Global ESG Disclosure Standards for Investment Products

Adopting Release

Introduction

This Adopting Release explains the significant differences between the Exposure Draft of the CFA Institute ESG Disclosure Standards for Investment Products (the "Exposure Draft") and the Global ESG Disclosure Standards for Investment Products (the "Standards"). CFA Institute issued the Exposure Draft on 19 May 2021 to seek public commentary on proposed requirements and recommendations. The publication of the Exposure Draft opened an eight-week consultation period that extended through 14 July 2021. The feedback received during that period, summarized in this Adopting Release, informed the development of the Standards.

The Exposure Draft used the term "compliant presentation" to refer to a presentation for an investment product that contains all the information required by the Standards. The term "compliant presentation" is replaced with the term "ESG Disclosure Statement" in the Standards, and this new term is used throughout this Adopting Release.

Summary Points

- Despite many differences between the Exposure Draft and the Standards in terms of wording, structure, and order of provisions, the scope of the information that an investment manager would disclose remains similar. The most significant change to the structure and ordering of provisions is that all of the provisions in Sections 2–10 of the Exposure Draft are contained in Section 2 of the Standards.
- Naming and labeling remain out of scope for the Standards, but a section on ESG terminology has been added. This section contains definitions from leading global organizations as well as usage recommendations for specific ESG-related terms. Additionally, an appendix has been added to help investment managers understand how to determine the applicability of provisions in the Standards.
- The notes and guidance that appeared in the Exposure Draft will be included in the Handbook for the Global ESG Disclosure Standards for Investment Products to be issued at a future date.
- With the exception of the recommendation for investment managers to obtain independent assurance on their ESG Disclosure Statements, all requirements and recommendations related to assurance (referred to as "verification" in the Exposure Draft) will be contained in the assurance procedures for the Global ESG Disclosure Standards for Investment Products to be issued at a future date.
- The ESG Technical Committee and CFA Institute will create an optional standardized format or template that incorporates, as appropriate, specific suggestions offered in comment letters for standardizing the format of ESG Disclosure Statements.

Stakeholder Perspectives

During the Exposure Draft consultation period, CFA Institute received 59 comment letters comprising more than 930 comments from 14 different countries and a variety of stakeholders. Comment letters were posted on the CFA Institute website unless the respondent requested the letter not be posted. Figure 1 shows breakdowns of comment letters by stakeholder group and geographic region.

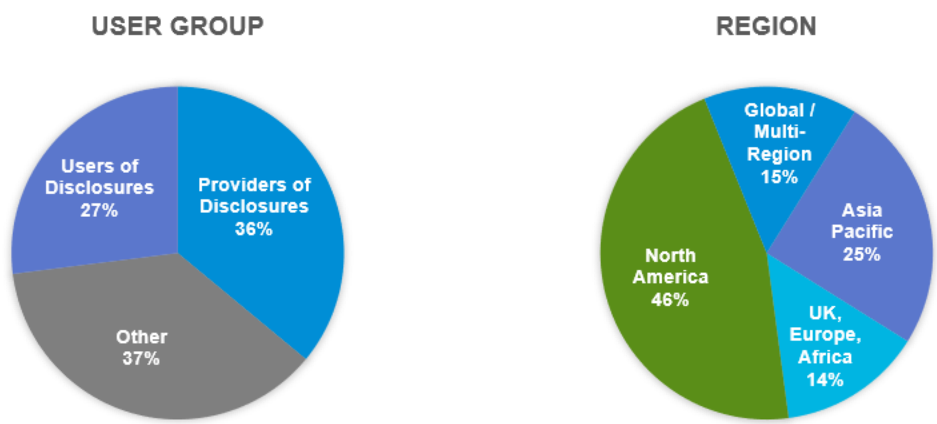

Figure 1: Comment Letters by User Group and by Region[1]

A key question posed in the Exposure Draft to all stakeholders was whether the draft provisions were helpful in establishing or clarifying the types of information that should be disclosed about an investment product's ESG approaches—that is, how ESG issues are considered in an investment product's objectives, investment process, or stewardship activities. With the exception of regulated retail fund managers, whose comments came primarily through their industry associations, all other stakeholder groups including investors, investment managers, consultants and advisors, database providers, regulators, and investment professionals indicated that the draft provisions generally addressed the information that is necessary and helpful to understand an investment product's ESG approaches.

