



भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CONSULTATION PAPER

DEPARTMENT OF DEBT AND HYBRID SECURITIES – POD III

PROPOSALS FOR EASE OF DOING BUSINESS BY ESG RATING PROVIDERS (ERPs)

OCTOBER 2024



भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

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Timeline to Respond

Comments on the Consultation paper (CP) may be sent by November 15, 2024

1. Objective and Background

- 1.1. The objective of this consultation paper is to seek comments / views / suggestions from the public on proposed amendment in provisions related to ESG Rating Providers (ERPs) in SEBI (Credit Rating Agencies) Regulations, 1999 (“**Regulations**”).
- 1.2. SEBI introduced a regulatory framework for ERPs, under Chapter IVA of the CRA Regulations, in terms of an amendment notified in July 2023.
- 1.3. Pursuant to the same, SEBI has received representation from ERPs, inter alia, seeking clarification on the applicability of certain provisions prescribed in the Regulations for ERPs following a subscriber-pays model. Further, ERPs have also sought clarification with regard to ESG rating of issuers/ products other than listed issuers/ securities.
- 1.4. The matters consulted in this paper are as under:
 - (a) Requirement of sharing draft ESG rating report with the issuer in case of ERPs following a subscriber-pays model
 - (b) Dealing with appeal and representation by the rated issuer in case of ERPs following a subscriber-pays model
 - (c) Dispensing with the requirement to disclose the ESG ratings to the stock exchange(s) where the issuer or the security is listed, in case of ERPs following a subscriber-pays model
 - (d) Specifying Activity Based Regulation for ERPs
- 1.5. The detailed proposals related to aforementioned items are mentioned in paragraphs 2 to 5 of this consultation paper.

2. **Requirement of sharing draft ESG rating report with the issuer in case of ERPs following a subscriber-pays model**

2.1. **Extant Regulatory Provision:**

Regulation 28L(1)(j) of the CRA Regulations stipulates that *“An ESG rating provider shall... share the draft ESG rating report with the rated issuer or the issuer whose securities are being rated, before publication of the same...”*

2.2. **Rationale for proposed change:**

2.2.1. ERPs have represented that sharing of ESG rating report with the rated entity/ issuer results in divulging a considerable amount of information, which would obviate the need for any subscription by such rated entities, thereby resulting in loss of business for ERPs following subscriber-pays model. However, in the interest of fairness and transparency, it may be appropriate to offer the rated entity an opportunity to provide relevant clarifications/ response on any inaccuracies related to the data/ assumptions considered by the ERP in their rating report. Therefore, in line with the relevant guidelines also specified for Proxy Advisors, ERPs following a subscriber-pays model may share the ESG rating report with the rated issuer and the subscribers at the same time.

2.2.2. Further, while the extant regulatory framework allows for the rated entity/ issuer to subscribe to its, it is felt that the same may result in a hybrid business model, which is not envisaged in the regulatory framework. Therefore, in case of ERPs following a subscriber-pays model, it may not be permitted for the rated entity/ issuer or its group companies or associates to be a subscriber to rated entity/ issuer's own ESG rating/ ESG rating on securities issued by rated entity/ issuer.

2.3. Proposal:

Accordingly, the following amendment to the Regulations is proposed:

2.3.1. It may be specified that ERPs following a subscriber-pays model shall share their report with the subscribers and the rated issuer at the same time. Further, this sharing policy should be disclosed by the said ERPs on their website.

2.3.2. ERPs following a subscriber-pays model shall ensure that the rated entity/ issuer itself or its group companies or associates are not permitted to be a subscriber to ESG rating and/ or rating of securities of the rated entity/ issuer.

Consultation 1: Requirement of sharing draft ESG rating report with the issuer in case of ERPs following a subscriber-pays model

Kindly provide your comments along with supporting rationale on the following:

- 1) Whether ERPs following a subscriber-pays model should share their report with the subscribers and the rated issuer at the same time?
- 2) Whether there should be a restriction on the rated entity/ issuer itself and its group companies or associates to be a subscriber to ESG rating and/ or rating of securities of the rated entity/ issuer?

3. **Dealing with appeal and representation by the rated issuer in case of ERPs following a subscriber-pays model**

3.1. **Extant Regulatory Provision:**

Regulation 28L(1)(j) of the CRA Regulations stipulates that “...the ESG rating provider shall grant an opportunity of appeal and representation, if requested for by the issuer.”

3.2. **Rationale for proposed change**

3.2.1. ERPs have represented that since the ratings assigned by ERPs following a subscriber-pays model are based on information available in public domain, including the sustainability disclosures made by the issuers, and not solicited by the issuer, the requirement for an appeal process may be dispensed with.

3.2.2. However, as also detailed in Para 2.2.1 above, it is felt appropriate to offer the rated entity an opportunity to make representation and provide relevant clarifications/ response on any inaccuracies related to the data/ assumptions considered by the ERP in their rating report.

3.3. **Proposal**

Accordingly, it is proposed to amend the Regulations to provide for the following:

3.3.1. ERPs following a subscriber-pays model shall also grant an opportunity of representation to the rated issuer. In this regard, ERPs shall define a timeline to receive comments from the rated entity/ issuer pursuant to sharing of the ESG rating report with the entity. All comments/ clarifications received from the rated entity within the specified timeline shall be included by the ERP as an addendum to the rating report. If the rated issuer has a different viewpoint on the

data/ assumptions stated in the rating report of the ERP, then the ERP, after taking into account the said viewpoint, may either revise the rating report in the addendum report or issue an addendum to the report with its remarks, for circulation to all subscribers as considered appropriate.

