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Sub: Comments on the Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets

At the outset, we, at Indian Association of Investment Professionals (IAIP), a member society of the CFA Institute, appreciate the opportunity to submit our comments to the **Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets**.

IAIP is an association of over 2000 local investment professionals who are CFA charter holders and about 6000+ professionals who have cleared exams, eligible and awaiting charter. The Association consists of valuation professionals, portfolio managers, security analysts, investment advisors, and other financial professionals that promote ethical and professional standards within the investment industry, facilitate the exchange of information and opinions among people within the local investment community and beyond, and work to further the public's understanding of the CFA designation and investment industry.

CFA Institute is a global non-profit association of investment professionals with over 170,000 members in over 165 countries. In India, the community of CFA charter holders is represented by the Indian Association of Investment Professionals (CFA Society India).

Through our global research and outreach efforts, CFA Societies around the world endeavor to provide resources for policy makers, financial services professionals and their customers in order to align their interests. Our members engage with regulators in all major markets.

CFA Society India appreciates SEBI's wide-ranging efforts in the area of ESG in recent years, from the Business Responsibility and Sustainability Reporting (issuers), ESG disclosure schemes (asset managers), to ESG ratings and other related products (ESG data providers). We also agree with the reasons provided for the regulation of ESG ratings, from ambiguity, inconsistency in disclosures and lack of transparency in methodology, to potential conflicts of interest.

That said, we would like to point out that while the primary users of ratings are, like the paper says, asset management companies, the ultimate users are the retail investors. In many instances, retail investors invest in ESG funds without understanding what the rating, the input for portfolio construction, represent. For example, many investors may invest in products with an expectation that they can express their sustainability preferences, or the companies which the funds invest in, has a positive impact on environment (impact objective). However, the ratings the asset managers use might have a slightly different objective, which is to primarily manage the ESG risks on companies (integration or financial risk objective).

It is not enough for ESG rating providers to communicate what the ratings represent to asset managers – indeed, asset managers are in a good position to understand the difference. It is equally important for asset managers to communicate it downstream to investors in clear language.

SEBI has come out with a paper on ESG disclosures already and should additionally mandate asset managers to communicate the ratings classifications, and its meaning to their users. More generally, we encourage SEBI to think about the ultimate users when framing rules for the intermediaries which operate in the upstream businesses (data providers, consultants, and the like).

The suggestions/ comments provided by CFA Society India in this response paper have been developed through a collaborative process guided by volunteer investment professionals. We would be happy to hear and discuss the merits / demerits of suggestions proposed by us and other practitioners and request to be included in the deliberation process.

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Sr. No	Issues (with page/ para nos)	Extract from Consultation Paper	Proposals/ Suggestions and Rationale
1	3.5.2. a	A listed entity who intends to **avail an ESG rating**, shall obtain the same **from only** a SEBI Accredited ERP.	**Proposals/ Suggestion:** The provision should be reframed to focus on the "**use of the ESG ratings**" by listed entities rather than where they "**avail the ratings from**". **Rationale:** Given the absence of a regulatory mandate for listed entities to "**avail ESG ratings**" for any capital market activity and given that the predominant business model proposed in this paper for issuance of ESG ratings is a "**Subscriber Pay**" model – any regulatory provision mandating "**how the rating is availed**" should be avoided and should focus on the how the ESG ratings provided by an ERP "**is/can be used**".
2	3.5.2. a	Further, if entities other than the top 1,000 listed by market capitalization wish to avail services of SEBI accredited ERPs, such entities shall make public disclosures in line with those prescribed in BRSR on mandatory basis prior to engaging with SEBI accredited ERPs. **Such ERPs shall provide ESG Rating, subject to disclosures related to BRSR being available in the public domain.**	**Proposals/ Suggestion:** This provision seems to be too prescriptive and limiting on ERPs and needs to be relooked at. **Rationale:** The provision seems to limit the scope of the ERP ratings only to entities where information is made available in the public domain. There are various ERP's currently, who in case of lack of data disclosures from companies, use estimation models providing some degree of insights on ESG risks and opportunities for investors resulting in more awareness and better decision making. It is not clear if this provision is limiting such ERPs to not rate a company until it publishes BRSR.
3	3.5.2. b	SEBI-registered entities engaged in fund-based investment activities such as mutual funds or alternative investment funds, desirous of using third-party ESG ratings as part of their decision-making process for investing in Indian securities, shall avail services of SEBI accredited ERPs. **Further, any passive funds launched by these entities shall be based on ESG related indices which use ratings of SEBI-accredited ERPs only.**	**Proposals/ Suggestion:** This provision should also clarify if mutual funds are allowed to introduce investment products using internal assessment scores/ ratings only and if such funds need to be registered as an accredited ERP before such investment products can be introduced. **Rationale:** The provision does not currently clarify on how mutual funds/ AIFs who only use internal assessment scores/ ratings for their decision-making process need to be dealt with, when introducing new investment products into the market.
4	3.6 a	Whether there is a need to regulate/ accredit ERPs in securities market?	**Views/ Comments:** Agree with this provision. There is an imminent need for ESG ratings and assessments to be subject to regulatory oversight and supervision. However, given the evolving nature of the industry, regulations should be broad and principle-based and not too prescriptive. Regulations should be adapted to the current market structure and should accommodate both large providers as well as smaller entities.

