Response Form
for the
Consultation Paper on the development of the CFA Institute ESG Disclosure Standards for Investment Products

CFA Institute is developing a voluntary, global industry standard, the CFA Institute ESG Disclosure Standards for Investment Products (the "Standard"), to establish disclosure requirements for investment products with ESG-related features. The purpose of the Standard is to provide greater transparency and comparability for investors by enabling asset managers to clearly communicate the ESG-related features of their investment products. The goal for this Consultation Paper is to elicit feedback on the proposed scope, structure, and design principles of the Standard. **All comments must be received by 19 October 2020 in order to be considered.**

Providing Feedback

Public commentary on this Consultation Paper will help shape an Exposure Draft, the initial version of the Standard, which is expected to be issued in May 2021. Comments should be provided in this response form. You may address as few or as many of the Consultation Paper's questions as you wish. Unless otherwise requested, all comments will be posted on the CFA Institute website.

<u>Guidelines for submission</u>

Comments are most useful when they:

- directly address a specific issue or question,
- provide a rationale and support for the opinions expressed, and
- suggest alternative solutions in the event of disagreement.

There is a section for general comments at the end of this response form.

Positive comments in support of a proposal are equally as helpful as those that provide constructive suggestions for improvement.

<u>Requirements for submission</u>

For comments to be considered, please adhere to the following requirements:

- Insert responses to numbered questions in the designated areas of the response form. Please do not remove tags of the type <QUESTION_XX>. Your response to each question must be framed by the two tags corresponding to the question. If you do not wish to respond to a given question, please do not delete it but simply leave the text "ENTER RESPONSE HERE" between the tags.
- Provide all comments in English.
- Assign a unique file name to your response form.
- Submit the response form as a Microsoft Word document.
- Submit the response form to standards@cfainstitute.org by 5:00 PM E.T. on 19 October 2020.

General Information (required)

Respondent: *(Please enter your full name if you are submitting as an individual or the name of the organization if you are submitting on behalf of an organization.)*	Ario Advisory (submitted by Mike Clark FIA
Stakeholder Group: *(Please select the stakeholder group with which you most closely identify.)*	Consultant or Advisor
Region: *(If you are submitting as an individual, please select the region in which you live. If you are submitting on behalf of an organization and the organization has a significant presence in multiple regions, please select "Global". Otherwise, please select the region in which the organization has its main office.)*	Global
Country: *(If you are submitting as an individual, please enter the country in which you live. If you are submitting on behalf of an organization, please enter the country in which the organization has its main office.)*	UK
Confidentiality Preference: *(Please select your preference for whether your response is published on the CFA Institute website.)*	yes, my response may be published

Consultation Paper Questions

Market Needs

Question 1: Do you agree that a standard is needed to help investors better understand and compare investment products with ESG-related features?

<QUESTION_01>

Yes.

However, we wish to offer a perspective which views the Standard in a somewhat different way to the route that the CFA Institute is currently taking, though there are overlaps.

Firstly, our perspective. We prefer the adjective ESG to be applied to one noun and one noun only: “risks.” Asset managers manage risks, and we believe the fundamental purpose of the Standard should be to help the investor (we tend to think primarily of “asset owners”, as typically defined) understand how the product manages risks. Asset managers are predisposed to see risks through the lens of standard finance theory, MPT and related paradigms. Investors (quite a wide CFA definition and perhaps pension fund asset owners are our best teachers) are predisposed to see risks through a wider, societal lens. The SDGs have been described as a “strategy for humanity”, and asset owners - e.g. those with a Universal Owner perspective - will assess risks in a somewhat different way from the “investment risk culture” of the average asset manager firm. Asset managers focus on alpha, asset owners on beta. Risk straddles both concepts, and can be systemic. Passive products can embed poor risk management when their tracking index suffers the same disability.

We therefore encourage the view that **the purpose of the Standard is to support the asset manager community in how they set out how they manage risks in the product, thus enabling the investor to determine if that aligns adequately with their (individual) view of risk**. Looking at it another way, some of the pioneering climate-related products were designed by asset owners. The asset managers who were shortlisted had to demonstrate during the tender/selection process that their specification of climate risk (using real world metrics as proxies for financial risk) was well-aligned with the investor (asset owner) view.

