Balanced Framework for ESG Disclosures, Ratings and Investing

1.0 Objective

This memorandum seeks the approval of the Board to amend the provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 **('LODR Regulations')**, and SEBI (Mutual Funds) Regulations, 1996 **('MF Regulations')** to prescribe a balanced regulatory framework for ESG Disclosures, Ratings and Investing, to mitigate green-washing risks while facilitating easier compliances.

2.0 Background

2.1. In recent years, there has been a growing recognition of the significant economic and financial impact of climate change and environmental, social and governance (ESG) risks. In the past 3 years, a number of ESG funds have been launched in India. As ESG Investing becomes mainstream, companies have been urged by both investors and regulator to make ESG related disclosures to their stakeholders. The use of ESG ratings and rating products by investors is also growing, as they increasingly factor ESG parameters in their investment decisions.

2.2. In view of the above developments, SEBI has mandated the top 1,000 listed companies (by market capitalization) to make ESG disclosures as per the Business Responsibility and Sustainability Reporting (BRSR) on a mandatory basis from FY 2022 - 23. SEBI, through AMFI, has also mandated disclosures for ESG labelled Mutual Funds. However, there is further scope for introduction of measures to address the risk of green-washing, to be undertaken by both companies and Mutual Funds. In the area of ESG disclosures, the need for assurance and expanding the scope of disclosures to the value chain are key requirements. In the area of ESG Investing, there is a need to ensure robustness of the disclosures being made by Mutual Fund (MF) schemes and to further strengthen the measures towards mitigating the potential risk of green-washing and mis-selling. Further, a key concern for regulators across the globe is ensuring the credibility and transparency of ESG Ratings. In this regard, SEBI is proposing a regulatory framework for ESG Rating Providers (ERPs).

2.3. In this backdrop, SEBI, in May 2022, constituted the ESG Advisory Committee ("EAC / Committee") to make recommendations to streamline the regulatory framework for ESG Disclosures, ESG Ratings and ESG Investing. The Committee had representatives from corporates, investors, rating providers, Mutual Funds, industry bodies, academicians, technical experts and other stakeholders.

2.4. The Committee submitted its report in February 2023, giving recommendations in the areas of ESG Disclosures, ESG Ratings and ESG Investing. Based on the recommendations of the EAC and internal deliberations, SEBI undertook public consultation ("Consultation Paper on ESG Disclosures, ESG Ratings and ESG Investing" enclosed at **Annexure A**) in the following areas:

2.4.1. <u>On ESG Disclosures</u>

2.4.1.1. Assurance of Sustainability Disclosures

2.4.1.2. ESG Disclosures for Supply Chain

2.4.2. <u>On ESG Ratings</u>

2.4.2.1. ESG ratings with Indian context

2.4.2.2. ESG Ratings on assured indicators

2.4.3. <u>On ESG Investing</u>

2.4.3.1. Enhanced Stewardship Reporting for ESG schemes

2.4.3.2. Mitigation of risks of mis-selling and greenwashing

2.4.3.3. Classification of ESG schemes

2.4.3.4. Annual Fund Manager Commentary

3.0 **Summary of public comments**

Comments were received from 75 entities/persons which included Chartered Accountants, corporates, consultants, ESG Rating Providers, industry bodies, investors, Proxy Advisors, legal firms, Mutual Funds and individuals. A summary of the public comments is placed at **Annexure B**. Analysis of public comments and the proposal is discussed in detail in the subsequent Paragraphs.

4.0 **ESG Disclosures**

4.1. **Assurance of Sustainability Disclosure (as per BRSR Core)**

4.1.1. Proposal in the Consultation Paper

4.1.1.1. **Framework of BRSR Core**

The Consultation Paper proposed a framework for reasonable assurance called the BRSR Core, which consists of a set of 9 critical ESG attributes and Key Performance Indicators (KPIs) under each of the E, S, and G attributes / areas that need to be reasonably assured. As compared with over 800 KPIs covered under the BRSR, around 46 KPIs are covered under the BRSR Core (other than intensity ratios, which are derived indicators). A brief of the attributes and KPIs in the BRSR Core, are as under:

a. **Green-house Gas (GHG) emission footprint**: Scope 1 and Scope 2 emissions
b. **Water footprint**: Usage of water from various sources and water discharge
c. **Investments**: R&D and capex investment in specific technologies to improve the environmental and social impact of products and processes
d. **Embracing circularity – waste management**: Total waste generated (with break-up of type of waste), waste recycled and waste disposed

e. **Enhancing employee well-being and safety**: Cost incurred on measures towards well-being of employees and workers, as percentage of total revenue and details of safety-related incidents

f. **Enabling gender diversity in business**: Gross wages paid to females as percentage of total wages paid, and complaints under POSH (Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013)

g. **Enabling Inclusive Development:** Input material sourced from MSMEs as a percentage of total purchases and wages paid to people employed in smaller towns (permanent or non-permanent /on contract) as percentage of total wage cost

h. **Fairness in engaging with customers and suppliers:** Percentage of negative media sentiment and number of days of accounts payables

i. **Open-ness of business:** Concentration of purchases and sale with trading houses, dealers and related parties along-with loans, advances and investments with related parties

In addition, the BRSR Core contains **intensity ratios** on the aforementioned metrics of GHG emissions, water footprint, and waste generated.

4.1.1.2. **Applicability of BRSR Core**

The following timelines were proposed in the Consultation Paper:

a. FY 23 – 24: Reasonable assurance of BRSR Core for top 250 listed entities

b. FY 24 – 25: Reasonable assurance of BRSR Core for top 500 listed entities

c. FY 25 – 26: Reasonable assurance of BRSR Core for top 1000 listed entities

4.1.2. <u>Rationale for proposal and approach</u>

4.1.2.1. Assurance of critical KPIs will improve the credibility of ESG disclosures and reduce the risk of green-washing, while at the same time limiting the cost of compliance which would otherwise have been incurred towards assurance of the entire BRSR. The BRSR Core also specifies the methodology to facilitate reporting by corporates and verification of the reported data by an assurance provider. It may be noted that the Committee had also undertaken a "proof of concept" exercise in respect of the methodology for verifications, before making its final recommendations.

