The environmental, social, and governance (ESG) investing trend continues unabated. According to the Forum for Sustainable and Responsible Investment, one out of every three dollars under professional management in the U.S. was managed according to sustainable strategies in 2020—roughly $17.1 trillion—and Bloomberg estimates that ESG assets will balloon to more than $50 trillion globally by 2025. A lack of standardized and precise ESG definitions has led, in some cases, to misstating how climate friendly investment fund assets are. This practice is known as “greenwashing.” Both European and SEC regulators have already begun to focus on this issue.

In March, the European Union’s Sustainable Finance Disclosure Regulation (SFDR) became effective. The SFDR functions as an anti-greenwashing rulebook. Since its publication in November 2019, the SFDR has resulted in a dramatic reduction in ESG labeling; between 2018 and 2020, the ESG label was stripped off about $2 trillion of assets.

In April, the SEC’s Division of Examinations issued a risk alert highlighting observations from recent exams of investment advisers, registered investment companies, and private funds offering ESG products and services.

However, a recent high-profile case has prompted a more urgent response.

According to media reports, Deutsche Bank’s first head of sustainability, Desiree Fixler, claimed the firm inflated its ESG assets. She was fired in March 2021, a day before the firm published its full-year results. The firm reported €459 billion euros of “total integrated ESG assets” at the end of 2020, and roughly 94 billion euros reported as ESG “dedicated” assets. By the second quarter of 2021, the bank said it had just over €70 billion euros in ESG assets and a further €16.4 billion euros of “illiquid green-labeled single assets in non-ESG classified products” after applying a revised ESG product classification approach. On August 25, 2021, the Wall Street Journal reported that the SEC and the U.S. Attorney’s Office in Brooklyn are investigating the firm for allegedly misleading clients about the nature of its sustainable investment offerings.

On September 1, SEC Chair Gary Gensler ordered staff to review funds’ language around climate and socially friendly investing.

“Many funds these days brand themselves as ‘green,’ ‘sustainable,’ ‘low carbon,’ and so on. I’ve directed staff to review current practices and consider recommendations about whether fund managers should disclose the criteria and underlying data they use to market themselves as such.”

Gensler speech at European Parliament Committee on Economic and Monetary Affairs

Key Takeaways for ESG Investment Funds

The SEC’s April risk alert was intended to highlight risk areas and assist firms in developing and enhancing their compliance practices and provide transparency regarding the SEC’s examination focus.

**Portfolio management practices of investment advisers and funds should be consistent with their disclosed ESG investing processes or investment goals.**

Examiners will be looking for consistency between claims and practice. Firms do not need a special set of policies and procedures for ESG. Policies and procedures should be designed around the investment strategies employed, whatever those strategies are.

SEC examinations of firms claiming to engage in ESG investing will focus on, among other matters, the following:

- **Portfolio management.** Examinations will include a review of the firm’s policies, procedures, and practices related to ESG and its use of ESG-related terminology; due diligence and other processes for selecting, investing in, and monitoring investments in view of the firm’s disclosed ESG investing approaches; and whether proxy voting decision-making processes are consistent with ESG disclosures and marketing materials.
SEC Cracks Down on ESG Funds’ ‘Greenwashing’

- **Performance advertising and marketing.** Examinations will include a review of the firm’s regulatory filings; websites; reports to sponsors of global ESG frameworks, to the extent the firm has communicated to clients and potential clients a commitment to follow such frameworks; client presentations; and responses to due diligence questionnaires, requests for proposals, and client/investor-facing documents, including marketing materials.

- **Compliance programs.** Examinations will include a review of the firm’s written policies and procedures and their implementation, compliance oversight, and a review of ESG investing practices and disclosures.

The following findings from recent examinations were highlighted:

- Portfolio management practices were inconsistent with disclosures about ESG approaches
- Controls were inadequate to maintain, monitor, and update clients’ ESG-related investing guidelines, mandates, and restrictions
- Proxy voting may have been inconsistent with advisers’ stated approaches
- Unsubstantiated or otherwise potentially misleading claims regarding ESG approaches
- Inadequate controls to ensure that ESG-related disclosures and marketing are consistent with the firm’s practices
- Compliance programs did not adequately address relevant ESG issues
- Compliance programs were less effective when compliance personnel had limited knowledge of relevant ESG-investment analyses or oversight over ESG-related disclosures and marketing decisions

**Best Practices**

- Disclosures should be clear, precise, tailored to the firm’s specific approaches to ESG investing, and aligned with the firm’s actual practices
- Detailed policies and procedures should address various stages of ESG investing (research, due diligence, selection, and monitoring)
- Compliance personnel should be knowledgeable about the firm’s specific ESG-related practices

**Conclusion**

BKD will continue to follow developments in ESG reporting. If you have questions, contact your **BKD Trusted Advisor™** today.

**Contributor**

Anne Coughlan
Director  
317.383.4000  
acoughlan@bkd.com