CFA SOCIETY UNITED KINGDOM

WE GROW TALENT

Cases on Ethics in Sustainable Investments

CFA Society United Kingdom

Introduction 3

Buy side analyst roles 4

Corporate issuer roles 12

Sales, marketing & investment communications roles at institutional investors 23

Sell-side analyst roles 34

Portfolio and fund manager roles 44

Private wealth manager/ advisor roles 55

Specialist ESG roles 64

INTRODUCTION

Sustainable investment has moved from being a niche activity to become mainstream over the last few years. Environmental, Social and Governance Assets under Management (AuM) are forecast to account for over 20% of all AuM by 2026, as per a PWC study conducted in 2022.

Investing sustainably and ethically is a minefield. Building on the framework provided by the CFA Institute Code of Ethics and Standards of Professional Conduct, CFA UK have created a suite of case studies to help investment professionals navigate awkward or contentious situations in sustainable investment.

To make it easier for you to find what you need, cases are organised by job role. Each case tackles ethical and conduct challenges outside of regulations in any specific jurisdiction. There are seven job roles in total, and the final report was devised based on feedback from valuable insights from our members, including the sustainability community, and especially from volunteers Ivy Tang, CFA, and Annabel Gillard, CFA.

CFA UK would like to thank the following members for their contributions towards this document: Jose C Valer, CFA, Emily Barnard, CFA, Jacopo Gadani, CFA, Dmitri Govorov, CFA, David Manuel, ASIP, Stephen Metcalf, CFA, Natalie Gregoire-Skeete, CFA, Yuhan Zhang, CFA

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BUY-SIDE ANALYST ROLES

BUY-SIDE ANALYST ROLES

Many buy-side analysts need to collect, handle and process ESG data at scale or rely on colleagues or external service providers to do this for them. This presents a new challenge, as ESG data is often unaudited, qualitative, and comes from a wide range of sources of varying reliability rather than from audited financial accounts or official trade figures. This means ESG data can be more easily misconstrued and is often a matter of interpretation rather than fact. Also, the growing influence that ESG data has on market prices means that analysts handling ESG data need to carefully consider whether it is MNPI.

Sustainability Context:

ESG data may often be disputed, partial or capable of different interpretations. In such situations, buy-side analysts should make clear whether the data that informs and influences their investment decision is opinion, based on possibilities or probabilities, or can legitimately be described as fact.

Personal and commercial bias can also easily enter investment decisions if adequate steps are not taken to retain analytical independence and objectivity. The qualitative nature of ESG data can lead analysts to 'fit the data to the story' and produce the commercially or personally preferred outcome. Firms should embrace good governance and peer and committee review procedures to minimise this risk.

Current ESG ratings and data methodologies vary significantly in the ESG topics they cover, how the topics are weighted, and the metrics used to measure ESG performance. Although regulators in the UK, EU and Asia are rapidly developing regulatory proposals for ESG ratings providers, the proposals mandate transparency rather than stipulating any particular approach[1]. Buy-side analysts must interrogate ESG ratings and data just as with all other data inputs into investment decisions. This means not taking them at face value, identifying the source, taking a view on their reliability, checking whether they have been independently assured, and considering data and opinions that might lead to an opposing view.

Key CFA Institute standards relevant to buy-side analyst roles:

[1] IOSCO published a set of principles for ESG ratings and data providers in November 2021. Voluntary codes of conduct modelled on it have been (or are being) developed in some countries. The European Union has published a draft text on the regulation of ESG rating activities and the UK has brought ESG ratings providers within the regulatory perimeter.

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I (B) INDEPENDENCE & OBJECTIVITY	Analysts need to retain their independence and objectivity. This applies as equally to sustainability considerations as to other investment considerations. Analysts should not allow commercial considerations or their personal sustainability views to bias their investment recommendations or independence.
II (A) MATERIAL NON-PUBLIC INFORMATION	As sustainability related information is becoming increasingly relevant and material for capital markets participants and is also often private and qualitative in nature, analysts have to exercise care when coming into possession of it. Whilst a change in a company's credit rating is recognised as material non-public information (MNPI), whether and when a change in an ESG rating is MNPI is not that clear. ESG ratings as MNPI fit within the UK's Market Abuse Regulation (MAR) definition of inside information, but there have been no notable FCA enforcement actions or court cases to date. Best practice suggests treating non-public knowledge of ESG rating changes as MNPI and staying up to date with legislation and regulation in relevant jurisdictions.
V (A) DILIGENCE & REASONABLE BASIS	Sustainability related information may be vague, incomplete, disputed, or wrong. Analysts need to be careful to establish the veracity of the sources and the quality of any sustainability related data before they use it in their recommendations.

APPLICATION OF THE CFA INSTITUTE STANDARDS (7 cases)

Issue 1: Lack of objectivity in recommendations influenced by ESG issues

Example

Albert, CFA is an equity research analyst for a portfolio management company and is currently performing an ESG analysis on the stocks his firm is holding for its clients. After doing his own detailed research, he finds out from an environmental activist's blog that a small oil exploration company in which his portfolio is currently invested is highly likely to be sanctioned by local authorities for environmental damage. Albert decides to talk to his manager as he is due to issue

an update in the coming weeks on his recommendation of this stock to clients; he believes this event could lead to significant fines and reputational issues for the company and impact its stock heavily. Albert's manager, however, recommends against notifying this concern when publishing the report given that, although likely, this is not yet certain and because this stock is held by most of their company's clients.

CFA UK Comment

Notwithstanding the pressure from his manager, Albert should not be influenced by the fact that most clients hold the stock. Provided Albert has carefully and independently assessed the validity and reliability of the information, and also confirmed it is not MNPI, we think that he should act with independence and objectivity when issuing the revised report and updated recommendation to his clients. Failure to do that would probably mean violating *CFA Institute's Standard I(B) Independence & Objectivity*.

Issue 2: Not complying with local personal data retention requirements

Example

Bart, CFA is an analyst at an asset manager, Eurnoe Group. She wrote her PhD thesis on the benefits of diversity, the conclusion of which was that, on average, companies with diverse senior management outperformed and had higher EPS numbers than firms with lower diversity. In her new role as an investment analyst, Bart is keen to put her theory into practice and decides to speak to the lead fund managers of the Eurnoe's Duvnee fund. They like her idea of using a gender and race screen and agree that if she could produce robust data to support it, they would allow her to run a small fund in their part of the Eurnoe group. Encouraged, Bart attends the AGMs of all the companies that the Duvnee fund invests in. She records the name, assumed race and gender of each senior management company representative she meets on her work computer. After three years, the correlation analysis shows a strong fit: the stock prices of the most diverse firms clearly outperformed. Impressed, the Duvnee fund managers start to use the diversity screen for their fund going forward. Bart is then contacted by Eurnoe's compliance officer questioning Bart's retention of the personal information of company representatives; they ask her to delete the information to avoid a violation of GDPR. Bart refuses, arguing they form the basis for the fund's investment decisions and that under Standard V(C) she needs to maintain these records for 7 years.

CFA UK Comment

Bart is right that she is required to keep the records for a minimum of seven years under *CFA Institute's Standard V(C) Records Retention* or longer if local regulations require her to do so.

However, the compliance officer is also correct. Under GDPR personal data concerning racial or ethnic origin is special category data. Processing special category data is allowed only if certain conditions are met, of which one that applies in this situation is the explicit consent of the data subject. Bart requires the permission of the "data subjects" to collect and retain their personal data. Under CFA guidance for *Standard I(A) Knowledge of the Law*, EU jurisdictional law takes precedence over the CFA Institute's Codes and Standards. To continue incorporating diversity analysis in the investment process for her fund while maintaining compliance with applicable law, Bart must seek the permissions required by GDPR and ensure that the permissions sought are consistent with the firm's desired retention period.

Issue 3: Improper access to non-public information through external experts

Example

Evans, CFA is a research analyst working for an insurance company. Her firm relies on the opinions of external sustainability experts to stay informed about the impact of climate change on the companies they insure. At a recent meeting, some experts indicated that a particular company that they had recently interviewed is significantly exposed to climate change transition risks and that they are working with the management of that company to mitigate these risks with appropriate strategies and action plans. Following the meeting, Evans immediately informs her risk colleagues about this. The insurance company then plans to implement an increase in the company's insurance premiums at the next renewal period.

CFA UK Comment

The opinion of external experts is often valuable to the work of many firms. However, these should be covered by a formal contract / NDA and an agreed protocol on information sharing. Experts who are working with a specific company to mitigate sustainability risk exposure of that company should not be disclosing material that would be MNPI based on the experts' access to confidential internal information from that company. The experts should have either not disclosed such information or confirmed that it is MNPI in the meeting with Evans. Similarly, Evans should have first checked whether this information was already publicly disclosed by the experts or the company before suggesting her colleagues act on it. Evans has likely violated *CFA Institute's Standard II(A) Non-Public Information* and passed MNPI received from experts' assessments to her colleagues.

Issue 4: Putting one's own interests ahead of client interests

Example

Short, CFA is an investment analyst at Greenland Pension Fund which exclusively focuses on sustainable investment opportunities. He has been assigned to review an investment in a renewable energy company, Runever Ltd. Through his research, he discovers that Runever uses the same green technology as another company in his coverage, Newnergy Ltd. Newnergy's most recent ESG rating was downgraded heavily earlier this year due to the discharge of toxic chemicals from its facilities directly into a river running through a nearby residential area. Studying Runever's investment memorandum, Short realises that Runever owns a factory built near his own house, which he is now in the process of selling. Short worries that the river around his house may also have been polluted with similar toxic chemicals. After conducting extensive due diligence, Short can find no evidence to suggest that Runever is disposing of its waste responsibly or is using different practices than Newnergy. Once public, this information would highly likely have a negative impact on his house sale both in terms of price and speed. Given that he can find no clear evidence of responsible disposal of environmental waste by Runever, he includes the serious risk of a copycat environmental problem in his report for Runever Ltd. However, he decides to delay issuing the report by a few weeks until he succeeds in selling his house.

CFA UK Comment

Short has probably breached *CFA Institute's Standard III(A) Loyalty, Prudence, and Care* as he delayed the issuance of his report disclosing the Runever factory's environmental risk. Short has placed his own interests before his clients', which is not loyal and lacks the necessary care of making his client's interests a priority. We think that Short also has a conflict of interest, and under *CFA Institute's Standard VI(A) Disclosure of conflicts*, he should recognise he has a financial interest in the timing of public release of his report, declare this to his line manager or compliance officer and discuss the most appropriate way forward.

Issue 5: Thorough due diligence and research in selection of sustainable funds

Example

Tomas, CFA works as an analyst at a UK based wealth manager in its manager research team. His primary responsibility is the research and selection of mutual funds to be used in the firm's sustainable investment portfolios. One of the funds he has been analysing scores very well on third party ESG metrics, with top quartile ESG scores based on its holdings. Some members of the portfolio management team are keen to add this fund to the firm's portfolios: it is run by a very

well-known asset manager, has the desired risk-return profile, and would improve the overall scores of the portfolios based on the third party ESG metrics. However, after further analysis, Tomas discovers that there are no mechanisms in the investment process for this fund to arrive at a sustainable portfolio, i.e. any positive scores of the portfolio's current holdings are purely coincidental and not an intentional outcome of the investment process. Additionally, he does not believe that the third party ESG scores being used are a good measure of sustainability, and as a consequence, on both counts, the fund does not actually meet his firm's policy for selecting sustainable investments. Accordingly, Tomas decides to not recommend the fund for inclusion in the firm's sustainable portfolios, much to the frustration of some of the portfolio managers.

CFA UK Comment

Tomas seems to have met his diligence responsibilities under *CFA Institute's Standard V(A) Diligence & reasonable Basis*. Tomas conducts thorough due diligence on the fund, and despite pressure from other internal stakeholders, does not think it meets the minimum acceptable standard for a sustainable fund. As such, he has no reasonable basis to recommend the fund. In addition, in many jurisdictions the lack of process would violate disclosure regulations. UK SDR requires that at least 70% of the product's assets must be selected with reference to a robust, evidence-based standard that is an absolute (as opposed to a 'relative') measure of environmental and/or social sustainability. EU SFDR requires that Article 8 and Article 9 products disclose the investment strategy that guides their investment decisions, such as objectives and risk tolerance.

Issue 6: Not verifying the accuracy of third-party ESG data and opinions

Example

Turner, CFA is an equity analyst responsible for analysing the sustainability data of his firm's stock universe. Given the large number of enterprises in the stock universe, and the lack of internal resources and processes, Turner relies on external advisers for compiling the companies' climate change targets and strategies (e.g. their TCFD reports and SBTi targets) and for their analysis and opinion on the data. Turner then aggregates and uses these external opinions outside his firm with a generic assessment in terms of the portfolio's alignment to net-zero by 2050.

CFA UK Comment

To meet his responsibilities under *CFA Institute's Standard V(A) Diligence & Reasonable Basis*, Turner should check and evaluate the information and assessment as he shares a responsibility for the accuracy and reliability of the data and opinions. We think that Turner should also encourage

his employer to develop a proper set of procedures and compliance checks to verify the information that is collected via third-party firms. When using internal and external advisers to provide an opinion, his firm should independently validate their assessments before marketing these externally.

Issue 7: Not managing funds in accordance with stated sustainability objectives

Example

Kemi, CFA works as an analyst at a leading hedge fund, ABC. which has enjoyed a top-quartile performance over the last five years amongst peer European equities funds. ABC explains the integration of ESG into the fund's investment process in its fund documents and state it is implemented in line with the "UNPRI / CFA Institute definition of ESG Integration" i.e. the "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions". The fund follows a prescribed decision process for all new investments, which includes a stage to consider ESG factors. Kemi was enthused by ABC's investment in one company, GreenHyo, which is at the forefront of green hydrogen development. Shortly after Kemi joins, the fund begins to underperform, and the CIO asks for a review of all the fund's holdings. GreenHyo had announced a significant new investment in a new technology and the analyst's in-house view was that it would take 5-10 years before the firm could generate material profits from this investment. GreenHyo had also just announced the loss of a large client contract. The fund managers sell down the GreenHyo investment and then short the stock. Kemi, CFA is affronted by the decision, stating that she did not want to work for a fund that placed short-term trading performance ahead of supporting sustainable companies and failed to follow the declared strategies of its funds.

CFA UK Comment

ABC's fund managers have likely not violated *CFA Institute's Standard V(B) Communication with Clients and Prospective Clients* as the UNPRI / CFA Institute definition of ESG integration does not require ESG factors to be dominant or primary at all times. ESG factors do have to be considered for every individual investment decision, but they can be overridden by other factors that may be determined to be more significant. Provided the disposal and shorting of GreenHyo stock was an exceptional case rather than a common occurrence, we believe ABC's fund managers' actions are in compliance with the fund documents.

