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Exam : **ESG-Investing**

Title : Certificate in ESG Investing

Vendor : CFA Institute

Version : DEMO

NO.1 Which of the following statements best describes Weitzman's dismal theorem?

- A.** Moral concerns about future climate damages demand the use of a low discount rate.
- B.** Economic asset value should be assigned to biodiversity to reverse its treatment as a free resource.
- C.** Standard cost-benefit analysis is inadequate to account for the potential downside from climate change.

Answer: C

Explanation:

Weitzman's Dismal Theorem (Option C) argues that:

Extreme climate risks cannot be properly captured by traditional cost-benefit analysis.

High-impact, low-probability climate events (e.g., runaway warming, tipping points) mean economic models underestimate catastrophic risks.

Option A (Low discount rate for moral reasons) is incorrect because Weitzman focused on uncertainty, not ethics.

Option B (Economic value for biodiversity) is relevant but not the core of the dismal theorem.

References:

Weitzman's Dismal Theorem Research Paper (2009)

IPCC Report on Climate Catastrophe Risk

CFA Institute ESG Economics and Climate Uncertainty

NO.2 A challenge to ESG integration at the asset allocation level when using mean-variance optimization is that it:

- A.** is highly sensitive to baseline assumptions
- B.** requires specialist knowledge to make informed judgments about future risk
- C.** could introduce an additional source of estimation errors due to the need for dynamic rebalancing

Answer: A

Explanation:

A challenge to ESG integration at the asset allocation level when using mean-variance optimization is that it is highly sensitive to baseline assumptions.

Baseline Assumptions: Mean-variance optimization relies on assumptions about expected returns, volatilities, and correlations among assets. Small changes in these inputs can lead to significantly different asset allocation outcomes.

Estimation Risk: The sensitivity to assumptions increases the risk of estimation errors, which can result in suboptimal asset allocation decisions and increased portfolio risk.

ESG Data Integration: Integrating ESG factors adds another layer of complexity, as ESG data can be inconsistent or incomplete, further complicating the optimization process.

CFA ESG Investing References:

The CFA Institute's materials on portfolio management and asset allocation discuss the challenges of mean-variance optimization, including its sensitivity to baseline assumptions and the difficulties in integrating qualitative ESG data into quantitative models.

NO.3 According to the Principles for Responsible Investment, which of the following is not an ESG engagement dynamic creating value for investors and companies?

- A.** Cultural dynamics
- B.** Learning dynamics

C. Communicative dynamics

Answer: A

Explanation:

Cultural dynamics are not a primary engagement dynamic identified by PRI. The key dynamics that drive engagement value include:

- * Learning dynamics (B): Mutual knowledge-sharing between investors and companies
 - * Communicative dynamics (C): Effective dialogue leading to ESG improvements
- References:
- * Principles for Responsible Investment (PRI) ESG Engagement Guide
 - * CFA Institute Investor Engagement & ESG Performance Report
 - * MSCI Active Ownership & Stewardship Study

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NO.4 According to a study by Berg, Koelbel, and Rigobon, the correlation of ESG ratings is:

- A.** High, and this can be a source of insight for investors
- B.** Low, and this poses a challenge for empirical research
- C.** Low, and this motivates companies to improve their ESG performance

Answer: B

Explanation:

Berg, Koelbel, and Rigobon (2022) found that ESG ratings from different providers (e.g., MSCI, Sustainalytics, FTSE) have low correlation, making comparisons difficult. This inconsistency hinders empirical research and leads to investor confusion.

References:

- * Berg, Koelbel & Rigobon (2022) "Aggregate Confusion: The Divergence of ESG Ratings"
- * MSCI vs. Sustainalytics ESG Ratings Methodology Comparison
- * CFA Institute ESG Data Inconsistency Report

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NO.5 With respect to exclusion policies, which of the following falls outside of the traditional spectrum of responsible investment?

