Navigating ESG Disclosure and Ratings' Conundrum

Reflections on the SEBI's Proposed Framework

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The Securities and Exchange Board of India's proposal on the India-specific parameters for incorporation in environment, social and governance disclosures is analysed in view of recent developments on the ESG disclosure and ratings globally. The paper has tried to understand whether SEBI's proposal provides an avenue for eliminating the confusion and restoring the lost trust in disclosure and ratings in a meaningful way.

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Concerns regarding businesses' social and environmental impacts have existed for many decades (Meadows et al 1972; Brown 1981). But measurement and reporting of these impacts gained substantial attention in the late 1990s and early 2000s (Milne and Gray 2013). The measurement and reporting were mainly aimed at plugging the growing trust deficit about the ability of the capitalist system to resolve the widening social inequality and degradation of the natural environment. It was increasingly felt that transparency through disclosures of information on the environment, social and governance (ESG) fronts would bring about changes in corporate behaviour, improve corporate accountability, and lead to better outcomes for employees, customers, the environment and local communities (Serafeim and Grewal 2016). The imperative to disclose was further triggered by the rising investor demand for value-relevant, non-financial information and increased risk perception among corporates (Bose 2020).

The term "ESG" emerged in January 2004, when the erstwhile secretary-general of the United Nations (UN), Kofi Annan, invited the chief executive officers (CEOs) of leading financial institutions to be a part of an initiative launched by the United Nations Global Compact (UNGC) with the support of the International Finance Corporation (IFC) and the Swiss government (Kell 2018). The initiative aimed to create a business case for embedding ESG in capital markets that eventually led to a report titled "Who Cares Wins" (IFC 2004). Around the same time, the United Nations Environment Programme Finance Initiative (UNEPFI) also released the Freshfields Report (2005), which reinforced the importance of ESG in the financial valuation process. These two reports eventually laid the foundation of the Principles for Responsible Investment (PRI), launched at the New York Stock Exchange in 2006. The collective assets under management (AuM) represented by all 3,826 PRI signatories (3,404 investors and 422 service providers) stood at $121 trillion as of 31 March 2021 (UNPRI 2022). In an earlier prediction by Bloomberg Intelligence, global ESG assets were expected to cross $53 trillion by 2025, representing more than a third of the $140.5 trillion in projected total AuM.

India is not far behind on the ESG front. On the social side, a significant step towards legitimising the social imperative of business in India was made by the Ministry of Corporate Affairs (MCA) for the first time through the launch of the corporate social responsibility (CSR) guidelines (MCA 2009). The guidelines emphasised care for stakeholders and the environment, ethical functioning, human rights, workers' welfare, and social and inclusive development, among other aspects. This eventually led to the framing of the new Companies Act, 2013.[1] In the same year, the National Voluntary Guidelines (NVGs) were published by the Government of India, which became the founding pillar of ESG reporting in India.

On the climate front, India is already on the path to decarbonisation. In 2016, the country submitted its first Nationally Determined Contribution (NDC) under the Paris Climate Agreement of the United Nations Framework Convention of Climate Change (UNFCCC), which was further revised in 2022. In the 21st UNFCCC Conference of Parties (COP) held in Glasgow in 2021, India pledged to achieve "net-zero" emissions by 2070.

In 2012, the Securities and Exchange Board of India (SEBI) released India's first ESG disclosure and reporting framework, namely Business Responsibility Reporting (BRR) in line with the NVGs. Initially, SEBI mandated that only the top 100 listed entities by market capitalisation needed to file BRR as part of the annual report (SEBI 2012). The mandate was progressively extended to the top 500 listed entities in 2015 (SEBI 2015) and further to the top 1,000 listed entities in 2019. The BRR was also revised in 2019 and relaunched in a more comprehensive avatar as the National Guidelines for Responsible Business Conduct (NGRBC).[2] The latest reporting framework, known as the Business Responsibility and Sustainability Report (BRSR), was launched in 2021. Though NVGs continue to remain the founding fulcrum of ESG reporting in India, the level and quality of disclosures as stipulated under BRSR improved significantly with a focus on disclosure of more quantitative information to enhance comparability across sectors and was also manifested through improved ESG metric and scores for the top 150 listed companies.[3]

