SUSTAINABLE INVESTING CERTIFICATE • 2026

Introduction to Sustainable Investing

Objectives, financial relevance, institutions and the investment chain

01

SECTION 1

What Sustainable Investing Is

Identify investment objectives, distinguish approaches, and explain why ownership and time horizons matter.

1

Sustainable investing: the working definition

Responsible investment is the umbrella; identify the objective and process of the approach within it.

- Sustainable investment has several uses, including selecting assets that support a sustainable economy.
- ESG integration examines how ESG factors affect investment risk and return.
- Financial materiality links an ESG issue to financial performance.
- Values and measurable impact may be additional investment objectives.

KEY POINT A fund name does not establish its objective, process or result.

What are we trying to sustain?

Brundtland Commission: meet the needs of the present without compromising future generations' ability to meet their own.

- A business can earn money today while damaging resources that people will need tomorrow.
- Responsible investment is an umbrella for considering ESG in investment decisions and ownership.
- Sustainable investing has overlapping uses; establish the objective and the actual investment process.

Why a longer horizon matters

A longer horizon can reveal risks and opportunities that short-term incentives encourage investors to overlook.

- Trading on expected near-term price movements differs from assessing the value an investment can create over time.
- Pressure for immediate results can discourage research and other projects with delayed benefits.
- Patient capital can support productive investment whose benefits take several years to emerge.
- Ownership practices and management incentives should support the investor's intended horizon.

KEY POINT A longer perspective can improve analysis; it does not mean every ESG issue affects only the distant future.

ESG categories can overlap

Environmental, social and governance classifications organise analysis, but their boundaries are not universal or mutually exclusive.

- Environmental analysis examines natural resources, ecosystems and interactions with the natural world.
- Social analysis considers workers, customers, communities and other affected groups.
- Governance analysis considers oversight, incentives, conduct and how organisations are directed.
- Animal welfare illustrates how an issue may appear under more than one category.

KEY POINT An analyst should examine an issue's consequences rather than dismiss it because another framework gives it a different category.

Recognising environmental, social and governance issues

The category helps organise an issue; the consequences determine the analysis.

- Environmental: emissions, water use, waste, pollution and deforestation.
- Social: human rights, forced labour, safety, working conditions and employee relations.
- Governance: corruption, executive pay, board structure, lobbying and tax practices.
- One issue can cross categories: polluted water can also damage community health.

Investment motives and overlapping approaches

Financial considerations and values can motivate different investment choices, while the methods used may overlap.

FINANCIAL EMPHASIS

- Ask how an ESG factor changes an investment's risk or return.
- Use material information when selecting and managing investments.
- Assess the approach against the investor's financial objectives.

VALUES AND OUTCOMES

- Ask which activities or outcomes the investor wishes to support or avoid.
- Use screens, themes or impact objectives as appropriate to that purpose.
- Assess the stated non-financial objective alongside any required financial return.

Separate the return objective from the social objective

The capital spectrum compares objectives; it is not a ranking of financial quality.

- Conventional investment seeks a financial return; responsible approaches also consider ESG in decisions and ownership.
- Impact investment intentionally pursues measurable positive outcomes alongside a financial return.
- Impact investors may seek market-rate or concessionary returns.
- Philanthropic grants support a purpose without expecting an investment return to the donor.

The spectrum of responsible investment approaches

Approaches differ in their selection criteria and intended outcomes, and several can operate within one portfolio.

Approach	Distinguishing feature
Socially responsible investment	Applies social and environmental evaluation criteria, often using scores and qualification hurdles.
Best-in-class	Selects qualifying ESG performers within sectors or industries.
Thematic investment	Selects opportunities associated with a particular environmental or social theme.
Green investment	Directs capital toward assets addressing environmental challenges.

The spectrum of responsible investment approaches (continued)

The rest of the spectrum: capital directed at social outcomes, measured impact, and investing aligned with principles.

Approach	Distinguishing feature
Social investment	Directs capital toward assets addressing social challenges.
Impact investment	Combines an intentional, measurable positive outcome with a financial return.
Ethical or faith-based investment	Aligns investments with principles, often excluding activities the investor objects to.

KEY POINT The approaches are not an exclusive checklist: a strategy may combine screening, thematic selection and engagement.

Green investment reaches beyond climate

Green investment directs capital towards environmental challenges, including nature and resource use.

- Examples include clean energy, energy efficiency, recycling, pollution control and biodiversity protection.
- Green investment can overlap with thematic investment or impact investment.
- A green bond earmarks its proceeds for environmental projects; that does not make every activity of its issuer green.

Social investment and underserved customers

A business can serve a social need and earn revenue from delivering that service.

- Bottom of the pyramid refers here to low-income communities underserved by conventional markets.
- Examples include microfinance, microinsurance, education, nutrition, healthcare and basic communications.
- Assess affordability, access and the actual benefit; selling to low-income customers alone does not prove positive impact.

Social impact bonds: payment depends on outcomes

A social impact bond links a public-sector payment to agreed improvements in a social service.

- Investors provide funding for a programme before the outcome is known.
- A public-sector counterparty pays according to the agreed outcome contract.
- Investors may receive part of the public-sector savings if the programme succeeds.
- The contract determines payment and risk; the name does not imply a guaranteed conventional bond return.

Thematic investing and impact investing

A sustainability theme identifies an area of investment; impact investing additionally requires intentional and measurable outcomes.

THEMATIC

- Begins with a theme such as water access or affordable healthcare.
- Selects investments associated with that theme.
- A theme alone does not establish an impact objective or responsible investment credentials.

IMPACT

- Begins with an intended positive environmental or social outcome.
- Includes measurement and tracking of the agreed outcome.
- Also seeks a financial return, which may differ across investors.

KEY POINT A fund name referring to clean water is insufficient evidence of an impact investment process.

Impact goals and financial return expectations

Impact investing combines an intended, measurable positive outcome with a financial return.

- Some investors accept below-market returns; others seek competitive or higher returns.
- Impact investment can occur in developed and emerging markets, and in private or public assets.
- An SDG label identifies a goal. A result needs an appropriate outcome measure and evidence.

Best-in-class and ethical exclusions

Within-sector ESG selection and exclusion of objectionable activities apply different admission rules to an investment universe.

BEST-IN-CLASS

- Ranks companies against ESG criteria within their sector or industry.
- Admits companies that meet a qualifying hurdle.
- Can retain broad sector coverage while seeking stronger ESG characteristics.

ETHICAL EXCLUSIONS

- Identifies activities or practices that conflict with the investor's principles.
- Removes investments that meet the exclusion criteria.
- May eliminate activities regardless of a company's relative ESG ranking.

KEY POINT Best-in-class can support benchmark similarity; it does not automatically preserve every benchmark weight.

Apply a screen to actual companies

A qualifying score, a within-sector rank and an exclusion test can produce different portfolios.

- Illustration: three companies score 82, 71 and 58 on a specified ESG scale.
- An SRI rule requiring at least 70 admits the first two. Industry weights can change how the score is constructed.
- A best-in-class rule ranks peers within each sector; the comparison group matters.
- Norms-based screening tests conduct against specified standards, such as UN Global Compact principles.

Patient capital and productive investment

An investor's time horizon can influence whether a company pursues projects with delayed benefits.

1. Investors reward immediate results and press management for near-term improvements.
2. Management becomes less willing to fund research whose benefits take years to appear.
3. A longer investment perspective gives those future benefits greater attention in the decision.
4. Patient capital can support projects that contribute to long-term value creation.

WHAT THIS MEANS Examine whether incentives support the stated horizon; a long-term label alone does not change managerial decisions.

Ownership adds a route to influence

Engagement seeks to influence an issuer's behaviour and can complement the way a portfolio selects investments.

- Equity owners may use dialogue with management or voting at shareholder meetings.
- Bondholders can also engage, although their rights differ from shareholders' rights.
- Engagement effectiveness depends on influence, the quality of the dialogue and the method used.
- Communicating possible divestment can form part of an engagement approach.

KEY POINT Selecting a holding and seeking to influence its conduct are different decisions that can be used together.

Values can guide ownership as well as exclusions

An investor can refuse an activity, seek changes in a holding, or combine both approaches.

- An ethical or faith-based mandate may exclude specified industries or practices.
- It can also use dialogue and shareholder rights to encourage changes in company conduct.
- Example: exclude tobacco while engaging other holdings on worker treatment.
- Whether to retain or exit a holding depends on the mandate and the prospects for change.

What sustainable investing is: review

Distinguish objectives, selection methods and ownership activity before assigning an investment label.

