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Submitted via email to: richag@sebi.gov.in, rohan@sebi.gov.in and mneeraj@sebi.gov.in

RE: Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets

Dear Ms Agarwal,

BlackRock¹ is pleased to have the opportunity to respond to the “Consultation Paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets” (“Consultation Paper”) issued by the Securities and Exchange Board of India (SEBI). BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs. We are highly appreciative of the efforts by SEBI to provide ever more transparency and related disclosures, including those related to ESG ratings. Thus, we welcome the consultation which aims to improve transparency in this area. We would like to take this opportunity to comment on the Consultation Paper. Although in agreement with the objectives, we have some concerns with the potential implications of the proposed regulations.

Executive Summary

We note the aim of the Consultation Paper that providers of ESG ratings operate in a transparent and regulated environment to balance the needs of all stakeholders. Our concern is that overly prescriptive regulations could undermine the ability of ESG ratings providers (ERPs) to provide a service that is useful to portfolio managers, in particular those managing portfolios across markets.

The salient points of our response are:

- ERPs need to be able to produce ESG ratings that are comparable across jurisdictions/ markets.
- A market regulator should avoid substantive regulations on the methodologies adopted which impact cross-market comparisons of ESG ratings.
- Although transparency on methodology is desirable, ERPs may consider their methodology as proprietary and not be willing to disclose as much as the regulator may require.
- A voluntary Code of Conduct may be considered as a means of ensuring that ERPs maintain certain minimum standards; adherence to the Code of Conduct may be made public for users to be aware of the standards that the ERP is (or is not) committed to.
- Indian issuers should not be prevented from engaging with ERPs even if these ERPs are not accredited by SEBI, as their ratings will be used by international investors.

Our main concern is that Indian issuers could become disadvantaged by regulations that international ERPs are challenged to follow. The unintended consequence could be that Indian issuers are no longer included in the international ERPs universe and thus affect their inclusion in both sustainability/ high ESG ratings

¹ BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

international portfolios as well as traditional portfolios for which ESG metrics are increasingly a key part of the investment decision process.

Below we present our comments on the Consultation Paper in the format requested. We reiterate our appreciation for SEBI giving investors the opportunity to provide feedback and welcome further discussion on the points raised, or on any other relevant matter. Thank you.

Yours faithfully,

Amar Gill
APAC Head of Investment Stewardship

Winnie Pun
APAC Head of Public Policy

3.6. Views/ comments sought on: 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.

Issues

- Rules to regulate or accredit ERPs should be globally harmonized with regard to substantial requirements on standards and supervisory oversight of ERPs.
- If regulators in certain markets issue respective standards for ERPs to follow, which may differ from one market jurisdiction/country to another, the ERPs may not be able to give a rating that is comparable across markets; the ratings may also be not comparable across certain markets with ESG rating requirements versus other markets without such requirements.
- We are concerned how the proposed rules might apply to ESG indices and benchmarks where Indian issuers are only a component.
- ERPs may view their methodology as proprietary and not be willing to provide the extent of transparency that a regulator may expect e.g. in the algorithms and how the ultimate ratings are derived.
- There is a significant risk that ERPs may not provide ratings for issuers in markets where regulators require them to be regulated and where ERPs are required to follow specified unique requirements for the given market, or where an ERP is required to provide greater transparency on methodology that it might consider proprietary.
- The unintended consequence could be that the issuers from that market could get removed from the universe of potential stocks in high ESG ratings or sustainable portfolios that take the ratings of these third-party rating providers as an important input.
- Issuers in a particular market that do not have an ESG rating (because international ERPs are prevented from providing one) may be disadvantaged from being included in traditional portfolios as well, as portfolio managers are increasingly required to integrate ESG considerations into their investment process by regulations in many jurisdictions.

Proposals/ Suggestions

- ESG ratings should be allowed to be provided by the ERPs based on the market needs and feedback from (potential) users. Regulators in individual market jurisdictions concerned about the lack of regulatory oversight over ERPs could recommend a code of conduct, or a statement of expected minimum standards that ERPs should follow in rating companies. The code of conduct may state the approach of the ERPs in deriving their ratings, rather than requiring full transparency on their methodology/ algorithms in determining the ratings which some ERPs may consider proprietary.
- The expected minimum standards that ERPs should follow could be provided by a global standards setting body such as IOSCO; we note that SEBI is a member of the IOSCO Board and could thus play a coordinating role in this matter within the organization.
- If international ERPs are subject to equivalent regulations in their home jurisdictions, SEBI should allow deference to those regulations without imposing further domestic regulations on them.
- An Indian issuer listing on markets that SEBI regulates should not be prevented from engaging with an ERP even if that ERP is not accredited by SEBI.

