ESG – Into the Mainstream

March 2022

Foreword

As environmental, social and governance (ESG) considerations exploded into the business mainstream over the past few years, climate change has dominated the ESG conversation (with efforts to limit global warming to 1.5 degrees Celsius still racing against time) India Inc. has been responsive to this urgency for some time now - several Indian businesses have voluntarily committed to reducing their carbon footprint and emissions. When it comes to ESG corporate performance, the expectations of key business stakeholders such as investors, regulators, customers, and employees are increasing.

ESG considerations are increasingly influencing the deployment of investment capital, and there is a tremendous appetite for ESG financial products. This has led to an increase in awareness in both the companies that are looking for investment as well as intermediaries such as rating agencies. The regulators are actively incorporating ESG and sustainability factors into the legal framework in ways that will change how companies operate.

In tandem with these regulatory drivers, investors are very much cognizant that corporate citizenship embraces businesses' social, environmental, and cultural responsibilities towards their employees, workforce, customers, and society. This is being signaled not just by preferring to put capital where it is utilised sustainably, but also through increased investor engagement on non-financial parameters such as workplace culture and conduct, resource efficiency, human rights violations in the supply chain, ethics, governance and corruption, product safety, and reputational risks.

All this has led to a complete change in the narrative around ESG in India. The question that markets are asking is not 'if' but 'how'. The answer perhaps is, by way of 'intent'- with companies stepping up to the call for corporate responsibility, investors leading the mission with stewardship and government enabling policies that facilitate the transition.

FICCI has been at the forefront of facilitating this dialogue, and continues to engage industry participants and regulators in several activities over the course of the year. FICCI's maiden ESG Summit is a surefooted step towards this endeavour.

FICCI and Trilegal are pleased to present to you this publication, ESG – Into the Mainstream, which presents thoughts and narrative on the key themes that the Indian industry will face in its ESG journey. While much work remains in furthering the ESG agenda, including in the areas addressed by this paper; it is encouraging to note that the trend has been in the right direction, and that changes that have been implemented in recent times will drive improvements in financing India's sustainability agenda.

Arun Chawla
Director General
FICCI

Upasana Rao
Partner
TRILEGAL

Kunal Gupta
Partner
TRILEGAL

Contents

1. Unlocking Green Finance

India has recently stepped up its climate action goals significantly beyond its previously set Nationally Determined Contribution (NDC) targets, committed to reach a non-fossil energy capacity of 500 GW and reduce the carbon intensity of its economy to less than 45 percent by the year 2030, and a Net Zero emissions target for the year 2070. At the same time India has also acknowledged that nearly $1 trillion needs to be mobilised as green finance towards achieving these goals.

India is a country of 1.3 billion people and the third largest emitter of greenhouse gases in the world, yet a growing economy with still expanding needs for infrastructure development. To achieve its climate targets and fund its green transition, India needs a large budget allocation, international finance from bilateral and multilateral sources and green private investments. India needs to improve its readiness to access and deliver climate finance from all available sources. This involves different aspects:

- Political and strategic readiness with a national green policy, planning and resource allocation,
- Creating investible projects, adopting measurement and disclosure standards, and
- Legal readiness to provide a framework that enables innovative financing structures and de-risking investment opportunities.

Policy interventions

Over the last decade, India's policy efforts have achieved significant renewable energy deployment. India already generates 20% of its power requirements from renewable sources. Producing renewable energy has become more cost efficient and supply is available at competitive pricing. The recently introduced production linked incentive (PLI) scheme for solar panels will reduce dependence on imported components and allow supply chains to be more resilient. India also announced the ambitious 'One Sun, One World, One Grid' (OSOWOG) programme with the Green Grids Initiative (GGI) of the UK, which entails connecting clean energy grids across continents. This is an opportunity for India to participate across the global renewable energy value chain.

Incorporating net-zero targets into overall domestic policy and sector-based interventions, will provide regulatory clarity to investors to finance India's plans for decarbonization and net-zero pathways to development. For example, transition to green mobility is quickly picking up with policy intervention and market response. The Faster Adoption and Manufacturing of Hybrid and Electric Vehicles scheme (FAME) and a Production Linked Incentive (PLI) scheme incentivises EV manufacturers and charging infrastructure providers, and different state governments have implemented their own EV policies and subsidies to promote e-mobility.

Another challenging policy issue is of carbon taxation. Currently India has a coal cess penalising the use of coal and excise duty on petroleum products, and certain states have implemented green taxes within their territories. India could introduce a uniform carbon tax policy which would incentivise Indian companies to prefer alternative energy sources.

Disclosure and transparency

One of the barriers that India faces in accessing green finance, is the lack of a green taxonomy. Regulators in India have acknowledged that reporting asymmetry and the lack of a standardised global taxonomy are the key reasons for the relatively high cost of green bonds which have seen low interest from investors.

A green taxonomy would provide clarity on what activities qualify as 'green' and establish the eligibility criteria for green finance. Adopting such a taxonomy would reduce the chances of greenwashing and enhance investor confidence. A green taxonomy will also lead to attention towards sectors in need for investment taking away the sole focus from renewables which tends to garner the most attention in India. Additionally, it will ensure that regulators such as Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) align their regulations with the taxonomy. While developing this taxonomy, policy makers could look at the green financing definitions as provided by Sustainable Banking Network (SBN); Principles for Responsible Investing (PRI); Carbon Disclosure Project (CDP); Sustainable Accounting Standards Board (SASB); OECD and UNFCC.

India's environmental laws specify environmental impact assessment protocols, pollution standards, compliance and disclosure requirements for industries. However, the current environmental legal landscape is insufficient and needs to be augmented to bring in a strong climate transition plan which industries can follow, and regulators can use to regulate. National environmental regulations may also need to be strengthened to align with standardisation norms under a new taxonomy.