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CORPORATE ISSUER ROLES

CFA Society United Kingdom

CORPORATE ISSUER ROLES

Corporate issuers around the globe and across all industries are adapting their strategy and business model to more sustainable pathways. They may be seeking out revenue streams from new products better designed to reduce their clients' emissions, they may be reducing their own exposure to climate change transition risks, or they may be adapting their product range to better address more diverse demographics in their target customer base. At the same time investors are looking for evidence of these developments in corporate disclosures.

Deciding what ESG-related data to publish, and how to communicate it in a clear and compliant manner, is a critical component in the sustainable investment chain. It involves several different role types within corporates, from the Chief Executive Officer and Chief Sustainability Officer to the Board and through to analysts in the corporate's finance, risk, and treasury functions.

Sustainability Context:

There is societal, political, and financial market pressure on corporates to present as green or sustainable an image as possible. The same is of course true of projecting financial strength or soundness, but there is a well-established reporting infrastructure for financial disclosures and most important disclosures are audited. These rules, standards and established practices serve to provide guardrails within which corporates must work.

For sustainability reporting, however, corporates currently face less in the way of specific rules or standards. There is a lack of agreed definitions that in turn can easily lead to investors making inaccurate comparisons or conclusions. As ESG data is new and evolving in nature, external stakeholders' understanding of a corporate's disclosures can be shallow and more easily manipulated. More data is not necessarily better data, either. Corporates can tell a positive story on lots of meaningless data and gloss over problem areas and avoid negative sustainability narratives.

Charter holders employed within corporates have a duty to fairly present their company's sustainability performance to investors and analysts. This means exercising rigour in researching new data, diligently ensuring its relevance to the company's sustainability narrative, and ascribing the right level of importance to it. In the long run, the equities, bonds and other financial instruments of those companies presenting a fair and accurate picture of their sustainability should have a far more stable market profile than those that seek to flatter and deceive.

A company can misrepresent its greenness not only in its non-financial disclosures to its investors but also in its general corporate communications and in its product and brand advertisements. Such statements can back-fire and corporate reputations come under pressure if their claims are scrutinised and found to be misleading. Equally there are growing instances of "green hushing" where companies refrain from making valid ESG related claims, as they fear the risk of regulatory scrutiny or legal challenge is not worth the positive impact.

Key CFA Institute standards relevant to corporate issuer roles:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I(C) MISREPRESENTATION	Companies are keen to promote their sustainable strategies to win positive publicity both in the investment community and in their marketplace for their products. While the rules around corporate financial disclosures have been developed over many years, sustainability disclosures are evolving and will continue to do so. There are several emerging standards on what must be disclosed, for example SASB standards, IFRS S1 and S2, CSRD in Europe, CCDR and SDR in the UK, and SEC requirements in the US. Companies can elect to over-promote positive sustainability information whilst down-playing or staying silent on negative sustainability data.
II(B) MARKET MANIPULATION	Taken to extremes, false statements around green credentials by corporates at times of bond, equity, or IPO issuance amount to market manipulation.
V(A) DILIGENCE & REASONABLE BASIS	Just as buy- and sell-side analysts have an obligation to thoroughly research and analyse data before commenting or opining on it, so too should analysts employed at corporates that are preparing the data. As the publication of ESG-related data is a new and rapidly evolving field, the range of metrics and methodologies is broad and not necessarily consistent, and data often does not need to be verified or audited, it is easier for confusing or false pictures to be advertently or inadvertently presented.

APPLICATION OF THE CFA INSTITUTE STANDARDS (9 cases)

Issue 1: Exploiting inadequacies in scope-3 data collection

Example

Srikanth, CFA works on the capital markets team within the treasury of TB Bank, a mid-sized retail and commercial bank. He is leading the project to issue TB Bank's inaugural Sustainability Linked Bond. As with most banks, over 80% of TB Bank's emissions relate to its loan exposures to borrowers and are classified as scope-3, rather than scope-1 or scope-2. Because of this dominance of scope-3 data in TB Bank's emissions profile, Srikanth knows that the SLB will not raise much investor interest (and therefore attract a "green premium" to their normal bonds) if only scope-1 and scope-2 data is disclosed in the issuance materials. Srikanth reviews the bank's historic and current emissions data and is unsurprised to find that the scope-3 data contains some significant gaps for large sectors of the loan portfolio. Knowing that scope-3 figures are notoriously unreliable he cherry-picks favourable proxy data from several peer banks to in-fill the scope-3 data gaps. The verification agent fails to robustly query the methodology behind the proxy data. TB Bank's SLB is welcomed by the market and achieves a premium of 10bps compared to TB Bank's normal bond curve. Srikanth is congratulated by TB Bank's Treasurer for the successful debut issuance.

CFA UK Comment

Srikanth is likely to have violated *CFA Institute's Standard I(C) Misrepresentation* and improperly encouraged investors to buy TB Bank's debut SLB issue at an inflated price, potentially also breaching *CFA Institute's Standard II(B) Market Manipulation* in the process. The use of proxy data to some extent to fill gaps in scope-3 data is unavoidable but it is probably not accurate to have cherry-picked the data from different peer banks for different sectors unless there was a strong underlying rationale. The selection rationale appears to have been to choose the most favourable proxy data; TB Bank's disclosure of the basis on which the proxy data was chosen is inadequate and has contributed to the verification agent's failure to query the basis of the data. Whether a company is required to report scope-3 data depends on the countries where it operates and the company type (by size and revenue), for example required in the EU, in the process of being adopted by the UK and excluded in the US SEC climate-related disclosure final rules.

Issue 2: Misleading performance reporting and inclusion of one off items

Example

Pearson, CFA works for ABC Plc, a listed company in the nation of Ultramania. Pearson is Head of Sustainability and responsible for all sustainability related corporate reporting, including disclosure of the firm's Scope 1,2,3 emissions. Pearson's remuneration KPIs are significantly related to the firm's carbon intensity per unit of revenue, and its consistency in reduction has contributed to sell-side analysts giving the firm a consistently high 'E'-score for their performance on environment. When assessing the latest annual carbon intensity numbers to be published in the firms' annual report, Pearson notices that the carbon intensity per unit of revenue is materially up this year compared to last year. Pearson decides to make some adjustments to the carbon intensity figures to account differently for one-off items this year which she believes have artificially inflated the numbers. Pearson is very aware of how important the trend in the carbon intensity number is, both for her own personal KPIs, and to sell-side analysts' valuations and opinions of ABC. The annual report is published with no disclosures around how the carbon intensity number has been adjusted for one-off items nor any footnotes to indicate it is an adjusted number. There is no regulation or policy covering adjustments to ESG disclosures in the nation of Ultramania. The report shows a continued downward trend in carbon intensity, and Pearson is praised by the ABC board for her good work which is factored into her variable remuneration for the year.

CFA UK Comment

Pearson is likely in violation of *CFA Institute's Standard I(C) Misrepresentation*. In adjusting ABC's emissions numbers without full disclosure, Pearson is giving the impression to stakeholders that ABC's emissions performance continues to improve. The full figures should be disclosed in the corporate reporting, with the appropriate footnotes to discuss any adjustments made to the figures to aid comparability.

Issue 3: Misrepresentation of ESG ratings to potential buyers

Example

Fleur, CFA oversees investor relations for her company Renew Energy Ltd. Before a scheduled major investor meeting, she performs background checks on the potential investors attending and finds that, unsurprisingly, a majority of these potential investors have a heavy ESG focus. Hence, Fleur decides to hire an ESG rating agency to assess Renew Energy's business and anticipates a good ESG rating to boost the company's share price. However, the overall ESG rating is only 5 on a scale of 1-10 due to a very low '2' rating on Governance dragging down high '8' and '9'

scores for Environment and Social, respectively. Fleur believes the Governance assessment is unfair and so contacts a second ESG rating agency for their ESG rating of Renew Energy. This second ESG rating is also a mid-range score, due to both Social and Governance mid-range scores. Selectively lifting criteria from the two ESG agency rating reports, Fleur presents Renew Energy's ESG rating as 'High' overall, using and averaging the high Environmental and Social scores from the first agency and the middle Governance score from the second agency.

CFA UK Comment

To promote her company with new potential investors at an investor meeting, Fleur cherry-picks the most favourable assessments and omits the least favourable assessments from the two different reports and combines them to create a misleading impression of the company. This appears to be a breach of *CFA Institute's Standard I(C) Misrepresentation*. If Fleur is going to proceed with any disclosure of these ratings, then as a minimum, Fleur should disclose the different ESG rating agency sources when presenting the breakdown of Renew Energy's ESG scores and acknowledge that the agencies had different scores and disclose their respective full scores.

Issue 4: Making exaggerated ESG claims in corporate advertising

Example

Bell, CFA is the Chief Sustainability Officer at Big Oil, a multi-national oil company. Responding to the direction from his board to help create a more sustainability friendly public image he, together with Big Oil's marketing department, designs and approves a new marketing campaign for Big Oil, with billboard logos stating: "The Future of Energy? Big Oil is now significantly scaling up its bio-waste business to fuel a sustainable energy future". Big Oil has tripled its capital investment into bio-waste plants this year, but it still only represents 2% of its total sales. Investment into traditional fossil fuel projects has declined in the same period but still accounts for over 85% of Big Oil's total capital investment. Big Oil's oil production continues to increase year on year. A journalist from a leading newspaper highlights the duplicity of the company's claims, suggesting they may constitute greenwashing.

CFA UK Comment

In approving the advertising campaign, Bell may have breached *CFA Institute's Standard I(C) Misrepresentation*, even if the campaign is legal under advertising standards. The advertising campaign could be misinterpreted to read that Big Oil is pursuing a "sustainable energy future", whereas, in fact, the company is increasing oil production, which dominates its business. It may have been more accurate to state that Big Oil is "increasingly investing in lower carbon energy solutions". By making exaggerated claims based on a small part of its business, Bell has attracted

the interest of a journalist trying to expose corporate greenwashing practices. As a result, the advertising campaign may do more damage than good to Big Oil's reputation and sustainability credentials, as well as risk fines (e.g. up to 10% turnover proposed under UK Digital Markets, Competition and Consumers Bill, and up to 4% turnover proposed under the European Green Directive)

Issue 5: Not complying with new rules for ESG disclosure

Example

Zanders, CFA works for a publicly listed company and is preparing their semi-annual sustainability report for the company's stakeholders and investors. Her company's board recently decided to change its rules for measuring its performance towards meeting its climate goals. Starting this year, off-setting carbon credits from renewable energy projects (typically purchased from external parties to offset their own carbon emissions) are no longer to be considered as valid offsets and included in the company's published GHG emissions figures. However, Zanders discovers that several of the company's regional offices have continued to buy carbon credits from third-party renewable energy projects as they were not properly notified of the revised rules.

CFA UK Comment

Despite the ongoing purchases of carbon credits by some regional offices, Zanders should not continue using the same calculation methodology from previous years. If she does not revise her methodology in line with the company's new rules, she may be in violation of *CFA Institute's Standard I(C) Misrepresentation*. Ideally, she would calculate the company's performance under both the old and the new carbon accounting recognition criteria and show the difference. Her report should also explain the company's motivation in switching its recognition criteria. A failure to do this would obscure her company's real performance against its stated aim of limiting its contribution to global warming and meeting the goals of the Paris Agreement. It may also make peer comparison analysis between companies in its sector misleading. The International Financial Reporting Standards (IFRS) International Sustainability Standard Board (ISSB)'s sustainability reporting standards also require disclosure of the old criteria, the new criteria, and the difference. The UK plans to broadly adopt these standards, after a period of consultation.

Issue 6: Misleading disclosures in IPO documentation

Example

Previn, CFA is the CEO of the company S-Tech, which manufactures hydrogen-electric and battery-electric heavy-duty commercial trucks and energy infrastructure solutions. It claims to have developed a functional zero-emission hydrogen electric truck and posted a video showing a hydrogen electric truck driving down a level road at speed. It also claims a high-density battery and hydrogen production capability. This leads most analysts and investors to believe that the technology is proprietary, highly advanced, and ready for widespread rollout across customers. The company subsequently lists on a U.S. exchange, following a reverse merger with a Special Purpose Acquisition Company (SPAC) and achieves an 'ESG premium.' A few months after listing, through some investigative journalism, it is alleged that S-Tech's technology is not what the company led the investment community to believe. For example, in its video the company towed a motorless truck up the hill and rolled it in neutral down a 3% grade. The SEC opens an investigation and multiple investors and the investment bank open lawsuits against S-Tech and Previn.

CFA UK Comment

We think that Previn is in breach of *CFA Institute's Standard II(B) Market Manipulation (information-based)*. If what is alleged turns out to be accurate, Previn disseminated false and misleading information surrounding the company's technology, and its advancement and readiness for rollout. This could be considered to have contributed to the company achieving an ESG premium' upon listing and distorted the price setting mechanisms in the market. Further, if it is confirmed that the company committed fraud by giving a significantly misleading impression of the advancement and readiness of their technology, Previn and others involved in the company risk fines and imprisonment.

Issue 7: Making recommendations based on vague and ambiguous sustainability claims

Example

Dunn, Investor Relations Officer at Big Oil, a multinational oil company, is holding an investor update meeting. During the presentation, she states: "Big Oil is committed to achieve net zero in its operations by 2050". This is the first time that Big Oil has made a public pronouncement of this strategic goal. Schulz, CFA, an analyst at Wella Pensionsfond, attends the presentation and immediately sends an email to his portfolio manager to buy Big Oil as this claim breaks new

ground and he believes it will improve the outlook for Big Oil shares.

CFA UK Comment

Dunn's statement was grandiose and aiming to support and redefine Big Oil's sustainability credentials. However, it was also ambiguous and insufficiently qualified with necessary details. We think that Schulz may have breached *CFA Institute's Standard V(A) Diligence & Reasonable Basis* as a result. Whilst the initiation of a net-zero target for the first time may be in and of itself sufficient to support a change of recommendation on Big Oil's stock, Schulz should really go further and properly interrogate the added information. Without for example i) ascertaining whether scope-3 emissions are included in the target (these probably represent a dominant share of Big Oil's emissions) and ii) clarifying whether "operations" in this statement referred only to the majority-owned domestic subsidiaries and not to any overseas, JV or minority-owned projects, he neglects to obtain important further definition behind his net-zero claim. He also fails to establish any detail regarding the key emissions reduction target milestones on the route to reach net zero-2050. Any immediate positive share price reaction to the initial news could quickly be reversed depending on the answers to these subsequent questions. Also note the possibility of regulatory breaches, for example the UK anti-greenwashing rule requires that claims be correct and capable of being substantiated, while the EU Green Claims Directive requires companies to substantiate claims about environmental aspects or performance using robust, science based and verifiable methods.

