Dhir & Dhir
Advocates & Solicitors
25 YEARS

THE HORIZON

Vol. 5 | Issue 2

ENVIRONMENTAL, SOCIAL & GOVERNANCE - NOT JUST ABOUT CLIMATE CHANGE?

The year 2020 witnessed two realities of both COVID-19 and the Black Lives Matter movement, which showcased the importance of ESG

Environmental, Social & Governance - Not Just About Climate Change?

SONAL VERMA, Partner & Global Leader (Markets & Strategy)
FAUZIA KHAN, Legal Associate

The year 2020 witnessed two realities of both COVID-19 and the Black Lives Matter movement, which showcased the importance of ESG and bringing the "S" in ESG to the forefront for society & businesses. ESG is no more only about climate change & carbon emission. Each component of ESG needs better implementation as per local laws & global principles.

ESG - a new age concept that is focused on crucial aspects of sustainability, ethical business functions, and adherence to the requisite global laws and procedures. Environmental, Social, and Governance (ESG) is a concept which is here to redirect global financial flows towards low-carbon economic growth. While worldwide, climate change continues to remain the leading concern, a survey on the acceleration of sustainable investing revealed that 58% of respondents believed that concerns over social issues such as diversity and inclusion of fair labour practices are expected to rise the most in the next 3-5 years[1].

The Financial Times Lexicon defines ESG as "a generic term used in capital markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies." The ESG components are taken into account as factors that help ascertain investment decisions and risk management with a sustainability lens within the organization. The primary objective is to build a culture that encourages, promotes, and achieves business standards that are more

Photo by Markus Spiske from Pexels

conscientious and are more likely to succeed in the long run.

A recent market intelligence report analyzed 17 exchange-traded and mutual funds with more than US$250m in Assets under Management[2] that select stocks for investment based in part on ESG criteria. With the world transformation at its peak today, there has been a surge in investors' demand for companies to disclose their evaluation process of identifying and measuring intangible assets and the ESG valuation that has an impact on the long-term value creation. A 2021 global institutional investor survey observed the growth in ESG integration during the global pandemic and its further rise among the institutional investors. A majority of the respondents were seen to consider climate crisis as a form of risk mitigation and that 31% of the largest institutional investors believe climate change to have a significant impact on organizational investments over the next three to five years.[3]

Background

The ESG journey began in 2004 when former UN Secretary-General Kofi Annan invited over 50 CEOs of major financial institutions to participate in a joint initiative to integrate ESG into capital markets. Subsequently, two reports, titled "Who Cares Wins" and "Freshfield Report" were published respectively. The reports featured how ESG issues are relevant for financial valuation and embedding environmental, social and governance factors in capital markets, and the potential to improve good business sense, thereby leading to more sustainable markets and the societies' overall upliftment. The two reports have served as the backbone for the Principles for Responsible Investment (PRI), a successful global initiative with over 1,600 members representing over $70 trillion Assets under Management (AUM). In 2017, the Network for Greening the Financial System was established as a global network of central banks and supervisory authorities advocating a financial system that supports the practice of sustainable development. This was followed by the European Union action plan for sustainable growth.

After that, numerous initiatives have been introduced globally, including stock exchanges, regulatory bodies, and institutional managers, amongst other industry-driven task forces. These are constituted to provide guidelines and recommendations on how to better integrate environmental, social and governance issues in sectors including asset management, securities brokerage services and associated research functions. Research shows that a well-integrated ESG practice can contribute to a healthier, more resilient and trusted financial market and further facilitate a contribution to sustainable development.

A report by the CFA Institute, the global association of investment professionals, observed 73% of the respondents to expect ESG ratings to influence a firms' cost of capital at a greater value in the coming years. Moreover, investment professionals expect a substantial rise in components like ESG index tracking a, climate transition strategies and global benchmarks on sustainable investing.[4]

Decoding ESG

The past few years has seen a growing trend of ESG investments, which although has a long way ahead, the investors community has witnessed a significant shift in focus from a pure risk-based approach to real world outcomes. The concept of ESG risk as a screening portfolio test for global investors help transition towards more sustainable business models and further contribute to sustainable development.

