Swiss Sustainable Finance

## Swiss Sustainable Finance response to Round 2 consultation on the Exposure Draft CFA Institute ESG Disclosure Standards for Investment Products

### 1. Introduction and background

In an effort to address market participant concerns of inconsistency and variation in ESG-related terms, investment approaches, and disclosures leading to confusion and misunderstanding between investors and asset managers, the CFA Institute is attempting to create a standard to improve comparability and transparency.

The purpose of the Standard is to provide greater transparency and consistency in ESG-related disclosures, resulting in clearer communication regarding the ESG-related features[1] of investment products. The CFA Institute is not seeking to define what constitutes an ESG or sustainable investment product or strategy or to make determinations about the relative strength of any one ESG-related investment approach versus another. Rather, the Standard will establish disclosure requirements so that investors can more easily understand the features offered by a particular investment product and make comparisons among investment products.

After a first round of consultations in 2020, the CFA institute released their Exposure Draft in late May 2021. You can view all related materials on their dedicated website.

CFA Institute is now looking for further feedback on this draft. Download the draft here.

The Disclosure Requirements and Recommendations include specific elements on the following levels:

- Fundamental Requirements and Recommendations
- Disclosure Requirements and Recommendations
  - General Information
  - Objectives
  - Benchmarks
  - Sources and Types of ESG Information
  - ESG Exclusions
  - ESG Information in Financial Analysis and Valuation
  - Portfolio-Level ESG Criteria and Characteristics
  - Process to Achieve Impact Objective
  - Stewardship

You can view the CFA Institute webinar which introduced this initiative in 2020 for more insights.

Additionally, you can view the webinar explaining the Exposure Draft held in June 2021.

The consultation includes general questions regarding the planned disclosure requirements as well as the freedom for respondents to provide feedback on any specific item outlined in the standards.

The CFA Institute collected feedback through a consultation. SSF aggregated feedback from its members in the following table.

1 CFA Institute defines ESG-related feature as: Any aspect of an investment product's design or implementation, including but not limited to objectives, metrics, benchmarks, constraints, policies, investment process, stewardship activities, and client reporting, that uses ESG information or intentionally addresses ESG issues.

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## 2. SSF answers to CFA Institute consultation on Exposure Draft: CFA Institute ESG Disclosure Standards for Investment Products

As SSF unites around 180 different members and partners, we acknowledge that finding aligned answers to the outlined questions is difficult. Should we receive very conflicting responses from SSF members and therefore be unable to consolidate the feedback we will refrain from answering that specific question.

| Question | SSF response |
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| **Questions for regulators and investment professionals** | |
| **Q1** Are the draft provisions helpful in establishing or clarifying the type of information that should be included in an investment product's disclosures regarding the ESG-related aspects of the investment product's strategy? | Swiss Sustainable Finance has chosen to answer the general questions under the category of "investment professionals".<br><br>With regard to ESG characteristics in section 8.A.1, these are defined extremely broadly with limited examples or reference to other documents that could provide meaningful examples. We believe more and more investors are likely most interested in this data in order to compare and make decisions on investments, which we feel did not receive adequate consideration within the standards. |
| Q2 Is there information that you would like to see disclosed in a compliant presentation that is not required by the draft provisions? Is there information required by the draft provisions that is not necessary? | SSF would have liked to see the recommended requirements in section 10.B.1 be listed as a requirement. We see transparency around voting and engagement outcomes as critical for investors to gain an understanding of how their investment manager considers ESG in their stewardship activities. This obviously also is linked to identifying impacts that are linked to the investment portfolio. |
| **Q3** Would the Standards be helpful in maintaining a commitment to professional ethics and integrity? | Yes we feel following such standards can potentially help market players maintain a commitment to professional ethics and integrity. This is obviously more so the case for audited disclosure statements. We see the standards however as mainly addressing the topic of transparency and easier comparability. |
| **Q4** Would the Standards be helpful in providing investor protection through product transparency? | We are not sure as to how far such standards can provide investor protection. As the disclosures between different companies can vary greatly due to the broad nature of the ESG space, it will be difficult to compare one disclosure statement to the next. For clients it will remain difficult to compare the depth and breadth of the sustainable investment process applied to a product. The issue of comparability, can only be truly solved once |

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| | standardized KPIs are defined, accepted and reported by product providers, and clients do not have to rely solely on reporting on a process level.<br><br>We also see that these standards likely are not very targeted towards retail clients, which is the segment in need of the most protection. Therefore they only indirectly help advance retail investor protection. |
| **Q5** Would the Standards be useful in serving as a mechanism to help investors align their ESG-related objectives with those of suitable products? | We fear that some of the simplifications made during the first consultation process may hinder investors from aligning ESG objectives to a suitable product. Having grouped many of the currently accepted sustainable investment approaches into one category (namely chapter 8 – portfolio-level ESG Criteria and Characteristics), we see an initial hurdle to first re-educate investors on the characteristics and effects of the traditionally accepted approaches, such as best-in-class and thematic investments. |
| **Q6** Would the Standards be useful in serving as a mechanism to develop product labelling in your country? | Yes, the standards could serve as a good basis for discussions around a transparency/disclosure label. However, they are not conducive to establishing what we refer to as an ESG or green label, as for those, specific KPIs must be defined and reported in order for a label to be rewarded. We feel that for the moment, there is not yet comparably data that lends itself to the development of a label. |
| **SSF comments on Section 3: Objectives** | |
| **Comments on Provision 3.A.1:** | We question if the definition of impact is precise enough: it is defined as "an intention to make a specific, positive, measurable contribution to an environmental or social issue." The questions raised are:<br>• What is a contribution? Is capital allocation on secondary markets a "contribution"?<br>• Do you relate to "investor impact" or "company impact"? The impact an investor has on a company through engagement activities is on a different level than the impact an investor has if they invest in a company that sells products that positively contribute to real-world issues. Extensive work has been done on this within the academic community here in Switzerland. You can find more on this topic in this paper: https://www.csp.uzh.ch/dam/jcr:ab4d648c-92cd-4b6d-8fc8-5bc527b0c4d9/CSP_Investors%20Guide%20to%20Impact_21_10_2020_spreads.pdf |

