Consultation paper on introducing disclosure norms for ESG Mutual Fund schemes

1. Introduction

With the increased interest and focus on investments in the Environment Sustainability and Governance (ESG) space globally, Asset Management Companies (AMCs) in India have also been launching equity schemes in the ESG space under thematic category. The AMCs are also launching Exchange Traded Funds (ETFs) and ETF Fund of Funds in India in ESG space.

Globally, the concept of ESG investments is still emerging and there are no universally agreed norms and standards. Standard setting bodies like IOSCO, FSB etc. are working in this area including development of standardised disclosures for funds in the ESG space.

IOSCO had published a Consultation Report for public comments on Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management in June 2021. The recommendations relate to improvement of practices, policies, procedures and disclosures by encouraging asset managers to take sustainability related risks and opportunities into account in their investment decision-making and risk management processes.

While such standards are yet to emerge, in the meanwhile, there is a need to introduce disclosure norms for domestic ESG Mutual Fund schemes considering the increased activity in this area.

It is understood that these disclosure norms would further evolve and undergo changes based on learnings and experience, both on the domestic and international front.

2. ESG Schemes launched in India and its AUM:

As on September 30, 2021, there are eight ESG Thematic equity schemes with an AUM of INR 12,085 Crores. There is one ESG ETF and one ESG ETF Fund of Fund with AUM of INR 174 Crores and 144 Crores respectively as on September 30, 2021.

3. Disclosures for ESG Schemes

While all Mutual Fund schemes are subject to disclosure norms, disclosures assume further significance for ESG schemes, in order for them to be true to label which should reflect consistently in its name, stated objectives, its documented investment policy and strategy and its investments.

(A) Disclosures in Scheme Information Documents (SIDs)

The following disclosures are proposed to be mandated for disclosure in the SIDs for Mutual Funds which launch ESG schemes. Mutual Funds which already have ESG schemes in existence are required to update their SIDs with the abovementioned disclosures:

(i) **Name of the scheme:** The name of the scheme should accurately reflect the nature and extent of the scheme's ESG focus taking into account investment objective and type of strategy followed. All AMCs will be required to have a Responsible Investment Policy incorporating aspects of ESG investing. The investment objective shall be as per the Responsible Investment Policy of the AMC.

(ii) **Investment objectives:** It shall provide transparency about the nature and extent of the scheme's ESG related investment objectives. Detailed objectives of the scheme need to be laid down stating how it aims to achieve this objective through its investment policy and strategy including the approach used for screening companies.

(iii) **Investment Policy:** The investment policy of AMCs should encompass processes to review the investments during a certain period and the strategy pursued. The strategy should include the broad universe of the companies in which they intend to invest. The investments should be designed to generate a beneficial ESG/sustainability impact alongside a financial return and the AMC should clearly state the intended 'real world' outcome in qualitative terms, especially for strategies related to Integration, Impact Investing and Sustainable Objectives.

Responsible Investment Policy of AMCs should be revised to contain a clause that from October 1, 2022, AMCs shall only invest in securities which have Business Responsibility and Sustainability Report (BRSR) disclosures. The existing investments in the schemes for which there are no BRSR disclosures would be grandfathered by SEBI for a period of one year i.e., till September 30, 2023. Schemes which invest in overseas securities would choose any global equivalent of the BRSR which will be specified by Association of Mutual Funds in India (AMFI).

(iv) **Investment Strategy:** The AMC shall disclose the type of strategy followed by scheme, with regards to sustainability / ESG characteristics which merit the nomenclature of an ESG fund. The following are some examples of ESG strategies:

a) **Exclusions:** Exclude securities based on certain ESG related activities, business practices, or business segments. The strategy should specify
   i. the characteristic / type of exclusion (Adverse impact, Controversy, Faith)
   ii. threshold or condition for exclusion, and
   iii. reference, where applicable, to any law/ regulation/ third-party standard/ guideline/ framework used in the establishment or evaluation of the criterion.

b) **Integration:** Explicitly consider ESG related factors that are material to the risk and return of the investment, alongside traditional financial factors, when making investment decisions.

c) **Best-in-class & Positive Screening:** Aim to invest in companies and issuers that perform better than peers on one or more performance metrics related to ESG matters. The details/specifics of the metrics should be disclosed.

d) **Impact investing:** Seeks to generate a positive, measurable social or environmental impact alongside a financial return and how the Fund Manager intends to achieve the impact objective. Provide methodology used to assess the effect that investments have, or may have, on environmental or social or governance issues. Describe the process for identifying and avoiding, mitigating, or managing adverse effects that the scheme or underlying companies' activities have, or may have, on environmental or social issues. The fund should seek a non-financial (real world) impact and evaluate if that impact is being measured and monitored.

e) **Sustainable objectives:** Aim to invest in sectors, industries, or companies that are expected to benefit from long-term macro or structural ESG-related trends. Describe the focussed objective including rationale for focussing on that objective.

f) Any other clearly defined ESG investment strategy

g) Any combination of above.

h) **Decision-making process for Investing:** Decision-making process for investing should include disclosure on use of proprietary or third party ESG Scoring Process / Methodology. The disclosure should broadly indicate the above including the due diligence on any data, research and analytical resources it relies upon when using proprietary methodology to be confident that it can validate the ESG/sustainability claims that it makes.

(v) **Disclosure of material risks:** Disclosure of unique risks that arise from a scheme's focus on sustainability. Disclosure of measures taken to mitigate risks related to green washing and risk of reliance on third party scores, if any, given the dispersion in scores across providers.

