The Evolving ESG Reporting Landscape

On November 1, 2021, Prime Minister Shri Narendra Modi, in his address at the COP26 global climate summit in Glasgow, shared India's commitment to climate change mitigation and its transition to a net-zero economy by 2070. It is expected that India will put climate change at the centre of decisions while outlining any regulatory policies. Businesses need to prepare for the changing market and ESG framework. The new ESG reporting requirement is going to help stakeholders to identify and measure the company's ESG performance in a similar way as done for financial results.

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INTRODUCTION

Environment, Social, and Governance (ESG) norms require companies to be socially responsible businesses by creating a more sustainable, inclusive, and prosperous economy. We have seen how COVID-19 crisis translated from a health crisis into one of the worst economic crises in recent history. In one of the recent incidences, people and animals died due to inhaling toxic styrene gas that leaked at the LG Polymers industrial plant near Visakhapatnam. Climate Change, Data Privacy, Human Rights violation, Corruption to name some are a few examples of challenges that India is struggling with. Each stakeholder is expecting that apart from the government, corporates shall also play a crucial role in dealing with these global challenges. Consumers are expecting high standards of sustainability from businesses. Employees are demanding fair, equitable, and safe working conditions. Regulators are keen on ESG as they need support from the corporate sector on issues like environmental pollution and CSR. And for the investor community, ESG is increasingly becoming the crucial factor in their investment decisions. ESG data can be used to assess and measure company performance on a range of topics relevant to the diverse stakeholders in a way similar to that of financial data to assess company performance for shareholders.

ESG INVESTMENT – A PARADIGM SHIFT

Investors are increasingly driven by the ESG factors that traditionally have not been captured in a company's balance sheet, but that can influence future returns. Based on the report from Global Sustainable Development, sustainable investments total is $35.3 trillion which is more than a third of all assets in five of the world's biggest markets.

As far as India is concerned, as of September 30, 2021, there are eight ESG thematic equity schemes with an AUM of ₹12,085 crores. There is one ESG ETF and one ESG ETF Fund of Fund with AUM of ₹ 174 crores and ₹ 144 crores respectively, as of September 30, 2021. Out of the 10 ESG thematic mutual fund schemes in India, 8 were launched after January 2020.

The Securities and Exchange Board of India (SEBI) has brought a consultation paper where it has been proposed to revise the investment norms for mutual fund schemes that invest as per the ESG philosophy. SEBI has proposed that from October 1, 2022, asset management companies should only invest in securities with Business Responsibility and Sustainability Report (BRSR) disclosures. The existing investments in the schemes for which there are no BRSR disclosures would be grandfathered by SEBI until September 30, 2023.

In ESG investing, a fund manager picks companies whose operations are considered socially responsible. As per current regulations, these schemes fall under the thematic sub-category. A minimum of 80% of the total assets of the scheme is mandated to be invested in securities following the ESG theme. Hence, these guidelines would apply only to the portion of investment towards the ESG theme.

KEY POINTS OF THE CONSULTATION PAPER

- All AMCs will be required to have a Responsible Investment Policy incorporating aspects of ESG investing.
- The Investment Objective shall provide transparency about the nature and extent of the scheme's ESG related investment objectives
- The investment policy of AMCs should include the broad universe of the companies in which they intend to invest

- The investments should be designed to generate a beneficial ESG/sustainability impact alongside a financial return and the AMC should clearly state the intended 'real world' outcome in qualitative terms, especially for strategies related to integration, impact investing, and sustainable objectives.
- Responsible Investment Policy of AMCs should be revised to contain a clause that from October 1, 2022, AMCs shall only invest in securities that have Business Responsibility and Sustainability Report (BRSR) disclosures.
- Aim to invest in sectors, industries, or companies that are expected to benefit from a long-term macro or structural ESG-related trends.
- Schemes, which invest in overseas securities, could choose any global equivalent of the BRSR specified by the Association of Mutual Funds in India (AMFI)
- AMCs to Monitor and evaluate the investments in terms of key performance indicators, real-world outcomes, active engagement, and stewardship activities with investee companies.
- Disclosures about policy on stewardship and shareholder engagement and past stewardship and shareholder engagement records.
- Maintenance of ESG Policy relating to investment

Principles for Responsible Investment which is an investor initiative in partnership with UNEP Finance Initiative and UN Global Compact provides a quick summary of how an investor can develop and implement a responsible investment policy and related processes. The existing policies need to change to comply with the new requirements. We believe that generating a beneficial measurable impact for all relevant stakeholders will be a key factor.