We need to move away from the all-too-frequent asset manager refrain: “Don’t worry, we have got all those ESG risks covered”. Such assertions need to be replaced by evidence that the investor (asset owner), potentially with their adviser, can evaluate the product’s risk management and then take an informed buying decision.

This leads us to suggest that the investor is particularly interested in how the asset manager views real world metrics (e.g. carbon footprint, portfolio warming, or perhaps a board governance metric, or gearing) as risk proxies for the investor’s specification of risk. With a segregated mandate, the asset owner can naturally drive that conversation. With non-segregated, pooled/commingled, products (which we assume is the focus of the Standard), we see the Standard as seeking to assist investors in making their assessment of a product where the asset manager might otherwise be reticent.

We can guide the CFA Institute towards some of the leading work in this area if desired.

<QUESTION_01>

Terminology

Question 2: Are any of the defined terms ambiguous? If so, how could they be clarified?

<QUESTION_02>

Yes. Building on our response to Q1, we see overlap between ESG matters, ESG-related Factors and ESG-related Features. They are all "risks specified by the sell-side", in our view.

We see ESG-related needs as simply "risks specified by the buy-side".
<QUESTION_02>

Purpose and Scope

Question 3: In addition to the examples listed in Table 1, which regulations and standards, either in existence or in development, should be considered during the development of the Standard to avoid duplication or conflict and to ensure alignment and referencing if and when applicable?

<QUESTION_03>

The IFRS Foundation Consultation which proposes the establishment of the SSB.

Also, please note the TCFD disclosures go beyond issuers and embrace asset managers and investors (aka asset owners).

<QUESTION_03>

Question 4: Do you agree that a disclosure-based approach would be more helpful to achieve the Standard's goals of transparency and comparability than a prescriptive-based approach?

<QUESTION_04>

Yes, strongly. It is neither possible nor wise to prescribe how an asset manager should assess risks at the product level, as that is their key skill. Equally, an investor will have their own individual assessment of risks. The disclosure-based approach is necessary to maximise alignment between the two parties.

<QUESTION_04>

Question 5: Do you agree that the Standard should focus only on product-level disclosures and not firm-level disclosures?

<QUESTION_05>

Yes. It seems likely that firm-level disclosures would be essentially marketing brochures. PRI Assessment is an adequate firm-level assessment until something better arrives.

<QUESTION_05>

Question 6: Do you agree that an asset manager should be permitted to choose the investment products to which they apply the Standard rather than be required to apply the Standard to all their investment products with ESG-related features?

<QUESTION_06>

Yes. We believe that all (or nearly all) products have ESG risks, by definition. As an investor we would ask an asset manager why a specific product seems – unusually! - not to be covered by the Standard. Does it really have no ESG risks?

Therefore, we would regard non-disclosure for some products as suggesting the firm was less capable of ESG risk management than firms who disclosed on all, or nearly all, their products.

Throughout, we encourage CFA to regard this work as **helping to correct a market (risk pricing) failure**. Even if not all investors (yet) recognise ESG risks, it is not the role of the Standard to tell them how they should do it. Investors must play their part, and become better buyers.

<QUESTION_06>

Design Principles

Question 7: Do you agree with the design principles for definitions of ESG-related terms?

<QUESTION_07>

Building on our response to Q1, we see a central element of this work as a **manager disclosing how they use real-world data (and not just financial accounting data) as a proxy for financial risk**.

<QUESTION_07>

Question 8: Do you agree with the design principles for disclosure requirements?

<QUESTION_08>

See response to Q7

<QUESTION_08>

Question 9: Should the Standard require that all disclosures be made in a single document? If disclosures were spread across multiple documents, would that pose a challenge for investors to understand and compare investment products?

<QUESTION_09>

Yes. There seems no net advantage to investors if they are required to search across multiple documents. We should seek to make this information as accessible as possible for investors (clients) and their advisers. Of course, other documents can have links pointing to the one master document.

