



## India Avenue’s ESG Policy – Phase II

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## Current ESG Practices Adopted

In our first paper we took the first step of negative screening out of 7 sub-sectors which were involved in business which was detrimental to India's environment and society.

- Paper
- Tobacco
- Alcohol
- Gambling
- Coal
- Nuclear
- Defence

We classified these as "Red" Industries and were to be excluded from mandates for advice from our investment advisers. Conglomerate companies where more than 20% of their revenue was generated from above activities were also screened out. "Orange" Industries were to be monitored for practices prevalent in the industry and the portfolios investment in these industries will henceforth be reported to the Investment Committee on a yearly basis. This included the following industries:

- Automobiles and Ancillaries
- Basic Resources
- Chemicals
- Construction and Materials
- Consumer Products and Services
- Energy
- Food and Beverage
- Industrial Goods
- Insurance
- Media
- Personal Care, Drugs and Groceries
- Real Estate
- Retail
- Telecommunications
- Travel and Leisure
- Utilities

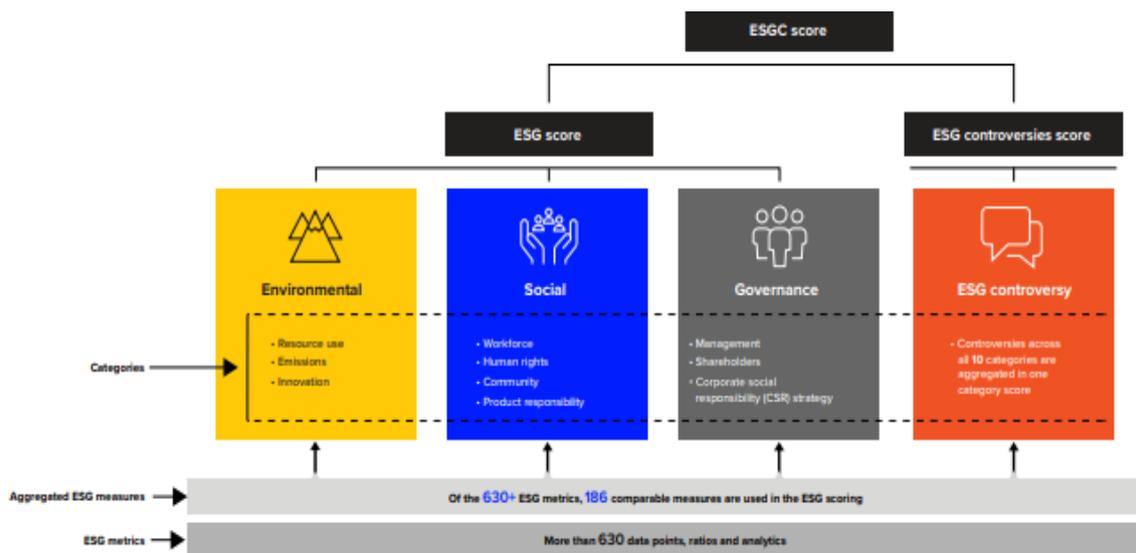
We incorporated a consciousness of better governance into our investment mandates with our investment advisers based in India. Our steps were taken keeping in mind our investment process does not have much control on the stock selection process, but more from mandate restrictions and discretion lying at our end when it comes to the gap between advice and implementation.

Indian asset managers are relatively nascent in their adoption of ESG related principles both in their due diligence (through analysts) and ultimate stock selection (portfolio managers). Generally ESG aligned products are negative exclusion products and separated from their core investment funds. Therefore one could say ESG is not a core philosophy of asset management firms in India at this stage.

Part of the issues have been related to availability of data once you go down the capitalisation curve i.e. outside the top 100 stocks. The advent of the Business Responsibility and Sustainability Reporting (BRSR) mandated requirement to provide standardised reporting practices from 31 March 2023 for India’s largest 1,000 companies, will provide data in a uniform manner across the universe of companies our fund typically invests in (top 800 companies in India by market cap).