More details on the overall views of each stakeholder group are described below:

- The consensus among institutional investors and asset owners was that an ESG Disclosure Statement would help them understand the ESG approaches used in an investment product. Most institutional investors and asset owners indicated that ESG Disclosure Statements would complement, streamline, or otherwise improve their existing due diligence processes, particularly if ESG Disclosure Statements were in an easily comparable format.

[1] Users of disclosures include investors, investor associations, consultants, advisors, and regulators. Providers of disclosures include investment managers and investment manager associations. "Other" includes CFA Institute member societies, standard setters, and non-governmental organizations (NGOs).

- Consultants and advisors indicated that an ESG Disclosure Statement would help them understand the ESG approaches used in an investment product. They unanimously agreed that ESG Disclosure Statements would help them identify investment products that suit clients' specific ESG-related needs and preferences. Consultants and advisors also indicated that ESG Disclosure Statements would be a useful supplement to their due diligence questionnaires and would streamline or complement their due diligence processes.
- Investment managers that provided a comment letter directly (as opposed to indirectly through an association) generally indicated the proposed provisions were helpful in establishing or clarifying the types of information that should be disclosed about the ESG approaches used in investment products. Many investment managers commented that the proposed provisions covered many of the questions typically asked in Requests for Proposal (RFPs) and Due Diligence Questionnaires (DDQs). Investment managers did not believe that ESG Disclosure Statements would completely replace RFPs and DDQs given the customized nature of RFPs and DDQs. Most investment managers said it would be feasible and practical to provide an ESG Disclosure Statement and that doing so would not conflict with their ability to comply with local laws and regulations—although it would also require significant effort.
- Database providers and database users indicated ESG Disclosure Statements would provide useful information that could be standardized for product searches. They expressed the desire for the Standards to be aligned with the European Union Sustainable Finance Disclosure Regulation (EU SFDR) and other disclosure regimes as they become codified.
- Regulators, exchanges, and investment professionals commented that the proposed provisions would help investors understand the ESG approaches used in investment products. They also generally indicated that the Standards would be helpful in maintaining a commitment to professional ethics and integrity, providing investor protection through product transparency, and serving as a mechanism to help investors find investment products that suit their ESG-related needs and preferences.
- Similar to their responses to the Consultation Paper, regulated retail fund manager associations urged CFA Institute not to proceed with the Standards or to delay issuance until regulators have completed their deliberations and rule-making processes. Moreover, they recommended that, rather than construct a standard, CFA Institute present its ideas as recommendations, enabling investment managers to draw from the provisions that are appropriate to their circumstances. Regulated retail fund manager associations strongly oppose disclosure rules and mechanisms that are distinct from, and sit alongside of, those established by local regulators. From these associations' perspective, having two different sets of rules creates a great deal of administrative effort as well as legal and compliance risk of disclosing information, without any additional benefit.

  The ESG Technical Committee and CFA Institute carefully considered these comments, recognizing that these responses come from associations with many members, and appreciate the perspective of regulated retail fund manager associations and their members. After extensive evaluation of alternative options and pros and cons, it was decided to move forward with standards rather than "recommended best practices." The current state of disclosures would not improve if investment managers could make only those disclosures they wish to make and if the Standards had no mechanism for independent assurance. It would be difficult to achieve the goals of fair representation, full disclosure, and comparability through recommended best practices.

Fair representation, full disclosure, and comparability certainly can be achieved through regulation, and if regulators are considering introducing or revising regulation or guidance, we hope that they will incorporate the requirements contained within the Standards. In many markets, investment products offered to "sophisticated" investors are not heavily regulated and may not be subject to disclosure requirements related to ESG approaches. In these markets, voluntary standards can bridge the gap and enable a greater degree of consistency in disclosures among various types of investment products. In some markets, disclosure regimes are still developing, and the Standards may play an important role in formulating regulatory requirements.

Some investment managers expressed concern that the Standards would become a de facto market requirement, similar to the Global Investment Performance Standards (GIPS®) that are also developed and maintained by CFA Institute. The GIPS standards became a de facto market requirement because investors saw the value of having standardized performance reports and began requesting them from investment managers. If the Global ESG Disclosure Standards for Investment Products become a de facto market requirement, it will be because investors see the value in standardized disclosure of the ESG approaches used in investment products.