<QUESTION_09>

Question 10: Do you agree with the design principle for independent examination?

<QUESTION_10>

Yes

<QUESTION_10>

Question 11: Should independent examination be required, or should it be recommended as best practice but ultimately left to the discretion of the asset manager?

<QUESTION_11>

There is no need to make it mandatory, at least at outset. Recommended as best practice, it should become a de facto standard over time. Asset managers who do not provide it will, in time, be trusted less. Market-based solutions around standards with assurance are common in a wide range of economic activity.

Further, the CFA should seriously consider how independent examination should be paid for. We need to avoid the problems that have arisen from "The Audited Pays", so familiar in the corporate sphere. For example, could the PRI be approached to fund this activity? If we view PRI signatory fees not as fees but rather as a "welcome tax on the investment system to correct a massive market failure", then this suggestion may seem less revolutionary than it appears at first sight. There is a strong alignment between asset owner interests and the Standard.

<QUESTION_11>

Question 12: Should the independent examiner (i) examine the disclosures relative to only the design of the investment product, or (ii) examine the disclosures relative to both the design and implementation of the investment product?

<QUESTION_12>

Both design and implementation. The investor is interested in how risk management is implemented. A buildings inspector does not just examine the architect's drawings, but also visits the property.

As with the Q11 issue, the investor market can be expected to demand both over time.

<QUESTION_12>

Proposal for General Disclosure Requirements

Question 13: Do you agree with the scope of the general disclosure requirements? Are there topics that should be added, deleted, or modified?

<QUESTION_13>

There seems little coverage of how the asset manager translates real world metrics into (financial) risk assessments. We encourage CFA to reflect on the importance of this point. **There is a risk that the Standard too readily reflects the asset manager view at the expense of the investor view. In our view, this is the greatest risk to the whole Standard initiative. We suggest CFA needs to encourage investors (asset owners) to "buy" the Standard, and hence position it accordingly. The "asset manager refrain" comment in our response to Q1 needs to be remembered!**

<QUESTION_13>

Question 14: Should the disclosure requirements address an investment product's intention to align with policy goals, such as the UN Sustainable Development Goals (SDGs), and if so, should these requirements be part of general disclosure requirements or feature-specific disclosure requirements?

<QUESTION_14>

No. We believe this type of disclosure will evolve naturally over time.

ESG risks are intrinsic to an investment product; policy goals are more aligned with real world outcomes (e.g. carbon emissions, health). See for example the Ben Caldecott exposition of CRM vs ACO in a recent excellent paper, and consider its more general application. We suggest the Standard might prompt this as an additional disclosure, where appropriate, and it is surely too early to make this mandatory.

<QUESTION_14>

Question 15: Should the disclosure requirements include an explanation of whether, and if so how, an investment product considers principal adverse impacts on sustainability factors and where to find additional information, as required by Article 7 of Regulation EU 2019/2088 Sustainable Finance Disclosure Regulation?

<QUESTION_15>

We are minded to respond No. As is clear, we believe investors and asset managers focus on financial risk (albeit investors/asset owners can typically have a wider perspective) so it will be difficult, at least at present, to address outcomes (PAIs) sensibly. This links with our Q14 response.

<QUESTION_15>

<u>Proposal for ESG-Related Features and Feature-Specific Disclosure Requirements</u>

Question 16: Do you believe that "ESG Integration" is a clear and appropriate name for this feature? If not, please suggest an alternative and explain why it would be a better choice.

<QUESTION_16>

We believe the first four features listed are essentially different ways of describing a risk stance.

The fifth is an outcome/event metric, another category, different conceptually from risk which is an ex ante concept.

The sixth is, again, another category, the Exercise of Ownership (the first two terms: Proxy, Engagement). We recommend the term Stewardship is never used as a surrogate for Proxy/Engagement which are more precise. In our view, Stewardship can readily include, for example, climate risk management in both the SAA and portfolio construction parts of the investment decision process.

