CHAPTER 27

INTRODUCTION TO CO… OTHER ESG CONSIDERATIONS

1. (C) **a company's internal procedures for addressing stakeholder relationships.**

   Explanation

   Organizational infrastructure refers to the practices and governance procedures that a company adopts to manage its stakeholder relationships.

   (Study Session 9, Module 27.1, LOS 27.d)

   Related Material

   SchweserNotes - Book 3

2. (B) **Non-executive directors.**

   Explanation

   Non-executive, or external, directors are typically viewed as more likely to act in shareholders' interests than executive, or internal, directors. Dual-class structures may allow a small group of shareholders, such as company founders and their heirs, to exercise control disproportionate to their ownership stake. Anti-takeover provisions limit shareholders' ability to bring about changes in management.

   For Further Reference:

   (Study Session 9, Module 27.2, LOS 27.i)

   CFA® Program Curriculum, Volume 3, page 626

   Related Material

   SchweserNotes - Book 3

3. (C) **both executives and non-executives can serve on the board of directors.**

   Explanation

   Independent directors and senior managers both serve on a single board with a one-tier board structure and are jointly responsible for determining corporate strategy.

   (Study Session 9, Module 27.1, LOS 27.f)

   Related Material

   SchweserNotes - Book 3

4. (B) **may be focused only on shareholder interests.**

   Explanation

   Under the shareholder theory of corporate governance, practices are primarily those that support shareholder interests, while under the stakeholder theory of corporate governance, the interests of various affected groups are considered and balanced. Corporate governance practices and definitions vary across countries.

   (Study Session 9, Module 27.1, LOS 27.a)

   Related Material

   SchweserNotes - Book 3

5. (C) **stakeholder theory.**

Explanation

Community groups may be one of the stakeholder groups considered under stakeholder theory.

(Study Session 9, Module 27.1, LOS 27.a)

Related Material

SchweserNotes - Book 3

6. (B) **whether management's incentives align with the firm's objectives.**

Explanation

Disclosures of a firm's remuneration programs enable an analyst to judge whether its compensation structure aligns management's incentives with the firm's objectives and shareholders' interests.

(Study Session 9, Module 27.2, LOS 27.i)

Related Material

SchweserNotes - Book 3

7. (A) **reduced default risk.**

Explanation

Ineffective corporate governance is likely to increase default risk.

(Study Session 9, Module 27.2, LOS 27.h)

Related Material

SchweserNotes - Book 3

8. (C) **directors.**

Explanation

Directors are legally responsible for their decisions and actions as board members. Neither regulators nor creditors face significant legal liabilities for their actions.

(Study Session 9, Module 27.1, LOS 27.b)

Related Material

SchweserNotes - Book 3

9. (B) **considering a single environmental or social factor when selecting investments.**

Explanation

Thematic investing refers to selecting investments with a view to a specific environmental, social, or governance factor. Identifying the best companies in each sector with respect to environmental and social factors is referred to as best-in-class investing. Excluding companies or sectors from consideration for investment based on environmental and social factors is referred to as negative screening.

(Study Session 9, Module 27.2, LOS 27.k)

Related Material

SchweserNotes - Book 3

10. (B) **remuneration committee.**

Explanation

Compensation for a company's senior executives is typically a responsibility of a remuneration or compensation committee.

(Study Session 9, Module 27.1, LOS 27.f)

Related Material

SchweserNotes - Book 3

11. (A) **act in the interests of the company and its shareholders.**

Explanation

The duty of loyalty requires a company director to act in the interests of the company and its shareholders. The board of directors is responsible for appointing the company's managers; the managers do not assign duties to board members.

(Study Session 9, Module 27.1, LOS 27.f)

Related Material

SchweserNotes - Book 3

12. (B) **annual and use cumulative voting.**

Explanation

With cumulative voting, minority shareholders are more likely to gain seats on the board of directors and influence corporate strategy and decisions than with majority voting. Compared to annual elections for all board seats, staggered board elections limit the ability of shareholders to select an entirely new board, except over a period of years.

(Study Session 9, Module 27.1, LOS 27.e)

Related Material

SchweserNotes - Book 3

13. (B) **Integrating ESG factors into the analysis of a company's risk and return characteristics is not considered a violation of fiduciary duty.**

Explanation

Using ESG factors in estimating the risk and returns of a company is not considered a violation of a manager's fiduciary duty to clients and beneficiaries. ESG considerations may conflict with fiduciary duty if they result in the manager accepting lower returns or higher risk than they otherwise would. A "values-based" investment objective is to express the investor's ethical beliefs through investment decisions. A "value-based" approach to ESG investing refers to considering ESG-related risks and opportunities alongside traditional investment considerations.

