

Investment Management | September 28, 2023

SEC Continues To Focus on ESG; Third Adviser Settles ESG-Related Enforcement Proceeding



On Sept. 25, 2023, the Securities and Exchange Commission (SEC or the Commission) entered into a settlement order (the Order) with DWS Investment Management Americas, Inc. (DIMA) for alleged violations of Sections 206(2) and 206(4) of the Investment Advisers Act of 1940, as amended (Advisers Act), and Rules 206(4)-7 and 206(4)-8 thereunder.¹ DIMA agreed to cease and desist from violating the Advisers Act and a censure; it also agreed to pay a \$19 million penalty.

In the Order, the Commission alleges that DIMA made materially misleading statements about its controls for incorporating environmental, social and governance (ESG) factors in research and investment recommendations for ESG-integrated products, including certain actively managed mutual funds and separately managed accounts. Additionally, the Commission alleges that DIMA marketed itself as a leader in ESG that adhered to specific policies for integrating ESG considerations into its investments but that DIMA failed to implement certain provisions of its global ESG integration policy, as it had led clients and investors to believe it had. Finally, the Commission noted DIMA's failure to adopt and implement policies and procedures reasonably designed to ensure that its public statements about its ESG-integrated products were accurate.

According to the Order, even though DIMA marketed itself as an ESG leader to clients and to investors in the funds that it managed, beginning in August 2018, DIMA failed to adequately implement certain provisions of the DWS Group GmbH & Co. KGaA (DWS, DIMA's parent company) global ESG integration policy (the Policy) in advising DIMA's ESG integrated products or to otherwise adopt and implement reasonably designed policies and procedures to ensure that its public statements about ESG integrated products were accurate. Among other things, in 2019, a version of the Policy was uploaded on DWS's U.S. public website, through which DIMA marketed its advisory services. In marketing itself and its managed funds and strategies, DIMA represented that, through this Policy, its research analysts were required to include financially material and reputation-relevant ESG aspects in valuation models, investment recommendations and research reports, and to consider material ESG aspects as part of their investment decisions. However, the SEC concluded that this representation was misleading because DIMA failed to adequately implement the Policy's research and monitoring compliance requirements. The SEC found internal analyses showed DIMA research analysts having inconsistent levels of documented compliance with the Policy's requirements to consider ESG factors in research and valuation models. The Policy remained published on the website, creating the impression that DIMA's employees were following the Policy.

¹ In re: DWS Investment Management Americas, Inc., IAA Release No. 6432 (Sept. 25, 2023), available at <https://www.sec.gov/files/litigation/admin/2023/ia-6432.pdf>.

The Order follows similar settlements by Goldman Sachs Asset Management, L.P. (GSAM)² and by BNY Mellon Investment Adviser, Inc. (BNY)³ for ESG policies and procedures failures. In the GSAM settlement, the SEC order stated that GSAM, despite having a common framework for ESG investment processes that included a proprietary ESG questionnaire, did not complete the ESG questionnaire for all issuers prior to those issuers' inclusion in ESG investment products. In the BNY settlement, the SEC order stated that BNY misstated ESG policies for certain mutual funds that it managed and 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.

Key Takeaways

- The SEC is maintaining its position that investment advisers should adopt compliance policies and procedures under Rule 206(4)-7 related to the ESG investment process. Although Rule 206(4)-7 does not explicitly require policies related to investment processes, this enforcement action and the two before it demonstrate 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 DIMA's employees' failure to comply with the Policy and consider ESG factors in research and valuation models materially impacted the employees' investment decisions, nor does it allege any material impact on clients or investors. These omissions indicate that the SEC continues to seek to enforce technical violations of the Advisers Act and rules regardless of materiality to investment decisions or impact on clients. Investment advisers should consider reevaluating 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. Investment advisers also should confirm that appropriate monitoring and controls are in place with regard to those policies and procedures.
- The SEC's investigation began more than two years ago, after a whistleblower alleged that DWS's annual report grossly exaggerated the amount of assets that were under ESG integration. As DWS noted in its press release relating to the settlement, the Order does not allege material misstatements in relation to DIMA's financial disclosures or the prospectuses of its funds.
- The penalties against investment advisers for failing to adopt and/or implement ESG policies and procedures are increasing. While the BNY settlement was for \$1.5 million and the GSAM settlement was for \$4 million, this Order eclipses the other two with a \$19 million penalty (in spite of the Order's statement that the SEC gave DIMA remediation and cooperation credit).



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² In re: Goldman Sachs Asset Management, L.P., IAA Release No. 6189 (Nov. 22, 2022), available at <http://www.sec.gov/files/litigation/admin/2022/ia-6189.pdf> (GSAM Settlement).

³ In re: BNY Mellon Investment Adviser, Inc., IAA Release No. 6032 (May 23, 2022), available at <https://www.sec.gov/files/litigation/admin/2022/ia-6032.pdf> (BNY Settlement).