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Through its publications, *White Black Legal – The Law Journal* seeks to foster critical legal thinking and contribute to the development of law as an instrument of justice, governance, and social progress, while expressly disclaiming responsibility for the application or misuse of published content.

ESG INVESTING AND FOREIGN PORTFOLIO INVESTORS: EMERGING LEGAL FRAMEWORK IN INDIA

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Abstract

Environmental, Social, and Governance (ESG) investing has emerged as a transformative approach in global financial markets, influencing the investment strategies of Foreign Portfolio Investors (FPIs). ESG refers to a set of non-financial criteria used to evaluate a company's environmental impact, social responsibility, and governance practices, while FPIs represent foreign investors participating in domestic financial markets through securities such as equities and bonds. In India, the Securities and Exchange Board of India has played a pivotal role in shaping the regulatory framework governing ESG disclosures and FPI participation, particularly through instruments like the Business Responsibility and Sustainability Report (BRSR). This article examines the legal and regulatory framework applicable to ESG investing by FPIs, highlighting its significance in promoting transparency, accountability, and responsible investment practices. It further analyses the role of ESG in advancing sustainable development by aligning financial objectives with environmental protection, social welfare, and sound governance. Thus, ESG-oriented FPI investment holds significant potential in fostering sustainable and responsible economic growth in India.

Keywords: *ESG, FPI, SEBI, BRSR, Sustainable Development, Corporate Governance, ESG Disclosure, Financial Regulation, Responsible Investment*

I. Introduction

India's capital market has experienced significant expansion in recent years, positioning itself as a prominent destination for global investment. A key contributor to this growth has been the increasing participation of Foreign Portfolio Investors (FPIs), who channel funds into Indian financial instruments such as equities, bonds, and other securities. FPIs play a vital role

in enhancing market liquidity, improving price discovery, and integrating the Indian financial system with global markets. Unlike Foreign Direct Investment (FDI), which is long-term and involves managerial control, FPI investment is typically short-term and market-driven in nature.

Concurrently, Environmental, Social, and Governance (ESG) investing has emerged as a dominant global trend, reshaping the manner in which investment decisions are made. ESG refers to a set of non-financial criteria that assess a company's environmental impact, social responsibility, and governance practices. Investors are increasingly recognizing that companies adhering to strong ESG standards tend to demonstrate greater resilience, reduced risk exposure, and sustainable long-term performance.

In the Indian context, ESG investing is closely aligned with the broader objective of sustainable development, which seeks to achieve economic growth while ensuring environmental protection and social equity. Regulatory authorities, particularly the Securities and Exchange Board of India, have begun incorporating ESG considerations into the financial regulatory framework, thereby influencing corporate behaviour and investment patterns.

This article examines the regulatory framework governing ESG investing by FPIs in India and its relevance to sustainable development.

II. Meaning and Concept

A clear understanding of the concepts of Environmental, Social, and Governance (ESG) and Foreign Portfolio Investment (FPI) is essential to examine their legal and practical implications within the Indian financial framework.

(A) Environmental, Social, and Governance (ESG)

ESG refers to a set of non-financial criteria used to evaluate a company's operations, ethical standards, and long-term sustainability. It has become a crucial tool for investors seeking to assess risks and opportunities beyond traditional financial metrics.

The Environmental component considers a company's impact on the natural environment, including factors such as carbon emissions, energy efficiency, waste management, and resource conservation. Companies that adopt environmentally sustainable practices are viewed

as less exposed to regulatory and climate-related risks.

The Social aspect examines a company's relationship with its stakeholders, including employees, customers, and the broader community. It includes considerations such as labour rights, workplace safety, diversity and inclusion, and consumer protection.

The Governance dimension focuses on the internal systems and practices that guide corporate decision-making. It encompasses board structure, transparency, accountability, executive compensation, and measures to prevent corruption and fraud. Strong governance frameworks are essential for maintaining investor confidence and ensuring regulatory compliance.

(B) Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment refers to investment made by foreign entities in the financial assets of a country, such as shares, bonds, and other marketable securities. These investments are typically passive in nature, meaning that the investor does not seek direct control or management of the company in which the investment is made.

In India, FPIs are regulated by the Securities and Exchange Board of India under a structured framework that governs their registration, investment limits, and compliance obligations. Unlike Foreign Direct Investment (FDI), which involves long-term commitment and managerial participation, FPI is generally characterized by its short-term orientation and high liquidity, allowing investors to enter and exit the market with relative ease.

Thus, while ESG provides a framework for responsible and sustainable investment, FPI serves as a key channel through which global capital flows into domestic financial markets. The intersection of these two concepts forms the foundation for understanding ESG-oriented foreign investment in India.

