Regulators will drive the ESG agenda

With a 10% shareholding threshold to propose resolutions linked to climate or otherwise, investors have a limited ability to set the ESG agenda. They will need to engage with companies, seeking disclosures, targets, and transition strategies on ESG linked issues while the agenda is set by the regulators.

The Securities and Exchange Board of India (SEBI) constituted ESG (-Environment, Social and Governance) committee submitted its report in February 2023. Navneet Munot of HDFC Asset Management chaired the committee (-disclosure, I was a member). Based on this report SEBI sought public comments on a comprehensive set of issues. First, the regulatory framework for ESG Disclosures by listed entities, second on ESG Ratings in the securities market and third ESG Investing by Mutual Funds. It separately invited comments on the regulatory framework for ESG Ratings Providers (ERPs). Based on the consultations and feedback, the SEBI Board on 29 March signed off on a regulatory framework enabling us to determine the direction its regulations will take. Even as we await the final set of rules, there are a few pointers.

Navneet Munot believes that SEBI has "taken a holistic approach focusing on the Disclosure-Rating-Investment trinity."

Turning first to disclosures. SEBI made ESG reporting using the BRSR framework mandatory for the top-1000 listed companies from FY 2022-23 onwards. For FY 2021-22, it was voluntary. While companies have just begun reporting, a few issues need addressing.

There are several issues that are likely to be addressed regarding disclosures. The first being how relevant is the global ask. Global disclosures do not always resonate with what is seen as being critical either to Indian companies or to our economy. Asking for a 'racial equity audit to identify adverse impacts on non-white stakeholders' or 'asking companies in the financial sector to set policies ending or restricting financing fossil fuels,' are just two examples. Companies will have no reason to address the first and the second is at odds with our current national priorities.

There is then the issue of greenwashing, which is nothing but putting a spin to show that a company's activities have a greater positive environmental impact than they actually do. Greenwashing is likely to be addressed through seeking reasonable assurance on nine parameters, referred to as 'BRSR Core.' These nine parameters are reflective of India's unique ESG challenges. The BRSR Core is expected to substantially facilitate this data capture. And as reasonable assurance can only be provided if there is clarity on parameters and their measure, these have been specified and such assurance has been made mandatory for the top 150 companies from 2023-24 expanding to 1000, in two steps, by 2026-27. For many entities, in addition to their own operations, the supply chain needs monitoring.

"This proposed roadmap for enhancing BRSR disclosures, including assurance with a glide path is aimed at addressing the need for relevant, credible and comparable data, while keeping in mind the cost of compliance," asserts Mr. Munot.

On ratings, the focus is on India-centric parameters and standards. In calling for a more standardized approach, the focus is on minimum specified criterion - although ERPs are free to add to these. As with almost all of SEBI's regulations, the emphasis here too is on disclosures of such ratings and the underlying rationale.

The third pillar are investors. Although less than US$ 1.5 billion of AUM invested in ESG-linked themes in our market, global estimates going as high as US$ 8 trillion, suggest that the Indian fund management industry is soon set to embrace this theme.

Funds can expect more disclosures around ESG, including engagement reporting. And in anticipation of a coming rush of funds, ESG Schemes are likely to be moved to a category of their own (- like large-mid-and-small cap) rather than a theme, allowing more stringent reporting.

The question to ask is, will SEBI and regulators continue guide companies on how to navigate the ESG waters? Do investors or stakeholders have a role?

In the US they believe they do. Shareholders here have already filed 542 shareholder resolutions on ESG issues this year, in line with 2022 which had a final total of 627. Contrary to what one might expect, such proposals are less common in continental Europe, partly because funds are less activist or unwilling dictate company strategy. This is also explained by the different regulatory thresholds for submitting shareholder proposals. Under SEC rules, this can vary from $2,000, $15,000, or $25,000, depending on the holding period. In Europe, this is higher, at 5% of the share capital, but member states may have other restrictions. For example, in Netherland such proposals need board approval.

ClientEarth, a registered environmental charity, has created two guides, for Europe and Asia, for regulations on climate-related shareholders resolutions. Cyril S. Shroff, Managing Partner, Anchal Dhir, Partner, and Richa Roy, Partner, of Cyril Amarchand Mangaldas; Umakanth Varottil, Associate Professor at the Faculty of Law, National University of Singapore contributed on the section on India.

The rules in India require 10% shareholders to propose a resolution – liked to climate or otherwise. Further climate and social matters do not typically fall within the types of matters that investors can ordinarily bring to vote. So, investors will engage with companies, seeking disclosures, targets, and transition strategies. Companies will do what they need to. But it will be the regulations that will drive the ESG agenda.

A modified version of this blog was published in Business Standard on 24 May 2023. The newspapers subscribers can access the blog by clicking this link or typing the following in your url: https://www.business-standard.com/opinion/columns/regulators-will-drive-the-esg-agenda-123052301213_1.html

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This article is a commentary on general trends and developments in the capital market.

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