CFA Society India

# India Insights

October 2021

## Thought Leadership in Action

## EDITORIAL

Hello Readers. This third edition of India Insights, our India Research & Advocacy Magazine ups the ante on our advocacy efforts in the fast-growing investment management industry in India. The Cover story on ESG Investing by Indian Retail Asset Managers gives you the inside scoop of how leading mutual fund managers are implementing decisions in ESG dedicated funds, industry challenges and the larger role of the independent external agencies in building a robust ecosystem for ESG data, stewardship and disclosures. This is the phase 1 of our long-term academic research on ESG investing in India, and the findings are remarkable but not very surprising, given the nascent stage of ESG capabilities among local investment community.

We are delighted with SEBI's quick response to mutual fund industry's woes on debt funds in 2020, by endorsing the concept of 'Swing Pricing' for debt mutual funds. The mechanism can be a springboard to tackling the issues around protecting the interests of long term or retail investors overshadowed by the huge flows from corporate entities and HNIs in such funds.

The CFA India Society recently concluded the second season of the Ethics Challenge among top Management Institutes in India, and the winning team will progress to the Asia Pacific challenge.

Other Advocacy initiatives, webinars and publications are listed on the last page for quickreference. Lastly, we are happy to share that the third edition of 'Corporate Governance in Investing' virtual summit comprising eminent industry speakers is scheduled on 19th and 20th November 2021. This year the summit is specifically focused on the role of Independent Directors in upholding governance among Indian corporate entities. Hope you can join us for the event.