Rationale

- Comparability of ESG ratings across markets is crucial for international investors; lack of inter-market comparability would undermine the value of the ratings provided by an ERP.
- The methodologies of the ERPs are different, and the weightings they give to different ESG factors differ; however, as long as their methodologies are explained, then users will choose the provider that most aligns with the user's view of what is most appropriate.
- The landscape of relevant issues for ESG assessments is rapidly evolving, hence requirements of what should be, or not be, incorporated in these ratings should not be unduly prescriptive which would risk stifling innovation and lead to rating systems not being dynamic enough to adapt to developments and factors that become increasingly relevant in ESG assessments.

- A code of conduct or a statement of expected minimum standards could address concerns regarding processes for ERPs, integrity of data, and potential conflicts of interest. ERPs may then explicitly state whether they follow specific codes of conduct, and thereby provide transparency for their users.
- If voluntary codes of conduct or a statement of expected minimum standards are found to be not effective and there is evidence that such codes/ statement fail to achieve policy intent, regulators could then consider introducing regulations on ERPs in a coordinated manner.

4.3. Views/ comments sought on: A) Should only Credit Rating Agencies (CRAs) and Research Analysts (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?

Issues

- ESG ratings are different from credit ratings; the expertise that goes into providing credit analyses is specific relating to financial viability to repay debt; this is quite different from ESG ratings which involve a very different and more holistic approach on environmental, social and governance issues.
- Similarly, analysts and companies providing equities or fixed income research ratings are not likely to have the expertise and approach required specifically for ESG ratings and are not likely to have greater immediate skills and expertise that can be transferred to ESG ratings. On the contrary, organizations that are startups or offshoots from other types of entity may be better equipped to provide ESG ratings if they possess the relevant skills and intellectual capital.

Proposals/ Suggestions

- CRAs should not have a monopoly or be the sole type of entity that may be permitted to provide ESG ratings.
- RAs who provide ESG ratings should not be restricted to those who have just equities or fixed income research experience, and/or from brokerage or asset management prior employment.
- Some service providers may offer data points relevant to ESG ratings even though they do not offer overall ESG ratings; these data providers of ESG relevant inputs should not come under regulation either.
- In-house assessments of ESG by asset managers and brokerage firms should not be in scope of being regulated if they are not offered commercially to external parties; if offered commercially to external parties then the recommendations should be similar as suggested for traditional ERPs i.e. that they be recommended to adhere to a voluntary code of conduct or statement of expected minimum standards.

Rationale

- ESG ratings require expertise and understanding of many different aspects of business operations from environmental impact, sustainability disclosures, human capital management, health & safety, to general corporate governance. CRAs do not *per se* have experience that lends credibility to being a provider of ESG ratings.
- Individuals who are employed to provide ESG ratings need a range of expertise and knowledge to provide appropriately holistic ESG ratings; the relevant experience is not necessarily only with those who have experience as an equities or credit analyst. For instance, individuals with expertise in preparation of accounts, either at issuers or at accounting firms, are likely to have relevant experience in determining materiality, similarly those with experience in sustainability consultancy, corporate governance professionals, other management consultants etc are likely also to have relevant experience.
- We believe limiting to certain types of experience required to be an analyst for ESG ratings is overly prescriptive and risks undermining the quality of analysis that goes into an ESG ratings. Taking a holistic view of factors and impacts on various stakeholders (such as community representatives or industry regulators) is required to arrive at a proper ESG assessment of a company.
- Asset managers and brokerage firms should be able to arrive at their own assessments of ESG for in-house purposes and to help inform the analyses they provide to clients and be allowed to provide such analyses to their clients as an auxiliary service to their main business.

5.7. Views/ comments sought on: a) Whether the above accreditation criteria, including net worth (Rs 10 crore, USD1.3 mn), are appropriate? b) Please offer comments on whether any additional conditions/requirements need to be specified, if any?

Issues

- Rs 10 crores or USD 1.3mn is an arbitrary capital requirement for an ERP.
- Some ERPs may rely on automation and artificial intelligence (AI), hence not require significant infrastructure, manpower and financial capital.

Proposals/ Suggestions

- A regulator does not need to prescribe minimum capital requirements for operations that are not inherently capital intensive.
- The sustainability of the business models of ESG ratings providers is a more important determinant of whether the provider is able to employ qualified professionals to perform the appropriate level of due diligence and research analysis.