3.3.2. Further, if the rated entity/ issuer desires clarification, inter alia, on the methodology or assumptions, the ERP should provide such a facility.

Consultation 2: Dealing with appeal and representation by the rated issuer in case of ERPs following a subscriber-pays model

Kindly provide your comments along with supporting rationale on the following:

- 1) Whether ERPs following a subscriber-pays model should grant an opportunity of representation to the rated issuer?
- 2) If yes, whether the process specified in the proposal at Para 3.3 above for dealing with comments/ clarifications received from the rated entity is appropriate and adequate? Should a rated entity/ issuer seeking clarification be provided a facility in some specific form and manner?

4. **Dispensing with the requirement to disclose the ESG ratings to the stock exchange(s) where the issuer or the security is listed, in case of ERPs following a subscriber-pays model**

4.1. **Extant Regulatory Provision:**

Regulation 28L(1)(d) of the CRA Regulations stipulates that “An ESG rating provider shall... promptly disclose the ESG rating assigned to any issuer or security, and any changes in ESG ratings or reviews, after periodic review or otherwise, to the stock exchange(s) where the issuer or the security is listed, and on its website, and issue press releases for the information of the investors”.

4.2. **Rationale for proposed change:**

4.2.1. Considering that ERPs following a subscriber-pays model assign ratings based on information available in public domain and not pursuant to any agreement with/ solicitation from the issuer, it may not be appropriate to mandate the ERP to report the ESG ratings to the stock exchange(s) where the rated issuer/ security is listed.

4.2.2. In any case, ERPs are already required to publicly disclose all ESG ratings on their website.

4.3. **Proposal:**

4.3.1. Accordingly, it is proposed to amend the Regulations to dispense with the requirement for disclosure of the ESG rating assigned and any changes in ESG ratings or reviews to the stock exchange(s) where the issuer or the security is listed, in case of ERPs following a subscriber-pays model. Such ERPs should affirm lack of any non-public information being in their possession or being harnessed for ESG Ratings.

Consultation 3: Dispensing with the requirement to disclose the ESG ratings to the stock exchange(s) where the issuer or the security is listed, in case of ERPs following a subscriber-pays model

Kindly provide your comments along with supporting rationale on the following:

- 1) Whether ERPs following a subscriber-pays model may dispense with the disclosure of the ESG ratings to the stock exchange(s) where the issuer or the security is listed?

5. Specifying Activity Based Regulation for ERPs

5.1. Extant Regulatory Provisions:

5.1.1. Regulation 28B(1)(c) of the CRA Regulations define “ESG rating provider” as “a person which is engaged in, or proposes to engage in, the business of issuing ESG ratings”.

5.1.2. Further, Regulation 28B(1)(b) defines “ESG ratings” as “rating products that are marketed as opinions about an issuer or a security, regarding its ESG profile or characteristics or exposure to ESG risk.....issued using a defined ranking system of rating categories, whether or not these are explicitly labelled as “ESG ratings””.

5.2. Rationale for proposed change:

5.2.1. Since the definition of ESG ratings/ ERP does not refer to the listing status of the rated issuer/ listed security, any person/ entity undertaking ESG rating or scoring (even for an unlisted entity/ instrument) may be required to seek registration from SEBI as an ERP. However, extant Regulations permit ERPs to provide ESG ratings to only listed/ proposed to be listed issuers/ securities and to undertake such activities as SEBI may notify.

5.2.2. Further, the Regulations do not include the enabling provision for ERPs to undertake ESG rating of other products/ issuers, under the respective guidelines of a financial sector regulator or any authority, as may be specified by SEBI.

5.3. Proposal:

In order to institute Activity-based regulatory framework for ERPs, the following is proposed:

- 5.3.1. Enabling provision may be added in the CRA Regulations for ERPs to undertake ESG rating of other products/ issuers, including unlisted issuers/ securities, under the respective guidelines of a financial sector regulator or authorities as may be specified by SEBI, and
- 5.3.2. Further, SEBI-registered ERPs rating other products/ issuers should not project themselves as SEBI-regulated ERPs and explicitly specify the regulator/ authority under whose purview such ratings are undertaken and do so in adherence to the rules or regulations or guidelines issued by such regulator/authority.
- 5.3.3. Entities that do not propose to undertake SEBI-regulated activities need not seek registration with SEBI.

Consultation 4: Specifying activity based regulation for ERPs

Kindly provide your comments along with supporting rationale on the following:

- 1) Whether the proposed amendments for instituting Activity Based Regulation for ERPs are appropriate and adequate?

6. Public Comments

6.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted latest by **November 15, 2024**, through the online web-based form which can be accessed using the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

6.2. Kindly go through the instructions mentioned on the above link before submitting comments on the consultation paper.

6.3. In case of any technical issue in submitting your comment through web based public comments form, you may contact the following through email with a subject: *"Issue in submitting comments on Consultation Paper on Proposals for Ease of Doing Business by ERPs"*.

a) Sarika Kataria, DGM (sarikak@sebi.gov.in)

b) Nishtha Tewari, AGM (nishthat@sebi.gov.in)

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