Environment signifying the "E" refers to the organization's functioning in the natural environment, which are exposed to major environmental risks including direct

We live in a rapidly evolving world with major sustainability challenges such as resource efficiency, climate change impacts and transitional risks, which keeps emerging with the introductions in regulatory and policy changes. For instance, COVID-19 has significantly influenced how stakeholders and organizations approach ESG.

financial and operational implications. The environmental aspect of ESG consists of an examination by investors of a company's natural resource usage, impact of its operations and value chain on the environment, including through resource use and carbon emissions. Some of the environmental components include climate change, carbon emissions, water crisis, renewable energy and natural capital.

"S" denoting Social in the ESG concept refers to the impact businesses have on their stakeholders i.e. customers, employees and in the communities they operate. Considering social factors as part of sustainable investing can be rewarding as the market responds to those who adequately safeguard social issues.

The Governance aspect is denoted by the letter "G" which involves corporate governance and business integrity. While the former pertains to the policies and procedures to be adhered to by organizations, the latter signifies how a company deals with corruption, bribery and avoid engaging with parties who may risk an organization's reputation. Governance covers components such as corruption & bribery, business ethics, board governance, diversity and ownership.

Global Regulatory Framework

1. Sustainable Development Goals (SDGs): Also referred to as the global goals for a sustainable future, the SDGs were adopted in 2015 by all UN member States. The 17 SDGs represented a universal call for immediate action to conserve the environment, address climate crisis, curb poverty and ensure that all nations achieve their targets for sustainability by 2030. The action recognized and integrated 17 SDGs having the potential to balance social, economic and environmental sustainability. These goals are beneficial to businesses as adhering to the same improves the company's corporate security & resilience and further demonstrates its alignment with society's national interest and upliftment.

2. The Sustainability Accounting Standards Board (SASB): An independent organization that has benchmarked standards for disclosure of financially material sustainability information by companies to their investors. These standards have identified ESG issues as most relevant to financial performance across industries.

3. Equator Principles (EPs): A risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects. It is primarily intended to provide a minimum standard for due diligence and monitoring to support responsible risk decision-making. At present, 37 countries have officially adopted the EPs, covering most international project finance debt within developed and emerging markets.

4. International Financing Corporation (IFC): An international financial institution, affiliated to the World Bank, which provides advisory and asset-management services with the objective to promote private-sector development in lesser developed countries. It uses means like loans and direct investments for such financing. It sets out performance standards, which are taken into consideration for accountability on environmental and social risks pertaining to an investment.

5. Global Reporting Initiative (GRI): It helps businesses, governments and other organizations understand and communicate their impacts on climate change, human rights and corruption. Its sustainability standards serve as an accountable and transparent common ground for organizations to consistently and credibly analyse and report their sustainability impacts.

6. Organisation for Economic Co-operation & Development (OECD): An international organisation that works to build better policies for better lives. The purpose is to shape policies that foster prosperity, equality, opportunity and well-being for all

7. The International Organization of Securities Commissions(IOSCO): Sector Specific Governing Laws & Regulations: Amongst various other regulatory bodies and global standards initiatives, one such standards is IOSCO, which is a task force created with primary focus on ensuring sustainability of finance and to gear up global efforts for an effective resolution of such issues. It includes improving sustainability-related disclosures and collaborating with other international organizations and regulators to avoid duplicative efforts and to coordinate supervisory approaches.

Impact Investing & Sustainable Financing

We live in a rapidly evolving world with major sustainability challenges such as resource efficiency, climate change impacts and transitional risks, which keeps emerging with the introductions in regulatory and policy changes. For instance, COVID-19 has significantly influenced how stakeholders and organizations approach ESG. While climate change risk is in the forefront, the impacts of the pandemic have been well documented, which indicate the social risks on an equal footing, thus, emphasizing on the need to adapt, to understand and indulge in ESG investments. A comprehensive ESG data analysis can offer respite in identifying and resolving impending hidden financial risks.

Traditionally, investments were focused on financial returns. However, with changes globally, businesses are moving towards more ethical and long term impact investments. Impact investments are investments made with a two-fold intention, i.e., to generate measurable social and environmental impact alongside a financial gain. Today, investors have begun to acknowledge that social and environmental issues also have a material impact to the financial outlook of investments. A noticeable trend shows that the investors are moving towards incorporating ESG aspects into their decision-making processes.