The Standards are voluntary. Investment managers are given the flexibility to choose the investment products to which they apply the Standards. Investment managers are encouraged to draw from the provisions within the Standards when preparing regulatory disclosures and marketing materials. However, investment managers must not state that the regulatory disclosures or marketing materials are in compliance, or in partial compliance, with the Standards unless all requirements of the Standards are met.

Responses to Questions Posed in the Exposure Draft

The Exposure Draft contained 22 questions directed at intended users and stakeholders of the Standards, and comments were solicited on all of the Standards' principles, requirements, and recommendations. Comments were used to formulate the Standards' scope and terminology and to ensure relevance to all stakeholders. Some comment letters suggested additional topics for disclosure beyond what was proposed in the Exposure Draft. These suggestions generally fell into one of the following categories.

Firm-Level Information

A number of commenters wanted to see provisions related to a firm's ESG policies, commitments, resources, and capabilities. To avoid overlap with other voluntary codes, standards, and reporting frameworks, firm-level information was deemed to be out of scope—with the exception of stewardship reporting. It was not possible to completely avoid firm-level policies and processes in the disclosure provisions related to stewardship activities. See the discussion on Stewardship in Section 10 for additional detail.

Reporting

Many commenters expressed a desire for required reporting of investment product holdings, activities, and outcomes as well as stewardship activities and outcomes. The Standards do not contain reporting requirements because time and resources were too limited to address reporting in addition to ESG approaches. However, reports on these topics are very helpful to prospective investors as well as current investors. Disclosure requirements related to reporting may be considered in a future edition of the Standards.

ESG-Related Risks

Some commenters suggested requiring disclosure of various ESG-related risks.

- Climate change risk

  Climate change risk includes but is not limited to (1) physical risks—that is, potential financial loss or underperformance resulting from global warming, rising sea levels, and increased extreme weather events—and (2) transition risks—that is, potential financial loss or underperformance resulting from the extent and pace of policy, technology, and infrastructure changes associated with climate change. Climate change can also cause obsolescence risk or stranded asset risk.

  Climate change risk is an exogenous risk. Many investment products have some degree of climate change risk depending on their objectives and strategies. Climate change risk is one of many types of risks that may fall under regulatory requirements for risk disclosure. To avoid potential conflicts or overlaps with regulatory requirements or guidance, the Standards have no requirements for disclosing risks concerning exposure to climate change or how an investment product's ESG approaches or other mechanisms address such exposure.

- Risks and limitations of the ESG approaches used in the investment product

  All investment objectives and investment strategies have risks and limitations. Some investment products that incorporate ESG approaches may weight certain industries or sectors more heavily than others, and some investment products that incorporate ESG approaches may have highly concentrated portfolios—that is, portfolios with a small number of investments or risk exposures. These types of risks are not unique to investment products that use ESG approaches. Principal risks of an investment product's objectives and strategies are one of many types of risks that may fall under regulatory requirements for risk disclosure. To avoid potential conflicts or overlaps with regulatory requirements or guidance, the Standards have no requirements for disclosing risks and limitations of the ESG approaches used in the investment product. The Standards do, however, require disclosure of the risks and limitations of the ESG information that is used as well as how those risks and limitations are managed. Although even financial information used in investment decision making has risks and limitations, and the quality of ESG information is improving, ESG information is neither standardized nor uniformly disclosed. Therefore, ESG information generally has more risks and limitations than traditional financial information. Consequently, it was decided that the Standards should address disclosure of the risks and limitations of ESG information.

Terminology

Some commenters were disappointed to see that the Exposure Draft had no requirements, recommendations, or definitions for terms commonly associated with ESG approaches. During the development of the Standards, it became apparent that requirements or recommendations for naming or labeling had a high likelihood of conflicting with local regulations. Therefore, the Standards contain no requirements or recommendations for the naming or labeling of investment products. To address commenters' concerns regarding terminology, the Standards include definitions from leading global organizations for common ESG approaches and recommendations for the usage of certain ESG terms related to the approaches.

Alignment with the EU Sustainable Finance Disclosure Regulation (SFDR) and the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)

Some commenters expressed a desire for the Standards to align with SFDR as well as the recommendations of the TCFD. SFDR and the TCFD recommendations were fully considered during the development of the Standards, and the Standards have been aligned to the extent feasible and practical given the intentional differences in scope and purpose among them.

