ESG Investing Scenario in India
Co-creating a better future

December 2019
ESG Investing Scenario in India

Conversations around limiting the average global temperature rise to 1.5°C have created a sense of urgency to tackle climate change. This unprecedented call for stepping up ambition and action has resulted in multiple developments to mobilize finance for addressing the climate crisis. Socially Responsible Investing (SRI) is gradually emerging as a key investment trend globally. Financial institutions (FIs) are integrating environmental, social and governance (ESG) factors in investment decision-making to supplement traditional financial analysis. Internationally, SRI assets have witnessed a 34% surge across five major markets (between 2016 and 2018), and stand at USD 30.7 trillion. Further accelerating this momentum, financial sector has recently announced several ambitious commitments. World’s largest asset owners, responsible for directing USD 2 trillion, have pledged to carbon-neutral investment portfolios by 2050. 130 global banks, collectively holding USD 47 trillion in assets, endorsed the United Nations Principles for Responsible Banking and committed to align business strategies with the Paris agreement and Sustainable Development Goals (SDGs).

In India, ESG investing has started to gain traction with the launch of dedicated ESG funds and asset management companies signing up for the United Nations Principles for Responsible Investment. The size of ESG-linked assets stands at USD 30 billion and is expected to grow to USD 240 billion in the next 10 years. With an aspiration to become a USD 5 trillion economy by FY 2024-25, India needs significant investments from global investor community. There are a growing number of institutional investors who are integrating ESG thinking to guide capital allocation, on a voluntary basis. However, a systemic response to ESG is becoming essential and is eventually slated to become an obligation. For instance, it is imperative for the Indian financial system to align strategies with frameworks such as the EU Action Plan on Financing Sustainable Growth and Task Force on Climate-related Financial Disclosures (TCFD), in order to position itself as a preferred destination for global investors.

Given that financial stability is intrinsically linked to ESG performance, mainstreaming this would lead to reducing the risk of stranded assets and improving the profile of investments. Undoubtedly, at an organizational level, ESG-aligned approach provides an opportunity to create long-term value, foster innovation of new products and services and respond to changing customer preferences.

This knowledge report ‘ESG Investing Scenario in India’ presents
a situational analysis of the emerging India landscape by identifying the barriers, highlighting the opportunities and benefits of aligning investments with ESG. The report suggests a set of recommendations to institutionalize an ESG-aligned approach at an organizational level. Strategic interventions include devising an integration strategy, incorporating ESG risks as part of enterprise risk management and enhancing transparency and disclosure mechanisms. At a functional level, key measures include building a robust ESG-aligned portfolio, measuring its performance and assessing its impact. The report further emphasizes the importance of investors to actively engage with investee companies to sensitise and educate them on the criticality of ESG. I am confident that this timely knowledge report will enable FIs to attribute strategic importance to ESG and gradually increase the pie of ESG-aligned investments within their portfolio. The report highlights the need for creating a level playing field for mobilizing ESG-aligned investments, through concerted action by stakeholders across the investment ecosystem. Thank you.
Sincerely,

Ravneet Gill
Managing Director & CEO,
YES BANK
Earlier this year, it took a 16-year-old to tell the world that “our house is on fire”. With global rise in temperatures, unforeseen heatwaves across Europe, and Amazon wild fires, the year 2019, literally saw the world burning. Such erratic weather instances have only grown over the last decade, causing over USD 1,000 billion of economic losses. India, too, stares at losing 10% of its GDP by the end of the century, if it fails to address climate change.

In addition to change in climate, depleting natural resources, growing population and increased pollution levels continue to raise questions on the conventional parameters of growth and development. Today, traditional economic models of capitalism are at a crossroads. The rising Environmental, Social and Governance (ESG) issues are increasingly defining the way business needs to operate. Realising this, more and more businesses globally are incorporating ESG aspects in core strategies, taking voluntary commitments and adopting targets, through leading initiatives such as RE100 or SBTi.

Similar developments have been seen in the finance sector, which is adopting ESG considerations at different levels. Conventionally, financial institutions focus on financial risks and returns, however the recent paradigm shift towards ESG, is recalibrating many investment strategies, to include a holistic assessment of financial, social and environmental aspects. Globally, there are policy developments in pockets, with European Union taking the lead, through its taxonomy and action plan on sustainable finance. UK, Japan and China too, have released specific policies directed towards sustainable finance and ESG. Voluntary investor networks such as the United Nations Principles of Responsible Investment with 2,372 signatories managing USD 86.3 trillion AUM, and Carbon Disclosure Project engaging with institutional investors with assets worth USD 96 trillion, are educating and facilitating investors for integrating ESG factors into decision making. World’s largest investors, responsible for directing over USD 3.9 trillion, have announced ambitious commitments towards net zero emissions. Further, initiatives like the UN Principles for Responsible Banking, provides a unified framework to embed sustainability at strategic, portfolio and transaction levels across a bank’s functional areas, and are accelerating this momentum.

As part of its fiduciary duty, YES BANK, has adopted an Environmental and Social framework to identify the existing and potential ESG risks and effectively manage the impacts arising out of its financing portfolio. YES BANK, as a founding member, has also played a key role in drafting the UN Principles for Responsible Banking to enable a significant alignment with the Paris Agreement and Sustainable Development Goals (SDGs).
In order to encourage the finance sector to adopt an ESG lens to mobilize capital, this report ‘ESG Investing Scenario in India’ covers the landscape of ESG investing and stresses on its business case to deliver long-term financial returns. This report presents mounting evidence that ESG integration will not only ensure superior financial performance, but also build resilience within financial institutions to withstand climate adversities. Despite these well acknowledged benefits, certain obstacles limit the growth of ESG investing in India, which are captured in this report. Availability of quality data to assess ESG performance, lack of market standards and taxonomy, perceived trade-off between financial returns and ESG performance, and limited technical capabilities, are some of the challenges that need to be addressed.

Key recommendations in the report include:

- Devising a customized ESG integration strategy and incorporating it within the risk management framework of institutions
- Building a target-based ESG-aligned portfolio, guided by an ESG framework, also aligned to SDGs
- Measurement, assessment and disclosure of portfolio impact (including impacts arising out of physical risks) to further enhance transparency around ESG performance, devise strategies to increase positive impact and gradually reduce negative impact of portfolio
- Fostering cross stakeholder collaboration through active engagement with the investment ecosystem to build capacities, enhance understanding of ESG and drive its application

This report will assist organizations embarking on their ESG journey and trigger conversations at a sectoral level to mobilize ESG-aligned investments. This report serves as an opportunity for all financial institutions in India transitioning towards inclusion of ESG based metrics to identify key drivers, embrace solutions and work towards making India, the world’s first 100% ESG aligned USD 5 trillion economy.

Namita Vikas
Senior Group President &
Global Head, Climate Strategy &
Responsible Banking,
YES BANK
Acknowledgement

The authors extend their profound gratitude to the ‘Expert Panel’, for making this report holistic, through their valuable observations and comments.

Adam Wolfensohn
Managing Partner
Encourage Capital LLC

Ben Ridley
Director, Sustainability Affairs
Credit Suisse AG

Anuj A. Shah
Managing Director
Head of US Operations
KKS Advisors

Bhavesh R. Bajaj
Associate – Research
Quantum Advisors Pvt. Ltd.
Eric Savage
CEO
Unitus Capital

Hardik Shah
ESG Practice Lead
GMO LLC

Navneet Munot
Executive Director and Chief Investment Officer
SBI Funds Management Pvt. Ltd.
Section I:

Introduction

ESG: ‘Re-defining’ Pathways to Development

In an increasingly complex and interconnected world, rising environmental and social challenges are re-defining the way Governments function, businesses operate and financial institutions mobilize capital. The numerous challenges faced by global economies, ranging from the climate crisis to poverty and unemployment, need urgent attention. The traditional economic growth model is at a crossroads and demands a fresh outlook and approach to reconcile economic growth with overall well-being. This paradigm shift requires concerted and collective action by all the stakeholders to better integrate environmental and social parameters in all aspects of decision-making.

Adopting a holistic approach to address Environmental, Social and Governance (ESG) risks and to leverage the emerging opportunities, is an idea whose time has come.

Top five global risks in terms of impact

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<td>Climate change</td>
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<td>Oil &amp; Gas price spike</td>
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<td>Geopolitical conflict</td>
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<td>Chronic disease</td>
<td>Chronic disease</td>
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<td>Diffusion of weapons of mass destruction</td>
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<td>Fiscal crises</td>
<td>Fiscal crises</td>
<td>Extreme energy price volatility</td>
<td>Extreme volatility in energy and agriculture prices</td>
<td>Failure of climate-change mitigation and adaptation</td>
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Environmental and Social risks are on the rise

Across the globe, ESG landscape has evolved significantly over the last decade. Analysis of the global risks identified by World Economic Forum (WEF) reveals that in 2009 and 2010, only one societal risk ‘Chronic disease’, was reported and no environmental risk featured in the top five risks in terms of impact. However, in 2019, four of the top five risks are related to societal or environmental issues.