With the aim of providing further inputs to the regulation process on ESG, an advisory committee was established by SEBI in May 2022. In the same vein, SEBI released a consultation paper in February 2023 with a focus on regulation of ESG disclosures by public companies, ESG rating provider and ESG investing by mutual funds; and to facilitate the balance between transparency, simplification, and ease of doing business in an evolving domain. SEBI has also mandated the top 1,000 listed companies by market capitalisation to make filings as per BRSR from FY 2023–24. It is critical to scrutinise SEBI's consultation paper and put it into perspective, as the document presents the first-of-its-kind reflection by the regulator as to where India is headed in terms of its ESG landscape in the next few years and what are the grey areas that still need reforms.

This paper takes a deep dive into the consultation paper with a particular focus on two major components, namely ESG disclosure and ESG ratings. The paper analyses the SEBI proposals in light of the recent developments on these two fronts globally. It then attempts to disentangle the complex web of entities in the ESG ecosystem that influences the ESG disclosure and ratings. Later, the paper focuses on the key challenges pertaining to ESG disclosure globally and assesses the contribution of SEBI's proposal in that context. Then the paper delves deeper into the ESG ratings' conundrum and analyses the value addition by the consultation paper in that respect. Then it ends with the concluding remarks.

Divergence and Opacity in ESG Disclosure

Major challenges in ESG disclosure: Although companies are the key providers of the ESG data, several other actors are an integral part of the ESG disclosure ecosystem. These include the investors, consumers, civil society, among others (Box 1).

The complex web of authorities and frameworks for ESG measurement and disclosure not only makes the disclosure unwieldy but also creates a huge burden for the companies making

Box 1: ESG Disclosure Ecosystem

Standard setting entities: These entities are responsible for coming out with detailed guidelines that help the disclosing entities in gauging the nature of ESG-related information they are expected to reveal; metrics to report on; and methods of measurement. Notable examples include the Global Reporting Initiative (GRI); Climate Disclosure Standards Board (CDSB), and the Sustainability Accounting Standards Board (SASB).

Framework developers: These entities are the influencers in the ecosystem and facilitate in understanding how better to develop and present the data of the disclosing entities in alignment with the objective of long-term value creation. Notable examples include the International Integrated Reporting Council (IIRC) and the Task Force for Climate Related Disclosure (TCFD).

Assurance providers: These entities provide professional advice and assurance to the disclosing entities on how to reveal ESG/non-financial information in the public domain. Notable examples include the big four, namely Deloitte, Ernst & Young, PwC, and KPMG.

Investors: They are the key stakeholders driving the ESG revolution and primarily comprise of asset owners, asset managers and private equity firms. They make use of available ESG information to take a measured decision on capital allocation; engage with the board of directors (BoD) of the disclosing entities on crucial issues pertaining to ESG; combine and internalise the ESG data on their portfolio companies in their practices of investment reporting.

ESG data providers/raters: They are the aggregators of the available entity-level ESG information. They rely on reports that are available in the public domain, conduct private research and/or request for company-level information wherever required. The data is provided in various forms (say, absolute and relative metrices, ranking or indices). Select data providers also rate the companies in terms of their ESG performance. Notable examples include Bloomberg, Dow Jones Sustainability Index (DJSI), Morgan Stanley Capital International (MSCI), Institutional Shareholder Services (ISS), Sustainalytics and Refinitiv.

Investment banks: These are facilitating intermediaries that are primarily involved in analysing market trends and company performance, including assessment of ESG information. They help the investors with recommendations on whether to buy, hold or sell. Notable examples include Merrill Lynch, Citigroup, Goldman Sachs, JPMorgan Chase, and Morgan Stanley.

Regulators: They comprise entities who can regulate and/or mandate ESG-related disclosure from companies under their jurisdiction and may include local, national, and supranational governments, financial regulators, stock exchanges for listed companies. For instance, MCA and SEBI are regulators of ESG-related information in India.