For Further Reference:

(Study Session 9, Module 27.2, LOS 27.j)

CFA® Program Curriculum, Volume 3, page 632

Related Material

SchweserNotes - Book 3

14. (A) **resolving the competing interests of those who manage companies and other groups affected by a company's actions.**

Explanation

Resolving the conflicting interests of both shareholders and other stakeholders is the focus of corporate governance under stakeholder theory. Shareholders are among the groups whose interests are considered under stakeholder theory.

(Study Session 9, Module 27.1, LOS 27.a)

Related Material

SchweserNotes - Book 3

15. (A) **at either the annual general meeting or an extraordinary general meeting.**

Explanation

Special resolutions may be voted on at the annual general meeting or at an extraordinary general meeting that is called specifically to address them. For Further Reference:

(Study Session 9, Module 27.1, LOS 27.e)

CFA® Program Curriculum, Volume 3, page 608

Related Material

SchweserNotes - Book 3

16. (B) **creditors.**

Explanation

A company's creditors prefer less risk because their potential gains from superior company performance are limited, while they have significant downside risk from poor performance that could threaten the company's solvency. Shareholders have the greatest gains from superior company performance. Suppliers may benefit from superior performance of a company to which they supply goods and services, but in general they prefer stable business operations and continuation of their business relationship with the company.

(Study Session 9, Module 27.1, LOS 27.b)

Related Material

SchweserNotes - Book 3

17. (B) **a common-law system.**

Explanation

Shareholder and creditor interests are considered to be better protected in a common-law system under which judges' rulings become law in some instances.

For Further Reference:

(Study Session 9, Module 27.2, LOS 27.g)

CFA® Program Curriculum, Volume 3, page 620

Related Material

SchweserNotes - Book 3

18. (A) shareholders and managers.

Explanation

The relationship between shareholders and managers is a principal-agent relationship. Shareholders, as principals, through the board of directors hire managers, as agents, to act in the best interests of the shareholders.

(Study Session 9, Module 27.1, LOS 27.c)

Related Material

SchweserNotes - Book 3

19. (A) agency relationship.

Explanation

This is an example of an agency relationship, which is also known as a principal-agent relationship. A company's senior managers are acting as agents, hired to act in the interest of shareholders who are the principal in the relationship

(Study Session 9, Module 27.1, LOS 27.c)

Related Material

SchweserNotes - Book 3

20. (A) organizational infrastructure.

Explanation

Organizational infrastructure is a company's corporate governance procedures and internal systems and practices for managing stakeholder relationships.

(Study Session 9, Module 27.1, LOS 27.e)

Related Material

SchweserNotes - Book 3

21. (B) shareholders.

Explanation

Compared to the other two groups, shareholders have the greatest potential gains from riskier strategies and can diversify their holdings across firms in order to reduce the influence of company specific risk. While senior managers can gain from company outperformance, they typically prefer less risk than shareholders because managers' risk of poor company performance on the value of their options and on their careers cannot be easily diversified away.

(Study Session 9, Module 27.1, LOS 27.b)

Related Material

SchweserNotes - Book 3

22. (C) **Governments.**

Explanation

Governments receive greater tax revenues when financial performance is excellent and profits are higher. Creditors do not receive extra returns for performance better than that is adequate to repay debt. Customers seek company stability and ongoing relationships with the company.

(Study Session 9, Module 27.1, LOS 27.b)

Related Material

SchweserNotes - Book 3

23. (B) **exclude investments with negative ESG characteristics from the investor's portfolio.**

Explanation

Constructing a portfolio based on ESG factors may violate fiduciary duty if doing so reduces expected returns. Analyzing ESG factors when assessing investment risk or using ESG factors to choose among otherwise equivalent investments would likely not violate fiduciary duty.

(Study Session 9, Module 27.2, LOS 27.j)

Related Material

SchweserNotes - Book 3

24. (A) **issuing stock dividends.**

Explanation

Issuing stock dividends does not necessarily favor one group of stakeholders over another because neither firm value nor earnings are affected by issuing a stock dividend. Covenants in debt issues protect creditor interests from management actions that would increase the risk of the debt. Including stock options as part of manager compensation serves to align the interests of senior management and shareholders.

(Study Session 9, Module 27.1, LOS 27.e)

Related Material

SchweserNotes - Book 3

25. (A) **integrating environmental and social considerations into the investment decision making process.**

Explanation

ESG investing is using environmental, social, and governance factors when making investment decisions. Investing only in companies that promote environmental or social initiatives favored by an investor is best described as impact investing. Excluding companies from consideration for investment based on environmental or social considerations is best described as negative screening. Impact investing and negative screening are two of the approaches an investor can use to implement ESG investing.

(Study Session 9, Module 27.2, LOS 27.j)

Related Material

SchweserNotes - Book 3