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

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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 three-part post, 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.

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 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.

Footnotes

[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.

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

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

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