Non-governmental organisations: They provide services to guide entities in measuring, benchmarking, reporting and improving on ESG performance and motivate the disclosing entities in having a stronger focus on ESG. Notable examples include Ceres, World Business Council for Sustainable Development (WBCSD) and World Benchmarking Alliance.

Source: WEF (2019).

the disclosure. There is a huge confusion around the information to disclose, the way to disclose and the intended beneficiaries. Another major challenge relates to identifying the "material" ESG issues. Conceptually, an ESG issue is considered "material" when it is identified by both the company and its key stakeholders as an area of concern, which, if left unaddressed or not internalised in business policy and strategy, may have a negative fallout on the environment and/or society, and may even affect the company's financial bottom line. The problem is that whether a particular issue qualifies as a material issue for a company or not is often context-specific and depends on the reporting structure adopted by the company concerned. Moreover, where a particular material issue will lie along the priority scale would depend on the extent of its importance and impact for the company. For instance, for a beverage giant like Coca-Cola or Pepsi, water is certainly a high-priority material issue.

Another area of concern relates to the measurement and disclosure of "s" part of ESG, as such issues are usually context-specific and vary widely across sectors and geographies. In fact, compared to "E" (environment) and "G" (governance), the "s" of ESG is way less tangible. "s" also has a larger heterogeneity as it covers under its ambit a whole gamut of issues that include human rights, labour standards, gender equality, as also wider issues pertaining to diversity, equity and inclusion (DEI) (HLS 2020a). At the first thought, even the emission scandal of German automobile giant Volkswagen appeared like an issue in the domain of "E," but once the crisis surfaced and became deeper, there was very little room for dispute that it is more in the "s" domain as it is largely about the "culture" that drives the organisational behaviour. COVID-19 has only strengthened the belief in "s" by evincing how "a major public health crises can affect every business, every industry, and every geography" (Saul 2022). Such heterogeneity makes it particularly challenging for companies to understand which "s" issues among the whole gamut of issues may be considered critical, how to go about measuring them appropriately, keeping in view the context, and how to go about benchmarking their performance on the "s" front.

Given the unresolved ambiguities around the notion of ESG (Rajgopal 2021) and the plethora of material ESG issues to grapple with for a company, it is indeed a daunting task to single out the "core" ones after accounting for the multifaceted views of diverse stakeholders. The dynamic and inter-temporal nature of materiality compounds the problem even further. Such complexities could end up disincentivising the disclosure process itself. Moreover, as the ESG data are largely unaudited and are voluntarily disclosed, there are structural issues around measurement and reporting. The data is also often incomplete and unreliable. The current system provides adequate room for companies to manipulate the disclosure process (HLS 2018). Hence, there is a potent risk of "greenwashing" through unverified claims of superior ESG performance by companies.

The dearth of standardised disclosures also leads to variation of reported metrics by companies. Thus, it may not be easy to assess whether company A is better than company B on a given aggregate metric or ratio, as the underlying data and methodology may not be the same. So, one may end up comparing apples with oranges. Therefore, it is challenging for a company to benchmark itself against its peers. The challenges might arise at the intra-company level too. For example, if one considers the amount of water it takes to produce a 1 litre bottle of Coke, the Coca-Cola company's own estimates have varied from less than 2 litres of water to 70 litres depending on the methodology used (Pucker 2021).

Due to problems in comparability of ESG performance, investors sometimes find it difficult to integrate ESG data into investment decision-making and management. Similarly, other key stakeholders like the regulators and wider society also face challenges in trying to figure out a company's contribution to a particular topic of interest (WEF 2019).

Stakeholder capitalism framework and SEBI's proposal: In appreciation of the imminent global need to tackle the problem of multiple standards and frameworks for ESG measurement and disclosure, and the associated challenges arising therefrom, five key international organisations in the ESG space joined forces in 2020 to make a notable announcement on a shared vision to arrive at a common, comprehensive, standard framework to collect and report on sustainability performance to various stakeholders (WEF and Deloitte 2020). These five organisations are Climate Disclosure Project (CDP), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) and Sustainability Accounting Standards Board (SASB). As a follow-up to this announcement, on 20 September 2020, the World Economic Forum (WEF) published a report of the CEOs of 120 companies in its International Business Council (IBC) titled "Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation." The report suggests 21 "core'" metrics in the categories of principles of governance, planet, people, and prosperity, with a supplemental set of 34 "expanded" metrics in the same categories (WEF 2020; Eccles 2020).