4.1.2.2. The following approach was adopted in developing the BRSR Core:

a. **Quantifiable and outcome-oriented metrics**

The KPIs sought in the BRSR Core are quantifiable, so as to facilitate comparability of the disclosures. The KPIs also incorporate metrics that are reflective of sustainable outcomes in companies. To illustrate, one of the metrics recommended by the Committee is 'gross wages by gender' which is reflective of whether a Company has gender diversity practices which attract and retain women in its workforce, including at senior levels.

b. **Relevance of the attributes / areas in the BRSR Core**

The BRSR Core contains factors that are relevant to both the manufacturing and service sectors and are relevant in the Indian / Emerging Markets Context. For example, under the 'S' parameters, attributes such as job creation, and inclusive development are considered. The 'G' parameters include open-ness/ concentration of business including related party transactions.

c. **Comparability across jurisdictions**

As mentioned above, the KPIs in the BRSR Core, contain a number of intensity ratios, such as intensity of Green-House Gas (GHG) emissions, water consumption, waste generation etc., so as to enable comparability, irrespective of the size of the Company. These intensity ratios are based on both revenue and volume. Considering that these ratios are also used by global investors and global ERPs, it is appropriate that intensity ratios based on economic value adjusted for Purchasing Power Parity (PPP) be computed in addition to the other intensity ratios, for global comparability to be fairer to low cost / developing economies. In the first phase, country level PPP may be used and over time, sector specific PPP may be developed.

4.1.2.3. There are approximately 18 KPIs proposed in BRSR Core that are currently not present in the BRSR and the format of the BRSR shall be updated to that extent, while implementing the BRSR Core. These KPIs are largely reflective of the Indian / Emerging Market Context or are "Summary" indicators.

4.1.3. Public Comments and Analysis

4.1.3.1. BRSR Core

Public Comments

a. Majority of the comments received, broadly agree with the proposal of having a BRSR Core. A number of suggestions received were towards having a sector specific BRSR Core or inclusion of critical KPIs for service sector, citing that many of the existing KPIs in BRSR Core are more oriented towards the manufacturing sector. Few comments suggested inclusion of KPIs on data breaches, energy consumption along-with consumption from renewable energy sources, employee attrition etc. Comments were also received suggesting that it should be explicitly clarified that certain metrics are not applicable to the service sector.

b. Comments were received suggesting the inclusion of additional metrics such as SOx, NOx and other air emissions, Scope 3 emissions, percentage of complaints resolved etc.

c. A number of comments suggested deletion of the KPI on R&D and Capex Investments made towards improving the environmental and social impact of products & processes stating that environmental and social impact / activity is not defined currently, can be subjective and may not be relevant for the banking and financial services sector. Many comments also suggested deletion of the metric on percentage of negative media sentiment, citing absence of standard measurement and that a neutral sentiment may give an incorrect picture. Concerns were also raised on the KPI on “Wages paid to people employed in smaller towns (permanent or non-permanent /on contract) as percentage of total wage cost”, stating that this may not be an appropriate KPI, since cost of living may be lower in smaller towns.

Analysis - The analysis and views on the above comments are as under:

d. In line with the BRSR which is sector-agnostic, the BRSR Core is also intended to cater to both manufacturing and non-manufacturing sectors. Further, the Guidance Note to the BRSR already states that if a KPI contained in the BRSR is not applicable to a Company, it will have the option to mention as 'Not Applicable' along-with reasons for the same.

e. Further, with regard to suggestions on sector-specific BRSR Core, it is noted that the International Sustainability Standards Board (ISSB) is working on industry-specific disclosure standards, thus, SEBI would consider developing sectoral standards in subsequent phases. Thus, suggestions on inclusion of additional KPIs in the BRSR Core such as SOx, NOx and other air emissions may be considered at a later stage, when sectoral standards are developed.

f. Suggestion on deletion of the wages paid to employees / workers in small towns owing to low cost of living in such locations, may not be accepted since this issue is relevant for all companies and hence, it would not affect comparability. It may be noted that this parameter is very relevant and important for emerging markets including India.

g. The suggestions for modifications in BRSR Core that may be accepted, are as given below:

   i. Inclusion of the following KPIs in the BRSR Core:

- Energy consumption along-with percentage of energy consumed from renewable sources
- Instances involving loss / breach of data of customers as a percentage of total data breaches or cyber security events

ii. Deletion of following KPIs

- R&D and Capex Investments to improve the environmental and social impact of products & processes
- Percentage of negative media sentiment

4.1.3.2. Intensity Ratios adjusted for Purchasing Power Parity (PPP) in BRSR Core

Public Comments

a. Majority of the comments received were in agreement with the proposal. However, practical challenges were cited in its implementation such as need for a standard source of PPP which is updated every year, absence of product/sector level PPP, relevance of PPP adjustment in case of banking sector and the complication that technology firms would face to adjust their offshore revenues derived from clients in different geographies.

b. Few comments also suggested that intensity ratios based on volume should be sector specific. Further, this ratio should be disclosed segment-wise in case of conglomerates operating in multiple lines of business.

c. Comments against the proposal cited that intensity ratios based on volume may be a better indicator for comparability rather than intensity ratios based on revenue adjusted for PPP, and that flexibility on the disclosure metrics on intensity ratios may be given.

Analysis - The analysis and views on the above comments are as under:

d. Considering that most comments support the disclosure of intensity ratios based on PPP in addition to other intensity ratios, the proposal may be accepted. As proposed in the Consultation Paper, in the first phase, country level PPP may be used and over time, sector specific PPP may be developed.

e. Sector-specific intensity ratios may be developed, when sectoral standards are developed. Further, in order to aid companies in reporting, examples on sector specific intensity ratios may be provided as guidance.

4.1.3.3. Assurance of BRSR Core

Public Comments

a. Majority of the comments received were in favour of the proposal on introducing reasonable assurance as per the BRSR Core. Additionally, suggestions were received on prescribing a glide-path for assurance of the entire BRSR.

b. Few comments also suggested to start with limited assurance as per the BRSR Core, instead of reasonable assurance.

