Regulatory interventions into ESG investments look set to rise: goodbye greenwashing?

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Regulatory interventions in environmental, social and governance (ESG) investments may well be more common in future, as authorities investigate Deutsche Bank for greenwashing.

The alleged misrepresentation

DWS, which is majority-owned by Deutsche Bank and is one of Germany's largest asset managers, has pledged to propose a special dividend of up to 1 billion euros in 2024, as it attempts to recover from allegations from a whistleblower that it misrepresented the share of its assets invested using ESG criteria.

Desiree Fixler joined DWS as group sustainability officer in June 2020. In August 2021 she alleged to investigators, regulators and journalists that the firm had been misrepresenting the sustainability of the investments it sold — a practice commonly known as greenwashing.

Despite the DWS supervisory board's internal review concluding that there was no evidence to support the allegations, investigations by the U.S. Securities and Exchange Commission (SEC) and Germany's financial regulator (BaFin) were triggered, including a police raid on the asset manager's Frankfurt offices on May 31, 2022.

Significantly, this raid appears to be the first potential criminal action linked to ESG in any jurisdiction. Asoka Woehrmann, DWS' chief executive, resigned from his position within days of the raid, and has since been replaced by Stefan Hoops.

What went wrong, and how it is being rectified

Part of the challenge for firms is that there is no formal market definition of what constitutes a "green", "sustainable" or "ESG-compliant" investment. The trade body for the German asset management industry has lamented the "vacuum of guidance".

Measures are, however, being taken to improve clarity:

- Since March 2021, the EU markets regulator, the European Securities and Markets Authority (ESMA), has required certain financial services firms to make sustainability-related disclosures on their websites and in any documentation relating to their financial products.
- In December 2021, the UK Financial Conduct Authority (FCA) introduced a mandatory disclosure regime for financial services firms and products to align with recommendations set out by the Task Force on Climate-Related Financial Disclosures (TCFD). It is considering a labelling regime to enable consumers to easily identify whether investment products have ESG credentials.
- Since August 2022, ESMA has required: (i) alternative investment fund managers and UCITS management companies to integrate sustainability into their portfolio and risk management processes and overall governance structure; and (ii) financial advisers and distributors to ask clients to specify their sustainability preference.
- In November 2022, the FCA announced the formation of a group to develop a voluntary code of conduct for ESG data and ratings providers, on which firms are increasingly reliant as they seek to expand their ESG products.

DWS has repeatedly denied any wrongdoing, although Hoops has confirmed that its previous statements on ESG may have been too "bullish" and that, while DWS is "fully committed to ESG", he would not be found using benchmarking phrases such as "world-class" or "leader" for green investments.

DWS has distanced itself from the "smart integration" ESG approach at the forefront of the whistleblower's complaint, and this is the likely cause of the 75% reduction in "ESG assets" accounted for in the firm's 2021 annual report, compared with its 2020 report (459 billion to 115 billion euros).

A German consumer group, however, filed a claim against DWS in late September 2022, in relation to the DWS Invest ESG Climate Tech fund. It claimed that the firm's marketing materials indicated that, while the fund invests 0% in coal, its holdings may include companies that derive up to 15% of their revenue from coal.

A hearing is set for March 10, 2023, and DWS has released a statement that it "remains convinced that the DWS advertising communications … comply with the legal requirements". This could suggest that asset management firms still have lessons to learn when it comes to statements regarding sustainability-related aspects of financial products.

Takeaways for asset management firms

The DWS raid is a warning to asset management firms to ensure that their ESG-focused statements and products are supported by accurate data. Allegations of greenwashing are being taken seriously and are under increasing scrutiny from regulators and shareholders in the United States, the EU and the UK. ESMA has identified greenwashing as a priority area under its Sustainable Finance Disclosure Regulation and the FCA is increasingly focused on protecting investors from greenwashing.

The SEC announced in March of this year that it would prioritise the exposure of exaggerated ESG performance and advertising claims by investors to address the risk of greenwashing, and in June launched an investigation into Goldman Sachs' asset management division (GSAM) regarding certain ESG claims made by its funds.

In November 2022, GSAM agreed to pay a $4 million penalty after the SEC found failings in the ESG research used by its investment teams and found GSAM had failed to follow consistently its own policies and procedures for ESG products. This is yet another reminder that no firm falls outside the scope of regulatory investigation.

Regulators' efforts to establish a clear, consistent and comparable regulatory framework for ESG financial services are slowly bearing fruit. This can only assist firms in navigating the complex ESG landscape, and asset management firms should welcome these developments and strive to get comfortable with the evolving guidance.

As ESG regulation becomes more coherent, the risk of successful enforcement action inevitably increases, and now is the time for firms to establish and embed best-practice policies and procedures to protect both their clients and themselves.

Complaints Procedure

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