For India, the SEBI's recent consultation paper proposes the introduction of the "BRSR core," which tows the same line as WEF and bears significant resemblance with its core metrics. However, the key performance indicators ("KPIs") for each environmental, social and governance attribute are befitting to India's context. The attributes that have been considered in the BRSR core are E (change in greenhouse gas [GHG] footprint, which accounts for Scope 1 and 2 emissions and associated emissions intensity; change in water footprint, which includes volume, intensity and discharge; research and development [R&D] expenses in reducing environmental footprint; circularity and waste management); S (employee well-being and safety; gender diversity; inclusive development); G (fairness in engaging with customers and suppliers; openness in business, which accounts for concentration of purchases and sales done with trading houses, dealers, and related parties plus loans and advances and investments with related parties). The intensity ratios, as indicated above in the E core, are usually based on both revenue and volume. Given that these ratios are also used by global investors and global ESG rating providers (ERPs), SEBI suggests that the ratios should additionally be computed based on economic value adjusted (EVA) for purchasing power parity (PPP) to enhance comparability across jurisdictions. As it may not be easy to calculate the EVA for PPP at a sectoral level, SEBI suggests that the country-level PPP should be used as a proxy to begin with, and sectoral EVAs could be calculated and incorporated in a progressive manner.

The SEBI makes a commendable effort in terms of computation to help with the vexed calculation of ERPs to enhance comparability as well as by trying to indigenise the metric and suit them to the Indian context. However, given the plethora of complexities in the calculation process, it remains to be seen how far it could go in addressing the problems of comparing apples and oranges.

Recognising that the BRSR framework is still at a nascent stage, the current framework is proposed to be revised to incorporate the KPIs specified in the BRSR core in the consultation document. A reasonable assurance on the BRSR core has also been proposed for the top 250 companies from FY 2023–24 to begin with, followed by the mandate for the top 500 listed companies, from FY 2024–25, and subsequently to the top 1,000 listed companies from FY 2025–26. Furthermore, to do away with greenwashing at the ESG scheme, the SEBI additionally proposes that the ESG-linked funds or schemes should invest "at least 65% of their AuM in companies which are reporting on comprehensive BRSR and are also providing assurance on BRSR core disclosures." The remaining investments of the scheme should be in companies reporting on BRSR.

The consultation paper, however, is unclear on what "reasonable assurance" means. As "assurance," reasonable or otherwise, cannot be a substitute for audit and ESG-related impacts cannot be audited unless they are reflected as line statements in a balance sheet (Serafeim et al 2019). Hence, adequate clarity is needed to understand the extent to which the reasonable assurance of the BRSR core enhances the veracity of disclosed information. This understanding is critical to restore the trust deficit that already exists in using ESG data and information.

Disclosure opacity in the supply chain: In a world of globally fragmented production networks, supply chains often have multiple tiers with contractors outsourcing to multiple subcontractors which makes traceability problematic. The Rana and Tazneen garment factory tragedies in Bangladesh where thousands of textiles workers lost their lives bear ample testimony as to how a disaster could crop up in the absence of audits and failure to trace social abuses in the supply chain (Banerjee 2018).

In the area of "E," particularly in the case of climate change, a company can measure its GHG emissions footprint at three levels: (i) Scope 1, that is, emissions produced in its own facilities and through owned vehicles and thus under its direct control; (ii) Scope 2, that is, emissions from purchased electricity; and (iii) Scope 3, that is, all other upstream and downstream emissions that include those generated in the supply chain, business travel by employees, and by the usage of the products sold. For apparel or footwear companies, for instance, Scope 3 emissions may typically comprise a significant proportion of their carbon footprint, but tracking and measuring such emissions is a very difficult exercise, given the multiple layers of the supply chain, which may be spread over multiple countries. Although technological advancements in the spheres of, say, blockchain, artificial intelligence (AI), sensors, etc, are opening up new vistas for measuring and monitoring the environmental footprints of companies throughout the supply chain, there is still a yawning gap as measurement may be non-standard, incomplete, opaque and sometimes misleading. Furthermore, given that many supply-chain partners may be small unlisted firms belonging to the informal sector, it may not be easy for them to track and report on ESG metrics.