Rationale

- A regulator need not prescribe minimum capital requirements for operations that are not capital intensive and where their financial strength is not key to the resilience of the overall financial system and the economy.
- A high level of minimum capital and manpower required may be a barrier to entry for startups that have novel approaches (e.g. AI) to arrive at ESG ratings and may also prevent relevant data inputs from not-for-profit organisations.
- Investors take ESG ratings as one of their inputs and, similar to broker/ sell-side earnings forecasts, asset managers do not rely solely on these in their investment decisions; hence there is no real need to set aside capital for legal recourse from the clients of the ERPs should the ERPs render poor quality research or service. As long as there is sufficient competition in the marketplace, market forces will drive business away from the poor-quality ERPs to the more credible providers.
- Regulators should avoid fostering an environment conducive to litigation against ERPs which would lead to muted ESG ratings.

6.7. Views/ comments sought on: a) Whether the above proposal on classification of ESG ratings [distinguishing between “ESG Impact Ratings” from “ESG Corporate Risk Ratings or ESG Financial Risk Ratings” and other types of ESG ratings] and other related products is appropriate?

Issues

- ESG ratings are generally a combination of disclosure, impact and risk. We would not recommend differentiating between ESG ratings that are classified as “Risk Ratings” and those that are classified as “Impact Ratings”.

Proposals/ Suggestions

- Regulators should avoid prescribing the labelling and classifications of ESG ratings.

Rationale

- Users of ESG ratings are able to ascertain what type of ESG analysis is provided by an ERP without labelling by the service provider; this may impose *a priori* classifications that may not meet the evolving needs that ESG ratings cater for.
- Globally, ESG ratings currently provided are not distinguished between “Risk Ratings” and “Impact Ratings”; requiring an ERP to impose these or other categories on its ratings would make the ratings not comparable with other ESG ratings by other providers.
- The holistic nature of ESG assessments would suggest that ESG ratings should generally take into account all the factors considered relevant by the ERP rather than having to exclude certain factors because their rating has been categorized in a certain way by the requirements of a particular regulator.

7.5. Views/ comments sought on: a) Whether the proposal on not having standardized ESG rating scales (i.e., standardized symbols and their definitions) initially is appropriate?

Issues

- ESG ratings are not presently standardized.

Proposals/ Suggestions

- Strongly oppose that ERPs be restricted from providing summary ESG ratings of companies, as long as an ESG rating is clearly distinguished from the credit ratings that may also be provided by the same group.

Rationale

- Regulators in various jurisdictions are imposing requirements on the disclosure of ESG characteristics of portfolios and funds. Hence, asset management companies need to be able to place companies into various buckets of ESG ratings based on the most appropriate ESG ratings that are available across markets.
- An Exchange Traded Fund (ETF) provider with exposure to thousands of companies across a region and globally needs a convenient cross-market classification of ESG ratings on companies.
- If an ERP is not able to provide a summary ESG rating on an issuer for a given market, there is a high risk that the companies from that market will not be eligible to be in the universe of stocks for portfolios that follow certain cross-market ESG ratings.

10.9. Views/ comments sought on section 8, 9 & 10: 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?

Issues

- We do not believe it is necessary for regulators to impose granular requirements on the transparency and governance structure of ESG rating process. Regulations should be principles-based so that they can accommodate different structures.

Proposals/ Suggestions

- We are broadly in agreement that an ERP should provide full disclosure that is easily available (e.g. on its website) on its methodology, classifications and other relevant aspects of its rating process to the extent that it does not compromise proprietary or confidential aspects of the methodologies as determined by the ERP.
- An ERP should be able to provide sector-specific and/or cross-sector ESG rankings.

Rationale

- Users of ESG ratings will often seek to understand how a particular company rates against other companies in its sector; users of the ratings may also need to place an issuer in an ESG rating that covers companies across different sectors and markets.
- It is crucial that the rating should be explicit whether it is a rating by sector or across sectors.

11.9. Views/ comments sought on: a) Whether you agree with the recommendation that the payment model should be subscriber-pay in the current Indian context?

Issues

- A 'subscriber pay' model is more appropriate for ESG ratings than an 'issuer pay' model.

Proposals/ Suggestions

- We endorse a subscriber-pay model.
- Companies should be encouraged to provide the underlying data used in ESG ratings. To be comparable across market jurisdictions, larger issuers and those in carbon-intensive sectors should

be encouraged to report by international sustainability reporting frameworks e.g. TCFD, SASB and the emerging ISSB.

Rationale

- There are greater potential conflicts of interest in the alternative, i.e. issuer-pay model, as is well documented over the years with CRAs.
- With a subscriber-pay model, effectively the market regulates the ERPs: if/when there are concerns about the ratings, users can and will change their ERP to a more credible provider.