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ESG TRANSFORMATION: SEBI's DRIVE TOWARDS SUSTAINABLE DEVELOPMENT IN INDIA

- ## What is ESG?

ESG ("**Environmental, Social, and Governance**") is a framework used to evaluate the sustainability and societal impact of a company or investment. Environmental factors assess a company's impact on the environment, such as carbon emissions and waste management. Social factors focus on a company's relationships with stakeholders, including employees, customers, and communities. Governance factors evaluate a company's internal systems and structures, such as board effectiveness and transparency. ESG considerations provide insights into an organization's management of risks, treatment of employees, and adherence to ethical standards. Recognized as crucial for long-term success, ESG is increasingly integrated into investment decision-making and aligns financial goals with positive societal and environmental outcomes.

- ## Tracing the Trajectory of ESG

The evolution of ESG can be traced back to early 1980s when discussions surrounding the EH ("**Environmental, Health and Safety**") matters became an integral part of the conversation in the United States ("**US**") corporate arena which aimed to effectively manage negative externalities such as pollution as well as addressing internalities such as employee health and safety standards. In 1990s, the EHS evolved into a movement of corporate sustainability, though only in developed countries, wherein the companies were looking to balance their economic growth opportunities and its environmental impacts. In next decade, the movement came to be known as Corporate Social Responsibility, wherein the corporate philanthropy was at the forefront of regulatory frameworks and corporate initiatives. [1]

[1]Kyle Peterdy, 'ESG (Environmental, Social, & Governance) – A management and analysis framework to understand and measure how sustainably an organization is operating' (*CFI*, 30 June 2022) <https://corporatefinanceinstitute.com/resources/esg/esg-environmental-social-governance/> accessed 31 May 2023.

The term ESG was first introduced in 2004, in United Nation Environment Programme Finance Initiative report in order to promote better investment markets with a more sustainable society.[2] However, it was during the late 2010s and early 2020s that the ESG became more prominent in both corporate and investor conversations. The US Forum for Sustainable and Responsible Investment reported that in 2022 around $8.4 trillion, representing 13% of the total US assets under the professional management, were sustainable investment assets.[3] Corporations are also responding to the growing sustainable investment through periodic ESG disclosures to attract sustainable capital and create continued growth. In 2022, amongst the traded companies in US, 96% of the companies listed in the S&P 500 and 81% of the companies listed in the Russell 1000 issued sustainability reports, reflecting adoption of widespread use of practices related to sustainability among the traded companies in the US. [4]

Corporate ESG disclosures are transitioning from voluntary to mandatory, driven by rapidly emerging government regulations in various jurisdictions. The European Union's Corporate Sustainability Reporting Directive ("**CSRD**") is spearheading this shift by mandating the use of European Sustainability Reporting Standards ("**ESRS**") that integrate sustainability with financial reporting, alongside third-party assurance.[5]

[2]UN Environment (Programme Finance Iniaitive), 'Who Cares Wins: Connecting Financial Markets to a Changing World' (*UNEPFI,* 2004) <https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf> accessed 31 May 2023.

[3]'US SIF "Trends Report" Documents Sustainable Investment Assets Of $8.4 Trillion' (*US SIF,* 2022) <https://www.ussif.org/blog_home.asp?Display=194> accessed 1 June 2023.

[4]'All-Time High of Sustainability Reports Among U.S. Publicly-Traded Companies: 96% of S&P 500 and 81% of Russell 1000' (*G&A,* 2023) <https://www.ga-institute.com/research/ga-research-directory/sustainability-reporting-trends/2022-sustainability-reporting-in-focus.html> accessed 31 May 2023.

[5]'Moving from corporate responsibility to impact' (*World Economic Forum,* 26 April 2023) <https://www.weforum.org/agenda/2023/04/moving-from-corporate-responsibility-to-impact/> accessed 1 June 2023.

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Hong Kong has made ESG disclosures mandatory for the listed companies and the fund managers. [6] Furthermore, the US Securities and Exchange Commission is expected to finalize new rules to make climate-related disclosures mandatory for public companies. [7]

In 2020, the World Economic Forum, International Business Council, and the big fours of accounting viz., Deloitte, PwC, KPMG, and Ernst & Young, at Davos, collaborated to establish a set of standardized ESG metrics. The framework aims to provide companies operating in diverse industry sectors with a consistent and transparent reporting system across and it emphasizes on 22 specific metrics that align with the Sustainable Development Goals ("**SDGs**") enumerated in UN's 2030 Agenda for

Apart from this, the Global Reporting Initiative, Carbon Disclosure Project, Sustainability Accounting Standards Board, Taskforce on Climate-related Financial Disclosures, and Workforce Disclosure Initiative are among the widely used frameworks by the corporations for the ESG disclosures. Additionally,, rating agencies such as MSCI, Sustainalytics, RepRisk, and Institutional Shareholder Services have developed their own ESG ratings to evaluate companies' ESG performance.[8] The establishment of framework of these metrics and ratings serves as a precursor for the authorities around the world to come up with standardized ESG reporting system that enables the sustainability and growth for all stakeholders.

[6] Urszula McCormack and Leonie Tear, 'Hong Kong's ESG regulatory framework and emerging enforcement and disputes risk' (*King & Wood Mallesons*, 22 June 2022) <https://www.lexology.com/library/detail.aspx?g=f52f1aa7-91c0-441d-85c7-4dfc3ac377e6> accessed 1 June 2023.