- Responsible investment is the umbrella used here; sustainable investment has several interpretations.
- ESG integration examines financially relevant factors in investment decisions.
- Long-term incentives can support productive investment with delayed benefits.
- Best-in-class selects within sectors without guaranteeing identical benchmark weights.
- Impact investing requires an intended, measurable outcome and a financial return.
- Ethical screens reflect principles, while engagement seeks to influence issuers.
- Responsible investment approaches can overlap and be combined.

SECTION 2

The Macro Debate and Financial Materiality

Connect investment motives and sustainability megatrends to company economics and portfolio-wide risks.

2

Financial materiality depends on the investment

An ESG factor matters financially when it can influence the economics relevant to a company or investment.

- A factor's relevance depends on the business model, supply chain and location of operations.
- Companies in the same sector may face different exposures and vulnerabilities.
- Investors should connect an issue to costs, revenues, asset values or other financial consequences.
- Client sustainability preferences can also matter to a mandate without being identical to financial materiality.

KEY POINT A sector label is not enough to declare an issue financially important or irrelevant to every company.

Corporate responsibility reaches business strategy

Corporate sustainability can affect the way a business operates, extending beyond charitable donations.

- A company can embed ethical and sustainability considerations in its business model.
- Responsible practices may support its acceptance by governments and communities.
- Effective management can influence employee satisfaction, productivity and innovation.
- Investors evaluate how these business effects matter for asset selection and portfolio construction.

KEY POINT A donation programme does not by itself demonstrate that a company manages the sustainability issues in its operations.

The macro-level debate, stated fairly

Different reasons for incorporating ESG lead investors to ask different questions about the same investment.

RISK AND ECONOMY

- Ask how emerging risks change security values and financial-system stability.
- Consider the effect of externalities on other holdings and the wider economy.
- Assess implications for returns needed to meet beneficiaries' liabilities.

IMPACT AND ETHICS

- Ask whether capital supports desirable outcomes or objectionable activities.
- Consider positive impact, exclusions and the investor's principles.
- Assess the objectives and preferences expressed by beneficiaries or clients.

Six perspectives on ESG incorporation

The curriculum explains ESG incorporation through several perspectives rather than a single investment motive.

Perspective	Question it raises
Risk	How do sustainability risks and opportunities affect investments and financial stability?
Fiduciary duty	How should a fiduciary act in beneficiaries' interests when ESG factors affect investments?
Economic	How do system-wide sustainability challenges affect market returns?
Impact and ethics	Which outcomes or activities should the investor support or avoid?

Six perspectives on ESG incorporation (continued)

Two more perspectives: what clients ask for, and what the rules require.

Perspective	Question it raises
Client demand	How do clients want their capital invested and its effects explained?
Regulation	Which investment or disclosure requirements must the investor address?

KEY POINT An investor may incorporate ESG because of several motives at once; identify the motive stated in the situation.

The risk perspective and financial stability

Climate now tops global risk rankings, and regulators have built it into supervision since Mark Carney's 2015 speech.

- The World Economic Forum's Global Risks Report 2024 puts climate at the top; classic economic risks have left the top five.
- In 2015 Mark Carney, Bank of England governor and FSB chair, gave the speech that anchored climate in financial regulation.
- Responses: the ECB's monetary policy, the Bank of England's biennial climate scenario analysis, the Bank of Japan's funding support, APRA's bank vulnerability assessment, MAS's TCFD mandate.
- Emerging markets too: India's climate data portal for stress tests, China's carbon emission reduction facility, and Mexico's research on climate and GDP.

KEY POINT Financial stability is the reason behind the risk perspective: climate is a system-wide exposure that supervisors now test.

Water scarcity can become an electricity cost

An environmental event can affect a company through an input that appears to be secured.

- The curriculum describes a Brazilian aluminium producer with its own hydroelectric capacity.
- Low reservoir levels reduced generation and forced purchases of expensive grid electricity.
- Trace the chain: water shortage, less power, higher purchased-energy cost, lower operating earnings.

What makes an asset stranded?

An asset can lose economic value before the owner expected to retire it.

- Policy, technology, demand or physical damage can reduce the cash flows an asset can earn.
- Example: a plant loses demand to cheaper alternatives but still has unrecovered investment.
- The curriculum's PG&E case connects wildfire liability with financial distress.
- A balance-sheet value is not proof that future economic benefits remain intact.

Why ESG can be part of fiduciary duty

A financial risk does not become irrelevant because it carries an ESG label.

- The 2005 Freshfields report argued that using ESG information to improve financial analysis is clearly permissible and arguably required.
- The PRI (2019) concluded that modern fiduciary duties require material ESG factors, client preferences, active ownership, system resilience and clear disclosure.
- These reports explain a debate; actual obligations must be read in their jurisdiction and investment context.

Four routes into company performance

Sustainability practices can influence both the costs a company bears and the opportunities it can capture.

Route	Potential financial connection
Efficiency and productivity	Resource savings and better workforce practices can reduce operating costs or improve output.
Fines and intervention	Anticipating regulation can reduce exposure to penalties and other adverse state action.
Externalities	Costs previously imposed on others may enter the company's own economics.
Megatrend opportunities	Products and operations can adapt to changing environmental and social needs.

KEY POINT These are possible transmission routes, not a guarantee that an ESG initiative will improve profit.

Resource efficiency and operating costs

Reducing waste can connect a sustainability improvement to operating performance.

1. A manufacturer identifies material discarded during production.
2. It improves its production process to use inputs more efficiently.
3. Less wasted material can reduce the inputs needed for a given output.
4. The analyst assesses the resulting cost savings alongside the cost of the improvement.

WHAT THIS MEANS This is an illustrative application of the efficiency channel, not a claim about any named company's results.

People and public policy change company economics

Costs and opportunities can change through employee behaviour and government intervention.

- Better working conditions can improve retention, reduce recruitment costs and support productivity.
- Illustration: avoiding 20 replacement hires at GBP5,000 each saves GBP100,000 before programme costs.
- Public intervention includes subsidies, market access, operating restrictions, taxes and penalties.
- Assess both the cost of the response and the business benefit; neither channel guarantees a profit gain.

How much is at stake for companies

Workplace quality, exposure to government action and major liabilities can all affect company value.

- Edmans 2011: Fortune's 100 Best Companies to Work For earned 2.3% to 3.8% a year more than peers over more than 25 years.
- McKinsey, Henisz and co-authors 2019: typically about one-third of corporate profits is at risk from state intervention, not only fines.
- EBITDA at stake: 50–60% in automotive, aerospace, defence and technology; 25–30% in pharmaceuticals and consumer goods.
- Largest fines: BP's USD20.8bn Deepwater Horizon settlement, Bank of America's USD16.65bn in 2014, Volkswagen's USD14.7bn in 2016.

KEY POINT BP's USD20.8bn is the whole settlement; Module 2's USD5.5bn Clean Water Act civil penalty is one part of it.

Private costs and negative externalities

An externality concerns effects outside a transaction that its price does not fully reflect.

PRIVATE COST

- Is borne by the producer or user involved in the transaction.
- Enters the private decision about production or consumption.
- May omit harm imposed on other people or businesses.

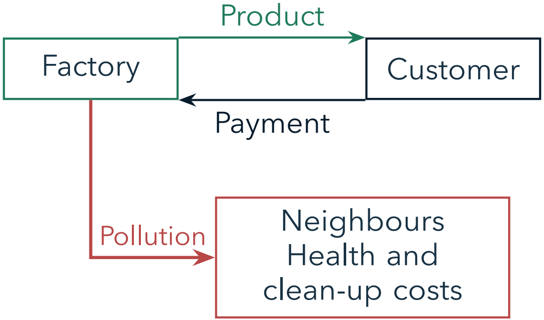
NEGATIVE EXTERNALITY

- Is a cost imposed on parties outside the transaction.
- Can cause social costs to exceed the costs considered privately.
- May later be internalised through public or private measures.

KEY POINT A cost is not external merely because it is environmental; ask who bears it and whether the transaction price reflects it.

Who bears the cost of pollution?

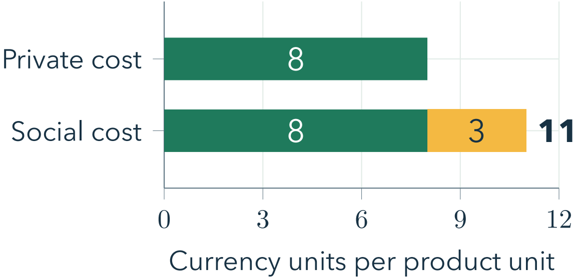
A transaction can impose costs on people outside it.



- The factory and customer agree a price.
- Neighbours bear harm that the price does not fully reflect.