Issue 8: Providing material non-public information (MNPI) and publishing a recommendation

Example

Cowell is the Finance Director of Rotate Inc., an S&P 500-listed wind-farm operator. Reading the pack for his board meeting next week he finds a very recent study from their engineering department which warns that the rotor blades in the oldest offshore turbines are deteriorating more quickly than anticipated, rendering the company's accounting assumptions for the asset lives of its turbines overly optimistic and making an impairment likely. To prepare for the board meeting and to determine the impact this might have on Rotate's stock price Cowell calls Rotate's broker's sell-side analyst, Davidson, CFA and asks how the stock might react to the announcement of an accounting impairment of c.EUR100 million, without saying why. Davidson responds that it would depend on the reason for the impairment and Cowell says he would rather not conflict Davidson and so ends the conversation. Davidson returns to his work continuing to read an article in a science research journal on the long-term impact of salt spray on galvanised steel joints in first-generation offshore wind turbines which is written by Edwards, a former university research

colleague and friend of his. He calls Edwards who excitedly discusses his findings, and the importance of an additional protective nickel coating now routinely applied in newer installations. He concludes that Rotate and several other companies are bound to be affected. Davidson rushes out a SELL note on Rotate and four other wind-farm stocks with significant old offshore portfolios, citing the research article and urging investors to underweight the stocks.

CFA UK Comment

It is likely that Davidson received sufficiently material NPI on his call with Cowell even though Cowell did not provide a reason for his question. Cowell should have indicated the information (even though incomplete) was MNPI. Similarly, Davidson should have confirmed with Cowell if the information was public or not, during or after the conversation, and the conversation recorded or internally logged. As a minimum thereafter, Davidson should have discussed the situation with his compliance officer and/or manager and showed them the research article. We think that both Cowell by way of disclosing MNPI and Davidson by way of publishing the SELL recommendation would be in breach of *CFA Institute's Standard II(A) Material & Non-Public Information*. In the event Davidson had received the go ahead from his compliance team by the time he has spoken to Edwards, Davidson's further conversation and research appear to be okay under mosaic theory and given that the research note was released publicly prior to any trading, no subsequent breach is indicated. Note that this assumes the call with Edwards was not an example of an analyst using an industry expert to obtain MNPI.

Issue 9: **Insufficient documentation regarding corporate employment practices and policies**

Example

Stuart, CFA, is Head of Medium-term Funding in the treasury department of MedBank and reports to MedBank's Treasurer, Jane Short, CFA. MedBank is considering issuing an ESG-linked Schuldschein*, with a tight deadline. One of the key ESG objectives is to promote diversity and inclusion opportunities as part of the issuance. One specific KPI is the increasing the share of women in the top management layer from 10% to 25% within the next 5 years. Amongst other tasks, Stuart decides to review the company's internal human resource policies to make sure they are aligned with this social objective. After a protracted period, during which he is distracted by other matters, he realises that the bank has no formally documented Diversity, Equity, and Inclusion (DEI) policy. Given the time he has taken to complete his policies review, however, Stuart realises that he can no longer address this issue and meet the target issuance deadline. Under pressure from Short about the delay to the issuance and with market conditions threatening

to become more volatile, Stuart softens the prospectus wording relating to MedBank's human resource policies and quickly approves the ESG-linked Schuldschein issuance.
**A type of private placement debt instrument used in Germany, usually with fewer legal requirements*

CFA UK Comment

Stuart's review of MedBank's human resource policies clearly highlighted the need for the inclusion of a formally documented DEI policy. We think Stuart is likely to be in violation of *CFA Institute's Standard V(A) Diligence & Reasonable Basis* as he did not complete the task with sufficient diligence and competence and, as a result, it is unlikely that the new Schuldscein is in full compliance with social bond issuance standards. Stuart should have explained the situation Short and sought a delay to the Social Schuldschein issuance until MedBank had an approved DEI policy in place. By allowing the issuance to proceed, Short may also have been in breach of *CFA Institute's Standard IV(C) Supervision* as she should have been monitoring Stuart's progress in meeting the various pre-conditions for the Social Schuldschein issuance.

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SALES, MARKETING & INVESTMENT COMMUNICATIONS ROLES AT INSTITUTIONAL INVESTORS

CFA Society United Kingdom

SALES, MARKETING & INVESTMENT COMMUNICATIONS ROLES AT INSTITUTIONAL INVESTORS

Within institutional investors, communications professionals stand closest to the risk of 'greenwashing'. They must ensure that sales and marketing literature and communications are accurate and do not exaggerate the sustainability credentials of their firms or its products. Regulations in the US, the EU and the UK have tightened up on the precise terminology that firms can use to describe the sustainability attributes of different investment products, and greenwashing can be a serious and costly breach.

Sustainability Context:

There are increasing societal as well as commercial pressures on firms to present as green or sustainable an image as possible, both for their firm and their fund products. Charter- holders employed within investment communications teams have a duty to fairly present their firms and funds' sustainability performance to underlying investors. All communications need to take account of the level of client understanding and appreciation of sustainable investments, particularly retail clients. Firm communications should fairly and clearly explain the firm's views of what distinguishes their sustainable investments from their other investments.

The regulations around "greenwashing" in marketing and communications are evolving rapidly, such as the "anti-greenwashing rule" in the UK from May 2024, the "green claims" directive in the EU, and the FTC's green marketing rules in the U.S. These regulations aim to address the risk of misleading or false sustainability claims, but are not uniform across different jurisdictions, making interpretation more difficult. Sustainability statements which investment firms might like to make require careful review against known available facts and relevant definitions. In recent years regulators have issued fines of over US $ 200m to various companies, including asset management firms, for related issues.

On the other hand, excessive regulatory and litigation risk may also trigger "green hushing" practices i.e. firms trying to downplay or omit references to positive sustainability impact.

The sustainability claims of an investment firm's fund managers and analysts need to be challenged by colleagues internally to ensure they are robust and can withstand subsequent regulatory scrutiny. As recent regulatory actions against several leading global investment firms have shown, a failure to do this is likely to result in subsequent censure, reputational damage, and potential fines.

Key CFA Institute standards relevant to institutional marketing roles:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I (A) KNOWLEDGE OF THE LAW	Investment communications staff are responsible for marketing their firm's investment products, often in multiple jurisdictions. As a result, they need to keep abreast of the current sustainability disclosure regulations in the markets into which they advertise or offer their products. This is particularly challenging currently as new standards and regulations are coming into force at different times in different jurisdictions.
I(C) MISREPRESENTATION	The investment industry has drawn some accusations of 'greenwashing' - the practice, often via marketing or sales materials, of overpromoting a given fund's social or environmental credentials. This is being increasingly monitored and supervised by regulators e.g. via SDR, SFDR, etc., and marketing staff need to be careful that they are accurately describing the real ESG characteristics of their products.
III (D) PERFORMANCE PRESENTATION	Reporting and positioning of investment performance is at the core of investment communications. In the context of sustainable investment strategies this can become more complex, and it is important to have an appropriate and transparent benchmark and ideally also explain performance attribution including the impact of ESG factors.
V (B) COMMUNICATION WITH CLIENTS AND PROSPECTIVE CLIENTS	Investment communications staff need to be careful to ensure that their communications with clients and potential clients regarding the sustainability credentials of their products are accurate. As much investment sustainability data is qualitative rather than quantitative and because some sustainability outputs are inherently difficult to measure, it can be easy to inadvertently overstate sustainability credentials.

APPLICATION OF THE CFA INSTITUTE STANDARDS (9 cases)

Issue 1: Misrepresenting performance track record as ESG methodologies evolve

Example

Terry, CFA is asked to prepare a presentation for his firm's ESG integrated sustainable investment fund. Highlighting the ten-year track record, he chooses a leading ESG benchmark index as comparator and presents the relative performance of the fund over the last ten years as evidence that the fund has a winning strategy and reproducible performance. The presentation also highlights that, over the years, the managers have evolved their process to continually reflect their understanding of the wider impacts of corporate activity, particularly adding a process to align the fund to net zero 2050 targets. While Terry thinks the ESG benchmark is currently a better fit for the fund in terms of composition than a traditional benchmark, he knows it was only created two years ago. To compare performance over the ten-year horizon, he uses back-tested performance for the benchmark, a detail he does not, however, mention or even footnote in the presentation.

CFA UK Comment

CFA Institute's *Standard I(C) Misrepresentation* requires that information presented is 'fair, accurate and complete' so we think that Terry's presentation falls short of the expectations of this standard as he provides a relative performance over a time-period when the fund benchmark and the investment process have both significantly changed as climate impact has become an increasingly dominant theme. Terry has likely also violated *Standard III(D) Performance Presentation* by not making full disclosure of the basis of the historical performance. This would also be a violation of GIPS – "Asset owners must disclose the date and description of any changes to the benchmark over time", notwithstanding that "In most cases, the asset owner should change the benchmark going forward only and should not change it retroactively".

Issue 2: False marketing claims around ESG integration

Example

Robins, CFA works as a product specialist for a leading global asset manager. As part of his role, he is responsible for compiling marketing materials for use in client presentation documents. Recent management focus has been on ESG, and Robins is keen to highlight the firm's strategic

aim to make the whole fund range ESG integrated. Whilst he was aware that the investment team was struggling to implement the new ESG integration strategy across its whole product range, he begins to make the claim in his materials that "all assets managed by the firm are ESG integrated". This is picked up by other colleagues in his firm who then also adopt it widely across the firm's marketing channels in multiple geographies. The following year a regulator asks to see evidence of this ESG integration. As Robins knew when he started to make his claims about ESG integration, the investment team had continued to struggle to implement the new strategy across its whole investment range. His firm is forced to admit to this regulator that a material fraction of assets under management did not have ESG considerations incorporated. The regulator announces its finding and fines Robins' firm for misleading marketing. Regulators in other geographies are alerted to the issue and Robins' firm faces accusations of greenwashing and suffers some significant client losses and reputational damage.

CFA UK Comment

Robins has probably violated CFA Institute's *Standard I(C) Misrepresentation* by knowingly overstating the firms' levels of ESG integration. Investment professionals who make false or misleading statements not only harm their direct investors but also reduce the level of investor confidence in the investment profession and undermine the integrity of capital markets as a whole. In a similar type of case, the SEC fined a leading fund manager $1.5m in 2022 for suggesting all the investments in certain funds had undergone an ESG review.

Issue 3: Failure to maintain knowledge of evolving sustainability laws

Example

Black, CFA works for Beta Fund Management, a medium-sized UK-based asset manager. Black has studied sustainable laws and regulations for the UK asset management industry with external education activities and study programmes, but the last one of these was over 2 years ago. She has now been assigned to a new ESG thematic fund that is expected to focus on compliance with national sustainability laws and regulations when making investment in the products covered. Black is thrilled to start communicating with clients and potential clients and disclosing to them what the eligibility criteria will be and which laws and regulations the fund will follow when making investments for them. She starts her marketing and communication activities, however, without checking what the updates are from the local regulators in terms of sustainability, as she believes she already has all the relevant knowledge and information from her previous education programmes and studies.

CFA UK Comment

Even though Black has dedicated much time to studying and updating herself on sustainability laws and regulations, we think Black could be in violation of CFA Institute's *Standard I(A) Knowledge of the Law* because she failed to stay informed and check the most recent applicable local laws and regulations before starting to communicate and engage with clients and potential clients. Black must be aware of the rapidly evolving requirements in this new and dynamic area. She should have sought guidance from appropriate, and reliable sources, such as the applicable legislation, official websites of regulators and approved external service providers sourced and contracted with by Beta Fund Management.

Issue 4: Making subjective and incomplete ESG claims and disclosures

Example

Ethan, CFA is responsible for the marketing of the ESG funds of an asset manager firm. She is currently trying to market a new fund that will focus on innovative AI-based technologies that can monitor and meaningfully address climate change. The fund's stock universe has been constructed relying on a combination of several complex rules based on her firm's investment system that can help determine both the (i) the 'integrity' of the technology and (ii) its potential impact. However, when Ethan finalises the marketing material for both new and existing clients, she decides to simplify the communication and only show the "good" and the "bad" green technology stock universe against relative fund benchmarks, without specifying the details of her firm's system and the rules it follows to pick and trade the stocks. Nor does she explain that the analysis is a simplification of the outputs of the firm's investment system and that further details of the system itself are available. Ethan's decision relies heavily on her desire to boost her firm's presence in a new market niche given investors' current high interest in green and sustainable opportunities. She wants to avoid being dragged into spending too much time explaining all the details of her systems to both existing and prospective clients, though if clients ask, these details must be provided.

CFA UK Comment

We think that Ethan's plan and decision probably violates CFA Institute's *Standard V(B) Communications with Clients and Potential Clients* if she fails to properly describe and explain the investment system and rules in detail to her clients. The new fund is targeting new niche market opportunities which require the complete communication of all the relevant limitations and inherent risks of such investments. Whilst the marketing materials do not need to contain these details themselves, they need to reference the risks, and explain that further detail is available and ideally refer to other sources where they are described in sufficient detail. In a similar type of

case, the EU regulator fined DWS $25m for potentially marketing ESG funds as 'greener' than they actually were.

Issue 5: Failure to make full and proper disclosure of the investment process

Example

Boyd, CFA is employed as Investment Product Manager for XYZ Asset Managers and is responsible for their range of ESG and sustainable investment strategies. The XYZ fund management team have completed a review of their investment process updating how they integrate ESG and assess investments to incorporate both biodiversity and net zero alignment into their investment process. Working with XYZ's marketing and investment teams she produces a 30-page 'process explainer' for prospective institutional clients and to support RFP requests. As XYZ's product range is sold to both institutional and retail investors the retail marketing head informs Boyd that the purpose of the communication is to improve the positioning of the products in the retail market by highlighting they are now designed to deliver both biodiversity impact and net zero alignment. Since XYZ's categorization of its funds by risk and sustainability impact are unchanged the marketing head argues that a detailed communication of the revised process is not needed for retail clients. Boyd signs off on the 'headline-only' campaign, despite its lack of detail, or any signposting to detailed information regarding the new process and the firm's interpretation of the concepts of biodiversity and net zero alignment.

CFA UK Comment

We think that CFA Institute's *Standard V(B) Communications with Clients and Potential Clients* has been breached because of the 'headline-only' marketing campaign into the retail market and the lack of any signposting to more detailed information. All clients should be treated fairly and communicated to in a language and manner that they can clearly understand. In this case, for the sake of providing a simplified marketing message, retail investors have been denied a clear explanation of the changes in the investment process as there was no signposting of any further information being available. Boyd should have ensured that the detail of the change in the investment process was readily available to all investors if they wished to access it. Without easy access to more detailed information or an offer to receive further documentation and explanation we think she has breached CFA Institute's Standard V(B).

Issue 6: Misleading marketing and promotion terminology

Example

Future-Finance, a prominent financial services company, has launched a new line of investment funds marketed as "climate neutral." They partnered with EcoCertify, a consulting firm, to help achieve and certify this status. Future-Finance's advertisements prominently feature the term "climate neutral" and include a QR code linking to EcoCertify's webpage, where detailed information about the carbon offsetting measures is provided.
Ramon Valdez, CFA, the head of ethical investments at Future-Finance, spearheaded this initiative, believing it would attract eco-conscious investors. However, the German Competition Authority has filed a complaint against Future-Finance, arguing that the term "climate neutral" is misleading. The complaint claims that consumers might misinterpret the term to mean that the company has significantly reduced or eliminated emissions rather than offsetting them. Germany's top court ruled that the term must be clearly explained within the advertisement itself to avoid misleading consumers. The court decided that a QR code linking to more information was insufficient.