[7] 'Moving from corporate responsibility to impact' (*World Economic Forum,* 26 April 2023) <https://www.weforum.org/agenda/2023/04/moving-from-corporate-responsibility-to-impact/> accessed 1 June 2023.

[8] Betsy Atkins, 'Demystifying ESG: Its History & Current Status' (*Forbes*, 8 June 2020) <https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=14780682cdd3> accessed 31 May 2023.

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- **ESG and India Inc**

The ESG considerations have now become a part of the global consensus, requiring corporate entities to demonstrate higher levels of ESG practices and performance. India is no different. The Securities and Exchange Board of India (**"SEBI"**) has been proactive in the development of ESG framework for the Indian corporate sector owing to *inter alia* the increased interest of the investors and other stakeholders in the ESG parameters of a company. SEBI had introduced Business Responsibility Report (**"BRR"**) for the listed corporate entities to report their ESG performance way back in 2012.[9]

The requirement for filing BRRs was for 100 listed entities in 2012 which was progressively extended to the top 500 listed entities in 2015. In May, 2021, SEBI mandated the top 1000 listed companies by market capitalization to report their ESG performance by filing Business Responsibility and Sustainability Reporting ("**BRSR**"), an updated version of BRR.[10]

SEBI has been engaging different stakeholders to come up with the norms for *inter alia* ESG reporting by Mutual Fund Schemes[11] and ESG Rating Providers (**"ERPs"**). [12] SEBI had constituted ESG Advisory Committee (**"Committee"**) in May, 2022 to provide recommendations on ESG Disclosures, Ratings, and Investing. Based on the recommendations of the Committee, SEBI released consultation papers in February, 2023 for ESG Disclosures, Ratings and Investing and

[9] https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

[10] https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

[11] https://www.sebi.gov.in/reports-and-statistics/reports/oct-2021/consultation-paper-on-introducing-disclosure-norms-for-esg-mutual-fund-schemes_53500.html

[12] https://www.sebi.gov.in/reports-and-statistics/reports/jan-2022/consultation-paper-on-environmental-social-and-governance-esg-rating-providers-for-securities-markets_55516.html

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for Regulatory Framework for ERPs. The need for streamlining the ESG practices by incorporating the local Indian context was recognized by SEBI in the aforementioned consultation papers. In latest developments, pursuant to the recommendations of the Committee and public consultation, the SEBI has notified Master Circular for ERPs[13] and BRSR Core which is a framework for third party assurance and ESG disclosures for value chain by the listed entities.[14]

These are major initiatives by the regulatory board to bring in profound changes in sustainable financing and reporting in Indian corporate sector. A Balanced Framework for ESG Disclosures, Ratings and Investing is pending before SEBI,[15] which after being approved and notified, in its final form, will complete the triad of ESG regulatory system. The regulatory focus on ESG disclosure and role of ESG ratings as provider of specific information work together to create a credible ESG investment landscape. The ESG framework in its final form aims to align with global standards while considering the unique social and economic factors of India. Apart from the global trend, all these developments are also in line with the obligation on India, pursuant to UN's 'Transforming our world: the 2030 Agenda for Sustainable Development'[16] and Paris Climate Accords,[17] to reduce its our overall carbon emissions to net zero by 2070.

[13] https://www.sebi.gov.in/legal/master-circulars/jul-2023/master-circular-for-esg-rating-providers-erps-_73856.html

[14] https://www.sebi.gov.in/legal/circulars/jul-2023/brsr-core-framework-for-assurance-and-esg-disclosures-for-value-chain_73854.html

[15] https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2023/1681703013916_1.pdf

[16] UNGA Res 70/1 (21 October 2015) UN A/RES/70/1. <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N15/291/89/PDF/N1529189.pdf?OpenElement> accessed 1 June 2023.

[17] U.N. Doc. FCCC/CP/2015/L.9/Rev/1 (12 December 2015) <https://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf> accessed 1 June 2023.

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- **Conclusion**

ESG has evolved into a crucial framework for evaluating the sustainability and societal impact of companies and facilitating ESG factored investments. It has gained prominence globally with the increasing regulatory efforts and standardization of ESG reporting and ratings. India, in alignment with global trends and obligations, is proactively developing its ESG framework through regulatory initiatives such as the consultation paper and the requirement of BRSR. India cannot afford to miss the opportunity presented by the Fourth Industrial Revolution. The nation is in a favorable position to accelerate its development and achieve prosperity for its citizens. India is also highly vulnerable to the devastating impacts of climate change. A report on Gross Domestic Climate Risk by XDI[18] states that 80% of the top 50 most at-risk states and provinces in 2050 are in China, United States and India. Despite India being a developing country with more social and economic constraints compared to other developed countries, the vulnerability due to climate change reinforces the urgency for India to prioritize sustainable goals and align its regulatory frameworks accordingly. Hence, it is in India's best interest for SEBI to actively pursue sustainable development and ensure its regulatory frameworks streamline ESG practices, incorporate local considerations, and establish a credible ESG investment landscape.

[18]XDI Gross Domestic Climate Risk Dataset (*XDI,* 2023) <https://xdi.systems/xdi-benchmark-gdcr/#GDCR> 1 June 2023.

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