Various studies have evidenced how investments driven good management of ESG issues can contribute to stronger market value creation. The ESG driven investing has matured to the point where it can greatly accelerate market transformation for the better. As conglomerates and investors experience greater responsibilities, influence and status, their operations and commitments contribute significantly in creating the future.

REFERENCES

[1]http://bit.ly/accelerationinsustainableinvesting

[2]http://bit.ly/esgfundsoutperforming_covid

[3]http://bit.ly/MSCI2021

[4]http://bit.ly/futureofsustainability

Key Updates - ESG

GLOBAL

1. The Biden Administration has been in the news for its robust policy and regulation reforms. The Administration is keen on expanding its focus in the ESG segment and is expected to issue the right framework that amplifies the integration of ESG factors in the American business initiatives. Read More

Some of the major reforms include;

• The Securities Exchange Commission (SEC): Gary Gensler, nominated by the President Biden to be the next chairman of the Securities and Exchange Commission. Assuming his confirmation, Genslor is expected to mandate ESG reporting and disclosures under the SEC. Read More

• Executive Order on Preventing and Combating Discrimination on the Basis of Gender Identity or Sexual Orientation (20 Jan 2021) This is of paramount importance on the Social aspect post the Black Lives Matter movement. Read More

• As per 4 Feb, 2021 press release on the White house portal, efforts to rejoin The Paris Climate Change agreement has started. This is a very important change for further focus on ESG as American corporates play a major role globally. Read More

Department of Labour: With impact investments at its peak, the Biden Administration is expected to encourage ESG investments, which was earlier neglected and not possible under the previous Administration. Read More

Environmental Protection Agency (EPA): The highlight of the Biden Administration's approach towards addressing climate change is the EPA. The objective of the current Administration is to prioritize environmental justice and incorporate relevant action to maintain human rights standards. Read More

2. Last year, US saw remarkable investments of $47 billion into investment strategies having a key focus on the ESG aspects. Read More

3. The increasing popularity and demand for ESG investments paved the way for the design of an ESG Diligence Questionnaire by the Loan Syndications and Trading Association at New York. The survey is to be completed by borrowers during the initial loan process with the purpose of deriving the requisite details from borrowers with respect to ESG aspects pertaining to the borrowing. Read More

INDIA

Budget 2021 – ESG Principles embraced for India's Growth

During her speech at the Union Budget 2021-22, the Finance Minister, Nirmala Sitharaman highlighted the 6 pillars of the budget this year. An analysis of these pillars, projects a framework of global acceptance, making India a liberal and attractive nation for trade and global supply chains passing through.

1. Health & well-being

2. Physical & Financial Capital and Infrastructure

3. Inclusive Development for Aspirational India

4. Reinvigorating Human Capital

5. Innovation and R&D

6. Minimum Government & Maximum Governance

The budget is likely to create a space for India as the fastest growing nation in the world and a pioneer in integrating the ESG framework alongside integration of the 17 Sustainable Development Goals (SDGs) for a sustainable future.
Read More

• Every company having net worth of rupees 500 crore or more, or turnover of rupees 1000 crore or more or a net profit of rupees 5 crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent Director. On 22nd January, 2021, many more changes have been introduced on CSR in India. Read More

• Proposed amendments to the mining laws, Mines and Minerals (Development and Regulation) Act, 1957, emphasizes on validation of environmental clearances.
Read More

• Due to the COVID-19 pandemic, companies will receive certain compliance relaxations with respect to the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations such as General Meetings, EGMs, physical copies of annual reports, etc. Read More

• Under Regulation 7 of SEBI (Prohibition of Insider Trading) Regulations, 2015, certain disclosure formats have been revised.
Read More

• National Green Tribunal in the matter of Aryavart Foundation Vs M/s Vapi Green Enviro Ltd. & Others dated 05/02/2021. NGT ordered to strengthen the functioning of environmental regulators. The issue of compliance of judgement of the Supreme Court was examined. Aspects of manning and functioning of the statutory environmental regulators is of key importance. Read More

THE FIRM IN NEWS

Dhir & Dhir Associates ropes in Sonal Verma to Lead the ESG Practice

Clients will Benefit from an ESG focused Global Advisory Desk

Dhir & Dhir Associates, a full-service law firm founded in 1993, has serviced clients globally as a single-window legal and regulatory advisor. The firm has offices in New Delhi, Mumbai, and Hyderabad and a representative office in Japan. The firm is now geared up to set up the ESG (Environment, Social & Governance) Practice. The decision comes after observing sustainable development, governance, risk and compliance becoming a central stress point at all global business forums, including the World Economic Forum. In India, the firm would be the first to launch a dedicated ESG practice led by Sonal Verma, who, in his last stint, led the Governance, Risk and Compliance focused consulting business at Legasis Services, Mumbai.

