Special Situation Funds (SSFS) for Resolution of Stressed Assets | Prior Shareholders' Approval Required for Appointment of Rejected Candidates | SEBI Seeks to Regulate ESG Rating Providers (ERPS)

SEBI has recently introduced the following significant changes:

A. **SEBI introduces Special Situation Funds (SSFs) for investment in stressed assets:** In order to address the growing concerns of stressed assets, SEBI has introduced a new category of Category I Alternative Investment Fund (**AIF**), which will invest only in 'special situation assets' as per the terms and conditions prescribed by SEBI. There are various regulatory norms introduced for SSFs, which are analyzed separately. In addition to changes focused on SSFs, SEBI has exempted large value funds for accredited investors from the requirement of filing private placement memorandums (**PPMs**) through merchant banker at least 30 days prior to launch of schemes.

B. **Amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015:** Key changes include the following-

- Prior approval of shareholders required for appointment/ re-appointment of directors / manager who failed to earlier get elected as directors/manager by the shareholders at a general meeting;
- To enhance ease of dealing in securities markets by investors, it has been decided that listed companies shall henceforth issue the securities in dematerialized form while processing certain service requests.

C. **SEBI seeks to regulate ESG Rating Providers (ERPs)**: In an important move, SEBI is seeking to bring ERPs within its ambit to ensure transparency and balance the needs of all stakeholders. With the growing importance of ESG globally, SEBI feels it is imperative to have a regulated environment of ERPs, which is currently unregulated. This will have a direct bearing on anyone looking to procure an ESG rating, including listed companies, AIFs, mutual funds, etc. Following proposals are recommended and public views are sought on the same:

- Accreditation of ERPs to assign ESG ratings to listed entities and listed securities and anyone who wish to avail ESG ratings;
- Accreditation criteria for eligible entities such as Credit Rating Agencies and Research Analysts;
- Transparency requirements and disclosures required to be made by ERPs;
- Governance structures of ERPs and prevention of conflict of interest;
- Proposed business model for ERPs in India.

The above changes have been analyzed below:

Introduction of Special Situation Funds (SSFs)

SEBI has introduced the following amendments to the SEBI (Alternative Investment Funds) Regulations, 2012 (**AIF Regulations**):

Amendment	Analysis / Explanation
Introduction of SSFs as a sub-category under Category I AIFs	SSFs have been approved as a sub-category under Category I AIF, which will invest only in 'special situation assets' and may act as a resolution applicant under the Insolvency and Bankruptcy Code, 2016 (**IBC**). This will allow SSFs to participate in the resolution process contemplated under IBC.
Permitted investments by SSFs | Meaning of 'special situation assets'	In order to drive focus of SSFs towards stressed assets, it has been specified that SSFs will invest only in special situation assets. Such assets include: ▪ Stressed loans available for acquisition in terms of Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 or as part of a resolution plan

Amendment	Analysis / Explanation
	approved under IBC; ▪ Security receipts issued by Asset Reconstruction Companies (**ARC**); ▪ Securities of investee companies (i) whose stressed loans available for acquisition in terms of Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 or as part of a resolution plan approved under IBC; (ii) against whose borrowings, security receipts have been issued by an ARC; (iii) whose borrowings are subject to corporate insolvency resolution process under Chapter II of IBC; (iv) who have disclosed all the defaults relating to the payment of interest/ repayment of principal amount on loans from banks / financial institutions; ▪ Any other asset/security as may be prescribed by SEBI from time to time.
Other features of SSF regulatory framework	▪ ***Minimum Corpus***: Minimum corpus of the schemes launched by SSFs to be as specified by SEBI; ▪ ***Diversification norms***: Diversification norms applicable to Category-I AIF will not apply to SSFs, unless specified otherwise. ▪ ***Minimum Investment***: Minimum investment by an investor to be such as may be specified by SEBI; ▪ ***Restriction on investment***: SSFs have been restricted from investing in (i) its associates, or (ii) units of any other AIF other than the units of an SSF, or (iii) units of SSFs managed or sponsored by its manager, sponsor or associates of its manager or sponsor; ▪ ***Lock-in period***: Any investment by an SSF in the stressed loan acquired under Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 shall be subject to lock-in period as may be specified by SEBI.