Private cost and social cost

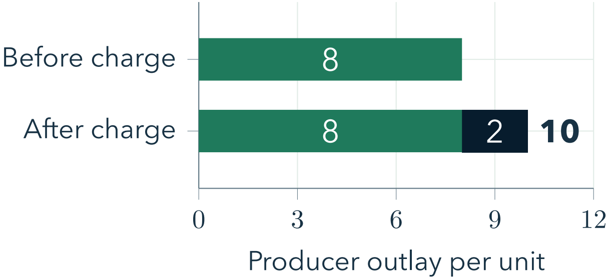
Social cost includes resources used and damage imposed on others.



- Production resources: 8 per unit.
- Pollution damage: 3 per unit.
- Social cost: 8 + 3 = 11 per unit.

A charge changes the producer's incentive

A tax payment does not, by itself, remove physical damage.



- Producer outlay rises from 8 to 10.
- Output and damage are unchanged in this comparison.
- Social cost remains 11. The tax is a transfer.

Different ways to bring external costs into decisions

Internalisation makes decision makers face costs or benefits previously left outside the transaction.

- A pollution charge attaches a price to covered emissions.
- Tradable permits constrain covered quantities and create a market price for allowances.
- Standards can restrict conduct directly; voluntary agreements depend on implementation and incentives.
- Positive externality example: knowledge created by research benefits other businesses without full payment.

How sustainability reaches financial performance

Internalisation can turn a cost borne by society into a cost relevant to an issuer's profits.

1. A production activity imposes pollution costs on people outside the transaction.
2. The producer's private cost does not include all of that social harm.
3. A charge, rule or agreement makes the producer bear more of the cost.
4. The investor reassesses the implications for the issuer's costs, profits and competitive position.

WHAT THIS MEANS The timing and extent of internalisation are uncertain; model the exposure instead of assuming an immediate, complete charge.

How external costs become investment issues

Timing, coverage and business responses affect the financial impact.

Unpriced pollution damage → Charge, regulation or agreement → Changes to costs, margins or demand

Company: which costs enter forecasts, when, and to what extent?

Portfolio: could one company's pollution damage other holdings?

Megatrends connect companies to the economy

Sustainability megatrends interact across firms and markets, creating risks that matter beyond a single holding.

- Technological innovation changes products, behaviour and business models.
- Demographic change and inequality affect workforces, demand and economic stability.
- Climate change and resource scarcity interact with demand for food, water and energy.
- Broadly diversified owners depend on the wider economy and can be affected when one company's externalities harm others.

KEY POINT Diversification across many securities does not remove exposure to deterioration in the economic system those securities depend on.

Technology changes both opportunities and risks

Rapid adoption can change costs, competition, behaviour and the skills a business needs.

- Automation can raise output and reduce repetitive work, while creating retraining needs.
- Digital services can expand access but also create privacy and reliability risks.
- Social media can spread useful information or amplify misinformation and controversy.

Population and inequality change economic demand

Demographic and distributional changes affect workers, customers and public finances together.

- Ageing can reduce the workforce and increase demand for healthcare and retirement services.
- A smaller workforce increases the importance of productivity and suitable skills.
- Inequality can limit opportunity, weaken demand and contribute to social instability.
- Germany's working-age population could fall from 54 million in 2010 to 36 million in 2060.

Climate change and resource scarcity

A larger, richer and more urban world needs more energy, food and water from finite resources.

- At the current pace of action, warming is predicted to exceed 1.5°C, where scientists expect significant and potentially irreversible change.
- Climate change could cut agricultural productivity by up to a third across large parts of Africa over the next 60 years.
- Global demand for water is expected to rise by 40% and demand for energy by 50%.
- The pressures amplify each other and reach companies through input costs and supply.

The macro debate and materiality: review

Identify the investment motive, the relevant exposure and the route through which the financial effect occurs.

- Financial relevance varies with company, business model and location.
- Risk, duty, economics, impact, client demand and regulation provide distinct reasons for ESG incorporation.
- Corporate responsibility can be part of business strategy rather than only philanthropy.
- Efficiency, intervention, externalities and megatrends can affect financial performance.
- Internalisation changes who bears a previously external cost.
- Universal owners have an interest in the health of the overall economy.

SECTION 3

Integration Challenges and ESG in Practice

Distinguish materiality concepts, assess implementation barriers, and interpret evidence without promising investment outperformance.

3

Materiality can change

Dynamic materiality means that the issues financially important to a company can change as circumstances evolve.

- Social movements, major events and regulatory responses can reveal previously overlooked exposures.
- A materiality assessment should therefore be reviewed rather than treated as permanent.
- Businesses may need to adjust their response as the relevant issues change.
- Investors should reassess the financial implications for the specific company and its activities.

KEY POINT Dynamic materiality concerns change over time; it is different from examining two directions of impact.

Financial materiality and double materiality

Double materiality considers company impacts on sustainability alongside sustainability-related effects on the company.

FINANCIAL MATERIALITY

- Examines how sustainability matters can affect the company financially.
- Asks about consequences relevant to the company's financial performance.
- Includes climate exposure when it can affect company economics.

DOUBLE MATERIALITY

- Also examines how the company affects people and the environment.
- Adds the company's outward impacts to the analysis.
- Can therefore include the company's contribution to climate change.

KEY POINT Double materiality is about directions of impact; dynamic materiality is about how financial relevance changes over time.

Materiality can run in both directions

Double materiality examines significant outward impacts as well as financially relevant inward effects.

Environment and society: water availability changes. → Company: operations depend on water and also discharge waste. → People and ecosystems: the discharge changes water quality.

WHAT THIS MEANS Assess significance in each direction. An outward impact may later become financially material through regulation, liability or demand.

Adoption barriers and implementation barriers

Some obstacles discourage an investor from adopting ESG, while others make an adopted policy difficult to implement.

BEFORE ADOPTION

- Concern that a smaller investment universe will damage performance.
- A restrictive interpretation of fiduciary duty.
- Advice that does not support consideration of ESG options.

DURING IMPLEMENTATION

- Difficulty converting financial and sustainability goals into an effective mandate.
- Insufficient expertise, data, tools or monitoring resources.
- A gap between public commitments and investment delivery.

KEY POINT Signing a policy addresses neither the need for a workable mandate nor the resources needed to implement it.

A cleaner portfolio can have different financial risks

Changing holdings can change sector exposure and performance relative to a benchmark.

- Excluding an industry changes the opportunity set and may concentrate the remaining portfolio.
- Tracking error measures variability in portfolio returns relative to benchmark returns.
- A low-emissions screen can shift weight away from heavy industry and towards financials or technology.
- Assess the new exposures; lower reported emissions do not automatically mean lower total investment risk.

Why material factors are hard to use

Recognising a financially relevant ESG issue does not automatically provide reliable data or a usable valuation adjustment.

- The availability and quality of disclosure vary across companies, locations and asset classes.
- Historical information can be a weak guide to future transition plans and emerging technologies.
- Investors need expertise, data, models and resources to translate an issue into an investment assessment.
- A qualitative score may identify a concern without showing its financial magnitude.

KEY POINT A high-quality description of a risk is not yet a quantified valuation input.

Turn imperfect ESG data into a useful assessment

Disclosed data, estimates and forward-looking plans provide different kinds of evidence.

- Identify whether a number was reported by the company or estimated by a provider.
- Check boundaries, time periods and whether the result fits the business and industry.
- Historical emissions describe past activity; a transition plan describes intended future change.
- Model opportunities as well as downside risks, and explain uncertain assumptions.

From ESG information to valuation

A valuation adjustment should follow an identified financial consequence and avoid counting the same effect twice.

1. Identify a sustainability exposure using the available information and assess the quality of that information.
2. Determine how the exposure could affect forecast revenues, costs or investment risk.
3. Choose an appropriate adjustment to forecasts, a discount rate or valuation multiples.
4. Check whether another adjustment or the market valuation already reflects the same concern.

WHAT THIS MEANS Multiple ESG adjustments are not automatically more rigorous; they can overstate a risk if their effects overlap.

Greenwashing is a claims problem

Greenwashing arises when sustainability-related claims mislead users about practices, performance or products.

- The concept extends beyond environmental claims to social and governance matters.
- The growth of ESG-labelled products increases the importance of examining what their claims mean.
- A stated commitment should be assessed against the investment approach and its delivery.
- Clearer standards and disclosure can help investors evaluate claims more consistently.

KEY POINT A sustainability label or statement of intent is not evidence that the claimed process or outcome has been delivered.

What the performance evidence actually supports

Evidence of a relationship with corporate financial performance does not establish that ESG funds consistently generate alpha.

- The curriculum discusses studies of operating performance, stock performance and investment performance.
- These measures answer different questions and should not be treated as interchangeable.
- Many corporate studies report positive relationships, but the findings are not uniform.
- Capturing a corporate benefit in a portfolio depends on investment decisions and the performance measure used.

KEY POINT A positive correlation at company level is insufficient proof of a fund's persistent risk-adjusted outperformance.

