Ajay Mahajan, MD & CEO quoted in LiveMint

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Sebi to soon issue paper on rating ESGs

FROM PAGE 1

Meanwhile, several third-party consultants and advisers are offering ESG scores to companies, but a lack of standardization has lent little credence to such scores or ratings.

Since 2020, when many rating agencies made their ESG ratings public for companies, a significant disparity was noticed in ratings provided to the same company. For instance, NSE's ESG index methodology comes from Sustainanalytics and BSE's from S&P Global's Corporate Sustainability Assessment. Both do not have the same set of top 10 companies by weightage. Only six are common to both, but they aren't in the same order.

"Divergence in ESG ratings can be largely attributed to individual methodologies and weightages adopted by rating agencies; another factor is possibly lack of data which results in the use of proxies. Regulatory standards will address that," the second person said.

Stressing on the need for standardization of ESG scoring metrics, Sankar Chakraborti, CEO, Acute Ratings, said, "presently, different rating and scores providers are following different interpretations of ESG, and many of them are unsustainable in the long run."

"The characteristic of a rating is that it should be under continuous coverage, use a scientific taxonomy and should be based on high-quality data, which is a matter of concern in the bulk of the cases. Clarity on how rating agencies should be providing ESG ratings/scores and how it can be used by users (mutual fund and investors) would help in adoption of ESG principles," Chakraborti said.

> Third-party consultants are offering ESG scores, but a lack of standardization has lent little credence to such scores

The Sebi paper may also seek to understand how firms are implementing recommendations of a task force on climate-related financial disclosures (TCFD). The recommendations, which were issued last year, provide firms with a broad-based framework on systematically reporting the impact of climate risks and opportunities, making it easier for investors to analyze a company's potential financial impact due to climate change.

The other major issue that the paper would seek to tackle is a conflict of interest. Rating agencies under prevailing norms cannot offer non-rating-related services that are based on financial metrics. This regulatory gap has resulted in rating agencies either offering ESG as an advisory service or setting up different rating firms such as one by Acute Ratings called ESG Risk AI.

In some cases, certain third-party advisory services, spawned due to regulatory gaps, provide both the scores and advice on improving ESG scores.

"Many agencies are providing grading of ESG scores as part of their research and consultancy businesses as presently non-ratings related services are not allowed to be offered by credit rating agencies. So, clarity on that front should be welcome. In the longer term, ESG analysis may become inseparable from the detailed financial and non-financial analytics done to assess ratings," said Ajay Mahajan, CEO, Care Ratings.

The third major area the ESG ratings paper will tackle is disclosure from asset management companies (AMCs) on how they use ESG disclosures and ratings to make investment decisions. In the past year, AMCs have launched seven ESG funds, with their assets under management crossing ₹12,500 crore as of December 2021.

"As the ones who use ESG ratings, their disclosures will be equally important," the first person said.

The whole idea behind standardization is to avoid the so-called 'greenwashing, the person added. Greenwashing is the process of conveying a false impression about how a company and its products are environmentally sound.