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

October 19, 2020

This response was prepared in response to CFA Institute's Consultation Paper on the development of the CFA Institute ESG Disclosure Standards for Investment Products, and should be read in conjunction with the same. For more information, please contact info@cfacanada.org.

General Comments:

The Standard as proposed will establish requirements related to investment products and will not apply at the firm level. The Working Group strongly believes there is market space and an urgent need for exploration and development of a parallel but distinct standard relating to firm-level (with consideration of application to both asset managers and asset owners) disclosures, as a separate and complementary initiative. The Working Group believes that the impact of such a parallel but distinct standard would be greatest and most complementary to the goals stated in this Consultation Paper if developed for simultaneous implementation with the proposed Standards for Investment Products. The Working Group has indicated strong interest in contributing to this additional standard setting process.

Further consideration and disclosure in the next stage of the process on this Standard could include a review of assumptions about and implicit expectations placed on investors, particularly retail investors, to inform themselves about the investment product universe and disclosures under the Standard. With these more clearly delineated, minimum product standards for use of the Standard should be considered to help facilitate more informed investment decisions relating to the Standard's Features and required disclosures.

There were a few underlying themes that seemed to reoccur and could be applied to all the ESG-related features and investment products with ESG features. These included a differentiation between intent and by-product, namely ESG-related features should be intentional and not a by-product of another investment feature that just happens to fit the parameters or definition for a given ESG-related feature. An additional recurring theme focused on the scope of application – such as the percentage of securities, issuers or holdings covered by the ESG-related feature. This should be disclosed to ensure investors understand the breadth of application of the ESG-related feature in their investment product. Finally, while these ESG-related features generally cover the current offerings and ESG investing strategies, these should also be flexible enough to incorporate future ESG strategies and product offerings.

As this Standard and others hopefully evolve, it will be important to monitor how these disclosures will complement, supplement and/or replace the information already included in industry databases on investment products and/or managers. Care should be taken to encourage clarity and ease of comparability of firms and products for investors. It would also be interesting to get additional information on discussions held to date with respect to the enforceability of the Standard for those that adopt it, and/or measures for non-compliance (or lapsed compliance over time). Finally, close attention must be paid to a rapidly developing ecosystem of local standards and regulation relating to ESG-related disclosures, investment products, and their managers, as continued interoperability of the Standard with these local standards and regulation must be a key focus.

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?

Yes, we agree. The Working Group had total consensus on this question, however we note that we strongly believe there is an urgent need for a parallel, but distinct expedited standard setting process applicable to firms (with defined application approaches for both managers and asset owners), which would be complementary to these Standards for Investment Products. We believe that the impact of such a standard would be greatest and most complementary to the goals stated in this Consultation Paper if developed for simultaneous implementation with the proposed Standards for Investment Products. The Working Group has indicated strong interest in contributing to this additional standard setting process.

Terminology

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

The Working Group believes the defined terms are generally clear, particularly in the context provided in the Consultation Paper which explained that the ESG- Related Features of a given investment product are ***not*** mutually exclusive. However, a number of Working Group respondents believed that this non-exclusivity of features relating to a given investment product should be given additional prominence, both generally and in relation to discussion of specific features, as it generated confusion when parts of the Consultation Paper were read in isolation by specialists, without the context of feature non-exclusivity as an over-arching paradigm. There was also some concerns raised that "ESG matters" may not be the best all-encompassing term as defined, although no viable alternative term found consensus.

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?

The Working Group was aware of several regulations and standards that should be reviewed to avoid duplication or conflict, including:

- Specifications for bonds: ICMA Green Bond / Social Bond Principles; ICMA Sustainability Linked Principles (forthcoming); LSTA Sustainability Linked Loan Principles;
- Specification for investment products: IFIC RI Framework; CIFSC RI Classification; RIAA (Australia)'s certification and labelling process;
- Specifications for investment approaches: SBAI's (Standards Board for Alternative Investments) forthcoming standards and recommendations for ESG;
- Specifications for issuer disclosures: IIRC (International Integrated Reporting Council) and CDP/CDSB (Climate Disclosure Standards Board)
- Classification of economic activities: EU taxonomy, Canada's Transition Taxonomy (forthcoming)

We caution, however, that the scope of any complementary regulations and standards (and related) must be clearly defined and relevant, otherwise it may potentially allow for creeping scope with respect to interoperability of the Standard.

