ESG NEWSLETTER

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Dear Members,

We are happy to share the First News Letter on Environmental, social, and governance.

ESG stands for environmental, social, and governance, and it is a set of standards that are used to screen potential investments or third parties.

The Sustainable Development Goals is the initiative of the United Nations (UN) and the biggest joint objective of the international community.The goals include a wide range of social problems (poverty, diseases, education, women, children, refugees, disputes etc.), environmental problems and climate change (climate change, energy, environmental pollution, water, biodiversity etc.), economic problems (technology, housing, working conditions, labour, employment, production and consumption, social structures, laws, infrastructure construction, domestic and international economy). The SDGs consists of 17 goals.

- **Goal 1: End poverty in all its forms everywhere**
- **Goal 2: End hunger, achieve food security and improved nutrition, and promote sustainable agriculture**
- **Goal 3: Ensure healthy lives and promote well-being for all at all ages**
- **Goal 4: Ensure inclusive and equitable quality education and promote life-long learning opportunities for all**
- **Goal 5: Achieve gender equality and empower all women and girls**
- **Goal 6: Ensure availability and sustainable management of water sanitation for all**
- **Goal 7: Ensure access to affordable, reliable, sustainable, and modern energy for all**
- **Goal 8: Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all**
- **Goal 9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation**
- **Goal 10: Reduce inequality within and among countries**
- **Goal 11: Make cities and human settlements inclusive, safe, resilient and sustainable**
- **Goal 12: Ensure sustainable consumption and production patterns**
- **Goal 13: Take urgent action to combat climate change and its impacts**
- **Goal 14: Conserve and sustainably use the oceans, seas and marine resources for sustainable development**
- **Goal 15: Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss**
- **Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.**
- **Goal 17: Strengthen the means of implementation and revitalize the global partnership for sustainable development**

Environmental, social, and governance, which was earlier considered as a non-financial factor, have now emerged as core values of companies also to major financial institutions, and stakeholders at the Global level. They are considered deeply in core management strategies that companies must implement for sustainable management and investment. Particularly, since the outbreak of COVID-19 in 2019, "eco-friendly," "social value," and " ethical behavior" have become the main policies of governments.

ESG finance is an investment method that shareholders and institutional investors consider with the company's financial factors in terms of "sustainable investment" when making investment decisions in a company, reflecting social and ethical values and eco-friendly sustainability.

Considering the Importance of ESG the securities market regulator, Securities and Exchange Board of India in its Board Meeting dated 29/03/2023 has Approved the Frame work for ESG disclosures by Listed Entities, ESG ratings in the securities market, and ESG investing by mutual funds to facilitate a balance between transparency, simplification and ease of doing business in an evolving domain.

In Addition to the above frame work the regulator has cleared a proposal for a regulatory framework for ESG Rating Providers in the Indian securities market and related proposals on enhanced transparency in ESG rating rationales, measures to mitigate conflict of interest by ERPs, facilitating augmentation of transition finance in India and ESG ratings based on assured data.

This newsletter covers articles on Environment, Social and Governance as well as the recent development with respect to Environment, Social and Governance.

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Standardising ESG reporting

Environmental, Social, and Governance (ESG) reporting has gained significant traction in recent years as investors, customers, and regulators are increasingly demanding more transparency and accountability from companies regarding their non-financial performance.

However, there is a lack of standardisation and consistency in ESG reporting, making it difficult for stakeholders to compare and assess companies' ESG performance accurately.

Multiple frameworks and standards such as Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Task Force on Climate-Related Financial Disclosures (TCFD), Business Responsibility and Sustainability Report (BRSR), and more provide guidance to companies on ESG reporting. These frameworks differ in their stakeholder focus, metrics, and scope—leading to confusion, both for companies and stakeholders. For example, the GRI requires companies to prepare their ESG disclosures with a broader focus on sustainability issues while the SASB focuses on industry-specific financially material ESG issues that can impact companies' financial performance. This variation in scope and metrics makes it difficult for stakeholders to compare ESG performance across companies and sectors.

In 2020, five leading sustainability reporting organisations globally announced their intention to collaborate on a comprehensive corporate sustainability reporting framework to provide a streamlined and consistent approach towards ESG reporting. COP26, held at Glasgow in November 2021, witnessed the announcement of the International Sustainability Standards Board (ISSB) to develop and promote global sustainability standards for the private sector. Established under the auspices of the International Financial Reporting Standards (IFRS)

Foundation, the ISSB is expected to release the final drafts for IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-Related Disclosures by June 2023 and make them effective starting January 2024.

