Dear Mr. Richa Agarwal,

General Manager, Market Intermediaries Regulation and Supervision Department of the Securities and Exchange Board of India (SEBI),

and respective team,

With great satisfaction, I congratulate SEBI for the pioneer initiative of planning to regulate the services of Environmental, Social and Governance (ESG) ratings for the investments market, a service that can also be useful for the bank lending market (with regards to companies that are securities issuers) and that has the potential to encourage (or not) more transparency on ESG issues from companies, leading to improved ESG governance and ESG performance, in a virtuous circle, if the right model is adopted.

Needless to say how much impact the alignment of financial regulations with the demands of Sustainable Development is able to produce in the real economy and, eventually, to the society as a whole.

We hope that the following contributions are fully and carefully considered, because they are based in a comprehensive and deep understanding of the dynamics of ESG finance, a topic that I have been working since 2014, initially with an academic focus (post-doctoral research) and lately within global impact initiatives, bringing the perspective of both a big emerging economy (Brazil, where I worked for the banking regulator and Central Bank) and of the European Union. Information on my background is available in the website www.sisctm.com.br.

I am at your disposal for further clarifications, if needed.

Best regards, from Lisbon, Portugal to Mumbai, India, March 8th 2022.

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Contributions to SEBI consultation paper on ESG Rating Providers

for Securities Markets

Question 3 – Scope of regulation and accreditation of ERPs

No specific comments. The model seems positive and sufficient for the current stage of ESG Finance.

Question 4 – Entity eligible to be accredited as ERP

I do not agree that only credit rating agencies and research analysts should be admitted. Actually, new market players (that sometimes enter this market exactly because of their sustainability expertise, ahead of the financial expertise) can contribute a lot to improve the quality of ESG ratings, rather than traditional finance experts who are still slowly adapting to the integration of ESG factors into investments, driven by investors demands. CRAs and RAs, many times, don't have enough sustainability expertise in their teams, and that leads to superficiality and narrowness of ESG ratings, which end up promising more than they do deliver.

The focus should be in the sufficiency of governance structure and expertise (question 5), that is able to avoid the entrance in the market of entities withouth enough stability.

Question 5 – Conditions for accreditation

The criteria established in the consultation paper are positive, but more clarity on what constitutes an "appropriate database collection" (item 5.3) is needed. For example, as a minimum, it should be established that:

a) compliance with ESG regulations should be verified;
b) performance according to the most relevant KPIs for each industry should be verified.

Moreover, a clear definition of what are the minimum ESG issues should be provided. Only when definition of what are ESG issues is established, the appropriateness of databases can ever be assessed – otherwise, it's just rethoric.

We propose the following ESG criteria, that should be weighted according to each industry:

- GHG emissions;
- energy mix;
- energy efficiency (consumption proportional to production);

- type and volume of solid waste;
- type and volume of effluents;
- type and volume of air emissions;
- water efficiency (consumption proportional to production);
- raw materials efficiency (consumption proportional to production);
- land use conversion;
- labor health and safety;
- risks of modern slavery and child labor in the value-chain;
- risks of negative impacts on gender issues;
- community health and safety;
- consumers health and safety;
- risks to traditional communities;
- risks to competition;
- tax responsibility;
- corruption prevention.

Question 6 – ESG Rating Products

The proposed differentiation between ESG Financial Risk Ratings and ESG Impact Ratings seems very positive.

However, it is not enough, because, only when a definition of minimal ESG contents is provided, it's possible to consider if a an "ESG Impact Rating" actually deserves this title. That is why a definition such as the one proposed in the answer to question 5 is needed.

Question 7 – Standardization of Symbols and Scales for ESG Ratings

While a standardization might not be the ideal model at this point, the regulation could establish a minimal number of levels of classification – for example, four levels (market leaders; above average; below average; poor performers).

Question 8 – Transparency

Transparency is one of the most relevant topics, especially with regards to the **sources of information and methodologies to assess them.** The IOSCO report on ESG ratings and data products providers (published in November 2021) points out: "*(m)ethodologies may vary in the number of data points, indicators or KPIs used to measure an issue (which can amount to hundreds, or, in some cases, thousands) and, in the case of scorings and ratings, the weighting applied, between different pillars (environmental, social and governance) and different sub-categories and indicators*" (p. 20). Using an ESG rating

without being aware of its methodology of course implies a high risk of misalignment between the rating and the ESG investment/lending strategy of the bank or investor. Therefore, minimal guidelines should be established with regards to the material coverage (ESG indicators), data sources and methodology (e.g., weight of each indicator). Investors need to know, at least: a) if only information reported publicly by companies is used; b) if further information is obtained from companies; c) which are the KPIs/datapoints and what is the solution if they are not available; d) if information provided by public bodies (and which ones), civil society organisations or by media is considered and further investigated.

The same report describes (p. 20): "*a lack of reporting can either lead providers to use industry averages, thereby possibly creating an incentive for poor performers not to report their information, or lead the provider to negatively assess the company.*" However, the possibility included in item 8.7 is clearly a disincentive to improve ESG performance of companies, which is the overall purpose of many investors interested is ESG investing strategies. In no way it is acceptable to assign industry average for non-disclosure of information. Non-disclosure can only be caused by one of two reasons: 1) the company doesn't even measure the indicator, which means a very poor governance; 2) the performance is poor (under average) and therefore it decides not to disclose (also because capital markets regulation do not define minimal/mandatory information). How can this lead to consider the average of the market players that disclose relevant information is a question without an answer. Actually, **the use of industry averages should be clearly forbidden**. The solution for the gap is quite simple – attribution of zero or of a minimal grade. This is a strong incentive for disclosure, while the attribution of the market average is a strong incentive for poor performers not to disclose.

Furthermore, the provision of item 8.9 that ratings may be provided at a sector-agnostic level incentivize that ESG indicators are not assigned an appropriate weight according to industry peculiarities. For example, energy efficiency cannot receive the same weight in a sector intensive in energy-use and and in a commercial company whose activities are performed during office hours; same for water efficiency and so on.

As a matter of fact, beyond requiring transparency of the methodology (as defined in item 8.4), the regulation should establish **minimal criteria/methodology to be part of ESG ratings**:

- sector specific ESG KPIs, according to the environmental, social and governance materiality of each aspect in each industry; for the definition of KPIs, environmental and social regulations should be always considered;
- location of operations with environmental and social impacts (including the whole value-chain), once impacts vary a lot according to the peculiarities of each ecosystem and of each community where the company's activities are developed;

- information that can be obtained from environmental and social regulators, either online or in any other format;
- information publicly disclosed by companies;
- information on relevant KPIs that is not publicly disclosed, but can be obtained directly from companies;
- information available at media or obtained from key stakeholders, proportionally to the relevance/complexity of KPIs.

Question 9 – ESG rating process

The provisions seem positive and appropriate. No specific comments or suggestions.

Question 10 – Governance and prevention of conflict of interest

No specific comments. The model seems positive and sufficient for the time being.

Question 11 – Business model

In order to strenghten the subscriber pay model (which has a lot of advantages in terms of conflic of interest), regulation could address the problem referred at item 11.4, that "*an issuer may not be contractually bound to provide information to ERPs*", which is certainly true. However, it's actually a problem whose solutiton is quite simple.

If regulation is being created to define that only authorized entities can provide ESG ratings, ESG indices and similar products, and **SEBI also has a mandate to demand information from companies that are issuers of securities, it can also include in this regulation a provision that companies are required to respond to questions of ESG rating services providers**.