Analysis - The analysis and views on the above comments are as under:

c. Reasonable assurance is more comprehensive and robust, as compared to limited assurance. Considering the same along-with the fact that assurance is being mandated for a limited set of KPIs, the suggestion of starting with limited assurance may not be accepted.

d. With regard to suggestion on prescribing a glide path for assurance of full BRSR, it may be mentioned that IOSCO is working along with IAASB (International Auditing and Assurance Standards Board) and IESBA (International Ethics Standards Board for Accountants) for the development of assurance standards on sustainability reporting. It would therefore be prudent to take up the issue of assurance of full BRSR at a later stage.

4.1.3.4. Methodology provided for assurance

Public Comments

a. Majority of the comments received were in favour of the proposed methodology for assurance. Comments were received with the suggestion that guidance may be provided on independence and eligibility of assurance provider.

b. It was also suggested that the proposed assurance methodology should be indicative, to allow for sector specific nuances. Further, suggestions were received to allow for estimations for electricity and water consumption for service sector and to mandate the assurance standard in addition to the assurance methodology.

Analysis - The analysis and views on the above comments are as under:

c. There is merit in the suggestion that the independence of an assurance provider may get compromised if it offers other non-audit related services or is associated with the listed entity in any form other than audit / assurance. In order to address the possibility of conflict of interest, it may thus be specified that the assurance provider or any of its associates should not sell its products or provide any non-audit / non-assurance related service including consulting services, to the listed entity or its group entities.

d. Considering the global developments on assurance standards for sustainability reporting, the use of any assurance standard or specifying eligibility requirements of assurance provider may not be mandated, at this stage. However, use of any assurance standard may be disclosed, in the assurance report.

e. With regard to suggestions on stating that the assurance methodology is indicative, it may be mentioned that the proposed methodology for assurance of the BRSR Core is only a base methodology and it would be clarified that any industry specific adjustments / estimations made in this regard, may be disclosed.

4.1.3.5. Applicability and timelines of BRSR Core

Public Comments

a. There was a mixed response on the proposal of timelines for applicability. While few commenters agreed with the proposed timelines, others suggested the same to be deferred by at least a year citing certain new indicators being added in the BRSR Core, that would need to be tracked and that obtaining reasonable assurance would entail additional cost.

Analysis - The analysis and views on the above comments are as under:

b. Assurance is critical to address the risk of green-washing. In order to address the concern of increased cost, assurance on only a very limited number of KPIs as mentioned in BRSR Core is being prescribed. Further, it has been over two years since BRSR was issued in May 2021 and 185 listed entities have voluntarily disclosed the BRSR in FY 2021-22. Such companies have gained experience of making disclosures as per the BRSR.

c. Considering that assurance is critical to ensure reliability of disclosures, the timelines for adopting assurance may not be deferred; however, taking into account the comments on cost, the scope may be increased gradually beginning with top 150 companies (by market capitalization) instead of the top 250 companies as proposed in the Consultation Paper and gradually increase the coverage to top 250, 500 and 1000 companies by FY 24 -25, FY 25 - 26 and FY 26 - 27 respectively.

4.1.4. In light of the aforesaid, there is a need to introduce assurance as per the BRSR Core and accordingly amend the LODR Regulations. The existing regulatory provisions and proposed amendments are placed below:

4.1.4.1. Existing regulatory provision – Regulation 34(2) (f) of LODR Regulations states the following:

34. Annual Report

(2) The annual report shall contain the following:

…………

(f) for the top one thousand listed entities based on market capitalization, a business responsibility report describing the initiatives taken by the listed entity from an environmental, social and governance perspective, in the format as specified by the Board from time to time:

Provided that the requirement of submitting a business responsibility report shall be discontinued after the financial year 2021–22 and thereafter, with effect from the financial year 2022–23, the top one thousand listed entities based on market capitalization shall submit a business responsibility and sustainability report in the format as specified by the Board from time to time:

Provided further that even during the financial year 2021–22, the top one thousand listed entities may voluntarily submit a business responsibility and sustainability report in place of the mandatory business responsibility report:

Provided further that the remaining listed entities including the entities which have listed their specified securities on the SME Exchange, may voluntarily submit such reports.

Explanation: For the purpose of this clause, market capitalization shall be calculated as on the 31st day of March of every financial year.

4.1.4.2. Proposed amendments

The LODR Regulations may be amended towards bringing in the requirement of assurance of the BRSR Core. Further, considering that the BRSR has replaced the Business Responsibility Report (BRR) and is now mandatory, the references to the BRR and to the voluntary adoption of BRSR are redundant and may be deleted. The draft amendments to Regulation 34(2) (f) of LODR Regulations are placed at **Annexure C**.

4.1.5. Proposal

It is proposed to introduce a framework for assurance of KPIs as per the BRSR Core and accordingly, amend the LODR Regulations as proposed in Para 4.1.4.2 above. The detailed framework shall be specified by SEBI by way of Circular.

4.2. ESG Disclosures for Supply Chain

4.2.1. Proposal in the Consultation Paper

4.2.1.1. The Consultation Paper proposed that from FY 24-25, the top 250 listed entities (by market capitalisation) may make ESG disclosures for their supply chain as per the BRSR Core on a “comply-or-explain” basis and from FY 25-26, obtain assurance on such disclosures on a “comply or explain” basis.

4.2.2. Rationale

4.2.2.1. For a number of companies, significant ESG footprints such as the use of natural resources, employment practices, emissions and wastages may be found in their supply chain. As per a report published by CDP in February 2022, on average, the emissions in supply chain are around 11.4 times greater than those in the company’s own direct operations.

4.2.2.2. At the same time, it is recognized that there are a number of complexities associated with ESG disclosures for supply chain. Considering that a number of supply chain partners may be small, unlisted entities, it may be difficult for such companies to track and report on a large number of ESG metrics. In order to balance the need for more transparency in the supply chain of companies along with limiting the compliance responsibility, the disclosures for supply chain may be limited to KPIs in BRSR Core.

4.2.3. Public Comments and Analysis

4.2.3.1. On need for ESG disclosures for supply chain

Public Comments

a. While most comments broadly agreed with the need for introducing ESG disclosures for supply chain of listed entities stating that such disclosures will give a better view of the overall sustainability of a Company, a number of comments suggested to introduce supply chain disclosures with certain thresholds or for direct or material suppliers. Few suggestions also suggested providing greater clarity on scope of disclosures, such as upstream / downstream entities, scope for entities belonging to financial services etc.

b. The commenters which disagreed with the proposal felt that the disclosures for supply chain should be considered once the existing disclosures are stabilized. Further, some comments suggested direct reporting/ disclosures by the supply chain rather than indirect reporting/ disclosures through the listed entities.

