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# ESG Regulation in China: An Emerging and Evolving Landscape



## I. INTRODUCTION

The ESG (Environmental, Social, and Governance) framework is gaining increasing recognition as both an investment philosophy and a guiding principle for corporate conduct on a global scale. Specifically in terms of investment, ESG focuses on a company's performance in environmental, social, and governance aspects, rather than solely concentrating on traditional financial metrics. At the corporate level, ESG represents the practice of incorporating environmental, social, and governance factors into management and operational processes.

While there is no unified standard for defining the specific components of ESG issues, both in China and internationally, there are also disparities in the ESG matters required for disclosure by regulatory authorities, securities exchanges, ESG disclosure standards published by international organizations, and the reference indicators used by ESG rating agencies. Nevertheless, there are common ESG themes, which generally include:

- Environmental(E): Covering aspects like greenhouse gas emissions, air and water pollution, energy efficiency, water and land resource management, biodiversity, clean manufacturing, green building, and renewable energy.

- Social(S): Encompassing employee welfare, workplace conditions, diversity and inclusion, product safety and quality, data security, responsible advertising, consumer relations, supply chain labor standards, human rights protection, community engagement, and philanthropic activities.

- Governance (G): Addressing anti-corruption, anti-bribery, anti-fraud, anti-money laundering, business ethics, risk management, shareholder rights protection, governance structure, board composition, taxation, and compensation systems.

In China, while the concept of ESG originated from abroad, it has gained momentum due to its alignment with the imperative of green economic development and social equity. This commitment was reinforced in 2020 when President Xi Jinping delivered a landmark address at the 75th United Nations General Assembly, pledging to achieve carbon peak by 2030 and carbon neutrality by 2060, encapsulating the ambitious 'dual carbon' goal. This commitment was subsequently incorporated into the 'Government Work Report,' further encouraging an increasing number of companies to prioritize ESG considerations to secure government support. Furthermore, the report to the 20th National Congress of the Communist Party of China stressed the importance of promoting common prosperity for the sake of social equity.

As of 2022, China has made progress in the realm of ESG. Notably, 99 Chinese asset management organizations have become signatories to the United Nations Principles for Responsible Investment (UNPRI). Moreover, 28.5% of A-share listed companies in China have published ESG-related reports.

## II. REGULATORY OVERVIEW

Since the establishment of a green finance system in 2016, ESG regulations in China have gained momentum, largely spurred by the country's commitment to carbon peaking and carbon neutrality. Below is a concise timeline of key ESG regulatory developments in China:

- August 2016: Seven authorities, including the People's Bank of China and the China Securities Regulatory Commission, issued the *<Guiding Opinions on Building a Green Finance System>* setting the groundwork for mandatory environmental information disclosure by listed companies.

- June 2017: The China Securities Regulatory Commission and the Ministry of Environmental Protection signed a cooperative agreement, aiming to collectively advance the establishment of a compulsory system for disclosing environmental information by listed companies.

- September 2018: The China Securities Regulatory Commission made a significant move by revising the *<Listed Company Governance Code>*, thereby laying the foundation for environmental, social responsibility, and corporate governance (ESG) information disclosure.

- November 2018: The China Securities Investment Fund Association introduced the *<Green Investment Guidelines (Trial)>* providing a clear definition of green investment, specifying its scope and objectives, offering guidance on conducting green investments, and presenting a framework for assessing the environmental impact of investment targets.

- June 2021: The China Securities Regulatory Commission revised format standards for annual and semi-annual reports, with a heightened focus on environmental protection and social responsibility.

- May 2021: The Ministry of Ecology and Environment issued the *<Management Measures for the Legal Disclosure of Environmental Information by Enterprises>* mandating eligible high-pollution enterprises, publicly listed companies, clean production review companies, and bond-issuing enterprises to disclose environmental information.

- February 2022: Four Chinese government departments, including the People's Bank of China, issued the *<Development Plan for Financial Standardization in the 14th Five-Year Plan>*. This plan outlines key tasks, including the development of green bond standards, formulation of environmental information disclosure standards for listed companies and bond-issuing enterprises, and the establishment of an ESG evaluation standards system.

- May 2022: The State-owned Assets Supervision and Administration Commission unveiled a plan named *<Enhancing the Quality of Central State-owned Enterprises Holding Listed Companies>*. This plan offers extensive guidance on improving the performance of central state-owned enterprises that have investments in publicly listed companies. A major goal set out in this plan is to ensure that all central state-owned enterprise-listed companies publish ESG special reports by 2023.