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?

The Working Group generally agrees and had consensus that a disclosure-based approach is preferable for an investment products standard, as it allows product manufacturers to create and distinguish their products from others. ESG-Related Features can be integrated into investment processes and products in different ways and it would be challenging to be exhaustive of all potential prescriptive avenues for a product standard. There was concern expressed by multiple Working Group members however about some minimum qualifying criteria (under one or more Features) for the application of a potential Standard to an investment product. There was also extensive discussion about the potential applicability of prescriptive elements in a needed separate but parallel firm-level standard relating to ESG.

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

Yes, the Working Group agrees that the Standard under consideration should focus only on product-level disclosures, but please see our remarks elsewhere in this response relating to the Working Group's belief that a separate, distinct, and parallel standard-setting process is needed for firm-level disclosures and firms (inclusive of managers and asset owners) more generally relating to ESG.

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?

The Working Group was in support of allowing an asset manager to choose the products to which they apply the Standard, with the understanding that as a voluntary standard it would be difficult to impose the alternative on asset managers, and perhaps lead to a 'failure-to-launch' from a standards-adoption perspective. However, we note that such allowance might negatively impact some of the objectives stated in the Consultation Paper, in that a manager may choose not to adopt the Standards for products with relevant features that should be in-scope for the Standards, given the potential time and costs of compliance for each compliant product. It might also negatively impact the objectives stated in the paper in that a manager may decide to 'cherry pick' which products to which it applies the Standard for commercial or competitive reasons. It will be important for there to be ***clear and required disclosure*** at the firm level (particularly relating to segregated managed accounts or other customized mandates) and investor education that ***not*** all of its investment products, even potentially some of those with ESG-Related Features, are subject to the Standards, which would also help to explain to investors that this Standard is ***not*** applied at the firm level. The possibility of imposing a 'comply-or-explain' approach was also discussed for firms applying the Standard to one or more products with ESG-Related Features, but not ***all*** products with ESG-Related Features (i.e. should a firm opt to ***not*** apply the Standard to a given product with ESG-Related Features, where other firm products are compliant). In this approach as discussed, there would be a required product-level disclosure relating to the non-application of the Standard to that given product, specifying the non-application of the Standard and (perhaps optional but recommended) any reasons for the same. As part of the development of a firm-level standard (as called for elsewhere), the Working Group believed that firm-level standard 'compliant' firms should be required to apply the product Standard (under consideration here) to all investment products with ESG-Related Features, but that it should not be a requirement that they do so as part of this product-level Standard under consideration. There was also discussion of the clear application parallels to the all-inclusive/universal nature of other firm-level standards (such as the GIPS Standards). Like prior comments, there was also discussion of some minimum qualifying criteria for application of the Standard to a given investment product.

Design Principles

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

Yes, we agree with these design principles. There was complete consensus from the Working Group on this question.

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

Yes, the Working Group generally agrees with the design principles for disclosure requirements and would encourage open-ended disclosure requirements where possible, however concerns were raised with respect to certain aspects of the proposal.

With respect to the focus on the content of the disclosure over the format, while firms should have flexibility to describe their products as they see fit (within any applicable legal/regulatory disclosure requirements), it may be difficult for investors/advisors searching for specific information to compare products if formats differ greatly from one another between products and managers. A preferred disclosure format(s) for ease of comparability could be suggested, and plain-language should be a suggested best practice where possible.

Additional examples and guidance on expectations for a “moderate level of detail” as well as “relevant information” would be helpful, as those terms may be ambiguous and could lead to multiple interpretations that vary between products and managers, reducing comparability. It is noted in the Consultation Paper that the disclosure should represent the “policies and procedures that govern the design and implementation of the investment product”. We recommend this be expanded to describe how these policies and procedures impact the holdings, exposures, and/or ongoing management of the investment product (e.g. reporting, monitoring, risk management, etc.). The requirements should confirm that disclosures cannot be non-specific boiler plate describing firm-level items and must seek to be product and feature specific.

The requirement to disclose “general” requirements that apply to all products that seek to comply with the Standard as well as feature-specific disclosure requirements only for products that have a specific ESG-related feature or set of features may also be confusing to investors and hamper the comparability of the products. Much of the general requirements applicable to all products of a firm or relating to a given strategy might better be handled as part of a firm-level standard (as called for elsewhere). Such firm-level general disclosures could include a firm’s approach to ESG matters, resources (either strategy-specific or firm-wide), the nature of resources (dedicated or shared personnel, technology, investments, data, etc.), and other relevant matters. For any general disclosure relating to this product Standard, a “comply or explain” model was again discussed, where a firm would have to explain why a given required or recommended disclosure is either absent or not applicable.