Analysis - The analysis and views on the above comments are as under:

c. Considering feedback from public comments, it may be clarified that ESG disclosures are proposed to be introduced for both upstream / downstream entities in the value chain of a listed entity and are not limited to suppliers. Hence, the term “value chain” is proposed instead of “supply chain”. Accordingly, the term “value chain” is used in subsequent paragraphs.

d. In view of the feedback on challenges in reporting for all value chain partners and considering ease of compliance, it is proposed that ESG disclosures may be introduced for top upstream and downstream value chain partners of a listed entity, comprising cumulatively 75% of its purchases / sales (by value) respectively, on a comply-or-explain basis.

e. On the comment that the ESG disclosures should be done directly by the value chain entities, it is stated that the there is a possibility of listed entity upstreaming / down-streaming its ESG risks to its value chain. This poses a structural vulnerability to green-washing by a listed entity. It is therefore proposed that the disclosures for its value chain may be done by the listed entity.

4.2.3.2. <u>On disclosures for value chain as per BRSR Core</u>

Public Comments

While most comments have agreed that ESG disclosures of the value chain should be as per the BRSR Core, a few others have made suggestions such as, the need for simpler disclosures, disclosures only of GHG emissions for value chain (Scope 3 emissions), disclosure of value chain related indicators that are currently part of leadership (voluntary) indicators in the BRSR on assessments done in the value chain etc.

Analysis - The analysis and views on the above comments are as under:

The BRSR Core already contains a very limited set of KPIs as compared to the overall BRSR; thus, ESG disclosures for value chain may be made as per the KPIs contained in the BRSR Core.

4.2.3.3. <u>On assurance of disclosures for value chain</u>

Public Comments

Comments broadly agreed to the proposal on introducing assurance on ESG disclosures, however few have suggested assurance of disclosures for value chain only for sectors having greater environmental and social footprint or if the proportion of value chain contribution to operating cost is high.

Analysis - The analysis and views on the above comments are as under:

Assurance of the disclosures is critical for ensuring reliability of disclosures. Accordingly, we may retain the proposal. In any case, the requirement proposed is on a comply-or-explain basis.

4.2.3.4. Applicability and timelines

Public Comments

While comments are broadly in agreement with the proposed timelines, few comments state that more time is required for implementation of ESG disclosures for value chain given that ESG reporting is at a nascent stage for some companies themselves, small firms in the value chain may not have the infrastructure to track ESG metrics etc. Few comments also suggested increasing the scope of the value chain disclosures beyond the top 250 companies.

Analysis – The analysis and views on the above comments are as under:

Considering that the proposal for introducing ESG disclosures for the upstream / downstream value chain entities is limited to the top 250 companies (by market capitalization) and is proposed to be introduced on a 'comply-or-explain' basis from FY 2024-25, it is felt that there is sufficient time for companies to guide their value chain on tracking the ESG metrics proposed in the BRSR Core. On the comments that the applicability of ESG disclosures for value chain may be increased beyond the top 250 companies, given that such disclosures may involve even smaller, unlisted entities, it is felt that the coverage of such disclosures may not be increased at this stage.

4.2.4. Proposed amendments

The LODR Regulations may be amended towards bringing in the requirement of ESG disclosures and assurance as per BRSR Core, for the value chain of listed entities. The draft amendments to Regulation 34(2) (f) of LODR Regulations are placed at **Annexure C**.

4.2.5. Proposal

It is proposed to introduce ESG disclosures and assurance for top upstream and downstream value chain partners of a listed entity, comprising cumulatively 75% of its purchases / sales (by value) respectively. This disclosure may be applicable to the top 250 listed entities (by market capitalization), on a comply-or-explain basis from FY 24-25 and from FY 25-26, assurance on such disclosures may also be provided, on a "comply or explain" basis. Further, LODR Regulations may be amended as proposed in Para 4.2.4 above. The detailed framework including the definition and extent of disclosures for the value chain, may be specified by way of issuance of Circular.

5.0 **ESG Ratings**

5.1. **ESG Ratings with Indian / Emerging Markets Context**

5.1.1. Proposal in the Consultation Paper

5.1.1.1. The Consultation Paper identified environmental, social and governance parameters that are relevant to Indian context that may be integrated in at least one of the ESG ratings for an Indian company. It may be noted that there would be no restriction on the ERPs to evolve additional customized ratings for specific user groups including global investors, depending on user needs.

5.1.1.2. The 14 identified parameters are placed at Annexure 2 of the Consultation Paper and are summarised as under:

a. Four environmental parameters have been identified across the following areas: energy (Perform, Achieve and Trade Scheme of the Government), water (Zero Liquid Discharge), waste management (Extended Producer Responsibility), and land usage/biodiversity (company operations in or around ecologically sensitive areas).

b. One socio-environmental parameter has been identified in respect of the amount spent in Corporate Social Responsibility, as a percentage of regulatory requirement on a look-through basis.

c. Four social parameters have been identified across the following areas: inclusive development (job creation in small towns; sourcing from MSMEs and aspirational districts) and diversity (wages/salaries by gender; job creation and infrastructure for differently abled).

d. Five governance parameters have been identified across the following areas: compliance (RegTech/ systems for monitoring and evidencing compliance), governance (percent of ‘against’ votes amongst non-promoter shareholders on appointment of independent directors), royalty payments, and related party transactions (share of RPTs; percent of ‘against’ votes amongst non-promoter shareholders on RPTs).

5.1.1.3. Additionally, with regard to assessment of environmental factors in ESG ratings, ERPs shall be required to consider India-specific environmental laws and government schemes, as well as factor-in intensity ratios after adjusting for PPP.

5.1.2. Rationale for proposal and approach

5.1.2.1. Environmental, Social and Governance (ESG) considerations in emerging markets is different as compared to developed jurisdictions. Emerging markets have a different set of environmental & social challenges, and it is critical for ERPs to consider these while assessing company’s ESG risks / opportunities and impact. Thus, there is a need for a unique set of metrics that should be factored in, while assigning ESG ratings. For instance, in the Indian context, issues such as job creation in smaller towns, gender diversity at overall employee level, and inclusive development are more relevant than in the developed markets.

