ESG Board's Responsibility – India and Globally

Forward-looking organisations started reporting their ESG performances complying with globally accredited frameworks such as GRI, TCFD and IR. Even unlisted companies voluntarily disclose their ESG measures based on the BRSR-lite format. Many large global investors have adopted well-defined ESG policies in their due diligence and investment monitoring processes. However, the Indian corporate ecosystem is still at a nascent stage of optimising its transition strategy, financing requirements and ESG profiles.

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In the words of Charles Darwin:

"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change."

As per United Nation World Commission on Economic Development:

"Sustainable development is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

INTRODUCTION

In India, it used to be a matter of great inquisitiveness and debate as well to understand ESG once it started doing the rounds in regulators and corporate corridors of late, since India has made CSR mandatory (albeit a bit late) under law. Corporate analysts started scratching their heads around the new bird by the name "ESG" that how it is different from "CSR", as to them, if some corporates are already spending towards environmental projects and social projects under their CSR initiatives, why ESG is being imposed on them which has the environment and society engrained in this term.

To understand – It is easy to conflate these two terms - CSR and ESG - because, in reality, these are different angles of measuring the same thing – a company's impact on society. However, the main difference between CSR and ESG is that CSR is an internal initiative to fulfill a corporate purpose whereas ESG reflects a company's external impact.

Views expressed in this article are the personal views of the writer of this Article.

Broadly, the term ESG comprises of the following elements:

- **Environmental:** Pertains to corporate climate policies, greenhouse gas emissions, pollution, deforestation, biodiversity loss, energy efficiency, water management, treatment of animals and compliance with environmental regulations, etc.;
- **Social:** Pertains to corporate's relationship with internal and external stakeholders, viz. employee safety and health, working conditions, diversity, equity and inclusion, conflicts and humanitarian crises and in risk and return assessments in enhancing or otherwise customer satisfaction and employee engagement; and
- **Governance:** Pertains to ensuring that a company uses accurate and transparent accounting methods, pursuing integrity and diversity in selecting its leadership and is accountable to shareholders and dealing with prevention of bribery and corruption, cybersecurity and privacy practices and the manner in which the leadership responds to and interacts with the stakeholders viz. shareholders, auditors, internal controls, employees, regulators, and media.

While ESG is generally considered to be market-driven, corporate and securities regulators around the world are beginning to modulate the ESG-orientation through legal or regulatory instruments, especially when it comes to ESG reporting.

Secondly, as both CSR and ESG continue to coexist in India, due to certain peculiar connotations of CSR under Indian emerging legal landscape, the regulatory focus has shifted more towards ESG in recent years. It is clear that nowhere has CSR acquired a more prescriptive status than in India where the basic corporate statute, the Companies Act, 2013 is elaborate about the obligations of companies to act in a manner that benefits the broader society, apart from shareholders.

And thirdly, and owing to India's philanthropic bend, the CSR regime in India seemingly fails to focus on the negative externalities that got generated by the regular business operations of companies, which has conventionally been captured within the domain of CSR elsewhere. Given the conceptual and genesis dissatisfaction surrounding CSR in India, the emerging trend of ESG takes on greater importance.

Post COVID-19 pandemic, global ESG investing picked up momentum as investors perceived COVID-19 as the century's first "sustainability" crisis, and thus have started adopting specific data around ESG for evaluating the material risk that an organization is exposed to, based on the externalities it is generating.

The data produced can also be used within an organization as metrics for strategic and managerial purposes. Additionally, the investors may use ESG data beyond assessing material risks to the organization in their evaluation of enterprise value assessment and management of sustainability-related risks and opportunities leading to higher long-term risk-adjusted return.

Evolution of ESG Regulations in India

ESG reporting in India (in an expanded sense) commenced in 2009 with the Ministry of Corporate Affairs (MCA) issuing the Voluntary Guidelines on Corporate Social Responsibility. Ever since, the reporting framework has come a long way with the introduction of Business Responsibility Reporting ("**BRR**"), Corporate Social Responsibility (CSR), National Guidelines on Responsible Business Conduct (NGRBC) and the newly introduced Business Responsibility and Sustainability Report (BRSR) (*introduced through a SEBI circular dated 10 May 2021).*

The erstwhile Indian Companies Act, 1956, was carrying one of the first ESG disclosure requirements for companies by way of disclosures in Board's Report of details regarding conservation of energy, along with annual financial statement, and the same disclosure requirements have

continued in the Companies Act, 2013, in addition to certain other requirements.

