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Certificate in ESG Investing summary (CFA)

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Ch. 1 - INTRO TO ESG INVESTING

1. **ESG investing** = approach to managing assets where investors explicitly acknowledge the relevance of ESG factors in their investment decisions, as well as their own role as owners and creditors.
 2. **Responsible investment** = strategy and practice to incorporate ESG factors into investment decisions and active ownership.
 3. **Social Responsible Investment (SRI)** = approaches that apply social and environmental criteria in evaluating companies. Investors implementing SRI generally score companies using a chosen set of criteria, usually in conjunction with sector-specific weightings. A **hurdle** is established for qualification within the investment universe, based either on the full universe or sector by sector. This information serves as a first screen to create a list of SRI-qualified companies.
 4. **Best in class investment** = positive screening selecting only the companies that overcome a **defined ranking hurdle**, established using ESG criteria within each sector or industry → **MSCI World SRI** (TOP 25% companies in each sector, TE 1.79%)
- The diversity of ESG ratings methodologies and lack of ratings convergence are a key challenge these strategies face. They may score highly based on the portfolio manager's methodology but more poorly on another set of ESG metrics used by the fund's investor

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CFA Institute ESG-Investing Exam Syllabus Topics:

Topic	Details
Topic 1	<ul style="list-style-type: none"> • Social Factors: This section focuses on analyzing social factors, including their systemic effects and material impacts. This section also provides methodologies for assessing social risks and opportunities at country, sector, and organizational levels.

Topic 2	<ul style="list-style-type: none"> Environmental Factors: This section examines environmental elements, covering systemic links, material impacts, and major trends for ESG Consultants. This section also reviews techniques for evaluating environmental impacts at the national, sectoral, and organizational levels.
Topic 3	<ul style="list-style-type: none"> Understanding Governance Factors: This section includes governance elements for ESG Investment Consultants, including core characteristics, governance models, and material impacts. It discusses how governance factors influence investment choices.
Topic 4	<ul style="list-style-type: none"> Investment Mandates and Portfolio Analytics: This domain explains to ESG Analysts the importance of constructing mandates to support effective ESG investment results. This section highlights key aspects, such as transparency and accountability, which are essential for asset owners and intermediaries to align portfolios with ESG priorities.
Topic 5	<ul style="list-style-type: none"> ESG Analysis, Valuation, and Integration: Targetted for ESG Consultants, this domain covers methods for embedding ESG factors into the investment process, the obstacles that may arise, and the impact of ESG considerations on valuations across various asset classes.

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CFA Institute Certificate in ESG Investing Sample Questions (Q541-Q546):

NEW QUESTION # 541

In ESG ratings, there is a size bias in favor of:

- A. Small companies
- B. Mid-sized companies
- C. Large companies

Answer: C

Explanation:

Large companies benefit from an ESG size bias because they have greater resources to report ESG data, comply with regulations, and manage sustainability risks.

Smaller companies struggle with disclosure due to limited budgets and fewer compliance requirements, which often results in lower ESG scores despite strong sustainability efforts.

References:

- * MSCI ESG Ratings Methodology
- * CFA Institute ESG Disclosure Challenges Report
- * Principles for Responsible Investment (PRI) ESG Data Challenges

NEW QUESTION # 542

Increased investment crowding into more ESG-friendly sectors is most likely to increase

- A. materiality thresholds
- B. expected returns.
- C. valuations

Answer: C

Explanation:

Increased investment crowding into more ESG-friendly sectors is most likely to increase valuations. When a significant amount of capital flows into ESG-friendly sectors, the demand for these assets rises, leading to higher prices and, consequently, higher valuations.

* Demand and Supply Dynamics: As more investors seek to allocate their capital to ESG-friendly sectors, the increased demand for these assets outpaces the supply, driving up prices.

* Market Perception: ESG-friendly sectors are often perceived as more sustainable and less risky in the

* long term. This positive market perception contributes to higher valuations as investors are willing to pay a premium for such assets.

* Lower Cost of Capital: Companies in ESG-friendly sectors may benefit from a lower cost of capital due to their attractiveness to investors. This can further enhance their valuations as the lower cost of capital translates into higher net present value of future cash flows.

References:

* MSCI ESG Ratings Methodology (2022) - Discusses the impact of increased capital flows into ESG-friendly sectors on market valuations.

* ESG-Ratings-Methodology-Exec-Summary (2022) - Highlights the relationship between investor demand for ESG assets and their market valuations.

NEW QUESTION # 543

With respect to ESG integration, adjusting financial model inputs based on an evaluation of a company's ESG risk factors is an example of a:

- A. qualitative approach.
- **B. quantitative approach**
- C. hybrid approach

Answer: B

Explanation:

Adjusting financial model inputs based on an evaluation of a company's ESG risk factors is an example of a quantitative approach. Here's why:

* Quantitative Approach:

* This involves the use of numerical data and mathematical models to assess ESG risks and incorporate them into financial models. Adjusting financial inputs like revenue forecasts, cost projections, or discount rates based on ESG factors quantifies the impact of these factors on financial performance.

* By integrating ESG risk factors into financial metrics, investors can better understand the potential financial implications of ESG issues and make more informed investment decisions .

* Qualitative vs. Hybrid Approaches:

* A qualitative approach relies more on subjective judgment and narrative assessments, such as analyst opinions or case studies, without necessarily converting these insights into numerical data.

* A hybrid approach combines both qualitative and quantitative methods, using narrative assessments alongside numerical data.

However, directly adjusting financial model inputs is a clear application of quantitative analysis .

CFA ESG Investing References:

* The CFA Institute's ESG curriculum emphasizes the importance of integrating ESG factors into financial models quantitatively to provide a comprehensive view of a company's financial health and potential risks .

NEW QUESTION # 544

To reflect weak governance of a private equity holding, an analyst's model should most likely include a reduction in the holding's:

- **A. Terminal value**
- B. Bankruptcy risk
- C. Cost of capital

Answer: A

Explanation:

When a private equity holding demonstrates weak governance, it may lead to lower long-term growth potential and higher risk. This

is reflected in a reduced terminal value in the analyst's valuation model, indicating lower anticipated future cash flows or exit value. ESG Reference: Chapter 7, Page 259 - ESG Analysis, Valuation & Integration in the ESG textbook.

NEW QUESTION # 545

In contrast to engagement dialogues, monitoring dialogues most likely involve:

- A. a two-way sharing of perspectives
- **B. discussions intended to understand the company, its stakeholders and performance.**
- C. conversations between investors and any level of the investee entity including non-executive directors

Answer: B

Explanation:

In contrast to engagement dialogues, monitoring dialogues most likely involve discussions intended to understand the company, its stakeholders, and performance. Here's a detailed explanation:

* Monitoring Dialogues:

* Monitoring dialogues are conversations between investors and company management aimed at gaining a deeper understanding of the company's performance and opportunities. These dialogues involve detailed questions from investors and are intended to inform buy, sell, or hold investment decisions.

* The primary focus is on understanding the company's operations, management practices, and strategic direction.

* Engagement Dialogues:

* Engagement dialogues involve a two-way sharing of perspectives, where investors express their positions on key issues and highlight any concerns. These dialogues can include conversations with any level of the investee entity, including non-executive directors, and are aimed at influencing company behavior and improving ESG performance.

CFA ESG Investing References:

* The CFA Institute's ESG curriculum delineates between monitoring and engagement dialogues, emphasizing that monitoring is more about understanding and assessing company performance, while engagement aims to actively influence corporate practices.

NEW QUESTION # 546

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