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TIME TO REBOOT?

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New SEBI Changes expected in 2023-24 on ESG-BRSR Regime

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INTRODUCTION

On 20th February 2023, The Securities and Exchange Board of India (SEBI), released a consultation paper on ESG Disclosures, Ratings and Investing in order to ensure transparency and simplification in the evolving world.

ESG (Environmental, Social, and Governance) risks have indeed been gaining increased recognition in recent

years. ESG factors refer to a set of criteria that are used to evaluate a company's performance and impact in areas beyond just financial metrics. These factors include environmental sustainability, social responsibility, and corporate governance practices. As a response to this, SEBI, made it mandatory for the top 1000 listed companies (by market capitalization) to make ESG disclosures in the Business Responsibility and Sustainability Report



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(BRSR) from Financial Year (FY) 2022-23 (<https://www.mondaq.com/india/climate-change/1069266/importance-of-new-business-responsibility--sustainable-reporting-framework> Refer to this article for a detailed analysis on importance of BRSR) and has also mandated the disclosures for ESG labelled mutual funds. Further, the regulator is also in the process of drafting a framework for ESG Rating Providers (ERPs).

With the growing recognition of ESG risks, SEBI felt the need to streamline the areas of ESG disclosure, ratings and investing. In this regard, the regulator has identified the need for assurance and expanding the scope in ESG disclosures, need for ESG Rating providers (ERP) to factor in the local/domestic context while providing ESG ratings and need to ensure robustness of disclosures and mitigate the potential risk of green washing and mis-selling under ESG investing.

SEBI constituted the ESG Advisory Committee (EAC), chaired by Shri. Navneet Munot MD & CEO HDFC AMC, to make recommendation regarding the same. This consultation paper lists down the recommendations and internal deliberations made by the EAC and seeks public comments on the same.

PART A – ESG DISCLOSURES

With BRSR becoming mandatory for the top 1000 companies (by market capitalization), EAC has identified 3 key areas that needs to be reviewed as part of this consultation paper. These three areas are as follows:

- Assurance to become the key for better credibility with regards to the disclosures made by companies.



Source: SEBI Consultation paper on ESG Disclosures, Ratings and Investing

- ESG disclosures by the Supply chain partners.
- Enhancement of BRSR by identifying and moving a few relevant leadership indicators to essential indicators.

The proposal made for public consultation with regards to the issues identified above are as follows:

a) In order to achieve the objective of assurance and credibility, the ESG Advisory committee has prepared a BRSR Core (https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-esg-disclosures-ratings-and-investing_68193.html Please refer to Annexure 1)

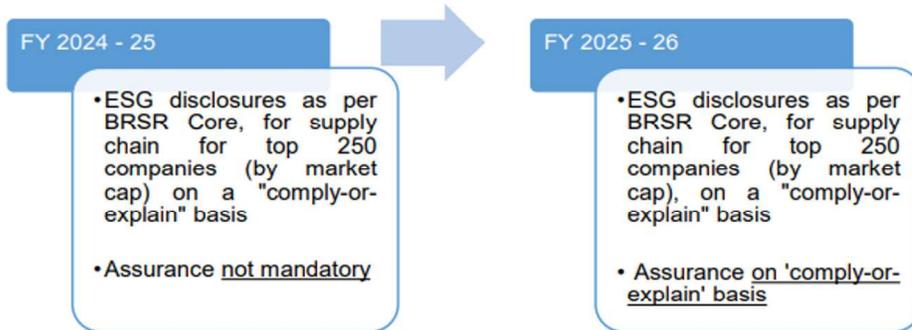
This document lists down select Key Performance Indicators (KPIs) for each E, S and G attributes and specifies the methodology for easy reporting and verification of data by an assurance provider. The BRSR core was prepared using certain approaches. These approach includes metrics in the KPIs that are reflective of sustainable outcomes in companies, containing factors that are relevant to both manufacturing and

service sectors and in Indian context, and the KPIs containing intensity ratios to enable comparability irrespective of size of company.

