GNLU CENTRE FOR LAW & ECONOMICS
Policy Recommendations

GNLU/CLE/PR-06
10 March 2022

Recommendations and Comments to the Securities and Exchange Board of India on the Consultation Paper on ESG Rating Providers for Securities Markets

Comments on behalf of the Research Group on ESG Rating Providers, GNLU Centre for Law & Economics

Centre Faculty

Prof. (Dr.) Ranita Nagar
Professor of Economics
Head of Centre for Law & Economics

Dr. Hiteshkumar Thakkar
Assistant Professor of Economics
Co-Convenor, Centre for Law & Economics

Student Members

Alankrita Pathak (Team Lead)
Aaiysha Topiwala
Divyang Shukla
Pranay Agarwal
Shubh Tejaskumar Naik
Yashvi Rupesh Bhagat

Index

I. Introduction

The Securities and Exchange Board of India released the Consultation Paper on ESG Rating Providers for Securities Markets, soliciting comments from stakeholders and members of the public. Keeping in mind the mandate of the Centre for Law and Economics at the Gujarat National Law University, Gandhinagar, an endeavor was made to study and analyze the Paper in order to provide comments for regulating the crucial space of Securities Markets and Economic and Social governance sphere.

Therefore, the Centre for Law and Economics constituted a Research Group to study the Paper and research on the proposals to suggest comments which would further guide the policy draft for efficient regulations in India. This document is a collection of the comments of the Research Group, where the focus of the group was to strike a balance between ensuring transparency, encouraging efficient and precise methodologies, and safeguarding consumers. Efforts were made to collate and scrutinize the working of such ESG Rating Providers across the globe. In order to bring a holistic picture to the table, the Centre also organized a Roundtable Discussion to discuss the recommendations of the Report with eminent practitioners and experts in the relevant industry.

II. General Comments

The present section provides certain general comments advanced by the Centre on the Paper on ERP's. The Research Group agrees with most of the proposals set out in the paper, but there are certain loopholes that need to be addressed. In order to increase the transparency the financial advisers should compulsorily publish the impact of their advice on sustainability factor. Moreover, to increase transparency there should be inclusion of factors like materiality. Addition of analysis of missing factors should also be there. Inclusion of factors like materiality will refine the system of rating providers. Also, the awareness of impact of advice on sustainability factors will help the investors make informed choice. Moreover, a clause that puts forth a condition on need of data analysis and storage within Indian Territory and specifying certain perquisite infra-structure for undertaking the same within Indian boundaries is must, keeping in mind the proposed DPA,2019 specifically data localization.

To summarize, restriction of who can become CRA is a bit problematic. Decoupling it from existing str and creating a separate registration process for ERP with a separate firm or handle within CRA that can be registered as ERP firm might be helpful. A separate channel and entity for ERP is needed within CRA to define differentiation between credit rating and ESG rating.

Currently, most CRA or RA are working as rating agencies for various categories and issues and therefore, there is high possibility of over-lapping among different rating methodologies, practices and working system. A separate dept. or firm will avoid the over-lapping of methodologies and practices within the CRA and establish an independent dedicated team for ESG ratings for best possible outcome. Moreover, the subscriber-pay model has been criticized, the IOSCO report states that it may lead to smaller investors being in a disadvantaged position and creating a burden on ERPs.

Coming to the methodology of grading, on the point that whether it should be sector specific or sector-agnostic, it was concluded that the best way to go about the same would be a hybrid approach wherein a general model is used for the S bracket and a specific one for the E bracket. It is also emphasized that the social-part needs to be catered to immediately because the same has been lacking attention for long now.

III. Specific Comments in Tabular Format

Sr. No.	Extract from the consultation paper	Issues (with page/para nos, if applicable)	Proposals/ Suggestions	Rationale
2.1.1	The first being the most important and definitive, is non-disclosure or inadequate disclosure by the ERPs and the second one is the large number of ESG products and services offered by the ERPs. Therefore it is proposed that a regulatory framework should be there to ensure uniformity and transparency	The non-disclosure of the methodology adopted for computing ESG ratings have several consequences on the data based on which the performance of companies is measured.	Clear and non-ambiguous terminologies with transparent methodologies adopted by various ERPs while giving the ESG ratings is needed for protecting the investors' interests and the resultant market failure. Also the ERPs should be providing the investors with the products/services offered and the objectives behind that to avoid any ambiguity in the market.	The sheer variety and inconsistency in the methodologies of computing and presenting the data and measures and lack of transparency among the data providers creates market wide inconsistencies and ambiguity making the investing sentiments fall.[1] There can be two ways to counter it: First is the corporate disclosure of the ESG ratings in the market. However the problem in it is that the ESG disclosure by the companies will rather create ambiguity instead of resolving it.[2] The only option left is thus, making it mandatory for the ERPs to disclose the services/products offered by them, the methodologies and the authenticity of the data and regulating them to make rating system uniform and transparent.

