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ESG: TRENDS TO WATCH IN 2021

— THOUGHT LEADERSHIP

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The new Biden Administration, COP26, a renewed push from China on climate change and a focus on how we build back better post COVID-19 means that 2021 is going to be the biggest year yet for ESG – environmental, social and governance issues. Here we explore some of the key trends to watch.

1

The transformation of U.S. policy

Climate issues are now an essential element of U.S. foreign policy and national security. Rejoining the Paris Agreement was one of President Biden's first actions alongside commitments to achieve net zero emissions no later than 2050 and to decarbonise US power generation by 2035. These announcements are likely to galvanise efforts regarding climate change internationally and domestically, and create significant opportunities for international investment in U.S. domestic climate projects.

Biden's Climate Plan (implementation of which depends, in part, on Congressional action) includes:

- Substantial spending on clean energy and infrastructure (both onshore and offshore), committing to US$2 trillion in investments over four years; as well as an amended regulatory framework for utilities to source clean energy instead of fossil fuels.
- An upgrade of the commercial building sector by retrofitting buildings, upgrading schools and improving energy efficiency in homes across the country.
- Plans to require public companies to disclose climate change-related financial risks and greenhouse gas (GHG) emissions in their operations, ensuring the U.S. joins the growing number of nations who are already mandating, or preparing to mandate, climate-related financial reporting. We anticipate that U.S. financial regulatory agencies will move to further assess and account for climate change in policy, enforcement and guidance measures.
- Repositioning the auto industry to focus on clean vehicles and speed up the transition to electric vehicles.

2

A new multilateral approach?

President Biden's commitment to the US rejoining global initiatives/bodies, including the Paris Agreement and the World Health Organization, signals a much greater focus on global co-operation. He says: "The United States will work with other countries and partners, both bilaterally and multilaterally, to put the world on a sustainable climate pathway. The United States will also move quickly to build resilience, both at home and abroad, against the impacts of climate change that are already manifest and will continue to intensify according to current trajectories." Leaders of more than 70 countries have committed to reduce emissions in recent months. The EU pledges to be net zero by 2050, and China announced that it will be net zero by 2060. President Xi Jinping has also said that China will triple its wind and solar capacity in the next ten years. During the COVID-19 crisis, CO2 emissions have fallen by 8% globally, but whether this will continue as the world recovers remains to be seen. Nigeria says that its recovery includes plans to phase out fossil fuel subsidies, and France and Canada have attached climate-related conditions to bail-out funds. However, China and India's COVID-19 recovery plans include the continued use of coal power. There may also be tensions over plans from both the EU and US to penalise high carbon imports that could open up new fronts in trade disputes with China. The renewed focus on climate will have a significant impact on businesses, who will be faced with implementation and disclosure issues and may face new regulation beyond climate change into other environmental issues such as plastics and chemicals.

COP26 – a gamechanger?

3

COP26, the 2021 United Nations Climate Change Conference, which will be held in Glasgow in November, has been described by the US climate envoy John Kerry as "the last best chance" to avert environmental disaster. With the US back in the fold, having rejoined the Paris Agreement and rolled out a series of executive orders aimed at tackling climate change, COP26 may make significant progress. U.S. re-engagement in international climate action is likely to encourage greater international carbon reduction and climate finance efforts at the COP26 meeting, and could help unblock continuing impasses on the development of a carbon market mechanism. However, whether COP26 will become this generation's Bretton Woods – the conference which laid the foundations for global economic order after the Second World War – remains to be seen. At the very least, more governments will need to commit to tougher emission cuts by 2030 and plan to reach net zero emissions by 2050. Richer nations will also need to fulfil their promises to deliver at least US$100 billion a year to help poorer countries protect against the impacts of climate change. How to achieve a "just transition" to a zero carbon world, which protects the rights of the poorest workers and communities – and who will pay for it – will be key questions. Equally importantly for COP26 to be transformative, it is clear that progress will be needed on unlocking and mobilising private capital.

Increasing legislation

4

We will see increasing regulation and legislation to deal with ESG issues across jurisdictions. The EU is a first mover with legislative proposals for mandatory environmental and human rights due diligence. The Sustainable Finance Disclosure Regulation, which applies from 10 March 2021, aims to increase transparency and prevent green-washing. It introduces harmonised disclosure obligations on asset managers and other types of financial institutions. Linked with this, is the Sustainable Finance Taxonomy Regulation, which applies from 1 January 2022 and provides an EU-wide 'dictionary' of environmentally sustainable activities. In the US, the legal and regulatory pace will accelerate under the Biden Administration with the ESG Disclosure Simplification Act; and regulations around racial equality, and anti-discrimination on the basis of gender, identity or sexual orientation. President Biden has also promised a "clean energy revolution" under an Executive Order on Protecting Public Health and the Environment and Restoring Science To Tackle the Climate Crisis. This will "hold polluters accountable, including those who disproportionately harm communities of colour and low-income communities; reduce greenhouse gas emissions; bolster resilience to the impacts of climate change; to prioritize both environmental justice and the creation of the well-paying union jobs necessary to deliver on these goals." We also expect to see greater focus by the Securities and Exchange Commission and other US regulators on "greenwashing." APAC (perhaps with the exception of Australia) has traditionally been seen as a laggard behind the EU and the US in developing mature ESG disclosure with many companies in the region still seeing it as a box-ticking exercise. China, however, is taking bold steps and is on the cusp of implementing a mandatory ESG disclosure regime for listed companies.