What the meta-studies found

Two reviews find mostly positive or neutral links between ESG and financial performance; the later one splits corporate from investment results.

- Clark, Feiner and Viehs 2015, 200 studies: 90% found good ESG standards lower the cost of capital; 88% better operations; 80% better stock performance.
- Whelan and co-authors 2021, over 1,000 papers: 58% of corporate studies positive, 13% neutral, 21% mixed, 8% negative.
- Investment studies: 59% found similar or better performance than conventional approaches; 14% found negative results.
- Among 59 climate studies: 57% of corporate studies positive; 65% of investor studies positive or neutral, 13% negative.

KEY POINT A frequent positive association is still not proof that a particular fund will outperform.

Company success does not automatically become fund alpha

A fund must capture an advantage after considering price, portfolio exposures and costs.

- Operating performance concerns the business; investment performance concerns what the investor earns.
- Alpha is performance unexplained by the chosen risk-adjusted benchmark or model.
- An apparent ESG advantage may partly reflect industry or factor exposure.
- A positive association does not, by itself, establish that ESG caused the result.

Three routes through which investors act

Investors can reflect sustainability through investment decisions, corporate engagement and policy engagement.

- Investment decisions include mandates, asset allocation, security analysis and portfolio selection.
- Corporate engagement addresses the practices or disclosures of investee companies.
- Policy engagement addresses rules and market conditions relevant to investors and beneficiaries.
- Institutions can combine these routes in ways consistent with their culture and investment style.

KEY POINT Do not equate engagement solely with voting, or assume that every sustainability action is a security-selection decision.

From an owner's objectives to the portfolio

A sustainability objective needs decisions and responsibilities along the investment chain.

Owner sets objectives and strategic asset allocation. → Mandate and manager selection define implementation. → Manager selects holdings, engages and reports progress.

WHAT THIS MEANS Monitoring feeds back into objectives, mandates and manager decisions; strategic allocation differs from selecting one security.

Corporate engagement and policy engagement

Engagement with an investee and engagement with policymakers address different decision makers and levels of influence.

CORPORATE ENGAGEMENT

- Addresses company boards or management.
- Seeks changes to a company's practices, decisions or disclosure.
- Can involve dialogue or the exercise of shareholder rights.

POLICY ENGAGEMENT

- Addresses the policy environment in which investments operate.
- Seeks market conditions that support sustainable returns and value creation.
- Connects public-policy issues to investors' responsibilities to beneficiaries.

KEY POINT A discussion with company management about emissions is different from seeking a change in market-wide disclosure requirements.

Challenges and practice: review

Sound integration requires relevant evidence, practical implementation and a clear understanding of the action being taken.

- Dynamic materiality requires reassessment as circumstances change.
- Double materiality adds the company's impacts on people and the environment.
- Adoption barriers differ from problems implementing an agreed policy.
- Data quality and historical models can constrain forward-looking analysis.
- Corporate performance evidence does not guarantee fund alpha.
- Investment decisions, corporate engagement and policy engagement are distinct routes.
- Check valuation adjustments for overlap and sustainability claims for support.

SECTION 4

Key Initiatives and the Size of the Market

Match institutions to their audiences and outputs, then interpret sustainable investment statistics with their scope and date.

4

Identify the audience before the acronym

Initiatives support different participants, so their intended audience helps explain what they ask those participants to do.

- The UN Global Compact provides principles relevant to company conduct.
- The Principles for Responsible Investment address investment and ownership practices.
- UNEP FI works with the financial sector on sustainable development.
- Banking and insurance frameworks should be distinguished from guidance for investors.

KEY POINT Similar sustainability language does not mean two initiatives have the same signatories, commitments or purpose.

United Nations initiatives

The UN-linked initiatives in this section address companies, financial institutions, investors and public-policy goals.

Initiative	Audience or function
UN Global Compact	Company conduct through ten principles covering human rights, labour, environment and anti-corruption.
UNEP FI	Partnership between UNEP and the financial sector supporting sustainable development.
PRI	Investor network supporting ESG consideration in investment and ownership practices.
Principles for Sustainable Insurance	Insurance-sector framework established through UNEP FI.

United Nations initiatives (continued)

The banking framework, and the goals addressed primarily to governments.

Initiative	Audience or function
Principles for Responsible Banking	Banking-sector framework associated with UNEP FI.
Sustainable Development Goals	Seventeen interconnected goals primarily directed at governments and also used by investors to frame intended impacts.

KEY POINT An investor using the SDGs as an impact framework has not thereby obtained certification of the investment's impact.

PRI and the UN Global Compact

The PRI focuses on investment practices, while the UN Global Compact provides principles for company conduct.

PRI

- Addresses investors and their investment and ownership practices.
- Has six voluntary principles.
- Supports implementation through tools, collaboration, policy work and reporting.

UN GLOBAL COMPACT

- Brings companies together around principles of responsible conduct.
- Has ten principles across four broad subject areas.
- Provides investors with a basis for assessing and engaging with companies.

KEY POINT Match an initiative to its audience and commitment, not merely to whether it is associated with the UN.

The six PRI commitments

The PRI principles connect the investment process with ownership, industry cooperation and accountability.

Area	Commitment in original summary
Investment decisions	Bring ESG considerations into analysis and decision making.
Ownership	Reflect ESG considerations in ownership policies and activities.
Investee disclosure	Ask invested entities for appropriate ESG information.
Industry adoption	Encourage wider acceptance and use of the principles.

The six PRI commitments (continued)

The last two commitments: cooperating on implementation, and reporting progress.

Area	Commitment in original summary
Collaboration	Cooperate to improve implementation.
Reporting	Describe implementation activities and progress.

KEY POINT The principles describe investor practices; they do not prescribe a universal exclusion list or guarantee portfolio outcomes.

Membership must be examined through implementation

The PRI combines voluntary principles with reporting and implementation expectations described in the curriculum.

- Its principles cover investment analysis, ownership, disclosure, industry adoption, collaboration and reporting.
- The curriculum describes annual reporting on responsible investment practices and a separate assessment process.
- It also describes minimum expectations for policy coverage, implementation responsibility and senior accountability.
- A reviewer should examine the institution's practices rather than infer portfolio quality from membership alone.

KEY POINT Membership, a public report and an assessment are different pieces of information; none is a guarantee of investment performance.

PRI reporting and minimum requirements

The curriculum distinguishes a public report, a private assessment and minimum implementation requirements.

- The transparency report is public; the assessment is private unless the member chooses to share it.
- The policy must cover more than 50% of assets under management under the requirements described here.
- Implementation needs assigned staff responsibility and senior commitment and accountability.

Read the PRI's growth with the right denominator

The curriculum records broad international adoption; membership is not proof of implementation quality.

- At 31 December 2023, the curriculum reports more than 5,300 signatories worldwide.
- Its regional chart lists 1,063 in the US and 844 in the UK and Ireland, alongside members across other regions.
- Research, education, committees and partnerships help investors develop and implement practice.
- A signatory count and signatory assets are different from assets demonstrably managed with a particular ESG strategy.

Climate agreements and disclosure pillars

International climate agreements establish direction, while disclosure frameworks help users assess an organisation's response.

- The UNFCCC provides the treaty setting for international climate negotiations and COP meetings.
- The Kyoto Protocol and Paris Agreement differ in the participation and commitments described in the curriculum.
- The Paris Agreement seeks to keep warming well below 2 degrees Celsius, with an ambition of limiting it to 1.5 degrees.
- TCFD organises disclosure around governance, strategy, risk management, and metrics and targets.

KEY POINT A state's climate commitment and a company's climate disclosure are connected, but they are not the same instrument.

Networks, tools and product disclosure

Different organisations support collaboration, impact measurement, market research, governance or investment-product disclosure.

Organisation or initiative	Distinctive contribution
GFANZ	Brings net-zero finance initiatives together across financial sectors.
Race to Zero	UN-backed campaign mobilising non-state actors around emissions-reduction commitments.
AIGCC	Supports Asian investors' awareness, capacity and collaboration on climate-related investment issues.
GIIN	Develops impact-investing infrastructure and resources, including IRIS+ impact metrics.

Reporting and standard-setting initiatives

Distinguish the issuer of a standard, the work informing it and the framework's continuing use.

Body or framework	Role described in the curriculum
GRI	Produces sustainability reporting standards serving a broad range of stakeholders.
ISSB	Develops a global baseline of sustainability-related financial disclosures for capital-market users.
SASB Standards	Form part of the Value Reporting Foundation work on which the ISSB draws.
TCFD	Climate disclosure recommendations continue within newer reporting arrangements after the task force's closure.

Who needs the disclosure, and what does it cover?

Different standards answer different users' questions.