<QUESTION_16>

Question 17: If an investment product had Feature (A), and only Feature (A), as defined above, would it be consistent with the CFA institute policy paper "Positions on Environmental, Social, and Governance Integration"? In other words, would it be clear that material ESG-related factors are considered alongside traditional financial factors solely for the purpose of seeking to improve risk-adjusted returns? If not, please suggest how that could be made clearer.

<QUESTION_17>

Building on our response to Q16, we do not believe it is possible to determine that is a product has Feature A and only Feature A.

<QUESTION_17>

Question 18: Is Feature (A) clearly defined? If not, please explain how the definition could be made clearer or more precise.

<QUESTION_18>

See response to Q17

<QUESTION_18>

Question 19: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (A)? Are there issues that should be added, deleted, or modified?

<QUESTION_19>

See previous responses

<QUESTION_19>

Question 20: Do you believe that "ESG-related Exclusions" is a clear and appropriate name for this feature? If not, please suggest an alternative and explain why it would be a better choice.

<QUESTION_20>

It is clear. However, we simply see this as a risk exposure the asset manager does not wish to take (in the hope/belief it aligns with the specifics of an investor's risk appetite)

<QUESTION_20>

Question 21: Are "negative screening" and "norms-based screening" similar enough, particularly in the types of issues to be addressed by disclosure requirements, that they can both be covered by Feature (B) ESG-Related Exclusions? If you prefer that they be two separate features, please explain the key differences in function, benefits, and disclosure requirements.

<QUESTION_21>

They add even greater granularity to a taxonomy that we believe may have too much already!

<QUESTION_21>

Question 22: Is Feature (B) clearly defined? If not, please suggest how the definition could be made clearer or more precise.

<QUESTION_22>

See earlier responses

<QUESTION_22>

Question 23: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (B)? Are there issues that should be added, deleted, or modified?

<QUESTION_23>

See earlier responses

<QUESTION_23>

Question 24: Do you believe that "Best-in-Class" is a clear and appropriate name for this feature? If not, is "Positive ESG Performance Profile" a better name? If you dislike both of these names, please suggest an alternative and explain why it would be a better choice.

<QUESTION_24>

See earlier responses

<QUESTION_24>

Question 25: Do you agree that Feature (C) is distinct enough, particularly in the types of issues to be addressed by disclosure requirements, that it should be separate from other features? If not, please suggest the feature with which it should be combined.

<QUESTION_25>

See earlier responses

<QUESTION_25>

Question 26: Is Feature (C) clearly defined? If not, please explain how the definition could be made clearer or more precise.

<QUESTION_26>

See earlier responses

<QUESTION_26>

Question 27: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (C)? Are there issues that should be added, deleted, or modified?

<QUESTION_27>

See earlier responses

<QUESTION_27>

Question 28: Do you believe that "ESG-related Thematic Focus" is a clear and appropriate name for this feature? If not, please suggest an alternative and explain why it would be a better choice.

<QUESTION_28>

See earlier responses

<QUESTION_28>

Question 29: Do you agree Feature (D) is distinct enough, particularly in the types of issues to be addressed by disclosure requirements, that it should be separate from other features? If not, please suggest the feature with which it should be combined.

<QUESTION_29>

See earlier responses

<QUESTION_29>

Question 30: Is Feature (D) clearly defined? If not, please explain how the definition could be made clearer or more precise.

<QUESTION_30>

See earlier responses

<QUESTION_30>

Question 31: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (D)? Are there issues that should be added, deleted, or modified?

<QUESTION_31>

See earlier responses

<QUESTION_31>

Question 32: Do you believe that "Impact Objective" is a clear and appropriate name for this feature? If not, please suggest an alternative and explain why it would be a better choice.

<QUESTION_32>

As noted above, we think this highlights the category challenge. Feature E has a focus on real world outcomes. Features A through D focus more on ex ante risk, with a financial framing. Outcomes are risk ex post, events. Formally, risk can never exist ex post!

That said, the term is clear.

<QUESTION_32>

Question 33: Is Feature (E) clearly defined? If not, please explain how the definition could be made clearer or more precise.

