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The rise of the ESG regulations in India

Published On: 13-03-2023

Why is in news? Post-pandemic, global Environmental, Social, and Governance (ESG) investing picked up momentum as investors perceived Covid-19 as the century's first "sustainability" crisis. In India, ESG is still in its infancy, with only25 out of 5,180investors becoming signatories of the United Nations Principles of Responsible Investing (UNPRI).

Background

Over the last decade, regulators and corporations around the world have embraced the idea that businesses should be measured not just on traditional economic metrics such as shareholder return, but also by their environmental impact, commitment to social issues and the soundness of their corporate governance and protection of shareholder rights.

While this development is partially due to the belief that companies have a distinct responsibility as corporate citizens, the main driver is the realisation that environmental, social and governance ("ESG") considerations need to be included by investors in a company's risk profile in order to accurately assess the enterprise

The evolution of ESG laws and regulations is, however, still at a nascent stage in India, where the focus is often on providing protections regarding the environment or workplace conditions without also incorporating the controls and disclosure that are a hallmark of contemporary ESG regulation.

What is Environmental, social and governance (ESG)?

ESG is a term used to represent an organization's corporate financial interests that focus mainly on sustainable and ethical impacts.

Capital markets use ESG to evaluate organizations and determine future financial performance.

While ethical, sustainable and corporate governance are considered non-financial performance indicators, their role is to ensure accountability and systems to manage a corporation's impact, such as its carbon footprint.

How ESG differs from CSR?

India has a robust corporate social responsibility (CSR) policy that mandates that corporations engage in initiatives that contribute to the welfare of society.

This mandate was codified into law with the passage of the 2014 and 2021 amendments to the Companies Act of 2013.

The amendments require companies with a net worth of ?500 crore (approximately $60 million) or a minimum turnover of ?1,000 crore (approximately $120 million) or a net profit of ?5 crore (approximately $6,05,800) in any given financial year spend at least 2% of their net profit over the preceding three years on CSR activities.

ESG regulations, on the other hand, differ in process and impact.

The U.K. Modern Slavery Act, for example, requires companies with business in the U.K. and with annual sales of more than £36 million to publish the efforts they have taken to identify and analyse the risks of human trafficking, child labour and debt bondage in their supply chain; establish internal accountability procedures; evaluate supplier compliance and to train supply chain managers regarding these issues.

The EU's Sustainable Finance Disclosure Regulation requires banks, pension funds, asset managers and other financial market participants to disclose how they have integrated sustainability risks into their investment decision-making processes.

And these are only examples; there are scores of such regulations at the state, national and transnational level.

Relevance of ESG in India

India has long had a number of laws and bodies regarding environmental, social and governance issues, including the Environment Protection Act of 1986, quasi-judicial organisations such as the National Green Tribunal, a range of labour codes and laws governing employee engagement and corporate governance practices.

The penalty for violations can be substantial. In June 2022, for example, the National Green Tribunal imposed a ?520 million ($63.7 million) penalty on the Udupi Power Corporation Ltd., a subsidiary of a major Indian conglomerate, for violating environmental laws and polluting its surroundings.

While these laws and bodies provide important environmental and social safeguards, new initiatives in India go further, establishing guidelines that emphasise monitoring, quantification and disclosure, akin to ESG requirements found in other parts of the world.

Indian companies can loseRs.7,138 billiondue to climate-related risks in the next five years if they do not build robust ESG frameworks on priority

Status of ESG implementation in India

Companies in high-emitting sectors like industry and energy face stringent scrutiny by the Government.

The Securities and Exchange Board of India (SEBI) also made ESG disclosures mandatory for the top 1,000 listed companies under its Business Responsibility and Sustainability Reporting (BRSR) initiative.

India has a defined mandate for Corporate Social Responsibility (CSR) for companies with Rs 5 billion net worth, Rs.10 billion turnover, or Rs.50 million net profit. These companies must spend at least 2% of their net profits on CSR endeavors and disclose their ESG profiles to attract capital from global ESG investors and financiers.

Post-COVID, 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.

The bank also focused on stress testing, strategy building, capacity building, and risk governance structure to address climate risk issues.

Moreover, the State Bank of India formulated ESG-compliant lending policies for companies, pushing them to act more responsibly.

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 exercises based on the BRSR-lite format. Many large global investors have adopted well-defined ESG policies in their due diligence and investment monitoring processes.

They capitalise on opportunities to promote ecologically impactful investing and environmental sustainability.

On the other hand, investors perform exclusionary screening for socially sensitive companies and avoid investing in entities with poor ESG parameters. However, the Indian corporate ecosystem is still at an early stage of optimising its transition strategy, financing requirements, and ESG profiles.

Challenges in ESG adoption in India

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

Employment generation is a big challenge in India, and the government is pushing hard to absorb employable youths through mega employment drives. It aims to create 1 million job opportunities with 890,000 vacancies in ministries and central departments.

Similarly, private companies should also consider recruiting apprentices and diversifying workforces as a part of their CSR initiatives. However, startups are trying to cope up with the funding winter.

Since the social impact is difficult to quantify, SEBI has constituted an advisory committee that aims to enhance BRSR and develop a parallel approach for standardising social metrics.

The Way Ahead

Companies that wish to maximise their opportunities in the global economy need to embrace these new requirements and adjust their organisations accordinglyFurther legislation regarding ESG are likely, given the increased emphasis by the Indian government on ESG issues, which can be seen in India’s more active role in global climate forums.