ESG in 2021 So Far: An Update (Part II of III)

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This is Part II of a three-part post. For Part I, providing an overview of correct ESG predictions for companies based in the U.K. and Europe in 2021, click here. Part III will discuss new areas of interest in the ESG field and make new predictions.

Executive Remuneration[1]

Executive remuneration has proved a contentious topic in 2021. A PwC report found that executive pay at the U.K.'s biggest companies dropped by nearly a fifth as companies responded to warnings from institutional investors that they expected remuneration to reflect the impact of the pandemic on stakeholders. Where companies failed to take this into consideration, such as Foxtons and Morrisons, a significant portion of shareholders voted against the companies' remuneration plans — particularly, where those companies received government support during the pandemic, raised emergency cash and/or suffered a substantial fall in share price.

Approval for remuneration resolutions in the U.K. fell to an eight-year low, but support only fell to 91.4% on average, and shareholders who voted against such policies remained reluctant to vote against the individuals responsible for these decisions. Of the companies that faced a revolt on their pay reports this year (defined as at least 20% opposition), less than a fifth faced pushback on the appointment of one or more directors, according to Proxy Insight, so little change was effected by the opposition to pay packages.

EU Sustainable Finance Disclosure Regulation (SFDR)[2]

Six months on from the initial implementation of EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector, many firms are still adapting to the obligations and requirements. Outstanding questions remain concerning the application of some obligations, particularly to entities established outside the European Economic Area (EEA). Furthermore, there remains a lack of guidance as to the full scope of the obligations — for example, whether a financial product

that includes ESG factors in its decision-making process falls within the scope of SFDR Article 8, which sets criteria for ESG funds.

There is additional regulatory uncertainty because a number of the obligations under the SFDR are meant to be elaborated on in regulatory technical standards (RTS). While a draft RTS was issued by the Joint Committee of European Supervisory Authorities in February 2021, the standards have not been finalised and the date for implementation was postponed from 1 January 2022 to 1 July 2022 Firms are therefore required to comply with some SFDR disclosure obligations without knowing whether those disclosures will be compliant next summer.

U.K. ESG Disclosure

In the U.K., the FCA has published an initial consultation regarding ESG disclosures by asset managers consistent with the requirements set by the international Task Force on Climate-related Financial Disclosures (TCFD). The obligations on asset managers are only due to come into force in January 2022 and will only apply to asset managers with more than £5 billion of assets under management. The obligations appear to be more limited in scope than obligations under the SFDR, and have a greater focus on climate-related disclosures than on social and governance factors.

As discussed above, the FCA has also recently indicated that it will focus on ESG funds, concentrating on the way in which information about ESG investment strategies and related information is disclosed. The FCA has indicated it sees no need for new rules in this area because regulated U.K. firms are already subject to comprehensive standards of disclosure.

Biden Administration ESG Policies[3]

It was clear from the early days of the Biden administration that it would take a very different approach to climate change and ESG matters than the Trump administration, and that has been reflected in a number of actions by different arms of the government.

For example, in March 2021, the U.S. Department of Labor announced that it would revisit, and not enforce, rules adopted in late 2020 that had called into question whether pension funds could consider ESG matters in their investment decision-making and voting decisions as shareholders. Removal of this uncertainty may have contributed to the record-breaking support during the 2021 U.S. proxy season for shareholder proposals relating to environmental and social (E&S) matters, with 34 E&S proposals receiving majority shareholder support, up from the previous record of 21 supported proposals in 2020. These votes are likely to spur enhanced corporate policies and disclosures in the remainder of this year and into 2022, and to alter the calculus for companies that receive shareholder proposals later this year for their 2022 annual meetings.

More recently, the U.S. Securities and Exchange Commission (SEC) announced that it will draw up new ESG rules in the coming months. In a June 2021 speech at London City Week, SEC Chair Gary Gensler stated that he had asked the SEC staff to develop recommendations for mandatory disclosure "around governance, strategy, and risk management related to climate risk" and regarding human capital disclosure. The latter could include metrics on workforce turnover, training, compensation and benefits, workforce demographics and health and safety.

In a July 2021 speech, Chair Gensler reiterated that he had asked the SEC staff to develop a mandatory climate risk rule proposal for the SEC's consideration by the end of 2021. Before he took office Acting Chair Allison Herren Lee solicited public comment on climate change disclosures. That resulted in the submission of more than 550 unique comment letters.

The SEC's regulatory agenda, published in June 2021, reflects the SEC Chair's focus on ESG matters, including disclosures regarding corporate board diversity, climate change, human capital management and cybersecurity risk governance. The SEC rulemaking process is likely to extend into 2022, however, so, in the near-term, enhanced corporate disclosures are more likely to be in response to the efforts of investors and other stakeholders.

Footnotes

[1] *Financial Times*, "UK chief executives suffer big pay cuts" (10 May 2021); *The Observer*, "Executive pay: big names that fell foul of shareholders" (26 June 2021); *Financial Times*, "Investors protest against big payouts for UK bosses" (18 May 2021); *Financial Times*, "Why investor pay revolts need to get personal" (2 June 2021).

[2] FCA Consultation Paper (CP21/17), Enhancing climate-related disclosures by asset-managers, life insurers and FCA-regulated pension providers, June 2021.

[3] U.S. Department of Labor, "US Department of Labor releases statement on enforcement of its final rules on ESG investments, proxy voting by employee benefit plans" (10 March 2021); SEC Chair Gary Gensler, Prepared remarks at London City Week (23 June 2021); SEC, "Public input welcomed on climate change disclosures" (15 March 2021); Gensler, Prepared Remarks Before the Principles for Responsible Investment 'Climate and Global Financial Markets' Webinar (28 July 2021); SEC, " SEC Announces Annual Regulatory Agenda" (11 June 2021).

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