Recognising the tracking challenges, the SEBI proposal recommends a phased manner of ESG disclosures for supply chain of top 250 listed companies in India (by market cap) on a "comply or explain" basis and assurance is not mandated to begin with. It is a challenging journey, and there is a clear need to bring about changes in a collective manner with regulators, businesses and other supply-chain actors working together, rather than working in silos. The SEBI proposal is just the first baby step in that direction.

An important issue, which is conspicuous by its absence from the discussions globally as well as in India, is that of the supply-chain resilience. No metric or KPI pertaining to this has been included either in the WEF Stakeholder Capitalism Framework or in SEBI's BRSR core. Information on the resilience-related KPI is, however, crucial to infer on the capability of businesses to effectively come out, adapt and grow from an unforeseen shock or stress, such as a pandemic or a climatic disaster (Rodin and Madsbjerg 2021).

The ESG Rating Quagmire

Comparing apples versus apples or apples versus oranges? The ESG rating (ESG-R) agencies play a crucial role in amalgamating ESG information and provide perspectives on companies' non-financial performance. In simple terms, an ESG-R score is a measure of a company's exposure to its long-term ESG risks. A superior ESG rating often helps companies generate a good reputation, attract investors and helps in bringing down the cost of capital (Nazir et al 2021).

The origin of ESG-R could be traced back to the 1980s when it all started with the aim of providing advice for ethical investing. Vigeo Eiris, the oldest rater which got incorporated in 1983 in the United Kingdom, aided churches and charities in incorporating their ethical principles into their investment allocation decisions (Avetisyan and Hockerts 2017; Mooij 2017). Over time, the ESG-R industry has grown manifold—both in terms of size, scope of activities and complexity. This growth may be attributed on the one hand to firms and/or companies, an increasing number of which went in for adopting sustainable practices and reporting in some form, and on the other to the investors, an increasing number of which adopted socially responsible investing (SRI).

The ESG-R industry suffers from the tension inherent in the world of self-reported and unaudited ESG disclosure, which is ridden with disparity and ambiguity both in terms of definitions and measurements. This industry in fact has an even more difficult task at hand, as they need to assimilate all available information and synthesise them into simple, easy-to-understand composite score or rank either in absolute or relative sense, which the investment community eventually relies on. To serve that purpose, the ESG rating providers (ERPs) need to establish rating methodologies for multiple industries and for firms at various stages in the value chain in an industry (Windolph 2011). The past few years are witness to a mushrooming of rating agencies. These raters adopt their individual approach to acquire and process the ESG data that they receive from companies and other organisations. Different ERPs also use different reporting frameworks (Table 1).

The ESG-R is more like a blackbox that relies on "subjective assessments based on patchy arbitrary data" (Wigglesworth 2022) whose length and breadth are often different. Hence, it becomes difficult to get clarity as to what kind of ESG data an ERP is considering and which algorithm it is using to analyse the data to come out with its ratings and analysis. Consequently, when different ERPs produce divergent scores for a given company—as is usually the case—it can be difficult for the market and the end-users (for example, investors) to gauge the reasons underlying such disparity and to assess the ramifications of the divergent ESG scores (HLS 2020b). A blatant example that has been brought to the limelight by Bloomberg Inc in the recent past is that of the ratings of McDonald's Corporation (McD). The world's biggest burger chain, which is also one of the world's largest beef purchasers, has reportedly emitted more GHGs in 2019 than entire nations like Portugal or Hungary. Such gigantic emissions are largely attributable to the company's supply chain (that is, Scope 3 emissions). Although McD registered an increase in emissions of about 7% between 2015 and 2019, generating 54 million tonnes of emissions in 2019, MSCI, a leading ERP, awarded a rating upgrade to McD in 2019 citing the company's environmental practices. Such apparent disconnect, however, has raised many eyebrows. The question is: Why would a leading ERP exclude carbon emissions from the calculation of McD's rating? This is because MSCI identified that "climate change neither poses a risk nor offers opportunities to the company's bottom line" (Simpson et al 2021). In a similar vein, the beverage giants, PepsiCo and Coca Cola, usually get high ESG scores from the biggest ERPs like MSCI and Sustainalytics, as they score high on parameters such as corporate governance and GHG emissions. However, criticisms of such high ESG scores are bound to arise, given that their core businesses involve the manufacturing and marketing of addictive products that are a major cause of diabetes, obesity and early mortality globally (Taparia 2021).