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?

The Working Group had near total consensus that the Standard should require all disclosures to be made in a single document, although it is unclear in the question’s phrasing whether that would be a single document for the firm or for one product. In any event, the Working Group believes a single document has a number of advantages, as (i) it is time consuming to look for the most relevant information or find updates if information is scattered; (ii) it will be easier for investors/advisors to compare investment products; and (iii) the firm/product manufacturer will only have to update one document. As the Standard is applied on a product-level basis, we have assumed that one single document would be produced for each product that is subject to the Standard. At the firm level, there could be a recommended or required practice of listing products of the firm that are in compliance with the Standard, consolidating this disclosure in a single summary document that included compliant products and hyperlinks to the individual product-level documents, while also emphasizing via disclosure (such as in a prominent header) that not all products of the firm (even those with ESG Features) are compliant with the Standard.

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

Yes, the Working Group found near-total consensus agreeing with the design principle for independent examination, but please see our remarks elsewhere in the response and under General Comments below for future consideration relating to the need for a separate firm-level standards development process.

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?

Conversation amongst the Working Group heard strong arguments both for and against mandatory independent examination, and thus we would support independent examination as a recommended best practice for asset managers. Verification may not be economic for smaller managers, or managers with few/small ESG-Feature products and required verification may deter compliance with the Standard by managers for such products. While in theory independent examination is ideal, for other ESG-related standards, not all reviews are equally stringent or cover the same matters. Care should be taken in the design of a verification process for the Standard to not introduce this lack of comparability, and to design a uniform verification process/standard such as that which exists for the GIPS Standards. The disclosure requirements for each product and anything firm-level should include a specific required statement as to whether an independent examination occurred, disclosure of the identity of who performed the verification, the methodology used (if multiple are available), and whether the verification was a second opinion or a third-party audit (if these are ultimately relevant paradigms within the Standard's verification framework). There was also discussion as to whether verification should have intersection (such as being required for compliant firms, or phased in as a requirement over time) with a potential manager-level standard, called for elsewhere as a separate and distinct standard-setting process by the Working Group.

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?

Generally, the Working Group believes that an independent examiner's review should extend beyond just the disclosures relative only to the design of the investment product, but believes that there are varying interpretations in this context with respect to the meaning of "implementation" of an investment product. The Working Group noted that there generally would not otherwise be an independent review of the implementation of the features of other investment products, and thus may be seen by some asset managers as either a new/novel process or overly restrictive to require it for ESG-Related Features. While the Consultation Paper references that evaluating the disclosures against implementation would involve comparing the disclosures with the asset manager's actions over time, practical examples would be helpful. It was discussed that this type of verification materially differs from that of other standards (i.e. the GIPS Standards) and so specification of what constitutes effective implementation initially and ongoing, and related verification processes likely represent a new and novel area of standards development for CFA Institute. It may also be worth considering whether verification should also encompass the targeted outcomes of the implementation (i.e. how it is tracked and monitored by the asset manager for the investment product).

<u>Proposal for General Disclosure Requirements</u>

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

The Working Group believes that the scope of the general disclosure requirements is good, although we would add requirements relating to generalized investment performance disclosures/metrics (perhaps by reference to the GIPS Standards), disclosure of product-relevant ESG-related metrics and performance KPI's, requirements for disclosure relating to the scope of Feature application in the investment product (i.e. whether the Features are applied to all holdings/asset classes or just a portion of the investment product's portfolio), whether there are any material limitations to the application of Features, and the investment product's benchmark. More specifically on benchmarks, they must be clearly defined, particularly if they are customized or not widely followed/utilized, and should identify whether they are generally ESG-adjusted or for the specific ESG Features of the investment product. Tracking error of the investment product should also be clearly identified explicitly or characterized as active risk, and specific disclosure should be required as to whether the targeted tracking error or active risk against any benchmark (or absolutely) has constrained the application of ESG Features within the investment product's portfolio. Another topic that could be included would be the percentage of the holdings of the product or specific held asset classes that are covered by the ESG-Related Feature (e.g. do the features only relate to the equity portions of a portfolio or only cover certain regions or securities with an ESG rating).