Read more in the coverages below;

mint | ASIAN LEGAL BUSINESS | BENZINGA | FOX34

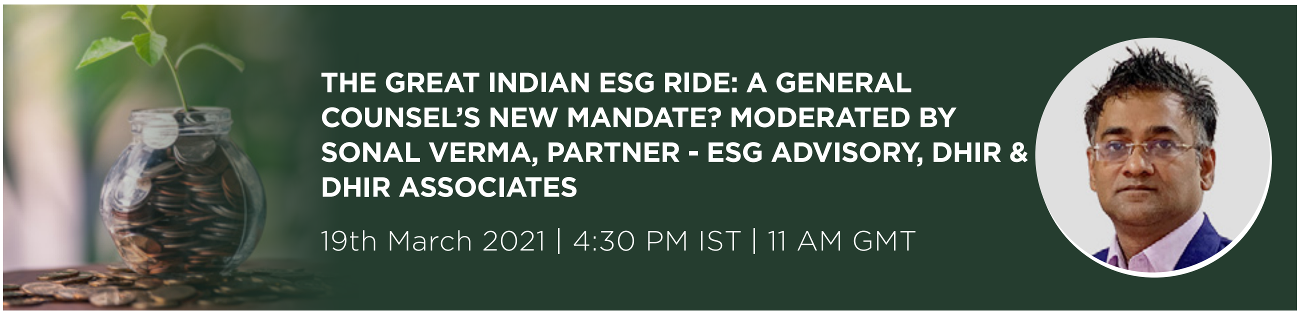
BW BUSINESSWORLD | WRDE COAST TV | MORNINGSTAR | finanzen.net

Hindustan Times | Business Standard | MARKETS INSIDER

yahoo!finance | Seeking Alpha

THE PODIUM

18th February, 2021 - Alok Dhir, Managing Partner, speaking at ASSOCHAM's Virtual Interactive Session on RBI's Revised Regulatory Framework for NBFCs and Digital Lending & Pre-Packaged Insolvency Resolution Process



14th January, 2021 & 20th March, 2021 - Amir Bavani, Principal Associate shared his views on 'Highlights of IBC in 2020' and 'Liquidation and Winding up of a company' in knowledge sessions organised by lawsikho.com.

5th February, 2021 - Guranpreet Singh Sarna, Associate Partner, speaking at the 9th Annual Real Estate & Construction Legal e-summit by Lex Witness.

Dhir & Dhir Associates is a leading full-service law firm in India serving as a single-window legal and regulatory advisor globally. It has offices in New Delhi, Mumbai, Hyderabad and a representative office in Japan. The firm's areas of practice include Restructuring and Insolvency, Corporate/Commercial Advisory and M&A, Real Estate, Banking and Finance, Dispute Resolution, Capital Markets, Infrastructure & Energy, Environmental, Social & Governance, IPR, Technology, Media & Telecommunications, Employment Law and Consumer Law.

NEW DELHI
D 55, Defence Colony, New Delhi - 110 024, India
T: +91 (11) 42410000
E: delhi@dhirassociates.com

MUMBAI
21 & 22, 3rd Floor, Onlooker Building,
Sir P.M. Road, Fort, Mumbai - 400001, India
T: +91 (22) 67472284
E: mumbai@dhirassociates.com

HYDERABAD
#30, First Floor, Raghava Ratna Towers, Chirag Ali Lane,
Abids, Hyderabad - 500001, India
T: +91 (40) 42208077
E: hyderabad@dhirassociates.com

JAPAN
Vent Vert Toyohashi, Centre 302, 1-3-1, Maeda Minami-machi
Toyohashi-shi, Aichi-ken 440-0851, Japan
T: +81 (0532) 218586
E: japan@dhirassociates.com

www.dhirassociates.com