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| | • Can an asset manager that invests in thematic or low carbon stocks claim to have impact if the underlying stocks have lower carbon emissions than others? |
| **Comments on Provision 3.A.2:** | We very much welcome that "trade-offs" are addressed within the standard. However, we acknowledge that identifying all trade-offs that may occur is quite a complex task, and providers will likely find this particular point difficult to implement in first rounds of use of the standard. |
| **SSF comments on Section 4: Benchmarks** | |
| **Comments on Provision 4.A.1:** | We refer to the sentence: "In the case of a readily recognized benchmark, the name of the benchmark will satisfy this requirement. Each investment manager must decide for itself whether a benchmark is readily recognized". This perhaps leaves too much open to interpretation and should be removed, or a list of readily recognized benchmarks should be provided. |
| **SSF comments on Section 5: Sources and Types of ESG Information** | |
| **Comments on Provision 5.A.1:** | We refer to the statement: "…it is sufficient to state that the ESG information comes from an ESG data provider." We question if this is sufficient information for an investor to fully consider the suitability of the product to their needs and instead think it should be a requirement to name the data provider(s). We often hear from institutional investors that they, in particular have preferences when it comes to data providers, with respect to similar views on ESG, therefore omitting this information does not allow for a proper suitability analysis. |
| **Comments on Provision 5.A.2:** | We refer to the phrase: "When an investment manager obtains ESG information from an ESG data provider, the investment manager may choose, but is not required, to describe the steps the ESG data provider takes to verify the data it provides." While we agree that the investment manager does not need to fully describe this process, we feel they should provide information on where to find this information within the documents of the ESG data provider. Investment Managers should clearly explain how they use the raw data, how many sources are used and how they build their own rating (i.e. copy paste or transformation). |
| **SSF comments on Section 8: Portfolio-level ESG Criteria and characteristics** | |

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| **General comments on Section 8:** | We find the description of this section rather confusing. They relate to approaches such as best-in-class, positive tilt and thematic. But then the standards only require a description of the underlying criteria. Does this mean that one has to describe all criteria used in a best-in-class rating (i.e. a rating that is based on hundreds of ESG data points to compare different companies)? And provide indicators on a portfolio level? We feel this may end up becoming a fundamental problem of this standard. With respect to proprietary ratings developed and used by asset managers, such criteria do not necessarily have a threshold but rather a score and a corresponding weight. The threshold is defined on the level of a rating or a rating average for the portfolio. Therefore, we find this section hard to interpret to cover, for instance, a best-in-class fund.<br>Additionally, for the moment Institutional asset owners would benefit from a better categorisation of such sustainable investments, rather than leaving it so broad. Those used here are so general, that especially asset owners will find it difficult to be able to compare products considering (at least in Switzerland) they are accustomed to evaluating investments based on the 8 commonly accepted approaches defined by most markets (See SSF Market Study 2021) https://marketstudy2021.sustainablefinance.ch/ |
| **SSF comments on Section 9: Process to achieve impact objective** | |
| **General comments on Section 9:** | Referring to this section, we feel that a last step is missing in the process. The investment manager should be required to publish whether or not the impact objective was reached and/or progress made. Based on point 9.B.1, we interpret that this is not a requirement. |
| **SSF Comments on Section 10: Stewardship** | |
| **General comments on Section 10:** | Referring to this section, we feel that a last step is missing in the process. The investment manager should be required to publish actions and progress on stewardship. Based on point 10.B.1, we interpret that this is not a requirement. |
| **SSF Comments on Glossary** | |
| **Comments on IMPACT OBJECTIVE:** | We question if the definition of impact is precise enough: it is defined as "an intention to make a specific, positive, measurable contribution to an environmental or social issue." The questions raised are:<br>• What is a contribution? Is capital allocation on secondary markets a "contribution"? |

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| | • Do you relate to “investor impact” or “company impact”? The impact an investor has on a company through engagement activities is on a different level than the impact an investor has if they invest in a company that sells products that positively contribute to real-world issues. Extensive work has been done on this within the academic community here in Switzerland. You can find more on this topic in this paper: https://www.csp.uzh.ch/dam/jcr:ab4d648c-92cd-4b6d-8fc8-5bc527b0c4d9/CSP_Investors%20Guide%20to%20Impact_21_10_2020_spreads.pdf<br>Can an asset manager that invests in thematic or low carbon stocks claim to have impact if the underlying stocks have lower carbon emissions than others? |
| **Comments on STEWARDSHIP:** | We question if the two following actions listed within your definition can be seen as a stewardship action in a sustainable investment context:<br>• exercise of warrants or embedded options,<br>• lending of securities,<br>We feel the term stewardship is watered down by adding these actions to the definition. In our view, such activities could potentially hinder effective stewardship activities and/or change the overall sustainability profile of the fund. |

## 3. Further information

### Links to important documents

Documents linked to the consultation can be found at: https://www.cfainstitute.org/en/ethics-standards/codes/esg-standards

Zurich, 26 July 2021