Hogan Lovells

Environmental, social and governance

New and Emerging ESG Laws

Across the world, governments are driving change in the ESG sphere and requiring greater accountability for ESG issues.

Regulators are responding to investor and consumer concerns about corporate "woke-washing" and "green-washing" by creating greater accountability and consistency across reporting frameworks and compliance requirements. The forerunner on legislative developments is the European Union, where a raft of new regulations relating to corporates' environmental and climate change impacts are shaping the way in which businesses operate.

We've set out new and upcoming ESG regulation across the world. We have selected these developments to include legislation passed in 2020 or 2021, and updates to previous legislation. This does not capture all new ESG laws, but we have highlighted certain interesting examples of ways in which various jurisdictions are addressing ESG issues in regulation. For further discussion of the key trends in ESG initiatives for 2021, please click here.

1. Europe: First to launch

The European Union has in many respects been a first mover in global efforts to legislate on ESG. From the pioneering Green Deal (examined in more detail at 2.1 below) to the four regulatory elements explored below, the EU has been leading the way on the development of ESG legislation.

Whilst this is forcing companies to take stock of their ESG impact to comply with reporting requirements, these spheres show a heavy focus on assessing sustainability within the E.U.

a) Disclosure Regulation

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector mandates that investment firms disclose their approach to ESG on their websites and in pre-contractual and periodic disclosures. In asking firms to make such disclosures, the Regulation necessitates firms' consideration of their ESG impact. By the end of 2022, investment funds will have to disclose any adverse ESG impact.

b) Taxonomy Regulation

Regulation (EU) 2020/852 establishes a taxonomy as a framework to encourage sustainable investment. It also amends the Disclosure Regulation. The taxonomy allows financial market participants and European authorities to assess whether certain economic activities are "sustainable", based on one or more of six sustainability objectives. The activity will need to meet four conditions in relation to those objectives to be considered environmentally sustainable. It must

- contribute substantially to one or more of the objectives;
- not significantly harm any of the objectives;
- be invested in compliance with minimum specified safeguards listed in the Taxonomy Regulation; and
- comply with technical screening criteria (to be published by the Commission).

It is intended that this taxonomy will extend beyond environmental objectives.

The Taxonomy Regulation was in force before the end of the Brexit transition period, so is on-shored into UK legislation, however the disclosure obligations will not come into force until 2022, so are not currently to be on-shored.

c) Amendments to MiFID, AIFMD and UCITS

The European Commission has introduced a series of draft measures amending the MiFID Delegated Directive, the MiFID Organisational Regulation, the AIFMD Level 2 Regulation and the UCITS Implementing Directive. These laws are amended to, among other things:

- update investors' internal organisation and risk management policies;
- update due diligence processes;
- integrate training on sustainability risk; and
- update suitability processes to include sustainability preferences.

It is expected that these will come into force in late 2021.

d) Due Diligence Regime

The European Commission is committed to introducing a due diligence regime whereby companies must conduct human rights due diligence into their supply chains. Companies may be required to implement adequate policies to account for their own impact and that of their supply chain on human rights, health and safety, and the environment.

The proposal is expected in the second quarter of 2021.

2. Supply Chain Due Diligence

France

Further, and in a similar vein to the EU's proposed law on sustainability and human rights due diligence for companies, France has already enacted the Duty of Vigilance law. This law establishes a legally binding obligation for parent companies to identify and prevent adverse human rights and environmental impact resulting from themselves, companies they control, and activities of subcontractors and suppliers with whom they have an established commercial relationship. The largest companies in France will therefore assess these risks under annual public vigilance plans.

In 2019, the first formal notice was delivered under the law to gas company, Total, requesting it identify any risks to human rights and the environment caused by its emissions.

Germany

Following Germany's adoption of a National Action Plan for the implementation of the UN Guiding Principles on Human Rights in 2016, in March 2021 the German government adopted a draft bill which obliges large companies with headquarters in Germany to ensure that human rights are observed throughout their entire supply chain.

Companies will be required to analyse risks to human rights, prevent violations and provide remedies, and create complaints procedures. These obligations are supported by severe fines for non-compliance and uncapped liabilities to enable private enforcement.

UK

In August 2020, the UK government followed suit and published a consultation on a new supply chain due diligence law aimed at protecting global rainforests and other sensitive habitats.

The Environment Bill 2019-2021 is currently under consultation and is expected to be adopted by mid-2021. As of November 2020, it had been updated to include restrictions on illegal deforestation by mandating that large businesses (with a specified turnover) assess their supply chain in relation to “forest risk commodities” and to ensure that local laws are complied with.

The UK government has also announced that the UK will make climate-related financial disclosures fully mandatory by 2025, through the Task Force on Climate-related Financial Disclosures (“TCFD”). The TCFD disclosure regime will apply to all UK registered companies, financial advisers and institutions, insurers, pension schemes and other organisations.

These laws show active moves towards demanding specific accountability from business.

3. Tackling Climate Change

Environmental legislation has been one of the fastest-moving areas of ESG law recently, and governments across the world are waking up to the huge public interest in tackling climate change.

a) Commitment to Net Zero or Carbon Neutrality

2020 saw the fifth anniversary of the Paris Agreement and the chance to take stock of countries' progress in tackling climate change. In a crucial development, more and more countries have committed to reducing their greenhouse gas emissions to net zero by the middle of the 21st century.

b) Green Deal

The EU has not yet enshrined the net zero commitment in law; however it has launched several climate change initiatives. The European Green Deal was presented in 2019 as a package of measures designed to combat climate change and the effects of climate change. 2020 saw several developments in the Green Deal, including a proposal for a European climate law to ensure a climate neutral EU by 2050 (not yet passed), a 2030 Climate Target Plan to reduce net greenhouse gases by 55% by 2030, an EU Strategy on Climate Adaptation to make Europe a climate-resilient society by 2050 and various other initiatives reviewing climate action and innovation.

