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Exam : Sustainable Investing

**Title : Sustainable Investing
Certificate(CFA-SIC) Exam**

Version : DEMO

1.Excluding investment in companies with a history of labor infractions is best categorized as a(n):

- A. universal exclusion.
- B. idiosyncratic exclusion.
- C. conduct-related exclusion

Answer: C

Explanation:

Excluding investment in companies with a history of labor infractions is best categorized as a conduct-related exclusion. This type of exclusion focuses on the behavior and practices of companies, particularly in relation to their treatment of employees and adherence to labor standards.

Behavioral Criteria: Conduct-related exclusions target specific behaviors or practices that are deemed unacceptable, such as labor infractions, human rights violations, or environmental harm.

Ethical Considerations: These exclusions are based on ethical and social considerations, aiming to avoid investing in companies that do not meet certain standards of conduct.

Impact on Valuation: By excluding companies with poor labor practices, investors aim to reduce exposure to risks associated with legal liabilities, reputational damage, and operational disruptions.

References:

MSCI ESG Ratings Methodology (2022) - Explains different types of exclusion criteria, including conduct-related exclusions, and their rationale.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the importance of considering company behavior in ESG investment strategies.

2.The offering of indexes and passive funds with ESG integration by asset managers

- A. preceded the offering of actively managed ESG funds
- B. occurred at the same time as the offering of actively managed ESG funds.
- C. followed the offering of actively managed ESG funds

Answer: C

Explanation:

The offering of indexes and passive funds with ESG integration by asset managers followed the offering of actively managed ESG funds. Initially, ESG investing was primarily driven by active management strategies, with passive ESG funds emerging later as demand grew.

Initial Focus on Active Management: Early ESG investing efforts were concentrated in actively managed funds, where managers could apply detailed ESG analysis and make discretionary investment decisions based on ESG criteria.

Development of ESG Indexes: As ESG data and methodologies improved, index providers began creating ESG-focused indexes. This allowed for the development of passive investment products that track these indexes, offering investors broad ESG exposure.

Market Demand and Growth: The growing interest in ESG investing led to the expansion of passive ESG funds, providing a cost-effective way for investors to integrate ESG factors into their portfolios. These funds have since gained significant traction in the market.

References:

MSCI ESG Ratings Methodology (2022) - Discusses the evolution of ESG investing and the initial focus on active management before the introduction of passive ESG funds.

ESG-Ratings-Methodology-Exec-Summary (2022) - Highlights the timeline of ESG fund offerings and the subsequent growth of passive ESG investment products.

3.Which of the following investor types most likely has the shortest investment time horizon?

- A. Foundations
- B. General insurers
- C. Defined benefit pension schemes

Answer: B

Explanation:

General insurers typically have the shortest investment time horizon among the three investor types listed.

Here's a detailed explanation:

Nature of Liabilities: General insurers deal with short-term liabilities, such as claims arising from accidents, natural disasters, or other events that can happen frequently and require prompt payment. This necessitates a relatively liquid and short-term investment portfolio to ensure that funds are readily available to cover claims.

Investment Strategies: Due to the need to maintain liquidity and manage risk, general insurers often invest in short-duration assets. These might include short-term bonds, money market instruments, and other liquid assets that can be quickly converted to cash.

Comparison with Other Investors:

Foundations: Foundations typically have longer-term investment horizons as they aim to support their missions over an extended period. Their endowment funds are managed to generate returns that can sustain operations and grant-making activities in perpetuity.

Defined Benefit Pension Schemes: These pension schemes also have long-term horizons, as they need to ensure that funds are available to meet the retirement benefits of employees over many years, often several decades.

CFA ESG Investing References:

The CFA Institute explains that general insurers have shorter investment horizons due to the nature of their liabilities and the need for liquidity to pay out claims promptly (CFA Institute, 2020).

The institute also notes that the investment strategies of general insurers are designed to align with their short-term liabilities, making their investment horizon shorter compared to foundations and pension schemes.

4.When assessing credit and ESG ratings, which of the following statements is most accurate?

- A. The correlation between country ESG risk and credit ratings is high
- B. The correlation between ESG ratings among rating providers is high
- C. The correlation between credit ratings among credit rating agencies (CRAs) is low

Answer: A

Explanation:

There is a high correlation between country ESG risk and credit ratings. Countries with higher ESG risks typically face higher borrowing costs and lower credit ratings due to the perceived increased risk associated with environmental, social, and governance factors. This correlation reflects the importance of ESG factors in assessing the overall creditworthiness and financial stability of countries.

5.A portfolio manager may need to adopt a more appropriate ESG benchmark rather than a broad market benchmark if the degree of exclusions results in:

- A. low active share and low tracking error
- B. low active share and high tracking error.
- C. high active share and high tracking error.

Answer: C

Explanation:

A portfolio manager may need to adopt a more appropriate ESG benchmark rather than a broad market benchmark if the degree of exclusions results in high active share and high tracking error. High active share indicates that the portfolio significantly deviates from the benchmark, while high tracking error measures the volatility of these deviations.

High Active Share: Excluding a significant number of securities from the investment universe to align with ESG criteria can lead to a portfolio that is very different from the broad market benchmark. This high active share reflects the extent to which the portfolio composition differs from the benchmark.

High Tracking Error: The deviations from the benchmark can lead to high tracking error, indicating the portfolio's performance can vary significantly from the benchmark. This variability can be a result of the different risk and return characteristics of the excluded securities.

Appropriate ESG Benchmark: To accurately measure performance and risk, it is essential to use a benchmark that reflects the ESG criteria applied in the portfolio. An ESG-specific benchmark would provide a more relevant comparison and better align with the investment strategy.

References:

MSCI ESG Ratings Methodology (2022) - Explains the importance of selecting appropriate benchmarks for ESG-focused portfolios to ensure alignment with investment objectives.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the impact of exclusions on portfolio metrics such as active share and tracking error, and the need for suitable ESG benchmarks.