The standards for disclosure and sustainability reporting are still at a nascent stage in India. In May 2021, SEBI issued a sustainability disclosure norm, 'Business Responsibility and Sustainability Reporting (BRSR) by listed companies', which mandates the reporting of ESG performance by top listed 1000 companies with the largest capitalization. Over time the sustainability standards under BRSR may be made mandatory for all companies which will allow companies to be transparent with investors about their ESG practices.

Banks, insurers, asset managers, pension funds and global investors need to rely on data and metrics to make informed decisions on capital allocation and risk underwriting. In the Indian context, investors have had to rely on voluntary disclosures by companies, which are often incomplete, inconsistent, and subjective. The Bombay Stock Exchange offers a benchmark index, which assesses the 'carbon performance' of stocks based on quantitative performance parameters. This is a step in creating an inclusive market-based mechanism to promote energy efficient practices amongst issuers and attract green finance. However, India needs regulatory standardisation of climate disclosure and reporting, to enhance its credibility and negotiate for green finance. Mandatory reporting standards, data and measurement will help to channelise institutional green investments to India.

Sources of finance

Raising green finance requires access to diverse sources of capital, public and private sector participation and appropriate financing structures. There is a need diversify financial assets and enable mobilization of private capital for sustainable development in India.

a) Green Bonds

In 2017, SEBI enabled raising capital through the issue of green bonds by Indian companies and mandated related disclosure norms broadly based on the Green Bond Principles framed by the International Capital Markets Association in 2014. Green bonds can be issued only for assets or projects with an environmental purpose such as renewable energy, clean transport, sustainable water or waste management, energy efficiency and climate change adaptation, and funds raised need to be utilised entirely for the same purpose. The eligibility criteria is clearly demarcated and many companies may not be eligible to issue green bonds to support their clean energy transition if they have long investment cycles in carbon assets.

The uptake of green bonds has been slow largely due to the lack of a green taxonomy and an assessment and rating framework. Green bonds can be scaled up if the domestic bond market is made stronger, the existing regulations are made more inclusive, the use of proceeds criteria is broadened. Credit enhancement methods through the creation of guarantee funds, issuing of sovereign green bonds, hedging support, and extending tax incentives to such bonds will further support the use of this instrument.

As of now Indian banks have only voluntary guidelines for responsible financing proposed by the Indian Banks Association, under which it is recommended that ESG factors be integrated into the investment, lending, and risk-management processes of banks. Preferring green investments in central bank operations, relaxing prudential requirements for investment in green sectors, and including other green labels within priority sector lending (which is currently focused only on renewables) will unlock high amounts of domestic capital from Indian banks.

The Indian government announced the issue of sovereign green bonds in the years budget session which would be a useful tool to raise capital at reduced cost of capital for diverse green projects in different sectors, and further catalyse the deepening of India's green finance market.

India's International Financial Services Centre (GIFT City) would also provide a suitable framework to channelize foreign capital for sustainable financing as it provides a platform within India where foreign currency can be accessed with low tax impact, trading exchanges are available for all asset classes, and innovative financial products and structures for debt financing can be explored with regulatory support and transparency.

To encourage more foreign debt financing for green projects, it may be recommended to provide relaxations under the regulations applicable to external commercial borrowings and issuing of debt securities to foreign portfolio investors, such as relaxations from various restrictions of maturity period, use of proceeds, pricing caps, withholding taxes, concentration and single issuer limits in cases where the debt is being raised is for green projects.

b) Developing an internal carbon market

One of the key outcomes of the COP26 conference in November 2021 was the conclusion of the Paris rulebook which included the agreement of the fundamental norms which will govern carbon trading. This development will give a push to develop a domestic carbon market for emission trading in India.

Currently India does not have an explicit mechanism for carbon pricing or market-based carbon trading.

A voluntary carbon market for the private sector may be developed by defining a mechanism for identifying quality carbon offsets, developing carbon accounting standards and a transparent pricing mechanism.

c) Blended Finance

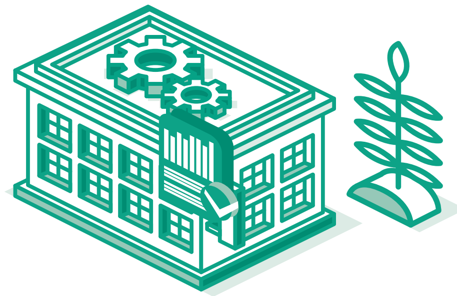
Accessing finance for small scale and micro impact projects requires moving away from traditional public grants, institutional lending and philanthropic sources, and explore blended finance structures that allow strategic use of development finance from private investors for sustainable development. Social impact bonds for climate transition can be used as a funding structure for small budget interventions at the district, municipal and state levels, which blends impact investing, public-private partnerships and outcome-based finance. Outcome based funding structures enable investors to provide upfront early risk financing to implement green projects. **There is a need to incentivise more investors willing to provide such "first loss capital" to de-risk projects and catalyse further investments.** Such incentives may be provided by offering more viable/investible projects where the outcome parameters are clearly defined, providing guarantee support to back stop unknown risks and providing regulatory relaxations to facilitate flexible funding structures.

d) Corporates and retail investors

Corporate funds can be a useful source for green finance. Indian company law mandates profit making corporates to allocate funds towards corporate social responsibility (CSR) activities which are unrelated to their own business. Many corporates choose to fund environmental causes as part of their CSR strategy, for example, afforestation or developing solar parks. There is potential for more concerted utilisation of CSR funds towards climate and greater impact can be achieved by creating CSR fund pooling vehicles which specifically target climate mitigation measures. However, certain compliance requirements under the CSR rules, particularly the requirement to transfer 'unspent' CSR funds to specified government relief funds, could be inconsistent with the needs of climate projects which have longer gestation periods.

