

ESG: Key Trends in 2020 and Expectations for 2021

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In a tumultuous year, one of the key clear messages to emerge from 2020 was that environmental, social and governance (ESG) concerns are here to stay. As mentioned in our 31 July 2020 article “[ESG in 2020: A Half-Year Review](#),” although many investors feared that the focus on ESG policies would fall away in the face of an economic crisis, the opposite appears to have occurred. The pandemic instead has triggered a debate on what societies really value, and at the same time exposed the extent of global interconnectedness and the “tragedy of the horizon” whereby societies fail to plan in the longer term and only address issues when it is too late. This focus continued throughout 2020 and, as a result, many now regard the coming months and years as an opportunity to rebuild economies with ESG matters, corporate purpose and sustainability firmly placed at the fore. In this article, we review the key trends that emerged in 2020 and continued to develop in the second half of the year. We then set out our expectations for the trends that will emerge or continue in the ESG sphere over the coming year.

Looking Back: What We Saw in 2020

A Banner Year for ESG Funds

In our half-year review, we discussed the growth of ESG funds and their apparent outperformance in Q1 2020. By the end of 2020, this performance had been further confirmed. The two U.S. equity funds with the best returns in 2020 were both focused on clean energy, and companies with the highest ESG ratings collectively outperformed their non-ESG counterparts.¹ Global inflows to sustainable funds rose from \$20 billion in Q1 2018 to \$80 billion in Q3 2020. Although this number represents only a small portion of the overall market, the sector is undeniably growing, with many investors continuing to argue that the growth is not due only to an interest in sustainability, but that investment in these funds is simply “good financial policy.”² However, criticism of certain ESG funds has also continued; for example, recent research by Common Wealth indicated that nearly a third of “climate funds” in the U.K. are invested in oil and gas, which some view as inconsistent with being an ESG fund. These criticisms remind us that a variety of viewpoints and confusion remains over the investment parameters of funds that refer to themselves as ESG funds.³

The Rise of the ‘S’ in ESG

Although a recent corporate secretary survey reported that nearly 75% of respondents named social factors as the most difficult element of the three areas for companies to integrate, the second half of 2020 continued to highlight the “S” in ESG. Demands for greater gender and racial diversity at management and board levels resulted in many large U.S. corporations pledging to report on their diversity, equity and inclusion (DEI) figures in an effort to increase transparency, and many companies working to improve their board diversity in the midst of the Black Lives Matter movement. In December 2020, BlackRock announced plans to vote against directors who fail to act to improve board diversity and asked U.S. companies to disclose the racial, ethnic and gender makeup of their employees. BlackRock also announced that it expects U.K. companies to follow published recommendations on increasing female board representation,⁴ further demonstrating the ever-increasing focus on diversity.

¹ *Financial Times*, “Green energy funds top league table in banner year for ESG” (26 December 2020).

² *Forbes*, “The Acceleration of ESG investing in a post-pandemic market” (22 December 2020).

³ Activist Insight, “In depth: The future of activism feels like ESG” (16 December 2020); Common Wealth, “Doing Well by Doing Good? Examining the rise of ESG Investing” (20 December 2020).

⁴ The Parker and Hampton-Alexander Review on FTSE Women Leaders.

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The end of 2020 also brought a new approach to worker status in the U.K. gig economy. Just Eat announced it will offer couriers pay-by-the-hour rather than per-job arrangements, as well as additional benefits such as pension contributions, holiday pay, sick pay and parental leave pay. The group already takes a similar approach in Europe, but this is the first time such a model has operated in the U.K. Just Eat said the move will mean its workers will earn at least the national minimum wage, increasing the security of their income, which has been one of the key sticking points in the worker status debate so far. The announcements reflect a wider focus on worker rights that will remain important in 2021. More broadly, the U.K. government was forced to cancel a post-Brexit review of workers' rights following protests from trade unions and opposition politicians.

Sustainable Legislation in the UK Post-Brexit

Following the announcement that the U.K. was reserving judgement on onshoring the EU Taxonomy Regulation (which establishes a framework to identify sustainable activities with a view of achieving certain environmental objectives), the U.K. chancellor announced in November 2020 the U.K.'s intention to implement its own "green taxonomy." This taxonomy will use the scientific metrics in the EU taxonomy as its basis, but subject such metrics to the review of a newly established U.K. Green Technical Advisory Group to ensure their appropriateness to the U.K. market. The chancellor also announced that the U.K. will become the first country in the world to require large listed and private companies (including banks, insurance companies and pension schemes) to disclose the threats to their business from climate change by 2025, with some listed companies expected to start reporting voluntarily in 2021. The chancellor's announcements indicate that, post-Brexit, the U.K. may be prepared to implement its own framework and break with EU legislation where it considers such diversion appropriate.