Alignment of ESG Approaches with Investors' ESG-Related Needs and Preferences

Some commenters were disappointed to see that the Exposure Draft did not discuss the suitability of various ESG approaches for investors' various ESG-related preferences. Although this topic remains important within the overall context of ESG investing, it was decided that a framework for matching investors' ESG preferences with ESG approaches should not be formally part of the Standards. A future "user's guide" for investors may address this subject.

Standardized Format

Another key question posed in the Exposure Draft to all stakeholders was whether it would be helpful to present ESG disclosures in a standardized format. Across all stakeholder groups except regulated retail fund managers, there was a strong consensus that a standardized format would be helpful, or even essential, to facilitate comparison of investment products. Investors, consultants, and advisors indicated that ESG Disclosure Statements, particularly if provided in a standardized format, would streamline and complement (but not replace) their existing product search, due diligence, and reporting processes. Several respondents indicated the format should be machine readable.

The ESG Technical Committee and CFA Institute will produce an optional standardized format or template that incorporates, as appropriate, the specific suggestions offered in comment letters for standardizing the presentation of ESG disclosures.

Notable Changes to Provisions Proposed in the Exposure Draft

1. General Principles and Fundamental Requirements

Provisions Related to General Principles

Unlike the Exposure Draft, the Standards do not contain a provision that prohibits presenting information in a way that would inhibit an investor's understanding of the investment product. The primary concern behind this proposed provision was the use of terms that are unfamiliar to investors. The ESG Terminology section of the Standards addresses this concern. Additionally, it was decided that this provision would be difficult to objectively verify by an independent assurance provider.

Unlike the Exposure Draft, the Standards do not contain a provision that prohibits presenting information in a way that makes it difficult for an investor to locate the required disclosures. The required statement of compliance (Provision 2.A.1.g) naturally requires the ESG disclosures to be grouped together, and thus it was decided this provision was unnecessary. Additionally, it was decided that this provision would be difficult to objectively verify by an independent assurance provider.

Provision Related to Information Provided by Third Parties

Unlike the Exposure Draft, the Standards do not require investment managers to ensure that the records and information provided by any third party on which the investment manager relies meet the requirements of the Standards. The language in the Exposure Draft was not intended to apply to "any" third party but rather any third party that provides information used to meet the requirements of the Standards. From a practical standpoint, this provision would likely apply only when an investment manager uses a subadvisor. It was decided that this provision was unnecessary because it explicitly stated a requirement that would be implicitly met.

Provisions Related to Providing ESG Disclosures to Investors

Some readers of the Exposure Draft inferred that the requirement to "make every reasonable effort to provide the investment product's compliant presentation to all investors prior to their initial investment in the investment product" implied that investment managers must have a process to physically or electronically deliver the disclosures to an investor prior to that investor's initial investment. The notes under this requirement explained that having such a process was not the only method to meet the requirement. To avoid confusion, this requirement has been revised in the Standards to say that investment managers must make ESG Disclosure Statements available to investors. Posting ESG Disclosure Statements on a public or limited-access webpage (or another digital platform) satisfies the requirement. With this change, it was decided that the requirement to provide the investment product's ESG Disclosure Statement to any investor that makes such a request was duplicative, and therefore, the Standards do not include that requirement.

Error Correction

Compared with the Exposure Draft, the requirement for the correction and logging of significant errors is simplified in the Standards. Investment managers are required to correct significant errors and include an explanation of the error in the ESG Disclosure Statement for a minimum period of one year after the correction. The Standards do not require keeping a log of significant errors. Although keeping such a log is good practice, it was decided that doing so is not critical to attain the goals of the Standards.

Independent Assurance

With the exception of the recommendation for investment managers to obtain independent assurance on their ESG Disclosure Statements, all requirements and recommendations related to independent assurance will be contained in the assurance procedures for the Global ESG Disclosure Standards for Investment Products.

2. General Information

A key goal of the Standards is to enable investors to more fully understand the ESG approaches used in an investment product. A question naturally arises as to whether certain non-ESG information should be included in ESG disclosures to help investors understand the context in which the ESG approaches are used. For the Exposure Draft, it was assumed that a few critical pieces of non-ESG information would be helpful to include in disclosures, including but not limited to an investment product's inception date, asset classes, and policies and procedures for notifying investors when material changes are made to an investment product. Feedback in comment letters argued that this type of information is readily available in other documents and should not be required to be restated in ESG disclosures. Based on this feedback, the Standards assume that investors will review the ESG disclosures alongside regulatory disclosures and other investment product materials. Therefore, the Standards do not include the provisions proposed in the Exposure Draft related to inception date, asset class allocation, and policies and procedures for notifying investors when material changes are made to an investment product.