- GRI addresses significant impacts for a broad stakeholder audience.
- IFRS S1 sets general requirements for sustainability-related financial information.
- IFRS S2 focuses on climate-related financial information.
- The standards took effect in 2024; adoption requirements depend on the jurisdiction.

Four questions behind the TCFD pillars

A climate report should connect oversight, business consequences, risk processes and measurement.

- Governance: who oversees climate risks and makes decisions?
- Strategy: how could climate change affect the business and its plans?
- Risk management: how are risks identified, assessed and managed?
- Metrics and targets: what is measured, and what progress is sought?

Networks, tools and product disclosure (continued)

The networks, and the voluntary standards that explain what a product actually does.

Organisation or initiative	Distinctive contribution
GSIA	Connects regional sustainable investment organisations and publishes market research.
ICGN	Promotes corporate governance and investor stewardship; also develops guidance on investment mandates.
CFA Institute disclosure standards	Voluntary standards explaining how investment products consider ESG in objectives, processes and stewardship.

KEY POINT An impact-measurement resource, a market survey and a product-disclosure standard solve different problems.

Reading market data without overclaiming

Sustainable investment statistics depend on the observation period, market coverage and definitions used.

- The historical 2022 GSIA dataset covers five major markets and reports about USD30.3 trillion in sustainable investment assets.
- Europe and the United States account for the largest shares.
- The reported decline in assets partly reflects changes in measurement methodology.
- The 2022 strategy comparison excludes Europe; engagement and shareholder action is its largest reported strategy.
- AUM, net flows and returns differ. Compare dates, market coverage and definitions before drawing a conclusion.

Two percentages can describe the same market

Always identify the denominator before comparing market shares.

- In the textbook's 2022 GSIA sample, Europe held about 46% of the sustainable investment total and the US about 28%.
- Regional penetration instead divides sustainable assets by all managed assets within that region.
- The five markets are Europe, the US, Japan, Canada, and Australia/New Zealand.
- Changes in methodology make comparisons across years difficult.

Market size depends on the segment

A strategy ranking and an investor-type split describe different aspects of the market.

- In the cited 2022 strategy comparison excluding Europe, engagement ranked first, integration second and exclusionary screening third.
- The historical retail share reached about one quarter in 2018; institutions held the remainder.
- The 2020 investor-type data omit Europe and Australasia; equivalent 2022 data were not reported.

Initiatives and market size: review

Learn each institution's audience and output, and keep market statistics attached to their definitions.

- PRI addresses investment and ownership practices; the UN Global Compact addresses company conduct.
- The PRI has six principles, the UN Global Compact ten, and the SDGs seventeen goals.
- GRI serves broad stakeholder reporting; ISSB develops a financial-disclosure baseline.
- TCFD's four pillars remain relevant after the task force's closure.
- GIIN supports impact investing, while GSIA provides market research.
- CFA Institute's product-disclosure standards are voluntary disclosure standards.
- Historical AUM comparisons require attention to scope, method and observation period.

SECTION 5

Market Drivers and Asset Owners

Explain how owners, beneficiaries and intermediaries shape demand, mandates and the implementation of sustainable investment.

What drives capital into sustainable strategies

Demand for sustainable investment develops through choices and information across the investment value chain.

- Asset owners influence demand through their investment decisions and expectations of managers.
- Consultants and advisers influence which products and approaches clients consider.
- Data, research and exchange disclosure practices affect the information available for investment analysis.
- Policy and regulation influence the environment in which these participants act.

KEY POINT A change in investor demand can affect several intermediaries; it does not reach an investee through only one route.

Four forces behind ESG demand

Preferences, rules, public awareness and better information can reinforce each other.

- Investor demand can change as wealth passes between generations and different owners express their preferences.
- Regulation and policy can require disclosures or consideration of sustainability issues.
- Public awareness can increase scrutiny of companies and investment products.
- Better data sourcing and processing can make analysis and implementation more practical.

Ownership sets the mandate

Asset owners set investment objectives and can implement them directly or through external managers.

- Owners make allocation decisions in light of objectives, market expectations and applicable constraints.
- Some manage investments internally; others delegate all or part of the work.
- A mandate communicates expectations for the investment product and potentially the manager's processes and resources.
- The owner's influence depends on implementation quality as well as the scale of its assets.

KEY POINT Delegation changes who performs investment tasks; it does not remove the need to define and oversee the owner's objectives.

Asset owners and asset managers

An owner sets objectives for its assets, while an external manager implements investment decisions within the agreed arrangement.

ASSET OWNER

- Owns the investment assets described in the arrangement.
- Makes allocation decisions and sets expectations for delegated management.
- Selects and oversees external managers when management is outsourced.

ASSET MANAGER

- Acts on behalf of clients in managing their assets.
- Makes decisions under the mandate or fund's governing documents.
- Provides implementation capabilities and information for the client's oversight.

KEY POINT Assets under management are not automatically the manager's own assets.

Asset owners and their investment purposes

The owner's purpose and obligations help explain its approach to sustainable investment.

Owner	Relevant purpose or exposure
Pension funds	Invest retirement savings and meet beneficiary obligations, often over long horizons.
Insurance companies	Invest premiums while managing insurance liabilities and investment exposures.
Sovereign wealth funds	Manage state wealth for objectives that can include stabilisation, future generations and strategic development.
Endowments	Support an institution's continuing activities through withdrawals from invested assets.

Asset owners and their investment purposes (continued)

The remaining owners: foundations investing for a purpose, and individuals expressing their own preferences.

Owner	Relevant purpose or exposure
Foundations and charities	Invest capital to support charitable purposes, with differences in how capital is raised.
Individuals	Express investment objectives and preferences directly or through advisers and investment products.

KEY POINT Owner categories suggest relevant questions; they do not establish identical horizons or ESG objectives for every institution.

What can stop an asset owner putting beliefs into practice?

Even a clear objective needs advice, staff capacity and an implementable mandate.

- A small owner may have limited staff and less bargaining power with service providers.
- Advice may omit relevant ESG options or fail to explain their investment trade-offs.
- A weak request for proposals may test policy language without testing actual capability.
- Use clear selection criteria, proportionate resources and continuing oversight.

Pension governance involves different roles

Trustees, executives and beneficiaries influence pension investment through different responsibilities and interests.

- Executives manage the pension fund's day-to-day functioning.
- Trustees hold fiduciary responsibility for the scheme and its beneficiaries.
- Beneficiaries contribute to or receive benefits from the fund and can express investment concerns.
- Delegation and alignment between trustees and executives vary across pension funds.

KEY POINT The person carrying out daily investment work is not necessarily the person with ultimate responsibility for the scheme.

Make a long-term mandate operational

A pension fund's long liabilities support long-term investing only when its mandate and oversight reinforce that horizon.

1. The owner identifies the long-term investment outcomes it wants the manager to pursue.
2. It sets mandate expectations for sustainability analysis, investment horizon and the manager relationship.
3. It requests reporting and metrics that help assess progress toward those expectations.
4. It uses frequent communication without turning every update into pressure for immediate performance.

WHAT THIS MEANS A long liability horizon can coexist with incentives for short-term behaviour; assess the mandate's actual implementation.

Three pension funds, three implementation choices

Compare the investment mechanism used in each historical case.

- ABP announced fossil-fuel-producer divestment, judging its ability to accelerate change through ownership insufficient.
- GPIF used ESG-themed indexes, emphasising public evaluation methods and provider governance.
- EAPF's manager search linked sustainability research with a long-term investment relationship.
- The cases illustrate exit, index selection and mandate design; they do not establish one universally best method.

Member preferences can change pension policy

Gather preferences, interpret the evidence and implement decisions within the fund's responsibilities.

- PGB surveyed members and used the results in decisions about tobacco and civilian-firearm exclusions.
- Horeca & Catering members highlighted labour, environment, fraud and corruption concerns.
- That fund adopted norms-related exclusions and a portfolio carbon-reduction objective.
- A survey informs governance; it does not automatically override financial responsibilities or prove all members agree.

The Rest case illustrates legal risk and a settlement

A settled dispute should not be described as a court ruling establishing a universal duty.

- A member challenged Rest in 2018 over climate-risk information and its treatment in his investments.
- The case settled in 2020; the fund made climate-related commitments described in the curriculum.
- The example shows how beneficiaries can challenge disclosure and management of financially relevant climate risk.
- Distinguish the claim, settlement commitments and any actual judicial findings.

Insurance exposures differ by business line

Insurance businesses encounter sustainability factors through different claims profiles and investment horizons.

PROPERTY AND CASUALTY

- Covers property damage and certain liability risks.
- Can be exposed to the frequency and severity of extreme weather.
- Physical climate risk can directly affect the claims side of the business.

LIFE INSURANCE

- Covers loss of life and can provide retirement products such as annuities.
- Is affected by demographic change and the nature of long-term obligations.
- Physical and transition risks can affect long-term investment values.