### ESG Scoring

According to Refinitiv it “offers one of the most comprehensive ESG databases in the industry, covering over 80% of the global market cap, across more than 630 different ESG metrics, with history dating back to 2002”.



“ESG scores from Refinitiv are designed to transparently and objectively measure a company’s relative ESG performance, commitment and effectiveness, based on company-reported data. This covers 10 main themes including emissions, environmental product innovation, human rights, shareholders and so on”.

The ESG controversies score is calculated based on 23 ESG controversy topics. During the year, if a scandal occurs, the company involved is penalised and this affects their overall ESGC score and grading. The impact of the event may still be seen in the following year if there are new developments related to the negative event, for example, lawsuits, ongoing legislation disputes or fines.

Score range	Grade	Description	
0.0 <= score <= 0.083333	D -	'D' score indicates poor relative ESG performance and insufficient degree of transparency in reporting material ESG data publicly.	 <p>ESG laggards</p> <p>ESG leaders</p>
0.083333 < score <= 0.166666	D		
0.166666 < score <= 0.250000	D +		
0.250000 < score <= 0.333333	C -	'C' score indicates satisfactory relative ESG performance and moderate degree of transparency in reporting material ESG data publicly.	
0.333333 < score <= 0.416666	C		
0.416666 < score <= 0.500000	C +		
0.500000 < score <= 0.583333	B -	'B' score indicates good relative ESG performance and above-average degree of transparency in reporting material ESG data publicly.	
0.583333 < score <= 0.666666	B		
0.666666 < score <= 0.750000	B +		
0.750000 < score <= 0.833333	A -	'A' score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly.	
0.833333 < score <= 0.916666	A		
0.916666 < score <= 1	A +		

## The India Avenue Equity Fund – 30 June 2022

### ESG Scores

Our portfolio scores an *ESG Combined score of 54.1* which is made up of an ESG score of 58.2 and ESG Controversies Score of 80.8. According to this score, *the portfolio is rated B- which equates to good relative ESG performance and above average degree of transparency in reporting material ESG data publicly.*

However, there are many issues to consider when breaking down the score. Firstly close to 30% of the portfolio has no scoring. Most of these are mid and small companies have a significant presence in the portfolio but are yet to have any ESG data recorded or coverage. This make is difficult to assess relative to its benchmark which has almost 100% exposure to India's top 100 stocks by market cap.

This issue will be resolved by March 2023 when ESG reporting of India top 1000 companies becomes mandatory.

### Carbon Emissions

India Avenue's portfolios excluded many of the companies which have high carbon emissions. Having said that, the Fund does own some high emission companies such as Hindalco (Aluminium), Ultratech (Cement) and Tata Steel (Steel). The *portfolio scores 62 for Emissions.*

Conglomerates	Banks	Cement	Tobacco	Resources	Oil Marketing
Indus Towers	State Bank of India	Grasim Industries	ITC	Vedanta	Hindustan Petroleum
Adani Transmission		Shree Cements		Coal India	Bharat Petroleum
Reliance Industries		ACC		JSW Steel	ONGC
Tata Power		Ambuja Cements			
Gail India					

Controversial Businesses

*The Fund's controversy score is 80.8.* The score is high as we don't have significant exposure to companies which are involved in "controversy" – reported in the media over the last 12 months. Companies which can be classified as controversial in our portfolio include:

Company	Industry	Controversy Score
Mahindra & Mahindra	Autos	59
Tata Motors	Autos	43
Bharat Forge	Auto Ancillaries	100
Axis Bank	Banks	13
ICICI Bank	Banks	79
Aurobindo Pharma	Pharma	25
Cipla	Pharma	52
AIA Engineering	Engineering	24
Interglobal Aviation	Aviation	8
Tech Mahindra	Info Tech	80
Hindalco Industries	Materials	66
Tata Steel	Materials	11
Ultratech Cement	Cement	50

All the controversies in our portfolio are related to armaments, with the exception of Cipla where it is related to abortifacients. However, the revenue generated from or related to armaments and/or abortifacients are below our threshold for contravention (less than 20% of revenue).