The committee has decided to update the BRSR to incorporate the KPIs proposed in the BRSR core that are not present and to mandate the reasonable assurance of these KPIs in a gradual manner. (FY 22-23 Reasonable assurance not mandatory, FY 23-24 Reasonable assurance on BRSR Core mandatory for top 250 companies, FY 24-25 Reasonable assurance on BRSR Core mandatory for top 500 companies, FY 25-26 Reasonable assurance on BRSR Core mandatory for top 1000 companies)

b) The disclosures relating to the Supply chain partners are currently a part of the Leadership Indicators in BRSR. However, as per the EAC, disclosures on a company's supply chain is important in understanding the footing of the company in its ESG journey.

Keeping in mind that the supply chain partners may be small, unlisted firms and it may be difficult for such



Source: SEBI Consultation paper on ESG Disclosures, Ratings and Investing

companies to track and report on a large number of ESG metrics, the committee has proposed to introduce a limited set of ESG disclosures (BRSR Core) for the supply chain partners. This will be made mandatory in a gradual manner. (FY 24-25 ESG Disclosures as per BRSR Core for supply chain for top 250 companies not mandatory, FY 25-26 ESG Disclosures as per BRSR Core for supply chain for top 250 companies on comply or explain basis mandatory)

3. PART 2- ESG RATINGS

Under Part 2, EAC has identified 2 key areas for review. These areas are as follows:

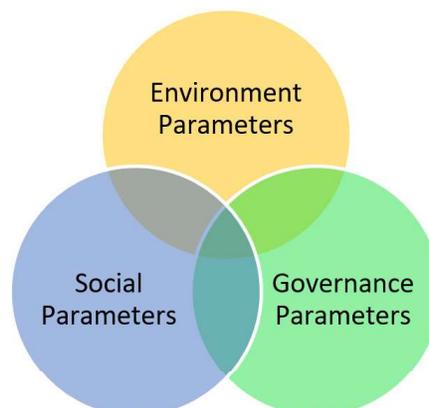
- Regulatory framework for ERPs in securities market.
- Unique set of metrics while assigning ESG ratings for emerging markets and developed jurisdictions.

The proposal made for public consultation with regards to the issues identified above are as follows:

- SEBI is in the process of developing a regulatory framework for ERPs
- The committee has developed

a list of 15 ESG parameters (https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-esg-disclosures-ratings-and-investing_68193.html refer to Annexure 2) having an Indian context to justify the environmental, social & governance challenges in emerging markets as compared to the developed markets. The committee has also clarified that this list is not an attempt to prescribe a uniform methodology for ESG ratings, rather a way to bring consistency.

The said list was prepared keeping in mind that Indian companies align their processes as per Indian standards set by Perform, Achieve & Trade (PAT) scheme, Extended Producer Responsibility (ERP) scheme etc., Social realities in India vary



and are very different from developed nations and that the governance structure should cover relevant areas such as related party transactions, Independent directors and the presence of a RegTech systems for monitoring compliance.

c) Seeing the relevance of ratings in investor decision making, the committee proposed that ERPs shall also provide a Core ESG Rating based on information/reports that are assured/ audited/ verified.

4. PART 3- ESG INVESTING

Under Part 3, EAC has identified 3 key areas for review. These areas are as follows:

- Association Of Mutual Funds (AMFI) in consultation with SEBI has prescribed Disclosures in Scheme Information Document (SID), disclosures related to engagement undertaken by AMCs for ESG schemes and General obligations related to declaration, resource augmentation, marketing material and development of common sustainable finance related terms and definition in ESG schemes of Mutual funds.

- SEBI has advised AMFI to empanel ERPs based on the parameters proposed by working group set up by SEBI.

- EAC has also provided recommendations to expand disclosure norms for ESG funds and measure to improve transparency regarding mitigation of risks of mis-selling and greenwashing among other things.

The proposal made for public consultation with regards to the issues identified above are as follows:



a. Voting disclosures

- The EAC proposed that there should be an increased engagement by AMCs/ Mutual funds for a better and stronger corporate governance in investee companies.
- Mutual funds under the current regulatory framework to mandatorily follow a Stewardship Code.
- AMCs shall provide better clarity on “in favour” or “against” votes cast on resolutions in a year by disclosing if the resolution has or has not been supported due to any environment, social or governance reason and in case of Mutual funds having holdings in investee company under ESG and non-ESG funds, proper rationale for “in favour” or “against” votes cast on resolutions for ESG and non-ESG schemes separately.

b. Disclosure of case studies

- EAC recommends ESG schemes to begin with disclosures as regards to case studies where the fund manager/analysts have engaged with portfolio companies with a clear objective of engagement, engagements carried out for exercise of votes and details of these engagement in a financial year. A glide path is suggested wherein the disclosures of case studies may be carried out after one year (From FY 24-25 onwards) and coverage of engagement number of company wise and Assets Under Management (AUM) AUM-wise after one more year (FY 25-26 onwards).

c. Mitigation of risks of mis-selling & greenwashing

- SEBI by the way of this consultation paper has tried to mitigate the risk of greenwashing both from an investee

company level and a scheme level.