Members of the Working Group sought clarification on the meaning of "time horizon of the ESG investment analysis" and any implied assumptions, as such analysis may be variable within the same investment product, and ESG analysis can often be inherently longer-term in nature.

At a high level, required disclosure might also be helpful to specifically disclose what ESG-related topics are focus(es) for the product, and how they relate to one or more of the environment, society or governance. Required or recommended negative disclosures on ESG-related topics specifically ***not*** covered in the management or features of the investment product could also be additive where applicable.

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?

The Working Group had clear consensus that the disclosure requirements should address an investment product's intention to align with policy goals, and should be as part of a feature-specific disclosure requirement, although it noted that the specific example provided of the UN SDGs focused the Working Group's comments on the appropriate disclosures relating to these specific policy goals, rather than the best positioning of disclosures relating to policy goals more generally. The Working Group sought clarity on other potential examples, and whether they would be wide-ranging in nature (like the UN SDGs) or more narrow in focus, and it was discussed that this delineation might drive the appropriateness of general or feature-specific disclosure relating to the policy goals in question.

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?

The Working Group did not reach clear consensus on this question but agreed during discussion that interoperability of the Standard with any existing or emergent regulatory or legislative requirements must be a core feature of the Standard. As such, disclosures relating to the EU's SFDR should be required for any product where the EU is an in-scope jurisdiction or regulator for the product or manager.

Proposal for ESG-Related Features and Feature-Specific Disclosure Requirements

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.

Yes, the Working Group believes "ESG Integration" is a clear and appropriate name for this feature.

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.

Yes, the Working Group believes that this usage of Feature (A) would be consistent with the policy paper. There was some discussion on the usage of "material" as the appropriate contextual descriptor, and whether 'financially material' might be more appropriate for this application.

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

Yes, the Working Group believes Feature (A) is clearly defined and is appropriately broad for the purposes of the Standard. While other defined terms such as replacing the term "material to the risk and return" with "financially material to the risk and return" could be considered, it is important to maintain flexibility for complementary definitions. The disclosure of how the manager sees Features interacting was also highlighted as a need by some Working Group members. There were also questions raised by the Working Group as to the need for a complementary firm-level standard relating to ESG Integration at the firm level more generally.

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?

Yes, the Working Group agreed with the issues to be addressed but would request a clarification of the last bullet point listed under the types of issues. Instead of disclosing "a description of the qualitative or quantitative attribution performance analysis, if any, for evaluating material ESG-related factors", we propose "A description of the qualitative or quantitative analysis used in determining ESG-related factors." It may be difficult to have a robust system of performance attribution based solely or partially on ESG-related factors. We believe there is also room to include additional disclosures. For example, since there are different integration methods for a product, for each category there should be disclosure on the extent to which the product integrates ESG (not all products will integrate ESG at the same level or across the same activities). Extensive discussion was had by the group on the multitude of important firm-level elements of ESG integration that would be more applicable to listing as part of a firm-level standard (as discussed elsewhere). Additional categories specifically at the product-level could include:

- Overall Strategy;

- Investment Process (analysis, data, investment decision);
- Risk Management (identification, assessment, measurement, monitoring) and Scenario Analysis;
- Implementation and Outcomes;
- Time Horizon;
- Portfolio Monitoring;
- Reporting; and
- Governance and Oversight.

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.

Yes, the Working Group believes "ESG-related Exclusions" is a clear and appropriate name for this feature. We suggest that there be specific disclosures on how the exclusion was determined and what the exclusions are comprised of (e.g. are they company-specific exclusions, sector-specific exclusions, etc.). We note however that many investors are instead familiar with the term "negative screening". However, there are significant regional differences as to what constitutes a valid basis for exclusion based on ethics, values, or beliefs. These may not be consistent with universally held and definitional paradigms of ESG and may push the Standard into areas of controversy and hinder adoption. Disclosure for investment products should be standardized yet flexible enough to integrate regional differences, however it may be outside the scope of this Standard to explicitly address screening on views relating to specific social and ethical issues.

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.

The Working Group believes the terms "negative screening" and "norms-based screening" are similar enough to be covered by Feature (B). The exact definition and explanation for the exclusion (e.g. if it is based on an issuer's industry or activity) should be left up to the manager/firm but must be clearly described. It could also be helpful in this description to differentiate on whether the screening application is positive or negative relating to issuer engagement in certain ESG-related activities.