5.1.2.2. At the same time, the proposal does not standardize or prescribe a uniform methodology for ESG ratings. The proposal identifies a minimum set of environmental, social and governance parameters to bring in consistency and aid ERPs in adopting a broad common approach, so as to make ESG ratings comprehensive as well as contextual. The identified parameters are reflective of environmental, social and governance outcomes.

5.1.2.3. It may be noted that there would be no restriction on the ERPs to evolve additional customized ratings for specific user groups including global investors, depending on user needs.

5.1.3. Public Comments and Analysis

Public Comments

5.1.3.1. With regard to the proposal on India-specific E, S, G parameters in ESG ratings, the comments were largely supportive.

5.1.3.2. Few respondents, while agreeing to the proposal, suggested certain modifications, which are summarized hereunder:

a. Certain respondents suggested that additional environmental, social and governance parameters be prescribed besides those proposed in the consultation paper, such as employment quality or gender diversity at board of directors. Further, certain respondents suggested regulatory prescription of weightages to such parameters as well.
b. Moreover, certain respondents suggested sector-specific parameters and guidance to be provided to ERPs.
c. Further, in reference to the guidance on environmental factors, certain respondents suggested that PPP-based adjustment for emissions-intensity may not be required since the information may either be not available or may add to divergence in ESG ratings.
d. Finally, certain respondents suggested that balance be maintained between India-specific parameters and other parameters that may have to be in line with international benchmarks.

Analysis – The analysis and views on the above comments are as under:

5.1.3.3. At this stage, the proposal focuses on identification of a minimum, yet essential, set of environmental, social and governance parameters to bring in consistency and aid ERPs in adopting a broad common approach, while not standardizing or prescribing a uniform methodology for ESG ratings. Accordingly, no additional parameters have been added at this stage to keep focus on the minimum essential India-specific E, S, G parameters and not add unnecessary compliance responsibility on companies or ERPs. Moreover, as a principle, the Board does not prescribe rating methodologies. A parallel may also be drawn with credit rating agencies (CRAs), wherein the Board does not prescribe weightages to financial parameters, but requires CRAs to monitor essential financial parameters such as liquidity or EBITDA. Instead, emphasis is laid on suitable disclosures.

5.1.3.4. Moreover, the Board's prescription of the 14 E, S, G parameters (as stated Para 3.1.1.2 above) still allows ERPs to assess additional E, S, G parameters that may need to be benchmarked with global standards, or as may be required on a case-to-case basis.

5.1.3.5. Further, the suggestion on PPP adjusted intensity ratios is similar to that received on PPP adjusted intensity ratio in BRSR Core. The same has been dealt in the earlier section. With regard to such metrics adding to divergence in ESG ratings, it may be noted that PPP-adjusted intensity ratio shall be disclosed by the companies to enable global comparability and therefore there may not be any concern on its availability or divergence. Hence, the guidance has been retained.

5.1.3.6. Finally, with regard to comments on sector-specific parameters and guidance to be prescribed by the Board to ERPs, the same may not be required at this stage, since ERPs have the discretion to choose parameters that are relevant to the sector of the rated company.

5.1.4. Proposal

It is proposed that ERPs may be required to consider India-specific parameters in ESG Ratings. This proposal shall be issued subsequent to prescribing a regulatory framework for ERPs. Further, the indicative list of India-specific ESG parameters shall be issued by way of Circular given that the ESG domain is at a nascent stage and regulatory guidance may need to be dynamic and may need to recognize global developments in the domain.

5.2. **ESG Ratings based on assured parameters**

5.2.1. Proposal in the Consultation Paper

5.2.1.1. The Consultation Paper proposed introduction of 'Core ESG Rating' that shall be offered by ERPs. A 'Core ESG rating' shall be based on assured or verified information or data, such as the Core BRSR.

5.2.2. Rationale for proposal and approach

5.2.2.1. It is observed that currently, ESG Ratings are generally assigned based on self-reported data by corporates, without any third-party assurance of such data.

5.2.2.2. Since investors are placing increased reliance on ESG ratings for making investment decisions, it is imperative that these ratings are reliable, and that the risk of green-washing is minimized.

5.2.2.3. In this context, since the proposed BRSR Core provides for disclosure of assured KPIs (glide-path based), it is proposed that in addition to their other products, ERPs shall also provide a Core ESG rating, which shall be based on information / reports that are assured / audited / verified.

5.2.3. Public Comments and Analysis

Public Comments

5.2.3.1. With regard to the proposal on ESG ratings based on assured/ verified data, the comments were largely supportive.

5.2.3.2. Few respondents, while agreeing to the proposal, suggested that Core ESG Rating may be based on comprehensive BRSR, for which limited or reasonable assurance may be prescribed by the Board after a specified time period.

5.2.3.3. Further, few respondents did not agree with the proposal for reasons summarized hereunder:

a. Certain respondents stated that while Core ESG rating may be helpful, it should remain optional for ERPs and not be mandated.
b. Further, certain respondents stated that there could be market confusion due to too many types of rating (core, transition, combined, India-specific, etc.).

Analysis – The analysis and views on the above comments are as under:

5.2.3.4. In view of comments regarding core ESG ratings to be voluntary for ERPs, the proposal has been revised to clarify that in case an ERP already offers an ESG rating product based on assured/ verified data/information, introduction of 'core ESG rating' may not be necessary for such ERP. However, if an ERPs does not have any ESG rating product that is based on assured data, then ERPs must introduce a 'core ESG rating' offering. It may be noted that such ERPs may still offer additional ESG rating products. Users of ESG ratings may use any of the ESG ratings as per their requirement.

5.2.3.5. Further, with regard to comments on market confusion due to multiple types of ESG ratings, it may be noted that users of ESG ratings are typically institutional investors and sophisticated market participants who may be able to differentiate between different ESG rating products. Further, the proposed regulatory framework for ESG rating providers mandate norms on, inter alia, transparency of rating methodologies and proper labelling of ESG rating products.

5.2.3.6. Finally, since at this stage, only BRSR Core is backed by independent assurance, ESG ratings based on assured parameters are proposed to be backed by BRSR Core and other assured/ verified data.

