

# **CFA Institute**

## **ESG-INVESTING Exam**

**Certificate in ESG Investing**

**Questions & Answers  
Demo**

# Version: 6.0

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**Question: 1**

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Which of the following sectors has the highest percentage of corporate profits at risk from state intervention?

- A. Banking
- B. Consumer goods
- C. Pharmaceuticals and healthcare

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**Answer: A**

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Explanation:

In evaluating which sector has the highest percentage of corporate profits at risk from state intervention, it is crucial to consider the exposure of various industries to regulatory changes, government policies, and state interventions. The banking sector, in particular, is highly sensitive to such interventions due to the following reasons:

**Regulatory Environment:** Banks operate under strict regulatory frameworks established by governments to ensure financial stability, consumer protection, and market integrity. These regulations can significantly affect banking operations and profitability. Changes in capital requirements, lending limits, and other regulatory policies can have immediate and substantial impacts on banks' profit margins.

**Government Policies:** Governments often implement policies aimed at influencing economic activity, such as monetary policy changes, interest rate adjustments, and fiscal policies. Banks are directly impacted by these policies as they influence lending rates, deposit rates, and overall financial market conditions.

**State Intervention:** During financial crises or economic downturns, governments may intervene in the banking sector to stabilize the economy. This can include measures like bailouts, nationalization, or imposing stricter controls on banking activities. Such interventions can disrupt normal business operations and affect profitability.

**Systemic Importance:** Banks are considered systemically important to the economy. Their failure can lead to widespread economic repercussions. As a result, governments closely monitor and regulate the sector, often intervening to prevent instability, which can affect banks' financial performance.

Reference:

MSCI ESG Ratings Methodology (2022) - This document outlines the factors affecting the ESG risks and opportunities for companies, emphasizing the regulatory and governance aspects that significantly impact the banking sector.

Energy Technology Perspectives (2020) - Although this document primarily focuses on energy technologies, it highlights the broader implications of state intervention in critical industries, including finance, for achieving policy objectives.

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**Question: 2**

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Scores used to construct ESG index benchmarks can be

- A. data based, but not rating based
- B. rating based, but not data based.
- C. both data based and rating based

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**Answer: C**

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Explanation:

ESG (Environmental, Social, and Governance) scores used to construct ESG index benchmarks can be based on both raw data and ratings derived from various data points and methodologies. The following references from ESG and sustainable investing documents validate this:

Data-based Approach:

ESG ratings incorporate vast amounts of raw data. For instance, MSCI ESG Research collects over 1,000 data points related to ESG policies, programs, and performance, including data on individual directors and shareholder meeting results spanning up to 20 years.

This raw data is sourced from a variety of inputs including company disclosures (e.g., sustainability reports, 10-K filings), government databases, and over 3,400 media sources that are monitored daily.

Rating-based Approach:

ESG ratings are not just aggregations of raw data but involve sophisticated methodologies to convert this data into actionable insights. MSCI ESG Ratings, for example, are assigned on a scale from AAA to CCC, reflecting the relative ESG performance of companies within their industry.

The process includes assessing exposure metrics (how exposed a company is to material ESG issues), management metrics (how well a company manages these issues), and continuously monitoring controversies and events that may impact these ratings.

ESG ratings also involve setting key issue scores and weights, which combine to form an overall ESG rating relative to industry peers. This integration of various data points and weighted scoring systems exemplifies the rating-based nature of ESG benchmarks.

By combining both these approaches, ESG index benchmarks ensure a comprehensive assessment of a company's sustainability performance. The data-based aspect ensures that decisions are grounded in factual, quantitative information, while the rating-based aspect provides a nuanced, comparative evaluation of ESG risks and opportunities across companies and industries.

These detailed methodologies align with the CFA ESG Investing standards, which emphasize the importance of integrating both quantitative data and qualitative assessments in ESG evaluations.

CFA ESG Investing Reference:

The CFA Institute's curriculum on ESG Investing highlights the need for both data-based and rating-based approaches in constructing ESG benchmarks. The CFA ESG Investing Exam Preparation materials emphasize understanding various ESG data sources, metrics, and the methodologies for aggregating these into ratings to provide a comprehensive view of a company's ESG performance.

