CIRCULAR

F. No. 756/IFSCA/ESG Schemes/2022-23 January 18, 2023

To,

All Fund Management Entities (FMEs) in International Financial Services Centres (IFSCs)

Dear Sir / Madam,

Sub: Disclosures by Fund Management Entities for Environmental, Social or Governance (ESG) Schemes

In exercise of the powers conferred by Section 12 and 13 of the International Financial Services Centres Authority Act, 2019, read with sub-regulation (2) of regulation 72 of the IFSCA (Fund Management) Regulations, 2022 ("Regulations"), and to promote consistency, comparability and reliability in disclosures concerning ESG schemes in IFSC, the International Financial Services Centres Authority (Authority) hereby specifies the framework for disclosures by the Fund Management Entities (FMEs) which intend to launch ESG scheme(s).

With this framework, IFSCA lays down standards and practices (including guidance) for FMEs launching and managing ESG schemes. The framework prescribed by IFSCA by way of this circular is principle-based and largely aligned with international best practices. IFSCA will continue to monitor the developments in this area and may supplement / update this Circular from time to time, as deemed appropriate, based on the experience gained.

Applicability

1. This Circular shall apply to FMEs that intend to launch and manage ESG scheme(s). For this purpose, "ESG schemes" would mean and include such retail schemes, Exchange Traded Funds (ETFs), restricted schemes and venture capital schemes, which:

A. have terms, such as ‘Environment’, ‘Social’, ‘ESG’, ‘Green’, ‘Sustainability’ or any combination thereof or similar terms, incorporated in their names, or
B. represent or market themselves as ESG focused schemes.

Initial Disclosures for ESG Schemes in Offer Document / Placement Memorandum

2. For every ESG scheme launched by a FME, the following disclosures shall be suitably made in the Offer Document / Placement Memorandum, as the case may be:

A. Name of the scheme

I. In order to enable investors to discern the ESG characteristics / themes / intended outcomes of an ESG scheme, the name of an ESG scheme should be reflective of its ESG focus and consistent with its ESG-related investment objectives and investment strategy.

Guidance: While the descriptions of the investment objectives and investment strategy of an ESG scheme will provide additional clarity regarding ESG characteristics / themes / intended outcomes that the scheme intends to achieve, the FME shall name the ESG schemes in such a fashion that it does not mislead the investors and is in consonance with the ESG focus of the scheme.

For example, a scheme launched with an intention to primarily invest with the prospects of getting a higher financial return while giving a small weightage to sustainable factors should not have ‘ESG’ or similar such terms in its name.

B. Investment objectives

I. FME should transparently disclose the nature and extent of the scheme’s ESG-related investment objectives, including details of the primary components of sustainability addressed by the scheme.

Guidance:

a. The FME should provide a clear declaration / statement of the ESG-related investment objectives, in addition to other objectives, if any, that the scheme intends to achieve through its investments.

b. A scheme may normally be considered to be 'ESG scheme', if majority of the investable corpus / assets under management of the scheme is proposed to be invested as per the disclosed ESG-related investment objectives.

Illustration: Investment objectives of an ESG scheme could include contributing towards global decarbonisation by investing in companies involved in renewable energy sector.

C. Investment strategy

I. The disclosures relating to this section should consist of a detailed explanation of the type of investment strategy, including the ESG-related investment strategy, that the FME intends to pursue with a view to achieve the stated investment objectives of the ESG scheme.

Guidance: While FMEs may devise investment strategies suitable for an ESG scheme, following are some indicative examples of ESG-related investment strategies:

a. Integration: This includes explicit consideration of ESG-related parameters, alongside the conventional financial parameters, when making investment decisions.

b. Best-in-class and Positive Screening: This entails investing in companies that perform better than their peers on one or more ESG-related parameters. Such investment decisions should be consistent and governed by a standard policy.

c. Impact investing: Under this strategy, the FME seeks to generate a positive and measurable environmental / social impact. The measurement of the real-world impact for such investments should be undertaken in a consistent manner and based on a standard policy to quantify and disclose the impact to the extent possible.

d. Engagement: Under this strategy, the FME seeks to engage with investee companies to improve their ESG score / profile. The FME invests in such companies where it can effectively engage for improvement in their ESG score / profile and, if the engagement does not result in improvement of ESG score / profile, takes certain pre-identified measures.

e. Transition: Under this strategy, the FME seeks to invest in hard-to-abate and other emission-intensive sectors, to upgrade their technology, processes and infrastructure, with the objective of achieving substantial reductions in greenhouse gas emissions.

D. ESG investment related processes

I. FME shall disclose the methodology for processes deemed relevant for ESG investments and include a description of the same in the Offer Document / Placement Memorandum of the ESG scheme, as may be applicable.

II. Further in case of ESG schemes which are retail schemes or ETFs, the FME shall ensure that these processes are also publicly disclosed on their website or by other appropriate means.

Guidance: With an objective to inform investors regarding the approach towards ESG-related investments and their monitoring, the FME should identify such processes which are deemed relevant for ESG investments and disclose their methodologies. These processes, among others, may include the following:

a. Regarding investment decisions, which should, among others, involve consideration of ESG scores/ ratings/ criteria/ profiles/ index. The investments should be designed to align with the ESG-related investment objectives;

b. Regarding FME's engagement with investee companies, which should, among others, include exercise of voting rights, in accordance with the ESG-related investment objectives of the scheme;

c. Regarding periodic review of the investments which should, among others, include assessment of their performance against the stated ESG-related investment objectives of the scheme;

d. Regarding exiting the investments, which should, among others, involve consideration of ESG scores/ ratings/ criteria/ profiles/ index.

