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A Study on the Corporate Law Basis and Institutional Connection of ESG Governance in China

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Abstract. With the development of sustainable finance and responsible investment, ESG has gradually transformed from a voluntary corporate social responsibility concept into a regulatory issue closely related to corporate governance, information disclosure, and investor protection. Articles 19 and 20 of the new Company Law of 2024 provide a corporate law foundation for ESG governance from the perspectives of business integrity, social supervision, stakeholder protection, environmental protection, and social responsibility. However, the Company Law still primarily adopts principled and aspirational provisions, while the ESG disclosure rules of stock exchanges, the Hong Kong Stock Exchange, and the European Union have gradually become mandatory, standardized, and accountable. This paper adopts a combination of normative analysis and comparative analysis. It first analyzes the corporate law foundation of ESG based on Articles 19 and 20 of the new Company Law, and then uses the ESG systems of the EU and Hong Kong as references to highlight the inadequate alignment between China's Company Law, securities disclosure rules, and corporate internal governance. This paper argues that the main problem with ESG governance in China is not the lack of rules, but rather the absence of an effective closed-loop mechanism connecting regulatory levels, responsible entities, disclosure supervision, and internal governance. In the future, a tiered and categorized ESG obligation system should be established, the responsibilities of the board of directors should be clearly defined, and the effectiveness of ESG governance should be improved through unified disclosure standards, third-party verification, and accountability mechanisms.

Keywords: ESG, corporate law, corporate governance, sustainable disclosure, comparative approach

1. Introduction

In recent years, ESG has gradually become an important standard for evaluating corporate long-term value, risk management, and social responsibility performance, and has been increasingly integrated with capital market information disclosure, investor protection, and corporate governance structures. Related research has pointed out that ESG is no longer just an ethical concept of corporate social responsibility, but has gradually become an important issue in corporate governance and the legal system [1-3].

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In China, Articles 19 and 20 of the new Company Law of 2024 provide an important legal basis for ESG governance. Article 19 requires companies to operate with integrity, abide by business ethics, and accept social supervision. Article 20 requires companies to consider the interests of stakeholders such as employees and consumers, as well as broader public interests such as ecological and environmental protection, and to assume social responsibility [4]. Although the above articles do not directly use the concept of "ESG", they provide a normative entry point for environmental, social, and governance factors to be incorporated into the company law system [2, 3].

However, there remains a lack of alignment between the general principles of company law and ESG disclosure rules in the market. Therefore, this paper explores the adequacy of Articles 19 and 20 of the new Company Law in supporting modern ESG governance, and whether effective alignment can be achieved between company law principles, securities disclosure rules, and corporate governance. This paper first examines the corporate law basis of ESG, then focuses on the institutional deficiencies in China regarding regulatory alignment, principal responsibility, disclosure supervision, and governance implementation, and finally offers corresponding recommendations.

2. Key issues of ESG and the Company Law priority system in China

Articles 19 and 20 of the new Company Law provide a foundation for ESG governance, but a foundation does not equate to a complete system. For ESG to truly function as a form of corporate governance, it needs to be integrated with securities disclosure rules, corporate governance, and external regulatory mechanisms. A comparison of the experiences of the EU and Hong Kong reveals that China's main problem is not a lack of ESG rules, but rather the absence of effective coordination between rules and governance mechanisms at different levels [5-7].

2.1. Challenges in regulatory alignment

The primary shortcoming in the current connection between ESG and corporate law is the inconsistency in the regulatory strength between corporate law and capital market disclosure rules. Although Article 20 of the new Company Law stipulates that companies bear social responsibility and encourages them to publish social responsibility reports, this article is still a principle-based and advocacy-based regulation [4]. In contrast, the ESG rules of mainland stock exchanges and Hong Kong stock exchanges have gradually formed more specific disclosure requirements, especially in terms of climate risk, environmental indicators, board responsibilities and sustainable development reports, showing a trend towards mandatory and standardized approaches [8, 9].

Taking the Shanghai Stock Exchange's "Self-Regulatory Guidance No. 14 for Listed Companies – Sustainable Development Report (Trial)" as an example, it explicitly stipulates that companies listed on the SSE 180 Index and the STAR Market 50 Index, as well as cross-border listed companies, should disclose sustainable development reports subject to review and approval by the board of directors [5]. The guidance also requires the disclosing entity to identify the financial and impact importance of relevant issues, and to analyze and disclose the impacts, risks and opportunities related to sustainable development around the core content of governance, strategy, impact, risk and opportunity management, indicators and objectives [5]. This demonstrates that the mainland capital market rules have elevated ESG disclosure to the level of concrete mandatory obligations.

