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STAKEHOLDERS EMPOWERMENT SERVICES (“SES”) COMMENTS ON

SEBI CONSULTATION PAPER ON REGULATORY FRAMEWORK FOR ESG RATING PROVIDERS (ERPs) IN SECURITIES MARKET

Name of the person proposing comments: Mukesh Solanki (Lead - ESG Research at SES)
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Category: ERP/ Research Analyst - Proxy Advisor & AMFI Empaneled ESG Rating Provider

REF:	Extract/ Brief of the Sub Regulation	Agree / disagree with proposed regulation?	Suggested Amendment, If any	Rationale
		Part B		
14.3.6	Weights of E, S and G scores in the assigned ESG rating			Only of E S & G, but not of subsections.
14.3.7	Brief explanation of rating intent to clarify if it represents unmanaged risks/ performance against risks/ impact etc. In case this is available in a methodology document, cross-linking of the relevant document would suffice			This relates to interpretation of scores or grades given and will be subjective.
15.3.1	ESG transition / Parivartan score	Agreed		This is an integral part of ESG Rating and would be seen in change in overall score on each parameter Y-O-Y. However, if any details of Parivartan score methodology are provided or industry comes to a conclusion, same can be adopted. **SES feels that there needs to be a regulatory guideline for same**.
16.1 - 16.3	16.1 With regard to aforesaid reference to business models of ESG rating providers, it is proposed that either a issuer-pays or a subscriber-pays business model be allowed for ERPs in India. 16.2 However, hybrid business models shall not be allowed for ERPs. In other words, an ERP shall not be allowed to assign certain ESG	**Disagree**		SES is against **Issuer pays** model for the following reasons: 1. Historically, we have seen that issuer pays model has multiple conflict related issues and having experienced it, why are we proposing to bring in conflict where none exists? 2. Who are the users of ESG ratings - Investors who have to invest and have a portfolio and also have a Portfolio ESG score. If the issuer pays model is adopted, in that case, all issuers must get their rating done by an ERP, else an investor will be using ESG rating of different providers for its portfolio, which will be inefficient as two providers will have diff rating model.

	rating based on issuer-pay model, while assigning another ESG rating based on a subscriber-pays business model. 16.3 The above proposal is to mitigate potential conflict of interests. An investor may rely on a certain ERP based on the assumption that the ERP assigns rating based on a subscriber-pays business model. However, the ERP might be assigning another ESG rating (or type of ESG rating) to the same company (or a group company) under an issuer-pays business model.			3. If an ERP decides to cover all companies which are listed, in that case why will an issuer pay? Unless it is mandated by law to use any one ERP? 4. For example, if a company A pays to ERP to do ESG rating, but Company B does not pay, however client wants B rating as well. Next time A will also not pay. 5. Best model is **user pays** model. It has no conflict and all ERPs will be covering all companies. Clients will have a choice to choose ERP and there will be no conflict. 6. Else, what will happen is that startups will have no business, as credit rating agencies will bundle product of credit rating and ESG rating. Thus, not only will there be a conflict created, it will kill competition as well.
		Annexure I		
28B(1)	"providing an opinion" Views sought on: (i) Whether the above definition of ESG ratings is appropriate? The same is broadly based on IOSCO recommendations. (ii) Whether any of the above definitions require any change(s)?		"Environmental, Social, and Governance ratings", or "ESG ratings" refer to the broad spectrum of ratings products that are marketed as providing ~~an opinion regarding~~ **a rating / score/ grade** an entity that is listed or proposed to be listed on a stock exchange recognized by the Board, or a security, that is listed or proposed to be listed on a stock exchange recognized by the Board, about its ESG profile or characteristics or exposure to ESG, governance risk, social risk, climatic or environmental risks or impact on society, climate and the environment, that are issued using a defined ranking system of rating categories, whether or not these are explicitly labelled	ERP only gives a rating/ score based on a model and **does not provide an opinion** as to whether it is good, bad, etc.
28C(1)	may continue to operate for a period of three months	**Disagree**	Three months be substituted by Six months or more	Even for research analysts, time was six months, which is extremely simple business compared to an ERP