SEBI also recently launched the Social Stock exchange in India which provides social enterprises and social venture funds an alternate platform to raise funds from institutional and retail investors and attract CSR funding with transparency. Clarifications will be required under the Foreign Contribution (Regulations) Act to enable foreign investors to invest in social venture funds listed on the social stock exchange.

2. Redefining Corporate Citizenship - the road to sustainability



The notion of corporate 'citizenship' is that corporations as members of society, carry obligations beyond their financial activities, to contribute positively to the community and environment. This construct is broader than the known ideals of corporate governance in which primacy is given to protecting the interests of the shareholders and maximising the economic value of a company. In a world engulfed with the pandemic, global warming and high levels of inequality, the pressure is rising on companies to embrace ESG (environment, sustainability, and governance) principles more holistically. The law and regulations in India are slowly adapting to this new reality.

Corporate Governance

Corporate governance, the practices by which the board and management of a corporation direct, control and oversee its affairs, has implications not only to the shareholders but also to the employees, lenders, vendors, customers, and other stakeholders, including the communities in which the business operates.

The scope of corporate governance regulations has evolved continuously. The traditional aspects included the role and conduct of directors, transparency and accountability, conflict of interest and investor relationship. Regulators, investors, and activist shareholders now increasingly expect boardrooms to focus on a wider array of issues such as gender diversity, risk management, succession planning and relationship with 'all stakeholders' of the business. The Companies Act, 2013 codified the fiduciary duties of directors for the first time, including the duty to act in good faith and promote the objects of the company in the interests of the employees, shareholders, community, and the environment. The Kotak Committee Report[1] noted that the board of director's strategy and evaluation of ESG matters is critical to the long-term future of the company and recommended that the board's obligation to redress shareholder grievances be broadened to include the responsibility to consider the 'various aspects of interests' of the shareholders and other stakeholders.

Courts in India have acknowledged that companies are not a mere legal device for carrying on trade, rather, they wield economic power that can affect society and the environment. In recent cases, the courts have recognised that the corporate world is moving to a regime of social accountability and have also questioned why companies cannot mobilise financial resources to align their commercial activities with corporate social responsibility.

Good corporate governance enables companies to attract capital and win investor confidence. Evidently, many investors have started to measure business performance in new ways, with greater attention to non-financial metrics and management of ESG risks. The meaning of long-term value creation is also changing in the expectation of investors. It is not only concerned with profit-making and the top line, rather a value system that includes employee engagement, environment sustainability, diversity and inclusion, risk management, cybersecurity and broader societal imperatives. The pandemic exposed the need to manage ESG risks in the entire supply chain to avoid business instability.

[1] Kotak Committee Report on Corporate Governance, dated 5 October 2017

Recent regulations introduced mandatory reporting requirements to help measure the performance of companies on ESG parameters. The Securities and Exchange Board of India (SEBI), the regulator for securities and commodity market in India, made 'Business Responsibility and Sustainability Reporting (BRSR)' mandatory with effect from 1 April 2022 for the top 1000 public listed companies in India by market capitalization. The BRSR includes quantifiable metrics as opposed to relying solely on qualitative standards. This will make the ESG practices of companies more transparent and require disclosure of matters concerning labour welfare, health and safety, human rights violations, conflict of interest of directors and key managerial personnel and other ESG relevant issues.

Other than the mandatory disclosures, the BRSR includes a category for voluntary disclosures, such as disclosing the company's strategy and sustainability initiatives to demonstrate its leadership. Over time these mandatory reporting regulations are expected to be extended to private companies and demonstrating ESG compliance will become a legal imperative.

Corporate Social Responsibility

Indian company law requires profitable companies to spend 2% of their profits annually on corporate social responsibility (CSR) activities. CSR activities are defined to include the promotion of education, health, poverty reduction, environmental sustainability, and gender equality. In the spirit of corporate philanthropy, CSR cannot include activities from which the company or its employees may themselves benefit.

Pursuant to the Companies (Corporate Social Responsibility Policy) Amendment Rules 2021 notified in January 2021, it is mandatory for companies with an annual CSR budget of Rs.10 crores or more to undertake impact assessments of their CSR projects through independent agencies. The revised law underscores that CSR is not merely a spending obligation. Companies are being encouraged to spend CSR funds with the objective of creating impact and to evaluate the impact of their CSR initiatives on the target beneficiaries or society. There is immense potential for companies to utilise the CSR model to participate more directly in creating a positive impact. For instance, corporates can collaborate with public authorities and investors to participate in impact projects with measured outcomes, and philanthropic CSR funds could be useful in innovative financing structures or for risk funding in blended finance projects.

Contributing to the sustainability agenda

Investors and asset managers have already integrated ESG factors in their mandates, but the approach is currently focused on target setting and compliance reporting. Many investors are keen to move beyond ESG investing into the next frontier of SDG investing or responsible investing which envisages investing in sustainability driven projects with intentionality and measuring the impact.

Progressive forward-looking companies are exploring ways to create positive impact by adopting one or more of the 2030 Sustainable Development Goals (SDGs) which have been set by the United Nations and adopted by all countries including India as the universal development agenda for this decade. These goals include a wide range of concerns, from poverty alleviation, education, gender equality, clean water and sanitation to clean energy, sustainable consumption and climate action. Governments across the world have pledged to reduce carbon emissions and combat climate change. At the much-observed 2021 United Nations Climate Change Conference (COP26), India announced significantly increased Nationally Determined Contributions (NDCs) for decarbonisation and the year 2070 as its target for achieving net zero emissions. The roadmap to achieving these sustainability goals will require massive participation and capital from corporates and investors.