Reinsurance shares an insurer's risk

A reinsurer accepts part of an insurer's exposure in return for a premium.

- Policyholders buy insurance; insurers may then transfer an agreed part of that risk to a reinsurer.
- Extreme weather can affect both the original insurer and the reinsurer.
- Risk transfer changes who bears losses; it does not eliminate the underlying physical damage.

Sovereign wealth follows state objectives

A sovereign wealth fund's mandate may combine financial objectives with broader objectives of the state.

- State-owned funds can manage wealth arising from capital surpluses.
- Objectives can include economic stabilisation or saving for future generations.
- A mandate can also support strategic development of the state's territory.
- Those purposes may align with ESG objectives, but alignment is not automatic.

KEY POINT State ownership does not prove a fund has an ESG mandate or an identical horizon to every other sovereign fund.

An endowment supports a mission over time

The investment portfolio finances an institution while its activities may raise mission-related concerns.

- A university endowment can finance teaching, research and scholarships from investment resources.
- Beneficiaries may question holdings that conflict with the institution's stated values.
- Compare exclusion, engagement and other permitted approaches with spending needs and long-term resilience.
- Governance must explain how financial responsibilities and mission considerations enter decisions.

Endowments, foundations and public charities

The source and purpose of capital affect investment choices.

- An endowment supports an institution's continuing activities through withdrawals from invested capital.
- In the curriculum's example, a private foundation originates its capital from one funder, often a family or business.
- A public charity raises its capital from the public.
- An institution may need to balance operating support, investment risk and its social mission.

Read retail demand with context

Retail participation in sustainable investment can grow over time while individual markets still experience periods of outflows.

- Retail adoption has generally developed more slowly than institutional adoption in the curriculum's account.
- Regional patterns differ, so global assets do not describe every local market.
- Fund flows can be affected by market conditions, performance and political scrutiny.
- Keep each reported trend attached to its period, market and measure.

KEY POINT A long-run growth statement and an outflow in a specific market-year can both be true.

Drivers and asset owners: review

An owner's influence becomes concrete through its objectives, governance, mandates and oversight.

- Owners, advisers, managers, information providers and policymakers interact across the investment chain.
- Owners can manage directly or delegate under an agreed mandate.
- Pension trustees, executives and beneficiaries have different roles.
- Long liabilities do not by themselves prevent short-term incentives.
- Insurance exposure can arise on both sides of the balance sheet.
- Sovereign wealth objectives need not automatically align with ESG objectives.
- Retail fund trends require regional, period and measurement context.

SECTION 6

Asset Managers and Financial Services

Distinguish managers, fund promoters and supporting financial services using the curriculum's own classification.

6

Who does what in the investment chain

The curriculum separates portfolio management from fund promotion and from supporting financial services.

Participant	Role
Asset managers	Select investments, manage portfolios and engage with investees.
Consultants and advisers	Help institutional or individual clients choose strategies and investment products.
Investment platforms	Provide information, ratings or recommendations that can influence fund selection.
Fund labellers	Assess funds against label criteria to support users' identification of product characteristics.

Who does what in the investment chain (continued)

Who else shapes the chain: providers of analysis, and exchanges that set listing practice.

Participant	Role
Research and rating providers	Supply analysis and information relevant to investment decisions.
Stock exchanges	Can strengthen issuers' disclosure practices and support sustainability-related market information.

KEY POINT Here, fund promoters include advisers, platforms and labellers; the term is not limited to firms launching new funds.

Managers shape portfolios and product offerings

Asset managers influence ESG characteristics through investment selection, engagement and the approaches they offer to clients.

- Managers choose securities and manage portfolios for asset owners.
- They can engage with investees about their ESG practices.
- They respond to client interest and can propose new investment approaches.
- Offerings have expanded from listed equities into fixed income, real assets and private markets, as well as passive products.

KEY POINT Managers are implementers and product developers; they still need to understand the client's objectives and constraints.

The same objective needs different tools across assets

Issuer type, ownership rights, liquidity and data availability affect implementation.

- A corporate share, a sovereign bond and a private investment expose investors to different rights and risks.
- Sovereign analysis examines a country, not a company's board or sales revenue.
- Private-asset data may require direct collection and contractual reporting.
- ESG indexes, systematic factor strategies and derivatives add implementation choices, developed further in LM07.

Active funds and index-based products

ESG considerations can influence both active investment decisions and the design of index-based products.

ACTIVE APPROACHES

- Managers make investment choices within the strategy's objectives and constraints.
- ESG considerations can inform security selection and engagement.
- Offerings extend across listed equities and other asset classes.

INDEX-BASED APPROACHES

- The index's design helps determine the investment exposure being offered.
- ESG-related indexes can act as benchmarks or the basis of passive funds.
- Data and research availability support the development of ESG indexes.

Implementation requires signals and resources

A manager's ESG capability depends on clear client expectations, appropriate resources and integration into the investment process.

- Unclear signals from owners can weaken the incentive to develop ESG capabilities.
- Narrow advice about client objectives can restrict the approaches considered.
- Research, staff and technology require resources, especially when ESG is treated as separate from core investing.
- Different jurisdictional disclosure requirements can create additional implementation demands.

KEY POINT A marketing commitment does not establish that investment teams have the resources or processes to implement it.

Fund promoters are a broader category

The curriculum groups consultants, retail advisers, investment platforms and fund labellers under fund promoters.

- Consultants help institutional investors establish strategies and select investment products.
- Retail financial advisers help individuals translate their objectives into investment choices.
- Platforms influence the information and recommendations available to fund users.
- Labellers help distinguish products using defined assessment criteria.

KEY POINT Use the course's stated definition: fund promotion here covers several gatekeeping roles, not only product launch or advertising.

Advice can enable or obstruct ESG

Consultants and advisers influence whether a client's sustainability preferences become practical investment recommendations.

- They can help clients understand relevant investment objectives and fiduciary considerations.
- They can incorporate ESG expectations into strategy, policies and manager selection.
- Manager research can examine capabilities, processes and implementation rather than only a stated policy.
- The PRI's work with these intermediaries addresses gaps between ESG concerns and the advice clients receive.

KEY POINT The availability of ESG products is insufficient when the advice process never identifies or evaluates them for the client.

Turn client expectations into manager selection

An adviser can translate sustainability expectations into criteria used to assess and appoint investment managers.

1. Clarify the client's investment beliefs and expectations concerning ESG.
2. Use those expectations when developing investment principles and the manager proposal.
3. Assess prospective managers' relevant capabilities and implementation processes.
4. Incorporate the expectations into the mandate and appointment decision.

WHAT THIS MEANS A shortlist should be connected to the client's expectations, with evidence about how the manager would implement them.

Fund ratings and certification labels

Ratings and labels both inform product selection, but users must examine the assessment each one actually provides.

PLATFORM INFORMATION AND RATINGS

- Help investors identify and compare funds or managers.
- Depend on the platform's analysis, coverage and classification approach.
- Can influence capital moving toward or away from a fund.

CERTIFICATION LABELS

- Indicate an assessment against specified label criteria.
- May address ESG broadly or a particular environmental theme.
- Can differ across jurisdictions, limiting easy cross-border comparisons.

KEY POINT A fund's name, a platform classification and a certification label are different signals; examine the criteria behind each.

Classification changes are not cash withdrawals

A database category, a certification label and a custody service answer different questions.

- Reclassifying a fund can change the measured sustainable-fund universe without investors withdrawing money.
- A fund can qualify for a label without using “ESG” in its name, depending on the scheme criteria.
- Custodians safeguard and administer assets; available reporting and data services vary by provider.
- A ratings or service provider supports decisions but does not take over the investor’s overall responsibility.

Financial services support investment analysis

Supporting institutions influence the securities available and the ESG information used to assess them.

Service provider	Illustrative contribution
Investment bank	Helps an issuer bring a green bond to market.
Sell-side analyst	Incorporates relevant ESG information into investment research and recommendations.
Credit rating agency	Considers relevant ESG factors in credit analysis.
Stock exchange	Can require or encourage ESG disclosure from listed issuers.
Proxy voting provider	Incorporates ESG considerations into voting services and recommendations.

KEY POINT A service supports a particular decision or information need; it does not replace the investor's overall assessment.

Managers and financial services: review

Match each participant to its decisions, advice and information.

- Managers influence holdings, engagement and available investment approaches.
- ESG can be incorporated into active and index-based products.
- Client signals, resources and jurisdictional requirements shape implementation challenges.
- Fund promoters include consultants, advisers, platforms and labellers in this curriculum.
- Consultants can link beliefs, proposals, mandates and manager selection.
- Ratings, classifications and labels require examination of their underlying criteria.
- Financial services support issuance, research, disclosure and ownership decisions.