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<td>Fiscal crises</td>
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<td>Climate change</td>
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<td>Unemployment and underemployment</td>
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<td>Large-scale involuntary migration</td>
<td>Major natural Disasters</td>
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<td>Critical information infrastructure breakdown</td>
<td>Failure of climate-change mitigation and adaptation</td>
<td>Severe energy price shock</td>
<td>Failure of climate-change mitigation and adaptation</td>
<td>Water crises</td>
<td>Natural disasters</td>
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Amongst the environmental risks, climate change has emerged as one of the greatest threats for businesses, governments and citizens at large. The compelling report by the Intergovernmental Panel on Climate Change (IPCC) ‘Global warming of 1.5°C’ has created a sense of urgency to limit the average global temperature rise to 1.5°C. Physical impacts of climate change are more pronounced than ever. The four-year period from 2015-2018 has been confirmed as the hottest on record by World Meteorological Organization. Climate change is also leading to...
increase in frequency and severity of extreme weather events. A record 7 million people have been forced to abandon their homes across 102 countries due to more than 950 climate-related disasters between January and June 2019. India too, had its own share in these damages, with economic losses from weather related events doubling over the last 30 years. As per ‘Brown to Green report 2019’ released by the Climate Transparency, India has lost maximum number of lives and is amongst the top 5 countries in terms of economic losses due to extreme weather events within G20 nations (between 1998 and 2017). From 2008 to 2017, India suffered losses to the tune of USD 45 billion. The Indian state of Kerala experienced one of the worst floods in 100 years, causing estimated losses of USD 4.25 billion. Floods in Bihar affected 7.2 million people and severely affected agriculture activity, destroyed infrastructure and property. The droughts have affected 680 million people between 2008 and 2017. The recent Fani floods accounted losses for INR 12,000 crores and damaged over 5 lakh dwellings. The impact, incidence and frequency of such natural disasters has only been increasing, with time.

Climate change is not the only challenge that needs urgent redressal. Availability of natural resources, air, land and ocean pollution, decline in flora and fauna species and waste management are some of the other issues linked to environment degradation that demands attention.

As far as social issues are concerned, the recently released UN Secretary General Sustainable Development Goals (SDG) Report 2019 has highlighted ‘increasing inequality among and within countries’ as a major cause of concern. Lack of employment opportunities for younger generations, disproportionate distribution of stunted children, gender inequality and global hunger continue to pose challenges to the society at large.

In India, performance on issues such as rising income inequality, high rates of unemployment, gender equality and urban poverty, reflected in the human development index continues to pose societal challenges. India, in fact, faces higher ESG risks as compared to other emerging economies, as shown in the figure below.
These rising ESG issues are impacting the profitability, growth and sustainability of businesses. Coinciding with the evolution of ESG landscape in the last decade, there are increasing number of incidents, where businesses have faced huge financial implications and loss of public trust due to their inability to anticipate and respond to ESG issues. The plethora of ESG risks faced by organizations include:

### Physical risks

Physical risks, in terms of damage to property and infrastructure due to weather events and natural calamities like floods, cyclones, drought

### Financial risks

Financial risks, in the form of shut-down of business activities, increased instances of liabilities in the form of insurance claims

### Reputational risks

Financial risks, in the form of shut-down of business activities, increased instances of liabilities in the form of insurance claims

### Regulatory risks

Regulatory risks, arising due to push from governments to adapt to changing legislations

### Litigation risks

Litigation risks, whereby there are negligence suits and charges inflicted, tied to non-compliance of environmental and social laws & regulations

Addressing these risks requires in-depth understanding and mainstreaming of ESG concerns in core business strategy. Alignment of business operations with ESG serves as an opportunity to innovate business models and exhibit adaptability and resilience to the changing business paradigms. ESG Performance has emerged as an indicator of an organization’s long-term sustainability, growth potential and future performance.
**Key Corporate disasters related to ESG issues**

- **2019**: Large electric utility filing bankruptcy in California, US due to liabilities caused by wildfires

- **2018**: Large copper smelter ordered to shut down on environmental grounds in India

- **2017**: Online cab service provider facing sexual harassment cases in India, leading to boycott movement on social media

- **2013**: Collapse of Rana Plaza building in Bangladesh, killing 1,132 people and injuring 2,500

- **2010**: Worst oil spill in US history causing irreversible environmental damages, costing the oil company USD 65 billion

- **2009**: One of the biggest corporate frauds in India, which led to removal of a tech-giant from Sensex, Nifty and tightening of corporate governance norms in India

*Source: YES Bank Analysis*
Growing Importance of ESG: Stakeholder Perspective

With the rising levels of awareness on ESG issues, risks stemming from them and their impact on businesses, ESG has emerged as a major focus area. There are multiple stakeholders who are demanding enhanced levels of transparency around ESG performance, including governments, regulators, central banks, financial intermediaries, institutional and retail investors.

Some of the key trends include:

- **Rise in climate-related legislation and policies**: There are increasing number of regulations by governments to address climate change, which are playing an instrumental role in driving ESG-aligned investments. For instance, when Kyoto Protocol was signed in 1997, there were only 72 laws or policies addressing climate change, in 2018, the number of laws and acts have reached well over 1,500.

- **Central banks are serious about climate change risks**:
  The coalition of central banks – Network for Greening the Financial System (NGFS) in its first comprehensive report outlined six priority areas for central banks, governments and industry. The essence of its recommendations is to embed climate-risk considerations within the monitoring and supervision activities of Central Banks and Financial Regulators (CBFRs). The report further recommends central banks to support financial institutions by providing technical assistance and sharing knowledge with the community. Some of the frontrunners include UK’s Prudential Regulation Authority, which is extensively working towards climate-related risks.

- **Stock Exchanges care about ESG**: The International Organization of Securities Commissions (IOSCO), the securities and exchanges regulator, published a statement in January 2019, setting out the importance of issuers considering the inclusion of ESG matters, when disclosing information to investors’ decisions. IOSCO has also established a sustainable finance network and organized its first meeting in June 2019 to exchange ideas between securities regulators, standard-setting bodies and the market players on sustainable finance.
Institutional investors are actively targeting sustainable investments: Institutional investors, mainly pension funds, insurance companies and sovereign wealth funds are engaging with corporate boards and shareholders on ESG-related matters and are adopting ESG policies to ensure a systematic approach to sustainable investing. This trend is visible across OECD markets and some emerging markets as well. Japan’s Sovereign Wealth Fund has announced the allocation of 10% to ESG investing. The funds in Norway, Canada and South Korea also integrate ESG information in investment decision-making.

Growing interest of retail investors in ESG: There is enough evidence to suggest that millennials are actively tracking sustainable development initiatives and are inclined to align their investments with social and environmental values. This presents a huge opportunity for financial institutions to tie their investments with positive environmental and social outcomes.

National governments in their capacity as policy makers are focusing on ESG factors as a means to promote sustainable development at a national-level to achieve Paris agreement targets and SDGs. Policymakers and governments across the globe have started to issue regulations in line with the growing importance of ESG. Across the world 38 of the largest 50 economies in the world have, or are developing, ESG disclosure requirements.

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In March 2018, the European Commission (EC) released an action plan for financing sustainable growth. The EU Action Plan aims to provide a regulatory framework to support and promote sustainable investment in the EU, in line with the global climate change commitments.

In 2016, EC appointed a High-Level Expert Group on sustainable finance, which published a report in January 2018 providing a comprehensive vision on how to build a sustainable finance strategy for the EU. The Report emphasized two urgent imperatives related to sustainable finance:

- Improving the contribution of finance to sustainable and inclusive growth by funding society’s long-term needs
- Strengthening financial stability by incorporating ESG factors into investment decision-making

The Action Plan proposes a set of recommendations, bucketed under three broad objectives:

- Reorient capital flows towards a more sustainable economy
  - Action 1: Establishing an EU classification system for sustainability activities
  - Action 2: Creating standards and labels for sustainable financial products
  - Action 3: Fostering investment in sustainable projects
  - Action 4: Incorporating sustainability when providing investment advice
  - Action 5: Developing sustainability benchmarks
- Manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues
  - Action 6: Integrating sustainability in credit ratings and market research
  - Action 7: Clarifying institutional investors and asset managers’ duties
  - Action 8: Incorporating sustainability in prudential requirements
- Foster transparency and long-termism in financial and economic activity
  - Action 9: Strengthening sustainability disclosure and accounting rule-making
  - Action 10: Fostering sustainable corporate governance and attenuating short-termism in capital markets
EU Action Plan on Sustainable Finance

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Source: Action Plan: Financing Sustainable Growth, European Commission
France’s Article 173, adopted in 2016, became the world’s first mandatory climate change financial disclosure law that imposed ESG and Climate reporting requirements. Article 173 applies only to publicly traded companies, banks and credit providers, asset managers, and institutional investors. It mandates climate change-related reporting, including a provision on physical climate risks, aligning with TCFD’s voluntary guidance on climate-related risk disclosure.

The Law sets out three requirements:

- Providing a general description of the investor’s ESG policy
- Disclosing the resources allocated to ESG analysis
- Explaining the methodology and the results of the climate risk analysis.

The law provides flexibility in fulfilling these objectives, however, with a “comply or explain” approach; reporting companies must comply or are required to provide justification for why climate risks are immaterial.