Table 1: ESG Frameworks Used by Various ESG Rating Providers

ERP Agency	ESG Framework Used by the ERP
Morgan Stanley Capital International	Sustainability Accounting Standards Board
Sustainalytics	Global Reporting Initiative
Institutional Shareholder Services Environment and Social Quality	Carbon Disclosure Project
RepRisk	Task Force on Climate Related Financial Disclosure
Vigeo Eiris	UN Sustainable Development Goals
Financial Times Stock Exchange Russel	UN Principle of Responsible Investment

Source: Authors' compilation.

In an interesting project hosted by the MIT Sloan School of Management titled "Aggregate Confusion Project,"[4] the divergence of ESG ratings has been investigated in detail based on data from six prominent ERPs. The findings indicate that measurement contributes to 56%, scope 38%, and weight 6% in the total divergence in ratings of the ERPs. A "rater" effect has also been detected where a rater's overall view of a firm influences the measurement of specific categories. Other identified causes of divergence include "company size bias" where companies with higher market capitalisation tend to be awarded better ratings than their lower market-cap peers. There could also be inherent "geographic biases." For instance, companies based out of Europe tend to receive relatively higher ESG ratings than peers based in the United States and elsewhere (HLS 2018).

Such a wide divergence makes it challenging to evaluate the ESG performance of companies, funds, and portfolios, which is the key intent of ESG ratings. It also decreases companies' incentives to improve their ESG performance because disclosing companies or entities receive a mixed signal from ERPs regarding the actions that are expected and valued by the market. The consequence would be an under-investment in ESG-related activities and an inherent tendency to greenwash. Furthermore, investors who rely on the ratings to make capital allocation or management decisions may face the risk of landing into a suboptimal decision. Low transparency and confusion also reduce faith in the ability of ESG ratings to support meaningful decision-making (Wigglesworth 2022).

ESG ratings in India and SEBI's recent proposal: Coming to India, as the ESG disclosure landscape is still shaping up, investors still rely only on rating provided by the more popular international ERPs to assess ESG compliance by portfolio companies. ESG-R is at a nascent stage in India and hence is not regulated at present. The first ESG rating by any Indian company has been obtained only in 2021 by Acuité. The company launched a risk assessment framework in the form of a product offering named ESG Risk AI, which would assess a company's ESG performance and assign a rating (*Economic Times* 2021).

In its consultation paper, the SEBI proposes that there should be a provision for core ESG rating beyond what the ERPs currently offer in their rating services. This "core" is supposed to be based on the BRSR core disclosure that is "reasonably" assured. By proposing the "core" ESG rating, SEBI also departs from the recommendation that has been made in 2021 by the International Organization of Securities Commissions (IOSCO 2021) in a report that talks about regulation of the entire range of ESG data and rating providers globally. The SEBI proposal clearly facilitates narrowing down the ambit of ESG rating, which is convenient for the sake of comparability. If implemented, it will also help investors decipher with a greater clarity as to what they are receiving as ratings when compared to the vexed and divergent ratings that are churned out of the blackbox of multiple ERPs.