[1] Sakis Kostankonis et al., *Four things no one will tell you about ESG data*, 31(2) J APP. CORP. FIN. 50, 53-57 (Spring 2019).
[2] Dane Christensen, *Why is Corporate virtue in the eye of the beholder? The case of ESG ratings*, 11-15 (Harvard Bus. Sch., Working Paper No. 20-084, 2019), https://ssrn.com/abstract=3793804.

2.1.3	Services other than in ESG space, which is an outcome of unregulated nature of the market, may cause potential conflict of interests. Also due to lack of transparency and inconsistency, there is a probability of misallocation or greenwashing.	As has been addressed in the consultation paper, the ERPs besides offering products in ESG space also provides services like index solutions and advisory services related to ESG ratings. But if these services are provided by the non-recognized organizations which used data from the ESG data vendors to create their own index solutions and advisory opinions, there lay a risk of turmoil among the investors endangering the stability in the market.[3] Also there lies an even greater risk of market failure if the advisory services are provided by the same ERPs providing the ratings to the same entities, which can lead them to give biased ratings.	The methodologies adopted by the ERPs are widely varied and thus shows different entities on different standings in terms of ESG fulfilments. However an improper methodology adopted could even result into misallocation of the funds. But at the same time, regulating the ERPs on a much larger scale will be a restriction on their innovations resulting into the market failure. Thereby, it will be better that the regulatory authority should mandate the ERPs to follow the same methodology with some variance (5-10%) to maintain uniformity and innovation at the same time.	As has been showed in the recent studies, most of the ESG indices show no evidence of performance of the entities[4] which further shows the unauthentic nature of these index providers which can shift the investing sentiments in an unfavorable manner and mislead them to make wrong decisions thereby causing misallocation and greenwashing which can possibly be prevented through heavy scrutinizing.[5]

[3] Robert G. Eccles et al., *Exploring Social origins in the Construction of ESG measures*, 3-7 (Saïd Bus. Sch., Univ. of Oxford, Working Paper, 2018), https://dx.doi.org/10.2139/ssrn.3212685. [Hereinafter "Construction"]
[4] Elroy Dimson et al., *Divergent ESG ratings*, 47(1) J PORTFOLIO MGMT. 75-87 (2020).
[5] Ellen Pei-yi Yu, *Greenwashing in Environmental, Social and Governance Disclosures*, 6-9 (Birkbeck Univ. London, Working Paper No. 52-101192), https://eprints.bbk.ac.uk/id/eprint/30701/.

2.1.4	In this section, it is contended that the ratings given by the foreign ERPs are based on the considerations suitable only for companies typically included in an Index. Therefore Indian companies are benchmarked with respect to the ESG ratings given by global ERPs and there is no differentiation in performance of issuers within the domestic sphere, thereby regulating the ESG ratings according to the Indian market.	The concept of ESG ratings has been fairly new to the Indian markets, which is evident with the ERPs and data vendors' global reach. These ERPs have diverse origins and have strong influence on the conception of sustainability, definition of materiality and the way ESG issues are measured, analyzed and sold.[6]	Where the methodologies and algorithms adopted by the ERPs are mostly varied across the globe, the global market and especially the laws in the developed markets hold significant relevance in the rating system. This cause the ratings given by the global ERPs to the Indian entities largely influenced on the global laws and markets and not the Indian market. Due to this, the entities have to either increase its costs on the ESG requirements or forgo the investments through which they lose considerable profits. Therefore, to make the data non-objective and avoid the turmoil created due to the change in the market laws of the developed world, it is necessary that	According to the Global Initiative Sustainability Ratings, there are over 100 organizations collecting data, analyzing and rating or ranking company ESG performance today, the origins of which are highly diverse.[7] The problem is further enhanced by the fact that the global changes impact the domestic laws and market as well. The Europe's change in its labor laws and the change in the rating methodologies by the ERPs can be taken as an instance where the ESG data become non-objective.[8] With the data vendors and ERPs being acting as global entities, rating the ESG of corporations of various regions, it is susceptible that the benchmarks are rather global and differentiated than regional, reducing the differentiation between the entities in the domestic sphere which creates ambiguity in the market among the investors.