As financial and non-financial disclosures requirements align, the key challenge for companies will be to integrate diverse metrics into a common report that meets the requirements of different stakeholders. Integrated Reporting (IR) is an approach that aims to integrate a company's financial and non-financial performance into a single report. It encourages companies to report on their strategic objectives, business model, and the broader context in which they operate, including their ESG performance.

Standardising ESG reporting

For companies to prepare for IR, they need to undertake a few key steps:

- Companies need to develop a clear understanding of how they create value over time (i.e., their value creation model). This involves identifying their key stakeholders, resources capabilities they utilise, and the broader social and environmental context in which they operate.
- Companies must embed ESG considerations into decision-making processes. This requires engaging with stakeholders, analysing risks and opportunities, and developing appropriate policies and procedures to manage ESG issues effectively.
- They need to conduct materiality assessment and identify relevant ESG metrics that matter the most to their business and stakeholders.
- Investing in data collection and management systems is key to effectively report on ESG performance. This involves identifying the relevant data sources, ensuring data quality and consistency, and reporting on the metrics in a standardised and comparable format.
- Effective stakeholder engagement is critical to the success of Integrated Reporting. Companies need to engage with their stakeholders, including investors, customers, employees, and communities to understand their expectations and receive feedback on the company's performance.

By integrating ESG considerations into financial reporting, IR helps companies identify and manage ESG risks and opportunities, enhancing their decision-making and ultimately driving sustainable value creation. Consider the practice of quarterly financial performance reporting. Driven by several factors, including regulatory requirements, investor expectations, and market pressures; a myopic focus on this may lead to prioritisation of factors favorable to enhancing short-term financial performance instead of long-term value creation. IR encourages companies to adopt an integrated thinking approach and report on their performance across multiple dimensions, including financial, social, environmental, and governance aspects. In doing so, companies can better understand and communicate their interdependencies between financial and non-financial performance—enabling them to illustrate the holistic value created over time and demonstrate how they are managing risks and opportunities in a sustainable way.

In 2017, the Securities and Exchange Board of India (Sebi) advised the top 500 listed companies to voluntarily adopt IR. Since then, according to a study conducted by the IFRS Foundation in 2022, over 2,000 companies in more than 70 countries have adopted the IR framework.

Further solidifying the growing role of IR in corporate reporting, the ISSB has encouraged the continued use of the IR framework to help achieve a globally accepted, comprehensive corporate reporting system.

Going forward, the adoption of IR will continue to grow—driven by several factors, including the increasing demand from investors for more comprehensive and integrated information, the need for companies to manage ESG risks and opportunities effectively, and the desire to demonstrate their commitment to sustainability and long-term value creation.

The case for embedding ESG into corporate strategies

With climate and sustainability slowly taking center stage, increasing attention is being paid to environmental, social and governance, or ESG, by all manner of stakeholders — investors, policymakers, regulators, corporates, and customers.
Yet, few organisations in India have been able to align their business strategies with it.
A comprehensive ESG vision, when plugged into a corporate strategy has the potential to deliver immense financial and non-financial value to an organisation over the long term.

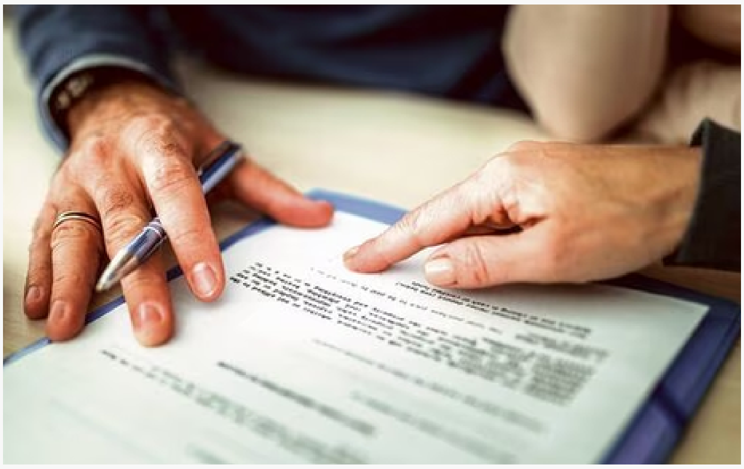
The financial value would be in the form of cost reduction, increased productivity, ramping up of sustainable products, and better access to finance.
Several academic studies have shown that companies with higher ESG scores reduce their cost of capital by up to 10%.