28C Bottom Views sought on:	(i) What criteria should be adopted to categorize ERPs? For instance, the source of **information obtained** for ESG rating, **net worth** criteria, nature of services offered, **size of the balance sheet**, **assets under managements of users of ESG rating providers**, etc. The intent of categorization is inter-alia to encourage start-ups / new entrants to join the ESG rating industry. For ease of reference, a tabular comparison of Cat-I and Cat-II ERPs is provided at Annexure II.	**Disagree** on source of information obtained; net worth criteria; size of the balance sheet, assets under management of users of ESG rating providers		ESG ratings are structurally and conceptually different from Credit ratings. 1.ESG ratings must be given only on basis of **publicly available disclosed information** there is no need for using any information from any other sources, specifically from the listed entity. As data points are performance of listed entity. Unlike Credit ratings, where future financial projections are used in evaluation. If confidential non-public data is allowed to be used, it is not only going to create **information asymmetry**, it will also make difficult for public scrutiny. And important question is - **why at all there should be any confidential data on ESG.** **2.NW/ Size of BS:** Market place / users accept product of ESG rating not on the basis of NW or BS Size but by quality, therefore there need not be any difference. Money need not necessarily bring quality. **3. Assets under management of users of ESG rating providers:** Strongly disagree, this will help create a monopoly as anyone who bags top three MFs will wipe out competition. SES started with ZERO clients and today probably has clients whose AUM must be higher than any other service provider. Had this differentiation been there, SES would be struggling even after a decade. It is the quality and independence and freedom from conflict which are most important. 4. **<u>All of the above run contrary to the intent about encouraging startups and new players.</u>**
28C Bottom Views sought on:	(ii) What further differences could be considered for Cat-I and Cat-II ERPs? For instance, it is proposed that only Cat-I ERPs may provide third-party certification for green debt securities.	Disagree		Why at all there is need to have two categories – if intention is to help startups. The moment SEBI creates two categories, B category will be deprived of all business. **Category I/II/III merchant bankers** are an apt example. The moment any issuer appointed a category II/ III MB, negative opinion was attached. **SES strongly opposes this.** SES was the first domestic ESG rating provider in 2018-2019, others followed suit. Just because SES is a not for profit, independent conflict free organization and in order to maintain its independence, has shunned any investor in SES, should principles of SES, which in opinion of SES are pillars of its independence, be compromised just to qualify to be Category I? **Let the market decide based on quality.**

Annexure II				
Annexure II Services Offered	(I) ESG rating of listed, or proposed to be listed, entities **and/or securities**; or (II) Any other product, service or activity as may be specified by SEBI, or (III) ESG rating of any other product, service or activity as may be required by another financial sector regulator or authority (specified by SEBI) under the guidelines of such regulator or authority; [Additionally, basis suggestions on the differences in categorization of Cat-I and Cat-II ERPs, restrictions / prohibitions shall be specified for Cat-II ERPs, for example, Cat-II ERPs shall not undertake certification of green debt securities.]	Disagree on ESG rating for **securities**		(I) **ESG rating can be only of an entity, not of any securities issued.** (II) No comment (III) conceptually a product cannot be given ESG rating, however since it is futuristic, no issues. Comment on green debt securities- their certification is strictly not ESG rating. While G part can never be separated from an entity based on securities issued or Bond issued. E or S part can be enhanced using Green Bonds. If an issuer says Green bonds are for enhancing G, then better not rate such issuer.
Annexure II	Net worth	**Disagree**		Conceptually, do not agree with **different categories**. SES, being a not for profit company with minimal net-worth has competed with likes of ISS/ Glass Lewis and domestic providers, which demonstrates that quality is not captive of net-worth or in domain of rich only. However, a minimum NW may be specified for **single category of ERP providers**. In case categorization is continued- existing providers of ESG Rating be allowed to be Category-I or **NW requirement be reduced to Rs 1.0 Crore** SES, rather than building NW is building capacity of its staff and empowering as it is staff which is giving quality output not NW.
Annexure II	Entities Eligible	Disagree on below point: CRAs or SEBI-registered intermediaries not eligible;		**Is it intentional or typo?** If CRAs or any intermediary not eligible, does that mean a new entity is to be formed and registered? If this is the intention, two problems: 1.It will run contrary to 28 C (1) proviso, which is giving time for existing ESG providers to register 2. For companies like SES, ESG is a natural extension, as G part is common with existing activities and a part of S is also covered in existing activity. Any separation of activity into different entity will entail increased cost and seamless RPTs as duplication of efforts will cost.