CFA UK Comment

We believe that Future-Finance has breached CFA Institute's *Standard I(C) Misrepresentation*, as the term "climate neutral" in its advertising was ambiguous and could mislead investors into thinking the company had significantly reduced or eliminated emissions, rather than offsetting them. Future-Finance should provide a clear explanation of what "climate neutral" means within the advertisement. *Standard V(B) Communication with Clients and Prospective Clients* is also likely to have been breached as the QR code linking to further information was found to be insufficient by the Court. Future-Finance should include explicit and comprehensive information about their climate-neutral measures in the advertisements themselves, ensuring that all relevant details, such as measures taken to offset carbon emissions, are readily accessible and understandable to investors without requiring additional steps. Given the legal ruling against Future-Finance, the team responsible was also evidently in breach of *Standard 1(A) Knowledge of the Law*, as it did not understand and comply with applicable rules, and regulations on sustainability disclosures.

Issue 7: Failure to ensure that clients understand the investment process

Example

Green, CFA works at a UK based wealth manager in the sales and relationship management team. She is currently working with a client prospect who is interested in investing in a discretionary investment solution. The prospect also has stated an interest in sustainability issues.

After a thorough client discovery process, Amanda believes the firm's sustainable portfolio is suitable for the client prospect. However, she believes that the process employed for the sustainable portfolio is too complicated for the prospective client to understand, as they are not a sophisticated investor. Instead of providing a full description of what sets the sustainable portfolio apart from a traditional one, during various pitches, she just states that it "only invests in good companies from an environmental and social perspective" and suggests that the fund would suit her because of her declared interest in sustainability issues. The client seems happy with this explanation throughout, and eventually agrees to invest in the solution.

CFA UK Comment

Green must ensure that her communication with the client satisfies her obligations under CFA Institute's *Standard V(B)*. While she need not describe the investment process in detail, she must outline its basic principles. This is particularly relevant with sustainable investing, due to the subjective nature of many of the issues at hand. Just because the client has expressed an interest in sustainability, it does not automatically follow that this fund's investment process meets her expectations of what a sustainable portfolio may look like. In a related case the SEC fined a prominent asset manager $4m for failing to follow its ESG investment policies and misleading its customers.

Issue 8: Dissociating from and reporting potential unethical actions

Example

D'Souza, CFA, works as a sales director for Omega Asset Management based in Europe, which has an existing sustainability fund being marketed to potential investors in Europe. Since the fund's launch some years ago, the EU has introduced minimum standards for sustainability funds being marketed to investors in Europe. D'Souza discusses this with her line manager, Akimwola, CFA, who concludes that the team does not need to assess whether the existing fund is compliant with the standards because the fund was launched prior to the introduction of the EU's minimum standards. D'Souza does not agree with this and feels it is unethical and non-compliant.

CFA UK Comment

This is a violation by Akimwola of CFA Institute's Standard *I(A) Knowledge of the Law*, as well as likely to be a regulatory breach (depending on the details of the case). From D'Souza's perspective, in order to remain in compliance with the Standards and the regulations, D'Souza should escalate the issue and discuss it with Omega's compliance department. Pending guidance from compliance, D'Souza can temporarily dissociate themselves from the potential violation by not taking any part in the marketing of the sustainability fund until an assessment vis a vis the

minimum standards has been made. Omega Asset Management should not market the product into Europe until it has been confirmed by compliance that there is no breach or the required action i.e. re-assessment is completed.

Issue 9: Minimising ESG disclosure to avoid regulatory scrutiny and oversight

Example

Frances, CFA, is an ESG analyst at a mid-sized investment firm that focuses on sustainable investments in public and private companies. She has been monitoring EcoWave, a renewable energy company, for potential inclusion in the firm’s green energy portfolio. EcoWave has a reputation for developing innovative wind and solar technologies, and its past sustainability initiatives have attracted attention from ESG-focused investors. Recently, however, Frances noticed an unusual change in EcoWave's approach to public communication. The company, which previously published detailed ESG performance reports and actively participated in industry-wide sustainability dialogues, has stopped sharing updates about its carbon-reduction targets and progress toward net-zero goals. Additionally, EcoWave did not renew its participation in the Science Based Targets initiative (SBTi), a program it had joined two years prior. When Frances reached out to EcoWave's investor relations team for clarification, she was told that the company remains committed to its sustainability goals but prefers a private and less public-facing strategy. The company feels it can focus more effectively on its long-term sustainability goals by avoiding the heightened scrutiny associated with public ESG disclosures, and is also considering going private. However, Frances questions whether this move is driven by a genuine commitment to sustainability or an attempt to sidestep accountability and is also uncertain about whether EcoWave’s approach aligns with her firm’s ESG investment criteria.

CFA UK Comment

EcoWave’s decision to limit ESG disclosures to the bare legal minimum, despite operating in renewable energy and having set sustainability goals, exemplifies “Green Hushing”. This is likely in violation of *Standard I(C): Misrepresentation*, as it might mislead stakeholders and undermine transparency and accountability. It is also possible that EcoWave’s reduced disclosures conflict with *Standard III(D): Performance Presentation*, which emphasizes the need for clear, complete, and accurate reporting. By withholding information, EcoWave may hinder investor’s ability to evaluate its sustainability performance objectively. Frances must assess whether the company remains committed to its long-term sustainability goals and that even after it may go private, whether she can recommend EcoWave as a viable investment without sufficient ESG data, in line with *Standard V(A): Diligence and Reasonable Basis*. Frances should request detailed information from EcoWave to verify its progress on sustainability goals and assess the implications of its green

hushing and privatisation approach, for example the risks associated with underplaying certain aspects of its business and its positioning vis a vis climate change and other ESG related risks.

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SELL-SIDE ANALYST ROLES

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SELL-SIDE ANALYSTS

Sell-side analysts may now need to collect, handle and process ESG data as part of their role or be able to understand and incorporate the conclusions of ESG analyst colleagues in their recommendations. Some clients will place great value on their ESG conclusions and knowledge, and others will place less or no importance on it. ESG data currently has limited influence on short-term market price movements but increasingly sell-side analysts managing ESG data will need to consider whether it is MNPI before disseminating more widely.

Sustainability Context:

ESG data is often qualitative and therefore may be disputed, partial or interpreted differently. In such situations, sell-side analysts need to be clear in their reports how much of their recommendations are based on opinion or interpretation, and not fact.

Personal and commercial bias can also enter their investment recommendations and invalidate them if adequate steps are not taken to retain both independence and objectivity. The evolving nature of ESG data could allow analysts to more easily 'fit the data to the story' and make a commercially or personally preferred, rather than appropriate recommendation. Firms should embrace peer review and other oversight practices to minimise these risks.

Sell-side analysts must interrogate ESG data just like all other data inputs into investment decisions. This means not taking data at face value, identifying the source, and taking a view on its reliability even when it comes from an in-house ESG expert. It also means looking at whether certain data fits with other inputs and actively searching for relevant data and opinions that present an opposing view.

Key CFA Institute standards relevant to institutional marketing roles:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I(B) INDEPENDENCE & OBJECTIVITY	Sell-side analysts can face commercial pressures from multiple directions: the corporate they are covering, sales staff, corporate finance staff and investor clients. The qualitative nature of much ESG data means that the risk of succumbing to outside influences and losing independence and objectivity is perhaps even greater.
II (A) MATERIAL NON-PUBLIC INFORMATION	As sustainability related information is becoming increasingly relevant and material for capital markets participants, the risks are increasing of it being MNPI. Whilst a change in a company's credit rating is recognised as MNPI, currently markets do not view a change in an ESG rating in the same way – but with many funds increasingly lined up to follow ESG indices and regulation progressing, this may not long continue to be the case.
V (A) DILIGENCE & REASONABLE BASIS	Much sustainability related information is currently vague, incomplete, disputed, or wrong. Analysts need to be careful to establish the veracity of the sources and the quality of any sustainability related data before they use it in their recommendations.

APPLICATION OF THE CFA INSTITUTE STANDARDS (9 cases)

Issue 1: Unfair treatment of ESG-interested clients and other clients

Example

Mikelsen, CFA is a sell-side research analyst at Mifidia brokers covering the consumer goods sector. Through her own research she discovers some local press articles about one of their coverage companies, Unscrupulous Plc, highlighting widespread human rights abuses in their supply chain, including slave labour and the trafficking of underage workers. The articles include a quote from the local regulator indicating that Unscrupulous Plc could be subject to a material

fine and is being investigated. Mikelsen proceeds to do more due diligence and discovers that initial paperwork has been filed by the local regulator on this matter, thus confirming to Mikelsen that this is not rumour or gossip. Mikelsen writes an update note on this discovery for clients with analysis around the possible size of a potential fine; she revises her ESG assessment of the company from AAA down to BB but leaves her investment recommendation as a Buy. Mikelsen has two distribution lists for clients, a general distribution list, and an ESG-focused distribution list for those clients with an interest in big picture ESG topics. Mikelsen decides to send the update note to only the ESG-focused distribution list since this is a big picture ESG topic and she has made no change to the investment recommendation, retaining this as a Buy.

CFA UK Comment

We believe that Mikelsen is in breach of CFA Institute's *Standard III(B) Fair Dealing*. Standard III(B) requires members and candidates to treat all clients fairly when disseminating investment recommendations or making material changes to prior investment recommendations or when taking investment action. We think that Mikelsen should disseminate this change in rating to the full distribution list, recognising that this discovery and the change in ESG rating could be of material importance to the general distribution list, irrespective of whether the non-ESG investment recommendation has changed.

Issue 2: Applying the mosaic theory to ESG analysis

Example

Simons, CFA is a sell-side research analyst in the energy industry analysing companies which have an advanced climate change strategy. He is intending to initiate recommendations on these stocks. He is meeting with the CEO of NorthStar Energy Co. Ltd., a fast-rising listed power generation company, which claims to be at the forefront of the sector's decarbonisation activities. The CEO admits to Sam that despite the company's bold general statements, decarbonising a small fraction of their operations may be more challenging than for some of its closest competitors. After the meeting, Simons conducts a detailed analysis and comparison with NorthStar Energy's sector peers and concludes that the measures to target net-zero so far announced by NorthStar Energy are less impressive than those of its major competitors. Therefore, Simons issues a report suggesting that the company will underperform the sector in reaching sustainability goals and disseminates the report to his clients.

CFA UK Comment

We believe that Simons arrived at his conclusions by piecing together both public and non-material non-public information that could affect NorthStar Energy Co. Ltd. Therefore, under the

mosaic theory, Sam has not violated CFA Institute's *Standard II(A) Material Non-Public Information* in disseminating his note. The statement comes from the CEO but is sufficiently vague (he uses the word "may"), lacks detail and pertains to "a small fraction" of their operations for it be considered material. Moreover, Simons could find sufficient detailed, specific information on NorthStar Energy and its peers in the public domain to substantiate this view.

Issue 3: Maintaining ESG research independence

Example

Doridoff, CFA is the Head of Research at a well-known investment bank. The bank's Technology team have been vocal supporters of a European manufacturer selling a technology seeking to reduce GHG emissions from shipping vessels. As a result of one of her team's onsite research visits, she starts to suspect that the company may be significantly overstating the GHG emission reductions achieved outside of laboratory conditions once the equipment is installed on ships, possibly to the extent that these ships might no longer comply with current emissions regulations. If true, this news would negatively impact the company, its reputation and its 1-3 year sales targets. When Doridoff calls the company's management for an update they remain extremely enthusiastic about their prospects. They are positive about the sales outlook and very dismissive of any suggestion that the product is ineffective in the real world and of any potential litigation. Digging deeper, Doridoff discovers a recent scientific research paper, throwing further doubt on the efficacy of the technology assessed in a real world setting. Doridoff reads these papers and decides to seek out expert advice. She next receives a call from the Head of Global Sales, who has a good relationship with one of the company's board directors, asking her how her team's research is coming along.

CFA UK Comment

We think that Doridoff needs to finish her research and her outreach to technical expert advice. Doridoff should also consult her company's policies and compliance before entering any in-depth talks with the Head of Global Sales. Such conversations may be a breach of internal information barriers around research and the Head of Global Sales would seem to have a potential conflict of interest. If Doridoff's research concludes that the company's claims are questionable, Doridoff should be prepared to ignore any pressure from the Head of Sales not to publish her conclusions.

Issue 4: Misrepresenting valuation of environmental technology

Example

Vorhol, CFA, is an equity analyst at Urban Capital (UC), an investment bank. Sitting on the sell-side of the bank, Vorhol specializes in nature-based solutions to address climate change and is updating his valuation of Iron Inc., a major steel manufacturer. Iron has recently announced a JV with Smart Trees Inc, with the purpose of planting trees to produce CO2 credits which Iron can then use to offset its Scope 1 emissions (i.e., emissions caused primarily in the steel manufacturing process). Smart Trees is a little known private company claiming groundbreaking tree planting technology, but with only a short-lived commercial track record. Public announcements show that the JV intends to invest $50million and will be established on a 50/50 equity basis by both partners, whereby Iron contributes all capital investment and Smart Trees its tree planting intellectual property. While discussing the case with his manager, Vorhol finds out that Smart Trees was recently founded by his manager's old friend. Smart Trees' tree-planting technology could be promising, but UC's IP lawyers have yet to complete their valuation assessment. The IP valuation is a requirement of the bank's procedures, but Vorhol's manager insists they should not wait for the lawyers to complete it and asks Vorhol to state in his report that the IP valuation was confirmed and Smart Trees' contribution to the JV done at fair market value. Concerned about possible repercussions from his manager, Vorhol issues a positive recommendation on Iron, stating that Smart Trees' IP contribution was made at fair market value, as supported by IP lawyers.

CFA UK Comment

We think that Vorhol is likely in violation of CFA Institute's Standard *I(C) Misrepresentation*, as he knowingly stated false information about the valuation of Smart Trees' tree planting technology, thus potentially manipulating a higher valuation for Iron. Vorhol's manager pressured his employee to state false information about the target's partner, thus also violating the same standard. Vorhol should have reported the situation to UC's compliance function and sought to disassociate himself from the valuation of Iron.

Issue 5: Mishandling material ESG non-public information

Example

Samuels, CFA is a sell-side analyst covering the water and wastewater sector. He has recently visited a sewage plant to discuss and assess the parallel production of a sustainable fertiliser. This fertiliser has been in the market for years, but it has been difficult to verify the veracity of its sustainability claims. In discussions with local environmental activists, they showed Samuels how they had been able to access meta data records proving the fertiliser had serious carcinogenic

components. They also told him that several local environmental associations were about to launch a class action lawsuit against the company that owns the waste treatment centre and produces the fertiliser. Samuels had suspected that the fertiliser had side effects but had unearthed no hard evidence to date. He concluded the meta data and threat of pending lawsuits were the final pieces in his research jigsaw and so he decides to quickly write up the issue and discuss the matter with his clients before the environmental groups launch their class action lawsuits.