III. Why ESG Matters for Foreign Portfolio Investors (FPIs)

The growing emphasis on Environmental, Social, and Governance (ESG) factors has significantly influenced the investment strategies of Foreign Portfolio Investors (FPIs). In an increasingly interconnected and risk-sensitive global financial environment, ESG considerations have become essential for informed decision-making.

One of the primary reasons ESG matters for FPIs is the need to mitigate long-term financial risks. Companies with poor environmental practices, weak governance structures, or inadequate social responsibility are more vulnerable to regulatory penalties, reputational

damage, and operational disruptions. As a result, global investors tend to avoid high-risk companies that fail to meet ESG standards.

Furthermore, ESG investing enhances the ability of investors to assess the sustainability and resilience of their portfolios. Issues such as climate change, corporate governance failures, and social unrest can directly impact a company's financial performance and market valuation. By integrating ESG criteria, FPIs can better anticipate such risks and make more stable investment choices.

In addition, ESG-focused investing promotes transparency and accountability in corporate behaviour. Companies that adhere to ESG norms are generally more forthcoming in their disclosures, which helps investors make well-informed decisions. This, in turn, fosters trust between corporations and investors, strengthening the overall integrity of financial markets.

Moreover, ESG investing aligns financial objectives with broader ethical and societal goals. For FPIs, this not only enhances reputational value but also ensures compliance with evolving global investment standards. Consequently, ESG has become a critical determinant in shaping investment flows and promoting responsible capital allocation.

IV. Legal and Regulatory Framework in India

The legal and regulatory framework governing ESG investing by Foreign Portfolio Investors (FPIs) in India has evolved significantly in recent years, primarily under the supervision of the Securities and Exchange Board of India. This framework seeks to ensure transparency, accountability, and responsible investment practices while aligning financial markets with sustainable development objectives.

(A) SEBI (Foreign Portfolio Investors) Regulations, 2019

The SEBI (Foreign Portfolio Investors) Regulations, 2019 constitute the primary legal framework governing the registration and operation of FPIs in India. Under these regulations, foreign investors are required to obtain registration from SEBI before participating in Indian securities markets. The regulations classify FPIs into different categories based on their risk profile and mandate compliance with eligibility criteria, disclosure norms, and investment restrictions.

Additionally, FPIs are subject to ongoing compliance obligations, including reporting requirements and adherence to investment limits prescribed by SEBI and the Reserve Bank of India (RBI). SEBI exercises continuous monitoring and supervisory control to ensure that FPIs operate within the regulatory framework and do not engage in activities that may disrupt market stability. Although these regulations do not explicitly mandate ESG compliance, they provide the foundational structure within which ESG- oriented investments operate.

(B) SEBI's ESG Disclosure Framework: Business Responsibility and Sustainability Report (BRSR)

A significant development in India's ESG regulatory landscape is the introduction of the Business Responsibility and Sustainability Report (BRSR) by SEBI. The BRSR framework mandates the top listed companies to disclose information relating to their environmental, social, and governance practices in a standardized format.

The objective of BRSR is to enhance transparency and enable investors, including FPIs, to make informed decisions based on reliable ESG data. It requires companies to report on various parameters such as energy consumption, carbon footprint, employee welfare measures, diversity, and governance practices. By institutionalizing ESG disclosures, SEBI has strengthened corporate accountability and encouraged companies to adopt sustainable business practices.

(C) Role of Corporate Governance Norms

Corporate governance norms play a crucial role in reinforcing ESG principles within the Indian regulatory framework. Effective governance ensures transparency in decision-making, accountability of the board of directors, and protection of shareholder interests. It also serves as a mechanism to prevent fraud, corruption, and mismanagement.

Strong governance practices are particularly important for FPIs, as they rely heavily on disclosures and internal controls while making investment decisions in foreign markets. Regulatory requirements relating to board independence, audit committees, and disclosure standards contribute to building investor confidence and enhancing market credibility.

In essence, the integration of ESG considerations into India's legal framework, supported by SEBI regulations and governance norms, reflects a gradual shift towards a more transparent, responsible, and sustainability- oriented financial system.

V. ESG Investing and Sustainable Development

Environmental, Social, and Governance (ESG) investing plays a crucial role in advancing the broader objectives of sustainable development, particularly in emerging economies such as India. Sustainable development seeks to achieve a balanced approach to economic growth, environmental protection, and social equity, ensuring that present needs are met without compromising the ability of future generations to meet their own.

In this context, ESG serves as an effective framework through which Foreign Portfolio Investors (FPIs) can align their investment strategies with sustainability goals. By prioritizing environmentally responsible companies, FPIs can channel capital towards sectors such as renewable energy, clean technology, and sustainable infrastructure. This contributes directly to reducing carbon emissions and promoting ecological balance.