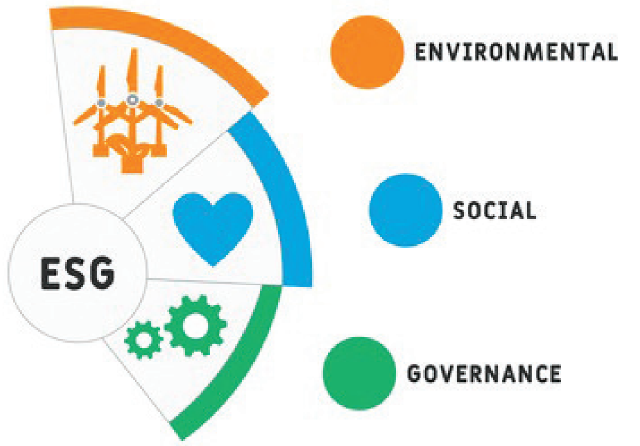
It is equally important to mention that to achieve the ESG target, an organization shall not resort to 'Greenwashing'. Greenwashing means practices of falsely promoting the Company as environmentally friendly when in reality it may be causing more harm to the environment through its activities and business operations.

It is high time that investors understand beneficiaries' interests and place them at the centre of investment decision-making. Over time, beneficiary satisfaction and awareness among beneficiaries is increasing and investors need to continuously engage and reconcile their obligations towards their beneficiaries by integrating ESG factors in their investment governance. Many investors point to their beneficiary engagement as a competitive advantage.

We expect that more companies will prefer to disclose BRSR voluntarily from the financial year 2021-22 to attract more investment from ESG thematic mutual funds. This will provide the company with an added advantage over its competitors.

ESG COMPLIANCE – A COMPETITIVE EDGE TO THE COMPANIES

Globally many regulatory authorities are making ESG-related compliances and disclosures mandatory and the companies



that can demonstrate a robust ESG focussed vision and business practices will be at a competitive advantage. This will also avoid the fines and reputational risks thereby protecting companies from bad publicity and mitigating costs by avoiding legal hassles. ESG challenges and Company's response and action on the same can be a powerful means for companies to differentiate themselves from competitors.

Consumers - Consumers are increasingly preferring products of companies that are environmentally and socially responsible. There is an increase in demand for sustainable and eco-friendly products. In India, the sale of organic products is growing. A new global report from the Economist Intelligence Unit, commissioned by WWF, shows a staggering 71% rise in online searches for sustainable goods globally over the past five years. The three main food players – Danone, Nestle, Unilever – have each set roadmaps to implement Zero Net Carbon by 2050 at the latest. The marketing efforts of the companies can be around its sustainability strategies and high ethical standards that can effectively increase their brand image and value.

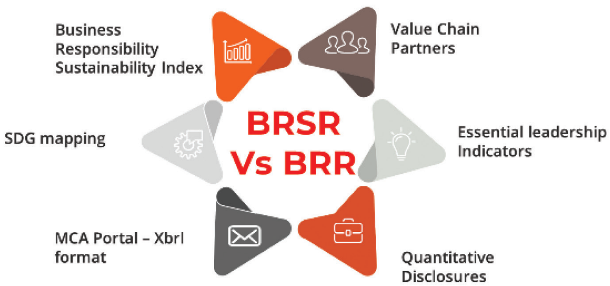
Value Supply Chain - Stakeholders have been cautious of doing business with Companies having a low score on ESG performance. E.g. The Unilever Climate Program has asked its willing companies to reduce Greenhouse Gas (GHG) emissions by 50% by 2030, report openly on their progress, and share their emissions and footprint data with the company. The current format of BRSR requires considerable data from value chain partners. In a few years, ESG compliance is going to be an important area in the selection of suppliers.

Global Market – ESG will be a game-changer for companies who want to do business with global players. Companies having a global presence will need to ensure that not only local but global standards on ESG are complied with. Countries / global customers would require the companies to transparently and accurately report the ESG related information.

Appropriate and prompt reporting of ESG performance is critical for being more visible and transparent as compared to the competition. Even though the mandatory requirement of BRSR compliance is for the financial year 2022-23, companies shall take proactive steps towards implementing the ESG program and adopt voluntary compliance to the new BRSR format.

WHAT HAS CHANGED IN BRSR COMPLIANCE AS COMPARED TO BRR?

Business Responsibility Report is currently applicable to the top 1,000 companies and is now part of the Annual report. SEBI, vide its circular dated 10th May 2021, came out with a new format of BRSR. The new format is voluntary for the financial year 2021-22 while mandatory from the financial year 2022-23. One of the governing principles of BRSR is that it will serve as "a single comprehensive source of non-financial sustainability information relevant to all business stakeholders – investors, shareholders, regulators, and the public at large."