Exemption to large value fund for accredited investors

In addition to changes focussed on SSFs, SEBI has exempted large value fund for accredited investors from the requirement of filing private placement memorandums (**PPMs**) through merchant banker at least 30 days prior to launch of schemes and incorporation of changes.

The aforesaid amendments have been made vide the SEBI (Alternative Investment Funds) (Amendment) Regulations, 2022 dated January 24, 2022 (available here).

Amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI has introduced the following amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**LODR Regulations**):

Amendment	Analysis / Explanation
Prior approval of shareholders required for appointment/ re-appointment of persons failing to get elected as directors/managers	▪ SEBI had recently amended LODR Regulations to provide that a listed entity shall ensure that approval of shareholders for appointment of a person on the Board of Directors is taken at the next general meeting or within three months from the date of appointment, whichever is earlier. SEBI has now made this provision applicable to a manager also. ▪ Additionally, SEBI has made the norms stringent for appointment or re-appointment of persons (including as a managing director or a whole-time director or a manager) who was earlier rejected by the shareholders at a

Amendment	Analysis / Explanation
	general meeting. Such appointment/ re-appointment will be done only with the prior approval of the shareholders. ▪ It has also been provided that statement attached to the notice for considering such appointment/re-appointment of such a person earlier rejected by the shareholders shall contain a detailed explanation and justification by the Nomination and Remuneration Committee (NRC) and the Board of directors for recommending such a person for appointment or re-appointment.
Utilization of proceeds of public or rights issue	▪ Where the listed entity has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, the monitoring report of such agency shall now be required to be placed before the audit committee on quarterly basis (as against annual basis provided earlier), promptly upon its receipt.
Issue of securities in dematerialized form in compliance with investor requests	▪ To enhance ease of dealing in securities markets by investors, it has been decided that listed companies shall henceforth issue the securities in dematerialized form while processing the following service requests: – issue of duplicate securities certificate; – claim from Unclaimed Suspense Account; – renewal / Exchange of securities certificate; – endorsement; – sub-division / Splitting of securities certificate; – consolidation of securities certificates/folios; – transmission; – transposition; ▪ It has been clarified that requests for effecting transfer of securities would not be processed unless the securities are held in the demat form with a depository and that transmission or transposition of securities held in physical or demat form shall be effected only in demat form. ▪ SEBI has issued detailed process that needs to be followed for fulfilling such requests.

This amendment has been made vide the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2022 dated January 24, 2022 (available here), and SEBI circular dated January 25, 2022 on Issuance of Securities in dematerialized form in case of Investor Service Requests (available here).

SEBI seeks to regulate ESG Rating Providers (ERPs)

In light of the revised set of sustainability and social related reporting requirements issued by SEBI vide circular dated May 10, 2021 (available here) and the increasing demand from the investors on evaluation and rating of ESG (Environment, Social and Governance) related parameters, SEBI has issued a consultation paper (**Consultation Paper**) on ESG rating providers (**ERPs**) for securities market.

Certain issues have been observed with the current ESG ratings and other related products ecosystem including ambiguity about the wide range of products offered, inconsistency in disclosures and transparency of the methodology and rating process, unregulated nature of market and potential conflict of interests, greenwashing, rating shopping and lack of India-specific ERPs.

