**CDSL/OPS/RTA/POLCY/2023/136** **July 21, 2023**

## SEBI – NEW CATEGORY OF MUTUAL FUND SCHEMES FOR ESG

Issuer / RTAs are advised to refer to the SEBI Circular viz. **SEBI/HO/IMD/IMD-I – PoD1/P/CIR/2023/125** dated **July 20, 2023,** regarding **New category of Mutual Fund schemes for Environmental, Social and Governance ("ESG") Investing and related disclosures by Mutual Funds [refer Annexure].**

Issuer / RTAs are advised to take note of the same.

Queries regarding this communiqué may be addressed to: **CDSL – Helpdesk** Emails may be sent to: helpdesk@cdslindia.com and telephone number 08069144800.

**sd/-**

**Nilesh Shah**
**Asst. Vice President – Operations**

भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

**CIRCULAR**

**SEBI/HO/IMD/IMD-I –PoD1/P/CIR/2023/125** **July 20, 2023**

**To**

**All Mutual Funds**
**All Asset Management Companies('AMCs')**
**All Trustee Companies/Boards of Trustees of Mutual Funds**
**All Registrar to an Issue and Share Transfer Agents('RTAs')**
**Association of Mutual Funds in India('AMFI')**

**Sir/Madam,**

**Subject: New category of Mutual Fund schemes for Environmental, Social and Governance ("ESG") Investing and related disclosures by Mutual Funds.**

1. Under the extant regulatory requirements, Mutual Funds are permitted to launch only one scheme with ESG investing under the thematic category for Equity schemes. In view of the industry representations for allowing multiple schemes with different ESG strategies and considering the increasing need for green financing, it has been decided to permit launch of multiple ESG schemes with different strategies by Mutual Funds.

2. The concept of ESG investments is emerging and therefore consistent, comparable, and decision-useful scheme disclosures is desirable to enable investors to make informed investment decision and to prevent greenwashing. In this regard, SEBI, vide letters dated February 08, 2022 and June 21, 2022 to AMFI, had prescribed disclosure norms for ESG schemes of Mutual Funds, as available under the 'Policy related letters/Emails issued by SEBI' in the Master Circular on Mutual Funds No. SEBI/HO/IMD/IMD-PoD-1/P/CIR/2023/74 dated May 19, 2023.

3. In order to suggest further measures to improve transparency, with a particular focus on mitigation of risks of mis-selling and greenwashing, an ESG Advisory Committee was set up by SEBI which provided recommendations for expanding the disclosure norms for ESG funds. Considering the recommendations of the ESG Advisory Committee and pursuant to public consultation on the matter, the provisions of the SEBI (Mutual Funds) Regulations, 1996 were amended on

June 27, 2023 (link) to *inter-alia* specify that the funds under ESG schemes shall be invested in the manner as specified by SEBI from time to time.

4. Accordingly, it has been decided to implement the following measures to facilitate green financing with thrust on enhanced disclosures and mitigation of green washing risk.

### 4.1. Thematic schemes on ESG Strategies

4.1.1. As Mutual Funds can presently launch only one ESG scheme under the thematic category of Equity schemes, in partial modification of clause 2.6.1(A)(9) of the SEBI Master Circular No. SEBI/HO/IMD/IMD-PoD-1/P/CIR/2023/74 dated May 19, 2023 on Mutual Funds, it is decided to introduce a separate sub-category for ESG investments under the thematic category of Equity schemes. Any scheme under the ESG category shall be launched with one of the following strategies (details of strategies are at Annexure A) -

a. Exclusion
b. Integration
c. Best-in-class & Positive Screening
d. Impact investing
e. Sustainable objectives
f. Transition or transition related investments

4.1.2. Minimum 80% of the total assets under management (AUM) of ESG schemes shall be invested in equity & equity related instruments of that particular strategy of the scheme (as per the above specified sub-strategies). The remaining portion of the investment shall not be in contrast to the strategy of the scheme. Mutual Funds shall endeavour to deploy a higher proportion of the assets towards the scheme's strategy under the ESG theme and make suitable disclosures.

4.1.3. AMCs shall ensure that the schemes launched by Mutual Funds are clearly distinct in terms of asset allocation, investment strategy etc.

4.1.4. The provision of new category for ESG schemes shall be applicable with immediate effect.

### 4.2. Investment criteria for ESG Schemes

4.2.1. Presently, the ESG schemes of Mutual Funds are mandated to invest only in such companies which have comprehensive Business Responsibility and Sustainability Reporting (BRSR) disclosures. It is decided that an ESG scheme shall invest at least 65% of its AUM in companies which are reporting on comprehensive BRSR and are also

providing assurance on BRSR Core disclosures (details on BRSR Core disclosures are as specified vide SEBI circular No. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 dated July 12, 2023). The balance AUM of the scheme can be invested in companies having BRSR disclosures. This requirement shall be applicable with effect from October 01, 2024.

4.2.2. Such ESG schemes which are not in compliance with the aforesaid investment criteria as on October 01, 2024, shall ensure compliance with the requirement by September 30, 2025. During the said period of one year, ESG schemes shall not undertake any fresh investments in companies without assurance on BRSR Core.

## 4.3. Disclosure requirements for ESG Schemes

4.3.1. **Scheme strategy to be reflected in scheme name**

Mutual Funds shall clearly disclose the name of ESG strategy in the name of the concerned ESG fund/scheme. For eg., XYZ ESG Exclusionary Strategy Fund, ABC ESG Best-in-class Strategy Fund etc.