The top-down policies and commitments from the Government will create pressure on Indian companies to look beyond business as usual. Government policies may lead to new regulations, taxes, and incentives to steer companies towards sustainable practices.

Investors may soon see the lack of a sustainability transition plan as a red flag. Climate reporting and climate accountability on the board of directors of companies have become mandatory in many countries as a response to demand from lenders, investors and other key stakeholders, and India may introduce similar compliance requirements in the future. Global consumers are looking at corporate sustainability reports and placing their choices with companies and brands who demonstrate environmental and social conscientiousness. It is common now to see employee retention and customer engagement also involve consideration of ESG aspects, such as diversity and inclusion and sustainability commitments by companies. It has become a business imperative for corporates to include ESG performance and sustainability considerations in their long-term corporate strategy.

While many corporations are planning their transition as an imperative to stay relevant in business, many others recognise the new market opportunities and are rushing to cater to the demands for cleaner technology and sustainable products in sectors like energy, e-mobility, agriculture, and others.

Investors and asset managers have already integrated ESG factors in their mandates, but the approach is currently focused on target setting and compliance reporting. Many investors are keen to move beyond ESG investing into the next frontier of 'SDG investing' or 'responsible investing' which envisages investing in sustainability driven projects with intentionality and measuring the impact.

Conclusion

It is within the above context that a new vision for corporate citizenship has emerged. Corporates will increasingly need to demonstrate ESG maturity to mitigate any harm caused by their business on the environment and society, and adapt positive responsible and sustainable practices to maintain the legitimacy of the business amongst stakeholders, and show corporate leadership to support India's transition to a sustainable future.

3. ESG Crisis Readiness and Response: A Toolkit

A. Legal and Regulatory Developments Impacting Businesses in India

The framework governing ESG disclosures for Indian companies and for foreign companies operating in India is developing rapidly. Previously, only somewhat limited ESG disclosures were required – for instance, certain reporting requirements on energy conservation under company law, and other, (comparatively) detailed disclosures under the Securities and Exchange Board of India's ("SEBI") Business Responsibility Reporting framework, 2015 ("BRR") for listed companies. The successor to the BRR – the Business Responsibility and Sustainability Reporting framework ("BRSR")- comes into force in April 2022. BRSR extensively builds upon BRR, by mandating more granular disclosures in areas covered under BRR (such as certain types of human rights issues), but also requiring disclosures in areas the BRR did not deal with (such as corrective action taken post ESG complaints).

Practically, enhanced disclosures usually lead to greater scrutiny of the matter from shareholders, investors, and regulators, and increased awareness of issues also engenders more whistleblower complaints. Consequently, we expect an increase in companies facing ESG crises, which will have significant impact on the company from a reputational and financial perspective. The manner in which emergent ESG concerns are dealt with also define how mature the ESG framework in a company is. In this chapter, we set out the changing framework of ESG regulations and then discuss strategies to pre-empt and response to ESG crises.

1. New norms in Business Responsibility and Sustainability Reporting for listed companies

The BRSR much-enhanced comes into effect for the top 1000 listed entities by market capitalization in April 2022. SEBI has said that the very idea behind mandating quantitative and standardized disclosures on ESG is to facilitate comparability across companies, sectors, and time, which will help investors make better investment decisions. These disclosures are also intended to propel companies to engage more meaningfully with their stakeholders, by encouraging them to look beyond financial parameters and consider their social and environmental impact.

Certain new features in the BRSR will significantly prompt listed companies to look into and remedy complaints and grievances under each of the nine principles under the National Guidelines on Responsible Business Conduct (Principles)[2] . Thus, this entails dealing with a wide range of issues (and not just those which have a direct or foreseeable financial impact).

[2] The nine principles are:
Businesses should conduct and govern themselves with integrity, and in a manner that is ethical, transparent, and accountable.
Businesses should provide goods and services in a manner that is sustainable and safe.
Businesses should respect and promote the well-being of all employees, including those in their value chains.
Businesses should respect the interests of and be responsive to all its stakeholders.
Businesses should respect and promote human rights.
Businesses should respect and make efforts to protect and restore the environment.
Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.
Businesses should promote inclusive growth and equitable development.
Businesses should engage with and provide value to their consumers in a responsible manner.

Disclosures of ESG Complaints: BRR v BRSR

Under the BRR, listed companies were required to disclose the **number** of complaints **received and pending** (at the end of the financial year) regarding: • Child labour • Forced labour • Involuntary labour • Sexual harassment • Discriminatory employment • Stakeholder complaints on human rights issues • Customer complaints/consumer cases	Under the BRSR, in-scope listed companies must disclose the number of complaints filed and pending resolution at year end, as well as **remarks**, corresponding to **each** of the **Principles**. The number of complaints received must be broken down according to the stakeholder from whom it is received: • Communities • Investors (other than shareholders) • Shareholders • Employees and workers • Customers • Value Chain Partners • Others

Disclosures of ESG Corrective Action: BRR v BRSR

Under the BRR, listed companies were only required to disclose the numbers of complaints (for the topics discussed above) that were received and were pending at the end of the financial year. Details of corrective action taken in response to complaints were not required to be disclosed.	Under the BRSR, covered listed companies must mandatorily disclose details of corrective action taken or underway on: • Fines, penalties, or actions taken by regulators, law enforcement agencies, judicial institutions on cases of corruption and conflicts of interest (by the entity and certain categories of its personnel) • Safety-related incidents or significant risks or concerns arising from assessments of (a) health & safety practices and (b) working conditions • Significant risks or concerns arising from assessments of child labour, forced/involuntary labour, sexual harassment, discrimination at the workplace, wages, and other human rights related issues • Anti-competitive conduct • Advertising, and delivery of essential services • Cyber security and data privacy of customers • Repeat product recall • Regulatory action on safety of products and services

Takeaway

While it remains to be seen how SEBI and investors will interpret and respond to the enhanced ESG disclosures in the BRSR, the new framework will significantly prompt listed companies to look into and redress complaints received in the above areas.