Central Banks are increasingly focussing on the linkage between financial stability and climate change risks. There are initiatives being led by central banks that focus on understanding, managing and enhancing transparency on climate-related risks.

The UK Prudential Regulation Authority (PRA) has issued supervisory notes asking financial institutions to implement Task Force on Climate-related Financial Disclosures (TCFD) recommendations on a voluntary basis. The PRA also expects banks and insurers to undertake scenario analysis to explore the resilience and vulnerabilities of their business model to a range of climate outcomes.
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Initiatives by Central Banks

- **Task Force on Climate-related Financial Disclosures (TCFD):** Established by the Financial Stability Board (FSB) in December 2015, the industry-driven task force aims to solve the barrier of information asymmetry for investors by providing a voluntary disclosure framework for financial institutions to disclose on climate risk. The four elements of disclosure include information on governance, strategy, risk management and metrics & targets.

- **Central Banks and Supervisors Network for Greening the Financial System (NGFS):** Launched in December 2017, the Network brings together central banks and supervisors committed to better understand and manage the financial risks and opportunities of climate change. The group is contributing towards development of environment and climate risk management frameworks in the financial sector and to mobilize mainstream finance to support the transition toward a sustainable economy. Since 2017, 46 central banks and regulators have joined NGFS.

Stock exchanges are establishing consistent guidance and structures across markets. Several stock exchanges have adopted listing rules on ESG disclosures. 90 Stock Exchanges across the world (including National Stock Exchange and BSE India Ltd.) have become partners of the United Nations-backed Sustainable Stock Exchanges Initiative, committing to promote sustainable investing through improved ESG disclosure requirements of listed firms.

Regulatory bodies like the China Securities Regulatory Commission (CSRC), in collaboration with China's Ministry of Environmental Protection, has introduced requirements that will mandate all listed companies and bond issuers to disclose ESG risks associated with their operations by 2020. Securities and Exchange Board of India (SEBI) has mandated inclusion of Business Responsibility Report (BRR) as a part of the Annual Report for top 500 listed entities and has recently decided to make it mandatory for top 1,000 listed companies. The reporting requirement is in line with the ‘National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs)’ notified by Ministry of Corporate Affairs, Government of India, in July, 2011.

These interventions by the regulators and exchanges differ in the level of obligation ranging from voluntary, to comply-or-explain to mandatory requirements.
Long-term institutional investors and asset managers are interested in understanding how organizations are identifying and responding to ESG risks and opportunities, to create not just profits but also long-term shareholder value. Investors such as Rockefeller Brothers, IFC-World Bank, The Wallace Fund and Ben & Jerry’s, have taken actions towards divesting their holdings in fossil fuels to combat climate change. Globally, USD 86.3 trillion AUM, managed by 2,372 managers are subscribed to United Nations Principles for Responsible Investment (UN PRI)\(^\text{11}\).

The UN PRI, along with Vivid Economics and Energy Transition Advisors, are building a Forecast Policy Scenario, laying out the policies that are likely to be implemented up to 2050 and quantifying their impact on the economy and financial markets. The forecast will provide useful information to investors for enhancing resilience of their portfolios and strategically allocate assets, by preparing them for the evolving policy and regulatory landscape.

Mitsubishi UFJ Financial Group (MUFG), one of the world’s largest bank by assets, recently revised its Environmental and Social Policy and announced that it will not provide financing for new coal-fired power generation projects. The Bank further aims to provide 20 trillion Yen between FY 2019-2030 towards building a sustainable society and achieving the Sustainable Development Goals (SDGs)\(^\text{12}\).

Additionally, there are several climate-related actions, pledges and coalitions led by institutional investors, including Montreal Climate Pledge, Fossil Fuel Divestment Commitments, Portfolio Decarbonisation Coalition, to name a few.

The world’s biggest asset managers (such as Vanguard), asset owners (such as California Public Employees’ Retirement System (CalPERS), California State Teachers’ Retirement System (CalSTRS) and pension funds (such as California State

\(\text{11} \) https://www.unpri.org/pri/about-the-pri

Employees’ Pension Fund and Government Pension Fund of Japan) have embraced ESG considerations in their investment screening, corporate engagement strategies and risk management practices. Asset managers in UK have launched ESG-based investment strategies, in lieu of demand from consumers and pension scheme providers for enhanced transparency. Swiss Re, world’s second largest re-insurer is shifting its entire USD 130 billion portfolio towards ESG Indices\textsuperscript{13}. Investment professionals see ESG as a means to future-proof their portfolios by transitioning towards carbon-neutral investments and divesting from carbon-intensive sectors.

\textbf{Net-Zero Asset Owners Alliance}

\textbf{12 of World’s largest investors make bold commitments to net-zero emissions:} Announced at the UN Secretary-General’s Climate Summit in September 2019, Net-Zero Asset Owner Alliance have committed to lead the global investment industry to the highest ambition to date in driving economies to carbon neutrality by 2050.

The Alliance, which represents more than USD 2 trillion was initiated by Allianz, Caisse des Dépôts, La Caisse de dépôt et placement du Québec (CDPQ), Folksam Group, Pension Danmark and Swiss Re at the beginning of 2019. Since then, Alecta, AMF, CalPERS, Nordea Life and Pension, Storebrand, and Zurich have joined as founding members. Recently, AXA, Aviva, CNP Assurances and Fonds de Réserve pour les Retraites (FRR) joined the Alliance. Members will seek to reach their net-zero commitment by advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. The commitment is made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.

\textbf{Commitments emphasise:}

\begin{itemize}
  \item Investor ambition and target-setting at portfolio level; reporting of contribution to progress in a sector-specific way
  \item Impact on the real economy and emissions; to the extent methodologies can be developed for this
  \item Implementation via a holistic environmental, social and governance approach for measuring and managing associated impacts
  \item Joint engagement, and monitoring of engagements, based on the most authoritative, credible scientific input to ensure consistency of messaging and ambition. This will build on existing good practice in active ownership such as that under development with Climate Action 100+
\end{itemize}

Source: UNEP FI

Key multilateral agencies like World Bank and International Finance Corporation (IFC) have played an important role in accelerating action on ESG issues. IFC’s Performance Standards on Environmental and Social Sustainability emphasizes on assessment and management of environmental and social risks and impacts’ labor and working conditions; resource efficiency; community health, safety and security; land acquisition; biodiversity conservation; indigenous people and cultural heritage. World Bank also has outlined Environment, Health and Safety guidelines to improve performance. These guidelines require their investees to analyze, assess and continuously comply with these standards / guidelines as a part of the investment contract.

Ceres Investor Network on Climate Risk and Sustainability

The Ceres Investor Network including over 170 institutional investors, managing more than USD 26 trillion in assets, is working towards advancing leading investment practices, devising corporate engagement strategies, and influencing key policy and regulatory solutions around sustainability and climate change. Some of the key initiatives and investor coalitions, Ceres is engaged with include:

Climate Action 100+: Launched in December 2017, with 225 investors with USD 26 trillion in AUM, Climate Action 100+ is now backed by more than 360 investors with more than USD 34 trillion in assets under management, including 87 North American investors. The Initiative aims to:

- Implement a strong governance framework in order to articulate Board’s accountability and oversight of climate change risks and opportunities
- Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement
- Provide enhanced corporate disclosure in line with the final recommendations of the TCFD and, when applicable, sector-specific Global Investor Coalition on Climate Change

Investor Expectations on Climate Change

The Investor Agenda: The Investor Agenda is a collaborative initiative that seeks to speed the transition to a low-carbon economy, by scaling existing investor actions and initiatives on climate change, and amplifying investor voices calling for government implementation of the Paris Agreement. The Investor Agenda provides investors with actions across 4 key focus areas including: Investment, Corporate engagement, Investor Disclosure and Policy advocacy.

Source: Ceres Investor Network on Climate Risk and Sustainability
**Retail Investors:** Changing demographics of retail investors is increasingly playing a major role in embedding ESG considerations in investments. Millennials consider finance and investments as powerful tools for changing the world. They also view ESG as an essential component of their own investments. According to a Morgan Stanley survey, more than 8 in 10 millennials are interested in sustainable investing. Since millennials are expected to have USD 19 trillion to USD 24 trillion in assets by 2020\(^4\), sustainable investing will experience a boom. With increasing participation of females in the labor market, preference for sustainable pension choices has seen a surge.

These developments have led to a transition of investor sentiments and investment strategies from purely based on risk-return profiles to encompassing non-financial considerations. ESG investing is emerging as an investment approach that provides an answer to this changing trend.

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ESG Investing is a holistic investment approach, which involves incorporating ESG factors into investment analysis process and decision-making. It is referred by many names such as socially responsible investing (SRI), ethical investing, sustainable investing, triple-bottom-line investing, green investing and has multiple definitions/interpretations.