Further, ESG-focused companies tend to have better operational efficiency, lower employee turnover rate, increased innovation, strong governance, reduced compliance costs, and better risk management — all of which bode well for shareholder value.

Businesses focusing on ESG initiatives have started attracting investments as the demand for sustainable investing has grown exponentially. For instance, according to data from Climate Bonds Initiative, annual green bond issuance topped the half-trillion mark for the first time, ending 2021 at $522.7 billion, a 75% increase on the prior year sum. India is also witnessing a number of ESG-focused funds, including both private equity and venture capital funds, wherein investors are looking towards organisations integrating ESG right from the inception stage.

Challenges linger

Despite growing awareness, there are roadblocks to ESG adoption in India.
As on date, only 121 organisations in India have committed to near- or long-term science-based emission reduction targets, as per Science Based Target initiative (SBTi) database. Of these, only 38% have got their targets validated from Science Based Target Initiative. Given the size and ecosystem of India Inc., these numbers are minuscule.



The first and main challenge faced by organisations in India is lack of understanding on the benefits ESG offers. This is even more pertinent in case of small and mid-size businesses. Most perceive ESG practices as a cost rather than an opportunity, which means the default move is to backseat ESG centric investments.

Second, given the breadth and scope of ESG, it involves collaboration of multiple stakeholders, some of whom have very limited understanding and clarity about their role in the organisation's sustainability journey.

The case for embedding ESG into corporate strategies

Third, unavailability of data and associated quality-related issues continue to be an obstacle in integrating ESG within an organisation's strategy.

Fourth is the absence of skilled ESG professionals capable of working within the confines of sustainability from an operational perspective. This is further complicated by frameworks and regulations, which are evolving at a pace never experienced before.

Ways to bring ESG to the mainstream

Still, the shift in management thinking with regard to the benefits of ESG is gaining ground. There are several ways to integrate ESG into corporate decisions that lead to sustainable development:

- Foremost is to have clear accountability and oversight at the Board level. This can be achieved through Board-level ESG committees or individual positions such as Chief Sustainability Officer (CSO). Some organisations have even gone a step further and formulated Board-level climate risk committees
- At the management level, senior executives must take responsibility and ensure that the future investments are ESG-centric and a sustainability culture is percolated and embedded at the bottom of the pyramid. This will eventually change a company's business model radically
- Organisations need to make ambitious ESG targets material to their business and prepare implementation roadmaps to achieve these targets. While conducting the materiality analysis, it is important that organisations consider double materiality i.e., the inward impact (of environment/climate on organisation) as well as outward impact (of organisation on environment and society). This would help in making their operations resilient to ESG-related risks
- Supply chain is a critical component to any business' success. It is essential that organisations identify emission hot spots and address risks within the supply chain, specially from a climate risk perspective
- Take stewardship responsibilities for products manufactured by instilling eco-design principles that consider product sustainability from start to finish
- It is also imperative to report and communicate assured data at least on an annual basis. This would boost investor and stakeholder confidence, and thwart green washing .
- Lastly, the journey toward sustainability involves multiple stakeholders within the organisation. Therefore, it is important to upskill employees with ESG skills to enable them to appreciate their role and contribute towards the organisation's sustainability journey

Mainstreaming ESG-led investing can have several benefits at the national level, too. According to a report by the World Economic Forum in 2021, India's green economy transition is expected to create over 50 million jobs and have an economic impact of over $1 trillion by 2030 and $15 trillion by 2070. The energy transition would require an accelerated approach to green technology innovation, a comprehensive framework to catalyse green finance, and a plan for climate adaptation.

Explained: Growing popularity of ESG funds and the recent Sebi guidelines

Environmental, social, and governance (ESG) funds have been a topic of interest for a while now with the funds providing returns as high as 3x. While ESG investing has been around for over 50 years now, it is still in its early days in India with only a few schemes being offered by asset management companies (AMCs). To understand, ESG investing is all about considering the impact of an investment on the environment, society, and governance.

The growing popularity

This type of investing is becoming more popular, especially among millennials who care about the future, said Tejas Khoday, co-founder and CEO at FYERS.

"In fact, there's already $37.8 trillion invested in ESG funds, and this number is expected to go up to $53 trillion in the next few years globally. The regulators are trying to create awareness and provide guidelines through different measures," Khoday told CNBC-TV18.com.