[6] Construction, *supra* note 3 at 3-5.
[7] GLOBAL INITIATIVE FOR SUSTAINABILITY RATINGS (2018), http://ratesustainability.org/about/why-gisr/ (last visited Feb. 26, 2022).
[8] *New and Emerging ESG laws*, HOGAN LOVELLS, https://www.hoganlovells.com/~/media/hogan-lovells/pdf/2021%20PDFs/2021_05_05_New_and_Emerging_ESG_laws.pdf (last accessed on Feb. 26, 2022).

			the ratings given by ERPs are more influenced by the Indian factors rather than the global factors.	
2.4	The ESG ratings can also follow the governance of the credit ratings by CRAs and can be a single output based on ESG disclosures made by the listed companies and other due diligence by the ERPs in ascertaining the ESG ratings of an entity.	The major criticisms of ESG as have been opined in section 2.1.2 and by various scholars raise critical questions on the accuracy of the ESG assessments. But without transparency and uniformity in both companies and ERPs, it is difficult to make an informed judgment relying upon authenticated ESG ratings. For that reason, in recent years, there is a growing demand for regulating the ESG market in the same manner as the Credit Rating system.	The governance of the ERPs is a critical question these days with the SEBI and other investor security agencies across the globe. But replicating the success got from regulating the CRAs through the same methodology can be valid if replicated for the quality assessments and ensure uniformity in the ratings, but apart from that the methodologies adopted for taking the regulatory actions and mandatory disclosures should be devised separately according to the requirements of the interest groups in the ESG market and ERPs.	While it has been indicated by the example of U.S. CRAs that the methodologies of the CRAs are too flawed to some extent, the CRA regulations can be applied to the ESG markets also to ensure transparency and prevent conflicts of interest.[9] Moreover as has been seen with the regulations for the CRAs, the threat of regulatory intervention may improve the analysis of ERPs leading to more accurate assessments. But wholly incorporating the idea of CRA would not be a good measure as the net worth requirement as has been set in case of Credit ratings do not make sense. While there has to be a certain level of capital structure, it should not be arbitrarily connected to CRAs and rather be focused on adequate skills and capital required in giving the ESG ratings. Nevertheless, the compulsory disclosures by the

[9] Wendy Stubbs, *Lifting the veil on environment-social-governance rating methods*, 9(4) SOC. RES. J. 622, 632 (2012).

				listed entities with regulatory mechanisms to ensure that will be needed to increase objectivity and transparency in the rating system.
3.5.1	As has been proposed by ESMA and SEC Thailand in sections 3.2.1 and 3.2.2 respectively, the ERPs should be registered and supervised by a public authority which will ensure consistency and transparency. However it is also opined that as the industry is comparatively new and has been experiencing innovations, it is important to estimate the ERPs as to capture broad spectrum of the existing products offered while also including future innovations. Likewise, regulatory actions should be proportionate enough to accommodate the interests of both large and small entities. In accordance of these objectives, it is proposed in this section to accredit ERPs for the purpose of assigning ESG ratings to listed entities and	In the given section, it is opined through the proposals of ESMA and SEC Thailand that for regulating the ESG ratings market, it is important that the regulatory structure and actions should be proportionate so as to cover broad spectrum of the products while keeping the scope for future innovations. But for that the regulatory authority (SEBI) would have to assess the market structure and the capital composition and requirements of all listed entities. This is not only a tedious exercise which will take much time and efforts of the regulating authority but is running into the risk of creating fears and suspicions in the securities market.	As has been cautioned by the ESMA and other regulatory bodies, it is needed that the market structure and capital composition of the entities be considered before making any decision or taking any action. It has been evident that the entities are judged not only by the ESG undertakings but also by their nature, nature of their products, capital composition and asset management, which also indirectly affect the ESG undertakings and thereby ratings of the entities. Therefore to maintain equality amongst the entities, it is necessary to devise the regulatory framework which	The needs for an efficient regulatory system for the ESG market is more than the costs. This too was the decision of the ESMA which abiding by its own proposals, is gathering more information on the market structure and capital compositions of the entities.[10] For an instance, a litigator company which deals with products harming the environment by nature should be given the ratings differently from the enabler companies which deal in the sustainable goods to give them the equal treatment. Therefore to emulate the proposals given by ESMA, it is required that the regulatory authority should take actions while accommodating the interests of all entities.