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This discrepancy affects the implementation of ESG obligations. If a listed company's ESG report contains material omissions, misleading statements, or greenwashing, the current liability is primarily based on securities regulatory rules, exchange self-regulatory rules, and information disclosure systems. However, company law provisions regarding the responsibilities of the board of directors, management, and corporate organs in ESG matters remain inadequately defined. In other words, while ESG has become a specific disclosure obligation in capital market rules, it remains primarily a value principle in company law. This misalignment between the company law's encouraging provisions and the market's mandatory disclosure rules can hinder the successful implementation of ESG.

Comparative experience further illustrates this institutional deficiency. The EU Corporate Sustainability Reporting Directive (CSRD) integrates sustainability information disclosure by eligible companies into statutory reporting obligations, while the European Sustainability Reporting Standards (ESRS) enhance the comparability and reliability of disclosures through double materiality, uniform disclosure standards, and third-party verification mechanisms [6, 7]. The Hong Kong Stock Exchange's ESG Reporting Guide, as part of its listing rules system, constrains issuers through a "comply or explain" mechanism and requires them to explain in their board statements how the board oversees ESG matters, identifies significant ESG risks, and reviews the progress of related objectives [9]. In contrast, the rules of mainland China have imposed mandatory or quasi-mandatory disclosure requirements on some listed companies, but Article 20 of the Company Law remains at the level of an advocacy that "encourages" companies to publish social responsibility reports. This has led to an unstable situation where the strength of the company law is relatively weak, but the market disclosure rules have been strengthened in advance.

2.2. Unclear main responsibilities

The misalignment of regulatory intensity will further impact the allocation of responsibilities within companies. When the Company Law fails to translate market-level ESG disclosure requirements into specific responsibilities for relevant bodies, it becomes difficult for the board of directors, audit committee, and management to establish a clear division of labor.

Whether ESG can truly enter corporate governance depends on whether there is a clear responsible entity within the company. From the perspective of corporate law, ESG involves long-term strategy, major risks, information disclosure, stakeholder protection and internal control, and should be linked to the responsibilities of the board of directors. Especially in the context of the new Company Law strengthening the governance function of the board of directors, the board of directors should become the core institution for ESG governance [10]. Related research shows that ESG factors may drive a shift in the content of directors' fiduciary duties, that is, when fulfilling their duty of diligence, directors should not only focus on short-term financial gains, but also need to consider environmental, social and governance risks that may affect the long-term value of the company [10]. However, the current Company Law does not clearly stipulate the specific responsibilities the board of directors bears for ESG matters. Whether the board of directors must review ESG reports, whether directors should bear the duty of diligence for false ESG disclosures, and whether the audit committee needs to review the quality of ESG data remain inadequately defined.

The changes in the audit committee system also reflect the problem of unclear main responsibilities. The new Company Law allows qualified companies to establish an audit committee within the board of directors to exercise the powers of the supervisory board, which elevates the status of the audit committee in internal corporate supervision [4]. ESG disclosure is not just about

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writing the report text. Its basis is the collection, verification and internal control of data information from multiple departments. Therefore, the quality of ESG disclosure is naturally related to the supervisory function of the audit committee. The Shanghai Stock Exchange guidelines also require companies to disclose the relevant organizational structure, scope of authority, information reporting mechanism, internal control system and assessment [5]. However, the current Company Law does not clearly define whether the audit committee has the responsibility of reviewing ESG data, supervising internal control or coordinating third-party verification, nor does it explain how the audit committee, the board of directors and management divide their work. As a result, although ESG reports need to be supported by true and complete data, it is still not clear who is responsible for data quality and risk control within the company.

Hong Kong's experience vividly illustrates this issue. The Hong Kong ESG framework more clearly emphasizes that the board of directors should supervise ESG matters, identify and assess major ESG risks, and ensure the establishment of appropriate management mechanisms [8, 9]. This shows that the ESG disclosure system must be supported by the board of directors' responsibility. Otherwise, even if the number of ESG reports increases, they may just be textual work completed by the disclosure department or public relations department, rather than a real corporate governance result.

