The rise of the ESG regulations

Why in news?

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.

What is Environmental, Social and Governance (ESG)?

- **ESG –** Environmental, social, and governance (ESG) investing refers to a set of standards for a company's behaviour used by socially conscious investors to screen potential investments.
- **Environmental criteria** – It considers how a company safeguards the environment, including corporate policies addressing climate change, for example.
- **Social criteria –** It examines how it manages relationships with employees, suppliers, customers, and the communities where it operates.
- **Governance –** It deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights.

How ESG differs from CSR?

- **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.
- **CSR Fund –** It requires companies with a net worth of ₹500 crores or minimum turnover of ₹1,000 crores or net profit of ₹5 crores in any financial year, to spend at least 2% of their net profit over the preceding 3 years on CSR activities.
- On the other hand, ESG regulations, differ in process and impact.
- **U.K. Modern Slavery Act –** Companies with annual sales of £36 million should publish the efforts they have made towards analysing the risks of human trafficking, child labour and debt bondage in their supply chain.
- **EU's Sustainable Finance Disclosure Regulation –** It requires banks, financial markets to disclose how they integrated sustainability risks into their investment processes.

Why is ESG relevant in India?

- **Regulating bodies –** India has long had a number of laws and bodies regarding environmental, social and governance issues, including the Environment Protection

Act of 1986.
- **NGT –** Quasi-judicial organisations such as the National Green Tribunal (NGT) govern employee engagement and corporate governance practices.
- **BRSR –** The Securities and Exchange Board of India (SEBI), revised the annual Business Responsibility and Sustainability Report (BRSR) required by the 1,000 largest listed companies in India.

The BRSR requirements are based on the National Guidelines for Responsible Business Conduct (NGRBC), which mandate that businesses: Conduct and govern themselves with Ethics, Transparency and Accountability.

What are the implications for Indian companies?

- **Different from CSR –** Compliance with ESG regulations, both originating in India and elsewhere around the world, thus, pose a significantly different challenge than India's CSR regulations.
- **China factor –** India should take full advantage of the growing decoupling from China and play a more prominent role in global supply chains and the global marketplace overall.
- This is particularly true when the supplier's own supply chains have several layers.
- **Shell companies –** Ownership that is obscured through shell companies can present additional challenges.
- **Due diligence –** ESG due diligence needs to be supported within the company with detailed procedures for assessing risks and controls for assuring that no corners are cut.

Reference

1. The Hindu | The rise of the ESG regulations