With a view to bridge these gaps and regulate the ERPs and ESG rating system in India, the Consultation Paper makes the following recommendations:

Proposal	Details of the Proposal	Views sought
Accreditation of ERPs for the purpose of assigning ESG ratings	▪ ***Listed entities***: A listed entity who intends to avail an ESG rating, shall obtain the same from only a SEBI Accredited ERP. ▪ ***Entities other than top 1000 listed entities (by market capitalisation)***: If such entities wish to avail services of SEBI accredited ERPs, such ERPs shall provide ESG Rating, subject to such entities making public disclosures in line with those prescribed in BRSR on mandatory basis, and it shall be required to continue making such disclosures to avoid information asymmetry. ▪ ***SEBI-registered entities engaged in fund-based investment activities***: SEBI-registered entities engaged in fund-based investment activities such as mutual funds or AIFs, desirous of using third-party ESG ratings as part of their decision-making process for investing in Indian securities, shall avail services of SEBI accredited ERPs. Further, any passive funds launched by these entities shall be based on ESG related indices which use ratings of SEBI-accredited ERPs only. ▪ ***Preparation of indices on Indian securities:*** To ensure uniformity, where an index-provider uses ESG ratings for formulation of index/indices on Indian securities, it shall use services of only SEBI-accredited ERPs for formulation of such index.	a) Whether there is a need to regulate/ accredit ERPs in securities market? b) If ESG ratings are to be regulated, is the regulatory scope mentioned in the Consultation Paper adequate? If not, requisite modifications to be suggested.
Entities that will be eligible to be accredited as ERPs	▪ ***Credit Rating Agencies (CRAs):*** Globally, CRAs in various countries have been providing ESG ratings. CRAs follow a well-defined process that ensures committee-based transparent evaluation, making them appropriate entities to be accredited as ERPs. ▪ ***Research Analysts (RAs)***: Existing ERPs provide ESG ratings based on publicly available disclosures, like filings, annual reports, sustainability reports etc. The assignment of ERP rating is also an intensive data analysis (quantitative) exercise which is in line with the current activity carried out by Research Analyst(s), albeit on varying scales. It is felt that ERPs provide analytical or evaluative services which are akin to the services provided by RAs. In view of above, SEBI-registered Credit Rating Agencies and SEBI-registered Research Analysts are proposed to be considered eligible to be accredited by SEBI as ERPs, subject to fulfilment of accreditation criteria.	a) Should only CRAs and RAs be considered to accredit as ERPs? b) Could any additional category of entities be specified as an entity eligible for accreditation as ERPs along with rationale for the same?
Accreditation Criteria	Given that investing entity would be relying on ERPs to make investment decisions, and to ensure continuity and provide reassurance to investors that the entity is fully equipped to meet the requirements of growth in operations, it is felt that ERPs need to be adequately capitalized in addition to other infrastructure requirements: ▪ ***Net worth***: CRAs/RAs with a minimum net worth of INR 10 crores, as per the latest audited financial statements, may be eligible to apply to be a SEBI accredited ERP. This net worth requirement would be in addition to the applicable minimum net worth	a) Whether the accreditation criteria, including net worth, are appropriate? b) Whether any additional conditions/ requirements need to be specified, if any?

Proposal	Details of the Proposal	Views sought
	requirement for the entity as CRA/RA. ▪ ***Infrastructure***: An ERP to have adequate infrastructure to undertake necessary due diligence for assigning ESG ratings to listed entities in accordance with the applicable laws. This shall include, but not be limited to, appropriate database collection and management systems, and analysis/ filtering tools (either inhouse or outsourced). ▪ ***Manpower***: Since ESG Rating is a knowledge and technical know-how driven exercise, certain minimum standards would be required to be specified in relation to manpower employed by ERPs, especially employees performing "core" functions which would be crucial to manage ERPs and carry out its operations in an appropriate manner. Therefore, it is proposed that ERPs shall have at least one specialist each in the following areas on a continuous basis: (a) data analytics (b) sustainability (c) finance (d) information technology (e) law ▪ ***"Fit and Proper" criteria***: The applicant should be a 'fit and proper person' as stated in Schedule II of SEBI (Intermediaries) Regulations, 2008. ▪ ***Review by SEBI:*** The accreditation shall be granted subject to review by SEBI every 2 years. However, the accreditation may be revoked at any time in case of material non-compliances by ERPs or in case of non-maintenance of the minimum net worth.	
ESG Ratings to fall under the proposed SEBI accreditation framework	Currently, the most common type of ESG Ratings and related research products currently provided by the ERPs are as follows: ▪ ***ESG "Risk" Ratings***: It is an assessment of a company's resilience to ESG related risks. This product assesses impact of social or environmental issues on the company's enterprise value. ▪ ***ESG "Impact" Ratings***: It is an assessment of the positive and negative impact of companies on the environment and society, along with an assessment of their corporate governance profiles. Such ratings would, therefore, incorporate factors such as greenhouse gas emissions by a company, or its corporate social responsibilities measures, etc. irrespective of the fact whether such factors have any impact on the company's enterprise value or not. ▪ ***Other ratings/benchmarking related products***: Apart from products which cover the entire environmental, social and governance aspects of a company, ERPs also provide a wide range of products focusing on individual components or key issues, for example, carbon risk rating, ESG disclosure ratings, corporate transition risk scores etc. ▪ ***Research related products***: Apart from different types of ESG	Whether the proposal on classification of ESG ratings and other related products is appropriate?