- A.** Indices
- B.** Listed equities
- C.** Corporate debt

Answer: A

Explanation:

Exclusion policies in responsible investment typically focus on specific asset classes, such as listed equities and corporate debt, where investors can directly apply ethical and ESG criteria to exclude certain companies or sectors from their portfolios. Indices, however, fall outside of this traditional spectrum as they represent broader market benchmarks.

Exclusion Policies: These policies are applied to directly exclude investments in certain sectors or companies that do not meet the ethical or ESG criteria set by the investor. Common exclusions include tobacco, firearms, and fossil fuels.

Indices: Indices are used to benchmark the performance of portfolios and are typically not subject to exclusion policies. They represent a broad market or sector and include a range of companies regardless of their ESG performance. While ESG indices do exist, traditional exclusion policies do not typically apply to standard market indices.

NO.6 To produce a rating, an ESG rating provider will most likely apply a weighting system to

- A.** qualitative data only
- B.** quantitative data only
- C.** both qualitative data and quantitative data

Answer: C

Explanation:

To produce a rating, an ESG rating provider will most likely apply a weighting system to both qualitative data and quantitative data. ESG ratings are derived from a comprehensive analysis that includes various types of data to assess the overall ESG performance of a company.

Quantitative Data: This includes measurable data such as carbon emissions, energy consumption, employee turnover rates, and other numerical metrics that can be directly compared across companies.

Qualitative Data: This involves subjective assessments such as the quality of governance practices, corporate policies, stakeholder engagement, and other narrative information that provides context and insights beyond the numbers.

Weighting System: The ESG rating provider uses a weighting system to balance the relative importance of different ESG factors, combining both quantitative and qualitative data to form an overall rating. This approach ensures a holistic view of the company's ESG performance.

References:

MSCI ESG Ratings Methodology (2022) - Explains the integration of both qualitative and quantitative data in the ESG rating process.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the use of a weighting system to combine various data types for comprehensive ESG ratings.

NO.7 When undertaking an ESG assessment of a private equity deal ESG screening and due diligence will most likely take place during:

- A.** exit
- B.** ownership
- C.** deal sourcing

Answer: C

Explanation:

When undertaking an ESG assessment of a private equity deal, ESG screening and due diligence are most likely to take place during the deal sourcing phase. Here's why:

Initial Evaluation: ESG screening at the deal sourcing stage allows investors to evaluate potential investments against their ESG criteria before committing significant resources. This helps in identifying any red flags or areas of concern early in the process.

Risk Management: Conducting ESG due diligence early helps in managing risks associated with environmental, social, and governance issues. By understanding these risks upfront, investors can make more informed decisions and potentially avoid costly issues later.

Integration into Investment Strategy: ESG considerations integrated during deal sourcing ensure that these factors are part of the overall investment strategy and decision-making process. This alignment is crucial for achieving long-term sustainable returns.

Regulatory Compliance and Reputation: Early ESG assessments help in ensuring compliance with relevant regulations and standards, and in protecting the investor's reputation by avoiding

investments in companies with poor ESG practices.

References:

MSCI ESG Ratings Methodology (2022) - Highlights the importance of early ESG assessments in identifying risks and opportunities, ensuring that ESG factors are integrated into the investment process from the beginning.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the role of ESG screening in the initial stages of investment to manage risks and enhance long-term value creation.

NO.8 Considering ESG integration, an advantage relevant to private real estate markets but not equities and fixed income is most likely:

A. majority ownership

B. coverage of assets by ESG rating agencies

C. adherence to the Global Real Estate Sustainability Benchmark (GRESB) rather than the Sustainability Accounting Standards Board (SASB) framework

Answer: C

Explanation:

In ESG integration, private real estate markets have specific characteristics that differ from equities and fixed income. One of the key distinctions is the framework used for sustainability assessment and reporting:

Majority ownership (A): Majority ownership is not unique to private real estate markets; it can also be relevant to equity markets, particularly in cases of private equity investments or controlling stakes in public companies.