Furthermore, in complete recognition of what should ideally be considered in the Indian context by the ERPs to carry out ESG rating, the SEBI additionally proposed 15 India-specific parameters that account for the developments on the relevant regulation and policies in the country. There is also a clear emphasis in the proposal that only standards/laws/guidelines pertaining to India should be strictly followed while carrying out the ESG rating. This is a welcome move as it may push the international ERPs away from a generic rating to a more contextual one that factors in the uniqueness and diversity of India's development challenges. However, implementing it would entail additional work for the international ERPs and hence might also be dis-incentivising for them to begin with. But this information would be crucial for the sake of comparability of ratings even between an Indian and an international ERP in the domain.

While proposing the "core" ESG rating, the SEBI also allows for a corollary that such ratings "must necessarily be based on assured or verified data, however, ERPs may provide an additional commentary/outlook/observations on data that may not be verified/assured." For instance, an unverified controversy is not supposed to be incorporated in the core ESG rating/score. However, ERPs can exercise the liberty to add a commentary on the issue if they so desire. It has been observed in the past that international ERPs usually end up downgrading the score whenever they come across any controversy, verified or otherwise. For instance, Volkswagen's rating post its emissions rigging controversy (*NYTimes* 2016) or online fashion retail giant Boohoo's rating post the allegation on labour exploitation in its supply chain (*FT* 2020) have been downgraded shortly after such incidents came to ERPs' notice. A similar fallout could be seen for Adani Group in India in the recent alleged governance failure (McGachey 2023) where the top ERPs like MSCI (*FT* 2023) and Sustainalytics (Reuters 2023) downgraded select companies in the group after they came across the news of the allegation. In that context, SEBI's proposal is timely as the corollary will provide the accredited ERPs in India an additional armour by allowing them to append a reasonable comment on a company if they feel so, and it is desirable that they should make full use of this privilege even if they do not change their rating of a company at the first go based on unverified data. It is also desirable that ERPs should become more proactive in exercising this liberty positively to comment rather than stay as passive observers to a company- or group-level crisis that could have serious potential fallouts on economic and social welfare of a nation.

The SEBI's proposal, however, is quite restrictive on two counts while specifying the ERPs' accreditation criteria. First, it proposes that only registered credit-rating agencies (CRAs) and research analysts would be eligible to be accredited with SEBI as ERPs. Second, SEBI proposes the criteria for the accreditation of ERPs with a net worth of around ₹10 crore. Along with the net-worth criteria, SEBI's proposal additionally requires demonstration of knowledge, sustainability, infrastructure, quality of staff and technical know-how to qualify for accreditation.

ESG-R as a concept is more complex and pervasive than credit rating. While the former incorporates diverse concepts of ESG aspects of a firm, and their individual as well as combined impact on not just the firm but also its stakeholders, credit rating is mainly about assessing the creditworthiness, or the ability to meet debt commitments, of a firm. So, the ambit of ERPs should supposedly be wider and must involve all seasoned players in the ESG domain.

Using the high-net-worth threshold, SEBI categorically precludes any opportunity for the small and medium private players to participate in the accreditation process. It may be worthwhile revisiting the net-worth threshold to make the participation process more inclusive, at least in the initial stage. Some of these players, who are currently precluded by the net-worth criteria, may even have a better understanding of the material issues and the pulse and context of the industry that is located, say, in a particular region in the country.

Typically, ERPs are paid for by the investor community, whereas the credit rating agencies are paid for by the issuer and thus the problem of agency, conflict of interest, and rating shopping are invariably associated with the credit rating industry (Stubbs and Rogers 2013). The SEBI, however, suggests that the payment would be subscription-based to provide independence to the ERPs. The SEBI also underscores that "while investors can be the primary source of revenue in the 'subscriber-pay' model, a subscriber may also include an issuer."

Conclusions and the Way Forward

This paper has deliberated on the complexity of the ESG landscape and the opacity inherent in the ESG-R space, and critically analysed the relevant portions of SEBI's consultation paper in that context. It also explored how far the SEBI proposals could succeed in providing a meaningful way forward for the ESG disclosure and ratings in India.

As standardisation is a prerequisite for reforming the ESG disclosure and rating landscape in India, SEBI took the first baby steps by providing some baseline construct, metrics and KPIs in terms of "BRSR core" and came out with some India-specific parameters that are proposed to be incorporated in the disclosure and ratings. However, given that the ESG compliance is still at a rather nascent stage in the country, there is a plethora of grey areas that still warrant a closer look.