CFA UK Comment

Although Samuels believes he can claim that the mosaic theory can cover him, we think that the information concerning lawsuits is MNPI, as the outcome may be substantial in terms of both money and reputation. Its materiality is linked to its role in making a previously presumed possible reputational risk and potential product liability case much more certain. The information is both non-public and material. As a result, we think Samuels will violate CFA Institute's *Standard II(A) Material Non-public Information* if he publishes his report or discusses this with his clients before the legal action is launched. We think he should instead prepare a research note and seek compliance clearance to launch the report and discuss it with his clients as soon as the information becomes public.

Issue 6: Failure to update client mandate for ESG preferences

Example

Ravi, CFA has family office clients for whom he manages discretionary portfolios based on long-standing founding family trust guidance. In recent years many of his clients have increasingly discussed their attitude to sustainable and responsible issues reflecting the changing attitude of the trust beneficiaries. He decides to reflect these discussions at review meetings in how he manages the portfolios even though the conversations have not been defined in a formal mandate change. He is confident that his clients will be happy with this and indeed at their quarterly meetings they are full of enthusiasm for the new direction.

CFA UK Comment

We think that Ravi should document and keep records of the client changes to their investment mandates to fulfil his responsibilities under CFA Institute's Standard *V(C) Record Retention*. Although he may be recording and documenting individual investment decisions within the portfolio he manages, he has not formally documented a change to the family office IPS. He needs to document the change in the governing mandate with the family office to ensure both that (i) the change is legal within the foundation or trust documentation and (ii) he can demonstrate that his clients have understood the change to the investment process and any material changes

to outcomes that may result from it. A clear agreement is required when a 'Sustainability' element is added to a client's mandate to ensure the client has understood and agreed the adjustment to their IPS.

Issue 7: Failure of ESG analyst to maintain independence and objectivity

Example

Johnson, CFA is an ESG Analyst covering energy and utility stocks within the sell-side research department of an investment bank. Johnson attends a meeting with Kyle, an ESG analyst at the market leading ESG ratings provider, Ecoratings, who is also an old friend from university. Kyle updates Johnson on a revised ratings methodology just announced by Ecoratings. The revised methodology rebalances the weightings of E,S & G factors within their scoring system, increasing the weighting of certain 'E' factors at the expense of some 'S' & 'G' factors. After the meeting and some further analysis and research, Johnson deduces that Ecoratings' new methodology will lead to several rating downgrades of stocks in his sectors. Johnson initially intends to publish a research note right away but then he learns that one of the bank's traders, Larson, CFA is heavily long of three stocks likely to be downgraded by Ecoratings; one of the companies is also a client of the corporate finance department and he sees no benefit in making himself unpopular with colleagues there. He decides not to publish the research note and continues with his existing buy-recommendations on the stocks until Larson, CFA sells down the long positions over the next few days.

CFA UK Comment

We think Kyle has not given Johnson material non-public information and Johnson has applied mosaic theory through further research and analysis to conclude likely future selloffs in several utility and energy stocks. However, by not changing his existing buy recommendations, because of the banks' long positions and corporate relationships, we think Johnson has breached CFA Institute's *Standard I(C) Misrepresentation.* By continuing with his existing buy- recommendations he has misrepresented his true opinion of several stocks he covers.

Issue 8: Cross selling ESG analysis without proper disclosure and compliance

Example

Tone, CFA, is working at Newvision Investment Advisory Ltd as a senior manager. He has recently received requests from several clients to add an ESG analysis section to their quarterly investment

review. Tone thinks this would be a great opportunity to cross-sell Newvision's new SaaS ESG ratings product for clients to monitor their ESG exposure and the ESG ratings of their portfolio holdings. Tone next arranges client meetings and runs through this new software. However, most clients say they only need the ESG report with their portfolio rating added to their quarterly report, i.e. only partial outputs from the new product. These clients say that they would pay additional compensation for this additional service if these ESG ratings could be added to the report. Since Tone is remunerated on a percentage of his fee generation this is an attractive enough outcome for him as he sees the clients would not pay for the full SaaS service. To allow other Newvision employees to promote this new ratings software in front of clients, any of them can access the platform to present and demonstrate the software to potential clients. Given the clients had asked for ESG analysis and agreed to paying for this additional service, Tone decides to personally add the product's ESG rating result directly to the relevant clients' investment quarterly reports, without informing his employer. Tone receives the additional fee income brought by the ESG section in the report but attributes it to his negotiating a higher fee rate based on his excellent service and client satisfaction.

CFA UK Comment

As the new software was developed by Tone whilst working at Newvision, Newvision is the owner of the new ratings product. As an employee, Tone owes loyalty to his employer, and we think he should not unilaterally make an unauthorised sale of a new service that the firm has not yet officially offered to its clients. We think that this is therefore likely a breach of CFA Institute's *Standard IV(A) Loyalty*. To avoid a breach of this standard, we think that Tone must work with Newvision to approve new products and services for Newvision clients.

Issue 9: Incomplete due diligence for green bond investments

Example

GreenEthica, a boutique investment firm specializing in ESG portfolios, recently recommended a corporate bond issued by GreenFlow Corporation to its clients. The bond was labelled as a "green bond" and certified by a third-party green rating agency. GreenEthica's investment committee based its recommendation on this certification without conducting additional due diligence on the proposed use of proceeds, underlying renewable energy project and the issuer's overall sustainability practices. Several months after the bond was included in ESG-focused portfolios, it was revealed that GreenFlow Corporation had ongoing environmental violations related to its core operations, which contributed to significant carbon emissions and deforestation. The area included the site where the renewable energy project was located. Despite the bond

funding a renewable energy project, the impact of the core operations and broader environmental concerns were not considered.

CFA UK Comment

Standard V(A) of the CFA Institute Code of Ethics and Standards of Professional Conduct requires members and candidates to exercise diligence, independence, and thoroughness in analysing investments, making recommendations, and taking investment actions. GreenEthica relied solely on a green bond certification from a third-party agency without conducting its own assessment of the proposed project and the environmental practices of GreenFlow Corporation and therefore failed to form a reasonable basis for its recommendation, especially as the issuer was involved in harmful environmental activities that directly contradicted the ESG focus of the firm's clients. GreenEthica should implement an independent analysis process to align the firm's practices with both Standard V(A) and Standard III(A), ensuring that the investments recommended meet the sustainability expectations of their clients.

In 2019, a study of over 70 green bonds found that about 15% of them failed to meet basic ESG criteria, despite being marketed as green bonds. While the voluntary EU standard for green bonds (considered the global benchmark) allows for third-party certification, the EU has also added a requirement to show how green bond investments feed into the transition plans of the company as a whole and for the company to be engaging in a general green transition.

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PORTFOLIO AND FUND MANAGER ROLES

CFA Society United Kingdom

PORTFOLIO AND FUND MANAGER ROLES

ESG and sustainable investment have moved into the centre stage of the investment world. Portfolio Managers must consider the sustainability objectives of each portfolio they run and the degree to which ESG issues influence its construction and performance. These need to be accurately described in their fund literature and investor communications. Portfolio managers also need to ensure that the introduction of sustainability objectives does not inappropriately conflict with each of their funds' other objectives.

Sustainability Context:

New sustainability regulations are providing greater definition to many, if not all, sustainability terms. In describing the objectives and performance of their investments, portfolio managers now need to ensure they use these terms in fund literature and client communications in a way that complies with new regulation such as UK's SDR and EU's SFDR. Where a portfolio is run without sustainability objectives this needs to be made clear.

To complicate the task of complying with regulatory disclosures, the requirements are likely to be different in each market and portfolio managers selling their funds into multiple markets need to know the differences.

For dedicated single client portfolios, managers need to ensure that the fund is run in accordance with the client's declared sustainability objectives in the investment policy statement. Where it is run to an ESG benchmark, this benchmark requires careful selection.

Where sustainability factors are being introduced to a portfolio for the first time, fund managers should consider if the funds' other pre-existing objectives have been compromised or enhanced by the changes and ensure this is explained to clients and reflected in fund literature along with any change of benchmark.

Fund managers need to consider the integrity of their ESG data and ratings sources, especially if they come from 3rd party providers. Much ESG data is qualitative, partial, and sometimes under dispute, so independent assurance of data providers should be sought.

Fund managers have always had to consider conflicts of interest in managing their portfolios. Running sustainable investment portfolios introduces additional potential sources of conflicts of interest, such as affiliation or membership with environmental or social lobby groups, which in turn may need appropriate disclosure and management.

There are a growing number of sustainability related corporate actions and portfolio managers should ensure that securities they hold are voted in a way that reflects their client's mandate.

Key CFA Institute standards relevant to portfolio & fund manager roles:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I (C) MISREPRESENTATION	Portfolio managers have been under growing pressure to make their existing funds appear more sustainable or to launch new funds which meet the sustainability targets of their clients. Previously sustainability has not been well defined and in cases it has been possible for portfolio managers to overstate their funds' sustainability credentials. Evolving regulations are providing more definition and now portfolio managers need to exercise care to ensure there is no misrepresentation.
III (A) LOYALTY, PRUDENCE & CARE III (C) SUITABILITY	Portfolio managers need to remain true to the agreed fund mandate and the sustainability and any other objectives of the client. Client representatives and intermediaries may through personal bias seek to either over- or under-play the importance of sustainability in the construction of the portfolio.
VI (A) AVOID OR DISCLOSE CONFLICTS	Adding sustainability as an investment objective may sometimes conflict with or require compromise with traditional factors. Equally a growing number of corporate actions involve sustainability issues, and these issues may conflict with other objectives of the fund. Finally, portfolio managers with strong personal sustainability convictions and outside interests need to ensure that these are disclosed appropriately and do not bias their professional judgement in performing their role.
I(A) KNOWLEDGE OF THE LAW	When funds are marketed in more than one jurisdiction, and they need to comply with the requirements of each jurisdiction. The introduction of sustainability as an objective or strategy for a fund further complicates this as sustainability regulations e.g. around disclosure, fund content, and fund labelling are still evolving in many areas and are not harmonised.

APPLICATION OF THE CFA INSTITUTE STANDARDS (11 cases)

Issue 1: Failure to adequately explain choice of a fund's index

Example

Dell, CFA is a fund manager constructing and marketing ESG funds. She is currently preparing a new fund that will focus on cross-cutting innovative technologies that can address climate change risks and opportunities. When she comes to pick the relevant fund benchmarks for reporting purposes, she decides on a mix of generic tech and environmental indices that she thinks can reflect the nature of the new fund. However, she is unable to provide adequate reasons for her selection in the marketing documentation, given that the benchmark selection is particularly challenging. The complexity and uniqueness of the companies and technologies of the new fund and the limited universe of companies in the green and sustainable sectors makes it difficult to appropriately combine them together under a single approach and methodology.

CFA UK Comment

Dell is probably in violation of CFA Institute's *Standard I(C) Suitability* as she failed to properly disclose the methodology behind the benchmark selection when reporting performance of the new fund. The new fund is targeting unique new opportunities which are difficult to reflect with an appropriate benchmark. Even though Dell considered these challenges in constructing the new fund, she should have disclosed this in the marketing documentation in a transparent way. Dell could refer to the GIPS disclosure guidance for the use of a custom benchmark or combination of multiple benchmarks: disclose the benchmark components, weights, and rebalancing process, if applicable; disclose the calculation methodology; and clearly label the benchmark to indicate that it is a custom benchmark.

Issue 2: Not ensuring fund sustainability investments remain suitable

Example

Lilly, CFA is the manager of ABC fund, an ESG-focused fund which currently invests in DEF, a company investing in energy efficient buildings overseas. DEF satisfies the requirements of a local 'best practice' code allowing it to be independently certified as providing positive environmental impact. However, a scientific study from a leading academic in the field finds that one of the innovative building materials that DEF has widely used has side effects which, if true, would negate DEF's positive environmental impact. After researching the matter, an independent assessor withdraws its sustainability certification of DEF. Yet the buildings continue to generate

reliable revenues at an attractive growth rate ahead of inflation. Lilly decides that ABC will retain its investment in DEF because the requirements of the local 'best practice' code are not mandatory in the countries where DEF operates or in ABC's own jurisdiction. Lilly also notes the lack of scientific consensus as to the sustainability of the specific building materials widely used by DEF. Lilly rationalises that if DEF's assets were located within ABC's own jurisdiction, then the independent assessor would have retained its positive impact certification.

CFA UK Comment

While the overseas code's requirements are not mandatory under local law, we believe the withdrawal of the certification means that Lilly must give careful consideration to divesting the holding in DEF. If the certificate is required under the terms of the fund mandate, then the DEF holding must be sold. Any justification to retain the DEF holding either based on the lack of scientific consensus, or the fact ABC's own jurisdiction may have retained the certificate, should be carefully scrutinised to ensure it is not being used as an excuse to reach a desirable conclusion. If Lilly continues to keep the asset in the fund, there should be suitable disclosure, ongoing monitoring of the situation and an explanation as to why Lilly has reached the decision that the asset remains in compliance with their mandate. A failure to do this may result in a breach by Lilly of CFA Institute's Standard *I(A) Knowledge of the Law.*

Issue 3: Misrepresentation of overall fund performance by omission

Example

Christie, CFA is writing an ESG report for the fund he runs and trying to demonstrate how the fund has had a positive sustainable impact. However, he has only a couple of favourable case studies from his analysts and supplements them with publicly available academic literature supporting the theme of "achieving positive impact by doing the right thing". The favourable case studies focus on examples of environmental impact reduction for a couple of industrial companies that have also been very good financial investments in the reporting period. He gives a high profile to the impact outcomes for the case studies and links this to their strong investment performance. He cuts and pastes some summary conclusions from academic studies linking financial and economic returns to good environmental practice.

CFA UK Comment

We think that Christie would likely be in breach of CFA Institute's Standard *I(C) Misrepresentation* as he misrepresents the source of the fund's strong performance by over-emphasising the case studies and linking the performance of those featured investments directly to ESG impact and omitting discussion of other reasons for it. As this is an ESG report, Christie should acknowledge

the small number of case studies with narrow focus on the area of environment and the report should contain balanced comment across the spectrum of issues it embraces. Narrative about E, S and G issues should be included, and standout case studies placed in perspective of the overall ESG analysis. When he is using excerpts from academic work to support the performance benefits of the fund he should firstly reference and acknowledge the sources to avoid plagiarism and secondly be careful to ensure the general finding is substantively true when applied to the fund's investments. Christie should avoid the temptation to simplify and highlight specific areas of success by assuming coincidence of facts is a causal relationship when it may not be.

Issue 4: Greenwashing of fund's environmental credentials

Example

Derwent, CFA is trying to demonstrate that his mediocre fund, which lacks any systematic ESG and sustainability factor analysis in its investment process, is an above average performing ESG fund in its impact. He reasons that the area of metrics and measurement methods is currently flexible and there is no clear consensus in calculating outcomes. He sets out to find the most positive bit of data to support each of the twenty ESG performance criteria his fund is assessed on. By cherry picking from Scope 1,2 or 3 climate impact facts and using different E, S and G scores from a mix of suppliers Derwent can show above average outcomes across the whole scorecard. He knows that he could have equally shown poor outcomes by selecting data differently.