The new format mainly has the following additional details as compared to BRR:

- Essential Leadership Indicators
- Quantitative data enables easy measurement and comparability across companies and sectors
- Data in MCA portal – preferably in XBRL format
- NGRBC (National Guidelines on Responsible Business Conduct) to be linked with SDGs
- BRSR data to be used to develop Business Responsibility-sustainability index
- Obtaining information of Value Chain Partners

> Globally many regulatory authorities are making ESG-related compliances and disclosures mandatory and the companies that can demonstrate a robust ESG focussed vision and business practices will be at a competitive advantage. This will also avoid the fines and reputational risks thereby protecting companies from bad publicity and mitigating costs by avoiding legal hassles. ESG challenges and Company's response and action on the same can be a powerful means for companies to differentiate themselves from competitors.

Information in BRSR will be filed electronically and integrated with the MCA21 database. This will ensure that the information will provide investors and other government agencies with increased data integrity and uniformity. It will also allow increased transparency of ESG related records for viewing of relevant stakeholders. Stakeholders including investors can easily compare the data with competitors / other sectors.

In addition to BRSR, there are many global standards that companies can adopt to implement their ESG program.

ALIGNMENT OF BUSINESS GOALS, PROCESSES AND REPORTING TO GLOBAL STANDARDS

The reporting on ESG issues has remained predominantly voluntary until the arrival of BRR and now proposed BRSR. Many voluntary standards are designed to support different kinds of stakeholders having different focus areas. Some key standards are listed below:

- **UN Sustainable Development Goals (SDGs)**: In 2015, the United Nations (UN) set out to solve the world's major economic, social, and environmental challenges in 17 critical areas by 2030. SDGs provide a framework and key areas of impact which will complement and support the ESG considerations to achieve a more sustainable future. While investors are putting significant effort into working out how the SDGs fit into their investment portfolios, at the same time some businesses are making SDGs part of their business goals. National Guidelines for Responsible Business Conduct (NGRBC) have been framed by MCA to ensure alignment with the emerging global concerns, the Sustainable Development Goals (SDGs), and the United Nations Guiding Principles on Business & Human Rights (UNGPs).

- **Global Reporting Initiative (GRI)** - GRI is an independent, international organization that provides standards for sustainability reporting. It also provides tools for integrating SDGs into sustainable reporting. These standards assist companies in reporting and communicating the ESG impacts transparently and accountably. Investors can easily assess, compare and decide their ESG investment strategy based on the reports.

- **Value Reporting Foundation (VRF)** – VRF is a global non-profit organization that offers a comprehensive collection of resources designed to help businesses and investors develop a shared understanding of enterprise value—how it is created, preserved, and eroded. VRF has three different resources that support business and investor in their decision making:

  - **Integrated Thinking Principles -** Through integrated thinking, organizations are better placed to tailor the business model and strategy to respond to the external environment it operates in and understand the risks and opportunities it faces.

  - **Integrated Reporting Frameworks -** Integrated reporting brings together material information about an organization's strategy, governance, performance, and prospects in a way that reflects the commercial,

social and environmental context within which it operates. An integrated report demonstrates the robust integrated thinking of the organization and is informed by comprehensive metrics and disclosure topics via the use of the SASB Standards.

- **SASB (Sustainability Accounting Standards Board) Standards –** SASB provides detailed industry-specific disclosure topics and metrics to inform what you include in your integrated report, lending insight into the subset of sustainability issues that are most closely tied to an organization's ability to create long-term value for investors. SASB currently has 77 industry-specific standards.

- **Carbon Disclosure Project (CDP)**: CDP is a not-for-profit that runs the global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts. Every year, CDP takes the information supplied in its annual reporting process and scores companies and cities based on their journey through disclosure and towards environmental leadership.

- **The Climate Disclosure Standards Board (CDSB):** CDSB is an international consortium of business and environmental NGOs that offers a framework for reporting environmental information with the same rigor as financial information. This framework helps companies to provide investors with decision-useful environmental information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials.

Being mindful of newly emerging global priorities, challenges, and expectations among different stakeholders allows Companies to formulate their ESG policy and position themselves more strongly. The above standards can be very helpful in designing and monitoring appropriate ESG programmes. Further, the adoption of the above standards can provide an opportunity to be visible in the global market and much-needed access to global investors and customers.