The **SEBI** introduced the requirement of ESG reporting way back in 2012 and mandated that the top 100 listed companies by market capitalization shall file a BRR. This was later extended to the top 500 listed companies by market capitalization in 2015.

Further, in May 2021, SEBI introduced a new reporting requirement on ESG parameters under the Business Responsibility and Sustainability Report ("**BRSR**") by amending regulation 34 (2)(f) of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015 ("**LODR Regulations**"). The BRSR seeks disclosures from listed entities on their performance against the nine principles of the 'National Guidelines on Responsible Business Conduct' (NGBRCs) and reporting under each principle is divided into essential and leadership indicators. The essential indicators are required to be reported on a mandatory basis while the reporting of leadership indicators is on a voluntary basis.

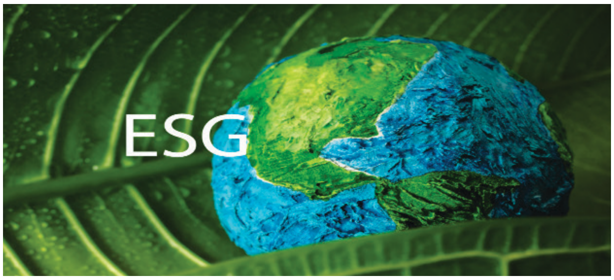
Such disclosures will be helpful for investors to make better investment decisions. The BRSR shall also enable companies to engage more meaningfully with their stakeholders, by encouraging them to look beyond financials and towards social, governance and environmental impacts.

With effect from the financial year 2022-2023, filing of BRSR has been made mandatory for the top 1000 listed companies (by market capitalization) and has replaced the existing BRR.

Further, the RBI is expected to issue guidelines for regulated entities to support green finance and mitigate climate-related financial risks, in the near future. As India, and the globe, works towards long term sustainability, there is no doubt that ESG is the future in all aspects of corporate and social endeavours.

ESG ON GLOBAL PLATFORM - REGULATIONS AND BEST PRACTICES

The Non-Financial Reporting Directive 2014/95/EU ("**NFRD**"), one of the major EU laws, requires (on "comply or explain" basis) public-interest entities with more than 500 employees to prepare and disclose a 'non-financial statement' (relating to diversity and non-financial information) in their annual management report.



In April 2021, the European Commission adopted a Corporate Sustainability Reporting Directive ("**CSRD**") which expands the scope of NFRD to all listed companies, including SMEs and introduces mandatory EU sustainability reporting standards for environmental, social and governance aspects. For financial years starting on or after 1st January 2024, CSRD will apply to companies that are already subject to NFRD, with the first report expected to be produced in the year 2025.

In the European Union, the Non-Financial Reporting Directive (NFRD) mandates insurance companies to publish reports on the policies they implement in relation to environmental protection, social responsibility, respect for human rights and anti-corruption and anti-bribery.

ESG regulation in Asia Pacific is accelerating as the need for greater transparency and tightened definitions for sustainable investment products moves with some urgency across the region. The 2X increase in the number of ESG policies in the region over the past 5 years has translated into increased corporate ESG disclosure across most APAC markets. Accompanying this are new and material cost considerations and an urgent need for upskilling by investors and corporates, as well as potential valuation implications for stocks based on levels of alignment with developing ESG standards.

The Singapore Exchange has made climate reporting mandatory for certain sectors, and all issuers are required to provide climate reporting on a "comply or explain" basis in their sustainability reports, while Hong Kong's Stock Exchange regulator has undertaken initiatives to introduce transparency, corporate governance and updated reporting guidelines to incorporate ESG focused requirements. In Japan, Government's Pension Investment Fund (PIF) has been functioning while keeping the ESG principles at its core. Indonesia and Taiwan have also changed their jurisdictions to promote green products and financing in line with ESG principles. China's Environmental Information Disclosure Act, 2008 mandates corporations to disclose environmental information. Annual resource utilization, pollution levels, waste generation, disposal method, and some other aspects can be disclosed voluntarily to gain more rights to grants and public support. A separate report with an environmental disclosure is also required from large companies listed on the Shanghai Stock Exchange.