Coverage of assets by ESG rating agencies (B): ESG rating agencies cover a wide range of asset classes, including equities, fixed income, and real estate. While the extent of coverage and focus may vary, it is not a distinctive advantage unique to private real estate markets.

Adherence to the Global Real Estate Sustainability Benchmark (GRESB) rather than the Sustainability Accounting Standards Board (SASB) framework (C): The GRESB is specifically designed for assessing the sustainability performance of real estate assets and portfolios. This benchmark provides a comprehensive framework tailored to the unique aspects of real estate, such as energy efficiency, water usage, and building certifications. In contrast, the SASB framework is more general and applies to a broad range of industries, including equities and fixed income. Therefore, the adherence to GRESB is an advantage particularly relevant to private real estate markets and not typically applicable to equities and fixed income.

References:

Global Real Estate Sustainability Benchmark (GRESB)

CFA ESG Investing Principles

Sustainability Accounting Standards Board (SASB)

NO.9 At the portfolio level, ESG integration will most likely consider:

A. Credit analysis.

B. Risk management measures.

C. Ownership and stewardship activities.

Answer: B

Explanation:

ESG integration at the portfolio level focuses on risk management to protect and enhance financial

returns.

Why B (Risk management measures) is correct:

ESG integration aims to reduce exposure to financially material ESG risks (e.g., climate risk, governance failures).

Portfolio managers use ESG data to assess company-specific and systemic risks.

Why not A or C?

A (Credit analysis) applies more to fixed-income investing.

C (Ownership & stewardship) relates to active engagement rather than ESG risk integration.

References:

PRI's Guide to ESG Integration at the Portfolio Level (2023)

NO.10 Which of the following social factors most likely impacts a company's external stakeholders?

- A. Working conditions, health, and safety
- B. Employment standards and labor rights
- C. Product liability and consumer protection

Answer: C

Explanation:

Social factors that impact a company's external stakeholders include those that affect customers, local communities, and governments. Product liability and consumer protection directly influence external stakeholders by ensuring the safety, quality, and reliability of products, which in turn affects consumer trust and regulatory compliance. Working conditions, health and safety, and employment standards primarily impact internal stakeholders, such as employees.

NO.11 Which of the following encourages institutional investors to work together on human rights and social issues?

- A. Human Rights 100+
- B. OECD Guidelines for Multinational Enterprises
- C. United Nations Guiding Principles on Business and Human Rights

Answer: C

Explanation:

The United Nations Guiding Principles on Business and Human Rights encourage institutional investors to work together on human rights and social issues. These principles provide a global standard for preventing and addressing the risk of adverse impacts on human rights linked to business activity, promoting collaborative efforts among investors to uphold human rights standards.

NO.12 When considering material ESG factors in real estate, which of the following is classified as an environmental factor?

- A. Local job creation
- B. Community engagement
- C. Use of renewable energy

Answer: C

Explanation:

The use of renewable energy is an environmental factor in real estate. Integrating renewable energy sources in real estate developments helps reduce greenhouse gas emissions and aligns with sustainability goals, making it a key factor in ESG assessments of real estate portfolios. ESG Reference:

Chapter 3, Page 153 - Environmental Factors in the ESG textbook.

NO.13 Primary ESG data can be sourced:

- A.** Only from public documents.
- B.** Only directly from companies.
- C.** Both from public documents and directly from companies.

Answer: C

Explanation:

Primary ESG data is obtained from both public documents and direct company disclosures (Option C), including:

Sustainability reports, financial filings, regulatory disclosures (public documents).

Company surveys, management interviews, direct engagement (company sources).

Option A is incorrect because ESG analysts often require direct engagement to get non-public data.

Option B is incorrect because some ESG data (e.g., emissions data, labor policies) is publicly disclosed in regulatory filings.

References:

GRI Sustainability Reporting Standards

PRI ESG Data Guide (2022)

CDP Climate and Water Disclosures

NO.14 Externalities for an infrastructure asset are issues:

- A.** Caused by the asset itself that impact the asset's surrounding environment.
- B.** Caused by the asset itself that impact the asset's technical ability to operate.
- C.** Originating outside the asset that impact the asset's technical ability to operate.