The underlying theme, however, of all these differing names is focused on long-term value creation and covers a wide spectrum of issues including how corporations respond to climate change, constraints posed by natural resources, established health & safety management systems, management of supply chains, policies around workers/employee satisfaction, established governance structures to name a few. Some of the popular definitions are:

- **United Nations Principles of Responsible Investing (UNPRI)**, an international network of investors, with more than USD 80 trillion of Assets Under Management, working together to incorporate ESG into investment practice, defines responsible investing as ‘an approach to investing that aims to incorporate Environmental, Social and Governance (‘ESG’) factors in investment decisions, to better manage risk and generate sustainable, long term returns’

- **Global Sustainable Investment Alliance (GSIA)**, an international collaboration of world’s seven largest sustainable investment membership organizations, defines sustainable investing as ‘an investment approach that considers ESG factors in portfolio selection and management’

Rating agencies like **Moody’s** reflects ESG risk in its ratings by taking qualitative and quantitative ESG factors into account and considering them in its overall analysis of credit drivers.

There are various factors that form the basis of an informed ESG investment decision and complement traditional investment analysis, by assessing non-financial risks. ESG parameters vary depending upon company, industry, geography and type of investment. Basing investments on ESG performance of companies is ‘smart economics’, as they allow investors to look beyond their traditional lens and analyse wide spectrum of issues that are traditionally not part of financial analysis, yet may have financial relevance. Some of the indicative ESG factors which play a role in determining the risk and return profile of an investment are shared below.
### ESG Factors considered in determination of risk and return of an investment

*(Indicative list)*

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<td>Deforestation</td>
<td>Impact on local communities</td>
<td>Shareholder rights</td>
</tr>
<tr>
<td>Air and water pollution</td>
<td>Child labour</td>
<td>Gender diversity</td>
</tr>
<tr>
<td>Water scarcity</td>
<td>Human rights</td>
<td>Bribery and corruption</td>
</tr>
<tr>
<td>Waste management</td>
<td>Equality</td>
<td></td>
</tr>
<tr>
<td>Biodiversity</td>
<td>Diversity and inclusion</td>
<td></td>
</tr>
</tbody>
</table>

- How the company manages its environmental impact?
- How the company treats its people?
- How is a company governed?

### Financial Health of a Company

*Source: YES Bank Analysis*
Research indicates that ESG investing delivers better returns, as companies with strong sustainability mandates demonstrate better operational performance. Such companies are generally less exposed to tail risks such as environmental accidents or penalties from regulators. ESG standards and processes, if implemented well, can serve as a guide for a company to ensure long-term sustainability and enjoy high levels of investor confidence.

Consider the 35-member MSCI India ESG Leaders Index, providing exposure to companies with high ESG performance relative to their sector peers, which has outperformed the 78-member MSCI Index over a long-term period from September 2007 to September 2019. It is evident that:

- **ESG Index performs better over the long-term**: Companies performing better on ESG parameters tend to be more competitive and generate better returns, leading to higher profitability and dividend payments, especially when compared to low ESG-rated companies.

- **Premium from investors/markets**: Given that MSCI India ESG Index is trading at a much higher value, it is apparent that investors and markets are ready to reward good ESG performance.

- **ESG Index is more resistant to shocks/tail risks**: ESG indices experience lower frequency of idiosyncratic risk incidents such as major drawdowns. Conversely, companies with low ESG ratings were more likely to experience major incidents.

“The world is changing dramatically right before our eyes. We are in an existential race against time to keep our planet inhabitable, especially for families living in poverty. The climate crisis and pervasive inequality, especially income and gender, are the issues of our time. We will be judged by what we do NOW. We can’t wait a single moment. Big companies need to stop talking about a focus on ESG, the environment and inequality, and actually start acting with the urgency that these impending disasters demand.”

— Eric Savage, CEO, Unitus Capital
ESG Index recovers from shocks at a faster pace: Given the strong systems and mechanisms put in place through ESG integration, companies with better ESG score are able to adapt to changes, foresee them better, hence prepare and recover from such changes at a faster pace.

Comparison of performance of MSCI India ESG Leaders with MSCI India


Source: YES Bank Analysis
ESG Investing - Evolution and Snapshot of Global Growth

Evolution of ESG Investing: Global Perspective

The rapid growth of ESG investing builds on the concept of Socially Responsible Investment (SRI) originated in 1800’s by religious groups. Quakers and Methodists established investing guidelines for their followers, other religious orders soon adopted a similar faith-based approach to investing. The first ESG Investing product, the Pioneer Fund, was launched in 1928 and practiced negative screening of investments based on social exclusions against industries, such as tobacco, gambling, and alcohol. ESG Investing has, since then, evolved during the last several decades to a more scientific and data-based methodology of investing.

Evolution of ESG Investing

- SRI stood for ethically oriented investing
- Referred to value-based exclusionary investment approach
- Outcome of renewed interest to include corporate governance into SRI
- Factors used along with financial, social and environmental factors
- Stemmed from investors’ interest for achieving improved risk/return outcomes

1500 onwards

1960 - to - mid-1990s

late - 1990s

2003 to present

- Guided by religious inclinations
- Negative screening or deliberately opting not to invest in companies or industries
- Not aligned with investors interests
- Marked by a transition from ethics-based investing towards incorporating ESG factors
- Linked to investment returns

Source: Sustainable Investing – Establishing Long-Term Value and Performance, Deutsche Bank

Evolution of ESG investing has been guided by multiple developments, including:

- Adoption of Paris Agreement and launch of SDGs, providing a blueprint to address sustainable development
- Emergence of several reporting frameworks such as Global Reporting Initiative (GRI), Integrated Reporting framework (IR), Sustainability Accounting Standards Board (SASB), disclosures such as Dow Jones Sustainability Index (DJSI) and Carbon Disclosure Project (CDP), frameworks to align business strategies like UN Principles for Responsible Banking and Task Force on Climate-related Financial Disclosures recommendations
- Coalitions/Initiatives such as United Nations Environment Programme Finance Initiative (UNEP FI), United Nations Principles for Responsible Investment (UN PRI), Climate Disclosures Standards Board (CDSB)
- Launch of broad-based and thematic ESG indices such as S&P Global Water Index, S&P Global Clean Energy Index, MSCI Global Environment Index, BSE Carbonex and Greenex, MSCI Women’s Index
Emergence of global ESG focused standards and institutions

- **1992**: United Nations Environment Programme Finance Initiative
- **1997**: Global Reporting Initiative
- **2003**: Equator Principles
- **2006**: United Nations Principles for Responsible Investment
- **2011**: Sustainability Accounting Standards Board
- **2013**: International Integrated Reporting Framework
- **2015**: Paris Accord: First universal climate agreement, Sustainable Development Goals, Task Force on Climate-Related Financial Disclosures
- **2017**: Corporate Leadership Group on integrated reporting
- **2019**: Principles for Responsible Banking, ISO Standard on Climate Change Adaptation

Source: YES Bank analysis
ISO Standard for Climate Change Adaptation

In September 2019, the British Standards Institution (BSI) has published its first standard on climate change adaptation- BS EN ISO 14090. The ISO Standard has been designed to provide a framework that enables corporates of all sizes to consider climate change adaptation when creating new policies, strategies, plans and activities. The standard also provides guidelines for organizations on how to prioritize measures that will increase resilience against future climate shocks, by demonstrating robust and credible risk management.

BS EN ISO 14090 is the first in a range of ISO standards in this area, and was developed with stakeholder insights from the Department for the Environment, Food and Rural Affairs (Defra), the Environment Agency, the Institute of Environmental Management and Assessment (IEMA), Institution of Civil Engineers and the Met Office.

Adoption and implementation of the standard allows the companies to contribute towards achieving SDG 13 on climate action.

Over a period of time, guided by these developments, ESG investing landscape has evolved and multiple strategies are adopted to embed ESG considerations in investments.

Source: edie newsroom
ESG integration involves systematic inclusion of material ESG factors into investment analysis and decision making, in line with investor’s values or to achieve desired environmental or social outcomes. Incorporating ESG into investment encompasses the following activities and strategies:

<table>
<thead>
<tr>
<th>Strategies for Integration of ESG Factors in Investment Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ESG integration involves systematic inclusion of material ESG factors into investment analysis and decision making, in line with investor’s values or to achieve desired environmental or social outcomes. Incorporating ESG into investment encompasses the following activities and strategies:</strong></td>
</tr>
<tr>
<td><strong>Negative/ exclusionary screening</strong></td>
</tr>
<tr>
<td>Exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria</td>
</tr>
<tr>
<td><strong>Positive/ best-in-class screening</strong></td>
</tr>
<tr>
<td>Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers</td>
</tr>
<tr>
<td><strong>Norms-based screening</strong></td>
</tr>
<tr>
<td>Screening of investments against minimum standards of business practice based on international norms</td>
</tr>
<tr>
<td><strong>Integration of ESG factors</strong></td>
</tr>
<tr>
<td>Systematic and explicit inclusion by investment managers of ESG factors into financial analysis</td>
</tr>
<tr>
<td><strong>Sustainability themed investing</strong></td>
</tr>
<tr>
<td>Investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture)</td>
</tr>
<tr>
<td><strong>Impact/ community investing</strong></td>
</tr>
<tr>
<td>Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose</td>
</tr>
<tr>
<td><strong>Corporate engagement and shareholder action</strong></td>
</tr>
<tr>
<td>Use of shareholder power to influence corporate behavior, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines</td>
</tr>
</tbody>
</table>

Adoption of these strategies has resulted in ESG investing emerging as a major force across global financial markets. The capital behind ESG-dedicated investments has shown robust growth globally. The value of sustainable investing assets in the five major markets of Europe, United States, Canada, Australia & New Zealand and Japan was at USD 30.7 trillion at the beginning of 2018, which is a 34% increase compared to 2016, according to the Global Sustainable Investment Review 2018 report released by the Global Sustainable Investment Alliance.