As a continuum of Financial Services Development Council's (FSDC) efforts in driving the ESG agenda in Hong Kong, a comprehensive collateral is developed to accentuate key actors' concerted efforts in developing a robust sustainable infrastructure and investment ecosystem in Hong Kong. The Monetary Authority of Singapore (MAS), Singapore's central bank, recently launched the ESG Impact Hub, a new entity that seeks to promote collaboration on ESG finance. The launch comes shortly after the Singaporean government announced a roadmap to becoming a global leader in green finance and sustainable fintech. It seeks to spur the ESG ecosystem by facilitating engagement between fintech companies, financial institutions, investors, and other ESG stakeholders.

In March 2022, the US Securities and Exchange Commission (SEC) proposed rule changes that would require registered entities to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements including greenhouse gas emissions, in order to assess their exposure to such risks.

Another sustainability reporting instrument by the New York Stock Exchange (NYSE) mandates that listed companies adopt and disclose a code of business conduct and ethics for Directors, officers and employees.

In addition to the above-mentioned regulations, global reporting standards such as the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board Standards (SASB) provide detailed industry-specific disclosure checklists and ESG-metrics which go beyond the general nature of BRSR.

INDIA - AT ESG CROSSROADS

In the Paris Agreement of the United Nations Climate Change Conference in 2021, India's Prime Minister committed to achieving net-zero carbon emissions by 2070.

Further, basis a multi-trillion-dollar global pool of ESG-driven capital, Indian companies are rapidly incorporating ESG into their holistic business strategy. They acknowledge that their responsibilities do not restrict to monetary returns only but also extend to carving a positive social and environmental impact.

Since then, ESG adoption is on the rise, fueled by clients' demand and a desire to make an impact. The ESG momentum continues to roll leading the investors to define, refine and evolve their strategies. This can be seen in the implementation arena, where investors are moving away from basic screening methods towards more targeted and sophisticated strategies, including thematic and impact investing. Thus, ESG integration remains the top implementation strategy showing how investors are taking a holistic approach as they look to comprehensively embed ESG into the investment process.

Socially Responsible Investing (SRI) is an investment strategy that highlights this one facet of ESG. SRI investors seek companies that promote ethical and socially conscious themes including diversity, inclusion, community-focus, social justice, and corporate ethics, in addition to fights against racial, gender, and sexual discrimination.

STATUS OF ESG IMPLEMENTATION IN INDIA

Forward-looking organisations started reporting their ESG performances complying with globally accredited frameworks such as GRI, TCFD, and IR. Even unlisted companies voluntarily disclose their ESG measures based on the BRSR-lite format. Many large global investors have adopted well-defined ESG policies in their due diligence and investment monitoring processes. However, the Indian corporate ecosystem is still at a nascent stage of optimising its transition strategy, financing requirements, and ESG profiles.

Post COVID-19 pandemic, India's banking and non-banking sectors have urgently switched focus to sustainable development. The RBI joined the Network for Greening the Financial System (NGFS) to contribute to global green finance and drive India's financial sector towards policy formation and climatic risk resilience development.

In the Insurance sector, since the insurance business has an intrinsic relationship with several environmental, social, and governance (ESG) factors, considering ESG factors in risk analysis and loss mitigation would prove beneficial to insurers trying to create their ground in the accountability towards a sustainable future and IRDA is cognizant about that fact.

An ESG indicator-driven insurance underwriting is inclined towards entities that hold up strongly on sustainability policies factors and ESG values that provide greater transparency into their practices and reputations. To merge all indicators of sustainability in insurance underwriting and risk analysis, it is important for insurers to efficiently analyze the large quantities of unstructured emerging dataset of a Company's ESG indicators.

CHALLENGES FOR ADOPTION OF ESG FOR CORPORATES

While ESG commitments stand on three pillars, the pillar 'S' is typically a missing link between business strategy and regulatory compliance.

SEBI's mandates not only look at the corporate's relationships with internal and external stakeholders but also give an insight into how the company protects its workers' well-being. Thus, a corporate's social indicators include employment opportunities, employee welfare, worker safety and training, human rights protection, social impact assessment, diversity, equity and inclusion. Similarly, private companies should also consider recruiting apprentices and diversifying workforces as a part of their CSR and ESG initiatives.

Developing a robust ESG architecture has become paramount in risk management, adaptation, accountability, and compliance from economic, social, and regulatory perspectives. Thus, India looks to integrate environmental and human health, collaboration and transparency, and transformation of various production modalities to honour its pledge of attaining net zero emissions in future.