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

While the Working Group is generally of the view that Feature (B) is clearly defined, we would suggest a few changes. There should be a clear distinction between products with portfolios that comply with the law that by happenstance have Feature (B) and those with an intentional / active feature.

We are unclear whether any minimal exclusion applied by a product would be adequate to meet the criteria of this Feature. For example, in Canada an investment product is prohibited by federal law from investing in a company involved in the making, selling, or use of cluster munitions and land mines. Would that result in all Canadian investment products meeting the criteria of Feature (B) because they are required to apply this ESG screen? There are also several ESG screens that have little or no impact on the investment universe, such as applying an asbestos screen to certain equity mandates. If applicable laws or regulation would require compliance with certain exclusions, and those are the only exclusions a product has, it should not also be considered to have this Feature. As with all ESG features, there should be a clear differentiation between intent and by-product, namely ESG-related Features should be intentional and not a by-product of another investment feature that just happens to fit the parameters or definition of a given ESG-related feature.

There is a Note currently referenced under Feature (C) which may be better or additionally placed under Feature (B), specifically, the reference to the following: “First, ESG-related exclusions are constructed using thresholds of exposure to certain products, practices, or activities. The principles, values, and ethical frameworks that typically underpin ESG-related exclusions usually characterize something as “acceptable” or “unacceptable,” and thus the investment decisions regarding certain products, practices, or activities tend to be binary as well—a potential investment is either eligible or not eligible. Exclusions constructed in this way may result in the exclusion of large segments of the universe and have a noticeable effect on risk and return.”

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?

Yes, the Working Group agrees with the issues to be addressed but believe there are additional disclosure items to be considered. It would be helpful to disclose whether exclusions are determined internally or by an external third party such as a consultant and/or ESG data provider. A description of either the relevant internal processes, or the process for evaluating and selecting an external party, along with a summary of their process, should be required. In addition to describing the manager’s ability to alter the exclusion methodology or the exclusions once generated, a description of the review processes and override process, if any, should be included. Explicitly stating the number of exclusion criteria could also be useful. Some description of the process for ongoing monitoring should also be required, along with a description of how it relates to the screens and their maintenance. With respect to description of the screens themselves in terms that are useful to investors, the basis for the screens (whether by revenue, profits, capital investment, etc.) and the magnitude or ‘cut-off’ threshold(s) (i.e. exclusion of all issuers with exposed revenue >5%) in detailed and quantitative terms would be ideal. Taking this one step further, there should be disclosure related to the scope of involvement that is relevant to the screen(s) utilized for the product. Using tobacco as an example, there should be disclosure whether the screen excludes issuers that only directly ‘produce’ tobacco, or whether the screen considers those issuers that are indirectly involved such as through tobacco distribution or as part of a tobacco producer’s supply chain. Anecdotally, some firms may say they are excluding specific industries or practices, but upon close examination have very wide or loose criteria that does allow some of these practices into their universe. Some members of the Working Group saw this as a regular source of ‘greenwashing’ related to this feature. Finally, when describing the differences, if any, between the investment product’s exclusions and the selected benchmark’s exclusions (if applicable), a description of the differences in the methodology as well as a description of monitoring activity and any remedial actions that are taken for non-compliance should be included.

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.

The Working Group did not reach clear consensus as to the appropriateness of the term “Best-in-Class”, as it might lead to investor confusion absent clear descriptive disclosures, but believes this name is likely better than suggested/available alternative names. The Working Group believed that additional emphasis was necessary, that it is an inherently relative comparison, and that there is no subjective judgement as to an absolute ‘Best’ connoted by this Feature. Further, this may further be a relative definition in that it may differ by investor and their preferences/priorities. As noted in the Consultation Paper, the product must clearly state which “class” is referenced, how it is defined, and what type of criteria would constitute "best" (i.e. sector vs. peer group) and how such criteria is tracked. Very clear guidance and examples in the final Standard should be provided as any term that is ultimately chosen will likely remain open to interpretation.

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.

Yes, the Working Group agrees that Feature (C) is distinct enough to be separate from the other features. The Working Group reached full consensus on this question.