Answer: A

Explanation:

Externalities are the positive or negative impacts of an asset that are not reflected in its financial costs.

Why A (Impact on the environment) is correct:

Infrastructure assets (e.g., roads, dams, power plants) create environmental and social externalities, such as:

Air pollution from transportation projects.

Habitat destruction from hydroelectric dams.

Noise pollution from airports.

Why not B or C?

B is incorrect-technical issues (e.g., equipment failure) are not classified as externalities.

C is incorrect-externalities originate from the asset itself, not external factors.

References:

OECD: Managing Environmental Externalities in Infrastructure Projects (2022)

NO.15 Institutional investors achieve their stewardship and engagement objectives in practice through which of the following?

- A.** Engaging directly with companies only
- B.** Utilizing proxy voting advisory firms only
- C.** Both engaging directly with companies and utilizing proxy voting advisory firms

Answer: C

Explanation:

Institutional investors achieve their stewardship and engagement objectives by both engaging directly with companies and utilizing proxy voting advisory firms. Direct engagement involves ongoing dialogue with company management and boards to influence corporate practices. Proxy voting advisory firms provide recommendations on voting matters at shareholder meetings, helping investors make informed decisions that align with their ESG priorities.

NO.16 Which of the following would most likely be the initial step when drafting a client's investment mandate?

- A.** Clarifying the client's ESG investment beliefs
- B.** Defining how ESG performance will be measured
- C.** Reflecting the client's investment beliefs operationally in the fund manager's investment approach

Answer: A

Explanation:

The initial step when drafting a client's investment mandate is most likely clarifying the client's ESG investment beliefs. This step is fundamental in ensuring that the investment strategy aligns with the client's values and objectives.

Step-by-Step Explanation:

Defining Investment Beliefs:

Clarifying the client's ESG investment beliefs involves understanding their values, priorities, and objectives related to ESG issues. This step is crucial to tailor the investment strategy to the client's specific needs and preferences.

According to the CFA Institute, establishing a clear understanding of the client's ESG beliefs helps in setting the framework for the overall investment approach and ensures alignment with their long-term goals.

Creating a Statement of Investment Principles:

This involves drafting a Statement of Investment Principles (SIP) that outlines the client's ESG beliefs and how these will be integrated into the investment strategy. The SIP serves as a guiding document for the investment manager.

The CFA Institute emphasizes that a well-defined SIP provides clarity and direction, ensuring that ESG considerations are consistently applied in investment decisions.

Operational Implementation:

Once the client's ESG beliefs are clarified, the next steps involve defining how ESG performance will be measured and reflected operationally in the fund manager's approach. However, these steps come after the initial clarification of beliefs.

The Principles for Responsible Investment (PRI) report suggests that aligning investment mandates with client beliefs and strategies is essential for effective ESG integration across asset classes.

Ensuring Alignment:

Ensuring that the client's ESG beliefs are accurately reflected in the investment approach requires continuous engagement and review. This helps in maintaining alignment with the client's evolving objectives and market conditions.

The CFA Institute notes that ongoing dialogue and review processes are vital to ensure that the investment strategy remains aligned with the client's ESG beliefs and delivers on their expectations.

References:

CFA Institute, "Environmental, Social, and Governance Issues in Investing: A Guide for Investment

Professionals." Principles for Responsible Investment (PRI) reports on aligning investment mandates with ESG beliefs.

NO.17 Which of the following best describes a challenge of ESG integration into investment processes?

- A.** Cultural challenges and biases within investment management firms
- B.** Overly detailed company-level ESG reporting that overwhelms investors
- C.** Standardized disclosures in audited financial statements that hinder differentiated analysis

Answer: A

Explanation:

A major challenge in ESG integration is cultural resistance and biases within investment firms.

Some traditional investment managers view ESG as non-financial or irrelevant to performance, leading to resistance in fully embedding ESG into decision-making.