2. Overseas due diligence laws impacting Indian suppliers and businesses

A spate of laws mandating human rights and environmental due diligence in supply chains have been passed in key jurisdictions such as Germany, France, etc. We break down below the key features of certain laws, including how they may become relevant for Indian businesses.

International ESG Diligence Laws Impacting Indian Businesses

GERMANY	FRANCE	NETHERLANDS	NORWAY
Law: the Act on Corporate Due Diligence Obligations in Supply Chains, 2021	Law: Law on the Corporate Duty of Vigilance, 2017	Law: Child Labour Due Diligence Act, 2019	Law: the Transparency Act, 2021
Effective w.e.f 1 January 2023 (in a phased manner)	In force	Effective w.e.f mid-2022	Not in force yet
Applicability: Initially, companies with >3,000 employees with head office, registered office or domestic branch in Germany	Applicability: Large French companies (meeting certain thresholds for number of employees and location of head offices)	Applicability: all nationally-registered multinational enterprises and **foreign companies that sell or supply goods or services to Dutch consumers more than twice in a calendar year**	Applicability: Companies above certain financial thresholds headquartered or with physical presence in Norway and offering goods and services in and outside Norway; and larger **foreign companies selling goods and services in Norway**
Relevance for Indian businesses: In-scope companies must conduct human rights and environmental due diligence on inter alia the activities of their direct/first-tier contractual partners, and to the rest of the supply chain in cases of “substantiated knowledge” regarding potential violations of duties of sub-suppliers.	Relevance for Indian businesses: in-scope French companies must identify and prevent adverse human rights and environmental impact resulting from **activities of subcontractors and suppliers with whom they have an established commercial relationship**	Relevance for Indian businesses: In-scope companies must ascertain if **production in their supply chain involves child labour.** The law will thus have practical implications on Dutch sourcing from India, and Indian companies selling goods and services to Dutch end-users.	Relevance for Indian businesses: In-scope companies must conduct due diligence regarding human rights. **Such diligence should cover the entire supply chain and business partners.** Given this, the law will have practical implications for sourcing from India, and Indian companies doing business in Norway and meeting the requisite financial threshold.

Takeaway

While many Indian businesses will not be directly governed by these laws, we expect to see more due diligence and audit exercises and related contractual protections as companies directly subject to these laws step up their compliance measures.

B. Best practices for pre-empting and handling ESG crises

1. Pre-emptive tools

a. Map the supply chain of key goods and commodities to conduct a risk assessment for ESG risks posed by suppliers

b. Once mapped, conduct a risk assessment to identify suppliers who may be in industries or geographies that are vulnerable to specific types of environmental and human rights risks
   For example: palm oil as an ingredient may involve deforestation in its supply chain silica as a component may involve forced or involuntary labour in its supply chain

c. Evaluate contracts with suppliers for the existence of robust clauses on the following:
   i. Prohibiting: forced and child labour, sexual harassment and other discriminatory practices at factory sits, the use of conflict minerals, unethical practices, etc;
   ii. Ensuring: compliance with laws on human rights, environment, labour and employment, especially wages and working hours, anti-bribery etc., as well as compliance with the company's policies and standards for its suppliers;
   iii. Including: rights of inspection and audit for the company, as well as an obligation of coopera tion for the supplier;
   iv. Such clauses may be modified depending upon the risk level assigned to each supplier in the risk assessment exercise.

d. Frame a well-defined code of conduct, including terms on subcontracting, for the company's suppliers and other third parties

e. Conduct regular training for suppliers on their obligations under the company's policies; for factory workers on their rights; and train on-site factory representatives to detect hidden signs of worker abuse by third parties supplying contract labour

f. Conduct (as needed depending upon the risk level assigned) background checks on suppliers prior to engaging them, surprise site visits to contract manufacturing locations, gather discreet information gathering by speaking to on-ground workers and community representatives

2. Handling ESG crises

In the event concerns regarding ESG harms are raised, multiple factors, including the aspects discussed above as well as changed expectations of corporate responsibility demand that such concerns be investigated. Below are some aspects that should be kept in mind while undertaking such exercises in India:

a. In case, the ESG concerns alleged are at the level of a supplier (and not within the company):
   i. site visits and interviews may be necessary to make breakthroughs on verifying the allegations. When buyer audits and inspections are not stipulated in the contract (as frequently happens, especially for third parties who work on a purchase order basis), business partners may resist such audits/inspections on grounds of confidentiality concerns, especially if they also provide identical services for other clients. In such cases, non-disclosure agreements are customarily relied on.
   ii. in relation to site visits and interviews, the contract with the business partner should be assessed to check whether there are any requirements to give reasonable notice.
   iii. there is no obligation under Indian law to terminate or pause the performance of services by the supplier pending the ESG investigation.

b. In case, the ESG concerns alleged are within the company:
   i. The fact-finding exercise may need to mine several sources of data, both within and outside the company. For instance, for issues of labour and wage violation, critical data is maintained at the factory level rather than on head office servers, as these may be manually entered in factory records and recorded in vernacular languages.
   ii. Collating data from sources external to the company, such as records of contractors and subcontractors, indirect suppliers, interviews with suppliers' workers, and local government registries may also be required. When interviews with workers not on the company's payroll are necessitated, these should be handled sensitively in order to minimise risks of retaliation against interviewed workers.