				3. Unlike Credit rating agencies, where issuer pays model is operated, in Proxy Advisory service providers, such conflicts are non-existent. (more on issuer pay model at relevant place)
Annexure II	Promoter Req- **Cat-I ERP must be promoted by one of the following:** (a) an entity regulated by financial sector regulator viz. SEBI, RBI, IRDAI, PFRDA, subject to receipt of requisite approval from the concerned regulator or authority;	**Disagree**		No need for different categories 1. Why "promoted by", why not the intermediary be registered as ERP? Is it necessary to have two legal entities, when work of Proxy Advisory and ERP is almost similar. 2. What is important is to create regulations which tackle conflict related issues.
Annexure II	Manpower Req. At least ten employees specialised in the following areas, at all points of time, with at least one specialist in each of the following areas: (i) governance, (ii) sustainability, (iii) social impact or social responsibility, (iv) data analytics, (v) finance, (vi) information technology, (vii) law	**Disagree**		1. The situation and issue is akin to what happened when Proxy Advisory regulations came. New products require first toddler steps and over a period of time capacity/ capability is created. Specialization in many areas prescribed is extremely difficult to obtain and it must be appreciated that ERP does not do anything except systematically recording the disclosed data into a model. ERP does not add an opinion on sustainability etc, as for 80 different industry segments experts will be different. 2. Ultimately it is the market place which will decide quality and acceptability 3. In order to ensure that non-serious non-capable people are kept out practice of AMFI approving ERP based on capability may continue without imposing manpower qualification/ experience criteria. SES has amply demonstrated it 4. Item 10 on page 17/47 clearly gives leeway to SEBI to accept application based on satisfaction. Past experience as ERP must be sufficient.
Annexure II	Business Plan based Targets	**Disagree**		Must be dropped, as there is no way a new entrant can give any commitment to regulator, more so when one does not know what is market size, what is competition. Registration cannot be subject to achievement of target. One may adopt a business model of providing rating free? SEBI cannot mandate minimum price for rating.
Annexure II	Fee to SEBI			Once the categories are dropped, a one time fee of Rs 1.0 Lac is fair

Annexure I				
Page 18/47	Views sought on: (i) Whether the above net worth and manpower requirements for Cat-I and Cat-II ERPs appropriate?	**Disagree**		Already detailed in earlier responses
Page 18/47	(ii) Is it appropriate, in order for all ERPs having a level playing field, to require CRAs to set up a subsidiary to conduct ERP rather than do so divisionally or departmentally within the CRA?	**Disagree**		**The entire paper has taken into consideration CRAs becoming ERPs.** **Not all ERPs are CRAs.** **Not all ERPs are conflicted.** When on one hand, encouragement is to be given to startups, why talk about division or subsidiary of CRAs? Existing ERPs, in whatever form they are operating must be allowed to register, ensuring that they follow all stipulation regarding conduct, ethical standards and conflict management.
Page 18/47	(iii) Whether the breakeven/revenue/client-based target is appropriate? The provision is intended to protect the interest of investors in securities markets, and prevent ERPs from resorting to malpractice such as indicative ESG ratings or incentivising rating shopping to attract clients. It may be noted that all three targets are based on self-declaration by ERP at the time of registration with SEBI.	**Disagree**		SEBI generally will not set minimum price for ESG rating: Unfair competition or incentivizing can only come if issuer pays model is used. In such case, CRAs can bundle their credit rating products with ESG rating. This way, any competition will be wiped out as companies engaged in proxy advisory services do not have any material pecuniary relationship with issuer companies and cannot bundle their products unless they compromise their ethical standards. It is precisely to stop malpractice, SES is insisting ESG rating be given solely on **public data** and no one to one data should be used. CRAs are at present in advantageous position as ESG rating of the entities, who have issued debt and listed the same can only be given by CRAs as only they have the data and data is not in public domain. This not only gives unfair competitive advantage to CRAs but also makes ESG ratings away from any scrutiny as data is not in public domain
Page 18/47	(iv) Whether the above conditions of registration appropriate?	Disagree		Separate entity registration must be deleted
Page 23/47	Views sought on: (i) Whether the above prescribed code of conduct for ERPs appropriate (please refer Sixth Schedule below	Agreed		
Page 23/47	(ii) Whether disclosure of ESG rating methodologies by ERPs, as proposed above, appropriate?	Agreed		