Best Regards,

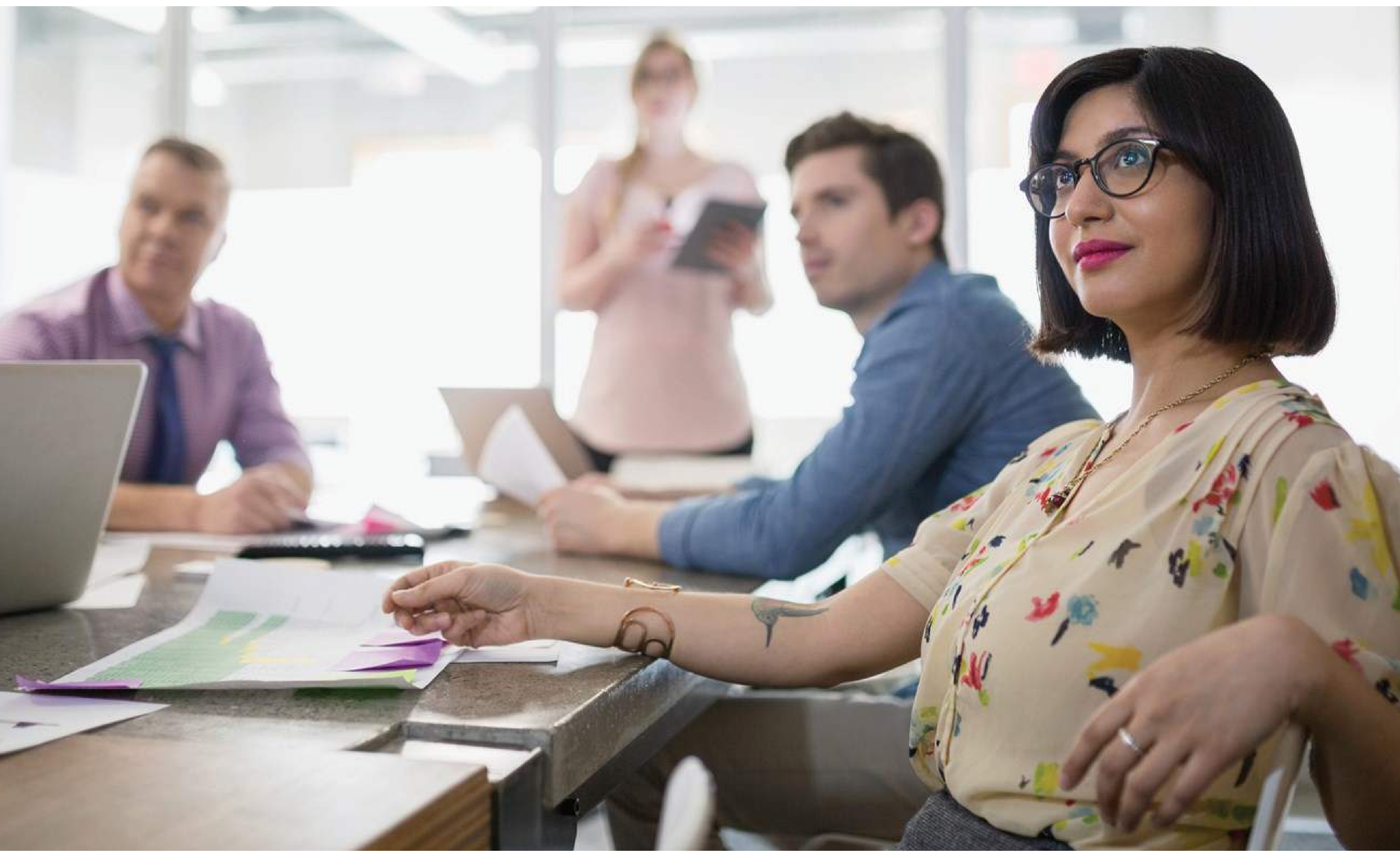
**Volunteer Editors**

Shamit Chokshi, CFA

Nimisha Pandit, CFA

# INDIAN ASSET MANAGERS ESG ROUNDTABLE:

## Another thematic idea or are Indian Mutual Fund Managers following a rigorous ESG agenda?



In a first of its kind in India, the CFA India society hosted a closed-door roundtable of India based ESG Fund managers to test the industry standards on data sourcing, integration, and disclosure practices for ESG funds.

With 9 ESG funds already managing industry AUM of ~$1.5bn, the Phase 1 of the study threw significant dispersion among funds in their investment frameworks, data sources, corporate resources, performance measurement and active risks in each portfolio. With the eventual release of the CFA Institute Global ESG Disclosure standards, we at the Research & Advocacy group see an enhanced role for the Society to build a credible thought leadership and academic research relevant in the Indian context.

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The key findings from the Phase 1 of the Roundtable below suggest that ESG investing among retail managers is at a nascent stage, but more importantly local asset managers envisage significant investments in human resources, and the larger ecosystem to pursue a credible stewardship effort in meeting ESG goals for each firm and their shareholders.

## Initial Observations:

- Most funds inculcated an ESG score and exclusionary screening. However, there were differences in approaches, scoring methodologies that resulted in different attributes across funds.
- Some funds had international stocks, even as the underlying benchmark had none.
- Disclosure on engagement with investee companies was limited.
- The median fund had an overlap of 65% with the broad market benchmark. A few funds have large holdings outside Nifty 100.
- There was considerable divergence in ratings of ESG funds across two ratings providers. This was also indicative of the dichotomy in ESG scores used as inputs in the funds.
- All except three funds had lower carbon intensity compared to the broad market benchmark.

## Our learning about the managers' guiding frame works and approaches

Asset Managers majority owned by a foreign parent co. are adopting frameworks developed by their global counterparts and customizing the process for local nuance.

Other funds have developed frameworks with the help of external expertise. Overall, asset managers maintain that with time and improved internal capabilities, their frameworks will evolve too.

A majority of the funds use ESG scores/ratings from popular external data providers. They keep a threshold for stocks to qualify for inclusion in the investable universe. Companies with low scores are considered for engagement, while some names are filtered out for high controversy scores. Some funds have developed internal ESG rating mechanisms for their portfolio construction.
There was a consensus view of the lack of sufficient in-house expertise to assess the technical parameters of the 'Environmental' factor, and how such metrics should be tracked at a portfolio level and be taken up for discussions with the underlying companies. Managers also find it difficult to fully integrate 'Environmental' factors, directing the forum to deficiencies in data availability, some technological and policy-related advances. We think The BRSR guidelines from SEBI can become a springboard to expanding the scope of such disclosures by specific industry sectors significantly linked to such issues.

The Stewardship related engagement with underlying companies remains more focused on governance, financial and Board related matters, and there is a huge lacuna in terms of proxy voting, debating, and seeking answers on ESG as an area of focus. While many Fund houses with ESG funds have started communicating with companies, their feedback remains mixed in the absence of stricter data transparency rules for ESG. Interestingly, managers found it challenging to reconcile external and in-house ESG and views, which makes relying solely on such providers fraught with research related risks.

### Data transparency and standardization, disclosures, and benchmarks

Managers find the data in BRSR guidelines to be in a raw format that lacks standardization. This can possibly make it difficult to interpret data comparison across companies. We are certain that authorities are refining the guidelines, and the following areas need to be relooked:

**a)** Need for more data granularity
**b)** Incomplete data provide little detail to get an accurate picture of where the company stands on a particular aspect.
**c)** Sector specific technical disclosures
**d)** Divergence between rating providers: This is indicative of lack of standardization in their approach and is challenging for the various managers to reconcile 'ESG' issues. The lack of a feedback loop between the rater and the rated company, as it is not issuer-paid is something that could be explored in the future
**e)** Dissatisfaction and discomfort with benchmarks:
**i.** Lack of choice in benchmarks. It is constructed using data from one external provider, and there can be divergence of views with such agency.
**ii.** Low confidence on the benchmark for being true to their purpose.