4. Regulation of ESG Ratings Providers in India

Background

A critical aspect of being able to take ESG compliance to market and position it as value accretive for businesses, is having easily available and standardized metrics to assess the compliance by industries with environmental, social and governance factors. Large companies, globally and domestically, are being evaluated by their investors and the market alike from an ESG standpoint along with an assessment of their corporate governance profiles, i.e., the company's resilience to ESG related risks, and the positive or negative impact of companies on the environment.

Many institutional investors have become signatories to global principles on responsible investing and are striving to align their investment decisions basis these principles, which include goals such as zero carbon emission, gender diversity, etc.

Proposed Regulatory Framework in India

While the focus on ESG is relatively nascent, multiple players have emerged in this arena. These include institutional investors such as mutual funds and alternative investment funds, proxy advisors as well as ESG rating providers **(ERPs)**. In the past couple of years, regulatory authorities in India have introduced requirements for certain listed companies to submit business responsibility and sustainability reports with an emphasis on ESG specific factors, and recommended stewardship obligations for institutional investors and mutual funds to actively engage with investee companies on ESG parameters.

While responsibilities have been cast upon listed companies and investors, there has been an evident regulatory gap in relation to ERPs who support investors by providing ESG rating products and ESG scales based on research analysis and rating methodologies. Recognizing that there is no uniform approach currently followed by rating agencies in evaluating ESG parameters, the capital market regulator, Securities and Exchange Board of India (SEBI) recently introduced a consultation paper on introducing a regulatory framework for ESG Rating Providers for the Securities Market in India **(Paper)**.

The Paper primarily identifies listed companies, institutional investors, asset management companies and index providers as the key recipients and users of ESG ratings. It recognizes that as on date, ESG rating services are largely provided by global and established ERPs coupled with domestic entities who are largely group companies of credit rating agencies or research analysts. With that context, the Paper proposes a framework for the accreditation of ERPs to ensure that the players in the market are referring to genuine data from reliable market intermediaries.

As part of the accreditation process, SEBI has prescribed certain eligibility criteria for ERPs, i.e. ERPs must be registered research analysts or credit rating agencies with SEBI and must meet minimum net worth requirements of INR 10 crores, possess adequate infrastructural facilities such as database collection and management systems to provide ESG ratings and human resources who have adequate qualifications / specializations to provide such ratings.

The Paper highlights the distinction between ESG Risk Ratings and ESG Impact Ratings and stresses on the need to classify distinct products appropriately, as well as disclose the process of ESG ratings. The Paper also addresses the key controversy that shadows the role of ERPs and manifests as conflicts of interests, primarily between ESG ratings and consultancy. In doing so, the Paper suggests a range of different measures such as the requirement for ERPs to formulate a detailed conflict of interest policy, and segregate personnel who work in the ESG Ratings department from any other activity undertaken by the ERPs, including ESG advisory and consultation services.

The Paper also considers whether ESG ratings should be provided on a sector-specific basis and leaves it open for ERPs to provide it on a sector-agnostic basis. In terms of remuneration for ERPs, the Paper adopts a 'subscriber pay' model, versus an 'issuer pay' model to minimize conflicts of interests.

Thoughts on the Proposed Regulatory Framework

Globally, there is little clarity in what ESG ratings or data products intend to measure. The composition of indicators within the ESG domain is largely a subjective matter and may vary from one organization to another. In contrast with credit ratings, where credit rating agencies rely on more tangible data driven metrics, the assessment of the ESG metrics is based on softer uncrystallized principles.

A key theme which emerges from SEBI's proposed regulatory framework is the need for disclosure of the methodology adopted for the data driven processes. For instance, some large global ERPs disclose the exact metrics against which it provides ratings to companies. These metrics could include carbon emissions, climate change effect, pollution, waste disposal, renewable energy, resource depletion, supply chain, political contributions, discrimination, diversity, community relations, human rights, cumulative voting, executive compensation, shareholders' rights, takeover defence, staggered boards, and independent directors.

These disclosures may also specify if the rating process involved any prior engagement with the company, whether through the issuance of questionnaires, interviews, etc. before according such ratings. In the process, ERPs may also classify whether its ratings are sector specific or sector agnostic, which may be particularly relevant for investment decisions in sensitive sectors such as pharmaceuticals, metals, etc. where environmental and social hazards constitute key ESG considerations.

Therefore, SEBI's proposal to require ERPs to disclose more, be it their methodologies for assigning ratings or policies around conflicts of interests, is a useful tool to encourage transparency and competency in the market. Alongside this, the fact that SEBI has refrained from prescribing any standardized rating scale will help preserve and boost the competitiveness and innovation in the evolving ESG ecosystem.

That said, the requirement for accreditation of ERPs must be revisited along with the proposal for eligibility criteria such as net worth requirements, infrastructure and man-power requirements. In an evolving regime such as ESG, the idea of light-touch and principle-based regulation would encourage more competition, innovation and efficiency, as opposed to formal requirements for registration and accreditation.

Lately, we have seen magazines, journalist houses and consultants engage in ESG advisory and ratings, and these have emerged as large players. Therefore, it is not only that those with credit rating or research analyst licenses assign such ratings. Further, the significance accorded to the net-worth and infrastructural facilities of an entity as determinative of the seriousness of the organization is rather misplaced and acts as an unnecessary barrier. In the past few years, we have seen experienced individuals transition into impact investing, ESG ratings, etc. from more lucrative conventional roles, to meet personal ethical and moral objectives. While these individuals may not have the prescribed net worth to classify as an ERP, they may certainly possess the requisite skill set to engage in ESG ratings.