The recommendation in the Exposure Draft to disclose the third-party ESG-related labels and certifications with which the investment product complies has been made a requirement in the Standards.

There are two new general information disclosure requirements: (1) the disclosure of a summary of ESG approaches used in the product, and (2) the disclosure of a summary of the ESG issues, if any, that systematically influence the investment product's objectives, investment process, or stewardship activities.

3. Objectives

As discussed in Section 2, the Exposure Draft assumed that including a few critical pieces of non-ESG information would be helpful, including but not limited to an investment product's financial objectives. Feedback in comment letters argued that this type of information is readily available in other documents and should not be required to be restated in ESG disclosures. Therefore, the Standards assume that investors will review the ESG disclosures alongside regulatory disclosures and other investment product materials, and hence, the Standards do not require disclosure of financial objectives. Only environmental and social impact objectives are required to be disclosed.

For the purposes of the Standards, environmental and social impact objectives are specific statements about desired changes or outcomes pertaining to the environment or society. Intention to generate positive environmental or social impact, by itself, does not constitute an impact objective. To be an impact objective, the intention must be stated in measurable or observable terms. Additionally, an allocation to certain types of investments—such as “sustainable” investments—by itself is not considered an impact objective for the purposes of the Standards.

Following the decision to limit Section 3 to environmental and social impact objectives, it became clear that the requirements in Sections 3 and 9 of the Exposure Draft could be combined. All of the disclosure requirements related to investments that are made with the intention to generate positive, measurable social and environmental impact alongside a financial return are contained within Provision 2.A.19 in the Standards.

4. Benchmarks

With respect to benchmarks, it was again assumed for the Exposure Draft that including a few critical pieces of non-ESG information would help investors better understand the ESG approaches used in an investment product. An investment product’s benchmark index was considered one of these critical pieces of information. Investment products may use an ESG index to define the investment universe or as a point of comparison for certain ESG characteristics of the investment product as well as a point of comparison for risk and return.

Regardless of whether an index is used as an investment universe, a point of comparison, or both, understanding the characteristics of an index used by an investment product can help investors understand that investment product’s characteristics. After considering feedback provided in comment letters, it was decided that information about the characteristics of “traditional” indexes—that is, those that do not include ESG considerations in their construction methodology—is readily available, and therefore, ESG disclosures need not describe those characteristics. If an investment product uses an “ESG index,” however—that is, an index that includes ESG considerations in its construction methodology—then it would be helpful for ESG disclosures to describe the characteristics of the index and how investors can obtain information about the index construction methodology. For clarity, the Standards have different provisions for using an ESG index as an investment universe (Provision 2.A.7) and for using an ESG index as a point of comparison (Provision 2.A.12).

5. Sources and Types of ESG Information

A minority of commenters said that the names of third-party ESG data providers should be a required disclosure, and these commenters provided very good arguments to support this position. In principle, this position is consistent with the goals of the Standards. In practice, many companies consider the identity of third-party suppliers to be information that is part of their proprietary investment process. The position taken in the Exposure Draft, and again in the Standards, is that the disclosure of the names of third-party ESG data providers may be *helpful* to investors but is not *necessary* if the investment manager provides a sufficient description of the types of ESG information used and a description of the sources from which the information is obtained.

For additional clarity, the Standards require investment managers to disclose the risks and limitations of the ESG information used, as well as the efforts taken to manage those risks and limitations. The Standards also require investment managers to disclose how and where ESG information is used in the investment process and stewardship activities.

6. ESG Exclusions

Based on feedback provided in comment letters, an important change was made to the provisions proposed in Section 6 of the Exposure Draft. Instead of mandating that all binding investment selection criteria be stated only in exclusionary terms, the Standards provide for binding investment selection criteria to be stated in inclusionary terms as well. An additional requirement was added for investment managers to state whether an investment is excluded from, or eligible for inclusion in, the portfolio when the criteria is met. With these changes, another important decision was made to change the phrase “ESG Exclusions” to “Screening” to provide for inclusive as well as exclusive selection criteria.

