SEC Settles with DIMA for ESG Infractions

Insights for Compliance and Risk

Part 1: 5 Things SEC Didn't Say

The SEC ("Commission") announced a settlement with DIMA (DWA Investment Management Americas, Inc., a Deutsche Bank subsidiary), on September 25, 2023 regarding several aspects of ESG and investments, and their marketing[1]. The settlement included a penalty of $19 million and a requirement to implement suitable controls. SEC settled with DIMA for anti-money laundering violations the same day – with a payment of $6 million, announcing both concurrently. This announcement comes at an interesting time. Investors and stakeholders await SEC action on disclosure requirements for climate-related risk and on human capital. Both have been in the queue for "any time now" for months. In the meantime, the ISSB published global rules for general sustainability disclosures and climate-related risk. The California legislature passed two bills requiring climate-related disclosures, including greenhouse gas (GHG) inventory for companies "doing business in California." Despite the delay in seeing final SEC rules on ESG, does this enforcement send a signal? Maybe yes, maybe no.

The Order says is straightforward and – at only nine pages – an easy read. It may be just as instructive at what the Order doesn't say – what SEC did not pursue as basis for enforcement. Douglas Hileman Consulting LLC (DHC) unpacks five such topics below.

1. **The SEC did not pursue actions on "ESG dedicated funds"** – those with "ESG" in their name. Rather, the SEC's actions pertained to "ESG integrated" funds, where DIMA indicated they incorporated ESG as a factor in evaluating investment decisions. The "ESG dedicated funds" can be considered "impact investments", where investors affirmatively express a preference for investments that go the extra mile on ESG issues. The topics may be focused (climate, employee diversity, fair wages, etc.) or a market basket of issues. Fund names can be clear or generic. But these were not SEC's focus. Rather, SEC focused on funds where the bank indicated they incorporated ESG as a factor in evaluating overall risk on financial returns.

   Takeaway: This approach treats ESG as a risk – in some cases potentially material – just like any other risk. This is not about impact or advocacy; it is about basic risk management.

[1] SEC press release found at https://www.sec.gov/news/press-release/2023-194; the SEC order at https://www.sec.gov/files/litigation/admin/2023/ia-6432.pdf

2. **The SEC did not question how DIMA determined materiality** in considering whether or how ESG (in whole, or specific issues) was evaluated in potential investments. "Material" appears in the Order seventeen times – in only nine pages! Materiality is a topic of spirited discussion in companies, with auditors, and with stakeholders as they consider new reporting and disclosure requirements. The European Union will require double materiality analysis, as does GRI. The EU reporting requirements will eventually be subject to external assurance. The SEC focused only on DIMA's processes for determining material topics and how they managed and controlled them – not about whether the processes or those risks were sufficient, appropriate, or in accordance with any particular standard or framework.

Takeaway: Materiality matters. Furthermore, it matters to various stakeholders in different ways. Any entity pursuing Sustainability reporting (or investments) should have a process to determine materiality (including double materiality) of ESG issues.

3. **SEC did not take issue with key aspects of DIMA's ESG Integration policy or the proprietary nature of analysis**. SEC did not take issue with whether the policy was robust, addressed the right issues, was aligned with risk – or even if it was feasible. SEC did not take issue with the ESG Engine – the proprietary tool used to evaluate ESG risk. SEC did not make judgements on whether the ESG Engine considered appropriate factors, or evaluated them reasonably – or even that the method is proprietary and not disclosed to investors.

Takeaway: The SEC is not judging whether policies or tools are sufficient, robust, or even whether they fulfill their objectives. [Yet?] Rather, the SEC focused only on whether DIMA actually did what they said they were doing[2]. If you say it, then do it.

[2] As a side note, this is consistent with one objective the SEC specified for the Conflict Minerals Rule. One of the two objectives of the [voluntary] Independent Private Sector Audit is whether the filer actually did what they said they did in the Conflict Minerals Report (filed with the SEC).

4. **SEC did not question the criteria or sufficiency of internal analyst research or ESG Internal Team review.** The Order describes one internal effort of research. When internal staff felt that additional efforts may not be sufficient, they launched a more detailed internal review. The SEC did not take issue with how these efforts were authorized, managed, designed or implemented. The SEC did not take issue with who performed the research or review; it did not mention whether Internal Audit was used, or whether external specialists were involved.

Takeaway: When taking a closer look at areas of potential gaps, it is very easy to get bogged down in strategy, design, project protocols, gathering evidence, and/or making conclusions. It is especially challenging when traditional requirements are not imposed via law or regulation. If there are potential problems, do something – anything – reasonable. Don't be paralyzed by options or constraints.

5. **SEC did not provide detailed, prescriptive remedial measures.** SEC stipulated only that DIMA's remedial steps "include, but are not limited to, modifying relevant processes, policies, procedures and controls." SEC implicitly acknowledged that it's DIMA's company. They can publish any policy they wish. Their executives can make any statement at any conference they wish. They can sponsor any article or quote in any trade journal they wish.

Takeaway: But the policies and procedures must be followed, and the statements must be true.

6. **BONUS:** The SEC did not use "fraud" or "greenwash" in the Order. The SEC did not indicate whether DIMA's actions or omissions had caused financial harm to investors, competitors or other stakeholders. The SEC did not state or indicate that DIMA's actions were intentional or deceitful. The Wall Street Journal reported August 25, 2021 that the former head of sustainability of Deutsche Bank AG's asset management arm made greenwashing allegations. The SEC also indicated they would move aggressively to follow whistleblower tips.

Takeaway: DIMA's woes may not be over on this topic. Competitors could allege financial damage, losing customers to DIMA due to false representations. Investors could take cues from the class action lawsuit filed against Delta Airlines, alleging they relied on marketing representations in making their decisions.

About Douglas Hileman Consulting LLC

Douglas Hileman helps clients with Sustainability compliance, risk, programs, reporting and disclosures and audits. He is an author of COSO's supplemental guidance "Achieving Effective Internal Control over Sustainability reporting (ICSR)", which has taken the accounting and audit community by storm. He is the only non-CPA and only ESG specialist on the author team. He has over four decades of experience in operations, corporate, management consulting, Big 4 firm experience (including during early Sarbanes-Oxley years), and with his consultancy. He was on the Volkswagen Monitor Team for three years, as the senior environmental management/ auditing specialist, working on behalf of the DOJ. He is in demand for training, workshops, and presentations at conferences. One distinction is his ability to bridge the gap between traditional financial reporting professionals (Accounting, Internal Audit, Finance) and functions responsible for much of the Sustainability data and information (Environmental, HR, IT, Operations, Procurement, Real Estate, etc.). More at www.douglashileman.com.