Proposal	Details of the Proposal	Views sought
	ratings, ERPs also provide research related products which may not necessarily include ranking or benchmarking but provide useful information on the ESG aspects of companies, industry etc, like screening tools, controversy alerts, ESG Index solutions, corporate governance research tools etc. **<u>Proposal</u>:** As there is a need to ensure clear and consistent use of terminology in ESG ratings, it is proposed that ERPs intending to get accredited with SEBI shall offer at least one of the following ratings products: a) ESG Impact Ratings b) ESG Corporate Risk Ratings or ESG Financial Risk Ratings c) Any other ESG related rating products, which may be appropriately labelled.	
Standardization of Symbols and Scales for ESG Ratings	Given the variety of products that may be offered under the umbrella of ESG ratings, it may be challenging, at this stage, to formulate a standardized rating scale for a market that is so varied, dynamic and evolving. However, the ERP shall prominently disclose on its website and in the ESG rating reports, the rating scale (symbols and their definitions) used by the ERP. Additionally, an ERP shall ensure consistency in the application of its ESG rating scale, and also ensure that there is a clear distinction between the CRA/RA's ESG ratings and its other ratings.	Whether the proposal on not having standardized ESG rating scales (i.e., standardized symbols and their definitions) initially is appropriate?
Transparency-Disclosures to be made by ERPs	▪ ***Disclosures on website***: Disclosure of ESG rating reports with the type of ESG rating product (whether impact-based, or risk-based, or otherwise) and the rating methodologies to be displayed on its website. ▪ ***Components of the ESG rating methodology***: ESG rating methodology of an ERP to include whether and how it defines the individual components, Environmental, Social, Governance of "ESG", including the specific issues being assessed, the Key Performance Indicators (KPIs) used weightage of each KPI and how to deal with incomplete and unreliable data inputs. ▪ ***Annual publication of evaluation of ESG rating methodologies***: Evaluation of their ESG-rating methodologies against the outputs which they have been used to produce to be published on an annual basis. ▪ ***Disclosure of data relied upon by the ERP***: The data and information sources that the ERP relies on, such as BRSR, to be publicly disclosed, including the use of industry averages, estimations or other methodologies when actual data is not available or not publicly disclosed. ▪ ***ESG rating report available on subscription bas***is: A detailed ESG-rating report may be made available on a subscription-basis, which shall have detailed analysis of rating arrived at, specific KPIs used methodology applied for the rating and shall provide a reference/ hyperlink to the methodology placed on website.	a) Whether the proposed norms relating to transparency, governance and conflict-of-interest issues in the ESG rating process are appropriate? b) Whether ERPs should be free to assign ESG ratings on a sector specific or sector-agnostic basis, subject to adequate disclosures on the same?