2.3. Disclosure of regulatory gaps

With the increase in the number of ESG reports, the issue of ESG governance in China has shifted from "whether to disclose" to "whether the disclosure is formal, accurate, complete and verifiable". The Shanghai Stock Exchange guidelines have required that information related to sustainable development should be objective and truthful, should not be selectively disclosed, should not conflict with legally disclosed information, and should maintain consistency in terminology, units, measurement methods and data calculation methods [5]. Related greenwashing regulations have also pointed out that selective disclosure, inconsistent standards and insufficient external verification are important causes of ESG information distortion and greenwashing risks.

From the perspective of corporate ESG report texts, the disclosure of regulatory deficiencies has not disappeared with the increase in the number of reports. Taking Tencent Holdings and Ping An Insurance as examples, Tencent disclosed data security, privacy protection, green data centers and ESG governance architecture in its ESG report, while Ping An Insurance disclosed sustainable finance, ESG risk management, responsible investment and third-party attestation arrangements [11, 12]. This indicates that large enterprises possess relatively robust ESG reporting capabilities. However, further observation reveals that these disclosures remain primarily anchored in institutional descriptions, business results and positive performance. Although Tencent disclosed data security and privacy protection mechanisms, its disclosures regarding risk identification and response procedures, continuous board supervision, internal control enforcement, and accountability mechanisms remain insufficiently specific [11]. Although Ping An Insurance disclosed ESG risk management and sustainable finance practices, its disclosures on how ESG factors substantially affect specific investment decisions, how the environmental performance of green finance projects is continuously verified, and how to explain and hold accountable those who fail to achieve their goals are still relatively limited [12]. Consequently, current ESG reports of Chinese companies tend to highlight corporate achievements ("what has been done") while failing to adequately address omissions, authenticity verification, and accountability mechanisms.

More importantly, the above problems all point to the risk of greenwashing, that is, companies create a greener and more responsible image than they actually are by selectively disclosing, using

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vague statements or unverified data. Related studies have pointed out that the root cause of the greenwashing problem lies not only in the companies' disclosure motives, but also in the lack of uniformity in sustainability information standards, insufficient external verification, and imperfect legal liability mechanisms [13]. The EU's CSRD and ESRS improve the comparability and reliability of ESG disclosure information by unifying disclosure standards, the principle of dual importance, and third-party verification mechanisms [6, 7]. Hong Kong's ESG rules promote companies to shift from general social responsibility narratives to more specific risk and indicator disclosures by strengthening board responsibilities and climate-related disclosures [8, 9].

2.4. Difficulties in implementing governance measures

The disclosure issues further reflect the lack of internalization of governance, that is, ESG has not yet truly entered into corporate decision-making, internal control and performance evaluation. Many companies perceive ESG merely as an annual reporting task involving material collection, data compilation, report drafting, rating agency engagement, or compliance with year-end exchange disclosure requirements. But true ESG governance should be integrated into corporate strategy and internal decision-making.

This issue is further illustrated by the reports of Tencent and Ping An. Both types of reports have disclosed relatively complete ESG governance structures, risk management or sustainable development working mechanisms [11, 12]. However, from the perspective of corporate law, there is still room for further refinement in the reports regarding the actual authority of relevant institutions, the path to reporting to the board of directors, the relationship between ESG objectives and major business decisions, and the linkage between ESG objectives and performance evaluation. In other words, disclosing the establishment of an ESG governance structure does not necessarily prove that ESG has been genuinely integrated into the board's decision-making and internal control systems.

From the perspective of corporate law, this issue is closely related to the company's articles of association and internal governance rules. However, most company articles of association have limited provisions on ESG matters. Whether a board establishes an ESG committee, how major ESG matters are reported, and how ESG risks are incorporated into internal controls often depend on voluntary corporate arrangements. The Shanghai Stock Exchange guidelines have already required the disclosing entity to establish and improve the company's governance structure and internal system, ensure that the internal institutions have the ability to identify, assess, manage and supervise the impacts, risks and opportunities related to sustainable development, and explain how the relevant processes are integrated into the company's internal management processes [5]. However, if the responsibilities of the board of directors and the audit committee are not further clarified at the level of corporate law, the above requirements may still remain at the level of disclosure compliance.

The Hong Kong ESG framework emphasizes the board's oversight of ESG matters, while the EU system mandates that companies establish data collection and risk identification mechanisms through sustainable disclosure requirements [6-9]. It is evident that external disclosure rules are unlikely to have a substantial effect without the support of internal governance mechanisms. Consequently, the next phase of China's ESG governance must go beyond merely increasing report lengths, focusing instead on embedding ESG into board responsibilities, internal controls, and corporate decision-making.