5.2.4. Proposal

It is proposed that ERPs shall offer 'Core ESG Ratings'. This proposal shall be issued by way of circular subsequent to prescribing a regulatory framework for ERPs and availability of the BRSR Core.

6.0 **ESG Investing**

6.1. **Mitigation of risks of mis-selling and greenwashing**

6.1.1. Proposal in the Consultation Paper

6.1.1.1. Investment criteria for ESG schemes

a. An ESG scheme shall invest at least 65% of its AUM in companies which are reporting on comprehensive BRSR and are also providing assurance on BRSR Core disclosures. The remaining investments of the scheme may be in companies reporting only BRSR. This shall be implemented with effect from October 01, 2024.

b. The schemes which are not compliant with the abovementioned criteria may be provided a further time period of one year i.e. till September 30, 2025 for compliance. During the said period of one year, no fresh investments in companies without assurance on BRSR Core should be taken up till the required criteria is met.

c. Under the monthly portfolio disclosure, security wise BRSR Core rating/scores shall also be disclosed as and when the same is made available by an ERP.

6.1.1.2. Independent assurance and certificate by Mutual Fund for ESG schemes

a. An independent reasonable assurance regarding the scheme portfolio being in compliance with stated strategy and objective of the scheme, as a measure to prevent greenwashing, may be introduced on a "comply or explain basis" from April 01, 2023 for FY 2022-23 and may be made mandatory from April 01, 2024 for FY 2023-24 onwards.

b. A certificate from Mutual Fund shall also be mandated from April 01, 2023 (i.e., for FY 2022-23) which can be based on an internal ESG audit which shall include checking the SID, Stewardship Reporting and Responsible Investment Policy of the ESG Fund etc., to ensure that what is being claimed in these documents is true and factual. In this regard, consultation was sought on whether the certificate should be given by Trustees or by AMCs of the Mutual Funds.

6.1.2. Public Comments and Analysis

Public Comments

6.1.2.1. On Investment criteria for ESG schemes

a. Proposed investment criteria and consequent restriction on fund flows could be a great incentive for companies to report on BRSR disclosure and obtain assurance on BRSR Core.

b. The proposed criteria will reduce the investment universe size as only 250 companies will be disclosing from FY 23-24 and the same will restrict Fund Managers towards creating an optimum mix and may have material impact on the investment flexibility for mutual funds, investment process and fund returns.

c. The criteria can be made more stringent with at least 90% of investment in companies with reasonable assurance and the balance of 10% could be in companies in the AUM that have sought limited assurance report.

d. The implementation of the proposed investment criteria can be made mandatory only when top 1000 companies start disclosing BRSR Core from FY 25-26 or at a later date so as to have adequate investment universe for the ESG schemes.

e. With regards to disclosure of BRSR Core ratings/scores, it is suggested by some that instead of separate Core ESG rating, it may be considered to mandate higher weightage for BRSR Core parameters in the existing ESG rating.

6.1.2.2. On independent assurance and certificate by Mutual Fund for ESG schemes

a. The comments are mostly in favour of independent assurance though it is stated that mandating independent assurance from April 1, 2023 appears early. Some have suggested that the independent reasonable assurance requirement maybe challenging as the required data may not be easily available. As regards Mutual Fund certification, while it is commented by some that certificate should be the responsibility of Trustees, others have suggested that the AMCs should be made responsible for the same.

b. Some have suggested that as Trustees may not have the domain expertise and may rely on AMCs for certification, Fund manager certification is preferable. On the other hand, it is also suggested that this should be the core responsibility of Trustees and they should carry out independent due diligence.

6.1.2.3. **Analysis** – The analysis and views on the above comments are as under:

a. As regards the concerns of availability of limited universe of securities under the proposed criteria, companies desirous of attracting investments from Mutual Funds will be nudged to voluntarily obtain an assurance on BRSR Core. As brought out in earlier paras, BRSR Core has a very limited set of KPIs for assurance in order to limit the cost of compliance by the listed entities. Further, as proposed in earlier paras, ERPs shall be mandated to provide BRSR Core rating based on information/report that are assured/verified/audited. Hence, to address the concerns of green washing, it is proposed that substantial portion of ESG schemes portfolio shall be invested in companies having assurance on BRSR Core.

b. As regards BRSR Core rating, as the risks of greenwashing is high, it is desirable to have specific ratings based on assured parameters as the same is more reliable.

c. An independent reasonable assurance on compliance of ESG schemes with stated strategy and objective of the scheme is proposed as a measure for mitigation of risks of mis-selling and green washing. Considering that relevant infrastructure for independent assurance on ESG schemes is still in nascent stage and market for providing effective assurance may evolve with time, such assurance may initially begin on a “comply or explain basis” from FY 2023-24 i.e. for FY 2022-23 and thereafter made mandatory for all ESG schemes from FY 2024-25 onwards.

d. As regards mandatory certification by Mutual Funds, in response to consultation sought on whether the said certification should be by Trustees or by AMC itself, there is a mixed response. In this regard, in the context of Trustees’ responsibilities, reference is drawn to another proposal being placed before the Board for defining core responsibility(ies) for Trustees, which is addressing the conflicts between unitholder interests and AMC’s stakeholder interests. In view of the same, mitigation of green washing may not exactly fall within the ambit of “core” responsibilities for Trustees. Further, independent evaluation of these areas may not be possible for Trustees at this stage and they may have to rely on submissions of AMCs / Fund Manager or internal/third party audits for assessing the same. Thus, as AMCs are primarily responsible for managing ESG schemes’ investments, it may be more appropriate at this stage to mandate the Board of AMCs to provide a certificate in this regard, which may be based on a comprehensive internal ESG audit.

6.1.3. Proposal

The proposals at paras 6.1.1.1 (a-c), 6.1.1.2 (a) and 6.1.2.3 (d) may be accepted.

The MF Regulations may be suitably amended to insert an enabling provision for specifying investment criteria for ESG schemes and other related modalities. The proposed enabling provision in the MF Regulations is provided below and the details in this regard may be specified by way of circular -

New provision under Regulation 43 of SEBI (Mutual Funds) Regulations, 1996 may be inserted as under:

"Moneys collected under Environmental, Social and Governance schemes shall be invested in the manner as specified by the Board from time to time."