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5	3.6 b	If ESG ratings are to be regulated, is the regulatory scope mentioned above adequate? If not, please suggest requisite modifications.	**<u>Views/ Comments:</u>** Please refer to the suggestions highlighted in point 1-3 above (responses to 3.5.2a and 3.5.2b). Additionally, the scope of the regulations can also be extended to other users of ESG ratings viz. investment advisors, PMS schemes etc.
6	4.3 a	Should only CRAs and RAs be considered to accredit as ERPs?	**<u>Views/ Comments:</u>** We opine that any regulations with respect to ERPs should be adapted to the current market structure and should accommodate both large providers as well as smaller entities, without overly burdening smaller entities with similar compliance burdens of either being a CRA and/ or RA. We also need to ensure that future innovations do not fall out of scope due to overly prescriptive regulations. The current market structure for ESG ratings is still evolving and has multiple entities such as ESG consulting firms, Fintechs, AI enabled technology firms who develop different ESG related products for investment decision making (in addition to larger established multinational ESG rating firms). While all such entities should operate in a transparent and regulated environment, there is a need to balance the extent of regulations such entities should be subjected to at this stage. **SEBI could consider drafting a separate set of regulations/ licensing norms for ERPs which are broad and principle-based and mandates measures related to governance, transparency, prevention of conflict of interest, and due diligence, but at the same time does not place undue compliance burdens on these entities.**
7	4.3 b	Could any additional category of entities be specified as an entity eligible for accreditation as an ERPs along-with rational for the same?	
8	5.7 a	Whether the above accreditation criteria, including net worth, are appropriate?	**<u>Views/ Comments:</u>** Given the current evolving market structure for ESG rating providers, we opine that the prescribed net worth of 10 crores is too high and may impede innovation in this space and entry of smaller players to launch new products/ methodologies to address ESG risks. While we agree and acknowledge the need for such entities to ensure continuity and protect the interest of clients (especially larger institutional clients), the regulations should also allow smaller entities who can cater to different market segments, and for which, such entities may not need a higher net worth for operations. SEBI could **consider a two-tier structure for ESG rating providers** and define the net worth requirements basis the service type/ users of the ESG ratings.
9	5.7 b	Please offer comments on whether any additional conditions/ requirements need to be specified, if any?	**<u>Views/ Comments:</u>** We agree to the manpower requirements mentioned in the provision 5.4 and SEBI's emphasis on certain minimum standards w.r.t manpower and ESG expertise. Additionally, SEBI could also recommend employees of such ERPs to undergo ongoing trainings and ESG certifications from reputed global and national educational institutions.

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10	6.7 a	Whether the above proposal on classification of ESG ratings and other related products is appropriate?	**Views/ Comments:** We agree with this proposal to ensure clear and consistent use of terminology in ESG ratings and have an appropriate classification of various ESG products. We also agree with the proposal that ERPs intending to get accredited with SEBI shall offer at least one of the prescribed ratings products. However, SEBI should consider how this proposal can be implemented in the Indian context, especially given that the ESG ratings market is dominated by multinational organizations which cater to global ESG products. Unless there is consistency in global definitions/ classifications of such products, this may lead to further confusion among investors locally and globally. Additionally, SEBI should also consider making it mandatory for all investment products (mutual funds, PMS, AIFs), if applicable, to disclose which of these categories of ESG ratings product have been used by the investment firm in their portfolio construction or investment decisions.
11	7.5 a	Whether the proposal on not having standardized ESG rating scales (i.e., standardized symbols and their definitions) initially is appropriate?	**Views/ Comments:** We agree with the proposal of not having standardized ESG rating scales initially and considering this proposal in the long run.
12	10.9 a	Whether the proposed norms relating to transparency, governance and conflict-of-interest issues in the ESG rating process are appropriate?	**Views/ Comments:** We agree with the proposed norms relating to transparency, governance, and conflict-of-interest issues in the ESG rating process. SEBI should also consider an additional provision w.r.t transparency for ERPs to disclose the below items for each rating product: • Breakup of percentage of actual data and estimated data on which the ESG rating is based • The time stamping of the data on which the ESG rating is based.
13	10.9 b	Whether ERPs should be free to assign ESG ratings on a sector specific or sector-agnostic basis, subject to adequate disclosures on the same?	**Views/ Comments:** We agree with the proposal and feel that ESG ratings should be assigned on a sector-agnostic basis, subject to adequate disclosures.
14	11.9 a	Whether you agree with the recommendation that the payment model should be subscriber pay in the current Indian context?	**Views/ Comments:** We agree with the recommendation that the payment model for ERPs should be a **subscriber pay model** and any resulting data gaps should be addressed by improving the sustainability-related disclosures by listed entities through appropriate and timely BRSR changes.