Sustainable investments now constitute a sizable share of professionally managed assets in each region, ranging from 18% in Japan to 63% in Australia and New Zealand. Out of the 5 regions, Europe, United States and Japan are the top 3 regions based on the value of sustainable investing assets. The fastest growing regions (from 2016-2018) have been Japan, followed by Australia/New Zealand and Canada.

### Growth of sustainable investing assets for 2014-2018 (asset values are expressed in billions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe (€)</td>
<td>9,885</td>
<td>11,045</td>
<td>12,306</td>
<td>12%</td>
<td>11%</td>
<td>6%</td>
</tr>
<tr>
<td>United States ($)</td>
<td>6,572</td>
<td>8,723</td>
<td>11,995</td>
<td>33%</td>
<td>38%</td>
<td>16%</td>
</tr>
<tr>
<td>Canada (CAD)</td>
<td>1,011</td>
<td>1,505</td>
<td>2,132</td>
<td>49%</td>
<td>42%</td>
<td>21%</td>
</tr>
<tr>
<td>Australia/New Zealand (AUD)</td>
<td>203</td>
<td>707</td>
<td>1,033</td>
<td>248%</td>
<td>46%</td>
<td>50%</td>
</tr>
<tr>
<td>Japan (¥)</td>
<td>840</td>
<td>57,056</td>
<td>231,952</td>
<td>6692%</td>
<td>307%</td>
<td>308%</td>
</tr>
</tbody>
</table>

Source: 2018 Global Sustainable Investment Review, Global Sustainable Investment Alliance
Key Emerging Trends in Global Sustainable and Responsible Investing Market

Most accepted ESG investing strategy: As Sustainable and Responsible Investing is picking momentum in global financial markets, the most widely adopted investment strategy continues to be negative or exclusionary screening, with a combined USD 19.8 trillion in AUM, followed by ESG Integration with assets worth USD 17.5 trillion under management and corporate engagement and shareholder action with combined assets worth USD 9.8 trillion. Investors are now geared to adopt ESG integration across their portfolio and 97% of asset owners and managers expect ESG information is going to become more relevant to the investment process in the years to 2030.17

Growing acceptance of other ESG investing strategies: Even though assets under three strategies: impact or community investing, sustainability themed investing and positive or best-in-class-screening are not huge, they have shown promising growth over the past two years, as shown in figure below

Global Growth of Sustainable Investing Strategies 2016-18

<table>
<thead>
<tr>
<th>Strategy</th>
<th>2018</th>
<th>2016</th>
<th>Growth 2016-18</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impact/Community Investing</td>
<td>$444.26</td>
<td>$248.47</td>
<td>79%</td>
<td>33.7%</td>
</tr>
<tr>
<td>Sustainability themed investing</td>
<td>$1,017.66</td>
<td>$818.61</td>
<td>92%</td>
<td>92.0%</td>
</tr>
<tr>
<td>Positive/best-in-class-screening</td>
<td>$1,641.87</td>
<td>$419.40</td>
<td>50.1%</td>
<td>50.1%</td>
</tr>
<tr>
<td>Norms-based screening</td>
<td>$4,679.44</td>
<td>$6,195.40</td>
<td>-31.6%</td>
<td>-12.1%</td>
</tr>
<tr>
<td>Corporate engagement and shareholder action</td>
<td>$9,834.59</td>
<td>$6,385.17</td>
<td>57%</td>
<td>8.3%</td>
</tr>
<tr>
<td>ESG integration</td>
<td>$17,543.81</td>
<td>$10,353.20</td>
<td>69%</td>
<td>30.2%</td>
</tr>
<tr>
<td>Negative/exclusionary screening</td>
<td>$19,770.96</td>
<td>$15,063.57</td>
<td>31%</td>
<td>14.6%</td>
</tr>
</tbody>
</table>

Source: 2018 Global Sustainable Investment Review, Global Sustainable Investment Alliance

New instruments for ESG Investing: Globally, new sustainable investing instruments such as green bonds, sustainability bonds and sustainability-linked loans have seen a rise

Global bond market

Global green bond issuances in first half of 2019 reached USD 117.8 billion, witnessing a growth of 48% (Y-O-Y). Non-financial corporates lead with 26% of issuances, followed by financial corporates at 19% of issuances. Top three issuers included ICBC (China), Bank of Jiangsu (China) and Citigroup (USA). Top 15 countries leading green bond issuance in first half of 2019 are depicted in figure below. The majority of green bonds from emerging markets in the first half of 2019 came from China (44%), followed by Poland (10%), South Korea and Indonesia (9% each) and Chile (7%).

Green bonds from local government and government-backed entities totaled USD 24.8 billion in first half, which has more than doubled from first half of 2018. USD 18.4 billion of sovereign green bonds were issued in first half of 2019; 3 new issuers (Netherlands, Hong Kong and Chile) entered the market, bringing total to 12 issuers. The Indian green bond market witnessed its first issuance in 2015 and since then 27 green bond issuances have been issued by 18 issuers (until May 2019), cumulatively amounting to USD 7.6 billion18.

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Green Bond Issuance: Top 15 countries

![Graph showing cumulative issuance of green bonds by top 15 countries.](image)

Source: Green bonds market summary, First Half 2019, Climate Bonds Initiative

Use of Proceeds: First Half of 2018 and 2019

![Bar chart showing use of proceeds for green bonds in 2018 and 2019.](image)

Source: Green bonds market summary, First Half 2019, Climate Bonds Initiative

The labelled bond market has expanded beyond green bonds. Sustainability and Social bonds also picked pace in 2018, with issuers and investors aligning strategies to achieve SDGs. The top three sustainability and social bond markets in first half of 2019 were Germany (USD 2.8 billion), South Korea (USD 1.6 billion) and France (USD 1.1 billion). New players that entered this market segment include Belgium, UK, Switzerland, Indonesia and New Zealand.
**Increasing divestments from controversial sectors**: In addition to these green investing strategies, there is a promising trend of investors and funds divesting from certain controversial sectors. Based on a survey, some of the top sectors where investors would increase their divestments by 2030 include nuclear weapons, tobacco, fossil fuels, alcohol.

**Total AUM of funds committed to divestment from fossil fuels**

Source: 350.org
Equity markets turning green: There are a variety of mutual funds and ETFs that are positively impacting environmental and social concerns. Environmental issues addressed include clean energy, energy efficiency, sustainable sourcing of raw materials, limiting waste. Social issues relate to gender, wealth inequality and providing healthy working conditions. Examples include:

- **Instruments aligned to Environmental impact**: Some of the largest clean-energy ETFs (by net asset value), are the iShares Global Clean Energy ETF, Invesco Wilderhill Clean Energy, First Trust Nasdaq Clean Edge Green Energy Index Fund. Some of the largest clean-energy mutual funds by net asset value are Pax Global Environmental Markets Fund, Green Century Balanced Fund and New Alternatives Fund

- **Social issues**: The largest fund by net assets that focuses on gender diversity is the SPDR SSGA Gender Diversity Index ETF

### Total AUM of ESG and sustainability-themed funds

Source: Bloomberg Intelligence

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Section III:
ESG Landscape in India

Evolution of ESG Investing: India Perspective

As far as India is concerned, the last decade has seen a stream of policy reforms and developments that have encouraged responsible corporate behavior:

- **2007**: Reserve Bank of India (RBI) issued a letter to all scheduled commercial banks, advising them on their role on Corporate Social Responsibility, Sustainable Development and Non-Financial Reporting.

- **2008**: Standard & Poor’s, CRISIL and KLD Research & Analytics launched the S&P ESG India Index, first investable index of companies whose business strategies and performance demonstrate a high level of commitment towards meeting ESG standards.

- **2009**: Ministry of Corporate Affairs (MCA) published Corporate Social Responsibility (CSR) guidelines, recommending all businesses to formulate a CSR policy centered around six core elements - care for stakeholders, ethical functioning, respect for workers’ rights and welfare, respect for human rights, respect for environment, and activities for social and inclusive development.

- **2010**: Department of Public Enterprises (DPE) issued CSR guidelines for Central Public Sector Enterprises (CPSEs), requiring Public Sector Enterprises to have a CSR Policy approved by their respective Boards of Directors.

- **2011**: MCA published National Voluntary guidelines (NVGs) on Social, Environmental, and Economic Responsibilities of Business. The guidelines were designed to be used by all businesses in India, to report on nine principles in the form of Business Responsibility Report (BRR).

- **2012**: Securities and Exchange Board of India (SEBI) issued a circular that made it mandatory for the largest 100 listed companies to publish an annual business responsibility report. The requirement was expanded to the 500 largest companies in SEBI’s Listing Obligations and Disclosure Requirements Regulations 2015. Bombay Stock Exchange launches Greenex and Carbonex.
These developments have fueled evolution of responsible corporate behavior in India, which in turn, have led to ESG investing gaining ground.
Factors Impacting Growth of ESG Investments in India

- **Evolution of an approach to greener economy**: India, under Paris Agreement, submitted its Nationally Determined Contributions in 2015, for the period 2021-2030. The ambitious commitments require an estimated USD 2.5 trillion investments between 2015 and 2030. Additionally, India is also committed to achieve the SDGs to drive its agenda of development without destruction. IFC in its report ‘Climate Investment Opportunities in South Asia’ has estimated an investment opportunity of USD 3.1 trillion in India.

