Indian Legal Regime for ESG

The need for addressing Environmental, Social and Governance ("**ESG**") related aspects, has never had more prominence than now. There is growing recognition of the financial and economic impacts of ESG risks across the globe. ESG is also attaining significance as the investors are increasingly relying on ESG as an important metric to guide their investment decisions. Internationally, regulators and enforcement agencies are taking greater cognizance of ESG related issues and a more stringent view of non-compliances or greenwashing by any business regarding their ESG credentials.

The impact of climate change, requirement of good governance and protection of interest of various stakeholders are increasingly forming part of various formal and informal dialogues, particularly in the post COVID era. At the 2021 United Nations Climate Change Conference ("**COP-26**") held in Glasgow, United Kingdom, India, along with 196 other countries made enhanced commitments towards mitigating the risks associated with climate change. The message conveyed by India at COP-26 was that the world needs mindful and deliberate utilization, instead of mindless and destructive consumption.

With so much being said and done in relation to ESG on a day-to-day basis, it is sometimes difficult to focus on the real issue. This note aims to explain the concept of ESG and provides a brief overview of the Indian regulatory landscape in relation to ESG.

WHAT IS ESG

Very simply, ESG norms aims to ensure that businesses are conducted in a more responsible manner. The business enterprises constitute and are considered as critical components of the social system and they are accountable not merely to their shareholders from a revenue and profitability perspective but also to the larger society which is also its stakeholder. Hence, adoption of responsible business practices by companies to cover the ESG aspects are as vital as their financial and operational performance. Compliance with ESG norms essentially requires every business to be accountable for the responsibility it has towards the environment as well as the people who make up the entire ecosystem either as employees or customers or other stakeholders.

ESG LEGAL REGIME IN INDIA

While there are various laws that have been introduced in India at different times for protection of the environment,[1] equitable treatment and overall well-being of employees[2] and for corporate governance, there has not been any single piece of legislation covering all elements of ESG or standards for ESG related criteria on a uniform basis. Even though in the last 10-12 years, various initiatives have been introduced to focus on ESG related compliances, this has been done in a fragmented manner and often on a voluntary basis.

The Ministry of Corporate Affairs ("**MCA**") has been providing guidance for ensuring responsible business conduct by companies. The MCA introduced the 'Voluntary Guidelines on Corporate Social Responsibility' in 2009, for mainstreaming the concept of business responsibility. These guidelines were subsequently revised after extensive consultations with business, academia, civil society organizations and the government, and issued as the National Voluntary Guidelines on Social, Environment and Economic Responsibilities of Business ("**NVG**").[3]

NVGs emphasize that businesses must endeavor to become responsible actors in society, to move towards sustainable growth and economic development. In March 2019, NVGs were revised and updated and the National Guidelines on Responsible Business Conduct ("**NGRBC**")[4] were released.

After introduction of NVG, the Securities and Exchange Board of India ("**SEBI**") also took note of the fact that the listed entities access funds from the public, and thus, have an element of public interest involved, and are obligated to make exhaustive continuous

[1] For instance, the Environment (Protection) Act, 1986 entails rules in relation to e-waste management, bio-medical waste, solid waste, ozone depleting substances, construction and demolition waste, hazardous waste, hazardous chemicals, plastic waste, batteries and rules to assess environmental impact of establishment of any industry. Water (Prevention and Control of Pollution) Act, 1974 and Air (Prevention and Control of Pollution) Act, 1981, imposes obligations on companies for prevention, control and abatement of water and air pollution. Additionally, Wildlife (Protection) Act, 1972, the Forest (Conservation) Act, 1980 and the Biological Diversity Act, 2002 ensures that companies do not interfere with the natural ecosystems of their area of operations.

[2] Factories Act, 1948 and state specific shops and establishment acts regulate working conditions and terms of employment of certain categories of workmen/employees. Payment of Wages Act, 1936, Minimum Wages Act, 1948 and Equal Remuneration Act, 1976 ensure fair and equitable pay. Contract Labour (Regulation and Abolition) Act, 1970 and Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 regulates employment of contract labor and prohibits child labor in India, respectively. Trade Unions Act, 1926, provides for registration of a trade unions and the rights/liabilities of a registered trade union. Employees State Insurance Act, 1948, Employees Provident Fund and Miscellaneous Provision Act, 1952, Payment of Gratuity Act, 1972 and Maternity Benefit Act, 1961 are other social security laws introduced for the benefit of workforce and for their overall well-being.