Also based on feedback provided in comment letters, the provision to disclose the rationale for binding investment selection criteria has been removed. However, a new provision (Provision 2.A.4) requires the disclosure of a summary of the specific ESG issues, if any, that systematically influence the investment product’s investment process, stewardship activities, or objectives. Under this provision, investment managers are expected to provide enough information for investors to understand the basis for the exclusions or inclusions.

7. ESG Information in Financial Analysis and Valuation

One important change to the requirements proposed in Section 7 of the Exposure Draft was to remove the requirement to disclose the rationale for using financially material ESG information in the financial analysis and valuation of the investment product’s investments. The rationale for considering financially material ESG information, or any other type of financially material information, is implicitly to attain the investment product’s financial—that is, risk and return—objectives.

Another important change made in the Standards is the replacement of the phrase “financial analysis and valuation” with “investment decision.” Some commenters inferred that the term “financial analysis and valuation” meant that the provision applied only to quantitative financially material ESG information. To be clear, it is acknowledged that qualitative financially material ESG information can be used in financial analysis and valuation. To ensure that the provision is applied as intended, the Standards use the term “investment decision” instead of “financial analysis and valuation.” For the purposes of Provision 2.A.8, the term “investment decision” means a decision to buy, sell, or hold a specific investment. It does not refer to a decision to set systematic investment criteria, set allocation targets, or set targets for ESG characteristics—these items are addressed in other provisions.

8. Portfolio-Level ESG Criteria and Characteristics

The provision to disclose the rationale for portfolio-level criteria has been removed. However, a new provision in the Standards (Provision 2.A.4) requires disclosing a summary of the specific ESG issues, if any, that systematically influence the investment product’s investment process, stewardship activities, or objectives. Under this provision, investment managers are expected to provide enough information for investors to understand the basis for portfolio-level criteria.

The first provision in Section 8 of the Exposure Draft has been split into several provisions in the Standards in order to clarify the differences between two types of portfolio-level criteria—criteria for portfolio-level ESG characteristics and criteria for an allocation to certain types of investments. The first type of criteria can be satisfied through investment selection, the weighting of investments, or a combination thereof. The second type can be satisfied only through the weighting of investments. In the Standards, Provisions 2.A.11–2.A.13 address portfolio-level ESG characteristics and Provisions 2.A.14–2.A.15 address allocation targets.

Based on significant support from comment letters, the recommendation proposed in the Exposure Draft about portfolio-level reporting to investors became a requirement in the Standards.

9. Process to Achieve Impact Objectives

As mentioned earlier, the requirements in Sections 3 and 9 of the Exposure Draft are combined into one section in the Standards. The only important change is that the recommendation proposed in the Exposure Draft about reporting on the progress toward attaining the impact objectives became a requirement in the Standards. The conditional statement at the start of the provision in the Environmental and Social Impact Objectives section of the Standards (Provision 2.A.19) begins with the phrase, "If investments are made with the intention to generate positive, measurable social and environmental impact alongside a financial return." This language is taken from the Global Impact Investing Network (GIIN) definition of "impact investments" to make clear the intention that these provisions apply to those investment products that incorporate "impact investing" as defined by GIIN.

10. Stewardship

One significant change to the provisions proposed in Section 10 of the Exposure Draft is the removal of the requirement to disclose a summary of the stewardship policies that are relevant to ESG issues. The provision for disclosing the rationale for considering ESG issues when undertaking stewardship activities for the investment product has also been removed. If ESG issues are typically considered when undertaking stewardship activities, however, investment managers must disclose the types of stewardship activities undertaken, the ESG issues typically considered, and how those stewardship activities and ESG issues relate to the investment product's objectives and investment process. Lastly, based on significant support from comment letters, the recommendation proposed in the Exposure Draft to disclose how stewardship activities are reported to investors became a requirement in the Standards.

Some comment letters noted that the disclosure requirements pertaining to stewardship activities may necessitate disclosure of firm-level policies or information, which have been deemed out of scope for the Standards. The provisions related to stewardship activities are indeed a carefully considered exception. Some investment managers have only firm-level stewardship policies and processes, whereas others use a combination of firm-level and product-level stewardship policies and processes. To require disclosure of only the product-level stewardship policies and processes may lead to an incomplete understanding of the product. Therefore, the provisions pertaining to stewardship activities must be sufficiently broad to cover all the policies and processes related to the stewardship activities undertaken for the investment product, irrespective of how the investment manager has decided to internally organize stewardship policies and activities.