Sebi's recent norms and credibility

Recently, market regulator Sebi announced a slew of measures to boost ESG-based investing in India through mutual funds. The fund houses have been given the freedom to launch more than one ESG scheme now.

"Though the step is emerging, it is opening a myriad of options for the investor community to invest in funds or a pool of companies that are adopting the ESG risk management framework, promoting social welfare, and having oversight on sustainability targets. Sebi's norms for third-party assurance on the ESG scheme and the fund manager's commentary will bring more credibility to such ESG funds," Prosenjit Ghosh, Group Chief Business Officer at Acuite Group, told CNBC-TV18.com.

Explained: Growing popularity of ESG funds and the recent Sebi guidelines

Current shortcomings

The environmental issues have expanded from the adoption of renewable energy to carbon pricing and carbon offsets. On the other hand, social issues in the areas of data privacy and security, diversity and inclusion have become very critical.

The challenge for companies, Ghosh said, lies in measuring, monitoring, and reporting.

"With Sebi mandating Business Responsibility Reporting (BRR) in 2015 and further Business Responsibility Sustainability Reporting (BRSR) in 2022, the disclosure levels of companies have improved. As per ESGRisk.ai, transparency scores that reflect the disclosures of companies have increased from 48.7 in FY19 to 58.5 in FY21 for NSE top 1000 companies," Ghosh told CNBC-TV18.com.

Sebi has mandated mutual funds to invest at least 65 percent of AUM in listed entities. Investors are increasingly looking for companies that make a positive impact on society and the environment. Proper disclosures along with evidence will improve the quality of reporting.

Mis-selling and greenwashing

There are many colours of ESG misreporting by companies as part of their Annual Report or Sustainability reports, such as greenwashing stakeholders and the public being misled about the organisation's environmental impact and/or initiatives. Then there is pinkwashing as well as whitewashing.

Greenwashing is an exaggerated claim about something's sustainable. On the other hand, pinkwashing is when entities practice fake advertising support to the LGBTQIA+ community.

Whitewashing means where entities report biased ESG data, etc.

"In such cases, if the AMC is aligning its ESG investment strategies and complying to only invest in companies that have assurance for core ESG parameters, and where the objectives of the scheme are met, then mis-selling of ESG funds is prevented. Further, the mis-selling of funds is possible where the fund manager is not factoring in the impact of the controversy or monitoring only financial indicators and diluting the significance of ESG parameters. It is very important for AMCs to have clear objectives for their ESG schemes and create a screening process for selecting and monitoring the portfolio," Ghosh told CNBC-TV18.com.

Are Indian companies ready for mandatory ESG disclosures?

Shakti Deb and Trisha Shreyashi

Environmental, social, and governance (ESG) agendas are progressively gaining prominence among regulators, investors across the globe, corporate boards and G20 summits. There is an increased commitment of their portfolio to ESG considerations as evident from ESG Mutual Funds. At the same time, indictments of greenwashing have also amplified.

Greenwashing entails a marketing strategy to exploit environmentally or socially conscious stakeholders by disclosing untrue or deceptive information about ESG practices. Greenwashing is due to a lack of standardised ESG norms, where some companies find leeway to disclose favourable ESG practices and hide negative practices through word puzzles. Thus, regulatory efforts to streamline ESG practices are gaining momentum across the globe.

ESG Compliance Gets Going

The capital market regulator- Securities and Exchange Board of India (SEBI), has taken a giant leap in ESG compliance. Initially, it came out with the Business Responsibility and Sustainability Report (BRSR). Recently, SEBI introduced a Consultation Paper on ESG Disclosures to update BRSR in terms of incorporating Key Performance Indicators on ESG (as BRSR Core). The introduction of the BRSR Core includes a constrained set of Key Performance Indicators (KPIs) under each E, S, and G attributes, for which listed organisations shall be required to have reasonable assurance that improves the credibility of ESG disclosures. It shall apply to the top 150 listed companies from FY 2023-24 and gradually extend to the top 1,000 companies by FY 2026-27. It is an epic journey of ESG reporting in India, starting from humble beginnings and evolving into a force for good. This decision marks a pivotal moment in the pursuit of sustainable finance. It will have a ripple effect in bringing smaller suppliers and service providers within the ESG fold, thereby resulting in deeper penetration of sustainability practices across all tiers of the business ecosystem. The prospect of it becoming mandatory for all listed companies is something to look forward to. It is, however, contested that this might make companies grumble over the tedium of compliance.

Are Indian companies ready for mandatory ESG disclosures?