<QUESTION_33>

No response

<QUESTION_33>

Question 34: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (E)? Are there issues that should be added, deleted, or modified?

<QUESTION_34>

No response

<QUESTION_34>

Question 35: Do you believe that "Proxy Voting, Engagement, and Stewardship" is a clear and appropriate name for this feature? If not, please suggest an alternative and explain why it would be a better choice.

<QUESTION_35>

No. We believe Stewardship is a slippery term (see earlier response). Also, we understand in some jurisdictions it can carry an uncomfortable religious connotation.

We propose "Exercise of Ownership Rights (Proxy/Engagement)", or "Exercise of Ownership Rights" or "Ownership Rights (Proxy/Engagement)"

<QUESTION_35>

Question 36: Do you agree that "Proxy Voting, Engagement, and Stewardship" should be a distinct feature? If not, would you prefer that the types of issues to be addressed by disclosure requirements be redistributed to other features or to general disclosures?

<QUESTION_36>

Yes, most definitely. But see our response to Q35 re terminology.

The value ascribed to, and the exercise of, ownership rights, and the proper reporting by asset managers of their Ownership activity to their investor clients, is a significant market failure. Indeed, the frequent unwillingness of asset managers to take their clients' voting instructions, and the weakness of many asset manager proxy polices, compounds this failure.

More resource needs to be devoted to this activity by many of the actors in the investment system. Giving greater focus to it in the Standard will help reduce the market failure.

We should ask ourselves why there are only two major global proxy service providers.

<QUESTION_36>

Question 37: Is Feature (F) clearly defined? If not, please explain how the definition could be made clearer or more precise.

<QUESTION_37>

Yes. Though we detest the term "ESG factors" in bullet point 3, which will come as no surprise.

<QUESTION_37>

Question 38: Do you agree with the issues to be addressed by the disclosure requirements specific to Feature (F)? Are there issues that should be added, deleted, or modified?

<QUESTION_38>

Adequate

<QUESTION_38>

Question 39: Do the six features described fully cover the spectrum of ESG-related features currently offered in the marketplace?

<QUESTION_39>

See previous responses

<QUESTION_39>

Proposal for Classification of ESG-Related Features According to ESG-Related Needs

Question 40: Does this list of ESG-related needs represent the spectrum of investors' ESG-related needs?

<QUESTION_40>

We see the statement in the document: *Today, an increasing number of investors have ESG-related needs or preferences in addition to financial needs* as blurring the risk issue. How do we know that those ESG-related needs or preferences are not financial (risk) needs? Put simply, we don't.

The investor's time horizon could be long enough so that many apparently (to outsiders) non-financial needs are indeed financial.

<QUESTION_40>

Question 41: Are these five ESG-related needs clearly differentiated and mutually exclusive?

<QUESTION_41>

We simply see them as risk appetite statements. Mutually exclusive? Absolutely not!

<QUESTION_41>

Question 42: Do you agree with the classification of ESG-related features according to ESG-related needs, as shown in Table 3? If not, how might it be improved?

<QUESTION_42>

See other responses

<QUESTION_42>

Users and Benefits

Question 43: Do you agree with the description of user benefits? Are there any benefits that should be added or deleted?

<QUESTION_43>

We hope we have explained adequately how we position “user benefits” in a strategic risk management context

<QUESTION_43>

Question 44: Do you agree with the terms used to define the users of the Standard? Are there any terms we should include, or avoid using?

<QUESTION_44>

See other responses

<QUESTION_44>

General Comments: Please enter general comments below.

<GENERAL_COMMENTS>

A comprehensive consultation, thank you. We hope our responses support your work. We believe the more the Standard can be a platform to stimulate deeper dialogue between buyers and sellers of investment product about risk, in a primarily financial/investment context, the more successful it will be.

To that point, we encourage the CFA Institute to ensure that the investor/asset owner voice in this consultation is given due weight. Asset manager firms (though not the CFA members involved in this work!) tend to favour, understandably, weaker challenge of the status quo.

Innovation challenges the status quo, by definition. We wish you well.

<GENERAL_COMMENTS>