(vi) **Asset Allocation**: As per extant regulations these schemes fall under thematic sub-category and so a minimum of 80% of total assets of the scheme shall be invested in securities following ESG theme. Hence, these guidelines would apply only to the portion of investment towards ESG theme. However, it is proposed that the residual portion of the investment should not be starkly in contrast to the philosophy of the scheme from the theme. AMC shall endeavour to have a higher proportion of the assets under the ESG theme and make suitable disclosures.

(vii) **Benchmark:** The benchmark should be continuously aligned with each of the environmental, governance and social characteristics followed by the scheme. The website of the respective Mutual Fund should also provide a link to the index methodology.

(viii) **Disclaimer:** Apart from the above, AMCs can provide suitable disclaimers, if any, for aspects related to the above disclosures in the SIDs.

(B) Additional Disclosures with respect to engagements undertaken by AMCs for ESG Schemes:

In addition to the above disclosures in the SID, AMCs are also required to undertake the following:

(i) **Monitor and evaluate:** AMCs should monitor and evaluate the investments in terms of Key Performance Indicators, real world outcomes, active engagement and stewardship activities with investee companies. In case of Impact Investing and Sustainable Objective investment strategy, Mutual Funds should assess, measure and monitor: (a) the sustainability-related product's compliance with its investment objectives and/or characteristics; (b) the sustainability impact of its portfolio to the extent applicable to the portfolio's stated design; and (c) its sustainability-related performance. The sustainability impact of a product's portfolio refers to the effect of the product's portfolio holdings on environmental, social and governance issues. ESG Funds to disclose on ESG engagement and stewardship activities on material/relevant ESG issues at the completion of every financial year.

(ii) **Stewardship and shareholder engagement disclosure**: Stewardship policy reflecting that the exercise of voting rights is in accordance with the objectives of the scheme. Disclosures about policy on stewardship and shareholder engagement and past stewardship and shareholder engagement records.

(iii) **Periodic Portfolio Disclosures**: AMCs shall disclose the following in simple and comprehensible language:

a) The contribution to 'positive environmental change', an investor might reasonably expect
b) The various ESG engagement and stewardship activities carried out during the financial year.
c) Link to BRSR disclosure for each security in the portfolio or global equivalent in case of overseas securities, wherever available.
d) Periodic reporting relating to whether a sustainability-related product is meeting its sustainability-related investment objectives or characteristics, including the product's sustainability-related performance and holdings, during the applicable time period.

(iv) **Maintenance of ESG policy related to investments:** AMCs should disclose on their website the following information covering various aspects of ESG investing such as:

a) Source of ESG information of underlying investments
b) Investment process and philosophy
c) Key ESG factors to be considered in decision making
d) Due Diligence methodology and its limitations
e) Engagement policies including stewardship
f) Monitoring of investments and evaluation.

4. General Obligations:

(i) The Board of the AMC should submit a declaration to the Trustees of Mutual Fund that the scheme is following its disclosed strategy and is in compliance with its Responsible Investment Policies on quarterly basis.

(ii) AMCs need to augment its resources and processes to take into account the ESG philosophy as a theme for launch and management of schemes in this space.

(iii) AMCs should ensure that the Marketing materials and website disclosures are fair, balanced and consistent with their regulatory filings.

(iv) As there is significant divergence in the terms and definitions related to ESG, AMFI should encourage industry participants to develop common sustainable finance-related terms and definitions in line with global standards. AMFI should also promote financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability related financial and investor education initiatives.

(v) As there is considerable activity in terms of development of global standards by various standard setting bodies, it is expected that going forward, the above disclosure norms are subject to change, based on the experience gained and based on emergence of appropriate standards and norms.

5. Public Comments

In order to take into consideration the views of various stakeholders, public comments are invited on the proposed disclosures for ESG schemes and following aspects of this consultation paper:

a) Whether SEBI should mandate the proposed disclosures for ESG schemes?

b) Whether the proposed disclosures are adequate or any additional disclosures should be mandated?

c) Whether Responsible Investment Policy of AMCs should be revised to contain a clause that from October 01, 2022, AMCs shall only invest in securities which have Business Responsibility and Sustainability Report (BRSR) disclosures?

d) Whether the existing investments in the schemes for which there are no BRSR disclosures should be grandfathered by SEBI for a period of one year i.e., till September 30, 2023?

e) Whether the general obligations mentioned para 4 above cast on AMCs/AMFI for ESG schemes be mandated?

f) Whether the same set of disclosures can be mandated for ESG schemes under debt category whenever allowed? Whether any additional set of disclosures required for debt ESG schemes?

The public comments may be sent to SEBI in the following format:

Name of the person/entity proposing comments: **Name of the organization (if applicable):** **Contact details:**			
Sr. No.	**Para of consultation paper**	**Suggestions/ Comments**	**Rationale**

In case of any other issues not dealt in the consultation paper may be provided in the following table:

Name of the person/entity proposing comments: **Name of the organization (if applicable):** **Contact details:**			
Sr. No.	**Other issues**	**Suggestions/ Comments**	**Rationale**

Kindly mention the subject of the communication as "**Comments on Disclosures for ESG Schemes**"

[Note: The respondent may specify whether they are market intermediary/ participant (mention type/ category) or public (investor, academician etc.)]

Comments in aforesaid format may be sent to the following, latest by November 16, 2021:

a. By email: to esgdisclosures@sebi.gov.in and/ or Shri B Krishna Rao, Assistant General Manager (krishnarb@sebi.gov.in)

b. By post: to the following address-
Shri Bithin Mahanta,
General Manager,
Investment Management Department – II (Division of Funds – III)
Securities and Exchange Board of India,
SEBI Bhavan, C4-A, G-Block,
Bandra Kurla Complex,
Bandra (East), Mumbai 400051

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