INVESTOR UPDATE
MARKET INTELLIGENCE

THE CORPORATE ESG GUIDE

THE UNJUST TRANSITION — REAPING THE WHIRLWIND

ANDREW ARCHER &
THE INVESTOR UPDATE TEAM

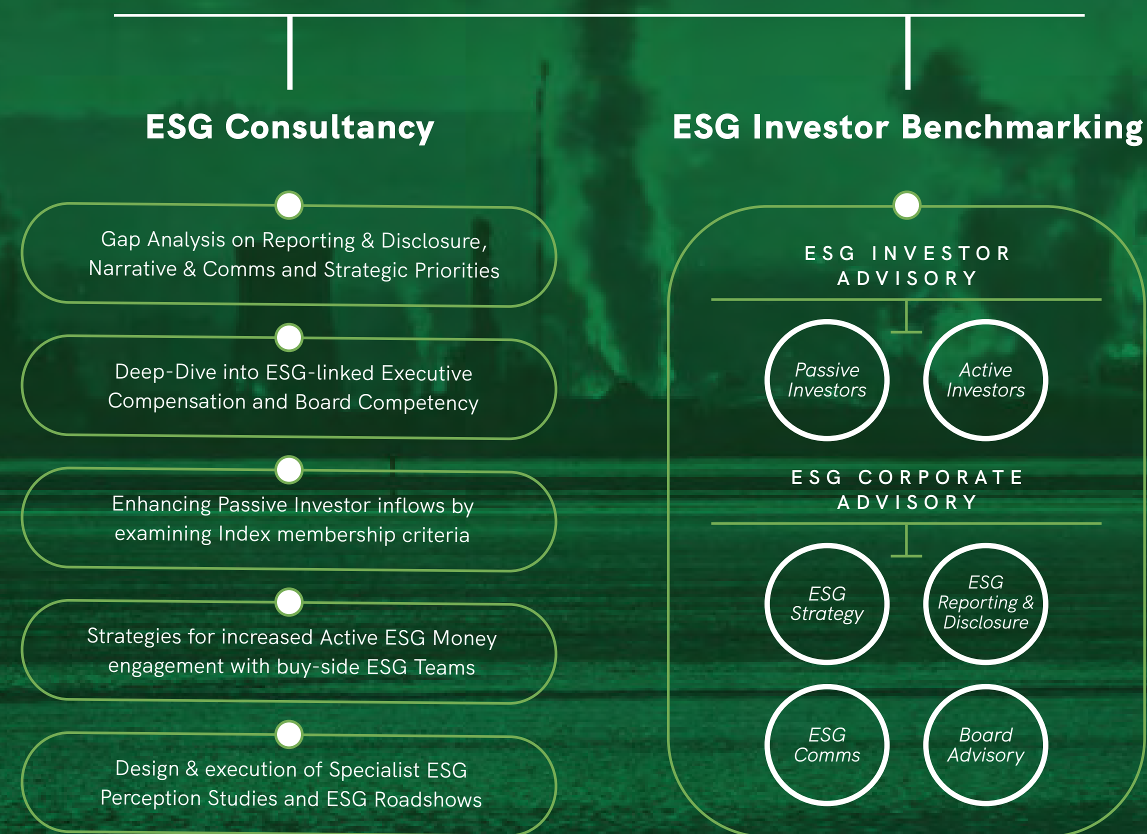
investor-update.com

About Investor Update

Investor Update is made up of some the most experienced individuals in the shareholder intelligence space.

We offer corporates and their advisors customised solutions ranging from timely shareholder identification and investor targeting to comprehensive, in-depth perception studies, proxy solicitation and ESG Investor Benchmarking and Advisory Services.

For further information on our services, visit our website investor-update.com, call us on +44 20 3371 1177 or email us at contact@investor-update.com.



THE CORPORATE ESG GUIDE

THE UNJUST TRANSITION — REAPING THE WHIRLWIND

By Andrew Archer & The Investor Update Team

December 2022

'*Injustice anywhere is a threat to justice everywhere*' was a slogan of Dr Martin Luther King, which he used to call people to fight for the justice they wish to have for themselves. Central to his point was the idea that we all are connected, and this runs to the very heart of the concept and challenge of The Just Transition. 'Justice' is the sustainable pattern of behaviour that is fair and equitable in support of a stable, sustainable society. Injustice is the imbalance that, in this context, has the potential to tear apart the global society if it is allowed to continue unchecked.

Every injustice — seen or unseen — represents a very real, very specific flaw in the balance of our social order. Over time, and probably sooner than most expect, that imbalance will circle back to destabilise the parts of the global society that are causing and/or ignoring these injustices. In this white paper we have sought to explore and understand The Just Transition, which can most concisely be defined as the mitigation of climate change through means that are fair to all constituents, across all geographies and all demographics. Alternatively, '*They who sow the wind will reap the whirlwind*' [Hosea 8.7].