### Conclusion:

Phase 1 of our ESG study already reveals divergence in approach and frameworks, subpar data quality, the absence of active stewardship policies among managers, and various challenges to reconcile external scores with a holistic view on tackling ESG issues in the economy. ESG integration remains work in process, while ESG disclosures among asset managers is rather very limited to their commitments under UN PRI and such other signatory agencies.

We take up ESG integration in investment decision making and disclosures in detail in the next phase of this study, with such findings to be released by the end of 2021.

# CONSULTATION PAPER FOR INTRODUCTION OF SWING PRICING

In September 2021, SEBI introduced the Swing Pricing mechanism as a tool to protect existing investors of debt mutual funds in the event of large inflows or redemptions from Mutual funds. Swing Pricing mechanism would ensure that the cost of such large transactions is borne by the new investor and not the existing ones. Swing Pricing is quite a popular policy for mutual funds globally. The swing pricing circular shall be applicable with effect from March 1, 2022.

Before introducing the mechanism, SEBI had floated a consultation paper for the same in July 2021. CFA Society India's advocacy group comprising of practitioners from Asset Management Industry had shared their feedback with SEBI on the consultation paper.

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**Key suggestions accepted by SEBI:**

- We supported the proposal to introduce swing pricing mechanism in India and also supported the hybrid model (both partial/full swing ) proposed by SEBI
- We concur with the option to facilitate swing pricing in both normal and market dislocation conditions. However, we recommended proposing some boundary conditions to ensure that the swing pricing doesn't end up becoming a differentiation criterion between schemes, leading to dilution of its effectiveness during normal times. In the final circular, instead of letting AMC's decide on swing threshold, SEBI has guided AMFI to prescribe broad parameters for determination of thresholds for triggering Swing Pricing. AMFI shall also prescribe an indicative range of swing threshold to the industry for normal times.
- Regarding scheme performance our recommendation was that the scheme performance should be presented both and without adjusting for swing factor, to avoid any confusion for investors. We also recommended that the scheme could have specific disclosures for application of swing pricing. In the final circular, SEBI has also accepted the need to have uniform scheme performance presentation and guided that the scheme performance shall be computed uniformly based on unswung NAV and additionally disclosures pertaining to NAV adjusted for swing factor along with the performance impact shall be made by the AMCs in specific format in their SIDs and in scheme wise Annual Reports and Abridged summary.

Tap here to read our complete response to SEBI

Tap here to read SEBI's proposal

## ETHICS CHALLENGE

CFA Society India in collaboration with CFA Institute successfully conducted the second season of the annual Ethics Challenge in India. The Ethics Challenge allows a unique opportunity to the students to learn about the CFA Institute Code of Ethics and Standards of Professional Conduct. It lets participants apply the principles to a real-world case involving a variety of ethical dilemmas, while competing against their peers.

The competition that started with 18 teams last year got bigger this year on multiple fronts. 32 teams from 32 unique colleges participated in the challenge. Out of those 6 shortlisted teams got a chance to present their analysis to the judges.

**The winners of the Ethics Challenge Season 02 are:**
**Winner** - Indian Institute of Management, Shillong
**1st Runner Up** - IIT Kharagpur - Vinod Gupta School of Management
**2nd Runner Up** - Indian Institute of Management, Bangalore
The Winners Team will be representing the CFA Society India at Asia Pacific finals.

## DIVERSITY, EQUITY AND INCLUSION CODE (USA & CANADA)

In March 2020, CFA Institute Inclusion & Diversity Steering Committee tasked the Diversity, Equity and Inclusion (DEI) Code Working Group (USA and Canada) with developing a set of principles to drive greater diversity, equity and inclusion within the investment industry. The group has developed a draft DEI Code to set standards within the investment industry.

**The Code outlines six key Principles** : Pipeline, Talent, Promotion and Retention, Leadership, Influence and Measurement.

Tap here to read the exposure draft

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## OTHER ADVOCACY INITIATIVES

### EVENTS, PROGRAMS & COMPETITIONS

- Sustainable Investing for Insurance Companies At a Time of Massive Change – Session Summary
- Webinar – Ethical Decision Making: Expanding Awareness for Investment Professionals
- Webinar - Disclosure Requirements in IFRS Standards – A Pilot Approach

### RESEARCH PUBLICATIONS & BLOGS

- Turbulent Times Ahead for Hard-to-Decarbonize Industries: Investment in Forestry is a Good Option – Link

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