

MEMO# 34158

May 24, 2022

SEC Charges Investment Adviser for ESG-Related Misstatements and Omissions

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TO: ICI Members
Investment Company Directors
Chief Compliance Officer Committee
ESG Advisory Group
ESG Fund Disclosure Working Group
ESG Public Company Disclosure Working Group
ESG Task Force
SEC Rules Committee SUBJECTS: Compliance
Disclosure
ESG
Litigation & Enforcement RE: SEC Charges Investment Adviser for ESG-Related
Misstatements and Omissions

In a settled enforcement action, the SEC charged an investment adviser for misstatements and omissions about environmental, social, and governance (ESG) considerations in making investment decisions for certain mutual funds that it managed.[\[1\]](#) To settle the charges, the investment adviser agreed to pay a \$1.5 million penalty.[\[2\]](#)

The SEC's order found that, from July 2018 to September 2021, the investment adviser represented or implied in various statements that all investments in certain funds had undergone an ESG quality review, even though that was not always the case. The order found that numerous investments held by certain funds did not have an ESG quality review score as of the time of investment.

The SEC's order referenced two groups of funds managed by the investment adviser and its affiliated sub-adviser. The sub-adviser maintained a Responsible Investment Team that researched ESG issues. For the first group of funds (Group A Funds), the sub-adviser required the Responsible Investment Team's proprietary ESG quality review for all investments. For the second group of Funds (Group B Funds), individuals at the sub-adviser who selected investments were permitted to, and did, select investments that were not researched by the Responsible Investment Team and thus did not undergo a proprietary

ESG quality review.

Misleading Statements in Prospectuses and Board Minutes

The SEC's order stated that the investment adviser made misleading statements regarding ESG quality review practices in the Group B Fund prospectuses' description about the funds' portfolio managers' security selection process because it failed to disclose that the sub-adviser neither required nor prepared quality reviews for all investments in the Group B Funds.

In addition, board minutes stated that the investment adviser represented to the board members that, prior to making any investment, the sub-adviser assigns to each company a proprietary ESG quality review rating designed to ensure that any material ESG issues of the company are taken into consideration. The SEC's order stated that this statement in the minutes was incorrect because the sub-adviser could, and did, select investments for the Group B Funds that were not subject to a proprietary ESG quality review.

Misleading Statements in RFP Responses

According to the order, statements included in the investment adviser's RFP responses that the sub-adviser's Responsible Investment Team prepared an ESG quality review for every security recommended by the sub-adviser's analysts were incomplete because the investment adviser did not also state that the sub-adviser could, and did, select portfolio investments that did not necessarily receive an ESG quality review. In addition, a representation that each security being considered for investment must have an ESG quality review was incorrect because the strategy, which tracked a Group B Fund, did not require ESG quality reviews to be performed before all investments.

Failure to Adopt and Implement Reasonably Designed Policies and Procedures

The order stated that the investment adviser lacked written policies and procedures reasonably designed to prevent inaccurate or materially incomplete statements in prospectuses, in RFP responses, or to the Group B Funds' boards about the sub-adviser's use of ESG quality reviews when selecting investments for the Group B Funds. According to the order, the investment adviser's compliance personnel were unaware before mid-March 2020 that quality reviews were not prepared for all Group B Fund investments and thus lacked pertinent facts when determining whether the investment adviser's prospectuses and RFP responses complied with the federal securities laws.

Violations, Sanctions and Remedial Efforts and Cooperation

The investment adviser consented to the entry of the order, which stated that, as a result of the conduct, the investment adviser willfully violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 (Advisers Act) and Rules 206(4)-7 and 206(4)-8 under the Advisers Act and Section 34(b) of the Investment Company Act of 1940. The investment adviser was ordered to cease and desist from committing or causing future violations of these provisions, censured, and ordered to pay a civil money penalty of \$1.5 million.

The order stated that, in determining to accept the offer of settlement, the SEC considered remedial acts promptly undertaken by the investment adviser and cooperation afforded the Commission staff. According to the order, throughout the staff's investigation, the investment adviser provided detailed factual summaries and made substantive presentations on key topics. The cooperation afforded by the investment adviser advanced the quality and efficiency of the staff's investigation and conserved Commission resources,

the order stated. The investment adviser also revised certain disclosure language and modified relevant processes, policies, and procedures.

Annette Capretta
Associate General Counsel

endnotes

[1] See SEC Press Release, SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations (May 23, 2022), available at <https://www.sec.gov/news/press-release/2022-86> and the order, In the Matter of BNY Mellon Investment Adviser, Inc., Administrative Proceeding File No. 3-20867 (May 23, 2022), available at <https://www.sec.gov/litigation/admin/2022/ia-6032.pdf>.

[2] Interestingly, unlike other recent enforcement proceedings in which the respondent was required to admit to the violations, in this order the respondent neither admitted nor denied the violations but consented to the entry of the order.

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