- **Action by global peers**: With increased recognition of implications of E&S risks, global sustainable investment community is actively driving the agenda and embedding ESG factors in investment decision-making. Global ESG funds are also investing in India and as per Global Sustainable Investment Alliance (GSIA), 41 Global E&S seeking funds have invested on an average 25% of their funds in India equities. 95 socially responsible funds have allocated on an average 18.5% to Indian companies. These figures are sizeable and are expected to lead to greater adoption of ESG investing in India.

- **Increased interest from domestic investors**: Earlier domestic investors played limited role in sustainable investments, however, the trend is changing:
  - Asset management companies are signing up to UN supported Principles for Responsible Investment. Ex. Kotak Mahindra Asset Management Private Limited (April 2018), Equicap Asia Management Private Limited (May 2017)
  - The Indian market has witnessed recent announcements/launches of ESG funds:
    - SBI Magnum Equity ESG Fund in May 2018
    - Avendus launched India’s first ESG-based fund in 2019 – Avendus India ESG Fund, a Category III Alternate Investment Fund (AIF) focused on providing investors the opportunities for long term risk adjusted returns by investing in companies that practice sound ESG policies. Avendus tied up with Institutional Investment Advisory Services (IIAS), which has formulated an ESG framework for identifying companies for the fund
    - The same year, Quantum Asset management Company launched its first open ended ESG fund – Quantum India ESG Equity Fund, with an objective to achieve long-term capital appreciation by investing in share of companies that meet Quantum’s ESG criteria
    - BNP Paribas Asset Management India has filed an offer document for its BNP Paribas India ESG Fund with SEBI. Similarly, Kotak Mahindra Asset Management Company has also filed for Kotak ESG Opportunities Fund with the market regulator.
With a vision to be a trusted and respected asset manager, SBI Funds Management Private Limited (SBIFMPL), believes that a Responsible Investment (RI) approach is perhaps the best way to ensure longer term wealth creation for clients. Given this, SBIFMPL actively encourages the integration of ESG criteria in the investment process. In May 2018, SBIFMPL changed the name and fundamental attributes of SBI Magnum Fund to SBI Magnum Equity ESG Fund:

<table>
<thead>
<tr>
<th>Name of the Scheme</th>
<th>SBI Magnum Equity ESG Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Objective</td>
<td>To provide investors with opportunities for long-term growth in capital through an active management of investments in a diversified basket of companies following ESG criteria</td>
</tr>
<tr>
<td>Investment Strategy</td>
<td>The scheme has a comprehensive check list of company’s performance and management of ESG parameters. The endeavour is to follow ‘ESG Framework’ in order to delve deeper into a company’s management practices, culture and risk profile which helps in understanding the impact on long term shareholders. Each security is scored, using publicly available data, on ESG parameters which can impact or pose risks to the long-term sustainability of the business. External specialist service providers are also engaged for the process. Active weights of a security are determined by the ESG scores. A positive score enables a positive active weight, and vice-versa. For securities lacking data, the portfolio manager collects data by engaging with the company.</td>
</tr>
<tr>
<td>Type of Scheme</td>
<td>An open-ended equity scheme investing in companies following the ESG theme</td>
</tr>
<tr>
<td>Positioning</td>
<td>Large Cap bias</td>
</tr>
<tr>
<td>Benchmark</td>
<td>Nifty 100 ESG Index</td>
</tr>
</tbody>
</table>

**Performance of SBI Magnum Equity ESG Fund (as on 31st Oct 2019)**

<table>
<thead>
<tr>
<th>Scheme Name</th>
<th>CAGR%</th>
<th>Point-to-point returns on standard investment of INR 10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI Magnum Equity ESG Fund</td>
<td>19.28</td>
<td>INR 11,928</td>
</tr>
<tr>
<td>Scheme Benchmark: Nifty 100 ESG TRI Index</td>
<td>15.15</td>
<td>INR 11,515</td>
</tr>
<tr>
<td>Additional Benchmark: S&amp;P BSE Sensex TRI</td>
<td>17.97</td>
<td>INR 11,797</td>
</tr>
</tbody>
</table>

Some of the challenges faced by SBIFMPL in starting the first ESG based fund and the strategy adopted to overcome the challenges:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Challenges</th>
<th>Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Absence of quality ESG data (including current and historical data for benchmarking)</td>
<td>Developing internal capabilities and engaging external service providers</td>
</tr>
<tr>
<td>2</td>
<td>Availability of India specific data and lack of data for companies with low disclosures</td>
<td>Developed an internal framework for ESG assessment</td>
</tr>
<tr>
<td>3</td>
<td>Lack of disclosure on quantitative metrics</td>
<td>Engagement with companies to encourage disclosure and benchmarking</td>
</tr>
<tr>
<td>4</td>
<td>Lack of examples of ESG Funds in domestic market to understand market expectations</td>
<td>Creating first mover advantage</td>
</tr>
<tr>
<td>5</td>
<td>No comparable ESG funds to benchmark performance</td>
<td>Comparisons done with existing equity funds</td>
</tr>
</tbody>
</table>

Source: SBI Funds Management Private Limited
Emergence of sustainability oriented indices in India: In order to track, monitor, assess and report ESG performance of companies, there are various indices:

- **S&P BSE Greenex**: Tracks the performance of the top 25 companies in terms of greenhouse gas emissions, market capitalization and liquidity.

- **S&P BSE Carbonex**: Tracks the performance of the S&P BSE 100 companies based on their commitments to combating risks arising from climate change. It combines non-financial risks, those arising from climate change along with financial risk to provide an integrated measure.

- **S&P BSE 100 ESG Index**: Tracks companies that follow a defined sustainability criteria with similar risk and return profiles of S&P BSE 100 companies. It has 69 constituent companies and has a proven track record of providing financial returns and outperforming the benchmark.

- **NIFTY 100 ESG Index**: reflects the performance of companies in the NIFTY 100 Index based on an ESG score.

**NIFTY 100 Enhanced ESG Index**: It is an advanced index which is similar in characteristics to NIFTY 100 ESG Index, except there is an additional parameter in consideration. The companies should have a normalized ESG score of at least 50% to be part of the index.

Increasing regulatory requirements: As described in the evolution section above, India is witnessing a slew of policy reforms to drive investments in emerging sectors like renewable energy, several voluntary and mandatory guidelines to drive responsible corporate behavior and reporting on material ESG factors.

These developments and announcements have led to a momentum in the SRI investment market in India. The size of the SRI asset base in India stands at USD 28 billion, which is 0.1% of the global SRI assets. The growth in the SRI assets have been fueled by domestic asset managers, where SRI assets have witnessed a growth of 70% in last two years\(^2\). Interestingly, the domestic capital markets which was previously dominated by exclusionary strategies from ethical and Shari’ah funds, has now diversified into ESG integration strategies.

### SRI Investing snapshot in India

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic SRI allocation in India</th>
<th>International SRI allocation in India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>USD 0.17 bn</td>
<td>USD 13 bn</td>
</tr>
<tr>
<td>2017</td>
<td>USD 0.21 bn</td>
<td>USD 25 bn</td>
</tr>
<tr>
<td>2019</td>
<td>USD 0.61 bn</td>
<td>USD 28 bn</td>
</tr>
</tbody>
</table>

Source: Catalyzing Private Capital for Green Investments in India

Challenges in Scaling ESG Investments in India

Despite India’s stride towards promoting ESG investing, backed by positive financial implications, certain challenges limit the growth of ESG investments:

- **Availability of quality data:**
  From a fund manager / investor / ESG analyst perspective, availability of quality data about companies’ environmental, social and governance performance is critical for effectively analyzing the investments. There are multiple sources of acquiring this data, including official sources like organization’s Sustainability Report & Annual Report and information available through public sources like news articles, which makes it cumbersome at times. ESG Analysts have also indicated that social and governance related issues can be traced through media and annual reports, however information on environmental performance is limited. There are third-party ESG data providers to address the quality concern, however, the limitation with using their data is the use of differing methodologies to calculate the score, which leads to high degree of variance. Data credibility and reliability hence continues to be a barrier in scaling ESG investments in India.

- **Lack of market standards/taxonomy:**
  There are multiple names associated with investments based on ESG analysis including ESG-based investing, impact investing, socially responsible investing, Sustainable and Responsible Investing. While these names are interchangeably used, different asset management companies, asset managers have devised their own definitions and interpretations to guide their investments. For instance, impact investing is generally tied to a specific environmental or social outcomes, whereas theme based investing may relate to investments in specific sectors like clean energy and energy efficiency. To add to this, there is a lack of standardization in ESG data collection, reporting methodology and impact measurement standards, which adds another level of complexity for investors, who are seeking clarity and comparability in ESG performance of companies.