In addition to these specific ESG regulations, several other Chinese laws incorporate ESG-related elements, including the *<Company Law>, <Criminal Law>, <Labor Law>, <Labor Contract Law>, <Antitrust Law>, <Anti-Money Laundering Law>, <Anti-Unfair Competition Law>, <Law on the Protection of Rights and Interests of Women>*, and *<Law on the Protection of Minors>*. For instance, the *<Anti-Unfair Competition Law>* imposes obligations on business operators to fulfill social responsibilities, prohibiting them from employing illegal measures that disrupt market competition order or undermine the legitimate rights and interests of consumers and other operators. Similarly, the *<Antitrust Law>* aims to enhance social welfare by curbing monopolistic practices, fostering an environment conducive to innovation, and protecting consumers, all contributing to China's economic and social sustainability.

As observed in the preceding overview, ESG regulations in China showcase the following distinctive features:

*1. Government-Led Oversight*

Unlike many Western countries where ESG frameworks often evolve from market-driven initiatives, China's approach is largely directed by governmental regulators. Key regulatory bodies, including the State-owned Assets Supervision and Administration Commission, Ministry of Ecology and Environment, the People's Bank of China, the China Securities Regulatory Commission, stock exchanges, and various associations, have played crucial roles in shaping ESG regulations and policies in China.

*2. Gradual Transition towards Mandatory ESG Disclosures*

China's ESG regulatory framework maintains a balance between obligatory and voluntary components, with an increasing focus on mandatory reporting, especially for publicly listed companies. Notably, the STAR MARKET on the Shanghai Stock Exchange has already implemented mandatory ESG disclosures. Additionally, in April 2022, Fang Xinghai, Vice Chairman of China Securities Regulatory Commission, hinted at the potential direction of requiring obligatory ESG reporting for all A-shares to align with international ESG standards. Furthermore, publicly listed State-owned Enterprises (SOEs) are actively responding to the State-owned Assets Supervision and Administration Commission's call for ESG integration, with the goal of ensuring that all SOE-listed companies integrate ESG principles into their operations and reporting by 2023.

*3. Rise in ESG Investment and Financing Trends*

In the financial and investment sector, various associations have introduced green financing guidelines and policies, along with asset management strategies rooted in ESG principles. These institutions, guided by these principles, may choose to exclude underperforming ESG companies from their investment portfolios or reduce their investments in such entities. Companies not aligning with ESG principles could encounter financial and investment challenges.

*4. Evolving ESG Framework*

While China's ESG policies continue to advance, there remains a discernible disparity when compared to the more comprehensive ESG regulatory systems in Western countries, particularly the EU. Despite the increasing focus on ESG disclosure, the lack of standardized metrics and reporting frameworks remains a prominent challenge in China.

## III. CHALLENGES AND TRENDS

ESG, still a relatively new concept in China, is beginning to capture the attention of both companies and investors. However, as China is in the early stages of ESG development, several significant challenges have emerged:

- *Limited Awareness:* ESG is in its infancy in China, and many market participants lack a comprehensive understanding of its principles and practices.
- *Diverse Reporting Practices:* Companies use a range of terms to label their ESG-related reports, such as «corporate social responsibility reports,» «sustainable development reports,» and «corporate impact reports.» Few directly incorporate «ESG» in their report titles. As a result, these reports vary widely in perspective, required components, and intended impact.
- *Economic Pressures:* The impact of the COVID-19 pandemic and economic pressures has led many companies to prioritize their commercial interests, sometimes at the expense of ESG compliance.

However, looking ahead to the medium term, we anticipate the development of more standardized ESG disclosure, evaluation, financing, and investment frameworks. This evolution has the potential to transform ESG performance into a recognized metric, much like credit scores, empowering consumers and investors to make informed choices with a focus on genuine ESG commitment over price considerations.

Over time, an increased emphasis on environmental protection is likely to motivate companies to invest in energy-efficient technologies, leading to long-term cost savings. Furthermore, embracing social responsibilities will not only enhance a company's reputation but also foster trust among consumers, investors, and regulatory bodies. Simultaneously, a strong commitment to good governance is expected to significantly contribute to a company's overall stability.

In summary, the future of ESG in China holds promise. It is expected to transition from an initial emphasis on short-term market value enhancement to the establishment of a comprehensive and standardized framework.

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