CFA UK Comment

Rather than acknowledging the complexity of his assessment and his fund's mediocre performance, Derwent has avoided applying a consistent, objective, and unbiased methodology and knowingly sought to misrepresent performance. Derwent's breach of CFA institutes *Standard I(C) Misrepresentation* (and SDR regulation) is demonstrated by Derwent's deliberate actions to cherry pick positive and exclude negative data to show his fund is making a positive impact.

Issue 5: Misrepresenting the potential future performance of a new ESG fund

Example

Tarrant, CFA is developing an ESG-integrated version of an existing European equities fund and building on the success of the existing fund. He gathers historic data firstly showing the traditional fund's historic benchmark outperformance and secondly that in recent years ESG screened European indices have outperformed traditional European indices. He publishes a report using this as evidence that investors can expect a stronger performance from the new ESG integrated

fund compared to both the existing fund and traditional European equities indices.

CFA UK Comment

We think that Tarrant's approach fails to comply with the requirements of CFA Institute's *Standard I(C) Misrepresentation* and does not comply with GIPS. It misrepresents likely future performance, on two counts:

- First, the integration of ESG as a stock selection tool changes the investment process. This change, and its potential consequences, need to be mentioned in his report. The new investment process will materially differ from that of the historic product and lead to different investment decisions. It is therefore a misrepresentation to use the track record of the old fund as an indicator of the new fund's performance.
- Second, due to the screening process, the ESG indices he is using have a high active deviation from the traditional benchmarks and it should not be assumed that historic outperformance of the ESG indices will consistently prevail in the future given the significantly different sector weightings and stock selections.

Issue 6: Not adhering to the investment process when 'E' and 'S' scores are in conflict

Example

Jane, CFA works at a large passive equity fund manager. One of the funds she helps manage tracks an in-house index based on the universe of S&P500 companies after screening out those companies which fail to either (i) achieve an ESG score of at least '7' from one provider of ESG ratings which their firm subscribes to or (ii) appear on a 'watch list' from a second ESG agency. Jane is responsible for preparing the compilation of the index and focuses on one particular company which manufactures and installs solar panels. Despite the obvious environmental benefits of its core activities, Jane notes the first agency only gives it a score of '6', marking it down heavily for Social factors due to industrial relations issues and poor health and safety related workforce practices in some of overseas component manufacturers in its supply chain. The second agency does not have the company on its watch list, and it gives detailed commentary about the 'Social' issues, highlights how the company is working to resolve the problems with its employees and explains why this merits the company not being on its watch list. Jane wonders whether the first agency is wrong and concludes that the company should be kept in the index.

CFA UK Comment

In our view, Jane has likely violated CFA Institute's Standard V(A) Diligence & Reasonable Basis. While ESG ratings can contain an element of subjectivity, the fund's rules around index

inclusion are clear and Jane does not have a reasonable basis to override the first ESG agency's score of '6', even if the second agency's reasons are valid and in short time the '6' is likely to be upgraded due to management remediation of the industrial relations and health and safety concerns at the company.

Issue 7: Misleading performance reporting following a change in fund strategy

Example

Otter, CFA, works for Crayfish Asset Management as a fund manager on a mainstream fund with an excellent track record of performance versus its benchmark. This mainstream investment fund has always permitted fossil fuel investments. However, with a notable change in client demand and expectations the firm is considering transitioning the fund to a sustainable fund by removing the fossil-fuel investments from the next year-end. Otter, CFA, instructs the marketing department to update the historic performance charts of the fund to demonstrate how the ex-fossil fuel NAV of the fund would have performed historically against the fund's new fossil-free benchmark. None of the labelling on the presentation is changed as they feel this performance track record is now representative of the fund being marketed.

CFA UK Comment

We think that Otter, CFA is in breach of CFA Institute's *Standard III(D) Performance Reporting* and GIPS. As presented, the performance track record does not represent the actual achieved performance of the fund historically, but it is presented as such; nor is the date of the change specified in the disclosures. If the fund manager wishes to illustrate how the ex-fossil fuel NAV would have performed historically against a relevant fossil-free benchmark, this should be presented as the results of a simulation with comments and disclaimers to highlight that this does not represent the performance of a real fund, or indeed the fund being marketed. The fund's actual performance over the entire period (before and after the change) can be chain linked, as also the relevant benchmarks.

Issue 8: Superficial sustainability assessment of investments

Example

Jahred, CFA is a senior portfolio analyst at Sustainable Advisors & Funds Management, an asset management firm focused on providing sustainable and impact investments for both professional and retail clients. Jahred has recently designed a new fund, domiciled in the UK, to focus on investments in shares of some of the largest renewable energy companies in emerging markets.

He intends to assign this fund a "Sustainable Focus" label under the UK's Sustainability Disclosure Requirements (SDR), as he expects a minimum of 70% of assets to be invested in renewable energy company shares. He develops a process for screening and choosing the selected universe of renewable energy companies, including financial, technological, macroeconomic, and governance factors. The selection process does not include an assessment of how such companies are mitigating environmental and social risks, as Jahred believes that given that such companies are "pure renewable energy players", and that the fund will be compliant with a "Sustainable Focus" label.

CFA UK Comment

While investing in renewable energy companies is often considered sustainable by many investors, this is only the case if supported by a proper assessment of environmental and social risks and their mitigation. Even though Jahred performed some screening, he omitted a detailed review of environmental and social risks and is therefore likely in breach of CFA Institute *Standard V(A) Diligence and Reasonable Basis.* There is also no indication of how the investments will be reviewed on an ongoing basis during the lifetime of the fund. From a regulatory perspective, UK's SDR (and major current sustainable finance taxonomies around the world) expect a robust and evidence-based analysis of the sustainability characteristics and risks of investments held within the required minimum allocation to such investments, and therefore the fund risks being rejected for approval by the regulator. In addition, the labelling and positioning of the fund could be misleading for investors, given Jahred's approach of relying on "pure renewable energy players", with only a high-level assessment and disclosure, and is likely to be in breach of *Standard V(B) on Communication with Clients and Prospective Clients.*

Issue 9: Failure to manage portfolio investments in line with the fund mandate

Example

Wong, CFA manages a fund focusing on impact investing. A few months ago, Wong invested in the shares of Atlas Waste, a foreign waste management company. Since it was bought, Atlas Waste has been a high performing asset in the fund and at the time of the initial investment it was in compliance with all relevant environmental regulations. These regulations have since been recently updated; however, they do not immediately apply to businesses that are already operational and the investment in Atlas Waste could therefore be considered 'grandfathered' for a few years.

CFA UK Comment

Atlas Waste is a high performing asset generating strong returns; however, it is no longer in full compliance with new environmental regulations. In this case, it is not yet non-compliant, because of the 'grandfathering' provisions in the regulations. Given the impact orientation of the fund, however, this is something that should be disclosed. Furthermore, there is an argument for removing it from the portfolio, depending on the precise description of the mandate and Wong will need to ensure that Atlas Waste is a suitable investment for the fund and document this. If the investment in Atlas Waste is retained but not compliant with the fund mandate, we believe Wong will be in breach of CFA Institute's *Standard III(C) Suitability.*

Issue 10: Loyalty to the client applied selectively

Example

Landau, CFA is a discretionary portfolio manager at ABC Asset Management. A client has asked to invest in a sustainability focused portfolio and so he selects a fund themed on climate change and environmental protection. ABC provide an annual sustainability report for clients that covers its range of model sustainable development portfolios. Landau is aware that this client's portfolio contains shares in a European battery manufacturing company which has been reported in the media as having sourced materials from mines in a frontier market country using child labour. His firm is still in the process of investigating the matter, however, and talking to the company before taking any divestment action. The sustainability report on the fund is annual and although the firm does not plan to make any comment publicly either until the annual report is due or when a final divestment decision is taken, Landau decides to call his client to appraise him of the issue. His loyalty to his client leads him to ask the client whether he remains happy with his current portfolio or wishes to switch out to another sustainable development fund not invested in the shares of the European battery maker.

CFA UK Comment

Landau is probably acting in accordance with CFA Institute's *Standard III(A) Loyalty, Prudence & Care* in informing his client of an issue that he reasonably assumes is a potential concern for his client, based on the client's declared focus on sustainable development goals. *Standard III(A) Loyalty, Prudence & Care* calls for the placing of client loyalty and care in meeting the client's wishes above any duty to other stakeholders. Landau should, however, ask his client for confidentiality and discretion around the discussion, even though the reports of the use of child labour are well documented in the press. Landau should also seek to ensure that he has the same conversation with all his other clients in the same position. All ABC clients with the same investment mandates should be treated fairly and be made aware of the issue.

Issue 11: Insufficient stewardship challenge of sustainability claims

Example

Maria, CFA, is an ESG analyst for a boutique asset management firm specializing in socially responsible investments. Recently she has been tasked with engaging and influencing a fast-fashion clothing chain, SwiftStyle, which has made public pledges to improve its environmental impact - publicly committed to using sustainable materials and reducing emissions intensity by 2025, and also announced a $200m investment in waste reduction initiatives in response to criticism of its environmental practices. Maria however becomes aware of a class-action lawsuit that alleges SwiftStyle's emissions have doubled since 2020, and raises questions about the authenticity of their claims. Maria meets with her contact at SwiftStyle, who explains that the lawsuit is without merit and talks Maria through a corporate presentation about SwiftStyle's sustainability goals and initiatives. Maria is satisfied with the meeting and commends the company on its strategy and vision. However, subsequently Maria does not receive the promised information on how the proposed investment will translate into measurable reductions in environmental impact, nor the data on emissions since 2020 that could contest the lawsuit.

CFA UK Comment

Maria should ensure that the data used to make investment recommendations is accurate and reliable as per Standard V(A): Diligence and Reasonable Basis. Her stewardship role requires her to try and engage the company to amend its practices, rather than simply exit the investment due to its unproven ESG claims. However, with SwiftStyle's alleged emissions increase, she should challenge the company's sustainability claims and require robust evidence and meaningful action. If she comes to the conclusion that SwiftStyle is merely engaged in a public relations strategy, Maria should escalate her concerns, for example requesting a meeting with an authorises or senior company official. Maria should advocate against prioritizing public perception over substantive action, and raise potential concerns under Standard I(D): Misconduct. In keeping with her stewardship duties and to uphold the CFA Institute's ethical standards, Maria must a) Request additional data to verify the claims, b) Advocate for greater ESG disclosure and accountability and c) Present a balanced assessment to her clients, including whether the companies' actions could pose broader reputational or financial risks.

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Whether wealth advisers have discretion over their private clients' investments or not, they need to be aware of, and document, their clients' sustainability related preferences as well as the relative importance of sustainability within the hierarchy of their investment goals. Only when this has been completed can a wealth adviser ensure that their advice, recommendations, and investment decisions comply with their clients' full wishes.

Sustainability Context:

Sustainability has added a new dimension to the roles of private wealth advisers and their relationships with clients. Advisers need to be aware of their clients' sustainability related preferences, to document them in their IPS and keep them updated.

Once documented, sustainability considerations then also need to be factored into investment advice, recommendations, and decisions. Advisers will have clients with a range of sustainability preferences, with those having none, those having some (perhaps governance and environmental but not social) through to those embracing all. Advisors will need to adapt their advice, recommendations, and investment decisions to the differing ESG goals of their clients.

The qualitative, disputed and sometimes inaccurate nature of sustainability data makes this new requirement particularly challenging. Private wealth advisors are typically not experts on all ESG matters, so they need to have specialist and expert opinion available that they can trust, either in-house or provided external to their firm. If done well, it can become an important way for an adviser to differentiate their firm favourably from competing firms.

Key CFA Institute standards relevant to private wealth managers/advisers:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I (C) MISREPRESENTATION	Wealth advisors should exercise great care in recommending investments to clients based on their sustainability credentials in cases where such credentials may be disputed or uncertain.
Iii (B) FAIR DEALING	Where aggregate client demand for a sustainable investment exceeds a firm's allocation, it may be acceptable to favour those clients that have expressed a sustainable preference over those who have not and allocate accordingly.
Iii (C) SUITABILITY	As Sustainability increasingly becomes a key consideration for clients in their investment decisions, private wealth managers should take time and care to discuss their clients' attitudes to ESG risks and issues and document them in their IPS. They should ensure that a client's investments mirror and balance each of the client's various investment goals. The pursuit of Sustainability goals should not put other financial goals at undue risk, particularly where clients' preferences or circumstances place greater importance on the latter.

APPLICATION OF THE CFA INSTITUTE STANDARDS (9 cases)

Issue 1: Misrepresenting past performance

Example

Garg, CFA is an investment advisor with Tukan Investment Managers. Her client is asking to recommend appropriate investment targets in the clean energy infrastructure fund sector. Garg identifies Solar Infrastructure Fund I, a first time fund raised by Helios Capital Partners. Having spoken with the firm's management, Garg learned that the PE firm was recently established by several partners, who have worked for over 20 years in renewable finance with major investment banks and developers. Garg recommends that her clients invest in Solar Infrastructure Fund I, omitting to mention it is the firm's first fund, but instead stating that the funds' general partners

have over 20 years of investment experience in the renewables sector.

CFA UK Comment

We think that Garg, CFA has failed to give complete, full, and accurate information in her investment recommendation clients. The GP's experience comes from their time spent with prior employers. In their capacity as a newly established PE firm, they may lack the prior employer's infrastructure process and other research and human resources that is likely to have been the firm's and not the individual's. Hence, we think that Garg is probably in breach of CFA Institute's *Standard I(C) - Misrepresentation* as she has failed to make a full and proper disclosure of the general partners' previous employment.

Issue 2: Exaggeration of sustainability claims

Example

Blue, CFA is an Investment Counsellor at a UK Wealth manager. She is under pressure from her manager to promote a solution that consists of an ESG-orientated portfolio of publicly listed global equities. The equities in question have been chosen because they derive at least 25% of their revenue from economic activities widely considered to constitute an environmental or social good. Her division head says she should include in any marketing materials language like, "this solution will help solve many of the global issues we face and will generate lots of positive impact". Blue thinks this statement is incorrect, due to the difficulties of measuring and attributing any impact to the portfolio, and that clients could easily be misled by this.

CFA UK Comment

Blue, CFA should faithfully market the solution as she perceives it, otherwise we think that she will breach CFA Institute's Standard I(C) Misrepresentation. She should not promote sustainability claims which she does not believe to be genuine just because her divisional head has said she should or because it may result in her accounts increasing their investments. Focusing on client education and explaining the concept of impact and what can be achieved with an investment portfolio is key. Blue should also raise her concerns with her manager and local risk team.