The social dimension of ESG further supports sustainable development by encouraging investments in companies that uphold labour rights, ensure workplace safety, and contribute to community welfare. Such practices not only improve the quality of life for stakeholders but also foster inclusive economic growth.

Moreover, the governance component of ESG strengthens institutional integrity by promoting transparency, accountability, and ethical business conduct. Effective governance mechanisms reduce the risk of corruption, fraud, and corporate misconduct, thereby enhancing investor confidence and ensuring the efficient functioning of markets.

In the Indian regulatory landscape, initiatives undertaken by the Securities and Exchange Board of India, particularly in relation to ESG disclosures, have facilitated this alignment between investment and sustainability. ESG investing thus bridges the gap between profit-making and social responsibility, enabling FPIs to contribute meaningfully to long-term sustainable development.

VI. Issues and Challenges

Despite the growing importance of ESG investing in India, several challenges hinder its effective implementation, particularly in the context of Foreign Portfolio Investors (FPIs).

One of the primary issues is the lack of uniform ESG rating standards. Different rating agencies

adopt varied methodologies and criteria for assessing ESG performance, leading to inconsistencies and confusion among investors. This lack of standardization makes it difficult for FPIs to accurately compare companies and make informed investment decisions.

Another significant concern is the practice of *greenwashing*, wherein companies exaggerate or misrepresent their ESG credentials to appear more sustainable than they actually are. In the absence of stringent verification mechanisms, such misleading disclosures undermine investor trust and distort market integrity.

Additionally, enforcement of ESG-related regulations in India remains relatively weak. While frameworks such as the Business Responsibility and Sustainability Report (BRSR) have been introduced by the Securities and Exchange Board of India, the absence of strict penalties and robust monitoring mechanisms limits their effectiveness.

The lack of a comprehensive ESG audit system further exacerbates the problem. Without independent third-party verification, the reliability and accuracy of ESG disclosures remain questionable, reducing their utility for investors.

Lastly, the inherently volatile nature of FPI investments poses a structural challenge. FPIs can quickly withdraw capital in response to market uncertainties or regulatory changes, which may undermine long-term ESG objectives that require sustained investment and commitment.

These challenges highlight the need for a more robust, transparent, and enforceable ESG framework to ensure that ESG investing by FPIs achieves its intended objectives.

VII. Suggestions and Recommendations

In order to strengthen the effectiveness of ESG investing by Foreign Portfolio Investors (FPIs) in India, a number of regulatory and institutional reforms are necessary.

Firstly, there is a pressing need for standardization of ESG rating mechanisms. The Securities and Exchange Board of India should develop a uniform framework or guidelines to harmonize ESG assessment criteria across rating agencies. This would enhance comparability, reduce ambiguity, and enable investors to make more informed decisions.

Secondly, the introduction of mandatory third-party ESG audits can significantly improve the credibility of corporate disclosures. Independent verification would ensure that the information reported by companies is accurate, reliable, and free from manipulation.

Further, stricter regulatory action must be taken against greenwashing practices. The imposition of clear penalties and legal consequences for misleading ESG claims would act as a deterrent and help maintain market integrity.

Improving the quality and depth of disclosures under the Business Responsibility and Sustainability Report (BRSR) framework is also essential. Companies should be encouraged, and where necessary required, to provide more detailed, measurable, and comparable ESG data.

Additionally, increasing investor awareness regarding ESG factors can promote responsible investment behaviour. Educational initiatives and transparent disclosure practices can empower FPIs to integrate ESG considerations more effectively into their investment strategies.

Collectively, these measures can strengthen India's ESG ecosystem, enhance investor confidence, and ensure that ESG investing contributes meaningfully to sustainable economic development.

VIII. Conclusion

ESG investing has emerged as a central consideration in the evolving landscape of foreign investment, particularly for Foreign Portfolio Investors (FPIs) seeking sustainable and responsible avenues of capital allocation. In India, the regulatory framework governing ESG has shown notable progress, primarily through initiatives undertaken by the Securities and Exchange Board of India, including the introduction of structured disclosure mechanisms such as the Business Responsibility and Sustainability Report (BRSR).

However, despite these advancements, the regulatory regime remains in a developmental stage and requires stronger enforcement, standardized practices, and enhanced monitoring to ensure effective implementation. Addressing challenges such as greenwashing, inconsistent ESG ratings, and limited audit mechanisms is essential to build a robust and credible ESG

ecosystem.

A well-regulated ESG framework has the potential to align foreign investment with national and global sustainability objectives, thereby promoting long-term economic stability and ethical business practices. Thus, ESG investing by FPIs can become a key instrument of sustainable economic growth if backed by strict disclosure and accountability mechanisms.

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