Some highly controversial businesses are not included in the portfolio such as Reliance Industries, Larsen & Toubro, State Bank of India, Bank of Baroda, Bharti Airtel, which are significant benchmark constituents. However, as noted before up to 30% of the portfolio is not ESG rated yet.

Lesser rated ESG Companies in the Portfolio

Companies	Industry	Rating
Bajaj Finance	Non-Bank Finance	C-
Avenue Supermarts	Retailing	C-
Bajaj Finserv	Non-Bank Finance (Hold Co.)	C
SBI Cards & Payment Services	Bank Credit Cards	C
Cholamandalam Investment	Non-Bank Finance	C
Shriram Transport Finance	Non-Bank Finance	C+
SBI Life Insurance	Life Insurance	C+
Bharat Forge	Auto Ancillaries	C+
Eicher Motors	Autos – 2 Wheelers	C+
Container Corporation	Industrials – Government Owned	C+
Pidilite Industries	Industrials – Adhesives / Paint	C+
Astral	Industrials - Pipes	C+
IPCA Laboratories	Pharmaceuticals	C+
Aurobindo Pharma	Pharmaceuticals	C+
Coforge	Information Tech	C+
Prestige Estate Projects	Real Estate	C+



Industries in which companies appear more likely to contravene include financial services like Banks, Non-Bank Finance, Insurance as well as Autos & Ancillaries, Industrials, Pharmaceuticals and Real Estate.

Governance structures which relate to conflicts with the objectivity of the Audit Committee, Board Structure and Diversity still impact companies, particularly within Financial Services. A company like Bajaj Finance has grown at a rapid pace and is unlikely to have had time to stop and think about their governance structures and lack of conflicts.

Given the significant company ownership by founders in India, it is unlikely that this problem can be addressed until growth rates mature somewhat. However, the regulator SEBI is making significant changes with the aim of protecting the minority shareholder (refer Appendix A).

### Our Advisers

The India Avenue investment process involves strong partnerships with its investment advisers. Whilst India Avenue continues to develop its own philosophy, it also needs to understand the progress being made by firms who provide advisory services via mandate. Currently we utilise the skills of three advisers; DSP Investment Management, Axis Mutual Fund and Old Bridge Capital Management, all locally based in India.

Adviser	Achievements	Policies
DSP	Signatory to the UNPRI Dedicated ESG staff <a href="http://www.dspim.com/mandatory-disclosures/dspim-responsible-investments-policy">www.dspim.com/mandatory-disclosures/dspim-responsible-investments-policy</a>	Voting Policy Responsible Investing Policy Stewardship Policy
Axis	25% owned by Schrodgers – helped to integrate Quality Focus lends itself to strong G focus <a href="http://www.axismf.com/esg-fund-scheme">www.axismf.com/esg-fund-scheme</a>	Voting Policy Responsible Investing Policy Stewardship Policy
Old Bridge	Process is linked to ESG implicitly but not explicitly	

Both DSP and Axis as largest mutual fund managers have commenced the process of building ESG integration into their process. This includes some of the following:

- Integrating due diligence at the company level by qualitative ratings and scoring
- Hiring specific ESG related staff
- Ratings on ESG can directly impact the investment decision (screening positively and apply a discount/premium to target prices, making stocks more/less attractive)

Old Bridge as a boutique investment firm established in 2015 with a lower number of staff and smaller client base is in the process of developing an explicit policy, but believes its investment process deals with the ESG issue today by:

- Screening out companies which score poorly on governance
- Embedding capital allocation at the forefront of their process which addresses governance and stewardship
- Investing in several companies which are positive for the environment as part of their thematic