Page 23/47	(iii) Whether ERPs will be able to disclose the extent to which a change in ESG rating is due to a change in the ESG rating methodology?	Agreed		
Page 23/47	(iv) Whether ERPs be required to publish an annual evaluation of their ESG rating methodologies? The same is in line with IOSCO recommendations and is aimed at periodic analysis (and necessary revisions) of ESG rating methodologies, in view of steep rating migrations in ESG ratings, if any. (As an illustration, steep drop in ESG ratings of companies such as Pacific Gas & Electric – arguably, the first case of a climate-change bankruptcy, despite high ESG ratings by certain providers).	-		This is a futuristic project, as evaluation model must be developed in consultation with ERPs by SEBI. The model has to be uniform. What are output parameters and their measuring tools has to be decided. Once it is done, **it will be acceptable**.
Page 23/47	(v) Whether the ESG rating transition rates will be an adequate proxy to measure performance of an ERP? This is akin to disclosures by CRAs on credit rating transitions.	**Disagree**		**There is a difference between ESG and credit Rating.** ESG rating is purely based on historical data and does not and should not be subject to subjective opinion. Whereas credit rating looks into future based on financial of date and projections and involves subjective assessment. In case of ERP, future improvement is not at all in control of ERP. If an entity focusses on ESG, its rating will improve. However, credit for same cannot be taken by ERP
Page 23/47	(vi) Whether the above transparency measures adequate and appropriate? W.r.t. *(11) Disclose, on their website, the general nature of compensation arrangements with clients and whether the ESG ratings assigned were solicited or unsolicited;*	Depends		This is applicable where ERP is rating an entity and getting paid. More detailed response on issuer pays model given elsewhere.

28L Page 24/47	Views sought on: Whether the above measures on conflict of interests are appropriate and adequate? If not, please provide any further suggestions to prevent conflict of interest. W.r.t. *(5) Structure reporting lines for their staff and their compensation arrangements to eliminate or appropriately manage actual and potential conflicts of interest related to their ESG ratings.* *(6) Not provide consulting or advisory on ESG ratings or areas related to ESG.*	Agreed		5. Only if compensation is related to ESG report related revenue 6. Agreed but "or areas related to ESG" needs clarification. For example, an agnostic tool to monitor ESG rating may not be disallowed. One to one advisory/ consulting must not be allowed.
28 M	(4) ESG rating definition, as well as the structure for a particular ESG rating product, shall not be changed by an ESG rating provider, without prior information to the Board.	Need Clarity		This is relevant only if original rating model is implemented with prior information to Board. What will be the basis on which SEBI will approve model? Is SEBI going to vet model or rely on AMFI Approval process? What will constitute change? Will report format change amount to change? Or additional parameter of evaluation added all across will amount to change? Is any new standard or development incorporated amount to change? SES is of the view that as long as all core parameters and all aspects of BRSR covered, any change beyond that is discretionary and may not require approval/ information to the Board. Is prior information sufficient or one has to obtain consent. SES is of the opinion SEBI should not assume additional burden, although SES would comply with the provision if implemented.
28O	(3)If the listed entity does not co-operate with the ESG rating provider so as to enable the provider to comply with its obligations under this Chapter, despite being under a contractual obligation to do so, the provider shall carry out the review on the basis of the best available information, in the manner as specified by the Board from time to time. Provided that if owing to such	**Disagree**		Since ERP will work on publicly available data there is no requirement for cooperation with company. If ERPs work with issuer and five ESG rating subjectivity will multiply as already model is subjective with asymmetric non-verifiable data problem gets compounded