SECTION 7

Policymakers, Regulators and Other Participants

Connect policy objectives to regulatory instruments and distinguish the scope of the curriculum’s jurisdictional examples.

7

Why financial regulators consider ESG

Financial regulators consider sustainability factors when those factors affect market integrity, investor protection or financial stability.

- Sustainability issues can affect the wider financial system and individual portfolios.
- Regulators seek orderly markets, safe savings and investments, and orderly growth of the financial sector.
- Disclosure requirements can help investors identify relevant risks and product characteristics.
- Environmental, labour and other regulators can also affect investees' conduct and disclosures.

KEY POINT An environmental policy, a company reporting rule and a financial-supervision measure have different functions.

Four themes of sustainable finance regulation

The curriculum groups investment-related sustainability regulation by the activity or participant it addresses.

- Corporate disclosure concerns information companies provide about relevant ESG matters.
- Stewardship concerns how investors interact with investees and exercise responsibilities.
- Asset-owner requirements concern institutions such as pension funds and insurers.
- Investor protection concerns transparency, product information and sustainability-related claims or preferences.

KEY POINT Identify who must act and what action is required before matching a rule to a category.

From policy objective to investment information

Policy goals can lead to financial instruments that help investors identify sustainability characteristics and risks.

1. Policymakers establish sustainability objectives, such as directing capital toward activities with environmental benefits.
2. They select measures such as incentives, restrictions or financial-sector requirements.
3. Taxonomies and disclosure standards make relevant activity characteristics and risks more visible.
4. Investors use the resulting information in capital allocation and risk assessment.

WHAT THIS MEANS A taxonomy helps classify activities; it is one instrument serving a policy objective, not the entire policy framework.

Regulation a candidate must be able to name

The named instruments address different parts of the information chain from companies to investment products.

Instrument	Role in the curriculum
CSRD	Corporate sustainability reporting within the EU framework.
EU Taxonomy	Classification of economic activities against environmental sustainability conditions.
SFDR	Sustainability-related disclosure concerning investment products and financial-market participants.
ESRS	Reporting standards used within the EU corporate sustainability reporting framework.

EU financial-product Ecolabel: a version clarification

Verified 13 September 2026: the financial-product criteria project has been discontinued.

- The textbook lists the initiative within the EU sustainable-finance architecture.
- The Commission now says its development has stopped and the work will inform SFDR revision.
- The existing EU Ecolabel for eligible goods and services is a different scheme.
- Learn the policy aim, but do not describe the abandoned financial-product project as an operating fund label.

Regulation a candidate must be able to name (continued)

The named instruments address different parts of the information chain from companies to investment products.

Instrument	Role in the curriculum
UK SDR	UK sustainability disclosure and product-labelling arrangements addressing clarity and greenwashing.

KEY POINT A corporate reporting standard, an activity classification and a fund disclosure requirement should not be treated as interchangeable.

Company reporting and product disclosure

Company sustainability reporting supplies issuer information, while product disclosure explains the investment product's sustainability characteristics.

CSRD AND ESRS

- Concern sustainability information reported by companies.
- CSRD provides the reporting framework and ESRS the associated reporting standards.
- Help users understand companies' sustainability matters.

SFDR

- Concerns sustainability disclosures in the financial-investment chain.
- Explains how investment products consider or promote relevant sustainability factors.
- Addresses transparency and adverse sustainability impacts of investment decisions.

CSRD: keep the legal version attached to the rule

Exam basis: the curriculum's thresholds. Update verified 13 September 2026: Directive (EU) 2026/470 narrows the scope.

- Curriculum: CSRD, effective FY2024 and replacing the NFRD, applies to companies meeting two of EUR40m turnover, EUR20m assets and 250 employees.
- Curriculum: non-EU companies with EU turnover above EUR150m; nearly 50,000 companies against 11,000 under the NFRD.
- Update: from FY2027, companies with more than 1,000 employees and over EUR450m net turnover; in force March 2026.
- Answer exam questions from the curriculum; use the amended scope for current practice. CSRD is not due diligence.

Whose risk, and whose harm?

A sustainability risk to the investment differs from an adverse effect caused by the underlying activity.

- Investment risk: water restrictions can reduce a company's earnings.
- Adverse impact: the company's pollution can damage water used by neighbouring communities.
- Principal adverse impacts focus on significant negative sustainability effects associated with investment decisions.
- The same issue can appear in both assessments, but the direction and purpose of the information differ.

Six EU Taxonomy environmental objectives

Taxonomy assessment distinguishes environmental objectives and also considers harm to other objectives and minimum safeguards.

Objective	Focus
Climate mitigation	Addressing the causes of climate change.
Climate adaptation	Responding to climate-related effects.
Water and marine resources	How an activity draws on fresh water and how it affects marine ecosystems.
Circular economy	Transition toward more circular resource use.

Six EU Taxonomy environmental objectives (continued)

The last two objectives: preventing pollution, and protecting and restoring ecosystems.

Objective	Focus
Pollution prevention and control	Preventing and controlling pollution.
Biodiversity and ecosystems	Protecting and restoring biodiversity and ecosystems.

KEY POINT A contribution to one objective is not a reason to ignore significant harm to another or the minimum safeguards.

Greening finance and financing green

The UK strategy distinguishes incorporating environmental factors into finance from directing finance toward environmental activities.

GREENING FINANCE

- Focuses on how the financial sector makes decisions.
- Embeds environmental and climate considerations in lending and investment.
- Addresses financial activities more broadly than a single green product.

FINANCING GREEN

- Focuses on where financial flows are directed.
- Supports activities associated with sustainable and resilient growth.
- Connects private capital with activities that advance environmental objectives.

KEY POINT The strategy's additional opportunity theme concerns the financial sector's role in developing green finance.

The four UK sustainability labels describe different goals

A fund's objective determines which label criteria are relevant.

- Sustainability Focus: assets meeting a sustainability standard.
- Sustainability Improvers: assets with potential to meet such a standard over time.
- Sustainability Impact: a predefined positive, measurable environmental or social impact.
- Sustainability Mixed Goals: a combination of at least two of the other objectives.

Supervision and transition plans have practical jobs

Climate policy needs institutions to assess risk, plan action and finance change.

- The PRA's supervisory work addresses climate-related financial risks in regulated institutions.
- The Transition Plan Taskforce developed guidance for credible private-sector transition plans.
- A plan connects an ambition to actions, governance, resources and progress measures.
- The UK strategy also seeks commercial opportunities from green-finance capabilities.

Regional policy examples and their purposes

The curriculum's jurisdictional examples combine classification, disclosure and supervision in different ways.

Example	Function described
China green finance	Supports the development of green financial instruments and related market structures.
Common Ground Taxonomy	Seeks comparability between Chinese and EU classifications to support cross-border green finance.
Singapore	Combines taxonomy work, environmental risk guidance, disclosure expectations and stress testing.
ASEAN Taxonomy	Combines a qualitative Foundation Framework with a Plus Standard using metrics and thresholds.

Australia, New Zealand and the US

Three markets at different stages: coordination, mandatory disclosure, and a proposal that changed.

Example	Function described
Australia CFR	Coordinates climate-related financial work, including bank vulnerability assessment and disclosure-standard development.
New Zealand	Uses climate-related disclosure requirements for entities within the stated scope.
US SEC example	Illustrates how a climate disclosure proposal can differ from the subsequently finalised rule.

Taxonomies can use different decision structures

Compare the assessment method before treating two classifications as equivalent.

- The Common Ground Taxonomy compares areas of commonality between Chinese and EU approaches; it is not automatic legal recognition.
- The ASEAN Foundation Framework uses qualitative assessment; the Plus Standard adds technical screening detail.
- A qualitative question asks how an activity affects an objective; a threshold tests a specified measured boundary.
- Singapore combines taxonomy work with environmental-risk guidance, disclosure and supervisory analysis.

Australia and New Zealand: identify the institution and scope

The curriculum's examples combine supervisory analysis with entity-level reporting.

- Australia's CFR coordinates agencies; APRA examines prudential risk and ASIC oversees relevant market and disclosure conduct.
- A bank vulnerability assessment asks how a climate scenario affects financial resilience.
- In the textbook's NZ scope, banks and scheme managers use an NZD1bn asset threshold; insurers also have an NZD250m premium test.
- The historical USD equivalents are 621.382m and 155.3455m; these are historical conversions, not new NZ thresholds.
- Listed issuers: the Act covers only large listed issuers above an NZD60m test and excludes growth-market-only issuers; the 2025 reform proposals were still not law when checked on 1 July 2026.

Distinguish a proposal from a final rule

The curriculum's US climate-disclosure example shows why a proposal's requirements cannot simply be attributed to its final version.