[3] *National Voluntary Guidelines on Social, Environment and Economic Responsibilities of Business'* issued by the Ministry of Corporate Affair, dated July 2011; as available at https://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf

[4] *National Guidelines on Responsible Business Conduct*' published by the MCA, dated 15 March 2019: as available at https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf

disclosures on a regular basis. Accordingly, in 2012, SEBI introduced the requirement for the top 100 listed companies by market capitalization to include the Business Responsibility Report ("**BRR**") as part of their annual report so that the relevant listed entities could describe the initiatives taken by them from an ESG perspective. In 2015, SEBI extended the requirement of making such disclosures to the top 500 listed companies. In 2017, SEBI advised that 'integrated reporting' may be adopted voluntarily from the financial year 2017-18 by the top 500 companies which are required to prepare BRR. Subsequently, in 2019, the requirement of making the BRR disclosures was extended to the top 1000 companies by market capitalization.

In 2021, the BRR was replaced by the Business Responsibility and Sustainability Report ("**BRSR**"), which is a more comprehensive reporting framework and focuses on measurable key performance indicators across all the principles of the NGRBCs.[5] The BRSR reporting is mandatory for top 1000 listed companies by market capitalization from financial year 2022-2023. Additionally, the MCA has, through 'Report of the Committee on Business Responsibility Reporting',[6] prescribed voluntary ESG disclosures in the format provided as BRSR Lite for other listed and unlisted companies.

The Indian Companies Act, 2013 (the "**Companies Act**") has codified the duties of directors in respect of their responsibilities towards community and environment. Section 166 of the Companies Act requires a director of the company to 'act in the best interest of the community as well as the environment'. The Supreme Court has held[7] that the duty of a director to act in good faith under section 166(2) of the Companies Act is not limited to the company and its shareholders but also extends towards the environment. The Companies Act further requires the annual board report to include the steps taken by the board of directors toward the conservation of energy, utilization of alternative sources of energy and capital investment in energy conservation equipment. Section 135 of the Companies Act and the rules framed thereunder constitute a comprehensive code on the corporate social responsibility of every company (irrespective of the type of industry or the number of employees).

A 'Sustainable Finance Group' ("**SFG**") has been set up in the Reserve Bank of India ("**RBI**") in May 2021 to co-ordinate with other national and international agencies on issues relating to climate change and with an objective to suggest strategies and introduce a regulatory framework, including appropriate ESG disclosures, which could be prescribed

[5] Circular on '*Business responsibility and sustainability reporting by listed entities'* published by the SEBI, dated 10 May 2021; as available at; https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

[6] *Report of the Committee on Business Responsibility Reporting* dated May 8, 2020 published by the MCA; as available at https://www.mca.gov.in/Ministry/pdf/BRR_11082020.pdf

[7] Supreme Court's judgment in *M.K Ranjitsinh vs Union of India* (Writ Petition (Civil) No. 838 of 2019); dated 19 April 2021

for banks and other regulated entities to propagate sustainable practices and mitigate climate related risks in the Indian context. The Indian Banks Association has also come up with a set of National Voluntary Guidelines for Responsible Finance, which asks members to factor commitment to responsible business in their lending and investment decisions.[8]

The foregoing legal developments demonstrate that the regulatory landscape for ESG in India has developed at a measured but regular pace in the last decade. The increasing focus of Indian regulatory authorities such as SEBI and MCA in respect of ESG related disclosure by companies through introduction of BRSR and BRSR Lite is reflective of the intent of such regulatory authorities to set up an ESG disclosure regime on a uniform basis and to ensure that corporates are walking the talk. The setting up of the SFG by the RBI, recognition by RBI of the importance of green finance in India and release of consultation paper by SEBI on 'Environmental, Social and Governance Rating Providers for Securities Markets' that proposes a framework to regulate ESG rating providers in India makes it amply clear that the Indian regulatory authorities are now catching up on the ESG trends that have been ongoing at a global level.

As these trends continue to grow, it will not be surprising if the Indian regulatory authorities will soon strive to put in place a uniform disclosure regime for all companies in India. The proliferation of ESG disclosure norms, globally and in India, and the value being attributed to ESG compliance, signifies that adherence by companies with ESG norms is no longer a discretionary conduct. Owing to this, the companies need to recognize the need for expanding their focus on the ESG related aspects and for mainstreaming them as part of their core business strategies.

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[8] *National Voluntary Guidelines for Responsible Financing*' issued by Indian Banks' Association in May 2017; as available at https://www.iba.org.in/iba_data/attachdocs/jul-2018/1532502771528.pdf