SEC Settles with DIMA for ESG Infractions

Insights for Compliance and Risk

Part 3: 5 Things Deutsche Bank Did Wrong

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. The Wall Street Journal reported on August 25, 2021 that DWS had disclosed in its 2020 annual report that it invested more than half of its $900 billion in assets using ESG integration[2]. The penalty isn't likely to directly affect executive compensation. But with intangible value comprising a major chunk of market capitalization, reputational damage should not be ignored.

The Order presents several facts, circumstances, and actions. The SEC doesn't state explicitly what they found "wrong" or how they decided what the penalty would be. The Order does outline mistakes and miscues, including several that could apply to any company in any industry. Douglas Hileman Consulting LLC (DHC) describes five such topics below. DHC also provides takeaways on what companies can do to reduce risk and add value, regardless of their industry.

Spoiler alert: Companies should leverage COSO's supplemental guidance "Achieving Effective Internal Control Over Sustainability Reporting". I am proud to be an author of this important document. It's free, and on COSO's website and mine.

1. **DIMA did not recognize that compliance obligations can be incurred via public statements**. Compliance obligations arise not only from laws, regulations. SEC cited public statements, including comments from a senior management and an article the company sponsored in a publication.

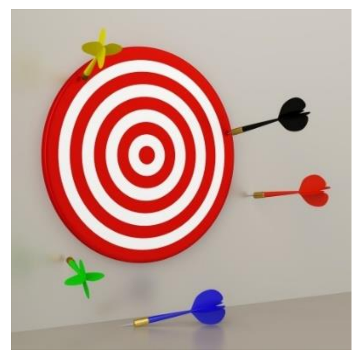
   Takeaway: If you say you are doing something – especially if people are relying on statements to give you their money – then you have created your own compliance obligations. All the systems, controls, and resources that are expected to fulfill any compliance obligations apply.

[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] As quoted by Columbia Law School's blog on Corporations and the Capital Market, accessed September 27, 2023 at https://clsbluesky.law.columbia.edu/2021/09/29/arnold-porter-discusses-esg-disclosure-and-whistleblowing/

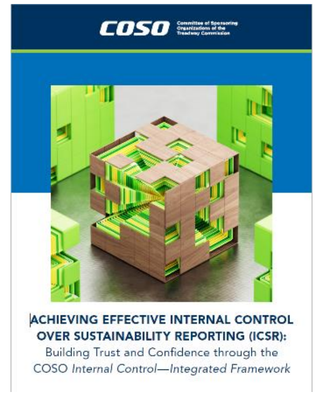
2. **DIMA did not recognize that external communications – and the compliance obligations that arise from them – need not be public.** The SEC cited communications DIMA made in Requests for Proposals from prospective clients.

Takeaway: Public disclosures to capital markets have been arguably the biggest driving force for standards for ESG disclosures in the last five years. B2B reporting, disclosures and communications get far less attention – because they are not public. In fact, this communications channel may include intellectual property and may be closely guarded, away from public view. Nonetheless, risks arising from B2B ESG reporting can be substantial. Sustainability reporting and disclosure standards increasingly take an approach that includes the entire value chain – both suppliers and users of products and services. ISSB standards S1 and S2 both take a value chain approach. Scope 3 greenhouse gas (GHG) emissions are entirely based on accurate, reliable flow of data and information along the value chain. Suppliers with insufficient or ineffective processes and controls to meet customer ESG demands risk losing customers. Indeed, the SEC also highlights the slow, incremental effort DIMA took to address findings identified in an internal assessment and a subsequent [somewhat deeper] review. This is a cue for companies to take findings from internal audits – whether second line or the third line Internal Audit activity – more seriously, and devote sufficient resources to addressing them on a timely basis.



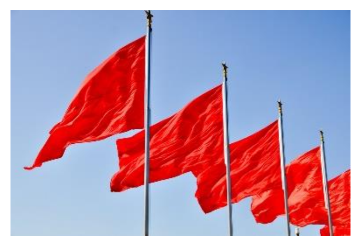
3. **DIMA did not make external communications (often marketing-centric) and internal activities match.** External communications, largely around marketing, overstated what the company was actually doing.

Takeaway: Marketing is often accused of hype. Stakeholders lament "greenwash" when Marketing overpromises. However, as DHC notes in Part 1 of this series, SEC did not take issue with the content of the ESG Integration Policy itself. If the company had developed and implemented robust processes and controls to follow it, the marketing collateral may have been fine.



4. **DIMA did not devote sufficient effort to design and/or to implement internal controls to achieve compliance with their own policies and procedures**. The Order described deficiencies in both the design and implementation of internal controls. This was the centerpiece of the SEC's enforcement effort.

Takeaway: Companies have extensive experience with processes, systems and internal controls. For companies publicly-traded in the U.S., requirements are imposed by Sarbanes-Oxley for internal controls over financial reporting. The financial services sector is among the most heavily regulated. COSO[3] released supplemental guidance to help companies understand how the Internal Control Integrated Framework applies to Sustainability reporting. "Achieving Effective Internal Control over Sustainability Reporting (ICSR)" was released in March 2023, to widespread acclaim. I am pleased to be one of the six authors of this document, which was the product of a year's intense efforts. The document walks through each of COSO ICIF five components and seventeen principles. It offers a synopsis of each, with perspectives and examples. DIMA – and every company – can leverage this document to improve the design and implementation of internal controls.



5. **The measures taken to improve compliance were nominal.** The Order indicates that senior leadership tried to emphasize the importance of the ESG Integration Policy by sending an email "encouraging them to be ambassadors of ESG integration."

Takeaway: Everyone is inundated with emails. An email by itself was certain to be ineffective without mechanisms to ensure its uptake and use. How many intended recipients received it? Read and understood it? How many proceeded to implement it – downloading or consulting the ESG Implementation Policy, or using the ESG Engine, within the subsequent 30 days? How many manager meetings, internal bulletins, or risk meetings reinforced the topic? There are many readily available mechanisms to re-introduce, reintroduce and monitor use of important policies and procedures. The COSO ICIF is often referred to as "porous"; no action belongs to a single component or principle. The level of effort expended on these improvements (as well as the level where they originated) speaks to the culture of compliance and the broader understanding of ESG as a risk at the organization.

[3] The Committee of Sponsoring Organizations of the Treadway Commission; see www.coso.org

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.