## Conclusion and Next Steps

### Phase II – India Avenue ESG Integration

The next phase would be to move up the value chain of ESG screening towards a more positive filtering. However we are conscious about moving at the appropriate pace. We look to implement the following in our next phase:

- ESG scoring of our portfolio via Refinitiv will allow us to monitor our portfolio relative to its benchmark over time, with the aim being to continue to make improvements. This process will improve as the Top 1000 companies in India are mandatorily required to provide transparent and consistent ESG reporting by March 2023.
- Partner with our investment advisers in improving due diligence done on prior to investing in companies to a more “active” level
- India Avenue seeks to undertake proxy voting in conjunction with views expressed by our investment advisers – which will create greater involvement in company decision making.
- Consider working with an India focused ESG consultant to consider appropriate improvements



## Appendix A - SEBI's Code of Corporate Governance

Recently, SEBI constituted an ad-hoc committee for reviewing and making recommendations of further strengthening of governance norms. SEBI has released specific guidelines for auditing and corporate governance in India based on this committee's recommendations, which are expected to be incorporated into the listing agreement between the company and the stock exchange.

### **(a) Board of Directors:**

The following are some points in this regard:

- The company's board of directors shall have an optimal balance of executive and non-executive directors.
- The number of independent directors will depend on the executive or non-executive nature of the Chairman.

### **(b) Audit Committee:**

Some points in this regard are as follows:

The organization shall appoint an independent audit committee, the constitution of which shall be as follows:

- It shall have at least three members, all of whom shall be non-executive directors, the majority of whom shall be autonomous, and at least one of whom shall possess financial and accounting skills.
- An independent director will be the Chairman of the committee.
- The Chairman will be present at the Annual General Meeting to address questions from shareholders.

The audit committee's task should include the following elements:

- Oversight of the company's financial reporting process and the disclosure of its financial reports to ensure that the financial statements are accurate, adequate, and reliable.
- Requesting that an external auditor be appointed and withdrawn.
- Checking the adequacy of the role of internal audit
- Updating the financial and risk management practices of the company.

### **(c) Remuneration of Directors:**

In the section on corporate governance of the Annual Report, the following disclosures on the remuneration of directors are made:

- All managers' remuneration plan components, i.e., wages, benefits, incentives, stock options, pensions, etc.
- Descriptions of fixed components and benefits linked to results, along with performance requirements.



**(d) Process of the Board Some of the points set out in this regard are:**

- The Board meetings shall be held at least four times a year, with a maximum period of four months between each of the two meetings.
- A director shall not be a member of more than ten committees, nor shall he serve as Chairman of more than five committees in all the companies of which he is a director.

**(e) Administration:**

A Management Discussion and Appraisal Report should form part of the shareholders' annual report, including discussions on the following topics (within limits defined by its competitive position).

- Risks and opportunities
- Segment-wise or product-wise performance
- Risks and Issues
- Discussion on financial results concerning the performance of operations
- Front of material growth in human resource / industrial relations.

**(f) Shareholders:**

In this respect, some points are:

- In the event of the appointment of a new director or the reappointment of a director, the following details must be given to shareholders:
  1. A short resume of the director (summary)
  2. Nature of his specialist knowledge
  3. Amount of organizations of which he retains the management and membership of the Board's committees.
- A Board Committee shall be formed under the chairmanship of a non-executive director to examine the redress of shareholder and investor grievances explicitly.

**(g) Corporate Governance report:**

A separate section on auditing and corporate governance shall be included in the Company's Annual Report. It shall consist of a comprehensive report on corporate governance.

**(h) Compliance:**

The company shall acquire a certificate from the company auditors regarding its auditing and corporate governance compliance conditions. This certificate shall be appropriated with the Directors' Report sent to stockholders and also forwarded to the stock exchange.