Therefore, a light-touch principle-based regulation coupled with increasing shareholder activism and investor awareness, will help set the broader framework within which ERPs operate, and act as a check on the activities of ERPs, which will in turn set the roadmap for corporate governance for the coming decades.

(By Invitation)
Fundamental power sector reform needed to incentivise climate finance

One desirable step for India to make itself more attractive to investors is to undertake fundamental reform of the power sector around strong market-based principles. This is also essential for an efficient carbon transition in India.

The picture is not rosy

For 30 years, many policy reform projects have been attempted in the power sector. A brief chronology: opening different aspects of the sector to private investment, initially generation and subsequently transmission and to a limited extent distribution; unbundling vertically integrated state-owned power utilities into separate entities executing generation, transmission, distribution, trading and regulatory functions; introducing limited areas of market-based competition including the creation of power exchanges; attempting privatisation of discoms and transmission assets; some improvement in regulatory capacity, particularly at the central level and; finally, multiple efforts by the central government to bail out and restructure discom finances.

The Electricity Act, 2003 was brought in when there was almost no private participation in the power sector. The reform brought about by the Electricity Act 2003 brought about privately owned independent power projects (IPPs). However, at least 4 bailouts have been required in the past 20 years to alleviate the financial stress in the sector from time to time.

As a consequence, state-owned discoms remain in chronically bad financial health. Total discom losses in FY2021 were estimated at Rs.0.9 trillion with accumulated losses at about Rs.5 trillion. In March 2021 overdue payments from discoms to power generators were at about Rs.0.68 trillion.

Despite increasing private investment in power generation, and more recently in transmission, the Indian power sector remains largely a state-controlled, mandate-based environment. The overwhelming prevalence of the long-term, fixed-price, non-negotiable PPA model hampers the potentially more sophisticated everyday response of market participants to price signals.

There are many familiar problems in the sector which is currently state controlled, such as:

- State procurement agencies and discoms passing on risks of obtaining permissions and acquiring land to IPPs.
- PPAs failing to provide adequate security for delayed payments, early termination, change in law and force majeure.
- Attempting to force reductions in power tariffs in signed and operational PPAs.
- Discoms in various states disputing agreed price mechanisms under signed PPAs despite advice issued by the Ministry of New and Renewable Energy of the Union government.
- Refusing to grant open access when required to do so by law and persisting with litigation.
- Disputes on agreed contract provisions in PPAs such as compensation in case of change in law and force majeure events.

The most recent consolidated reform effort, in the shape of the Electricity Amendment Bill 2021, has positive elements but is incomplete. The attempt to introduce competition in distribution and provide more customer options is significant but does not adequately take into account the market power of legacy state discoms. In a recent important report on the reform of the distribution sector prepared for Niti Aayog, it is acknowledged that India will not be able to achieve a high-growth, low carbon economy unless the distribution sector achieves profitability. The report highlights some key reforms considered necessary for the power distribution sector such as the need to separate utilities from the state and increase private participation.

The problem could deepen

In the context of climate change and consequent commitments to the international community, these problems could get worse.

Indian action on emissions: India went from 4% of global emissions in 2000 to 7% in 2021. While the growth of electricity generation and emissions averaged 5% over the last 20 years, the growth of electricity generation in the recent period (2016-17 to 2020-21) was lower at 2.8% reflecting the difficulties of the economy in this period. This low growth of emissions may not obtain in the future. Rapid growth of Indian emissions would sit uneasily in a decarbonising world. Greater pressure may come together, upon India, our COP26 announcements notwithstanding, to make progress on the long game of decarbonisation.

The investment strategy of Indian firms is affected by climate change: Private firms now face an ESG-inflected investment environment where access to debt and equity capital requires decarbonisation in the firm and its supply chain. The cost of capital for debt or equity finance for carbon-intensive investments is higher. Firms respond to the incentives associated with international asset pricing. Buyers are not content to accept carbon-intensive power from the grid, and expect the electricity system to accommodate more renewables.

International trade competitiveness concerns could reshape the incentives of Indian actors: Countries at a more advanced stage of their carbon transition fear that their contribution to a global public good comes at the cost of competitiveness when pitted against production in more polluting countries. This has led to the idea of carbon border taxes. In July 2021, the European Commission adopted a proposal for a new Carbon Border Adjustment Mechanism (CBAM), which will put a carbon price or tariff on imports of a targeted selection of products. The main objective of the CBAM, which is proposed to commence in 2026, is to ensure that European emissions reduction efforts contribute to a decline in global emissions, instead of merely moving carbon-intensive production outside Europe. Indian exporters will see direct links between international competitiveness and the extent of decarbonisation within their firm and supply chain, and within the electricity system of the states in which they operate. This will impact decisions on the question of where production within India takes place: private firms may avoid states which have low economic freedom in purchasing renewables and where renewables make up a lower fraction of discom supply.

Internal stress in the electricity sector which renewables will exacerbate: Grid electricity in large parts of India is over-priced, carbon-intensive, and unreliable. Customers want to exit through various means, including captive or 'third-party' corporate PPAs. Some corporations face pressure from their investors to control emissions and an increasing number are making voluntary formal commitments towards achieving net zero emissions. There are strong incentives for generators and buyers to arrive at transactions that bypass the cross-subsidy system. The shrinking base of customers who can be charged high prices will create escalating fiscal stress in the electricity sector.

The case for fundamental reform

There is a need to step back from the tactical detail of the electricity sector and its everyday policy activities, into a more coherent policy strategy, aligned with international climate change related commitments to 2030 and beyond. The problem of climate change, and the problem of electricity policy, both demand a large number of actions by numerous actors across long periods of time.

In this context, power sector reform needs to be based on two main principles: Increase the role of prices in the electricity sector and privatise firms in the power sector, especially the discoms.