- The textbook describes a 2022 SEC proposal covering climate governance, impacts and emissions information.
- That proposal included Scope 1 and Scope 2 emissions and material Scope 3 emissions.
- The textbook's account of the March 2024 final rule states that Scope 3 emissions were excluded.
- Identify the version and date in a situation before determining which described requirement belongs to it.

KEY POINT This is a comparison within the curriculum's historical example, not a claim that every proposed requirement became final.

Policymakers and regulatory instruments: review

Read a sustainability rule through its objective, audience, instrument and version.

- Regulation can address market integrity, investor protection and financial stability.
- Themes include company disclosure, stewardship, asset owners and investor protection.
- Taxonomies classify activities; company and product disclosures inform different decisions.
- EU alignment requires contribution, no significant harm, safeguards and relevant technical criteria.
- Greening finance and financing green differ; labels describe particular objectives.
- Distinguish proposals, enacted rules and dated textbook examples.

SECTION 8

Global Regulation and Module Recall

Interpret the curriculum's fiduciary and stewardship examples, explain other participants' roles, and consolidate the module.

8

How different policy levels combine

Global, regional and national strategies, notably the EU Action Plan on Financing Sustainable Growth, have driven policy growth.

- Regulation is expected to move from “comply or explain” to “comply and explain”.
- Disclosure is expected to move from voluntary to mandatory.
- Policy is expected to move on to implementation and reporting.
- A narrow regulatory view of fiduciary duty, such as the US Department of Labor’s 2020 rule, can hold ESG investing back.

KEY POINT Learn the three shifts as a set: they describe the direction of travel, not one country’s rule.

“Comply or explain” still requires an explanation

Different governance frameworks attach different consequences to non-compliance.

- Comply or explain: follow a provision, or explain a departure under the framework.
- Comply and explain: comply and explain how compliance is put into practice.
- An explanation should allow users to assess the reasons and practical consequences.
- The Network for Greening the Financial System (NGFS), 140 central banks and supervisors founded in 2017, treats climate risk as a supervisory concern.

Fiduciary duty requires attention to context

The curriculum's fiduciary cases distinguish relevant financial considerations from decisions motivated by other objectives.

- A fiduciary acts for beneficiaries rather than for the fiduciary's personal preferences.
- The US case describes prudence, loyalty and diversification in the pension context.
- The UK case distinguishes financially relevant factors from limited circumstances for considering non-financial concerns.
- The examples also show that regulatory interpretations can develop over time.

KEY POINT An ESG label alone does not determine fiduciary treatment; identify the factor's relevance, decision context and applicable case.

The curriculum's ERISA case

ERISA, the Employee Retirement Income Security Act, sets prudent-person standards for US private-sector plans.

Area	Principle or distinction in the case
Scope	US private-sector plans; public plans often use ERISA as a benchmark.
Loyalty	Act solely for plan participants and beneficiaries.
Prudence	Invest with the care, skill and diligence of a knowledgeable prudent person.
Diversification	Diversify to minimise the risk of large losses.
Liability	Sponsors that breach these duties may be personally liable.

KEY POINT The duties stay fixed; the Department of Labor's reading of ESG within them changed.

The Department of Labor's early ESG guidance

From 1994 to 2015, US Department of Labor guidance under ERISA moved towards recognising ESG value.

Date	Department of Labor position
1994	Interpretive Bulletin 94-1: economically targeted investments are compatible if expected returns match similar-risk alternatives.
2008	Considering collateral, non-economic factors should be rare and documented.
2015	Interpretive Bulletin 2015-01: collateral benefits may count if investments are economically equivalent; ESG can affect value.

KEY POINT "All things being equal": social benefits may count only when returns match similar-risk alternatives.

The Department of Labor's rules, 2020 to 2022

The pendulum swung back in 2020 and forward again by 2022.

Date	Department of Labor position
2020	Final rule: "non-financial objectives" replaces ESG; decide on financial factors only.
March 2021	Statement of non-enforcement of the 2020 rule.
October 2021	A new rule proposed to allow ESG criteria and proxy voting.
December 2022	Final rule: climate and other ESG factors may be considered when relevant to risk and return.

KEY POINT A financially relevant ESG factor and a non-financial tie-breaker are different grounds for a decision.

Financial factors and non-financial concerns

The UK case study treats financially relevant factors differently from decisions motivated by non-financial concerns.

FINANCIAL FACTORS

- Matter to the financial assessment of the investment.
- The cited Law Commission report says trustees should take them into account.
- An ESG issue can belong here when it is financially material.

NON-FINANCIAL CONCERNS

- Reflect other motives, such as disapproval of an industry.
- The cited report requires good reason to believe members share the concern.
- It also requires that the decision not risk significant financial detriment to the fund.

KEY POINT Apply the two conditions together within the UK case study; do not turn them into a universal rule for every investor.

Stewardship joins investment and ownership

The curriculum's UK Stewardship Code 2020 example connects stewardship responsibilities with investment and material ESG issues.

- It covers asset owners, and asset managers that manage assets for UK clients or invest in UK assets.
- Service providers such as investment consultants, proxy advisers and data providers are covered too.
- Principles are supported by reporting expectations.
- Principle 7 requires signatories to integrate stewardship and investment systematically, including material ESG issues and climate change.

KEY POINT Exam basis: the 2020 code. Update verified 18 September 2026: the UK Stewardship Code 2026 applies from 1 January 2026.

Engagement policy and reporting in SRD II

The EU case links an engagement policy to disclosure about how ownership responsibilities are exercised.

Reporting area	What the account should explain
Investment strategy	How engagement is connected to the investor's investment approach.
Dialogue	How the investor communicates with investees.
Shareholder rights	How voting and other shareholder rights are exercised.
Collaboration	How the investor works with other shareholders.
Conflicts of interest	How potential conflicts arising in the activity are addressed.

KEY POINT The existence of a policy is different from evidence explaining how that policy is implemented.

The other participants and why they matter

Investees, governments, civil society and academia affect both investment opportunities and the information available to investors.

- Investees manage ESG exposures and decide what information to disclose about them.
- Governments can connect investment with infrastructure, pensions and the transition to a low-carbon economy.
- Civil society can demand transparency, expose weak practices or help improve understanding of ESG issues.
- Academia examines ESG factors, investment decisions and their effects on companies and financial markets.

KEY POINT An investee can be a company, project, agency or jurisdiction; it is not limited to a listed corporation.

Company action and investor action

Companies manage their own practices, while investors assess exposures and influence capital allocation or ownership decisions.

INVESTEE COMPANY

- Manages operational and strategic sustainability issues.
- Chooses how to disclose relevant practices, exposures and effects.
- Can integrate corporate responsibility into its business model.

INVESTOR

- Assesses the implications for investment decisions and objectives.
- Uses information to select, allocate capital and evaluate holdings.
- Can engage with issuers about their conduct and disclosure.

KEY POINT An investor's consideration of ESG and a company's sustainability management are related activities performed by different decision makers.

Why governments seek private investment

Public resources alone may not meet retirement, infrastructure and transition financing needs.

- Pensions: public pensions are under strain, so citizens rely more on corporate or private plans.
- Infrastructure: building or restoring water, transport and energy systems is costly for treasuries.
- Transition: moving to a low-carbon economy requires significant shifts in capital.
- Governments can encourage attention to financial materiality and impact to advance national priorities.

Why universal owners consider system-wide effects

A diversified owner's financial results depend on economic conditions shared by many of its investments.

1. The investor owns assets across companies, sectors and regions.
2. A harmful practice benefits one company while imposing costs elsewhere in the economy.
3. Those costs affect other holdings or the market conditions supporting their returns.
4. The owner considers the portfolio-wide consequences when assessing its investment and ownership approach.

WHAT THIS MEANS A gain for one holding need not be a gain for the owner's total portfolio.

Asset classes in the historical market data

Public equities and fixed income dominated the historical ESG asset mix described in the curriculum.

- At the start of 2019, public equities were over 50% of ESG assets and fixed income 36%.
- Other assets include real estate, infrastructure and private markets.
- An asset-class split differs from a strategy split: the same asset class can support several ESG approaches.
- These are historical observations, not a live estimate of 2026 market composition.

Module 1: review

Sustainable investment links objectives and material issues to practical decisions across the investment chain.

- Investment selection and engagement can combine financial considerations with other stated objectives.
- Sustainability issues can affect costs, risks, externalities and opportunities.
- Universal owners depend on the health of the broader economy.
- Owners communicate expectations through mandates and oversight.
- Managers, advisers and other intermediaries influence how expectations are implemented.
- Financial regulation and investee disclosure shape the information available to investors.
- Implementation requires resources, credible evidence and scrutiny of sustainability claims.

Introduction to Sustainable Investing

Continue to the practice questions for this module.