Institutional Investor Action in Relation to ESG

ESG matters increasingly found their way onto the slate of resolutions at shareholder meetings in 2020, especially those related to climate change. Support for these resolutions is increasing — not just among individual investors, but also among institutional investors. For example, JPMorgan backed 38% of environmental resolutions globally in 2020, up from 10% in 2019, while Wellington supported almost 42% of such resolutions, up from 8.5% in 2019.⁵ Such actions were not restricted solely to environmental

⁵ *Financial Times*, "BlackRock criticized over drop in climate votes" (4 October 2020).

concerns. In October, the Russell 3000 Director Diversity Disclosure Initiative — a coalition of institutional investors and advisers overseeing \$3 trillion in assets — encouraged U.S. public companies to disclose the racial makeup of their boards in an effort to encourage and increase board diversity. The number of Black, Asian and minority ethnic (BAME) directors in the Russell 3000 only surpassed 10% in 2019, with black directors making up only 4.1% of that total, indicating that considerable progress still needs to be made.⁶ Pension funds also began to take greater action in the ESG sphere — for example, in November 2020, Scottish Widows announced that it would divest nearly half a billion pounds from companies that fail to meet ESG standards in accordance with its new exclusions policy. The policy targets companies that derive more than 10% of their revenue from thermal coal and tar sands, manufacturers of controversial weapons, and violators of the UN Global Compact on human rights, labour, the environment and corruption.

Looking Forward: Our Expectations for 2021

Below are 10 key 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.

⁶ Bloomberg, "Investors Overseeing \$3 trillion push for board racial diversity" (28 October 2020).

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2. Green bonds and the sustainable debt market⁷

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 finance⁸

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

⁷ *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).

⁸ *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).

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 sustainability⁹

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.

⁹ *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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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.

6. Incoming legislative changes¹⁰

The Sustainable Finance Disclosure Regulation (SFDR) will apply starting 10 March 2021, in European Economic Area (EEA) member states. Following Brexit, the SFDR will not be implemented in the U.K.; however, financial market participants in the U.K. that conduct marketing or have other operations in the EEA may have to comply with the SFDR in relation to such marketing or operations. In the meantime, the U.K. government is continuing to work towards its own ESG regulatory framework. The chancellor has made clear a desire to make London the "green finance capital of the world" and we expect to see greater regulatory action to achieve this goal over the course of 2021. While the form of the U.K. legislation remains unclear, many U.K. firms will hope for some alignment with the EU regulations in order to avoid additional compliance complications.

7. COP26 and the private sector's response¹¹

The 2021 United Nations Climate Change Conference (COP26) will be held in Glasgow after having been delayed due to COVID-19. Although the public is demanding fast and effective action from governments, the UN climate change conferences so far have generated promises that are not being followed by action to cut emissions in order to meet the Paris Agreement climate goals. After the events of 2020, the public has expressed a hope that COP26 will see a shift in approach from world leaders and that governments will seize the opportunity to implement decisive change.

It is not only the public sector that will be closely watching the summit; companies and businesses will also be paying close attention. We may see a "bottom-up" shift, with the private sector driving action to combat climate change. We have already seen the banking sector in particular pledging to take greater action to protect climate stability in 2021. British banks have announced that they will launch a range of climate-related products in 2021 and that they intend to raise their lending standards in response to criticism that they have been slow to act on ESG policies. Deutsche Bank plans to take further action and, starting in 2021, intends to link its top executives' pay to the lender's achievement of its sustainability goals, which will be determined by measuring the volume of sustainable financing and investment that complies with ESG criteria and how the bank is ranked by rating agencies. Deutsche Bank has set up a sustainability committee and is aiming to reach €200 billion in standard sustainable investment by 2025.

¹⁰ *Financial Times*, "Pitfalls, opportunities and people to watch in 2021" (3 January 2021).

¹¹ *Financial Times*, "UK banks to launch wave of green products" (2 January 2021); *Financial Times*, "How to stay ahead of the ESG curve in 2021" (30 December 2020); *Financial Times*, "Climate efforts have entered a tricky new phase" (30 December 2020); Bloomberg, "Deutsche Bank to Link Executive Pay to Sustainability Goal" (6 December 2020).

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Despite such strides, a cohesive public-private initiative is necessary, with the banks underscoring that both the U.K. and Europe require the correct infrastructure and environment to enable companies to take the steps necessary to meet their climate goals. How this relationship plays out through 2021 will determine the success and speed with which countries will meet their ESG goals.

8. Demand for harmonization of ESG standards¹²

A growing desire for clearer ESG standards and a harmonization into a single consistent framework can be seen across a range of sectors and industries.