While ESG reporting complexity (B) is a challenge, it does not outweigh the fundamental organizational and mindset barriers that slow adoption. Standardized disclosures (C) actually help rather than hinder ESG integration.

References:

- * CFA Institute ESG Integration Framework
- * Principles for Responsible Investment (PRI) Survey on ESG Adoption Barriers
- * MSCI Research on ESG Culture in Investment Firms

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NO.18 When optimizing a portfolio for ESG factors, as constraint parameters are tightened, the deviation from an optimal portfolio most likely:

- A.** decreases.
- B.** is not affected.
- C.** increases.

Answer: C

Explanation:

When optimizing a portfolio for ESG factors, as constraint parameters are tightened, the deviation from an optimal portfolio most likely increases. Here's a detailed explanation:

Portfolio Optimization and Constraints: Portfolio optimization aims to maximize returns for a given level of risk or minimize risk for a given level of return. Introducing ESG constraints means the optimization process must adhere to additional criteria, such as limiting investments in companies with poor ESG scores.

Tightening Constraints: Tightening ESG constraints means imposing stricter rules on the selection of assets.

For example, excluding a broader range of companies based on their ESG performance. This reduces the universe of eligible investments, which limits the choices available to the optimizer.

Deviation from Optimal Portfolio: The optimal portfolio in a traditional sense (without ESG constraints) is one that lies on the efficient frontier, offering the highest expected return for a given level of risk. Adding constraints typically moves the portfolio away from this frontier because the optimizer can no longer select the combination of assets that would have provided the best risk-return trade-off without considering ESG factors.

Impact of Tightened Constraints: As constraints are tightened, the selection of assets becomes more

limited, and the ability to fully optimize the risk-return balance decreases. This results in a greater deviation from the traditional optimal portfolio because the optimizer is forced to work with a smaller, potentially less efficient set of investments.

CFA ESG Investing References:

According to the CFA Institute, "Tightening constraints in portfolio optimization generally results in a less efficient portfolio due to the reduced number of investment opportunities" (CFA Institute, 2020). The CFA Institute's ESG investing framework explains that while ESG constraints can lead to improved sustainability outcomes, they may also result in deviations from the traditional optimal portfolio due to limited asset selection.

NO.19 A company's Scope 2 emissions are:

- A. emissions from purchased energy.
- B. direct emissions from core operations.
- C. emissions produced by suppliers and customers.

Answer: A

Explanation:

Scope 2 emissions refer to indirect greenhouse gas emissions resulting from the company's consumption of purchased electricity, steam, heat, and cooling. (ESGTextBook[PallasCatFin], Chapter 3, Page 133)

NO.20 If a company faces significant environmental regulations, investors would most likely decrease the company's:

- A. discount rate.
- B. terminal growth rate.
- C. cash flow projections.

Answer: C

Explanation:

Facing significant environmental regulations may reduce a company's cash flow projections due to the costs associated with compliance, fines, or the need to invest in cleaner technologies.

(ESGTextBook

[PallasCatFin], Chapter 7, Page 325)

NO.21 Which of the following climate risks are systemic risks to the financial system?

- A. Policy and legal risks
- B. Technology and stability risks
- C. Physical and transitional risks

Answer: C

Explanation:

Systemic risks to the financial system from climate change include both physical and transitional risks

Physical risks refer to the direct impact of climate change, such as extreme weather events and gradual changes in climate. Transitional risks are associated with the shift to a lower-carboneconomy, including policy changes, technological advancements, and changing consumer preferences. These risks are interconnected and can significantly affect economic and financial stability.

NO.22 Under the disclosure guide for public equities published by the Pension and Lifetime Savings Association (PLSA), fund managers are expected to report on:

- A. ESG integration only.
- B. stewardship activities only.
- C. both ESG integration and stewardship activities

Answer: C

Explanation:

Under the disclosure guide for public equities published by the Pension and Lifetime Savings Association (PLSA), fund managers are expected to report on both ESG integration and stewardship activities. Here's a detailed explanation:

ESG Integration:

Fund managers are required to disclose how they integrate ESG factors into their investment processes. This includes the identification and management of ESG risks and opportunities. They need to provide examples of material ESG factors identified in their analysis, how these factors influence their investment decisions, and how they monitor ESG risks over time .