Curbing Greenwashing

SEBI's measures reiterate the evolution in the corporate disclosure era, where companies must guarantee responsible disclosure by providing third-party assurance. The concept of assurance is not a new phenomenon in corporate governance understanding. It is an obvious expectation from any reporting entity. Assurance of ESG disclosures aims at cracking down on attempts of greenwashing.

Although assurance plays a vital role in guaranteeing the quality of ESG disclosure, it does not supplement the monitoring role of investors. Investors need to comprehend any admonitions attached to an ESG assurance report and be equipped to assess to what extent a reporting company is committed to ESG considerations.

Quality Of ESG Disclosures

Process-oriented assurance indicates whether ESG disclosures conform to a particular ESG reporting standard. In contrast, content-oriented assurance connotes whether the reporting is credible enough to be relied upon regarding the quality and completeness of the information disclosed.
Content-oriented assurance is costlier than process-oriented assurance as it demands that the assurance provider appointed is independent and credible in terms of possessing functional expertise on every strategised parameter of the ESG factors. Therefore, some firms may comfortably switch to process-oriented assurance due to their familiarity with the said approach in financial auditing practices.

The SEBI proposed KPIs on ESG and the detailed assurance approach. Yet the one-size fits all applicability of such KPIs may render a challenge for companies to pursue corporate purpose-driven ESG considerations. Ideally, corporate purposes must irradiate ESG considerations. Also, the demand of stakeholders is ever-changing; hence companies must leverage to approach ESG driven by corporate purposes.

To survive and scale up in the tectonic shift in the demand for disclosure from mere corporate disclosure to ESG disclosure, companies must reflect and disclose the rudimentary premises of ESG implementation. It entails how ESG considerations are internalised within their governance framework, materiality assessment of ESG parameters, resource investment for harmonising ESG with business purposes, challenges in ESG integration, impact of ESG mandates on organisational performance and projected impact. These disclosures may serve as robust gestures of ESG commitments and an add-on to the assurance process.

Due to funding winter ESG-led funding reaches $7.9 bn in 2022: Report

Of the overall private equity and venture capital investments of USD 61.6 billion in India, as much as 13 per cent or USD 7.9 billion came through the ESG route in 2022, as per an industry analysis.
As the funding winter deepened from the first quarter of 2022 after the Russian invasion of Ukraine and the resultant risk aversion, the overall funding from PE/VCs into the country declined 12 per cent from the 2021 peak, when it had scaled USD 69.8 billion, according to a report by industry body Indian Venture and Alternate Capital Association (IVCA), prepared by Bain & Company.

But the report noted that ESG (environment, social and governance) focused investment route emerged as a breakout theme in 2022, with investments in clean energy and electric vehicle companies accelerating to reach USD 7.9 billion, which was more than double from 2021 and 13 per cent of the yearly netting, accordingly to the report.

ESG has gone beyond being a mere talking point to becoming a key driver of deal-making, with the share of ESG-aligned investments reaching almost 13 per cent of the total PE-VC investments in 2022 at USD 7.9 billion from around 5 per cent in the previous few years, the report said.

Going forward, it is clear that the ESG agenda is shifting from mind-share to wallet-share, especially in key sectors of clean energy and mobility, the report added.
ESG investment is largely concentrated in clean energy (solar and wind power) and electric mobility -- which contributed to around 90 per cent of the USD 19.2 billion invested in ESG across 2018-22. Clean energy, especially solar, saw strong deal activity in 2022 with investments of USD 5 billion.

The year also saw marquee deals, such as the UAE fund Mubadala and Blackrock entering Tata Power, KKR in Serentica Global and Hero Future Energies and TPG Rise in Tata Motors' EV arm Tata EV, the report added.
The electric mobility segment is also growing and has attracted over USD 4 billion since 2018 and is gaining more traction.

According to the report, there is significant movement in the domestic EV market, which saw more than 150 per cent growth in deal value to USD 2 billion in 2022. Electric two-wheelers are expected to see increasing penetration from 2-3 per cent in 2021 to 18-20 per cent by 2026 as they become more cost competitive.

India's share of private equity and venture capital investments in Asia-Pacific grew from 15 per cent in 2021 to 20 per cent in 2022, as China plus one tailwind and India's macro robustness made it a bright spot for investing amid decelerating capital flow into the region.
Private equity has seen remarkable growth, especially in the past decade, from an investor base of 200 to over 800 now, as well as an expansion in exit opportunities.