

7th February 2022

India to standardise rules for ESG ratings

Recently, the Securities and Exchange Board of India (SEBI) proposed to standardise the ratings of listed companies on Environmental, Social and Governance (ESG) metrics in a [consultation paper](#). The consultation paper is an outcome of SEBI's discussion with various stakeholders that brought to the notice of the regulator that most of the current ESG rating providers (ERPs) employ methodologies that differ significantly between themselves without sufficient disclosures.

SEBI remains concerned over the unregulated nature of the market that is fraught with potential conflicts of interest. This as per SEBI has led to a lack of transparency and inconsistency in ESG ratings by investors as well as various ERPs increasing the risk of misallocation and greenwashing.

Following SEBI's [decision](#) to mandate business responsibility and sustainability reporting disclosure (BRSR) for the country's largest 1000 companies by market capitalisation, this recent proposal is another step taken by the regulator to combat greenwashing in a fast-growing yet highly unregulated space.

Further, In the consultation paper, SEBI proposes to accredit ERPs including credit rating agencies and research analysts based on a list of criteria that includes (a) net asset value proposing a minimum of INR10crores (USD 1.2mn), (b) infrastructure to undertake necessary due diligence for assigning ESG ratings which includes but not limited to, appropriate database collection and management systems, and analysis/ filtering tools (either in-house or outsourced) and (c) manpower to carry out the operations in an appropriate manner with one specialist each in data analytics, sustainability, finance, information technology, and law who are employed on a continuous basis. The accreditation of ERPs would be subject to review every two years and it can be revoked at any time in case of material non-compliance by ERPs or in case of non-maintenance of the minimum net worth. Essentially, ERPs will be treated as market intermediaries and the stringent requirements could potentially drive out some smaller players that are currently in the market.

In terms of the consistent product categorisation in ESG ratings, SEBI also proposes to distinguish rating products by “ESG Risk Ratings”, “ESG Impact Ratings” and “Benchmarking-related Products”, setting a foundation for further regulations in each sub-product category.

With respect to governance and prevention of conflicts of interest, SEBI proposes that a detailed policy should be in place for managing conflicts of interest and related disclosure shall be made. For instance, analysts involved in ESG rating assessments shall disclose any conflict of interest involving a company/ issuer to the ERP and shall not be allowed to rate such companies.

In terms of the business model of ERPs, SEBI has proposed that ERPs must include a ‘subscriber-pay’ model instead of an ‘issuer-pay’ model which has the potential to create conflicts of interest. In an ‘issuer-pay’ model, an ERP derives revenues from issuers and could be inclined to give higher ESG ratings to issuers that pay more.

Due to multiple challenges and the nascent nature of the industry, ESG rating providers are currently unregulated. SEBI’s proposal to strategically formulate regulations for ERPs ahead of all global markets reflects India’s determination in eliminating greenwashing and improving market confidence with greater transparency.

The information contained herein is issued by JK Capital Management Limited. To the best of its knowledge and belief, JK Capital Management Limited considers the information contained herein is accurate as at the date of publication. However, no warranty is given on the accuracy, adequacy or completeness of the information. Neither JK Capital Management Limited, nor its affiliates, directors and employees assumes any liabilities (including any third party liability) in respect of any errors or omissions on this report. Under no circumstances should this information or any part of it be copied, reproduced or redistributed.