Stewardship Activities:

Stewardship activities involve how fund managers engage with companies they invest in to promote sustainable business practices and good governance.

This includes voting at shareholder meetings, engaging in dialogue with company management, and participating in collaborative initiatives aimed at improving ESG standards across the industry .

CFA ESG Investing References:

The CFA Institute's ESG curriculum emphasizes the dual role of ESG integration and stewardship in sustainable investing. Both aspects are crucial for ensuring that ESG considerations are fully embedded in the investment process and that fund managers actively contribute to improving corporate practices through engagement and voting .

NO.23 The world's first formal corporate governance code emerged in:

- A. Germany.
- B. The United States.
- C. The United Kingdom.

Answer: C

Explanation:

The first formal corporate governance code was the Cadbury Report (1992) in the United Kingdom. It established principles of good corporate governance, emphasizing board effectiveness, accountability, and audit transparency.

The U.S. Sarbanes-Oxley Act (2002) and Germany's Corporate Governance Code (2002) came much later.

The Cadbury Report influenced global corporate governance frameworks, including OECD Principles of Corporate Governance and the G20 Corporate Governance Code.

References:

Cadbury Report (1992)

OECD Principles of Corporate Governance (2015 Update)

NO.24 For engagement strategies to deliver meaningful results in a cost-effective and time-effective manner, investors must:

- A. identify which company in their portfolio is most in need of engagement
- B. raise all possible concerns with the company which has the most risk in their portfolios
- C. frame the engagement topic into a broader discussion around strategy and avoid discussing long-term financial performance with a company's board

Answer: A

Explanation:

Effective Engagement Strategies:

For engagement to be meaningful and cost-effective, investors need to prioritize and identify which companies in their portfolio require the most attention.

Targeted Engagement:

By focusing on the companies most in need of engagement, investors can allocate their resources more efficiently.

This targeted approach helps in addressing significant ESG risks and opportunities that can materially impact the company's performance.

Broader Discussion:

While it is important to frame the engagement topic within the company's broader strategy, discussing long-term financial performance and risks is crucial for holistic engagement.

References:

Identifying the company most in need of engagement is a recommended strategy in the 2021 ESG investing documentation.

NO.25 Fund labelers are most likely classified as:

- A. regulators
- B. fund promoters.
- C. financial advisers

Answer: B

Explanation:

Fund labelers are most likely classified as fund promoters. Fund promoters are responsible for marketing and promoting investment funds, including those with specific labels such as ESG or green funds.

Marketing Role: Fund promoters play a key role in marketing investment products to potential investors. They use labels such as ESG, green, or sustainable to attract investors interested in these themes.

Product Differentiation: By labeling funds with ESG or other sustainable labels, fund promoters differentiate their products in the market. This helps investors identify funds that align with their values and investment criteria.

Regulatory Compliance: Fund promoters must ensure that the funds meet the criteria for the labels they use.

This involves compliance with relevant regulations and standards that govern the use of ESG and other sustainable labels.

References:

MSCI ESG Ratings Methodology (2022) - Discusses the role of fund promoters in marketing and labeling investment products to attract investors.

ESG-Ratings-Methodology-Exec-Summary (2022) - Highlights the importance of accurate labeling and promotion of ESG funds to ensure transparency and investor trust.

NO.26 According to a study of the Hermes UK Focus Fund: which of the following engagement objectives was most likely to be achieved through shareholder activism?