6.2. Enhanced Stewardship Reporting for ESG schemes

6.2.1. Voting disclosures by ESG schemes

6.2.1.1. Proposal in the Consultation Paper

a. Presently, Mutual Funds are required to compulsory vote in respect of all resolutions of their investee companies and disclose voting decisions along-with rationale. To have more transparency on votes cast by ESG schemes, it was proposed that under rationale for voting decisions (whether" in favour" or "against"), AMCs shall disclose if resolution has or has not been supported due to any environmental, social or governance reason.

b. In instances where the voting approach for ESG and non-ESG schemes of any Mutual Fund is not similar, AMCs shall provide details and rationale for votes cast on behalf of ESG schemes and non-ESG schemes separately, otherwise the reporting can be at AMC level.

c. The enhanced voting disclosures were proposed to be implemented from FY 2023-24 i.e. for Annual General Meetings held from April 01, 2023 onwards.

6.2.1.2. Public Comments and Analysis

Public Comments

a. While most of the comments are in support of the proposed enhanced disclosures, there are few comments stating that bifurcation of votes may be difficult and will increase compliance at the fund house level. It is also expressed that there is a risk of higher public/ media misinterpretation of detailed voting disclosures by AMCs.

b. While most of the comments are in support of proposed implementation timeline, there are some suggestions to implement after a period of one year which will give adequate time to AMCs to evolve the policies for exercising the voting rights taking into account environment, social and governance reasons and also to wait till all listed companies have published their annual report and mandatory comprehensive BRSR for FY 2023 is disclosed i.e. by August 30, 2023.

Analysis- The analysis and views on the above comments are as under:

c. While Mutual Funds are presently required to disclose all voting decisions with rationale under the present provisions, proposed enhanced voting disclosures by ESG schemes will provide better clarity on “in favour” or “against” cast with specific focus on environmental, social and governance reasons.

d. Considering the Mutual Funds may have holdings in the same investee company(ies) under ESG and non-ESG funds, the reporting may be made on an AMC level on “in favour” or ‘against” votes in cases where the voting approach for ESG and non-ESG schemes is same. Thus, separate disclosures for ESG schemes is proposed only in instances where the voting approach for ESG and non-ESG schemes is not the same.

e. Also, in order to give adequate time to AMCs to evolve the policies for exercising the voting rights the voting disclosures may be mandated from FY 2024-25 i.e. for Annual General Meetings held from April 01, 2024 onwards.

6.2.1.3. Proposal

The proposals at para 6.2.1.1 (a,b) and 6.2.1.2 (e) may be accepted and specified in detail by way of circular.

6.2.2. **Disclosure of Case Studies**

6.2.2.1. Proposal in the Consultation Paper

a. For further enhancement of stewardship reporting requirement, it was proposed that ESG schemes can start with disclosing details of case studies where Fund Managers have engaged with portfolio companies with a clear objective of engagement and engagements carried out for exercise of votes.

b. Further, when the case study matures, ESG schemes would be expected to report number of engagements carried out in a year, the modes of communication employed, and if any outcomes were achieved in the reporting year. If ESG schemes have a specific objective, then reporting shall be done on engagements and outcomes achieved (if any) in the reporting year based on that objective.

c. The disclosure of case studies may be carried out after one year i.e, from FY 2024-25 onwards and coverage of engagement number of company wise and AUM-wise, after one more year i.e, from FY 25-26 onwards.

6.2.2.2. Public Comments and Analysis

Public Comments

a. The disclosure of case studies should cover identified material topics with outcomes and also ones which did not have any outcome.

b. The disclosures should also include any deviations from the expected impact/probable outcome/strategy and the reasons for it. Also, rather than case studies, more quantifiable ESG characteristics can be disclosed.

c. Along with dialogues with investee companies' management, proposals for shareholder resolutions and collaboration engagement with other investors can also be covered.

d. Most of the comments are in support of the proposed implementation timelines.

Analysis - The analysis and views on the above comments are as under:

e. The proposed disclosure of case studies is intended as an enhanced stewardship reporting measure which shall also include details of engagements and outcomes, if any, of the same.

f. Further, additional areas for case studies and disclosures, if any, may be finalized after consultation with Association of Mutual Funds in India (AMFI).

g. As regards the implementation of the proposals, considering that outcomes take time and require continuity for a certain period, disclosures of case studies can begin from FY 2024-25 and the engagement details can begin after one more year i.e, from FY 2025-26 onwards.

6.2.2.3. Proposal

The proposals at paras 6.2.2.1 (a, b) and 6.2.2.2 (f, g) may be accepted and specified in detail by way of circular.

6.2.3. **Annual Fund Manager Commentary**

6.2.3.1. Proposal in the Consultation Paper

a. Under the Fund Disclosures, annually a section of 'Fund Manager Commentary' may be added which highlights how ESG strategy is applied on the fund, how engagements are carried out, any escalation strategy that the Fund Manager may have applied on the portfolio companies, specific examples or comment on observations in the portfolio companies in the reporting year, annual tracking of ESG rating movements in the investee companies.

b. Fund Manager commentary shall suitably disclose percentage of AUM invested in such companies where there is no BRSR disclosures (permitted to remain invested in such companies till September 2023) and its impact, if any, on the Fund score.

c. This requirement shall be mandated from April 01, 2024 (i.e, for FY 2023-24) onwards.

6.2.3.2. Public Comments and Analysis

Public Comments

a. While the comments received are largely in favour of the proposal, one of the suggestions is that disclosure of annual tracking of ESG rating movements in Annual Fund Manager's commentary need not be mandated.

b. Regarding timelines, while the responses are largely in favour of the proposed timelines, some have suggested that requirement may be aligned with timelines for assurance on BRSR Core and other related timelines.

c. Case studies can be covered in 'Annual Fund Manager Commentary' as disclosing case studies separately on periodic basis may be confusing.

Analysis - The analysis and views on the above comments are as under:

d. An annual commentary by ESG scheme's Fund Manager will facilitate enhanced disclosure and transparency regarding the Fund Manager's approach towards managing funds of ESG schemes. Further, case studies and engagement details as referred to in para 6.2.2 may also be included in the proposed annual commentary.

e. Considering the lack of transparency in ESG proprietary ratings, SEBI had mandated disclosures of ESG scores provided by AMFI empaneled ERPs. In view of the same, proposed annual tracking of ESG rating movements should also be of rating/scores provided by such ERPs.

f. As regards implementation of Fund Manager Commentary, the ESG investments are presently mandated to be only in companies with BRSR disclosures and thus are not dependent on assurance on BRSR Core, the implementation glide path as proposed in the consultation paper may be accepted.