Proposal	Details of the Proposal	Views sought
	▪ ***Comparison of ESG ratings***: An ESG rating may be provided at a sector-agnostic level, to facilitate comparison of ESG ratings of one company from other companies within the same industry as well as companies operating in other industries.	
ESG Rating Process	▪ ***Consistency***: ERP to follow a proper rating process and ensure consistency in application of its methodology for the same product (as publicly disclosed) across ESG ratings assigned by it. ▪ ***Objectivity and independent***: ERP to exercise due diligence at all times, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process. ▪ ***Professional rating committees***: Every ERP to have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating. All ESG rating decisions, including the decisions regarding changes in rating, to be taken by the rating committee. ▪ ***Continuous surveillance***: An ESG rating shall be subject to continuous surveillance by an ERP (except if it is a one-time rating) and shall be promptly reviewed after any ESG-material event, such as any controversy or publication of the BRSR. ▪ ***Written policies and procedures***: ERP to have written policies, procedures and/or internal controls designed to ensure the processes and methodologies are rigorous, systematic, and applied consistently. Further, rating methodologies to be reviewed and updated periodically. ▪ ***Operations Manual***: ERP to formulate an Operations Manual/ Internal governing document, which shall inter-alia, cover operating guidelines, criteria, policies and procedures related to the ESG rating process. The following shall be specified: (a) Detailed ESG rating process (b) Basic Minimum information required for conducting the Rating Exercise (c) Questionnaires / Communication with the rated entity (d) Policy regarding internal approvals and timelines at each step of the Rating Exercise (e) Policy regarding monitoring and review of ratings, including the timelines within which such review is to be completed	
Governance structures of ERPs and prevention of conflict of Interest	▪ ***Detailed policy on managing of conflict of interest***: Each ERP to formulate detailed policy on managing conflict of interest. Such policy to be prominently disclosed on its website. ▪ ***Identification and disclosure of conflict of interest***: An ERP shall identify, disclose and, to the extent possible, mitigate potential conflict of interest that may arise between ESG rating offering and other relationship with the covered entities such as ESG consulting etc. ▪ ***Elimination of conflict of interest***: An ERP shall structure reporting lines for their staff and their compensation	

Proposal	Details of the Proposal	Views sought
	arrangements to eliminate or appropriately manage actual and potential conflicts of interest related to their ESG ratings. ▪ ERP not to provide ESG ratings to its related entities or securities issued by them or the ERP. ▪ ***Corporate structure***: The corporate governance organisational and operational structures of the ERP shall be sufficient to identify, manage and mitigate any potential conflicts of interest. ▪ ***Business relationships not to affect ESG ratings***: An ERP shall take steps to help ensure the ESG ratings would not be affected by the existence of or potential for a business relationship between the ERP (or their affiliates) and any entity or any other party for which it provides ESG ratings. ▪ ***Disclosure of conflicts of interest by analysts***: The analysts involved in ESG rating assessments shall disclose any conflicts of interest involving a company / issuer to the ERP and shall not be allowed to rate such companies.	
Business Model	***Current business model***: The existing business model is 'subscriber pay' since there is no regulatory mandate to avail ESG ratings. Globally as well, it is seen that 'subscriber-pay' is the predominant business model followed by most ERPs. ***Advantage of the 'subscriber pay' model***: This model may also ensure greater responsiveness to investor concerns and furtherance of investor protection agenda. An investor paying for a specific rating could demand customised analysis, attuned to their goals/organizational requirements, from the ERP. However, it may also put smaller investors at a disadvantage, as their ability to subscribe to multiple product packages will likely be constrained by financial cost. ***Proposal***: It is proposed that ERPs may be mandated to follow a 'subscriber-pay' business model. It may be noted that while investors may be the primary source of revenue in a 'subscriber-pay' model, a subscriber may include an issuer as well.	Whether the recommendation that the payment mode should be subscriber pay in the current Indian context is agreeable?

The aforementioned proposals are made vide the Consultation Paper dated January 24, 2022 (available here). Public comments can be submitted till **March 10, 2022**.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

Manendra Singh, Associate Partner – Email – manendrasingh@elp-in.com

Tanvi Goyal, Principal Associate – Email – tanvigoyal@elp-in.com

Aditi Ladha, Associate – Email – aditiladha@elp-in.com

Ambareen Khatri, Advocate – Email – ambareenkhatri@elp-in.com