This is likely to be a key area of legislative development in the coming years.

c) Emissions trading schemes

A recent trend in climate policy has been the introduction of emissions trading schemes, under which emissions obligations are to be kept by participating businesses.

The EU emissions trading scheme is the largest in operation and has been running since 2005. Various other countries have developed trading systems, including South Korea, Canada, Japan and New Zealand.

In November 2020, China drafted new rules for a planned national carbon emissions rights trading scheme. Under the scheme, companies will be required to issue emissions reports, subject to strict disclosure and verification requirements. Failure actively to produce these reports may lead to fines of up to CNY 30,000.

d) Canada: COVID loans and climate change?

In an interesting contribution towards its net zero commitment, Canada has introduced the Large Employer Emergency Financing Facility program, which provides short-term loans to large employers affected by the COVID-19 pandemic. Employers are required to publish an annual climate-related disclosure report, highlighting how their corporate governance, strategies and policies help manage climate-related risks and opportunities. This is explicitly stated as a contribution to achieving Canada's commitments under the Paris Agreement and its 2050 net zero goal.

4. Corporate Responsibility

a) Corporate Conduct

Several countries have recently taken steps to encourage transparency and good corporate governance. 2020 saw the publication of the Belgian Corporate Governance Code, which applies to Belgian companies trading on a regulated market and replaces the 2009 Code. The 2020 Code includes provisions encouraging independence of Board members, transparent governance procedures and equal treatment of shareholders.

In 2020, the Financial Reporting Council published the UK Stewardship Code, which sets out good practice for institutional investors on engagement with investee companies. Among other things, institutional investors must set guidelines on how they will engage with an investee company on various ESG-related risks.

In the UK, responsibility is also becoming mandatory in the world of pensions, following the implementation of the Pension Schemes Act 2021. The Act allows the government to regulate when and how pension schemes should be required to adopt enhanced governance requirements and report in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations (please see below). Pension scheme trustees will need to put in place effective governance, strategy, risk management and accompanying metrics in relation to climate risks and opportunities. The Act currently only affects the largest pension schemes, and the government will consider whether to include smaller schemes in 2023.

By contrast, the U.S. has recently been much less keen to adopt ESG-specific reporting requirements, and in June 2020, the U.S. Department of Labor proposed legislation requiring pension plan investment fiduciaries to prioritise financial returns, notwithstanding any non-pecuniary benefits (which may include ESG factors)

In 2020 the Securities and Exchange Commission declined to publish any new rules in the ESG sphere. Disclosure of ESG risks is only required if the risks are "material".

b) UK: Social Value in Government Contracts

The launch of the UK government's social value model in public procurement in 2020 now requires government departments to score potential suppliers on their contribution to social value objectives. These objectives include supporting COVID-19 recovery, tackling economic inequality and driving equal opportunity.

5. Human rights and equality

a) EU

In December 2020, the EU showed its colours as a leading ESG player again when the European Council adopted the EU's first global human rights sanctions regime. This new regime allows the EU to impose travel bans and financial sanctions on targeted individuals, entities and bodies (including state and non-state actors) responsible for, involved in or associated with serious human rights violations and abuses worldwide, irrespective of where they occurred.

In January 2021, the European Commission also held a consultation with business and human rights advocates in a bid to develop its proposed corporate human rights and environmental due diligence law this year (see above).

b) U.S.

In February 2021, President Biden pledged to put human rights at the heart of US foreign policy. Whilst no legislation has yet emerged, he has sought a return to the UN human rights council and is reviewing:

- **arms sales;**
- **US involvement in the war in Yemen;**
- **the opening of US borders to refugees (up to 125,000 from 15,000);** and
- **the treatment of Muslim Uyghurs in China.** This marks a notable shift from the Trump administration however these are early days. President Biden will face significant challenges in enacting these changes, and in a list of foreign policy priorities, Human Rights Watch recommended that embracing human rights at home in the U.S. should be the President's first concern.

c) Switzerland: diversity and equality

In a new step for equal pay, Switzerland has passed a 2020 amendment to its Equality Act, mandating that organisations with over 100 employees should analyse the equality of pay between their men and women employees by 30 June 2021. Public entities must publish their results, again showing progress towards accountability in corporate structures.

d) E, S, G?

It is notable that these social issues have not seen much legislative development. The last year or so have shown us the massive demand for social change across the world, from the Black Lives Matter protests of 2020 to the women's campaigns of 2021, to ongoing human rights protests in Hong Kong, Lebanon, Myanmar and Russia (to mention only a few), all against a backdrop of COVID-worsened unemployment and poverty.

Legislatures have often been slow to react to the public will for action against climate change, and we are still waiting for regulation on climate change to catch up with public commitments, but we have seen progress in the environmental and governance spheres of ESG regulation in a way that we have yet to see on social issues.

The world of ESG law is gaining momentum and presents challenges and opportunities for your business. Hogan Lovells has a wealth of experience in these fields and can help you navigate these changing times. Contact us today to find out how we can advise you on ESG risks and opportunities.

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