[10] ESMA LAUNCHES CALL FOR EVIDENCE ON ESG RATINGS, https://www.esma.europa.eu/press-news/esma-news/esma-launches-call-evidence-esg-ratings (last visited Feb. 27, 2022).

	securities.		ensures an equitable rating system in the market.	
3.5.2(a)	In the given section, three proposals are made for ascertaining the scope of accreditation of ERPs. In the first proposal, it is suggested that any listed entity shall have to obtain the ESG ratings through SEBI accredited ERPs only. In the second proposal, it is suggested that entities other than top 1000 listed by market capitalization, if want ESG ratings, then it will have to make public disclosures as prescribed by BRSR mandatorily prior to obtaining the ratings from SEBI accredited ERPs. In the third proposal, it is further suggested that once an entity makes a BRSR disclosure, it will continue to make it to avoid informational asymmetry.		The regulatory actions and disclosures should not be limited to the listed entities as the SEBI has powers to impose its actions even on the unlisted entities as well for the protection of the investors and prevent any market disruptions. Because of that, a lighter version of the disclosures should be made mandatory for the unlisted entities too. Moreover, for both the listed and unlisted entities, the SMEs should be given some relaxations as to the BRSR disclosures with some mandatory ones which are highly important to determine the ESG commitments of the firm. But it is recommended that to avoid informational asymmetry, the relaxation should	In the given section, three proposals have been given which will be separately dealt with. 1ST PROPOSAL: The section proposes for compulsory ESG ratings from the accredited ERPs. But it only proposes that for the entities listed under the SEBI, leaving the unlisted entities unregulated. The MCA committee in 2020, in this context, recommended that unlisted entities should also be regulated with regulatory provisions.[11] In accordance to that, it is proposed that entities above a specified threshold of turnover will be regulated by SEBI on the directions of MCA and smaller entities may adopt a *Lite* version of the regulations made for the major entities on an voluntary basis. 2ND PROPOSAL: The top 1000 listed entities are already required to adhere to the BRSR disclosure requirements, thus implying that the proposal makes it mandatory for all

[11] REPORT OF THE COMMITTEE ON BUSINESS RESPONSIBILITY REPORTING, 7 (Min. Corp. Affairs, Govt. of India, 2020), https://www.mca.gov.in/Ministry/pdf/BRR_11082020.pdf.

			not be extended to those entities which have rather fully complied with the BRSR disclosures.	listed entities to adhere to BRSR disclosure requirements for getting ESG ratings from accredited ERPs. With the large entities, the requirements are justified which will enhance the transparency and enable investors to make informed decisions. But the requirements should be made flexible with the small entities with low market capitalization and turnover. While the general and management disclosures can be made mandatory, the essential indicators like social impact of company and data of training programmers should be made voluntary for the small entities. The reason being that mandatory disclosures on such indicators will increase the pressure on its costs which will put entities in a dilemma to either bear costs of high ESG commitments or forgo investments, thereby making the regulatory action inappropriate. However the ratings should be greatly influenced by the contributions given to the research and development and the mother KPIs like waste management. <u>3RD PROPOSAL:</u>

				The smaller entities should be given a relaxation in fulfilling some of the essential indicators but the non-uniformity in the information may lead to ambiguity in the market. Therefore if the entity fulfils the disclosure requirements for which it was exempted, the entity should not be entitled for that relaxation any longer to maintain information symmetry.
3.5.2(b)	In the given section, it has been proposed that the registered entities involved in the fund based activities, if desire to use ESG ratings to make an informed decision while investing in Indian securities, will avail the facilities of SEBI accredited ERPs. Further, it is proposed that the passive funds launched by these entities should be based on ESG Related indices provided by SEBI accredited ERPs only.		It is necessary for the protection of such a large amount of market assets held by the entities engaged in the fund based activities that the ESG ratings they rely upon while making the investments is based on the transparent, uniform and unambiguous methodologies to avoid any greenwashing or misallocation and the resultant market failure.	With the climate related challenges making people think of sustainable finances more than ever. In India, where the concept of ESG is in its infancy, at least 17 mutual funds based on ESG are already operating in the market. In an event, chairman of SEBI, Ajay Tyagi informed that as of December 2021, the mutual asset management was Rs. 37 trillion with 11 mutual funds as ESG themes.[12] The high market value of capital assets with the entities involved in fund based activities makes it important that their investments are secured and are based on authentic information and informed decision to