The rise of ESG litigation and the challenges for business

5

Activist shareholders and NGOs are targeting governments and businesses and increasingly using litigation in efforts to combat climate change and protect human rights. Columbia Law School says that in 2020 the number of climate change related cases almost doubled, to 1,550 in 38 countries, and shows no signs of slowing. The big questions for the courts are: who is responsible? Who will bear the financial burden of the lasting changes caused by climate change? Many disputes stem from these unresolved questions. Investors are beginning to pursue claims against companies for inaccurately representing their ESG credentials and/or failing to manage and disclose climate change and other ESG risks, particularly in the U.S. It is a trend that is already spreading to Europe and Asia.

As well as disputes involving companies, there are growing challenges to governments on climate change issues. For example, in July 2020 a 'world first' case was filed in the federal court of Australia alleging the government had failed in its duty to disclose climate change impacts on the value of government bonds. And in February, a court in Paris found the French state guilty of failing to address climate change and for not fulfilling its commitments to tackle greenhouse gas emissions.

6

Sustainable tech

From the carbon footprint of Bitcoin, to the cultural and ethical issues raised by developing products using personal data or AI, ESG considerations and challenges abound for tech. We expect to see tech firms being held to greater account on ESG issues. Take the right to privacy – users are increasingly switching to encrypted messaging and video call services as they become more concerned about who has access to their personal and sensitive data. This year we expect to see tech companies compete to demonstrate that they are the most privacy-centric platform. Diversity and inclusion will be key, with a move towards greater investment in fintech firms led by BAME and female founders. And with an increasing focus on governance, financial firms will need to develop documented procedures on the development, implementation and use of tech which may impact consumers or society at large. Taking AI as an example, this might include ethics frameworks, explanations of the AI approval processes and allocation of responsibility. The Tech For Good movement, which sees tech as the solution to some of society's most significant problems, is growing rapidly, and offers a number of opportunities including Assistive Technology designed to improve the quality of life for those living with disabilities; and Telemedicine and Medtech – improving access to healthcare, whether it be through remote patient monitoring or delivering healthcare to those who live far from hospitals.

7

Social risks become a boardroom issue

Social risks – the "S" in ESG – are rapidly becoming a crucial issue for boardrooms. They include: business and human rights; corruption; supply chain management and transparency; consumer protection; investment in local communications; and labour and employment issues, such as diversity and inclusion, working conditions, and child labour laws. The focus on these areas is likely to intensify post COVID-19. We are already seeing a strategic shift from a reactive approach to dealing with issues, such as diversity and inclusion, to a proactive one.

COVID-19 is a catalyst for change and we expect to see a growing number of companies overhaul their work-life balance approach, or showcase the human rights compliance and sustainability of their supply chains, or position themselves as "doing no harm." But this is not without risk. What happens to the board and the business if they are unable to achieve these goals? To avoid being accused of 'social washing', they will want to be sure that hard regulatory requirements, metrics and disclosure provisions are met and softer cultural principles observed. Increased risks include: whistle-blowers highlighting a mismatch between image and the reality; discrimination claims where employees say that an ESG stance goes against their philosophical beliefs; regulatory, investor or consumer scrutiny (and possibly fines or censure) if company disclosures about sustainability do not match the reality, or if they are not sufficiently operationally resilient.

8

Build back better

The UK, the U.S., the EU and a growing number of companies have said that post COVID-19 they intend to build back better and learn lessons from the pandemic. But what does that mean in practice? Many businesses demonstrated flexibility – L'Oreal, for example, paid small and medium-sized suppliers early to help them weather the crisis, fashion brand Barbour repurposed its production lines to make PPE for the NHS free of charge – but others were accused of not considering the health and safety of employees by keeping warehouses and stores open. We expect a shift in corporate culture to address issues of employment engagement, employee mental health and diversity and inclusion. Companies are likely to capture enhancements in disclosures and market positioning to improve stakeholder value and investment potential.

The need to rebuild coincides with a renewed focus on the development of renewables and other innovative energy technologies. This includes the hydrogen industry, which is developing at pace in Europe and APAC. Hydrogen has enormous potential for use in a wide range of applications including flexible electricity generation and storage, heavy duty transport, heating and certain industrial applications. However, major barriers still need to be overcome in terms of policy and technology uncertainty, the right regulatory mechanisms, value chain complexity, infrastructure needs and public acceptance.

There is also likely to be a much greater focus on green buildings and greener living. The UK, for example, plans to significantly ramp up the minimum energy efficiency standards that commercial building owners must meet if they wish to rent out commercial buildings. This is likely to trigger major refurbishment programmes by real estate owners. The EU is also proposing a 'renovation wave' to improve the energy efficiency of buildings.

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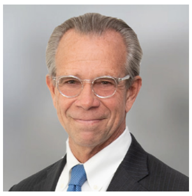

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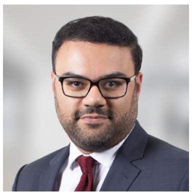

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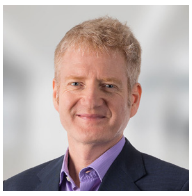

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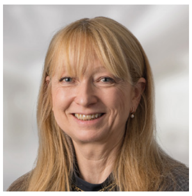

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