10 March 2022

ASIFMA AMG Feedback on SEBI's Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets

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On behalf of the Asset Management Group ("**AAMG**") of Asia Securities Industry & Financial Markets Association ("**ASIFMA**")[1] and the Securities Industry and Financial Markets Association's Asset Management Group ("**SIFMA AMG**")[2], we would like to submit our response to the Securities and Exchange Board of India ("**SEBI**") Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets.

Overall comment

Our members who are predominantly global asset managers, are pleased to have the opportunity to present our views during this consultation.

The International Organization of Securities Commissions ("**IOSCO**")'s report on ESG Ratings and Data Product Providers ("**IOSCO Report**") recommends improving the reliability of raw ESG data and ESG data products, as well as transparency around ESG ratings methodology, and reducing conflicts of interest. These are very much the concerns of our members.

As users of ESG data and ratings, our members commend SEBI's efforts to regulate ESG ratings providers in India. We believe however that the proposed accreditation of ESG Ratings Providers ("**ERPs**") ("**Proposed Rules**") will be challenging for the industry, as the rules predominately seek to determine *who* can provide ESG ratings, thereby reducing product choices for users, but not necessarily directly addressing the concerns of industry around improving data and methodology integrity.

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[1] ASIFMA is an independent, regional trade association with over 150 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, professional and consulting firms, and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative and competitive Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, AAMG also provides insights on global best practice and standards to benefit the region.

[2] The Securities Industry and Financial Markets Association's Asset Management Group ("SIFMA AMG") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

We believe it is also worth highlighting a potential unintended consequence if SEBI were to impose unilateral regulations on international ERPs. They may choose to suspend their ESG ratings which could result in Indian companies not being eligible to be included in high ESG / sustainability portfolios. Thus, we hope that SEBI will not prevent Indian companies from engaging with international ERPs even if these ERPs are not accredited by SEBI, and on the other hand, that Indian companies regulated by SEBI would not be discouraged from speaking with these international ERPs.

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Extract from Consultation Paper	Issues (with page/para nos., if applicable)	Proposals/ Suggestions	Rationale
Sr. No. 3.6. a) Whether there is a need to regulate / accredit ERPs in securities market? b) If ESG ratings are to be regulated, is the regulatory scope mentioned above adequate? If not, please suggest requisite modifications.	We think that any rules to regulate or accredit ERPs should be globally harmonised. We *do not* support narrow accreditation of ERPs and regulation of ESG ratings. <u>ESG data vs ratings</u> Our members distinguish between ESG data and ESG ratings. ESG data is used as an input by asset managers for the purpose of measuring, tracking and reporting on the sustainability aspects of their investments' business activities. ESG ratings are primarily used by investors and our clients to compare and rate different products from an ESG perspective. Many large asset managers may have internal proprietary methodologies to derive their own ESG ratings and may not be solely reliant upon 3rd party ESG ratings. Yet, our members may rely on a range of providers including the ERPs considered in the current scope of the Proposed Rules, for a suite of ESG data products beyond just ESG ratings. <u>ESG indices</u> We are also concerned about how the Proposed Rules may apply to ESG indices of which Indian securities are only a	<u>Code of conduct</u> AAMG in its joint response with SIFMA AMG, to IOSCO's consultation on Regulation of ESG Ratings and Data Products and Providers at an international level have suggested the adoption of a voluntary industrywide code of conduct for ESG ratings and data providers. This is also one of the recommendations in the IOSCO Report. Whilst many members view a code of conduct favourably, one member notes there are challenges in ensuring the effectiveness of a code. <u>International developments</u> We note that the European Securities and Markets Authority has published a Call for Evidence on market characteristics for ESG rating providers. It is anticipated that this consultation will be followed by a complementary consultation from the European Commission. We also note the efforts of the International Sustainability Standards Board to standardise company disclosures will help to improve the inputs into ESG ratings.	<u>Market mechanism supplemented by the right enhancements</u> Some members believe that the market currently functions sufficiently, whilst regulation adds a cost burden at a time when resources are constrained. There is a certain ability to 'vote with your feet' by choosing the best providers. Yet members are to an extent reliant upon those providers with the requisite breadth and history of data, despite their shortcomings. Areas of concern for users of current ESG ratings and data include improving the integrity of data / speed in correcting errors; and transparency in methodology, price changes / fee structures and conflicts of interest. Given the current level of developments in the international market, we believe that the right regulatory tools should be in place, without jeopardising innovation and diversity of choice for investors. It is likely that certain aspects are better suited to a code of conduct to not impede innovation (e.g. identity of data providers), whilst other measures may benefit from the firm hand of law (e.g. the reliability of input and output data).