[12] Kundan Pandey, *With plans to standardize ESG rating, India's market regulator takes a step towards sustainable finance*, MONGABAY (Feb. 10, 2022), https://india.mongabay.com/2022/02/sebi-proposes-regulation-of-esg-ranking-providers/.

				ensure growth in the market. Thus, it is essential that to secure the interests of these entities, they only avail the services of accredited ERPs which will provide objective and transparent ESG ratings of the corporate entities. Moreover, to secure the interests of the investors in the passive funds market, the indices which these entities track should be accredited and regulated.
3.5.2(c)	In the given section, it is proposed that to ensure uniformity, the index provider, if needs ESG ratings for formulation of index/indices on Indian securities, it shall use the services of SEBI accredited ERPs only.		The sustainability indices in India are having a vast impact on the investment decisions made in the market. As has been noted in the previous recommendations, the investment assets and capital can be an amass amount which involves the interest of several investors. Therefore, it is recommended that the ESG indices providers should be given unambiguous and transparent disclosures of the ESG commitments of	Index/indices with the ESG ratings are becoming popular in the recent years. This can be seen in the outperformance of the three sustainability indices of India over Sensex during the Covid-19 crisis implying the rising importance of sustainability investing in India.[13] However with the non-uniformity and objectivity in different indices, which shows different companies with different ratings, there is a threat to the interest of the investors. The solution to the problem lies in two stages. Firstly, the regulatory authority should take regulatory actions to ensure

[13] Moinak Manti & Parthajit Kayal, *Socially responsible investing: Indian investors are taking to ESG investments*, FINANCIAL EXPRESS (Nov. 3, 2021, 12:30 AM), https://www.financialexpress.com/money/socially-responsible-investing-indian-investors-are-taking-to-esg-investments/2362104/.

			the entities to prevent any misallocations and the resultant market failures.	uniformity in the ESG rating system and transparency in the methodologies adopted by the ERPs. Secondly, it should be made mandatory for the index providers to get ESG ratings from the accredited ERPs only where the regulatory actions of the authority will extend.
4	Entity eligible to be accredited as ERP-CRAs and RAs	Restricts the entry of other potential entrants as ERPs without any proper justification.	Need to remove this entry barrier limiting ERPs to CRA and RA, and opening application to all agencies who wish to apply for the same and possess the min requirement of capital requirement (set by SEBI after due consultation as pointed under suggestion for 5.2.) for undertaking ESG ratings.	Restricting entry to CRA and RA is an arbitrary blockage thereby preventing participation of firms that have the required potential for ESG ratings but are barred because of not being CRA or RA, limiting the ERP to the already existing well established CRA /RA. Need of a level playing field where all those with potential are given the opportunity for best and optimal result on ESG ratings thereby achieving the ultimate goal of this proposed policy.
4. additional clause	A new sub clause on a specific firm or department within CRA/RA	Currently, most CRA or RA are working as rating agencies for various categories and issues and therefore, there is high possibility of over-lapping among different rating methodologies, practices and working system.	1. setting a perquisite of a separate firm or department within CRA or RA that specifically deals with ESG ratings for being eligible as an ERP	A separate dept. or firm will avoid the over-lapping of methodologies and practices within the CRA and establish an independent dedicated team for esg ratings for est possible outcome.