First, a lot of clarity is necessary on the notion of "reasonable assurance." There is a need to expand on the concept and elucidate whether it could be considered as a substitute for audit. Moreover, given the dynamic nature of the "material" issues and also that the data are disclosed voluntarily and unaudited, the question is: How far could the proposed "reasonable assurance" go in addressing the legitimate concerns about greenwashing or ESG-washing by companies through unverified claims on their performance?

Second, considering the opacity in both disclosure by companies and divergence in methodologies for ratings, there is no doubt that the pressure from the stakeholders would mount for harmonising them, as stakes in the ESG space become progressively higher. Aligning with the BRSR core, as proposed in the SEBI's paper, is likely to pave the way for the first stage of harmonisation and comparability, especially in the Indian context and hopefully without the ERPs losing out on their competitive edge, which they otherwise enjoy through their differentiated offerings.

SEBI, however, has deliberately shied away from commenting on methodologies pertaining to ESG ratings. One can understand that providing indicative guidelines or suggesting regulatory frameworks would be the only forte of a security regulator like SEBI. However, given the methodological complexities and diverse algorithms of the ERPS, chances are higher that the problem of comparing apples with oranges may persist.

Third, there is also a need to expand the BRSR core to design and incorporate some KPIs for supply-chain resilience to assess the risk-coping capacity of the system in case of any unforeseen stress or shocks.

Fourth, it needs to be duly acknowledged that much of the confusion in ESG ratings arises due to lack of effective, active cross-system dialogues between the stakeholders in the ESG ecosystem. There is thus a clear need for more collective, consistent messaging across all stakeholders. That will not only strengthen the disclosure and rating process but would also restore much of the trust capital that the ESG rating industry has lost in the quagmire.

Fifth, despite being in the infant stage of the ESG-R industry, there is already a degree of fatigue among the investee firms because of the reluctance to share data, often referred to as "survey fatigue." This arises due to the multiplicity of the ERPs that ask for diverse sets of data, overburdening the responding or disclosing entity in the process. This inherently leads to a company's reluctance to respond at all, or to respond in a half-hearted manner with incomplete data, leading to a compromise on the integrity of the process of data collection and curation. The SEBI's proposal towards standardisation through a "core" is a welcome move in the direction towards consolidation and standardisation. However, it remains an open question as to whether it would really do away with the fatigue and ensure accuracy and integrity, given the diverse intent of ERPs.

Sixth, SEBI's recent proposal does not leave much room for expanding the accreditation space given the nature of the participants and the net-worth threshold that it specifies. Therefore, it is worthwhile revisiting the accreditation criteria to make the participation process more inclusive.

Finally, by design, there is an inherent bias in the ESG disclosure and rating industry to cater only to the needs of the investors. However, given the importance and relevance of ESG for the wider public, it is imperative to design the disclosure and rating systems in such a way that it could be used by a wider set of stakeholders, including government, regulators, civil society and public at large.

NOTES

1 As per Section 135 of this act, companies with a turnover of ₹1,000 crore, or a net worth of ₹500 crore, or a net profit of ₹3 crore are required to spend at least 2% of their three-year average annual net profits on CSR activities listed in Schedule VII of the act.

2 The new format comprises disclosures on materiality analysis, stakeholder engagement, and social and environmental impacts in "essential" and "leadership" categories. The "essential" is about fulfilling minimum requirements and "leadership" pertains to industry leaders in sustainability. The leadership indicators emphasise on disclosures pertaining to the value chain.

3 A study carried out by CARE ratings in 2021 evinces improved scores on ESG metrics around emissions, push towards renewable energy, diversity and inclusion and key governance issues such as independence of audit committees and better board functioning (available at: https://www.careratings.com/uploads/newsfiles/21102021014100_ESG_Article_Oct21.pdf).

4 https://mitsloan.mit.edu/sustainability-initiative/aggregate-confusion-project (viewed on 20 March 2023).

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