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3. Directions for improving the system for connecting ESG with Company Law

As mentioned above, the deficiencies in China's ESG governance are mainly concentrated in four aspects: standard alignment, principal responsibility, disclosure supervision, and governance implementation. Accordingly, the following sections propose targeted recommendations to address these areas.

First, regarding the misalignment issue. The new Company Law should, on the basis of Articles 19 and 20, strengthen mandatory disclosure requirements and establish a tiered and categorized ESG obligation system. For large listed companies, key index sample companies, companies listed both domestically and overseas, and enterprises in high-pollution and high-risk industries, a higher degree of mandatory disclosure requirements may be applied; for general listed companies and small and medium-sized enterprises, a combination of standardized disclosure, simplified disclosure, or voluntary disclosure should be adopted. The Shanghai Stock Exchange guidelines have already reflected a similar tiered approach and can serve as the basis for the connection between the Company Law and securities rules [5].

Second, regarding the issue of subject responsibility, China can draw upon the experiences of Hong Kong and the EU to construct a tripartite accountability framework comprising "board oversight, audit committee review, and management execution." The ESG rules of the Hong Kong Stock Exchange have clearly defined the board of directors' responsibility for supervising ESG matters and reviewing the progress of objectives [8, 9]. The EU CSRD and ESRS have strengthened the standardization, attestation and internal control requirements for sustainable information disclosure [6, 7]. Leveraging the reform of audit committees under the 2024 Company Law, a legal foundation can be established for audit committees to supervise ESG data quality, internal controls, and third-party attestation arrangements [4]. On this basis, management can rely on the information reporting mechanism and internal control system required by the Shanghai Stock Exchange guidelines to be responsible for daily data collection, risk identification and specific implementation [5].

Third, regarding selective disclosure, indicator differences, and the risk of greenwashing, core indicators should be standardized and clearly defined, and the scope of application of third-party verification should be gradually expanded. For material omissions, misleading statements, and serious greenwashing, the mechanisms for liability for securities misrepresentation, liability of directors and senior executives, and civil compensation should be linked to increase the cost of illegal disclosure [5, 14].

Fourth, to counter the tendency of ESG to remain merely a reporting formality, it must be deeply embedded in substantive corporate governance. The Shanghai Stock Exchange guidelines require disclosure of information reporting mechanisms, internal control systems and performance evaluation [5], and the Hong Kong Stock Exchange rules also emphasize that the board of directors supervises ESG matters and the progress of objectives [8, 9]. Therefore, companies should incorporate major ESG matters into their articles of association, board meeting rules, internal control and performance evaluation, thereby translating ESG into routine governance operations.

Finally, regarding the integration of artificial intelligence (AI) into ESG governance, its auxiliary role and responsibility boundaries should be clarified. While AI can assist in report review, data comparison, risk identification, and regulatory screening, its outputs serve merely as auxiliary references and cannot replace human regulatory or corporate judgment. Enterprises that use AI to generate or assist in the writing of ESG reports cannot use "AI generation" as a reason to exempt the company, board of directors, management and information disclosure personnel from responsibility

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for the authenticity, accuracy and completeness. At the same time, when AI processes ESG data such as supply chain, employees, environmental monitoring and trade secrets, it should comply with data security and personal information protection rules. The EU AI Act's requirements on transparency, interpretability and human supervision can provide a reference for China's institutional design [15].

4. Conclusion

Overall, Articles 19 and 20 of the new Company Law of 2024 provide a normative foundation for ESG governance to enter the corporate law system. However, China's ESG framework still needs to forge a more effective synergy between the general principles of company law and stock exchange disclosure rules. In the future, efforts should be made to promote ESG from an annual reporting task to a daily corporate governance responsibility by unifying mandatory disclosure standards, clarifying internal responsibilities, strengthening third-party verification, and improving greenwashing accountability mechanisms.

The limitations of this study lie in its primary focus on normative and comparative analysis, lacking sufficient empirical examination of listed companies' ESG reporting practices, the efficacy of third-party verification, and greenwashing accountability cases. Furthermore, due to space limitations, this paper fails to further differentiate the differences in ESG obligation capacity among companies of different industries and sizes, and also fails to delve into the applicability of ESG governance to non-listed companies. These issues require further in-depth research in the future.

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