ESG COMPLIANCE – A GOLDEN OPPORTUNITY

Companies should consider ESG as an opportunity rather than a compliance ritual. Businesses need to be able to assess their ESG position and compliance level and benchmark it against the competition and sector as a whole. It is also essential for companies to be able to identify and manage ESG issues that are important and relevant for their business. In addition to ensuring compliance with regulatory framework, ESG integration into the business can derive substantial benefits to business which may include:

- **Cost Reductions –** While Companies may have to invest and incur costs to implement ESG initiatives, the cost of ignoring ESG can be substantially high. With the increase in ESG focused investment, the cost of financing for companies having high ESG scores will be decreasing over the years. Further ESG non-compliance will also mean higher regulatory, environmental, and litigation risks and fines.

- **Reputation –** ESG and reputation are inseparably linked with each other. A good corporate reputation is one of the greatest assets. During challenging times, public perception and a positive ESG reputation will grow and will lead to better relationships with the stakeholders. This will eventually lead to higher profitability and sustainable growth for the Company.

- **Employee Productivity –** Employees are the strongest advocates and facilitators in Company's ESG program and implementation. A strong ESG performance is becoming increasingly important to attract and retain talent. This also will reduce employee turnover, provide better customer retention, and increase productivity.

- **Investor Awareness –** Recently shareholder activism is putting a lot of focus on governance-related issues. Proxy advisors are playing a key role and ESG is one of the important factors wherein guidance is provided in ESG assessments and integrate ESG into their investment decisions.

- **Valuation:** Company's performance in ESG areas is going to put a premium on its valuation. With investors giving preference to companies having a high standard of ESG, it will reciprocate in increasing the wealth of the shareholders.

The benefits and results of ESG performance far outweigh the costs linked for its implementation and provide long-term value and business resilience. This also helps in responding to any disaster situation like Covid-19 in a much more effective way. The companies shall take immediate steps for leveraging their ESG and sustainability programs.

STEPS TO ESG COMPLIANCE

Section 166(2) of the Companies Act states that the Directors shall act in good faith to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment. This shows that directors have a fiduciary responsibility towards ESG and failure to comprehensively and adequately monitor ESG issues could well be considered as negligent in the performance of duties.

The Board of directors has the responsibility to provide vision and direction for the ESG approach of the Company. The Board should also be aware of current ESG status including determining the ESG matters that are most material to their business. Companies shall establish broad-level ESG strategy and oversight with clear allocation of function-wise responsibilities. Companies can consider adopting the below steps to start their journey towards ESG implementation:

- **Conducting health check**: It is important to make a honest assessment of the current compliance level towards ESG. Further companies need to identify key ESG areas which are going to materially affect the business performance and stakeholders.
- **Industry Benchmarking:** Conducting a benchmarking exercise into the assessment provides information on the ESG maturity of competitors. This will also help in understanding industry challenges, opportunities, and best practices related to ESG.
- **Establishing Governance Structure:** Companies have been setting up dedicated ESG functions within the organization and identifying specific goals for it. Apart from regular monitoring by the Board of Directors, it will be prudent that ESG progress is governed by a Committee of Directors.
- **Setting up ESG framework and Goals**: The crucial step is to build an ESG framework for the Company which will provide a roadmap. One can look at the established frameworks like UN SDGs and then identify goals that will align with business objectives, meet stakeholder expectations and also demonstrate commitment to ESG.
- **Policies and Processes:** ESG policies and procedures provide basic guidelines for its employees and to third parties dealing with the Company. These will include areas like responsibilities of each function, communication and awareness, internal controls, auditing practices, and reporting.
- **Implement ESG:** For effective implementation of ESG, it is necessary to ensure that there is integration between ESG and business practices. Each function shall be assigned responsibility and accountability towards key performance indicators of ESG and then regularly monitored for the identified deliverables.
- **ESG Risk Management:** Regulation 21 of LODR requires the formation of a risk management Committee for the top 1,000 companies by market capitalisation and conducting Risk Management for various risks including ESG related risks. Transparent and consistent assessment of ESG risks and their integration into the existing Risk Management Framework will provide a comprehensive risk framework. This will also mean that company needs to regularly review and update the ESG strategy depending on ever-changing business challenges or regulatory framework.
- **Reporting**: Accurate and transparent reporting of ESG data is important. Transparent reporting enables stakeholders to gain a clear picture of a company's direction and progression. Apart from BRSR companies can adopt some of the above-mentioned standards like GRI to arrive at an appropriate report.

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The above steps can act as guidance and will need to be modified depending on the needs of the business.

CONCLUSION

The philosophy behind the ESG criteria is to recognize the effect companies have on the environment and society as a whole. In the wake of changing global dynamics, ESG is no longer an option for any Company or even for any Country. The ultimate objective of the regulator is to enhance transparency to the stakeholder by providing relevant ESG related information. At the same time, ESG Management is becoming an integral part of investment decisions and environmentally and socially conscious investors will drive ESG implementation by the companies.

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