III. The strategy and methodology description may be further supplemented by disclosure of various tools deployed for investment decisions, which, among others, may include the following:

a. Investment universe

b. Methodologies of reckoning ESG scores/ ratings/ criteria/ profiles/ index that are intended to be taken into consideration and material assumptions, if any, made in that process

c. Details of the external service provider(s), if any, for the ESG scores/ ratings/ criteria/ profiles/ index that are intended to be taken into consideration

d. Key Performance Indicators (KPIs) intended for the measurement of ESG-related performance of the scheme

e. The minimum percentage of investable corpus / assets under management that shall be invested as per the disclosed ESG-related investment objectives

f. Definitions / standards used for classifying assets as green or sustainable or such other terminologies.

E. Disclosure of Risks and Risk Management Practices

I. Consistent with the need to achieve high levels of transparency, the FME managing an ESG scheme should disclose all the specific risks that arise on account of the scheme's pursuit of ESG-related investment objectives, related investment strategies and processes, in addition to all the other material risks faced by the scheme.

II. Further, wherever feasible, the risk management practices should also be disclosed by the FME.

Guidance: FME may identify and disclose all the relevant risks / limitations. Illustrations of some risks that typically arise from a scheme's ESG focus are as follows:

a. Risk of concentration in certain type of investments

b. Risk of reliance on third party providers for ESG scores/ ratings/ criteria/ profiles

c. Limitations of the methodologies and data used

F. Benchmark

I. Wherever feasible, FME may designate a reference benchmark for the ESG scheme to measure the attainment of its ESG focus and/or financial performance vis-à-vis the benchmark.

II. Where such a benchmark is designated, the FME should provide explanation as to how it is relevant to the scheme and also provide a link to the benchmark methodology in the offer document or placement memorandum of the scheme.

Periodic Disclosures for ESG Schemes

3. For every ESG scheme launched by a FME, it shall disclose to the Authority and investors, on a half-yearly basis for a retail scheme and on annual basis for other types of schemes, the following:

   A. Compliance with the stated ESG-related investment objectives of the scheme;

   B. ESG-related performance;

   C. Actual proportion of the investable corpus / assets under management invested as per the stated ESG-related investment objectives.

   D. If an ESG scheme relies on engagement with investee companies as a significant means to implement its investment objectives/strategy, it shall disclose the efforts, including voting activities, undertaken in engagement with investee companies;

   E. Where a benchmark is designated for the scheme, comparison of scheme's performance vis-à-vis the reference benchmark;

   F. Changes, if any, carried out in the methodologies or processes which are deemed relevant for achieving ESG-related objectives;

   G. Changes, if any, in the external ESG scores/ ratings/ criteria/ profiles/ index provider; and

   H. Key findings/Major observations of Internal audits or third-party validation, if undertaken with respect to the scheme's portfolio or its ESG-related investment objectives.

4. FMEs managing ESG schemes which are in the nature of retail schemes or ETFs shall publicly disclose the above at a suitable place on their website or by other appropriate means.

Guidance: The periodic disclosures are aimed at providing updates to the investors of ESG schemes regarding the progress towards the ESG objectives and other important information in this regard. While FME may suitably disclose the above, the following may be taken into account:

a. As part of disclosure of compliance with the ESG-related investment objectives, as per clause 3(A), FME may use qualitative information and quantitative metrics, where available;

b. For the disclosure of ESG-related performance, as per clause 3(B), FME may disclose the same in terms of the pre-determined KPIs, expected outcomes and other relevant factors;

c. For compliance with clause 3(C), the FME shall disclose the exact proportion of such investments. Further, the FME should disclose the details of full portfolio as per the Regulations;

d. As the external service providers, such as ESG scores/ ratings/ criteria/ profiles/ index provider, play a very critical role in the overall functioning and decision making of the FME managing an ESG scheme, any changes carried out with respect to these service providers or any other service provider deemed relevant by the FME should be periodically disclosed to achieve compliance with clause 3(G);

e. FME is required to carry out monitoring and performance evaluation of ESG schemes, as detailed in the subsequent section, and disclose the result of the same to achieve compliance with clause 3(H).

<u>Passive ETFs or Schemes</u>

5. ETFs or Schemes tracking an ESG Index shall comply with the requirements under this Circular to the extent applicable and provide complete details of the chosen Index, including its methodology and composition, along with the rationale for choosing the Index.

<u>Monitoring & Performance Evaluation</u>

6. Considering the unique nature of ESG schemes, the FME should undertake, on a half-yearly basis for a retail scheme and on annual basis for other types of schemes, the following:

A. Assessment of their compliance with the stated ESG-related investment objectives of the schemes.

B. Measurement of the ESG-related performance of the scheme by evaluating any pre-determined KPIs, expected outcomes and other relevant factors.

C. The marketing materials and advertisements are consistent with the disclosures made in terms of this Circular.

D. Declaration to the fiduciaries (persons referred in regulation 17(2)) by an authorised person of the FME certifying that the ESG scheme is pursuing the stated ESG-related investment objectives and following its disclosed ESG-related investment strategy while adhering to the ESG-related investment methodologies. Where available, this may be backed by third-party validation / certification. In case of any material deviations or adverse observations, the fiduciaries shall bring the same to the notice of Authority.

A copy of this Circular is available on the website of International Financial Services Centres Authority (IFSCA) at www.ifsca.gov.in.

Yours faithfully

Sd/-

Pavan Shah
Deputy General Manager
Division of Investment Funds – I and New Products & Services
Capital Markets Department
Email: pavan.shah@ifsca.gov.in
Tel: +91-79-61809844