- **Traditional mindset of investors/asset managers:**
  There is a perceived trade-off between financial returns and robust ESG performance. It is assumed that ESG integration/screening comes at an additional cost. This mistaken belief in the minds of investors and asset managers and short-term focus on maximization of returns, constraints growth of ESG investing.
Lack of track record of ESG funds: Majority of the ESG funds in India have been launched in last 1-2 years and are in the process of undertaking investments. Given this, India does not have a long track record of ESG-aligned funds and their performance as compared to non-ESG products, which inhibits investments.

Limited technical capacities: ESG as a theme is evolving at a rapid stage and all the players along the value chain are gradually becoming familiar with it. There is a dire need to upgrade skills, to include social, environmental considerations, for greater understanding of risk and opportunities, to provide financing solutions. Advocacy is an important aspect of responsible investing, which requires sensitizing investors and businesses about the benefits of ESG investing.

“As part of our fiduciary responsibility, value system and risk management strategy, it is our core belief that a business run in the best interests of all stakeholders seldom fails to create lasting value for its investors. Companies focusing on triple bottom line (people, planet and profits) deliver sustained returns over a long period. Asset managers should pull up their values-based stocks as the need to invest with an eye on environmental, social and governance issues will only get stronger.”

— Navneet Munot, Executive Director and Chief Investment Officer
SBI Funds Management Pvt Ltd
Section IV: Recommendations and Way Forward

The set of complex and interconnected challenges, as highlighted earlier, call for adoption of an integrated ESG-aligned investment approach. There are 3 key pillars of aligning an investment approach to ESG (Figure below) and can be summarized in the form of a ‘3I model’, which stands for:

- **Initiate**
  - **Initiate industry-wide engagement to advance ESG approach**: In order to enhance understanding of ESG space, build technical skills and capacity, contribute towards formulation of enabling policies, financial institutions need to work in tandem with ecosystem stakeholders

- **Integrate**
  - **Integrate ESG-aligned investment approach within business strategy**: Strategic level interventions include devising an ESG integration strategy, recalibrating risk management frameworks and enhancing transparency and disclosure mechanisms

- **Implement**
  - **Implement ESG-aligned investment approach at operational level**: Putting in place processes and practices to implement ESG investment approach involves building the ESG-aligned portfolio, assessment of performance and the impact of the portfolio and constant engagement with investee companies on enhancing their ESG performance

![3I Model Diagram](image-url)
Before an organization embarks on its ESG journey, as a starting step, it is very important to arrive at a clear and consistent definition of ESG. This would result in a common understanding of what constitutes ESG amongst different stakeholders. A common definition will serve as a guideline for implementing organization on ‘What’ to achieve and measure progress accordingly.

For investors, it will help in standardization of information that needs to be gathered and compared across industry/sectors, and for governments, this information would be helpful in tracking implementation, gauge alignment and assess progress made at a national-level towards achieving Paris agreement and SDG targets.
Initiate Industry-wide Engagement to Advance ESG Approach

Given the central role that is played by policymakers, regulatory bodies, industry associations, stock exchanges and pension funds in development of ESG standards and industry wide best practices, financial institutions need to actively engage with them to drive change at a sectoral level through:

✓ **Policy advocacy:** An active engagement with stakeholder spectrum, specially policymakers and regulators, will result in formulation of new enabling policies or influencing existing policies to level the playing field and drive ESG investments. Dialogues to foster greater collaboration and leverage the power of partnerships would result in creation of frameworks, market standards and coalitions to further increase awareness and achieve on-ground action. A recent example of how one-third of the global banking sector came together to drive change is the launch of United Nations Principles for Responsible Banking.

### UN Principles for Responsible Banking

Recently, on the occasion of UN Climate Action Summit 2019, United Nations and leading global banks launched the Principles for Responsible Banking. 130 banks collectively holding USD 47 trillion in assets, signed up to the Principles and committed to strategically align their business with the goals of the Paris Agreement and the Sustainable Development Goals.

The Principles for Responsible Banking were developed by a core group of 30 Founding Banks through an innovative global partnership between banks and the UNEP FI.

**Principle 1: Alignment**

We will align our business strategy to be consistent with and contribute to individuals’ needs and society’s goals, as expressed in the sustainable development goals, the Paris climate agreement and relevant National and regional frameworks.

**Principle 2: Impact and Target Setting**

We will continuously increase our positive impacts while reducing the negative impact on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.
The Principles are supported by a strong implementation framework that defines clear accountabilities and requires each bank to set, publish and work towards ambitious targets. By creating a common framework that guides banks in growing their business and reducing risks through supporting the economic and social transformation required for a sustainable future, the Principles pave the way for the transformation to a sustainable banking industry.

Source: UNEP FI
Capacity building: ESG being an evolving field, requires training and diversification of technical and managerial skills of practitioners to develop greater understanding of risks and opportunities to provide ESG-aligned solutions. It is very important to cascade ESG values and strategy across the organization to send a clear signal to the staff about institutions’ stance on sustainable investing. Banks/investment managers may consider formulating cross-functional teams to bring in diverse expertise and evolve a coordinated ESG strategy. Capacity building of the ecosystem is equally important to drive accelerated growth of the sector. Several reputed organizations like PRI Academy, CFA Institute, UNEP FI offer multiple courses to enhance ESG skills.

Research and Analytics: Analysis of large amounts of data is important for investors and asset managers to create a balanced risk-return adjusted portfolio. Augmenting research capabilities will lead to enhanced understanding of latest market trends, industry insights and vulnerabilities, refining of organization’s own ESG strategy, analysis of performance of peers.
Integrate ESG-Aligned Investment Approach within Business Strategy

**ESG integration strategy**: ESG integration refers to explicit and systematic integration of ESG factors in investment analysis and investment decisions. Every organization has unique material ESG issues depending upon the business operations, sectors catered, country of operation and ESG awareness levels. Based on all these factors, FIs may choose to adopt any one particular approach or a combination of approaches ranging from negative or exclusionary screening, positive screening, sophisticated sustainability themed investing approaches

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**Quantum Advisors ESG Approach**

In order to deliver long-term value from ESG, Quantum Advisors’ ESG evaluation approach pertains to identification of companies that can act as long term stewards of capital. The analysis is guided by material ESG issues, where governance forms core of the ESG analysis. Typical focus areas include capital allocation, board composition, quality of disclosures and treatment of minority shareholders.

### Data Sources
- Sustainability reports (GRI Framework)
- Business Responsibility Reports (BRR) and annual reports
- Sustainability Accounting Standards Board (SASB)
- Pollution Control Board Filings
- Industry associations (WBCSD, WRI)
- News reports
- Interaction with management

### Proprietary research (Blended Approach)

**Company disclosures** (30% weight)
Companies are evaluated on their levels of disclosures provided in their sustainability reports / business responsibility reports / annual reports. Companies with higher disclosures get higher scores.

**Qualitative factors** (70% weight)
- Evaluate companies on their ESG performance relative to their peers on material ESG aspects.
- Check for any past violations / red flags of certain ESG metrics and corporate governance regulations

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### Scoring system

**Company disclosures**
- Binary scoring systems: +1 for disclosure, 0 for non disclosure
- Scores standardized from 0 (minimum) to 100 (maximum)

**Qualitative factors**
- Negative scoring system: Dependent on relative performance v/s peers or v/s national / global regulations
- Penalty for ESG non compliance
- Scores standardized from 0 (minimum) to 100 (maximum)

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**Consolidated score**
- Ranges from +30 (maximum to -70 minimum)

Source: Quantum India ESG Equity Fund Scheme Information Document
✔ **Risk management frameworks:**
Adapting risk management framework to include ESG risks and integrating it with investment policy encourages sustainable investments. There are multiple steps involved in systematic integration of ESG risks including:

- **Identification of risks:**
  Identification of material ESG risks is the first and most important step. This can be done through materiality assessment, SWOT analysis, stakeholder surveys or engaging an external ESG expert.

- **Prioritization of risks:**
  Portfolio scenario analysis techniques could be employed to assess and prioritize impact of ESG factors on risk and return profiles.

- **Devising risk response:**
  There are multiple techniques to mitigate/address ESG risks at an organizational, portfolio or investment-level. One of the commonly adopted approach by Banks to mitigate ESG risks is the adoption of Environment and Social frameworks, based on international frameworks like IFC Performance guidelines and Equator Principles.