Streamlining People and Processes is important in the ESG agenda of companies which must integrate reporting, strategy-making, and business transformation. It is predicted that Key and Senior Management Personnel will play vital roles in designing strategy, driving performance, reporting results, and leading a company's ESG transformation. It however becomes necessary to engage competent professionals to source and analyse data, create bespoke datasets, and deploy ESG data tools to streamline processes, supply chains, and customers.

Avoiding Greenwashing / ESG washing is another important matter in the implementation of the ESG agenda. Greenwashing basically involves making an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly or have a greater positive environmental impact than they actually do. It is generally performed through the use of environmental imagery, misleading labels, and hiding tradeoffs, which means using false information to intentionally hide wrongdoing, error, or an unpleasant situation in an attempt to make it seem less bad than it is. In addition, greenwashing may also occur when a company attempts to emphasise sustainable aspects of a product to overshadow the company's involvement in environmentally damaging practices. Businesses should consider and record ESG-driven risks and opportunities and address transparency issues to avoid accidental Greenwashing/ESG washing.

KICK-OFFS WITH ESG – APAC & INDIA

One study suggests that the six emerging ESG Policy Themes across Asia Pacific (APAC) region including India, Australia, China, Hong Kong, Japan, New Zealand, Singapore, and South Korea, are:

Theme 1: Green Taxonomies - a classification system for "green" economic activities which can be used to inform disclosures (viz. green revenue/capex tied to aligned activities) or for sustainable financing purposes (viz. bonds, loans).

Theme 2: TCFD-aligned climate related disclosures - Disclosure requirements aligned with the Task Force for Climate-Related Financial Disclosures (TCFD) recommendations on how climate risks are considered and embedded into a firm's strategy and processes. This covers the areas of Governance, Strategy, Risk Management, Metrics and Targets.

Theme 3: Carbon pricing schemes - National carbon pricing schemes through imposition of Carbon Taxes or Emissions Trading Schemes (ETS) which puts a direct cost on a company's carbon emissions, creating a direct incentive to de-carbonise.

Theme 4: Supply chain due diligence & transparency - Policies towards (i) establishing effective supply chain risk management systems and processes, (ii) including ESG risks in supplier due diligence (viz. human rights violations), and/or (iii) greater transparency and disclosure of risks, processes, and performance.

Theme 5: Corporate ESG disclosures - Requirements for companies to (i) publish a dedicated ESG or Sustainability report, and/or (ii) report on a specific list of ESG metrics and KPIs.

Theme 6: ESG Fund requirements - ESG-labelled financial products requirements which may mandate specific disclosures (viz. explaining how ESG is integrated into the investment process or mandating specific metric disclosures) and/or setting investment thresholds (like a minimum % of AUM invested in "ESG" stocks, etc.).

However, a general overview of progress across APAC region on these Policy Themes are summarised as under requiring serious action wherever lacking:

- Green Taxonomy development is less advanced, however, in a global context, the direction of travel is very positive.
- Considerable progress in mandating TCFD-aligned reporting positions APAC as a leader, globally.
- Many different carbon pricing schemes are in place now, however, application in some markets limits their impact.
- Corporate ESG disclosure requirements remain focused on emissions, energy, and diversity metrics.
- Greater supply chain risk management, due diligence, and transparency policies are needed.
- Policies mandating ESG fund requirements to accelerate are needed as the risk of greenwashing rises and as demand for more product-level transparency increases.

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Data suggests that Indian companies can lose around Rs.7 billion due to climate-related risks in the next 5 years if they do not prioritize building robust ESG frameworks. As a preventive measure, businesses should demonstrate climate resilience and strive to eliminate emissions to attract investors by:

- Utilising resources optimally - Environmentally responsible enterprises must focus on sustainable sourcing, resource allocation, and optimal utilisation of resources. They should pay attention to waste management, emissions, water consumption, 3-R practices, Extended Producer Responsibility (EPR), and Life Cycle Assessment (LCA) mandates.
- Switching to renewable energy solutions - best-in-class high-efficiency solar and wind energy products can deliver energy efficiency of up to 98%.

Directors' Duties and ESG Considerations

The principles of Corporate Governance lay a greater emphasis on long-term sustainable value as opposed to the pursuit of profits solely for the benefit of shareholders. Such ESG considerations have also received a thumbs up from the investor community on the basis that the longer-term interests of all the stakeholders enjoy a great deal of alignment. Under such a dispensation, companies and their directors bear a duty to act to protect the long-term sustainable value for a broader range of stakeholders beyond shareholders.