- A. Remuneration policy changes
- B. Improvements to investor relations
- C. Restructuring and financial policies

Answer: C

Explanation:

According to a study of the Hermes UK Focus Fund, engagement objectives most likely to be achieved through shareholder activism include restructuring and financial policies. The study found that the success rate for achieving objectives related to restructuring and financial policies was higher compared to other objectives such as remuneration policy changes and improvements to investor relations. This indicates that shareholder activism is more effective in driving changes in corporate structure and financial strategies.

NO.27 Philanthropy is most likely associated with:

- A. impact investing
- B. shareholder engagement
- C. corporate social responsibility

Answer: C

Explanation:

Philanthropy is most likely associated with corporate social responsibility (CSR).

Impact investing (A): Impact investing focuses on generating social or environmental impact alongside financial returns. While philanthropy can be a form of impact investing, it is more commonly linked to CSR.

Shareholder engagement (B): This involves shareholders actively engaging with companies to influence their ESG practices. Philanthropy is not a direct form of shareholder engagement.

Corporate social responsibility (C): CSR encompasses a company's efforts to contribute positively to society, including philanthropic activities such as donations and community involvement.

References:

CFA ESG Investing Principles

Definitions and distinctions between CSR, impact investing, and shareholder engagement

NO.28 A meat-processing company does not sell its pork products in predominantly Muslim countries. Investing in the company on this basis would be considered an example of:

- A. faith-based investing.
- B. norms-based exclusion.
- C. considering religion as a social factor.

Answer: B

Explanation:

Excluding investments in companies that sell pork in predominantly Muslim countries falls under norms-based exclusion, as it is guided by religious and cultural norms. (ESGTextBook[PallasCatFin], Chapter 4, Page 192)

NO.29 ESG factors can affect credit risk at:

- A. Issuer level only.

- B.** Industry level only.
- C.** Both issuer level and industry level.

Answer: C

Explanation:

ESG factors can impact credit risk at both issuer and industry levels by influencing financial stability, regulatory compliance, and reputational risks.

Issuer level: A company's ESG risk exposure (e.g., environmental violations, governance scandals) can lead to downgrades or higher borrowing costs.

Industry level: Sectors like coal mining, oil & gas, and tobacco face systemic ESG risks (e.g., climate regulations, social opposition).

Credit rating agencies (e.g., Moody's, S&P, Fitch) integrate ESG risks into credit assessments.

References:

S&P Global's ESG & Credit Ratings Framework

Moody's ESG Risk Assessment Reports

NO.30 Advantages of investing in ESG indexes include:

- A.** A standardized methodology for ESG performance.
- B.** Identifying firms or countries that prioritize sustainability.
- C.** High transparency and disclosure of precise methodologies.

Answer: C

Explanation:

ESG indexes (e.g., MSCI ESG Leaders Index, FTSE4Good Index, S&P ESG Index) offer investors structured, rules-based exposure to companies that meet specific ESG criteria.

Why C is correct:

ESG indexes follow clear methodologies that determine which companies are included or excluded. Transparency is a key feature-investors can access index construction rules, ESG scoring criteria, and weightings.

Why not A?

ESG scoring methods vary across index providers (MSCI, S&P, FTSE, etc.), meaning there is no universal

"standardized" approach.

Why not B?

ESG indexes do not directly "identify" firms prioritizing sustainability-they include firms based on ESG ratings and predefined metrics, but inclusion does not necessarily mean a company prioritizes sustainability over profits.

References:

MSCI ESG Indexes Methodology

FTSE Russell: ESG Index Construction and Transparency Guidelines

NO.31 Which of the following is an example of the internalization of negative externalities?

- A.** A car manufacturer receiving subsidies for electric car production
- B.** A farmer paying taxes based on the level of soil degradation on its farmland
- C.** An electronics manufacturer retaining more employees after improving working conditions

Answer: B

Explanation:

Internalizing negative externalities refers to a situation where a company must bear the costs of the negative environmental or social impacts it causes. In this case, a farmer paying taxes based on soil degradation reflects internalization, as the farmer is being penalized for harming the environment. ESG Reference: Chapter 3, Page 169 - Environmental Factors in the ESG textbook.