This integrated approach ensures that ES

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**Question: 3**

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When undertaking an ESG assessment of a private equity deal ESG screening and due diligence will most likely take place during:

- A. exit
- B. ownership
- C. deal sourcing

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**Answer: C**

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Explanation:

When undertaking an ESG assessment of a private equity deal, ESG screening and due diligence are most likely to take place during the deal sourcing phase. Here's why:

**Initial Evaluation:** ESG screening at the deal sourcing stage allows investors to evaluate potential investments against their ESG criteria before committing significant resources. This helps in identifying any red flags or areas of concern early in the process.

**Risk Management:** Conducting ESG due diligence early helps in managing risks associated with environmental, social, and governance issues. By understanding these risks upfront, investors can make more informed decisions and potentially avoid costly issues later.

**Integration into Investment Strategy:** ESG considerations integrated during deal sourcing ensure that these factors are part of the overall investment strategy and decision-making process. This alignment is crucial for achieving long-term sustainable returns.

**Regulatory Compliance and Reputation:** Early ESG assessments help in ensuring compliance with relevant regulations and standards, and in protecting the investor's reputation by avoiding investments in companies with poor ESG practices.

Reference:

MSCI ESG Ratings Methodology (2022) - Highlights the importance of early ESG assessments in identifying risks and opportunities, ensuring that ESG factors are integrated into the investment process from the beginning.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the role of ESG screening in the initial stages of investment to manage risks and enhance long-term value creation.

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**Question: 4**

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Which of the following statements about corporate governance is most accurate? Companies with a more diverse board of directors are most likely associated with

- A. lower profitability
- B. lower stock return volatility.
- C. less investment in research and development.

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**Answer: B**

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Explanation:

Companies with a more diverse board of directors are most likely associated with lower stock return volatility. This relationship is based on the following factors:

**Improved Decision-Making:** A diverse board brings a range of perspectives and experiences, leading to more comprehensive and balanced decision-making processes. This can result in better risk management and more stable corporate performance.

**Enhanced Reputation and Trust:** Diversity on the board can enhance a company's reputation, leading to greater trust from investors, customers, and other stakeholders. This can contribute to more stable stock performance.

**Risk Mitigation:** Diverse boards are better equipped to identify and mitigate risks, including ESG-related risks. Effective risk management can reduce the likelihood of negative events that could cause stock price volatility.

**Long-Term Focus:** Companies with diverse boards are often better at focusing on long-term strategic goals rather than short-term gains. This long-term perspective can contribute to more consistent and stable stock returns.

Reference:

MSCI ESG Ratings Methodology (2022) - Provides evidence that companies with strong governance, including board diversity, exhibit lower volatility in their stock returns due to better risk management and decision-making.

ESG-Ratings-Methodology-Exec-Summary (2022) - Highlights the positive impact of board diversity on corporate performance and stability, supporting the link between diverse boards and lower stock return volatility.

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**Question: 5**

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Which of the following greenhouse gases (GHGs) has the longest lifetime in the atmosphere?

- A. Methane
- B. Carbon dioxide
- C. Fluorinated gas

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**Answer: C**

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Explanation:

Among the greenhouse gases (GHGs) listed, fluorinated gases have the longest atmospheric lifetimes. Here's a detailed breakdown:

#### Methane (CH<sub>4</sub>):

Methane is a potent greenhouse gas with a significant impact on global warming. However, its atmospheric lifetime is relatively short, approximately 12 years.

#### Carbon Dioxide (CO<sub>2</sub>):

Carbon dioxide is the most prevalent greenhouse gas emitted by human activities, particularly from the burning of fossil fuels. CO<sub>2</sub> can remain in the atmosphere for hundreds to thousands of years, but it is still not the longest-lived compared to fluorinated gases.

#### Fluorinated Gases:

Fluorinated gases, such as hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF<sub>6</sub>), are synthetic gases that have extremely long atmospheric lifetimes, often ranging from a few years to thousands of years. For instance, SF<sub>6</sub> can remain in the atmosphere for up to 3,200 years.

These gases are typically used in industrial applications and have a high global warming potential (GWP) due to their longevity and heat-trapping capabilities.

#### CFA ESG Investing Reference:

The CFA Institute's ESG curriculum emphasizes understanding the different types of greenhouse gases, their sources, and their impacts on climate change. The curriculum specifically points out the longevity and high global warming potential of fluorinated gases, which makes them a critical focus in ESG assessments and climate risk evaluations.