✔ **Transparency and Disclosure mechanisms:**
ESG risk disclosure is an essential step towards building market transparency and a resilient financial system. For instance, there are frameworks like TCFD for disclosure on climate risks. Specifically for physical risks, coalitions like Climate Resilience Risks and Opportunities Coalition (Climate RROC) are bringing together financial institutions to measure and publically disclose climate-related physical risks and opportunities by 2021. As investment managers, it is extremely important to share periodic updates on the investment strategies i.e. how ESG factors are integrated and measured across funds/portfolios.
As an active investment manager, AXA IM is committed to tackle the impacts of climate-related risks and intends to play a key role in limiting global warming. Its climate change policy is fully aligned with the Task Force on Climate-related Financial Disclosures (TCFD) framework and is centered around four pillars:

- **Divestment and risk mitigation**: As part of its ESG integration process, AXA IM decided in November 2016 to divest from companies, which earn more than 50% of their revenue from coal-related activities. In December 2017, AXA IM, through its new in-house climate risks policy, extended its stance on coal to ESG open-ended funds and all third-party clients for their dedicated funds on an ‘opt in basis’

- **Active Stewardship**: As part of its Responsible Investing (RI) and Stewardship policies, AXA IM engages with companies, most exposed to climate change, to heighten their climate action efforts. It is also actively involved with Global Climate 100+ engagement group, a collaborative, investor-led programme, targeted towards most significant global polluters

- **Reporting and investment integration**: AXA IM, over the past two decades, has invested heavily in qualitative and quantitative resources to support ESG integration in investment processes, including development of proprietary ESG scoring methodology. It employs Article 173- France’s climate risk reporting law to provide updates on integration of ESG factors in its funds and is planning to consider new climate indicators with forward-looking metrics to improve its ESG reporting

- **Corporate Responsibility**: AXA IM is committed to reduce its own carbon footprint as part of its corporate responsibility and has identified power (energy), transportation and paper, water and waste as focus areas

*Source: Climate Change policy: Acting for positive change, AXA Investment Managers*
Implement ESG-Aligned Investment Approach at Operational Level:

**ESG-aligned portfolio:** The structure of an ESG portfolio depends upon the end goal and balance required between financial (alpha generation) and social/environmental objectives. There are numerous factors/themes that can be considered while building a portfolio and strategies vary from exclusion, to tilting towards a particular theme or a combination.

For example, JP Morgan Asset Management provides a wide range of investment solutions that caters to diverse financial and non-financial needs of its clients summarized in the table below.

<table>
<thead>
<tr>
<th>GOALS</th>
<th>Exclusions</th>
<th>Positive Tilt</th>
<th>Best-In-Class</th>
<th>Thematic</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Avoid companies that do not fit specific standards and values</td>
<td>Position portfolio to current or future leaders across sectors to incorporate explicit ESG considerations</td>
<td>Have strong belief in how sustainability-related issues will drive long-term outperformance; want to maximize exposure to the most sustainable industries and companies</td>
<td>Position portfolio to a specific long-term environmental or social theme to reduce exposure to risks and/or increase exposure to new investment opportunities</td>
<td>Produce and measure portfolio on both returns and impact</td>
</tr>
</tbody>
</table>

**JP morgan Asset management proposition**

| JP morgan Asset management proposition | The exclusion of certain sectors, companies or practices from a fund or portfolio based on specific values or norms based criteria | Investment style in which the portfolio is tilted toward sectors, companies, or projects with positive ESG characteristics | Investment style that involves investing only in companies that lead their peer groups in respect of sustainability performance | Top-down investment approach; investments in themes or assets specifically related to sustainability | Investments made with the primary goal of achieving specific, positive environmental/social benefits while also delivering a financial return |

*Source: Stronger Portfolios Built for a Changing World, September 2019, J.P. Morgan Asset Management*
Another example is from Credit Suisse’s of how its Credit Suisse Real Estate Fund Green Property is driving sustainable real estate investments.

Credit Suisse Real Estate Fund Green Property

Credit Suisse Real Estate Fund Green Property, launched in 2009, is the largest Swiss real estate fund for sustainable real estate investments. The fund invests in high-quality new construction projects located in strong economic regions in Switzerland.

Sustainability is the main criteria used for the selection of new construction projects, which must meet the stringent requirements of greenproperty. The greenproperty approach takes into account environmental, economic & social concerns and assesses the projects on the basis of five quantitative and qualitative criteria – utilization, infrastructure, energy, materials, and life cycle.

- **ESG portfolio performance and impact assessment**: It is important to develop metrics to assess performance of portfolios on integration of ESG concerns. Examples of parameters that can be used to assess and report the performance include: environmental parameters such as tons of CO₂ avoided, renewable energy generated; social parameters such as percentage of employees having long-term employment contracts or receiving training; governance parameters such as percentage of companies having independent and/or women as part of their Board of Directors. While reporting on good performance is a pre-requisite, it is also important to identify companies not performing as per the set ESG criteria.

- **Engagement strategy with investee companies on ESG issues**: Investors, as part of their fiduciary duty, must proactively devise an active engagement strategy with investee companies to protect and enhance the value of their assets in the long term, by improving their awareness levels on pertinent ESG issues. A constructive dialogue can result in greater accountability and improvement in risk return profile of the portfolio companies. The dialogue can be either directed towards proactive engagement with the portfolio companies to co-create shared value by incorporating material ESG factors in the business strategy or hand hold companies to rectify certain issues, which if left unattended, would result in exclusion from ESG-aligned investment.
Sustainability Investing is integral to Robeco Institutional Asset Management’s overall strategy. Robeco believes that engagement with investee companies on financially material sustainability issues has a positive impact on investment results and on society. Robeco adheres to some of the internationally accepted frameworks, best practices and codes of conduct, which also forms a basis of its engagement with investee companies:

- International Corporate Governance Network (ICGN) statement on Global Governance Principles
- United Nations Global Compact
- United Nations Sustainable Development Goals
- United Nations Guiding Principles on Business and Human Rights
- OECD Guidelines for Multinational Enterprises
- Responsible Business Conduct for Institutional Investors (OECD)

Principles guiding engagement with the listed companies

- Coherent corporate sustainability strategy
  - Maximize Sustainability Operating Performance
  - Focus on Materiality
- Manage environmental issues effectively
  - Implement an Environmental Management System
  - Assess and disclose environmental impact
  - Prepare for environmental incidents and prevent or minimize environmental damages
  - Innovate to improve environmental performance
  - Contribute to environment-friendly public policy
  - Embrace climate change
  - Manage water risks

Manage social relationships effectively

- Contribute to human rights
- Engage with stakeholders
- Respect labor rights
- Guarantee health and safe working environment for employees
- Develop human capital management policy to attract and retain employees
- Stimulate innovation
- Reduce environmental, health, and safety impacts of products
- Implement a supply chain management program

To manage corporate governance issues effectively

- Improve board quality and functioning of the board
- Improve corporate culture
- Improve risk oversight and management
- Implement appropriate executive remuneration policy
- Improve audit function
- Improve disclosure and transparency
- Allow shareholders to use their rights over companies and enhance those rights where necessary
- Prevent all forms of corruption
- Accountable tax practices

Source: Robeco’s Engagement Policy, Robeco Institutional Asset Management
Inclusion of ESG factors, in investment decision making and disclosures, has reached a classic inflection point and is heading towards the mainstream. In this changing landscape, understanding ESG risks and opportunities would help businesses use information to adapt to the changing world, and help investors make informed decisions.

Each step and every improvement along the way would bring benefits to investors and businesses, now and in the long-term. Evolution of ESG space calls for standardization amongst the practitioner-led policy initiatives in the short term. Policymakers and regulators could play a galvanizing role in the transition by establishing a long-term, standardized, focused, and predictable policy framework to encourage ESG investments.

Focus on ESG and its systematic integration in business strategy will provide an opportunity to:

- **Innovate business strategy that creates ‘value’**: With mounting ESG risks to businesses, a starting point of future-proofing business strategy is a strong commitment to contribute towards sustainable development. Corporate stewardship to balance profits and purpose leads to innovation of products, processes and business models, which provides competitive advantage.

- **Move from data to analytics**: Various reporting frameworks and requirements including Sustainability Reporting, Business Responsibility Report, CDP, DJSI and MSCI, to name a few, requires qualitative and quantitative data on ESG performance. The ability to collect, segregate and analyse this sea of data and information, presents an enormous opportunity for companies to make more informed decisions about long term sustainability goals, and devise actionable plans to address sustainability. In this interconnected world, it is very important to understand the intricate linkages between key environmental, social and governance issues and how they have an impact on each other. Understanding these connections would result in a concerted and orchestrated response to internal and external stakeholders.

- **Improve reporting quality**: During their ESG journey, organizations would experience transition from boilerplate reporting, to ensure contextualization and completeness within their reporting practices. For example, with emerging climate change risks, investors may want to know what the Paris agreement and SDGs means to the company and how will they tackle climate change risks posed or faced by their businesses. Public reporting on internationally accepted frameworks serves as an opportunity to share approaches, risk mitigation strategies and preparedness to deal with business-specific material issues. Moreover, the process of collecting the information and reporting ESG performance involves and engages the top management on key ESG issues, relevant for their operations and industry.

- **Foster employee satisfaction and enhance brand image**: Employees these days want to be associated with brands that are not only cognizant about ESG concerns, but have a strategy to effectively respond to them and exhibit a clear image. Millennials are more...
conscious about environmental and social issues and take into consideration the impact their actions have on the society. This changing mindset would become a key deciding factor for youth to decide their preferred employer and investment opportunities.

Thus, aligning investments with ESG provides opportunity for businesses to re-design their growth models, policymakers to re-enforce sustainable development policies and investors to re-orient capital towards climate action targets and SDGs.

“ As the ESG conversation has shifted over time from “values” to “value”, the Indian business community is well poised to integrate these concepts into a corporate sustainability strategy that produces a more inclusive India with positive, multi-stakeholder impacts. Congratulations to YES BANK for their ongoing responsible banking efforts and continued leadership in the field. ”

— Anuj A. Shah, Managing Director, Head of US Operations, KKS Advisors
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