Issue 3: Not staying true to the objectives in a family account IPS

Example

A family office contracted to run a family trust is mandated to manage a portfolio to provide a steady income to c.100 individual family members. The lead trustee, and family scion, wants to compensate 'Society' for the environmental damage caused by the original family chemicals

business and so is determined for the family trust to pursue investments in R&D-led companies involved in "clean tech" and nature-based solutions. He constantly pressurises his managers to invest in new technologies and early-stage, high-growth companies with green solutions. This is at odds with the trust mandate that places primacy on generating a minimum level of income for the family diaspora. The trust's Investment Director, Bruce, CFA nevertheless steadily increases his investment in these pre-cash generating companies forcing him in turn to steadily sell more positions in mature, dividend-generating shares and bonds.

CFA UK Comment

We think that Bruce is likely in contravention of CFA Institute's *Standard III(A): Loyalty, Prudence & Care*. Bruce is treating the family scion as the sole client and ignoring firstly that the family trust is his true client and secondly the trust's mandate and purpose. His loyalty should be to the trust beneficiaries as a group and not to one individual beneficiary; his duty of prudence and care means that he needs to observe the requirements of the mandate i.e. ensuring the reliability of the portfolio income. Bruce should suggest that all beneficiaries are consulted, and the trust mandate is updated formally and to provide clear guidance on the importance of ESG factors.

Issue 4: Fair allocation between ESG clients and non-ESG clients

Example

Purple, CFA works as an investment advisor for a national wealth manager. He manages discretionary, single line multi-asset portfolios for several clients. Some of these clients have expressed no interest in ESG/Sustainability and are invested in his "standard" portfolio, whereas others who have expressed interest in owning ESG funds are invested in his "dedicated sustainable" portfolio. Both portfolios have the objective of maximising returns, while the "dedicated sustainable" has additional constraints around only investing in companies deemed sustainable by a firm wide policy. Purple becomes aware of a new bond issue from a fast-growing renewable energy company, which he wants to allocate to all portfolios, as he believes it is a risk/return maximising trade and meets all the sustainability requirements as well. The new issue is oversubscribed, however, and the block he has been allocated is insufficient to initiate a position size above the minimum lot size for all portfolios, as stipulated by the firm's policy. He believes that the clients in his "dedicated sustainable" would gain more utility from this trade, given their expressed interest in sustainability, so he only allocates to these portfolios, thereby also allowing him to initiate these portfolios with a meaningful position in the new issue.

CFA UK Comment

We think that Purple is in compliance with CFA Institute's *Standard III(B) Fair Dealing*. An allocation to all clients cannot be done because the firm's total allocation is insufficient to give

everyone the minimum lot size. Therefore, it is reasonable to allocate the investment to clients to whom it is more suitable given their sustainability goals rather than forego the investment opportunity for all the firm's clients. However, Purple should also escalate the need for the firm to have a formal policy for allocation at which details allowable discretion.

Issue 5: ESG driven investment contradicting client's Investment Policy Statement

Example

Janith, CFA is a private wealth manager for Windmill Investments, a UK private wealth fund manager building a reputation for expertise in green investment. Its fund range is dominated by ESG, best-in-class and impact funds but includes a handful of traditional, non-sustainable funds as well. Like Windmill's other wealth advisors, Janith receives commissions based on AuM sold and the commissions are higher, the greener the product. The impact funds pay the highest commission. Brown, 72, is one of Janith's clients and they have an agreed Investment Policy Statement (IPS) in place which records that Brown's prime investment goal is income given his age, capital sufficiency and low risk appetite. Despite this Janith seeks to include an impact fund in Brown's portfolio. This fund produces no income and contains equity investments in early-stage clean-tech and green-tech companies. It is scored as 'high risk' but has a strong track record with compound growth averaging over 20% over the last 5 years. Janith argues that the fund offers diversification from Brown's other investments, that his other investments already produce sufficient income for Brown's needs and that this 5% allocation is acceptable.

CFA UK Comment

We think that Janith has most likely not breached CFA Institute's *Standard III(C) Suitability* as the impact fund does not materially compromise the sufficiency of income that Brown's overall portfolio produces given the low percentage allocation, and Janith believes it may offer diversification benefits. However, Janith will need to explain to Brown her rationale for including the impact fund investment within his overall portfolio and keep it under periodic review in case Brown's income needs change or the income from the remainder of the portfolio drops for any reason. Failure to do so would likely be a breach of *Standard III(A) loyalty, prudence, and care.* Also, to comply with Standard VI(A) Janith should also disclose her firm's commission scales for the different products.

Issue 6: Addressing Unsolicited Trading Requests & Sustainability in the IPS

Example

Sanders, CFA is a private wealth manager managing ESG and impact portfolios for clients. One of her clients, Jersey, is currently invested in an active investment strategy targeting 'Sustainable Stocks" and has a dedicated Investment Policy Statement ("IPS") in place. The definition of what constitutes a "Sustainable Stock" is in line with Sanders' firm's policy. Jersey asked Sanders to include a new stock in the portfolio, a fast-growing producer of battery components for EVs that was recently listed on the stock exchange and is currently a very popular share. Even though the stock meets most of the parameters of Jersey's IPS, Sanders is concerned that the stock does not qualify as "Sustainable" as per the strict IPS' definition. Press reports have cited concerns around environmental damage from the battery components produced, which, in turn has been denied by the company. If the concerns are confirmed, the company would not meet the conditions around Sustainability set out in the IPS.

CFA UK Comment

Before accepting the trade, we think that Sanders must have a conversation with Jersey about the Sustainability criteria in the IPS. Although the client may consider the new stock sustainable, the client's view on what constitutes a sustainable stock may differ from what is currently in the IPS. In this instance, the IPS can be revised to reflect this new understanding, or the client can direct Sanders to purchase the stock outside of the IPS mandates. If she traded on the stock without doing this, she runs the risk of violating CFA Institute's *Standard III(C): Suitability*.

Issue 7: Identifying suitable investments to satisfy a client's sustainability investment objectives

Example

Orange, CFA is a private wealth manager for high net worth clients at a private bank. He meets with a prospective client who is particularly interested in sustainability issues and wants his investment portfolio to reflect this. The prospective client does not have a particularly good knowledge or understanding of investments and is mostly focused on his personal views around issues like climate change rather than what can be achieved with an investment portfolio. In the jurisdictions in which Orange operates, there are no regulations around sustainable investing. Orange therefore constructs a portfolio of global equities that he claims is sustainable and meets the client's needs because he has only chosen equities with top quartile "ESG Ratings" provided by a leading third-party provider of ESG ratings whose services his bank subscribes to.

CFA UK Comment

Orange should ensure that the prospect fully understands the sustainability characteristics of the investment solution in question. If he does not do this, we think that he will likely breach CFA Institute's *Standard III(C): Suitability* as it is evident that the sustainability characteristics of any investments are important to the client prospect. Using the CFA Institute's definition of sustainable investing as a guide, "a course of action 'which minimizes natural and social resource depletion", he should describe the investment selection process and explain how the solution he is proposing reflects the prospects' views on sustainability. If Orange's firm has a more developed or codified view of what constitutes a sustainable investment, then rather than relying just on external ratings, he should follow this instead.

Issue 8: Failure to thoroughly research and understand emerging technologies

Example

Godwin, CFA is preparing a research note for his HNW advisory clients covering the subject of ESG and sustainable investment options. He wants to produce a single newsletter and show his clients the fund options he can offer them. He is, however, struggling with the diversity of material that the funds have supplied him and what seem at times to be conflicting recommendations from the different fund managers. Godwin feels that to include all their information might result simply in confusion and much lower product interest. Godwin therefore decides to simply list the funds along with the fund self-ratings and labels provided by the fund managers. He is pleased with how it looks although he knows that each fund's underlying definition of ESG is very often different from others. He does not want to complicate the report, so leaves it to the reader to dig deeper if it occurs to them to do so.

CFA UK Comment

We think that Godwin is likely in breach of CFA Institute's *Standard V(A) Diligence & Reasonable Basis*. He has himself not dug deeper to allow his advice to be based on an adequate understanding of the issues and the processes underlying the products he is selling. He needs to properly advise his clients so they can understand the different products and how, despite seemingly similar labelling, the outcomes of the products may differ significantly both in reality and in intent, rather than just list the fund ratings that the funds have provided him with. Consequently, we think that Godwin is also likely in breach of CFA Institute's *Standard V(B) Communications* with clients and potential clients.

Issue 9: Failure to disclose variable commissions to clients

Example

Joyce is a Director at Brice Willis Wealth Managers ("BWWM") where she has worked for several years managing the discretionary portfolios for HNW clients. Her client portfolio has seen a reasonable amount of turnover - there have been a few high-profile departures over the years to rival firms - but she picks up a lot of new clients through central referral because of her successful track record of new product sales which often earn her higher commissions than traditional products. BWWM have launched a new range of sustainability portfolios and the firm's top management have put a lot of emphasis on the strategic importance of this initiative succeeding. To support this, they have put in place commission arrangements which pay their wealth managers, such as Joyce, a higher commission on sales of investments into the new sustainable fund range than on the firm's traditional fund investments even though the fees paid by the clients are the same. Joyce decides to capitalise on this, so at the start of each annual client review meeting she systematically talks about the impact of climate change on her daily life and then switches to high profile ESG situations where companies have got into difficulties. When reviewing the clients' IPS she expresses strong personal views about the risks to the world from climate change and about how it is everyone's responsibility to promote green technologies and withdraw support from polluting activities. By doing this she subtly seeks to persuade clients to add sustainability goals to their investment strategies which then enables her to make the portfolio switches. She makes no disclosure of the higher commissions that she will earn from the sustainability fund range products.

CFA UK Comment

BWWM's internal commission structures seem to have created a conflict of interest for their employees. However, by not properly disclosing the fee arrangements Joyce is encouraging her clients to make a change to their IPS without knowing the full implications of it - i.e. the commission increases to Joyce. Through her failure to disclose the conflict of interest to her clients, we think that Joyce will have breached CFA Institute's *Standard VI(A) Conflicts of Interest.*

CFA SOCIETY UNITED KINGDOM

WE GROW TALENT

SPECIALIST ESG ROLES

SPECIALIST ESG ROLES

ESG analysts perform an important role in the investment process across many asset classes ranging from public equities and corporate bonds to private credit and infrastructure assets. In their key function of researching and interpreting ESG data they encounter many ethical issues.

Sustainability Context:

In many respects the role of an ESG analyst is similar to that of a traditional financial analyst. They provide an opinion, which is the outcome of an investment decision making process and arrive at this through data analysis.

The nature of the data which ESG analysts use, however, and the framework which they may use to analyse it, is different from that used in traditional financial analysis. Whilst equity and credit analysts alike must use subjective judgements when evaluating the investment prospects of a given corporate security there is typically a common understanding of what information the analyst requires and how it will be used. With ESG ratings, both facts are not necessarily true. Information may not be fully available and currently providers of ESG ratings use a wide range of different frameworks which may produce contradictory conclusions.

ESG analysts work at a variety of organisations with different functions. They may work for a firm providing public ESG ratings; they may work at an investor providing such ratings internally; they may be hired by a corporate to provide an assessment of the company or they may be paid directly or indirectly by investors. It is important to understand the commercial and political influences that might be at play on an ESG rating and/or data, whether it comes with or without a grading.

ESG standards and regulations are evolving rapidly, covering reporting and disclosures of climate-related financial risk, ESG data and ratings, investment labels and carbon markets. The US SEC 'Name Rule', requiring that 80% of a fund's portfolio matches the asset advertised by its name, was adopted 20 Sept 2023. The EU Greenwashing Directive was endorsed by the EU Parliament on 17 Jan 2024. The UK anti-greenwashing rule was effective on 31 May 2024. Currently, ESG ratings are unregulated in most jurisdictions, unlike credit ratings which are regulated in many countries. Ethical standards are therefore currently the only barrier to poor practice. Regulation is however not far away; IOSCO has set down four principles to guide all ESG ratings and data service providers, regulation is expected to be introduced in the EU, and in the UK the Treasury has confirmed its desire for the FCA to regulate ratings providers, following the voluntary code of conduct introduced by the FCA earlier.

Key CFA Institute standards relevant to specialist ESG roles:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I(B) INDEPENDENCE & OBJECTIVITY	The ESG analyst's role is typically to provide an opinion – one that may be pivotal - in an investment process. They may therefore come under pressure to change the integrity that opinion in a variety of ways from different stakeholders and interested sources.
I(C) MISREPRESENTATION	Making judgements on ESG matters is currently much more subjective than making judgements on financial data and investment professionals' knowledge of ESG issues is lower. It is therefore easier for ESG issues to be inadvertently or deliberately misrepresented by ESG analysts.
II(A) MATERIAL NON-PUBLIC INFORMATION	The investment world is still getting used to handling and processing ESG data. There is perhaps less precedence and automatic understanding about which ESG data should be treated as price sensitive information.
V(A) DILIGENCE & REASONABLE BASIS	ESG data is often imperfect or incomplete, and often proxy data is used, extrapolating trends from related data where real data is absent or incomplete. ESG analysts need to ensure that the data they use in this way is done so with reasonable basis, be satisfied that real data is unobtainable and clearly explain in their reports where proxy data has been used and how it has been compiled.
VI(A) CONFLICTS OF INTEREST	ESG analyst opinions are often an important component of investment decisions. Providers of ESG ratings can be either investor- or issuer paid or be exposed to other commercial or political interests. These should be declared so that the ESG rating or opinion can be scrutinised with that potential bias in mind.

APPLICATION OF THE CFA INSTITUTE STANDARDS (11 cases)

Issue 1: Lack of transparency in allocation of proceeds of sovereign green bonds

Example

David, CFA, works for Green World Investments, a firm that specializes in advising on and arranging sustainable finance capital raising. Recently David has focussed on sovereign green bonds as a prominent opportunity, given that they account for around 11% of the total sustainable debt market, and he secures a mandate to market the new sovereign green bond issued by the country of Valerdevia. The bond is marketed as supporting renewable energy projects, but David knows that a portion of the funds will be directed toward improving the energy efficiency of coal plants, a fact that is not highlighted in the promotional materials. David feels that energy efficiency also indirectly contributes to sustainability, and as the Government of Valerdevia has a wide portfolio of projects and fund raising, funds raised effectively go into the same pot and a Government has discretion on spend. Sarah, a potential investor, and long-time client, asks David if the funds raised from the bond will be used to promote renewable energy projects, as she is keen to ensure the allocation is consistent with marketing of the bond as a vehicle for climate-positive investments. David reassures her that the bond is dedicated to environmentally friendly projects without specifically mentioning the coal-related investments.

CFA UK Comment

We think David breached *Standard I(C) – Misrepresentation*, failing to disclose that part of the funds will go to coal-related projects. He provides incomplete information, leading Sarah to believe that all the proceeds will fund renewable energy, which is not the case. Also, *Standard III(D) – Performance Presentation* was likely breached; by not mentioning the full details of how the funds will be allocated, David is not providing fair and accurate information, violating the ethical requirement to present the investment's performance and characteristics honestly and transparently. He is also likely to have violated accepted principles for green bonds issuance, which require proceeds are genuinely allocated to well defined projects and align with broader sustainability goals. David's actions resemble real-world situations where greenwashing has been alleged in sovereign green bonds. For example, Poland's sovereign green bond issuance in 2016, and Mexico's issuance faced scrutiny due to a lack of transparency in how funds were allocated to projects, some of which had questionable environmental impacts. These examples emphasize the importance of ensuring that green bond transparency and accurate representation are maintained throughout the process.