- The mission to create a cohesive global ESG accounting standard against which to measure performance is still ongoing, with different initiatives led by the Sustainability Accounting Standards Board and the International Financial Reporting Standards foundation. Projected timelines indicate that an overarching standard will be released (or, at the very least, close to agreement) in 2021.
- The International Organization of Securities Commissions is working to identify “commonalities” among the vast range of sustainability disclosure standards from across the world in order to make it easier to compare information. The organisation aims to complete its initial work and seek industry input by October 2021.
- In the U.K., an investigation by the Competition and Markets Authority (CMA) into the meaning of “eco-friendly” is underway due to the flexible use of the term in marketing materials. Although the CMA has said it will focus on U.K. marketing practices, the agency also made clear that it would take a leading role in researching green claims in a global context. This could have the knock-on effect where companies found to be “greenwashing” may become open to class actions under the U.K.’s collective actions regime. The U.K. Supreme Court’s judgement in *Merricks v. Mastercard* in December 2020 breathed life into this regime, setting a low bar for obtaining certification (a prerequisite to the class action proceeding to a full trial).¹³ Companies suspected to be violating green protocols may therefore be exposed both to regulatory scrutiny from the CMA and claims for damages from disgruntled customers.

¹² *Financial Times*, “How to stay ahead of the ESG curve in 2021” (30 December 2020); Gov.uk — “CMA to examine if ‘eco-friendly’ claims are misleading” (2 November 2020).

¹³ Skadden client alert “*Merricks v. Mastercard* — UK Supreme Court Clarifies Low Bar for Class Action Certification” (7 January 2021).

9. ESG activism¹⁴

The rise of ESG activism over recent years promises to continue in 2021, with the added pressure of investors ready to scrutinize the behaviour of companies throughout the pandemic. The European small-cap and mid-cap markets are thought to be full of companies whose value can be significantly increased with further attention to ESG factors, offering a wealth of opportunity for activists in the coming months.

In particular, investors are likely to be interested in social factors, including the treatment of employees during the pandemic and supply chain transparency. We have already witnessed pressure on organisations that paid out generous dividends and bonuses to repay any money received through job retention schemes, and boards should expect greater scrutiny of whether their appointments of new directors and executives better reflects the societies within which their companies operate.

Also, investors expect increased accountability from companies. This trend was already emerging in 2020, with, for example, the French oil and gas major Total facing a resolution demanding that the company set emission reduction targets. Although the proposal was defeated, 17% of shareholders voted in favour of the resolution, which reflects shareholders’ growing interest in voting on climate transition action plans. This interest has been the focus of the Say on Climate initiative, established by the Children’s Investment Fund Foundation. Mark Carney, the UN’s climate envoy and the former governor of the Bank of England, has backed the initiative and in November 2020 encouraged investors to force companies to submit their climate change strategies to annual shareholder votes. He argued that this could improve oversight of pledges to slash greenhouse gas emissions. In December, Unilever announced that it intends to offer shareholders a regular vote on its plans to tackle climate change, becoming the world’s largest company to do so and the first FTSE 100 company to offer shareholders a recurrent say on its efforts to address such challenges. If this new approach yields performance gains for the company in 2021, others may be inspired to follow its lead. Additionally, in December 2020, Moody’s Corporation announced its affirmation of the principles contained in the Say on Climate campaign, as well as a shareholder vote on its climate change effects, at its 2021 annual meeting.

¹⁴ *Corporate Counsel*, “Investors are watching ESG — in 2021, they look to measure it” (4 January 2021); *Financial Times*, “How to stay ahead of the ESG curve in 2021” (30 December 2020); Activist Insight, “In depth: The future of activism feels like ESG” (16 December 2020); *Financial Times*, “Unilever to put its plans to fight climate change to shareholder votes” (14 December 2020).

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10. Biden administration ESG policies

The Biden administration represents a significant shift in viewpoints from the previous administration with respect to climate change and DEI matters, as reflected in some of the executive orders signed by President Joe Biden during his first days in office. Still, the process for any new rulemaking by the U.S. Securities and Exchange Commission mandating ESG disclosures easily could extend into late 2021 or later, with new rules becoming effective in 2022. The change in tone sets the stage for continued private sector efforts, led by investors and

asset managers, to call on U.S. public companies to (i) expand and enhance their ESG disclosures until such time as mandatory disclosures arise and (ii) continue their efforts to address climate change and DEI challenges. Also, the change in administration should remove any cloud over whether pension funds and other investors can consider ESG matters as part of their investment strategy and take these matters into consideration in their annual meeting voting decisions. These votes, in many cases in the second quarter of 2021, may spur additional corporate action over the second half of the year.

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