Hogan Lovells

Environmental, social and governance

Key ESG trends

2022

2022 promises to be a landmark year for environmental, social and governance (ESG) initiatives.

Following concerns that COVID-19 would dampen ESG efforts, the global focus on **“building back better”** has instead set the tone for ESG issues to remain a priority for governments, corporate boards, investors and consumers.

This is a global trend: from **COP26,** the rapid growth in impact financing and inves ting, to the continued dialogue about diversity and inclusion sparked by the Black Lives Matter movement, ESG ripples are being felt across all industries, sectors and geographies.

Below we set out the **five key ESG trends** we expect to see in 2022 and some thoughts on how businesses should prepare to respond to the rapidly increasing demands for stronger ESG performance from consumers, investors and regulators.

1. Reporting, disclosure and the importance of data

2022 will be the year global financial regulators and voluntary standard frameworks converge around concrete measures to improve data quality and coverage. These requirements go beyond climate-related reporting and also incorporate wider environmental and social factors.

Investor-grade, high-quality ESG disclosure will drive investment decisions, consumer spending habits and regulatory compliance. This data is not only important in order to access finance and comply with regulations; reliable data will also show a company its risks and opportunities and allow it to facilitate a robust business strategy featuring ESG risk-management.

There is a growing body of laws and regulations governing disclosure of environment and climate-related data which increasingly aims to scrutinise green claims and requires the true integration of sustainability into investment decision-making.

a) In the UK, reporting in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) (in force April 2022), and the UK Stewardship Code improve the standard of data surrounding asset owners' and managers' sustainability considerations.

b) In the EU, asset managers and other financial market participants must disclose an array of new sustainability data under the Sustainable Finance Disclosure Regulation. ESG related disclosures are also required under the EU Taxonomy Regulations.

c) The US and other jurisdictions are also considering changes to their climate-related disclosure regimes.

For more information, see our guide to New and Emerging ESG Legislation.

These hard-law requirements are overlaid with investor expectations, market best-practices and "soft law" voluntary reporting standards, such as the UN Global Compact, the Extractive Industry Transparency Initiative and UNPRI.

Whether required by law to disclose, or encouraged to do so by investors and stakeholders, Boards must ensure they are in a position to manage ESG disclosures. As disclosure requirements become more onerous, current ESG policies should be reviewed, responsibility for ESG performance should be clearly delegated and Boards should consider whether their current reporting practices adequately support legal obligations, branding and wider ESG commitments.

The increase of data gathering and disclosure has a correlative effect. Companies and governments are using data driven technologies like artificial intelligence, machine learning, and the internet of things to monitor and improve environmental compliance and worker safety, while also increasing operational efficiency.

At Hogan Lovells, our team includes both lawyers and scientists, advising on:

Development and publication of standards for ESG-related due diligence, disclosure and contractual provisions;

Governance mechanisms that incorporate consideration of this data; and

ESG policies and ESG investment policies.

2. The rise of social and governance issues, with a focus on diversity and inclusion (D&I), and human rights

Events such as the COVID-19 pandemic and the Black Lives Matter movement have generated unprecedented momentum for company stakeholders to demand that Boards take action on a broad range of social and governance issues. Two areas – human rights and diversity and inclusion (D&I) – warrant particular focus for businesses.

Human rights and the responsibility of businesses for the impacts they have through their sales, supply-chain and operations are likely to be the subject of new European laws which may change the boundaries of corporate responsibility in the social arena.

This focus on social issues will increasingly become a bankability issue: major investment firms and asset managers have signalled that they will require companies to disclose diversity data. There is a corresponding rise in shareholder activism relating to diversity and work culture in large organisations.

a) D&I objectives have become a measure of an organisation's values and regulators are responding to the need for greater transparency on these issues. The UK has implemented gender pay gap reporting for companies since 2017 (albeit with a pause during the COVID-19 pandemic) and some businesses are disclosing ethnicity pay data on a voluntary basis, with calls for this to be made mandatory. Broader reporting requirements are being rolled out; subject to transition periods, companies listed on the Nasdaq stock exchange are subject to a "comply or explain" requirement to have two Board members who are from under-represented groups.

b) Previously viewed by some as a task for NGO campaigns and CSR initiatives, the prevention of adverse human rights impacts in the context of global business is increasingly being tackled by legislation, including:

- *EU-level mandatory human rights due diligence legislation;*
- *the first EU human rights sanctions regime;*
- *the German Act of Corporate Due Diligence in Supply chains which is one of the most significant human rights due diligence statutes; and*
- *bills from the U.S. House of Representatives addressing goods made using forced labour in the supply chain.*

3. The shifting discussion about the environment and the green finance boom

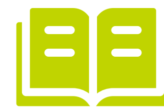
As the planet looks to “build back better” in the aftermath of the COVID-19 pandemic, we expect increasingly complex conversations about adaptation and climate resilience, the importance of biodiversity and financing of the energy transition, as well as the need for a “just” transition.

Businesses continue to shift their focus on growing threats to nature and biodiversity. The Taskforce on Nature-related Financial Disclosures (TNFD) calls nature loss “a planetary emergency” and aims to create a framework for corporates and financial institutions to assess, manage and report on their dependencies and impacts on nature. The World Economic Forum estimates that $44 trillion of economic value generation representing more than half of world GDP is moderately or highly dependent on nature. Companies must consider nature-positive solutions as part of operating practices and should expect reporting requirements to expand to include disclosure on the impact of their activities on land and under water.