Increase the role of prices in the power sector

There will be many questions and challenges in organising the Indian electricity sector in the coming decade. How should renewables and storage be combined? How should the demand side be re-organised so as to best fit into the intermittent renewables generation? What is the role for decentralised ("micro-grid") solutions in the future, as opposed to the 20th century model of large generators and large distribution companies? How will technology change renewable generation, batteries, electric vehicles, etc. and how will the electricity system constantly reshape itself, with profits and losses being made by firms based on the correctness of their bets? What is the true cost of renewable energy given the existence of implicit subsidies like having must-run status and a waiver of transmission charges?

The detailed design of how production should take place is best performed through the self-organising system of the market economy, where decisions about technology and business models are made by self-interested actors that interact through markets and respond to prices. State intervention must be narrowly designed to address market failure. The key element that is missing in the Indian climate transition is an electricity sector that operates in the price system, with supply and demand that make prices, and prices that reshape decisions of all firms and all users.

Deep privatisation is necessary

Numerous difficulties stem from state ownership of discoms, whether in negotiating risk allocation under 'model contracts' or excessive litigation and slow judicial contract enforcement. This reduces confidence in the sector and the Indian market. Discoms have low incentives to follow economic rationality. The occasionally ambiguous and sometimes protectionist treatment of state-owned discoms by the regulatory authorities enables policy mistakes. For private investors, excessive state bureaucracy in the sector creates policy risk. For a sector more rooted in the price system, we need privatisation, particularly of the discoms.

Conclusion

Power sector reforms will go a long way towards encouraging ESG-led investment in India's climate transition. It should be noted that despite having an apparently buoyant renewable energy sector, India receives only a fraction of global clean energy transition investment. According to BloombergNEF, in 2020, worldwide investment in renewable energy capacity hit $303.5 billion, the second-highest annual figure ever. Of this, Europe accounted for $81.8 billion, and China was at $83.6 billion. India was at $6.2 billion.

Reforms will also provide a more favourable environment to introducing policy instruments such as carbon taxes, which in turn will lend stability to India's ESG investment environment. The climate transition gives us the opportunity to think boldly about India's climate transition: we should not lose this opportunity.

List of Contributors

TRILEGAL Team

CHAPTER 01
Unlocking Green Finance
CHAPTER 02
Redefining Corporate Citizenship - the road to sustainability

- **Upasana Rao**, Partner
- **Urvi Agarwal**, Associate
- **Jayesh Kumar Singh**, Intern

CHAPTER 03
ESG Crisis Readiness and Response: A Toolkit

- **Kunal Gupta**, Partner
- **Shreya Kundu**, Senior Assosiate
- **Vidushi Gupta**, Intern

CHAPTER 04
Regulation of ESG Ratings Providers In India

- **Shruti Rajan**, Partner
- **Vidhi Shah**, Associate

GUEST Contribution

- **Akshay Jaitly**,
Strategy and Policy Advisor,
Founding Partner Trilegal and Advisor NIPFP

About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry. From influencing policy to encouraging debate, engaging with policy makers and civil society, FICCI articulates the views and concerns of industry. It serves its members from the Indian private and public corporate sectors and multinational companies, drawing its strength from diverse regional chambers of commerce and industry across states, reaching out to over 2,50,000 companies.

FICCI provides a platform for networking and consensus building within and across sectors and is the first port of call for Indian industry, policy makers and the international business community.

Ms Jyoti Vij
Deputy Secretary General
FICCI

E Jyoti.vij@ficci.com

About TRILEGAL

Trilegal was founded in the year 2000 and has grown rapidly to become one of India's leading law firms. We are a top-tier full-service law firm with over 500 lawyers who are led by 71 partners. Our partners and lawyers are equipped with the right combination of local insight and expertise and ensure that we deliver cost- effective, deal oriented and high-quality legal advice.

Our core strengths are the commitment and client centric approach of our lawyers. We pride ourselves for dealing with complexity, thinking out of the box and coming up with innovative solutions for our clients. Our approach to work involves a deeply analytical understanding of Indian law and experience of the market, which allows us to effectively calibrate/assess legal risk and provide practical advice.

The firm and its lawyers have been consistently ranked and recognised by leading legal publications across each of our practice areas.

For any queries and feedback on this white paper, please contact the following

Upasana Rao | Partner
E Upasana.Rao@trilegal.com

Kunal Gupta | Partner
E Kunal.Gupta@trilegal.com

Disclaimer

The information contained in this Knowledge Paper prepared by Trilegal at the instance of FICCI, is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). Neither FICCI nor Trilegal and their respective members are by any means rendering legal advice or other professional services or advice through the material in this Knowledge Paper. This Knowledge Paper does not contain all information available on the subject of ESG. It should serve only as a general guide and not as the ultimate source of subject information. While best efforts have been used in preparing this Knowledge Paper, FICCI and Trilegal make no representations of any kind and assume no liabilities of any kind with respect to the accuracy or completeness of the contents.

FICCI and Trilegal shall not be held liable or responsible to any person or entity with respect to any loss or incidental or consequential damages caused, or alleged to have been caused, directly or indirectly, by the information contained herein. The information in this Knowledge Paper is not intended to be relied upon as the basis for any decision which may affect any person or entity. Independent professional advice should be sought for taking any action on any issue mentioned in this Knowledge Paper. Further, this Knowledge Paper is aimed at providing information on some pertinent topics relating to ESG in India as they stand today. This is subject to change with future amendments and modifications. FICCI and Trilegal assume no responsibility to update this Knowledge Paper in the event of such future amendments and modifications. The paper is finalized on **08 March 2022.**

FICCI

TRILEGAL

FICCI.IN

TRILEGAL.COM