Issue 2: Corporate misreporting of emissions data

Example

Ewans, CFA works as an ESG analyst for a credit rating agency and is conducting a review of his rating of Ocean Cruises, a listed company. Ocean Cruises is headquartered in a country where there is no regulation or stock exchange requirement to audit climate change related data in corporate disclosures. During his due diligence, he notes that some of Ocean Cruise's sustainability disclosures cannot be properly reconciled with the global warming targets of the Paris Agreement with which they claim to be aligned. Ewans notes that his calculations produce much higher emissions figures than those disclosed by Ocean Cruises. Having talked to the company's sustainability team, he receives Ocean Cruise's emissions calculation methodology (on a confidential basis) and realises that it does not include all types of emissions recognised in the Paris Agreement methodology. Ewans decides to have further discussions with the company's sustainability team on this issue, but he now only receives very vague answers without an appropriate explanation that can help him reconcile his calculations.

CFA UK Comment

Given the potential materiality of this situation, we think that Ewans should inform his supervisor to help determine the best way forward. This may include pausing the issuance of the credit update, expressing concerns to the company, and giving them time to provide further information to reconcile the calculations. If Ewans continues to disagree with the company, rather than withdraw the credit rating, we think he may have to publish his report detailing the differences between his view and the company's view on the disclosures. The materiality of his finding may be such that it leads to an ESG rating downgrade – both 'E' and 'G' scores look challenged by the situation. Given the possibility that the information Ewans is holding may become material price sensitive information at this stage, he should also check with his firm's compliance department or appropriate legal counsel to determine whether there are applicable securities or local stock exchange regulations that would require disclosing this situation to any relevant authorities.

Issue 3: Not observing overseas regulations when they conflict with internal firm rules

Example

Dell is the sustainability analyst at ABC asset management; he is tasked with recommending sustainable investments and advising on ESG risks across ABC's fund range. A few years ago, ABC adopted ESG practices, and an in-house sustainability methodology based on current science and best commercial practice. The methodology stipulates exclusions and a set of core metrics for all funds to follow and monitor. Dell developed a spreadsheet to apply these rules and monitor ESG and sustainability issues at the company level. He uses the output of this to provide data to his legal and marketing departments to ensure compliance of ABC's fund reporting and

product labelling. Some of ABC's funds are invested in utilities with exposure to nuclear projects since the fund manager has identified nuclear power as part of a climate change positive energy solution. The fund also excludes investments in oil & gas companies that are undertaking new fossil fuel developments but makes an exception for those investing heavily in transitioning to renewables. Contrary to the view of ABC's fund management team, Utopia, one of their target markets announces its decision to classify all nuclear and gas related revenues as unsustainable in its Green Taxonomy.

CFA UK Comment

ABC asset management is subject to local market reporting regulations for the funds it sells in multiple jurisdictions. The change in fund reporting rules in Utopia creates a conflict with ABCs in-house methodology for the purposes of their fund reporting to clients in Utopia. As a result, the process Dell uses to provide data internally is no longer consistent with Utopian local law on disclosures and we believe Dell is likely to be found to be in breach of CFA Institute's *Standard I(A) Knowledge of the Law* if ABC continues to market the fund there.

Issue 4: Insufficient data integrity checks in assessing ESG impact on valuation

Example

Johns, CFA, is an ESG analyst at Rainbow, an EU based ESG rating agency. Johns is asked to make an investment valuation and issue an ESG rating for. Green Trees, a newly established forestation company in the MENA area. This region is a harsh environment for forest growth and there is no local regulated carbon market so any carbon credits generated can only be realised for cash within the global voluntary market. While assessing Green Trees, Johns believes that the two major factors impacting its valuation are (1) the cost of planting trees and (2) the price of carbon credits. Johns decides to use proxy assumptions for tree planting costs from a few recent projects in Indonesia rainforests, where conditions are perfect for forestation. Johns also decides to use the average price of the EU regulated market as a proxy for carbon credit prices, as he is very familiar with it.

CFA UK Comment

We conclude that Johns has not used proper diligence in developing the fundamental assumptions and benchmarks for the project. He should perform further due diligence and analysis to make sure the key proxy input assumptions he proposes to use are appropriate. For the tree planting costs, these could be high due to the harsh climate conditions and highly likely will be much higher in the MENA Region than in Indonesia. For the carbon credit price, the fundamentals of the voluntary global carbon market may be completely different from the EU regulated market and render invalid his valuation model. We believe Johns is in danger of

violating CFA Institute's *Standard V(A) Diligence & Reasonable Basis* unless he revisits the key proxy input costs and prices in his valuation model.

Issue 5: Due diligence in research and selection of sustainable funds

Example

Brown, CFA works at a UK based wealth manager in the manager research team. His primary responsibility is the research and selection of mutual funds to be used in the firm's sustainable investment portfolios. One of the funds he has been analysing scores very well on third-party ESG metrics, having top-quartile ESG scores based on its holdings. Some members of the portfolio management team are keen to add this fund to the firm's portfolios: it is run by a very well-known asset manager, has the desired risk-return profile, and would improve the overall scores of the portfolios based on the third-party ESG metrics. However, after further analysis, Tom discovers that there are no mechanisms in the investment process for this fund to maintain a its high ESG score, i.e. the positive scores of the portfolio's current holdings are purely coincidental and not an intentional outcome of the investment process. Additionally, he does not believe that the third-party ESG scores being used are a good measure of sustainability, and consequently, on both counts, the fund does not actually meet his firm's policy for selecting sustainable investments. Accordingly, he decides to not recommend the fund for inclusion in the firm's sustainable portfolios, much to the frustration of some of the portfolio managers.

CFA UK Comment

We think that Brown has met his diligence responsibilities under CFA Institute's *Standard V(A) Diligence and Reasonable Basis*. He conducts thorough due diligence on the fund, and despite pressure from other internal stakeholders, does not think it meets the minimum acceptable standard for a sustainable fund. As such, he has no reasonable basis to recommend the fund.

Issue 6: Failure to identify the real client

Example

Berry, CFA is an ESG fund rating analyst at Green Ratings. She is called by Wallis at Great Investments who asks her to issue a fund rating on his flagship institutional 'Bluebottle' impact fund. Berry is pleased that she has been assigned to this as she has previously rated several other Great Investments funds and Great Investments are a prestigious client for Green Ratings. In the process she has come to know Wallis well over a few years. When Berry conducts her analysis, she concludes that the fund is on the borderline between a '7' (lower) and an '8' (higher). Deciding to determine the precise rating later she sends a draft over to Wallis for checking with

an '8' earmarked in the rating box. Wallis sends an email back with relatively minor comments and attaches the legal documentation for commissioning the rating. Reading this, Berry learns for the first time that the rating is private and is being paid for by Spider Investments, a large institutional investor looking to take a substantial position in the Bluebottle Fund. Wallis' additional feedback is immaterial to the rating, but when Berry double checks the rating score, she spots a miscalculation she made earlier and realises that the Bluebottle fund's rating overall is now definitely more of a '7' than an '8'. However, she is reluctant to change this to a '7' as she does not want to have to explain the reasoning to Wallis and disappoint him. She feels embarrassed about her miscalculation and worries it might damage their relationship and lead him to not use Green Ratings in the future. She does not stop to think that her actions could damage Spider Investments, who may invest in the Bluebottle Fund on the premise it is rated '8' rather than '7' and submits the report to her firm's ratings committee as an '8'. As the rating is private, she concludes that there is little risk that anyone will notice it, though she will obviously need to be available for questions from Spider Investments once they receive her rating.

CFA UK Comment

We think Berry has probably violated CFA Institute's *Standard III(A) Loyalty, Prudence & Care, Standard VI(A) Failure to disclose a Conflict of Interest and Standard I(B) Independence & Objectivity*. She has allowed the commercial interests of her relationship with Wallis and Great Investments to cloud her impartiality and consequently has also overlooked who her actual client is in this transaction i.e. Spider Investments. Wallis had a conflict of interest in 'commissioning' the rating which he either should have declared at the outset or had Spider Investments contact Berry directly and would have been in breach of CFA Institute's *Standard VI(A) Conflicts of Interest.*

Issue 7: Inadequate records of how ESG criteria are applied

Example

Pink, CFA works as an ESG manager for a leading equities global asset manager. As part of her role, she is responsible for compiling ESG assessments as part of the firm's ESG integration process for its global equity strategy. These assessments do not always follow a pre-defined format or formal process, but typically involve the merger of qualitative analysis from external equity research analysts with some quantitative ESG scores and metrics prepared by Pink. The broader investment team uses Pink's reports extensively in all aspects of the management of the fund, which they believe allows them to refer to the fund as "ESG Integrated". Pink diligently conducts this work over the years, and ESG assessments are conducted on each investment taken into fund portfolios. However, when the firm's internal audit asks to see evidence of this, they uncover that much of this work cannot be verified because of the informal nature of Pinks's work

and record retention process.

CFA UK Comment

To comply with her responsibilities under CFA Institute's *Standard V(C),* we think Pink should document and retain the evidence of her ESG assessments. Members and candidates must retain records that substantiate the scope of their research and reasons for their actions or conclusions. We take the view that this record retention requirement applies not only to decisions to buy or sell a security, but also to reviews that do not lead to a change in position. Prominent examples of regulatory actions and fines in this area also indicate the importance that regulators attach to record keeping.

Issue 8: Failure to ensure continuous learning of ESG team

Example

Barden, CFA is the newly appointed Head of Sustainable Equities at Euro Invest who have just rebranded half their funds with Sustainable and ESG labels. He inherits a team of established analysts and portfolio managers. On reviewing their job descriptions and remuneration packages he observes that, whilst his own job description and objectives have been structured to appropriately reflect the firm's product evolution and broader mandate, his teams have not, and contain Euro Invest's standard appraisal targets, focused solely on the financial performance of funds and no reference to sustainability objectives. Several of his team, had requested relevant training ahead of the rebranding of the funds. However, the appraisals have been signed off as "training to be reviewed in 12 months" and any other training was to be offered "depending on performance".

CFA UK Comment

If Barden does nothing about this situation, we think that he will be in breach of CFA Institute's *Standard IV(C): Responsibilities of Supervisors*, which requires that he promotes all activity (including training) to ensure that employees under his supervision comply with applicable laws, regulations, and firm policies. Clearly Euro Invest and Barden's predecessor in the role did not prepare the team for the product transition. We think Barden should instigate adequate training and education programs to up-skill his team either by internal training or arranging for external training. We also think Barden should consider aligning his team's incentive remuneration structures with the firm's new product offering.

Issue 9: Misrepresenting technological innovation to manipulate markets

Example

Paris, CFA is a hedge fund trader. She has recently built up a large stock position in a young and fast-growing biofuels company. She was attracted by the company's profile and its claims that their products are environmentally friendly and almost carbon neutral, therefore suggesting that the company has a huge upside potential. However, after speaking later with several industry experts, Paris found out that the products of this company are not as "green" and "sustainable" as they claim, and that eventually environmental regulators will start taking actions against this company to align these claims to real data and facts. Wishing to avoid reporting large losses on her position, Paris decides to start disseminating in the market the notion that this company has recently patented a new novel biofuel mix which will disrupt the market. The stock price of this company goes up and KK sells her stock pocketing a decent gain from her position.

CFA UK Comment

We think that Paris is in likely violation of CFA Institute's *Standard II(B) Market Manipulation*. She misled others into believing false information to profit from the market's reaction to her report. This is also likely to be illegal under local laws such as under the UK Fraud Act and under US laws.

Issue 10: Unintentionally abusing positions in one market to manipulate another market

Example

Benson, CFA works for Huge Hedge Fund ("HHF") and is based in the nation of Offshoria. HHF has accumulated a large set of short positions in the shares of high-emitting industrial companies in the Group of Central Eurasian Nations, which are subject to the CEN Emissions Trading Scheme. Part of the investment thesis is that available carbon emission allowances are currently under-priced. Until the full negative externality of carbon emissions is correctly priced, the market price of carbon emission allowances should shift upwards thus reducing the profit of the companies which have to buy them. To capture the full alpha from their view, Benson also buys carbon emission allowances in the Group of Central Eurasian Nations. The trade is moderately successful and so Benson decides to continue to buy further allowances. As the price of carbon increases, the shares of the high emitting industrial companies start to experience a consequential price decline. Risk management at HHF is poor and it later transpires that HHF has unwittingly come to own a significant position in carbon allowances, of which they were not aware. On seeing the price spike in the market, and before HHF can close out its positions, The Group of Central Eurasian Nations decide to release reserve emission allowances, thus reducing their

market price, and the share prices of the industrial companies then recover.

CFA UK Comment

It is possible that Benson is not in breach of CFA Institute's *Standard II(B) Market Manipulation* as there seems to be no deliberate intent to manipulate either market. Benson was executing transactions in two different markets in line with their hedge fund's views. However, both the industrial company share prices, and the carbon emission allowances have clearly been impacted by their market activity and potentially the market in carbon emission allowances may have been cornered inadvertently. Benson needs to check with the Compliance and Legal teams as to whether 'intent' is required for there to be market manipulation in both Offshoria as well as the markets in which i) the companies' shares and ii) the emissions allowances are traded. Although HHF did not realise a profit from this set of transactions, this may not preclude market manipulation from having potentially taken place in the eyes of one of these regulators. In this case, Benson may have breached CFA Institute's *Standard I(A) Knowledge of the Law* as they should have been aware of the definition of market manipulation in the markets in which they were actively trading.

Issue 11: Failure to research the differences in regulations between two countries

Example

Singh, CFA is advising Tacto, a major industrial conglomerate based in Country A. As a major manufacturer of industrial goods, Tacto has significant scope-2 emissions from using electric power generated from fossil fuels. Tato has recently made serious commitments to reduce its GHG scope-1 and -2 emissions throughout its global operations. As one measure to meet these commitments, Tacto plans to purchase RECs from renewable power generators in Country A, where most of its manufacturing is concentrated. Additionally, Tacto is planning an M&A transaction to acquire a smaller industrial company based in Country B. The M&A target currently uses fossil-powered electricity, and Singh advises Tacto that it can purchase RECs from a local solar plant in Country B. This plant, however, is not connected to the grid, and as such, is a "captive producer" serving only one buyer. Whilst RECs from captive producers may be used in Country A, Country B's regulations do not allow it, requiring that RECs should come from a renewable power producer connected to a grid.

CFA UK Comment

We think that Singh, CFA has failed to adequately research the regulations of Country B and assumed that they are the same as those of his home market in Country A. Singh has therefore

provided poor advice to his client, and we believe he is likely in violation of CFA Institute's *Standard V(A) Diligence and Reasonable Basis.*