5.2	Net worth: It is felt that the minimum net worth should be prescribed in such a manner that it is not so prohibitively high that it would deter serious players or be anti-competitive. However, it is desirable to have a minimum net worth which would ensure capital adequacy commensurate with the required scale of operations and infrastructure and future growth projections. ESG ratings require skilled manpower and adequate infrastructure to conduct necessary due diligence for assigning and reviewing ESG ratings. Hence, a SEBI-accredited ERP needs to be adequately capitalized. Therefore, it is proposed that CRAs/RAs with a minimum net worth of Rs. 10 crores, as per the latest audited financial statements, may be eligible to apply to be a SEBI accredited ERP. This net worth requirement would be in addition to the applicable minimum net worth requirement	The problems of CRAs/RAs acting as ERPs and granting both credit ratings as well as ESG ratings creating confusion in the minds of the public	Certain changes to the proposed accreditation process as proposed by SEBI are: 1. Disclosing the minutes of the meeting(s) where discussions, debates and deliberation was held on method of determination of the minimum capital requirement to adjudge the suitability of the minimum capital requirement. Based on SEBI Act, 1992 and Right to Information Act, 2005 provisions. Alternately: 2. Establish sector specific ERPs which would provide ESG ratings for their respective industries which would make inter-industry and intra-industry ratings more comparable. To eliminate the problems of	The given recommendation by the SEBI in essence prescribes a minimum net worth which would act as a hurdle to cross in order to enable entry in the ERP industry. SEBI is a statutory body with wide-ranging powers established under the Securities and Exchange Board of India Act, 1992 which thereby makes it a public body. The decision of SEBI to fix the minimum capital requirement at Rs. 10 Crore is based on some rationale on which some discussion was undertaken in the meeting of the SEBI. Although the infrastructure requirements (Point 5.3) and Manpower requirements (Point 5.4) help in shedding some light on the matter, the same do not give the full information With the enactment of the Right to Information Act, 2005 the Right to information has been made a fundamental right and owing to the same, the minutes of such meeting where such conclusion was reached and the discussion and rationale behind the said decision would help one understand the reason for the minimum capital requirement and

			confusion	judge the same based on the soundness of the reasons thereunder. History has shown that ever since the ERP industry has gained momentum industries which do not have a lot to do with the environmental and social aspect have often been given very high ESG Ratings. For eg: Banking and Technology sector have little to no impact on the Environmental and Social aspect. On the other hand, manufacturing firms which have such impact are rated poorly but when compared with industry standards, they should have been given a high ESG Ratings. Hence, ESG Ratings should be relative and not only that, firms who are rating ESGs should also be arranged accordingly. What is required is sector specific ERPs which provide ESG rating for their individual sectors respectively. Further, an adjustment of the minimum capital amount is required to be made since smaller size industries would require smaller size ERPs which could then be more accurate and comparable inter-industry as well as

				intra-industry. The compulsory blanket 10 crore capital requirement would act as a barrier to new entrants in the industry and unnecessarily take away well-knowledged firms which in turn would lead to the society as a whole missing out on sustainable development by investing in firms with reliable and high ESG Ratings. Further, to eliminate the problems of CRAs/RAs acting as ERPs and granting both credit ratings as well as ESG ratings creating confusion in the minds of the public, (point 7.3) the same can be eliminated by simply creating ERPs separate from CRAs and not having an overlap of the 2 sectors but establishing ERPs as a whole separate institution of bodies.
5.2.	It is proposed that CRAs/RAs with a minimum net worth of Rs. 10 crores, as per the latest audited financial statements, may be eligible to apply to be a SEBI accredited ERP.	10Cr. min. threshold is seen as an arbitrary benchmark with no proper justification and it tend to limit participation as ERP within big, reputed CRA/RA, thereby preventing entry of other worthy participants or certain CRA and analysts who lack the min net worth	Remove the arbitrary clause on min net-worth of 10cr. and rather come up with just a min. capital requirement appropriate for conducting ESG ratings and justify the same capital-requirement benchmark based on adequate ERP	This will lead to removal of barrier to entry of worthy players lacking the min net worth and at the same time, the capital requirement will ensure that the ERPs can meet the adequate level of capital for conducting ESG ratings.