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

Yes, the Working Group believes Feature (C) is clearly defined. Please see our response to Question 22 above, which suggests moving or adding some specific Notes from Feature (C) to Feature (B). In addition, in general, the wording in the Notes would suggest that the Feature excludes the approach of removing the biggest risks from an ESG perspective without leaving clear disclosure guidelines for such an approach. Consideration of more appropriate disclosure for discretionary or risk-ranked rather than rule-based/'automatic' exclusions should also be considered. One potential solution would be to add guidance on describing any process related to selecting companies for exclusion based on reducing exposure to the biggest material risks.

If ESG ratings are used as a basis to determine Best-in-Class, then it should also be noted (either generally or specific to this Feature) that a high ESG rating does not necessarily mean it is an objectively ESG-minded company.

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?

The Working Group agreed with the issues to be addressed by the disclosure requirements but believe there are additional disclosure items to be considered. It would be helpful to disclose whether inclusions or relative weightings are determined on the basis of internally-generated data or by an external third party and/or based on external data such as ESG data providers. In addition to describing the discretionary ability to change the weighting, inclusion, or "best in class" methodology, a description of the override process, if any, should be included. Explicitly stating the number of consideration criteria could be useful. When describing the differences, if any, between the investment product's construction and that of the benchmark's, differences in the methodology as well as monitoring and any remedial actions that are taken for non-compliance should be included. A description of the peer group that is used should also be included as we understand this can significantly change the relative performance or positioning of a security.

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.

Yes, the Working Group believes that "ESG-related Thematic Focus" is a clear and appropriate name for this feature. We have a concern that "principles-based" may be problematic due to definitional issues, and the inherently relative nature of principles, as raised previously.

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.

Yes, the Working Group agrees that Feature (D) is distinct enough to be separate from other features. The Working Group reached full consensus on this question.

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

Yes, Feature (D) is generally clearly defined, however the Working Group has a few suggestions for consideration. In the Notes section of the Feature, it indicates that "The term refers to an alpha-generating strategy that identifies long-term macro or structural trends and then invests in securities with positive exposure to those trends". The Notes should also indicate that conversely products could also short or underweight securities with a positive exposure to those same trends or seek to invest in securities with negative exposure to those same trends (for a similar net effect). All these approaches should be valid approaches to this Feature.

The Notes also provide that "The companies' overall ESG performance is not necessarily considered. Therefore, some companies could have weak performance on one or more ESG metrics but nonetheless be positioned to financially benefit from addressing an ESG matter". Some Working Group members disagreed with this statement and felt that an implicit baseline of some ESG analysis must be conducted for the strategy to fit within the Feature. These same members felt that while it is true that some companies may have weak performance on one or more ESG metrics, that is a truism with all ESG analysis and so recommend removing that phrase. In any event, this may not be implicit or clear to investors, and should therefore be prominently disclosed should a baseline qualifying criteria not be introduced.

Consideration should also be given to including in the Notes a requirement to disclose the thresholds being considered for exposure to the theme, and scope of theme-alignment within the product, as not every thematic product will be comprised of investments aligning 100% with the theme.

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?

Yes, the Working Group generally agrees with the issues to be addressed by the disclosure requirements, but it recommends including, in addition to a description of the ESG-Related Thematic Focus, the ESG factors which are considered to analyze issuers for inclusion in the strategy. Another issue to disclose should be with respect to the benchmark used, which should be defined, why it was deemed to be most applicable to the product, and the disclosure should also explain how the holdings and performance of the product may deviate from that of the benchmark. As previously raised, consideration should be given to requiring disclosure of the scope of Feature application within the product, thresholds for inclusion/relevant exposure decisions as not every thematic fund will be filled with companies operating 100% in the theme, and whether comparable non-ESG products exist. Clarity should also be required around whether the product qualifies under this Feature due to intentional ESG-related decisioning, or due to the product's theme being ostensibly ESG-related and therefore applicable (i.e. are all 'water'-themed products inherently eligible under this feature, or must there be qualifying ESG-related criteria applied or ESG-related decisioning).

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.

Yes, the Working Group believes "Impact Objective" is a clear and appropriate name for this feature.