NO.32 Which of the following is a minimum requirement for Principles for Responsible Investment (PRI) membership?

- A. Participation in a shareholder engagement platform
- B. The establishment of accountability mechanisms for responsible investment implementation
- C. Implementation of Task Force on Climate-related Financial Disclosures (TCFD) recommendations

Answer: B

Explanation:

A minimum requirement for PRI membership is the establishment of accountability mechanisms to ensure that responsible investment policies are effectively implemented within the organization.

(ESGTextBook

[PallasCatFin], Chapter 9, Page 509)

NO.33 Information for use in ESG tools can be collected directly via:

- A. news articles.
- B. third-party reports.
- C. company communications.

Answer: C

Explanation:

Information for use in ESG tools can be collected directly via company communications. This includes sustainability reports, financial disclosures, press releases, and other direct communications from the company. Such sources provide primary data that are essential for accurate ESG analysis and assessment.

Top of Form

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NO.34 The concept of double-agency in society refers to the conflict of interest between

- A. corporate CEOs and shareholders
- B. money managers and asset owners.
- C. corporate CEOs and money managers

Answer: B

Explanation:

The concept of double-agency in society refers to the conflict of interest between money managers and asset owners. This concept arises when there are two levels of agency relationships, each with potential conflicts of interest.

Principal-Agent Relationship: In the first level, asset owners (principals) delegate the management of their assets to money managers (agents). The money managers are expected to act in the best interests of the asset owners, but their own interests might not always align with those of the asset owners.

Secondary Agency: The second level involves the relationship between the corporate CEOs (agents)

and the company's shareholders (principals). Here, the CEOs are supposed to act in the best interests of the shareholders, but again, there might be conflicts of interest.

Double-Agency Conflict: The double-agency conflict occurs because the money managers, who are agents of the asset owners, also act as principals when dealing with corporate CEOs. This dual role can lead to conflicts where the money managers' decisions may benefit themselves or the CEOs rather than the asset owners.

References:

MSCI ESG Ratings Methodology (2022) - Explains the principal-agent relationships and how conflicts of interest can arise at multiple levels, leading to the double-agency problem.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the importance of aligning interests between asset owners, money managers, and corporate executives to mitigate the double-agency issue.

NO.35 Which of the following is most likely the primary driver of ESG investment for a life insurer?

- A. Reputational risk
- B. Recognition of lengthy investment time horizons
- C. Awareness of financial impacts of climate change

Answer: B

Explanation:

Investment Horizon:

Life insurers have investment horizons that can span decades, aligning with the long-term nature of their liabilities. This long-term perspective is crucial in managing and matching assets to future liabilities.

According to the CFA Institute, life insurers are particularly focused on long-term sustainability and stability, making ESG factors relevant as they can significantly impact long-term investment performance.

ESG Integration:

ESG integration helps life insurers manage risks and seize opportunities that are pertinent over long investment periods. This includes climate change risks, social trends, and governance issues that can affect the performance of investments over time.

The MSCI ESG Ratings Methodology highlights that incorporating ESG factors can improve the resilience of investment portfolios to long-term risks, aligning well with the objectives of life insurers.

Financial Impacts:

Recognizing the financial impacts of climate change and other ESG factors, life insurers aim to mitigate risks associated with environmental, social, and governance issues. This proactive approach helps in maintaining the solvency and profitability of the insurance business over the long term.

Studies show that ESG factors can influence credit ratings, investment returns, and overall financial stability, which are critical considerations for life insurers with long-term obligations.

Regulatory and Stakeholder Pressure:

Increasing regulatory requirements and stakeholder expectations for sustainable and responsible investment practices also drive life insurers to integrate ESG factors into their investment strategies.

The CFA Institute notes that regulatory frameworks and stakeholder demands are increasingly aligning towards greater ESG integration, influencing life insurers to adopt these practices.

References:

CFA Institute, "Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals." MSCI ESG Ratings Methodology documents, which discuss the relevance of ESG

factors in long-term investment strategies for insurers.