		and the financial threshold as required by SEBI but have high skills and expertise, thereby harming the ultimate goal of improving and formalizing ESG ratings by ERPs.	analysis, keeping it an optimal rate without any arbitrary capital-requirement to restrict entry of ERPs.	
5.3.	ERP must have adequate infrastructure to undertake necessary due diligence for assigning ESG ratings to listed entities in accordance with the provisions of SEBI Act, 1992 and regulations made thereunder	Lack of Information on infrastructure needed in specific details for ESG ratings beyond the specific act mentioned	Listing of specific infrastructure requirement for ESG ratings	Need of clear instructions on specific infrastructure To conduct optimal ESG ratings in today's time when the act listed for infrastructure Is of 1992.
5.4.	Proposed that ERPs shall have at least one specialist each in the following 5 areas on a continuous basis:	No specific qualities listed as pre-requisite for appointing the specialized workers under 5 listed areas creating ambiguity	Requirement to specify certain key qualifications or positions or quality, one must possess to be appointed as a specialist within the 5 areas for working in ERP under ESG ratings. (suggesting high threshold portfolios to be selected with better qualification and experience)	A pre-requisite on selection of specialist provides a greater threshold for that post so individuals with high qualification and experience needed to work for ESG ratings are appointed for that post, thereby maintaining high level of accuracy in ERPs rating process.
7.2	A parallel may be drawn to credit rating agencies in India, for which SEBI regulations were put in place in 1999, but the rating symbols and their definitions were standardized	While it is true that SEBI regulations for credit rating agencies were put in place in 1999 and were standardized only later in 2011.	A parallel should not be drawn between the two situations. The 1999 CRA regulations had been ahead of their time and had helped the	Not having standardized scales will not fulfil the purpose of regulations and will fail to bring the transparency and objectivity that SEBI wants to introduce in the context of ESG

	only in 2011. A similar approach may be sensible for ESG rating scales, given the dynamics of the industry. Thus, it is proposed that, to begin with, SEBI may not standardize rating scales (i.e., rating/ scoring symbols and their definitions) at this stage.	The previous regulations were deemed insufficient in the face of the financial crisis of 2007-08 and a need to strengthen the same was felt. (Report of the Committee on Comprehensive Regulation for Credit Rating Agencies). Further, the 2011 circular publishing the standardized norms itself states that common rating symbols and definitions are needed for ease and to achieve high standards. (SEBI Circular CIR/MIRSD/4/2011)	Indian economy mitigate the brunt of the financial crisis, despite that, additional standardizations were added so that the CRA framework was strong. Learning from this, to make a strong framework, SEBI should standardize the rating scales.	ratings.
7.5	Whether the proposal on not having standardized ESG rating scales (i.e., standardized symbols and their definitions) initially is appropriate?		Invest India, The National Investment Promotion and Facilitation Agency of the Government of India under the Ministry of Commerce and Industry divides Indian companies into 31 sectors ranging from agriculture & forestry to retail & e-commerce. Keeping these sectors in mind, the sector-specific standardization	Considering the dynamic market, it is important to take up the challenge and standardize the available ESG Rating products. This would allow for the creation of adequate regulations and a baseline that can later be updated in accordance with the changing market. Standardized metrics for the analysis of environmental, social and governance factors are necessary so that different rating providers don't end up using different baselines. Further, as

			can be undertaken and additionally, SEBI could hold the ability to add/remove sectors in accordance with market needs. It may be concluded that the proposal on not having standardized ESG Rating scales is not appropriate. It will not fulfil the purpose of regulations and will fail to bring the transparency and objectivity that SEBI wants to introduce in the context of ESG ratings. The comparison with credit rating agencies is itself an example of why standardization should be done. If standard scales are to be introduced, they should be introduced as soon as possible. It may not be necessary to standardize scales of all the ESG related products offered right away, however, the rating scales for the most relevant ESG should be standardized so	one of the major concerns is the interpretability of ratings, remaining non-standardized would continue to feed into the problem even if transparency in methodology is mandated. Differences in underlying methodologies would render the actual ratings insufficient, and result in a lack of comparability and correlation between ratings provided by different ERPs. **(OECD ESG Investing and Climate Transition: Market Practices, Issues and Policy Consideration.)** An OECD report emphasizes that core metrics of ESG reporting should be confirmed and standardized and additionally, sector-specific tailored metrics should be developed to achieve the most meaningful ESG ratings. **(OECD Report ESG Investing: Practices, Progress and Challenges, pg. 64)** An international survey cited in a World Economic Forum publication on ESG states that ‘lack of comparability across firms’ and ‘lack of standards in reporting ESG information’ were top reasons that impeded

