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Question 1. (Single Select)

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

Correct Answer: A

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.

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 .

Question 2. (Single Select)

Human rights violations are most likely to affect workers employed

A: by first-tier suppliers to publicly traded companies
B: by second-tier suppliers to publicly traded companies.
C: deep within the supply chain of publicly traded companies.

Correct Answer: C

Explanation:

Human rights violations are most likely to occur deep within the supply chain of publicly traded companies. Here's why:

First-tier Suppliers:

First-tier suppliers are those that directly supply products or services to a company. These suppliers are often under greater scrutiny from the company and external stakeholders, including auditors and regulatory bodies. Publicly traded companies typically enforce stricter compliance and monitoring mechanisms at this level .

Second-tier Suppliers:

Second-tier suppliers supply products or services to the first-tier suppliers. While there is still some level of oversight, the scrutiny diminishes as the layers in the supply chain increase. Human rights violations can occur here, but they are less frequent compared to deeper levels in the supply chain .

Deep within the Supply Chain:

Suppliers deeper within the supply chain, such as third-tier and beyond, are the least visible and have the least amount of oversight. These suppliers often operate in regions with weaker regulatory frameworks and less stringent enforcement of labor laws. Consequently, they are more prone to human rights violations, including poor working conditions, forced labor, and child labor.

Companies may not have direct business relationships with these deeper-tier suppliers, making it challenging to enforce ethical practices and human rights standards.

CFA ESG Investing Reference:

The CFA Institute's ESG curriculum highlights the importance of supply chain transparency and the risks associated with human rights violations at different levels of the supply chain. The curriculum emphasizes that deeper tiers within the supply chain are often where the mostsignificant human rights risks are found, and it encourages investors to assess and address these risks in their ESG evaluations.

Question 3. (Single Select)

What is the underlying principle of the corporate governance code in most markets?

A: If not, why not
B: Apply or explain
C: Comply or explain

Correct Answer: C

Explanation:

The underlying principle of the corporate governance code in most markets is "comply or explain." This principle mandates that companies either comply with the established governance guidelines or explain why they have not done so. This approach allows for flexibility while encouraging transparency and accountability in corporate governance.

Flexibility and Adaptability: The "comply or explain" approach provides companies with the flexibility to adapt the guidelines to their specific circumstances. If a company believes that a certain recommendation is not suitable for its situation, it can choose not to comply, provided it

explains the reasons for this decision.

Transparency: By requiring companies to explain their non-compliance, this approach promotes transparency. Stakeholders, including investors, can assess the company’s governance practices and make informed decisions based on the explanations provided.

Encouragement of Best Practices: This principle encourages companies to strive towards best practices in governance, while allowing for deviations when justified. It balances the need for high standards with the recognition that one size does not fit all.

MSCI ESG Ratings Methodology (2022) - Discusses the principles of corporate governance codes and highlights the "comply or explain" approach as a common standard in various markets.

ESG-Ratings-Methodology-Exec-Summary (2022) - Provides insights into how corporate governance codes are designed to promote transparency and accountability through the "comply or explain" principle.

Question 4. (Single Select)

Which of the following is an example of a bottom-up ESG engagement approach? An asset manager:

A: joining the PRI Collaboration Platform
B: sending out a letter to the CFOs of all investee companies
C: initiating dialogue with an investee company's investor relations team

Correct Answer: C

Explanation:

A bottom-up ESG engagement approach involves direct interaction with specific investee companies to address ESG issues. Initiating dialogue with an investee company's investor relations team is an example of this approach.

Direct Communication: Engaging directly with the investor relations team allows asset managers to discuss specific ESG issues relevant to the company. This direct line of communication can

lead to more detailed and company-specific insights.

Targeted Engagement: This method focuses on individual companies, enabling asset managers to address specific concerns and influence company practices more effectively. It allows for a deeper understanding of how ESG issues are managed at the company level.

Active Ownership: By engaging with companies, asset managers exercise active ownership, encouraging companies to adopt better ESG practices. This can lead to improved ESG performance and, ultimately, better long-term investment returns.

MSCI ESG Ratings Methodology (2022) - Highlights the importance of direct engagement with companies as part of an effective ESG strategy.

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses various engagement approaches and emphasizes the value of direct dialogue with investee companies in improving ESG practices.

Question 5. (Single Select)

The concept of double-agency in society refers to the conflict of interest between

A: corporate CEOs and shareholders
B: money managers and asset owners.
C: corporate CEOs and money managers

Correct Answer: B

Explanation:

The concept of double-agency in society refers to the conflict of interest between money managers and asset owners. This concept arises when there are two levels of agency relationships, each with potential conflicts of interest.

Principal-Agent Relationship: In the first level, asset owners (principals) delegate the management of their assets to money managers (agents). The money managers are expected to act in the best interests of the asset owners, but their own interests might not always align with those of the asset owners.

Secondary Agency: The second level involves the relationship between the corporate CEOs (agents) and the company's shareholders (principals). Here, the CEOs are supposed to act in the best interests of the shareholders, but again, there might be conflicts of interest.

Double-Agency Conflict: The double-agency conflict occurs because the money managers, who are agents of the asset owners, also act as principals when dealing with corporate CEOs. This dual role can lead to conflicts where the money managers' decisions may benefit themselves or the CEOs rather than the asset owners.

MSCI ESG Ratings Methodology (2022) - Explains the principal-agent relationships and how conflicts of interest can arise at multiple levels, leading to the

ESG-Ratings-Methodology-Exec-Summary (2022) - Discusses the importance of aligning interests between asset owners, money managers, and corporate executives to mitigate the double-agency issue .

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