The mirroring of this approach is found in Section 166(2) of the Companies Act, 2013 which codifies directors' duties by stipulating that the directors shall act in good faith and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment.

An analysis of the provisions of Section 166(2) suggests that directors of Indian companies would be required to identify and address ESG risks and implement strategies to address them. This aligns itself with the financial model of ESG because risks such as climate change could bring about direct financial impact on companies, especially those in industries that are particularly vulnerable to climate effects. Moreover, a company's indifferent attitude towards ESG risks could also invite adverse reputational repercussions, with the shareholders ultimately facing the financial consequences. For example, Directors could be exposed to liability if they display conscious disregard or willful neglect of the ESG risks emanating from the operations of a company, such as environmental impact. This could also arise when the directors measure the success of the company (and their own) by deploying short-term yardsticks rather than alternative strategies that would have accounted for long-term sustainable value.

The second element of Board's duties is laying down of a detailed risk management framework as prescribed under Indian corporate and securities laws. Moreover, independent Directors are called upon to bring their 'independent judgment' on matters relating to risk management. Similarly, under the SEBI LODR Regulations, Board responsibilities include reviewing and guiding the company's risk policy and ensuring that appropriate mitigating mechanisms for addressing risks are in place.

If we look at some of the judicial precedents (may be termed as landmark ones), the Hon'ble Supreme Court of India, in the matter of *M.K. Ranjitsinh v. Union of India*, sounded concerned with the specific duty of directors to consider 'the protection of the environment' and treated it to be at par with duties to other stakeholders, including shareholders. Since the expression 'environment' does not find a definition in the Companies Act, 2013, the Supreme Court imported the meaning ascribed to the said term under Section 2(a) of the Environment (Protection) Act 1986 which defines the word to include the 'inter-relationship which exists among and between water, air and land and human beings, other living creatures, plants, micro-organisms and property. Thus, the span of this definition is adequately capable of accommodating almost all the ESG risks.

Further, in the matter of *Tata Consultancy Services v. Cyrus Investments Private Limited*, the Hon'ble Supreme Court, in the context of Section 166(2) of the Companies Act, 2013, observed that 'the history of evolution of the corporate world shows that it has moved from the (i) familial to (ii) contractual and managerial to (iii) a regime of social accountability and responsibility.' It then went on to note that 'what is ordained under Section 166(2) is a combination of private interest and public interest.'

CONCLUSION

ESG and sustainability are closely related. ESG investing screens companies based on criteria related to being pro-social, environment-friendly and with good corporate governance policies and practices. Together, these features can lead to sustainability. ESG, therefore, looks at how a company's management and stakeholders make decisions while sustainability considers the impact of those decisions on the world.

India's focus on Directors' duties to consider shareholders as well as other stakeholders lay a strong statutory foundation for the legal recognition of ESG, both on a financial basis and as the basis of an entity approach. Coupled with this are strong regulatory moves by the Indian financial regulators to develop ESG reporting and to encapsulate ESG concerns as part of shareholder stewardship initiatives. Although there have been significant legislative and regulatory measures towards ESG in India, several challenges remain, and the efforts thus far can only be work-in-progress.

Singapore, Hong Kong and New Zealand are at the forefront of imposing mandated requirements on both investors and corporates, with Japan, Taiwan and Malaysia also mandating for corporates and/or some financial institutions.

Lack of domestic carbon pricing in some countries may put companies at greater risk of incurring a carbon tax when exporting to overseas markets. As part of Europe's strategy to protect domestic production while tightening their own carbon mitigation policies, the EU has introduced a new Carbon Border Adjustment Mechanism (CBAM) which will effectively tax certain goods being imported into Europe from jurisdictions with lax carbon policies.

Significant developments in supply chain due diligence policies across Europe and the US emphasise the need for more robust practices by APAC corporates, given both the region's unique position as a global supply chain hub and its high exposure to social and environmental risks.

Downstream companies are now being held more accountable for these social and environmental risks throughout their supply chains by consumers (viz. reputational damage for controversies emerging through supply chains), investors (viz. exclusions based on violations of human rights in supply chains), and regulators (viz. through the growing body of supply chain due diligence and transparency regulations globally).

The investor's focus should be on using ESG data to measure performance rather than mere disclosure alone, as it leads to higher returns and is a better signal for quality. ESG performance, if measured correctly, can serve as a flag for operational excellence, culture and risk that manifests into financial outcomes and provides a signal of more resilient business models,

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