			that an investor can compare ESG ratings of different companies from different ERPs and still easily interpret the available information.	investors' ability to utilize ESG ratings in investment decisions. **(World Economic Forum, Seeking Return on ESG Advancing the Reporting Ecosystem to Unlock Impact for Business and Society, January 2019) (Amel-Zadeh, Amir and George Serafeim, "Why and How Investors Use ESG Information: Evidence from a Global Survey", Financial Analysts Journal, vol. 74, no. 3, 2018, pp. 87-103.)** The previously mentioned WEF publication suggests that, practically, broadly applicable metrics that are deemed as being of high value to end-users should be aligned first. A recent initiative by non-profits CDP, Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), Integrated Reporting (IR) and Sustainability Accounting Standards Board (SASB) has aimed to standardize 'sustainability' reporting. **(CDP, CDSB, GRI, IIRC and SASB. Reporting on enterprise value, December, 2020)** SASB has tried to promote a standard for reporting for which they have recognized 77 industries and

				identified impact factors for each of these industries; the use of which would lead to an appropriate ESG Rating. Many of these recommendations come from the global west/ developed countries, one needs to be cautious before applying these ideas in the Indian Context.
	Manpower: Since ESG Rating is a knowledge and technical know-how driven exercise, certain minimum standards would be required to be specified in relation to manpower employed by ERPs, especially employees performing “core” functions which would be crucial to manage ERPs and carry out its operations in an appropriate manner. Therefore, it is proposed that ERPs shall have at least one specialist each in the following areas on a continuous basis: i. data analytics, ii. sustainability, iii. finance iv. information technology, law	Need for more personnel.	In addition to the 5 compulsory personnel, another additional member needs to be added, namely: 1. an expert analyst in the given field *Provided that* the recommendation above with respect to the establishment of the sectoral ERPs is accepted.	The given recommendation deals with the minimal required manpower to require in the ERP for effective and efficient as well as reliable analysis of data and the consequent ESG rating thereunder. In pursuance with the recommendations given above if the recommendation pertaining to establishment of sector specific ERPs should be accepted, the same will have an effect on the manpower requirements in addition to the ones laid down in the given Paper. The additional requirement would be that of an expert analyst in that respective sector who could analyse the environmental, social and governance aspect in comparison with the standard on the given sector and thereby give an accurate and clear

				ESG Rating.
11.9	Views/ comments sought on: a) Whether you agree with the recommendation that the payment model should be subscriber pay in the current Indian context?		It is not necessary to mandate the subscriber-pay model, it may be recommended and considering that it is the market norm, in all possibilities, it will be followed. Further, considering how small the size of ESG investments are at present and how quickly they are growing, it may be prudent to initially analyse the market trends rather than mandating a business model. The area should be provided with flexibility. Thus, SEBI should refrain from prescribing a business model, at this stage. The regulatory body should instead focus on pricing, transparency and disclosure regulations.	The subscriber-pay model has been criticized, the IOSCO report states that it may lead to smaller investors being in a disadvantaged position and creating a burden on ERPs. **(International Organization of Securities Commissions, 'Environmental, Social and Governance (ESG) Ratings and Data Products Providers: Final Report' November 2021)** However, the current ESG rating demand, as stated in the consultation paper, is primarily through institutional investors. At present, there doesn't seem to be an imminent need to change the current business model. Other business models that are used in such situations may not be efficient in this case. The issuer-pay model may lead to a higher disclosure as companies would willingly be obtaining a rating but since ESG ratings are not mandatory it might lead to companies not opting for obtaining an ESG rating at all. Further, the risk of greenwashing/ rating shopping would still remain. The disclosure and transparency regulations should

				cover any gaps in information rather than reliance on the payment models. Additionally, as the consultation paper itself states, the 'subscriber-pay' model puts smaller investors at a disadvantage, the regulatory body mandating such a model would be unfair. For example, MSCI's ESG Research Services cost US$7,500 on the lower range on an annual subscription basis, smaller investors may not be able to afford such high costs. **(MSCI ESG Research LLC, Brochure, 10 March 2021.)**

GNLU CENTRE FOR LAW & ECONOMICS

Gujarat National Law University, Attalika Avenue, Knowledge Corridor, Koba, Gandhinagar – 382007, Gujarat, India

Ph: +91-79-23276611/12, Fax: +91-79-23276613,

Email: cle@gnlu.ac.in

Website: https://gnlu.ac.in/Law-And-Economics/Home