Extract from Consultation Paper	Issues (with page/para nos., if applicable)	Proposals/ Suggestions	Rationale
	component (Section 3.5.2.c.)	We would suggest that SEBI take international developments into account in finalising its Proposed Rules.	
Sr. No. 4.3. a) Should only CRAs and RAs be considered to accredit as ERPs? b) Could any additional category of entities be specified as an entity eligible for accreditation as an ERPs along-with rational for the same?	We *do not* support the accreditation of a small selection of ERPs. ESG ratings are not the same as credit ratings. Difference of approach and opinion, and offerings of different kinds of data services are valuable to users. This is one of the reasons that ESG ratings have displayed lower correlations viz. credit ratings between different providers. ESG ratings and data providers also synthesise data from boutique ESG specialists in their ratings, and/or offer the specialised data on their ESG data platforms. Our members rely on various data sources: the identified ERPs, the boutique specialists, as well as non-traditional / alternative ESG data providers, such as governmental and non-governmental agencies, as well as in-house capabilities.	<u>Level playing field</u> Having many different providers is not a major source of greenwashing risk. There are many start-ups operating in Europe, for example, in a highly fragmented market. SEBI should allow all ESG ratings and data providers to operate in the ESG landscape in India. We believe that anti-greenwashing efforts would more effectively protect end-investors if directed at disclosures by asset managers and product distributors.	<u>Reduce barriers to entry</u> Accreditation of a narrow selection of providers risks increasing consolidation of players (reducing choice for users) and increasing barriers to entry for new / niche players which can help create a more dynamic and innovative ESG landscape. <u>In-house capabilities</u> As mentioned earlier, many large asset managers process ESG data internally and may even create in-house ratings. We would ask SEBI to confirm that in-house capabilities of asset managers would *not* be in scope for accreditation, as it would not be appropriate for asset managers to furnish their intellectual property in the public domain.

Sr. No. 5.7. a) Whether the above accreditation criteria, including net worth, are appropriate? b) Please offer comments on whether any additional conditions/requirements need to be specified, if any?	A minimum net worth of Rs 10 crores (~USD1.3m) is a prescriptive requirement, and potentially prohibitively high for smaller Research Analyst ("**RA**") firms. Yet it is not applied to the boutique specialists who provide data to the ERPs. On the other hand, some of the ESG data providers that asset managers use are non-governmental organisations ("**NGOs**") which may not be capitalised in the same way as a for-profit enterprise. Thus, we believe net worth is a weak accreditation criteria. On b), other data providers may rely upon automation and artificial intelligence, lessening the requirement for infrastructure and manpower.	<u>Level playing field</u> We reiterate that SEBI should allow all ESG ratings and data providers to operate in the ESG landscape in India.	<u>Reduce barriers to entry</u> We reiterate that accreditation of a narrow grouping of providers is not beneficial to the efficient functioning of the market for ESG data. If SEBI is minded to implement accreditation, our members would find criteria that took providers' processes and procedures with respect to data reliability, methodology transparency, conflicts of interest into account, more valuable.
Sr. No. 6.7. a) Whether the above proposal on classification of ESG ratings and other related products is appropriate?	Typical ESG risk ratings focus on how an ESG issue impacts a company and do not always give sufficient weight to the impact on wider society and environment. Emerging impact metrics and ratings try to address this. Notwithstanding, many ESG ratings are a combination of impact and risk. As such, we would not differentiate between ESG "Risk" Ratings and ESG "Impact" Ratings.	<u>No classification</u> We *do not* think the classification of ESG ratings is appropriate. As different ERPs and users may define risk and impact in different ways, it would be better for the ERPs to be fully transparent on its taxonomy and methodology instead.	The proposed classification does not provide better clarity for users, but rather forces providers to pigeonhole ratings as either risk or impact.

Sr. No. 7.5. a) Whether the proposal on not having standardized ESG rating scales (i.e., standardized symbols and their definitions) initially is appropriate?	ESG ratings are not currently standardised globally. In fact, ESG ratings of different providers may be different according to perceived market need.	<u>No standardisation</u> We agree that ESG rating scales should *not* be standardised in India.	A standardised scale would lead to increased risk of greenwashing as it would imply consistency or comparability between different ratings when this does not exist.
Sr. No. 10.9. a) Whether the proposed norms relating to transparency, governance and conflict-of-interest issues in the ESG rating process are appropriate? b) Whether ERPs should be free to assign ESG ratings on a sector-specific or sector-agnostic basis, subject to adequate disclosures on the same?	ESG ratings are a sub-set of broader ESG data products, so any norms should apply to the wider ESG dataset. On b), we would strongly assert that SEBI should not define how ESG ratings should operate.	<u>Spirit of the norms</u> As described earlier, we support the spirit of proposed norms, potentially as a code of conduct for ESG ratings and data providers. Some members believe the transparency aspects should only be made available to subscribers. Please refer to our comments on Section 11.9 about where disclosures should occur.	<u>Implementation</u> We support the various aspects of the norms, but we want to understand how these norms would interact with the accreditation process (if SEBI were to proceed with accreditation), i.e. would adoption of these norms be a condition for accreditation.
Sr. No. 11.9. a) Whether you agree with the recommendation that the payment model should be subscriber pay in the current Indian context?	Our members agree that a 'subscriber pay' model would be better than an 'issuer pay' model. We cannot comment on the economic viability of the 'subscriber pay' model but refer back to our concerns mentioned earlier about the risk of international ERPs choosing to suspend their ESG ratings of Indian companies.	<u>Transparency</u> We support the transparency norms described in Section 8, especially in providing high-level methodology to retail investors. To the extent that detailed methodology is required by institutional users of ratings and data, some members believe this should only be made available to subscribers and potential subscribers.	<u>Viability of revenue model</u> We do not see ESG ratings and data products as commoditised products. For members that increasingly use non-traditional or alternative data sets, protecting the confidentiality of providers' approaches is important to protect their competitive advantage, and the viability of their revenue model. This ensures a healthy and vibrant ecosystem of ESG ratings and data providers.