

# ESG RATINGS: SEBI PROPOSES NORMS FOR ENTITIES

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

The reporting requirements, still unapproved, aim to provide comparability across bank books

**MUMBAI** : The Securities and Exchange Board of India (Sebi) on Monday issued a consultation paper to streamline and standardize the ratings of companies on Environmental Social and Governance metrics.

As per the paper only Sebi accredited entities can provide ESG ratings. These entities can include ratings agencies, Sebi registered research analysts among others. These criteria would be applicable for top 1000 companies according to market capitalization.

Sebi has sought comments on the paper by 10 March.

On January 23, Mint had reported that the markets regulator will soon issue a discussion paper to standardized norms while entities rate companies on ESG factors, and secondly will put in place a mechanism to avoid conflict of interest.

The consultation paper is a result of Sebi's discussion with various stakeholders that brought to the notice of the regulator that most of the ESG ratings providers or ERPs are rating hundreds of publicly listed companies based on public information on subscription basis.

The issues pertaining to ESG ratings mostly involved ambiguity of the wide range of ratings products offered along with inconsistency in disclosures and transparency of the methodology and rating process.

Sebi's 19-page consultation paper pointed out that "Although the purpose and definition of ESG rating products offered by different ERPs may be the same, the underlying methodologies utilised are likely to differ significantly between ERPs without sufficient disclosures."

Further Sebi said, Given the unregulated nature of ESG Ratings and ERPs being in unregulated space globally, currently many ERPs offer services other than ESG space such as index solutions, advisory services related to ESG etc.

Further, due to lack of transparency around the manner of usage of ratings by investors as well as types of ESG ratings products of different ERPs, there is a significant risk of misallocation and greenwashing.

In terms of the consistent use of terminology in ESG ratings, it has been proposed by Sebi that the ESG rating products may be referred to as 'ESG Corporate Risk ratings' or ESG Financial Risk Ratings', so as to distinguish them from ESG impact ratings.

With respect to governance and prevention of conflict of interest, Sebi proposed, that a detailed policy should be in place for managing conflict of interest and this should be clearly disclosed on the websites.

The new proposed norms may infact force many of the ERPs to rethink their model as the products they are offering and business models they are following are different. For instance,

many ratings provider have started including ESG relevant disclosures in ratings commentary which may not be allowed going forward.

Crisil, India Ratings and ICRA did not offer any comments. Few rating agencies said that they are still evaluating the paper.

"Acuite group and ESGRisk.ai is carefully evaluating the ideas proposed in the discussion paper released today. The guidelines when finalised will provide an opportunity to Indian markets to use India specific rating criteria, models instead of simply relying on ESG rating reports that are designed for Europe and US. We also believe, this will help Indian companies to recalibrate its strategies and align with expectations of global investors and Indias commitments to International community," said Sankar Chakraborti, CEO, Acute Ratings.

Sebi further said that ERPs should not provide ESG ratings to any related parties or securities issued by them or the ERP.

The analysts involved in ESG rating assessment shall disclose any conflicts of interest involving a company/ issuer to the ERP and shall not be allowed to rate such companies.

As a business model all the ratings will be provided under the 'subscriber-pay' business model.

"It may be noted that while investors may be the primary source of revenue in a 'subscriber-pay' model, a subscriber may include an issuer as well.", the consultation paper said.

"We welcome this consultation paper and believe it's a good step and shall go hand in hand with the mandatory disclosures for the top 1000 listed companies. With more clarity around these aspects, issuers would be inspired to disclose more granular details of their ESG performance which will help build more robust credentials and attract more investments into such companies," said Ajay Mahajan, CEO, Care Ratings.

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