6.2.3.3. <u>Proposal</u>

The proposals at para 6.2.3.1 (a) to (c) may be accepted and specified in detail by way of circular.

6.3. **Classification of ESG schemes and Scheme Name**

6.3.1.1. Proposal in the Consultation Paper

a. As Mutual Funds can presently launch only one ESG scheme under thematic category of Equity schemes, a new category for ESG schemes was proposed with ESG sub-categories viz, Exclusions, Integration, Best-in-class & Positive Screening, Impact investing and Sustainable objectives.

b. ESG schemes under the proposed new category shall be permitted with minimum 80% investment of total assets in equity stocks of a particular theme as per the sub-categories. However, residual portion of the investment should not be starkly in contrast to the philosophy of the scheme from the theme. AMCs should endeavor to have a higher proportion of the assets under the ESG theme and make suitable disclosures.

c. The name of the ESG strategy shall be included in the name of the concerned fund/scheme. For example, XYZ ESG Exclusionary Fund, or ABC ESG Best-in-class Fund etc.

6.3.1.2. Public Comments and Analysis

Public Comments

a. New categorization will help investors to direct their funds on ESG themes they resonate the most with, while boosting growth in the select companies.

b. Some have commented that strictly defining the investment strategy may lead to missing out on some opportunities and Mutual Funds should be allowed to innovate and submit new categories, which SEBI can approve on a case by case basis, whereas others have proposed sub-categories of ESG funds are likely to confuse investors and advisors.

c. While some have stated that Indian markets lack enough depth to create dedicated ESG multiple portfolios, there are others who have suggested including more sub-categories in the proposed new category for ESG scheme including a “transition” or “transition-related” sub-category.

d. It is also suggested that passive strategy can be added keeping in mind ESG ETFs, and a combination of ESG sub-categories may also be allowed as most investment managers follow a combination of strategies to meet their investment objectives.

e. As regards inclusion of strategy name in the scheme name, the comments received are largely in favour of the proposal though few have commented that a fund having mix of strategies would fail to give full picture of investment strategy to the investor.

Analysis - The analysis and views on the above comments are as under:

f. A separate category for ESG investments under the Equity schemes will enable AMCs to launch multiple ESG schemes with diversified strategies. As regards sub-categories for ESG schemes, it desirable to have standardized sub-strategies with defined characteristics to ensure uniformity in practice across ESG schemes of Mutual Funds.

g. As regards suggestions received for inclusion of other sub-categories, most of the suggested themes can be covered under one or more of the proposed five sub-categories. However, we may consider including “transition or transition related investments” as an additional sub-category along with the five sub-categories proposed in the consultation paper. Further, ESG schemes may be launched with other sub-strategies or a combination of sub-strategies, as may be notified by SEBI from time to time.

h. The regulatory requirements for active ESG schemes may be made applicable on passive ESG schemes also in the manner as may be specified by the Board.

i. To have increased transparency and to ensure that an ESG scheme accurately reflects the nature and extent of the scheme's ESG focus taking into account investment objective and strategy, it is desirable that the strategy / sub category is mentioned in the scheme name and the same may be accepted. The proposed disclosuremay be mandated from the date as may be specified by SEBI.

6.3.1.3. Proposal

The proposals at paras 6.3.1.1 (a - c) and 6.3.1.2 (g - i) may be accepted and specified in detail by way of circular.

6.4. **Disclosure of name of ESG rating provider**

6.4.1.1. Proposal in the Consultation Paper

a. The name of the ESG rating provider may be disclosed alongside the ESG score disclosures in the monthly portfolio disclosures by ESG schemes.

b. This requirement may be made mandatory from April 01, 2023.

6.4.1.2. Public Comments and Analysis

Public Comments

a. The comments received are largely in favour of the proposal.

b. The disclosure of reason for change in ESG rating provider may also be made on yearly basis.

c. ESG scoring from ERPs will add to confusion because the rating agencies score may not be aligned to ESG score based on proprietary research by the fund.

Analysis - The analysis and views on the above comments are as under:

d. ESG schemes are presently required to use scores arrived at by AMFI empanelled ESG rating providers to publish securities wise score along with weighted average Fund score in the monthly portfolio disclosures. However, as disclosure of the name of rating provider is not mandated by SEBI, it is desirable that ESG schemes disclose name of the ESG rating provider alongside the score disclosures in the monthly portfolio disclosures.

e. The disclosure of rating provider may be mandated in the monthly disclosure from the date as may be specified by SEBI. Further, the reason for change in a rating provider may also be mandated to be disclosed on a yearly basis.

6.4.1.3. Proposal

The proposals at paras 6.4.1.1 (a) and 6.4.1.2 (d, e) may be accepted and specified in detail by way of circular.

7.0 Proposals to the Board

7.1. The Board is requested to consider and approve the following proposals:

7.1.1. On ESG Disclosures

7.1.1.1. Introduction of a framework for assurance of KPIs as per the BRSR Core and amendment to the LODR Regulations, as mentioned at Para 4.1.5 above

7.1.1.2. Introduction of ESG disclosures and assurance for value chain of listed entities and amendment to the LODR Regulations, as proposed at Para 4.2.5 above

7.1.2. On ESG Ratings

7.1.2.1. India-specific parameters in ESG ratings, as mentioned at Para 5.1.4 above

7.1.2.2. Introduction of ‘Core ESG Ratings’ for ERPs, mentioned at Para 5.2.4 above

7.1.3. <u>On ESG Investing</u>

7.1.4. The proposals at Paras 6.1.3, 6.2.1.3, 6.2.2.3, 6.2.3.3, 6.3.1.3 and 6.4.1.3.

7.2. The Board is requested to consider and approve the proposals as in the Memorandum and authorize the Chairperson to make consequential and incidental changes and take necessary steps to give effect to the decisions of the Board.

ANNEXURE A

The Consultation Paper is available on www.sebi.gov.in

ANNEXURE B

This has been excised for reasons of confidentiality.

ANNEXURE C

This shall be notified at a later date.