In recent years we have seen a proliferation of net-zero commitments from companies and countries. The Glasgow Financial Alliance for Net Zero (formed of over 450 firms representing ~$130 trillion, or 40% of the world’s financial assets under management) signed up to achieve and deliver net zero by 2050, and marked a significant shift towards private funds forming part of the climate crisis solution. With the increase in companies and governments making net-zero commitments in recent years, sustainable and green bonds are set to boom as carbon-intensive companies issue debt to raise capital and use the proceeds for carbon- reduction activities.

More generally, we also see that rebuilding from the pandemic presents opportunities for capital markets. In Europe, for example, 30% of the €800 billion recovery fund is dedicated to green and sustainable finance. With so much government-issued debt that will be tagged to sustainability, and significant interest from private markets, the already booming sustainable finance market is set for even greater growth.

In order to access this finance, businesses must evidence a credible transition plan which includes suitably ambitious targets and is innovative in its approach to tackling climate change and biodiversity loss. To meet the demands of investors, stakeholders and regulators, companies must consider nature-based solutions, their use of technology and their place within circular economies.



Request a copy of our Energy Transition Handbook to learn more.

4. Strong governance and legally walking the talk

Good governance underpins all ESG activities. Boards should ensure they are aware of legislative developments, align their legal frameworks with any public statements and protect themselves against accusations of greenwashing. In a world of "crowd-reg" and increasing shareholder activism, governance structures should promote transparency, trust, diversity and integrity.

Investors and consumers expect companies to set ambitious targets, particularly relating to climate and D&I strategies. Companies must meet these expectations whilst not over-reaching and failing to deliver on their promises.

Accusations of green-washing or lack of authenticity can derail a company, so robust systems which produce reliable, sciencebased data should be an essential part of any Board's targetsetting and reporting processes.. Shareholder activism and class actions can result in serious reputational harm, divert management time and limit investment so companies should be proactive in engaging with stakeholders and managing their ESG journey.

It is no longer sufficient for a company to consider only its own corporate commitments to environmental and social issues. These issues should be integrated into the wider legal framework, including in its supply-chain, contractual precedents, and recruitment, retention, payment and promotion practices. Policies alone are not sufficient; best practice is now for clear KPIs, reporting and audits on this information.

Speak to a member of our Business integrity Group (BiG) about the "health-check" we offer to review whether your business infrastructure is delivering on your ESG commitments and suggest how changes to your legal and contractual frameworks can be implemented to drive your purpose and performance. To get started, try our app to see if your legal frameworks are driving your business purpose.

5. COP26 and governmental ESG commitments

We have recently seen numerous countries making historic commitments to achieve carbon neutrality or net zero emissions – to emit no more carbon dioxide than they remove from the atmosphere – by 2050. The United Nations now estimates that countries representing around 65% of global CO2 emissions and around 70% of the world's economy has committed to reaching net-zero emissions or carbon neutrality. China, which represents nearly 30% of global CO2 emissions, committed to become carbon-neutral by 2060. As fossil fuels currently account for 85% of China's energy consumption, meeting that target will require a radical overhaul of its energy profile.

In the US, Biden has signed an order for government to achieve net-zero by 2050; the roadmap includes cutting its emissions by 65% by the end of this decade, a carbon pollution-free power sector by 2035, and a plan for the financing of the energy transition.

In November 2021, the UK and Italy co-hosted the UN's COP26 climate conference in Glasgow. COP26 marked the most significant climate policy conference since COP21 which ushered in the Paris Agreement and saw almost every country in the world gather together in Glasgow, Scotland to discuss the global priority of tackling climate change. COP26 has shaped the global response to climate change and altered the landscape in which businesses operate.

Key topics discussed at COP26 affect all businesses and their stakeholders and the key learnings from the conference should be considered in any target-setting and business strategies going forward. The five main priority areas addressed were:

- Adaptation and resilience: 'Helping people, economies and the environment adapt and prepare for the impacts of climate change'.
- Nature: 'Safeguarding ecosystems, protecting natural habitats and keeping carbon out of the atmosphere'.
- Energy transition: 'Seizing the massive opportunities of cheaper renewables and storage'
- Accelerating the move to zero-carbon road transport: 'By 2040, over half of new car sales worldwide are projected to be electric'. —Finance: 'We need to unleash the finance which will make all of this possible and power the shift to a zero-carbon economy'.
- COP26 and recent governmental commitments set the scene for even greater regulatory reform across the globe.

As a result of these discussions, some pressure will be felt by private companies, as they also expected to form part of the solution for tackling climate change. Businesses must therefore be in a position to respond effectively to the outcomes of COP26, policy changes, social shifts and accelerating stakeholder scrutiny.

With so many powerful forces in play, it is clear that ESG issues will continue to grow as a priority for corporate boards, investors and governments in 2022. Alongside that growth will come opportunities and challenges that will need to be addressed through the law, so it is critical that in-house teams prepare accordingly.

Contact us for more information and to help you navigate.

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