4.3.2. **ESG scores of securities**

4.3.2.1. Mutual Funds shall disclose the following in their monthly portfolio statements of ESG schemes:

a) Security wise BRSR Core scores {as and when the same is made available by SEBI registered ESG Rating Provider (ERPs)}, along with the BRSR scores.

b) Name of the ERPs providing ESG scores for the ESG schemes, along with the ESG scores. In case there is a change in ERP, the reason for such change shall also be disclosed in the next monthly portfolio statements of ESG schemes.

4.3.2.2. These requirements shall be applicable with immediate effect.

4.3.3. **Voting disclosures by ESG schemes**

4.3.3.1. Clauses 6.16.10 and 6.16.11 of the SEBI Master Circular on Mutual Funds dated May 19, 2023 requires the Mutual Funds to compulsory cast votes in respect of all resolutions of their investee companies. Further, the AMCs are required to make disclosures of votes cast on their website on a quarterly basis, along-with the specific rationale supporting their voting decision.

4.3.3.2. In addition to the above, in order to enhance transparency on votes cast by ESG schemes, it is decided that under the rationale for voting decisions (whether" in favour" or "against"), the AMCs shall categorically disclose whether the resolution has or has not been supported due to any environmental, social or governance reasons.

4.3.3.3. The disclosure of voting rationale may be made at the Mutual Fund level. However, in instances wherein the voting approach for ESG and non-ESG schemes of any Mutual Fund is not same, the details and rationale for votes cast on behalf of ESG schemes and non-ESG schemes shall be disclosed separately.

4.3.3.4. The enhanced voting disclosures shall be applicable from FY 2024-25 i.e. for Annual General Meetings held from April 01, 2024 onwards.

4.3.4. **Annual Fund Manager commentary and disclosure of case studies**

4.3.4.1. A 'Fund Manager Commentary' along with the additional disclosures with respect to engagements undertaken by Mutual Funds for ESG schemes, as required to be disclosed in terms of SEBI letter dated February 08, 2022, shall be provided in the Annual Report of the ESG schemes. The Fund Managers Commentary shall include the following:

a) Examples on how ESG strategy was applied on the fund, how engagements were carried out, any escalation strategy that the Fund Manager may have applied on the portfolio companies, annual tracking of ESG rating movements in the investee companies etc.

b) Case studies where Fund Managers have engaged with portfolio companies with a clear objective of engagement and engagements carried out for exercise of votes.

c) The details on number of engagements carried out in a year, the modes of communication employed, and if any outcomes were achieved in the reporting year shall be included in the fund managers' commentary. If ESG schemes have a specific objective, then reporting shall be done on engagements and outcomes achieved (if any) in the reporting year based on that objective. Additional areas to be covered in case studies and minimum disclosures shall be specified by AMFI in consultation with SEBI.

d) Annual tracking of ESG rating / score movements in the investee companies.

4.3.4.2. The Fund Manager commentary shall suitably disclose percentage of AUM invested in such companies where there is no BRSR disclosures (investments prior to October 01, 2022) and its impact, if any, on the Fund score.

4.3.4.3. In case there is a change in ERP, reason(s) for such change recorded by AMCs shall also be disclosed in the fund manager's commentary.

4.3.4.4. The requirement of Annual Fund Manager commentary shall be applicable from FY 2023-24. The disclosure of case studies at para (b) and (c) above shall be applicable from FY 2024-25 and the engagement details shall be disclosed from FY 2025-26 onwards.

4.3.5. **Assurance on ESG Schemes**

**A. Independent assurance**

4.3.5.1. The AMCs shall obtain an independent reasonable assurance on an annual basis regarding their ESG scheme's portfolio being in compliance with the strategy and objective of the scheme, as stated in respective Scheme Information Documents. Such an assurance shall be on a "comply or explain basis" for all ESG schemes for FY 2022-23 by December 31, 2023. Thereafter, disclosure of assurance shall mandatorily be made in the scheme's annual report.

4.3.5.2. The Board of AMCs shall ensure that the assurance provider for an ESG scheme has the necessary expertise, for undertaking reasonable assurance.

4.3.5.3. The AMCs shall also ensure that there is no conflict of interest with the assurance provider appointed for providing assurance on their ESG schemes. For instance, it shall be ensured that the assurance provider or any of its associates do not sell its products or provide any non-audit / non-assurance related service including consulting services, to the AMC or its group entities.

**B. Certification by the Board of AMCs**

4.3.5.4. The board of directors of AMCs, based on comprehensive internal ESG audit, shall certify the compliance of ESG schemes with the

regulatory requirements including disclosures, in annual report of the scheme.

4.3.5.5. The aforementioned internal ESG audit shall *inter-alia* include verifying the Scheme Information Documents, Stewardship Reporting and Responsible Investment Policy of the ESG Funds and any other relevant document, to ensure that what the statements made in these documents are factual.

4.3.5.6. This certification shall be applicable with immediate effect. The board of directors of AMCs shall provide the certificate for FY 2022-23 by December 31, 2023. Thereafter, the certification shall be disclosed in the Annual Reports of the schemes.

5. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with the provisions of Regulation 77 of SEBI (Mutual Funds) Regulations, 1996, to protect the interest of investors in securities market and to promote the development of, and to regulate the securities market.

6. The circular is available on SEBI website at www.sebi.gov.in.

**Yours faithfully,**

**Peter Mardi**
**Deputy General Manager**
**+91-22-26449233**
**Email: peterm@sebi.gov.in**

## ANNEXURE A

**a. Exclusion**

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. Transition or transition related investments**

Aim to invest in companies and issuers that support/facilitate environmental transition and just transition. The investment should generate a positive and measurable social and environmental transition.

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