ESG: Key Trends in 2020 and Expectations for 2021 (Part II of III)

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This is Part II of a three-part post. For Part I, looking back at important trends and topics in 2020, please click here.

Below are the first 5 of 10 key environmental, social and governance (ESG) trends and topics that we expect to be prominent in 2021, some of which are continuing trends from 2020, while others may emerge in response to the events of 2020.

1. Flexible work arrangements

The COVID-19 pandemic has led to more people working from home than ever before, and furlough schemes have alternately given employees unanticipated time off from work. As COVID-19 vaccination takes effect and a full return to work and offices becomes a possibility, we expect employee requests for flexible work arrangements to be an important topic for employers. Flexible work includes flexible start and finish times and working from home options. Under English law, all employees have a legal right to request flexible working once they have worked for an employer for at least 26 weeks, and employers must address requests in a "reasonable manner." Whether a request is reasonable will likely depend on the way the workplace looks post-pandemic, which may not yet be clear, but is something employers will need to assess in 2021. The determination will also involve environmental considerations, given the potential to reduce the commuting and transportation use, and, with a growing trend for smaller office footprints, employers may already be considering more flexible working arrangements.

2. Green bonds and the sustainable debt market[1]

Although sustainable debt remains a small part of the overall market, it is proving to be an increasingly popular tool for companies seeking to raise capital. Though green and sustainability-linked loan issuance declined in 2020, 2019 featured an exceptional volume of loan issuances, and now the current market is expected to remain steady in the coming months. Meanwhile in the sustainable bond market, green bonds continued to dominate in 2020 despite a temporary "cooling" of interest. Investors expect a rush for green bonds in 2021 as policymakers seek a sustainable recovery. For example, the EU has announced that it will launch €225 billion worth of green bonds as part of the borrowing program that will fund its COVID-19 recovery plans. The Swedish bank, SEB, which arranged the first ever green bond over a decade ago, expects governments and companies to issue $500 billion in green debt in 2021 — nearly half the total that has been raised since the creation of the asset class. HSBC has made a slightly more conservative estimate of between $310 billion and $360 billion in green bond issuances in 2021.

Green finance is not the only available product, with sales of sustainability-linked bonds (SLBs) also set to surge amid rising market awareness. These offer an attractive alternative to green bonds for issuers, as SLBs are not required to ring-fence funds for specific green projects. Instead, issuers are rewarded (or penalized) for achieving (or missing) key ESG metrics. This popularity of SLBs has been aided by a new market framework and the European Central Bank's (ECB) plan to begin buying notes with environmental targets starting in January 2021. The ECB's involvement in the SLB market has helped legitimize the bonds as an investment vehicle. In 2021, Bloomberg expects SLB issuances to swell to as much as 30% of global corporate ethical-debt sales (having only accounted for 10% in 2020).

3. The rise of brown/transition finance[2]

As companies across all industries and sectors grapple with ESG concerns and face heightened scrutiny from multiple stakeholders, we are also likely to see a rise in "brown" or "transition" finance. This as yet rarely used form of financing can help polluting industries, which are often precluded from accessing other aspects of the sustainable debt market, fund environmental improvements. Oil companies Eni S.p.A. and Total SE have already floated the possibility of using transition bonds in 2021.

Although some investors suggest that transition finance can be used as a vehicle for "greenwashing," many recognise the important role it will need to play as companies work towards achieving necessary emission reduction targets. Banks and investment firms are likely to advocate for this more nuanced approach to sustainable finance and for more discussion and understanding of the grey areas in the meaning of "green" as they seek to help their clients access these instruments. Transition finance will offer the chance for more companies to access sustainability-focused investments and improve their environmental credentials with their consumers and investors.

4. Supply chain sustainability[3]

Throughout the second half of 2020, online fashion company Boohoo's alleged infringement of employment and modern slavery legislation across its supply chain remained of interest to the public and set the stage for increased awareness and scrutiny of the supply chains behind leading brands. In November 2020, Boohoo appointed Judge Brian Leveson to monitor its efforts to improve working conditions in its supply chain, an indication of just how seriously both investors and the brand took the allegations. Similarly, towards the end of 2020, the spotlight on supply chains resulted in public backlash to Pretty Little Thing's Black Friday sale, with consumers querying how the fashion company could sell clothes for five pence while also sourcing its products ethically.

