SBI MUTUAL FUND
A PARTNER FOR LIFE

Sustainable Investing

Mutual Funds are trustee of people's money and owe a fiduciary duty, first to their investors and then to the community at large. It can be best served, not by trying to maximise short-term profitability, but by ensuring optimisation of long-term return and risks.

As part of our fiduciary responsibility, value system and risk management strategy, it is our core belief that a business, run in best interests of all stakeholders seldom fails to create a lasting value for its investors. ESG investing is an approach where apart from financial considerations, one looks at **E**nvironmental footprint, **S**ocial impact and **G**overnance factors (ESG) of the investee companies. Companies focussing on triple bottom line (People, Planet and Profits) deliver sustained returns over a long period and hence, we integrated ESG factors in the investment decision making process a few years ago.

Environmental risks are bound to gain prominence in India. As per WHO, India inhabits 14 of 20 most polluted cities of the world. It ranks amongst the top three nations to see the highest number of deaths from air-pollution. The country is fast pacing towards water stress zone. As per a NITI Aayog study, 40 cities are likely to face drinking water shortages over the next decade. There are serious concerns about soil degradation in India and increased oceanic acidity world over. Rising inequality, with poor literacy and human development index in a democratic society has the potential to creates risks for businesses as well.

Even as India is growing faster than most other economies, it is still a US$ 2000 per-capita country and is yet to catch up meaningfully in the income ladder. In the process, the resource intensity of consumption is bound to rise. If history is any guide, ignoring the sustainability aspect can be damaging. China serves as a classic example. While high growth facilitated dramatic increase in consumption levels, it led to a rapid degradation of the eco-system, choking pollution and rising social tensions. Eventually, their policy makers had to shut thousands of manufacturing plants too rapidly.

Some of the policy developments in India too, such as Delhi's experiment with odd-even cars, move towards BS-VI compliance and now Electric vehicles, plastic ban in Maharashtra, plant closures in Karnataka around Bellandur lake were in response to rising pollution. We witnessed social backlash, leading to a copper plant closure in Tamil Nadu, SC's ban on liquor sales on highway and cancellation of coal blocks allocation (with adverse impact on mining and power companies). On the governance front, multiple instances of auditor resignations, excessive leverage, questionable 'related party transactions' and accounting issues have recently come to the fore. Such issues may remain unattended for years. But once brought to the surface, it erodes the economic value of the businesses at one go. To sum, investors can ignore ESG issues at their own peril.

Look at it another way: equity fund returns are largely a function of the beta (market return) and the alpha that fund manager generates above the market. Market return, in long term, is dependent on the economy. Long-term sustainable growth of the economy comes only when businesses focus on sustainability. So, when large fund houses start focusing on ESG, it signals the companies to integrate sustainability in their business practices, which in turn creates long term win-win for all.

Globally, large pension funds started putting pressure on fund managers to adopt ESG in their fund strategy. In India, we as a large fund manager are taking up this mantle, without necessarily waiting for our investors to ask us to do so.

Further, there is growing global evidence of better risk adjusted performance of ESG strategies, which is also contributing to the rapid growth in their AUM. Even in India, the NIFTY 100 ESG index has outperformed NIFTY 100 index across time periods.

It has been challenging for us to implement the framework due to inadequate data availability. However, regulatory requirement of sustainability reporting now applicable to Top 500 companies has helped. Over time, policy nudge combined with better data and analytics will facilitate a more systematic approach.

As part of ESG framework, we look at around 50 parameters across the Governance, Environmental & Social aspects, with the emphasis being in that sequence. These include energy and water consumption, carbon emissions, use of renewable energy, waste management, long term impact of companies products and business on environment and society, supply chain, relationship with workers, government and local community, composition and quality of board of directors, related party transactions, accounting quality, executive compensation, minority shareholder protection etc. The relative importance of these parameters differs across sectors.

Advocacy is a critical part of responsible investing strategy and we work with several institutions to sensitize Indian Companies as well as Investors on the importance of ESG compliance for their long-term success. SEBI has also stipulated that mutual funds should play an active role in ensuring better corporate governance. Over and above exercising the voting rights, we actively engage with our investee companies on ESG related matters.

The best preparation for tomorrow is doing your best today. Asset managers should pull up their values-based socks as the need to invest with an eye on environmental, social and governance issues will only get stronger.

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