- An ESG scheme shall invest at least 65% of its AUM in companies which are reporting on comprehensive and core BRSR and remaining in companies reporting comprehensive BRSR.
- No investment is to be made in companies without core BRSR disclosures till it’s done. (1st October 2024 onwards).
- Security wise core BRSR ratings shall be disclosed in monthly portfolio disclosures.
- Third party reasonable assurance (scheme portfolio in compliance) may be introduced on comply or explain basis from April 2023 and mandatorily from April 2024.
- Mandatory certificate from a Mutual fund from April 01, 2023 and makes

Trustees responsible for a certificate.

d. Classification of ESG schemes

- As proposed by the EAC, Mutual funds might want to launch multiple diversified ESG schemes and hence a new category may be introduced. Each AMC may be permitted to launch one ESG scheme each under 5 listed categories (https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-esg-disclosures-ratings-and-investing_68193.html Refer to page 13). AMCs shall try to have a higher proportion of assets under ESG theme and make relevant disclosures.

e. Other proposals

- EAC proposed to mandate AMCs to include name of particular ESG strategy in the name of fund/scheme and disclose the name of ERP alongside the score disclosures in monthly portfolio.

- It is also proposed to add a “Fund managers” commentary under the Fund disclosures, annually which should disclose the percentage of AUM invested in companies where there is no BRSR disclosure and its impact on fund score along with other requisites (https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-esg-disclosures-ratings-and-investing_68193.html Refer to page 14). (From 1st April, 2024 onwards).

5. ROAD AHEAD

Climate change and sustainable development concerns are two interconnected issues that have gained significant attention in recent years. They represent some of the most pressing challenges facing humanity and the

planet, and they are closely linked to various environmental, social, and economic issues.

ESG (Environmental, Social, and Governance) considerations have gained recognition and importance in India’s corporate landscape in recent years. The recognition of ESG factors in India is driven by several factors. First, there is an increasing awareness of environmental challenges, including air pollution, water scarcity, and climate change, which has prompted companies to incorporate sustainable practices into their operations. Second, social issues such as gender equality, labour rights, and community development have gained prominence, leading companies to focus on their social impact and stakeholder engagement. Lastly, good governance practices, transparency, and ethical conduct are being emphasized to improve corporate accountability and investor confidence. As a result, there has been a growing emphasis on ESG reporting and disclosures in India, with regulators, investors, and stakeholders advocating for more standardized and transparent ESG metrics.

Investors are relying heavily on the disclosures made by the companies and the ESG rating providers in their decision making. However, the EPRs not being regularized by any statutory framework, opens up the securities market to a potential risk. In order to mitigate the said risk, SEBI has formulated a regulatory framework for “ESG Rating Providers” or “ERPs” (https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-regulatory-framework-for-esg-rating-providers-erps-in-securities-market_68337.html). 



Sonal Verma leads the ESG Practice in the firm as a Partner and Global Leader – Markets & Strategy. With his crossroad working with business & laws – he brings advice & technology for effective change management in the journey of ESG. Sonal is well acclaimed for his work in regulatory & compliance programs over the last decade. He had in the past worked with 1800 plus clients in India and 61 other countries globally. He has worked with the top 3 unicorns and many Fortune 500 companies. His clients have been across different industries, viz. Automotive and OEMs, Pharma and Life Sciences, Manufacturing, Chemical Industry, BFSI, Infrastructure and Utilities (including stateowned PSUs), e-Commerce and Fintech Companies, Diversified Conglomerates etc.



Anshita Agrawal is an Associate with the firm working in the ESG Domain. Her core expertise lies in compliance decoding of various legislations along with its respective regulations, researching on various legal frameworks and aspects related to ESG and Sustainability.