Although the topics of sustainable wages and ethically sourced materials are not new concerns relating to the fast fashion industry, as previously discussed in our 29 October 2020 client alert "Finding the 'S' in ESG: Boardroom and Employee Considerations," the pandemic has heightened consumer awareness of what it means to feel safe in the workplace. In 2021, businesses should therefore aim to conduct thorough risk assessments, gain full visibility of their supply chains, and ensure they are acting ethically and sustainably. Public concern about working conditions — both those immediately visible and those hidden in supply chains — is unlikely to waiver, meaning investors will also be keeping an eye on this area. In addition to contributing to consumer satisfaction with a brand, such focus and visibility will assist companies in ensuring that their operations and supply chains are well run and that no other potential risks are being overlooked.

5. Remuneration benchmarks

ESG considerations will continue to impact remuneration policies and practices during 2021 and beyond. With the pandemic-related economic environment resulting in intensified scrutiny of compensation and accelerating investor focus on responsible remuneration practices, remuneration will be impacted in various ways, ranging from investor and public expectations regarding overall compensation packages, focus on pay gaps and fair remuneration structures to the continuing discussion on using ESG metrics in performance-related pay.

While the extent to which investors advocate for ESG metrics differs, investors and regulators remain clear that (i) where ESG metrics are included in performance targets, there must be a clear link to strategy; (ii) the measures must be quantifiable; and (iii) the weighting of performance-related pay should favour financial and business risk-based performance measures. The direction of travel towards more widespread incorporation of relevant ESG metrics is evident. We may also begin to see more prescriptive requirements in relation to ESG and remuneration in investor guidance, governance codes and regulations. One example is the Financial Conduct Authority's adoption of the Taskforce for Climate-related Financial Disclosures (TCFD) principles in the U.K. Listing Rules as the standard framework for the new requirement for companies with a premium listing to make an environmental disclosures statement in their annual report for accounting periods beginning on or after 1 January 2021. The guidance to the TCFD principles includes that organisations in all sectors should consider describing whether and how climate-related performance metrics are incorporated into remuneration policies. Boards and remuneration committees can expect increasing discussion on how ESG matters relate to strategy, including the link to compensation arrangements and the design of performance measures.

The role of remuneration in social and governance benchmarks will also remain high on the agenda, with investors and the public alike continuing to demand restraint in executive compensation, remuneration outcomes that reflect the continuing impact of the pandemic on the business (and in particular any government or shareholder support relied on by the business) and fair use of remuneration structures across the workforce. Mandatory pay gap reporting and the accompanying narratives, along with the extent to which companies provide voluntary pay gap disclosures and report more generally on workforce pay in relation to executive pay, are likely to receive increased focus.

For Part I of this post, please click here. For Part III, please click here.

Footnotes

[1] *Financial Times*, "Analysts expect as much as $500 billion of green bonds in bumper 2021" (4 January 2021); *Reuters*, "Green bond issuance expected to reach nearly $500 billion in 2021 — SEB" (10 December 2020); Bloomberg, "ESG Bonds Offer Rare Bright Spot Next Year in Europe" (9 December 2020); Bloomberg, "Obscure Bonds to enter Major League of ESG Corporate Debt Market" (4 December 2020).

[2] *Financial Times*, "How to stay ahead of the ESG curve in 2021" (30 December 2020); *Financial Times*, "What we got right — and wrong — in 2020" (23 December 2020); Bloomberg, "ESG Bonds Offer Rare Bright Spot Next Year in Europe" (9 December 2020).

[3] *Financial Times*, "How to stay ahead of the ESG curve in 2021" (30 December 2020); *Forbes*, "Redefining 'Normal': The Top 5 ESG Trends for 2021" (10 December 2020); *Financial Times*, "Boohoo hires Leveson to monitor its supply chain" (26 November 2020).

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