuer in an ESG investment product and to maintain completed ESG questionnaires in a shared database. GSAM also made representations regarding the use of the ESG questionnaires to the board of trustees of the two ESG mutual funds, in pitch books to intermediaries, and in requests for proposal. The Commission alleged that (i) GSAM failed to adopt written policies and procedures related to its ESG investment processes prior to 2018, and (ii) when GSAM adopted written ESG policies and procedures, it failed to implement them by not completing the ESG questionnaires for all issuers prior to inclusion in the ESG investment products and by failing to maintain such questionnaires in a central location.

The Order follows the settlement by BNY Mellon Investment Adviser, Inc. (BNY) to charges that it allegedly misstated ESG investment policies for certain mutual funds it managed.<sup>2</sup> In the BNY Settlement, the SEC order stated that BNY represented or implied in various statements that all investments in the funds had undergone an ESG quality review, even though that was not always the case.

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**KEY TAKEAWAYS****What does this mean for investment company and investment adviser clients?**

- The Order demonstrates that the SEC expects investment advisers to adopt compliance policies and procedures under Rule 206(4)-7 related to ESG investment processes. Although Rule 206(4)-7 does not explicitly require policies related to investment processes, this enforcement action demonstrates that the SEC interprets the compliance rule to require such policies to prevent ESG-related funds from deviating from their stated investment goals. Investment advisers should consider their existing policies and procedures in light of this Order.
- The Order does not allege any facts indicating that the lack of completed ESG questionnaires for each position held by the ESG investment products materially impacted the investment decisions or the composition of the funds. Similarly, the Order does not allege any material impact to shareholders or clients.<sup>3</sup> These omissions indicate that the SEC will seek to enforce technical violations of the Advisers Act and rules, regardless of materiality to investment decisions, fund composition or impact on shareholders or clients. Investment advisers should understand that the SEC may bring similar actions as a way to demonstrate its regulatory agenda and prevent possible future violations when it comes to ESG investment products.
- The SEC noted in the Order that GSAM did not provide its staff with sufficient guidance concerning the ESG policies and procedures and related ESG questionnaires. Investment advisers may want to re-evaluate their training for applicable personnel (compliance, investments, legal, etc.) to confirm that all personnel understand their obligations regarding the firm's ESG policies and practices.
- The SEC focused on what was provided to the mutual funds' board, in requests for proposals and in marketing materials and suggested those materials could have been misleading because they referenced the ESG questionnaires that were not routinely completed.<sup>4</sup> Investment advisers should closely review ESG-related materials provided to boards, shareholders and prospective clients in light of the Order.
- **Bottom line:** The SEC remains hyper-focused on what it perceives to be greenwashing by investment advisers and investment companies and will use the existing statutory framework and the full panoply of Advisers Act rules to enforce its ESG regulatory agenda. In light of the aggressive enforcement program under Chair Gensler, additional ESG-related enforcement actions may be on the horizon.

<sup>1</sup> [In re: Goldman Sachs Asset Management, L.P.](#), IAA Release No. 6189 (Nov. 22, 2022).

<sup>2</sup> [In re: BNY Mellon Investment Adviser, Inc.](#), IAA Release No. 6032 (May 23, 2022) (BNY Settlement).

<sup>3</sup> In fact, for one of the mutual funds, the Order indicates that, while the questionnaires were being completed during the initial seed period, the questionnaires were completed for nearly all of the investments prior to launching the fund to the public. Similarly, in the BNY Settlement, the SEC did not allege facts indicating any material impact on the composition of the fund portfolio or to fund shareholders from the failure to conduct an ESG quality review for each investment.

<sup>4</sup> The SEC did not charge GSAM for making false or misleading statements.

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