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

The Working Group believes Feature (E) is generally clearly defined but did not reach complete consensus on this question. It was suggested that the Notes section should refer to the importance of measurability as a unique and defining aspect of the Feature. It was also suggested that mutual intentionality on the part of the investor and investee (and by extension the product's manager and product's investor) as to impact objectives is key to this Feature. Impacts must be measurable and measured usually through Key Performance Indicators that are determined by the firm/manager or through their utilization of a third-party framework, with these measurable impacts being defined and communicated ex ante. Other ESG Features do not include the necessity of measuring the impact of their investments. It was suggested that different market participants have different interpretations of the term "impact", particularly as the meaning may differ between frameworks or voluntary standards, and thus a wide interpretation should be permitted to provide for future flexibility. As the current definitions differ, there may be potential for alignment through future CFA Institute thought leadership or research initiatives on this topic. It was suggested that the language and terminology used relating to this Feature should align to those used by leading frameworks on impact, such as the Impact Management Project, rather than aligning to a given standard.

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?

The Working Group generally agreed with the issues to be addressed but would add a few suggestions as clarifications. With respect to the requirement to describe the methods used to measure performance against the stated impact objective, it is important to note by whom it is measurable, what is being measured, and over what time horizon. It would also be important to state the Key Performance Indicators and to have them listed, and to let investors know whether the firm/manager will report on the impact of the strategy, the frequency of the same (at least annually was suggested as a baseline), and which impacts are subject to such reporting. The Working Group acknowledges the structural challenges involved in measurement, but impact should be measured using defined metrics that are identified and communicated ex ante. Disclosure should also be encouraged as to the manager's weighting or decisioning on impact objectives relative to the financial objectives implicit in the product's investment strategy.

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.

Yes, the Working Group believes that "Proxy Voting, Engagement, and Stewardship" is generally a clear and appropriate name for this feature, though considerable concern was raised as to qualifying these activities as ESG-related in the Feature name, or through reframing to an inclusive alternate label such as **"ESG-related Active Ownership"**. Discussion was also had as to whether some level of activity under this feature is in fact a feature of all investment products, where most investment managers see some subset of proxy voting and engagement activities as implicit to their fiduciary duty as investment managers, and whether there should be qualifying criteria for certain activities as eligible for disclosure under this Feature (and by extension the Standard) when considered in isolation. There were certain Working Group members who strongly viewed certain types of activity (such as stewardship research/thought leadership, policy development/advocacy work, and originating ESG-related proxy proposals) as clearly defining this Feature distinctly, but who saw some relatively 'passive' baseline of ESG-related proxy voting and other related activity as being a general qualifying criteria of any ESG-related product, with any of the other applicable Features being more applicable as descriptors to the product. The Working Group also noted the intersection of this Feature with the commitments of PRI signatories. We would suggest further exploration of the types and standards of disclosure more applicable (and appropriate in many cases) to firms or a given investment strategy relating to this feature as part of the development of a firm-level standard.

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?

Yes, the Working Group agreed that Proxy Voting, Engagement, and Stewardship should be a distinct feature, subject to the points raised about it being ESG-related and having some minimum qualifying criteria (raised in the response to Question 35).

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

Yes, the Working Group believes Feature (F) is clearly defined, however it would recommend some changes. It is important when describing policies and guidelines for proxy voting, engagement and stewardship that the breadth of activities be clearly explained, including the amount or percentage of holdings that a manager engages with or votes their proxies on, and the processes followed for engagement and proxy voting, particularly relating to ESG-related concerns. It is also important to describe whether they are limited in scope to holdings in each product or being conducted more widely to seek broader systemic change. Active ownership involves shaping the context in which investors and companies operate, and policy and standards work is a key aspect. Another example of engagement that can be given includes interaction with management and/or the board of directors of an issuer.

The Working Group struggled with whether these items would be more appropriately described as a general, and not feature-specific, disclosure requirement. The Working Group also struggled in that several the key differentiating features of a credible effort relating to this Feature were more firm-centric than product-centric (such as thought leadership, policy, research and/or advocacy efforts). Another concern was that some degree of proxy voting, engagement and stewardship activities are obligations all asset managers share, whether or not their investment products have ESG-related features. The Working Group believes there needs to be further discussion as to qualifying minimum criteria (or representative examples) for disclosure as a specific ESG-related Feature, versus activities that would be present otherwise in a product otherwise well-described using other Features. In such cases more general description not specific to this Feature might be more appropriate. At the same time however, it may be appropriate to have a distinct feature if the manager intends to differentiate itself or a given investment product on the basis of its proxy voting, engagement, and stewardship activities specifically on ESG-related matters, in which case this should be more clearly articulated in the definition as stated above, and through required disclosures above and beyond minimum standards.

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?