	lack of co-operation, an ESG rating has been based on the best available information, the provider shall disclose to the investors the fact that the ESG rating is so based.			
28 M	(5) A provider shall disclose to the stock exchange(s) where the rated entity is listed, as well as through press release and websites for general investors, the ESG rating assigned to such entity or its securities, after periodic review, including changes in ESG rating/ reviews, if any	Need Clarity		ERPs do not have any right to upload or feed information to exchanges. Press release is also not a solution as entities like SES rarely issues press release. However, displaying on website along with changes if any is acceptable. Further we must be considerate to commercial prudence as well. If ERPs display all ratings factor wise, users may take scores from websites and not subscribe. Hurting entire industry badly even before takeoff. A middle path has to be formed. It could be selective disclosures/ masked disclosures or delayed disclosures.
28 M	(7) An ESG rating provider shall have efficient systems to keep track of material ESG-related developments to ensure timely and accurate ESG ratings.			ESG ratings will be an annual exercise and scores will not change much as data will come from BRSR and Annual Report, which is an annual feature. **However extraordinary developments needs to be captured and addendum must be issued with updates.**
28 M	(8) A provider shall attempt to continually improve information gathering process with entities / securities covered by its products.	**Disagree**		As SES believes information sources must be public sources mainly Annual Report, BRSR, exchanges disclosures and regulatory disclosures. ERP must streamline such data sources. SES does not wish nor encourages one to one exchange of data between issuer and ERP
28 M	(9) A provider shall respond to, and address issues flagged by entities covered by its ESG rating products while maintaining the objectivity of these products.	Agreed		
28 M	(10) A provider shall share a draft of the ESG rating report with the rated entity before publication of the same. The provider shall also grant such entity an opportunity of appeal and representation before the provider.	**Disagree**		As ERP will give independent rating and will not be paid by entity concerned, the first right to see Rating report is of paying client (Investors MFs etc) however ERP must also send rating report to entity concerned and if any factual error pointed out same must be corrected without fail **Since there will be no subjectivity in rating once the correct data is used, there is no question of appeal.**
28N	(2) An ESG rating provider shall disseminate information regarding	Need Clarity		Only on website and e mail to clients and concerned entity

	the newly assigned ESG ratings, and changes in ESG earlier rating promptly through press releases and websites.			
28 P	(2) An ESG rating provider shall adopt and implement written policies and procedures designed to help ensure the issuance of high quality **ESG ratings based on publicly disclosed data sources where possible and other information sources where necessary, using transparent and defined methodologies**	Need Clarity		This in slight contradiction to 28W where it says information obtained from entity (issuer) be kept confidential. ESG rating must be only on publicly available data.
28U	(1) Every ESG rating provider shall keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, as applicable, namely: (a) copy of its financial statements as on the end of each accounting period; (b) a copy of the auditor's report on its accounts for each accounting period. (c) a copy of the agreement entered into with each client; (d) information supplied by each of the client or rated entities; (e) correspondence with each client or rated entities; (f) ESG ratings assigned to various entities or securities including up gradation and down gradation (if any) of the ratings so assigned.	-		(c) wherever applicable. There may not be a contract, only mail confirmation. In case service provided on complimentary basis there may not be any confirmation as well. Small players have to first convince users about quality of their product before paid subscription starts. Issue arises only in case it is the entity which is rated is paying. (d) as above (g) & (h) only when ERP has an overriding discretion to interpret scores and give subjective rating
28W	1.Every provider shall treat, as confidential, information supplied to it by the rated entities and no provider shall disclose the same to any other person, except where such disclosure is required or permitted	**Disagree**		If 28 P(2) is implemented and all data is from public source , this becomes redundant SES would strongly recommend no use of private data to avoid subjectivity, privileged info.

	by or under any law for the time being in force, or unless explicit consent in writing has been obtained from the rated entities. (2) Private or confidential information or data shared by any client for purpose other than ESG ratings shall not be used by the ESG rating provider for undertaking ESG ratings, unless explicit consent in writing has been obtained for the same from the said client. No private or confidential information or data shall be obtained from any other entity. (3) Every provider shall adopt and implement written policies and procedures designed to address and protect all non-public information received related to their ESG rating products.			