Breckinridge CAPITAL ADVISORS

CFA Institute ESG standards address investment product disclosure practices

Authors

ROB FERNANDEZ, CFA
DIRECTOR, ESG RESEARCH

Key Takeaways

- The CFA Institute issued the first global voluntary standards for disclosing how an investment product considers ESG issues.
- The institute's standards are intended to address a broad range of ESG practices and approaches.
- Breckinridge is developing its disclosures in compliance with the standards.

The CFA Institute issued the first global voluntary standards for disclosing how an investment product considers environmental, social and governance (ESG) issues in November 2021. The CFA institute is a global association of investment professionals that promotes ethical, operational, and educational standards, and offers the well-recognized Chartered Financial Analyst (CFA) professional designation.

The institute's Global ESG Disclosure Standards for Investment Products are intended to address a broad range of ESG practices and approaches including research integration, screening, impact, thematic, best-in-class, proxy voting, and engagement. The Standards are intended as ethical principles for the fair representation and full disclosure of an investment product's ESG approaches.

The institute reports that the standards are intended to help investors consultants and distributors to better understand, evaluate, and compare ESG approaches, and to complement and streamline manager search, product selection, due diligence, governance reporting, and record-keeping processes. For investment managers, the standards may facilitate sales and distribution of investment products, save time and effort responding to requests for proposals and due diligence questionnaires, reduce legal and compliance risk, and enhance a manager's brand. Breckinridge is developing its disclosures in compliance with the standards, with support from the CFA institute, with the goal of finalizing them in 2023.

Global standards like the Global ESG Disclosure Standards for Investment Products play an important role, alongside regulation, in shaping industry practices. The standards have been designed to accommodate the full range of investment vehicles, asset classes, and ESG approaches. For example, the standards seek to address "greenwashing" as well as the difficulties that investors may face when trying to understand, evaluate, and compare investment products that incorporate one or more ESG approaches.

The Standards have been, and will continue to be, developed, maintained, and promoted through a collaboration of volunteer subject matter experts and CFA Institute through a process informed by public consultation. The Standards are jointly approved by CFA Institute and its ESG Technical Committee. *(Ed. Note: Rob Fernandez serves as a member of the institute's ESG Technical Committee.)*

In order to state that ESG disclosures for a particular investment product comply with the standards, investment managers must: 1) Document policies and procedures for establishing and maintaining compliance with the requirements of the standards, 2) Prepare ESG Disclosure Statements for each product that is to be considered, 3) Notify the institute by submitting a form on the institute's website after completing the first ESG Disclosure Statement and annually thereafter, and 4) Make its ESG Disclosure Statements available to investors.

To assist investment managers in development of their own disclosures according to the standards, the institute has released additional materials including independent assurance procedures, a handbook that explains the provisions of the Standards, and an optional template to standardize the format of investment product ESG disclosures.

For Investment Professional and Institutional Use Only.

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All investments involve risk, including loss of principal. Diversification cannot assure a profit or protect against loss. Fixed income investments have varying degrees of credit risk, interest rate risk, default risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer-term securities. Income from municipal bonds can be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the IRS or state tax authorities, or noncompliant conduct of a bond issuer.

Breckinridge believes that the assessment of ESG risks, including those associated with climate change, can improve overall risk analysis. When integrating ESG analysis with traditional financial analysis, Breckinridge's investment team will consider ESG factors but may conclude that other attributes outweigh the ESG considerations when making investment decisions.

There is no guarantee that integrating ESG analysis will improve risk-adjusted returns, lower portfolio volatility over any specific time period, or outperform the broader market or other strategies that do not utilize ESG analysis when selecting investments. The consideration of ESG factors may limit investment opportunities available to a portfolio. In addition, ESG data often lacks standardization, consistency and transparency and for certain companies such data may not be available, complete or accurate.

Breckinridge's ESG analysis is based on third party data and Breckinridge analysts' internal analysis. Analysts will review a variety of sources such as corporate sustainability reports, data subscriptions, and research reports to obtain available metrics for internally developed ESG frameworks. Qualitative ESG information is obtained from corporate sustainability reports, engagement discussion with corporate management teams, among others. A high sustainability rating does not mean it will be included in a portfolio, nor does it mean that a bond will provide profits or avoid losses.

Net Zero alignment and classifications are defined by Breckinridge and are subjective in nature. Although our classification methodology is informed by the Net Zero Investment Framework Implementation Guide as outlined by the Institutional Investors Group on Climate Change, it may not align with the methodology or definition used by other companies or advisors. Breckinridge is a member of the Partnership for Carbon Accounting Financials and uses the financed emissions methodology to track, monitor and allocate emissions. These differences should be considered when comparing Net Zero application and strategies.

Targets and goals for Net Zero can change over time and could differ from individual client portfolios. Breckinridge will continue to invest in companies with exposure to fossil fuels; however, we may adjust our exposure to these types of investments based on net zero alignment and classifications over time.

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