Yes, the Working Group agrees with the issues to be addressed by the disclosure requirements specific to Feature (F). We would suggest adding a few disclosure issues, however. In addition to stating the policies and procedures and specific goals for engagement, the themes, team, documentation, tracking and impact on the investment product should be disclosed. With respect to proxy-voting policies and goals, we suggest additional disclosure for the frequency of voting, the percentage of holdings voted and disclosure of how proxies were voted. In particular, we support required disclosures relating to securities lending activities and whether the lent securities in the portfolio are recalled for all votes and if there are any holdings that are restricted from being utilized in a securities lending program for reasons relating to this Feature. There was also further discussion amongst the Working Group about the manager or firm-level activities relating to this feature such as policy and standards work, and how to relate it to a specific product, or whether they are better addressed via a complementary manager/firm-level standard (that could also address asset owner activity).

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

Yes, the Working Group believes that the six features fully cover the spectrum of features in the marketplace, with the caveats noted elsewhere in this response.

<u>Proposal for Classification of ESG-Related Features According to ESG-Related Needs</u>

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

Yes, the Working Group believes this list of ESG-related needs generally represents the spectrum of investors' ESG-related needs, with some novel cases for additional consideration, as well as the fact that flexibility needs to exist for adaptation and evolution of investors' needs and products in the marketplace. There may be a nuance/spin-off need from the current wording of Need #4, which provides that "I want to capitalize on investment opportunities related to long-term environmental or social trends". There is also a class of investors that capitalize on companies' adaptation and evolution with respect to ESG issues, such that returns are generated as companies make changes, which is a bit different than the fourth need, and sometimes characterized as the desire to capture an 'ESG momentum' return premium or stream. The fourth need itself could also be reworded to include the word "specific"; i.e. "I want to capitalize on investment opportunities related to specific long-term environmental or social trends", to distinguish it from ESG integration.

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

Some level of confusion arose amongst the Working Group when examining the stated five ESG-related needs vis-à-vis ESG-related features. While there is some degree of mutual exclusivity in definition (perhaps 'reasonably distinct' is a more appropriate descriptor), there is not mutually exclusivity in application, and this should be made clearer. There was discussion as to how clearly a given need (or combination of needs) can be objectively answered by specific ESG-related features or a given product in the context of investor or recommendation-specific circumstances. Some Working Group members felt that many products are inherently designed with multiple or a combination of these needs in mind, making this type of matrix analysis inherently challenging. Additional clarification could elicit further consideration, along with illustrative examples of how the needs are intended to interact for investors seeking investment products.

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?

The Working Group did not agree with the classification of ESG-related features according to ESG-related needs, as shown in Table 3, and as characterized already in our response to Question 41. The Working Group's responses to this question elicited a wide array of constructive feedback, much of which is repeated elsewhere in this letter. As an example, proxy voting and engagement, as part of Feature (F), could to some degree apply to all needs, which mirrors our commentary in response to Feature (F), where some degree of this type of activity would likely be present in many products which do not specifically intend to pursue this Feature, and should bear consideration under a potential firm-level standard. In addition, Need #2 and Need #3 could be mapped to Feature (D), and Need #4 could also be mapped to Features (B), (C) and (E). With respect to the format of the table itself, we would recommend additional language be used to remind users of the core principles of each Feature. For example, Feature (E) (Impact Objective) could use the same language from earlier on in the Consultation Paper that specifically references "change in outcome" and could reflect additional comments elsewhere in this response. It will also be important to note, particularly for retail investors, that if only these five needs are identified in a matrix, it does not mean that a given product completely covers this need. For example, Need #3 references relatively fewer negative effects (however, an exclusion fund that excludes fossil fuel companies may still include securities of other issuers that are having a negative impact on biodiversity). For Need #3, there was also discussion of relative emphases of positive vs negative effects. Investment products also can have many different ESG features, as these are not mutually exclusive, and this should be prominently indicated on the matrix and elsewhere in the paper. The Working Group also resurfaced the need for a parallel and distinct, complementary firm/manager-level standards development process as part of the discussion of this question, with some needs being addressed at least partially at the firm/manager level as opposed to in the features of a given product.

<u>**Users and Benefits**</u>

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

Yes, the Working Group agreed with the description of user benefits.

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?

Yes, the Working Group agreed with the terms used to define the users of the Standard.

Our sincere thanks to the generous efforts of Working Group members in compiling this response.

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