Key White Paper Findings & Conclusions

→ **THE JUST TRANSITION:**

With the devastating impact of climate change being increasingly felt across the world, the concept of The Just Transition now takes centre stage. This White Paper highlights how certain social groups are disproportionately affected by the devastating consequences of climate change and pinpoints the importance of Just Transition considerations for business operations everywhere. However, the drivers for prompting companies to consider the Just Transition are diverse and varied, ranging from regulation to stakeholder intervention and investor pressure. Our research suggests that achieving systematic structural change is imperative to unify all sections of society as it transitions to net zero.

→ **INDUSTRIAL DISRUPTION:**

The structure of many industries will have to undergo significant reconfiguration to secure the required reduction in GHG emissions. If this process of decarbonisation is conducted without proper consideration of the societal consequences, the resulting negative impacts on the lives of individuals and communities dependent on carbon-reliant sectors will be severe. The unemployment and deterioration of local economies would likely lead to societal discontent, undermining the momentum of climate mitigation policies and potentially derailing efforts to transition to a more sustainably structured economy.

→ **APAC - THE APEX OF IMPACT:**

The Asia-Pacific region has the most extensive and material exposures to the physical climate risk and includes some of the world's biggest emitters - China, India, Japan and Indonesia. Despite this, decarbonisation in the region is hampered by limited political will. Less than 25% of APAC governments committed to reducing emissions and 43% of electricity in the region is still sourced from coal and, perhaps unsurprisingly, the region is suffering the greatest impact of climate change. Meanwhile, APAC disclosure is second only to Europe, but meaningful targets are lacking and while ESG Investment levels are increasing they are well short of what is required.

INVESTOR UPDATE
MARKET INTELLIGENCE

→ **THE SUPPLY CHAIN CHALLENGE:**

A critical threat to the Just Transition is the complex and convoluted nature of modern sourcing processes and systems. This paper highlights the need for companies to manage their global supply chains from a human rights perspective, despite the daunting nature of this challenge. Implementing a human rights program within the "four walls" of a company can be difficult enough, let alone extending such oversight programs beyond the first tier of suppliers, which may include tens of thousands of entities across the globe, affecting potentially hundreds of thousands of people and communities. However, recent geopolitical events such as Russia's invasion of Ukraine highlighted the importance of having a strong, efficient and robust supply chain to transition to a carbon-free economy.

→ **ESG MEGA-CAP SPONSORSHIP:**

There is a hope and expectation that funds that are mandated for ESG and Sustainability would result in both the capital sponsorship of innovative and disruptive companies that would subvert the conventions of industry to solve the challenges of climate change. This hope is not entirely dead, but the vast majority of ESG capital (by some definitions a third of global assets under management) is deployed in the mega-cap giants of the tech world. Most ESG Funds have a high concentration of US-based stocks, with Alphabet Inc being by far the most widely owned stock among ESG-mandated funds.

→ **ASK THE AUDIENCE:**

The second section of this White Paper explores the perspectives and reflections of some of the most influential global entities — Corporates, Investors and Charities — the result of more than 30 interviews with the most senior specialists from each organisation. The collective experience of the contributors has been examined and this has shaped and informed the thesis of Section 1. Within Section 2, the ideas and initiatives of individual interviewees have been weighed and championed. Most interviewees acknowledged the multifaceted and intersectional nature of climate change and agreed on the pivotal role that the private sector can and should play in the decarbonisation drive. Understandably, those companies directly affected by climate change are often the first to act by accelerating their efforts to reduce GHG emissions.

→ **RISK EVALUATION:**

Companies vulnerable to physical asset destruction caused by climate change have created specialised risk management mechanisms to monitor and counter these effects, with some taking the lead in decarbonisation despite insufficient regulatory standards. Meanwhile, the increased loss of property value from natural disasters has incentivised investors to calculate the probability, location and timing of extreme climate events. Many contributors talked about the need to look beyond risk management systems to strategic development when assessing climate change with some predicting that climate risk will become a primary financial and audit consideration in the coming years.

→ **ACCESS TO CAPITAL AT RISK:**

The recent developments in climate-related legislation and increased physical risks highlight the reality of the threat that the industrial world faces as well as the specific operational and financial challenges that companies and investors must overcome. Most interviewees recognise the increase in investor expectations and pressure on investee companies to act on their physical climate risk exposures. Investors point to certain minimum standards that companies must fulfil to continue having engagement and access to capital. We observed an accelerated awareness and urgent interest in addressing and mitigating the physical climate risks they face and also the consequences these are having on local communities.

→ **THE USE & UTILITY OF THE UN SDGS:**

The UN SDGs are increasingly becoming an important tool for the private sector, allowing corporations to underline their commitments to the Just Transition and to link their sustainability efforts with the priorities of the broader world. We observe the SDGs being used by companies to focus their sustainability actions and build awareness for ESG within their organisations and facilitate stronger communication with their stakeholders. This was echoed within the charity sector with SDGs helping them to reflect the more sophisticated narratives of their corporate partners. However, support was far from unanimous with some concerns being expressed about the oversimplification of the challenge and questionable utility of SDGs as a tool to properly enhance and promote ESG efforts at a company level.

→ **DATA FRUSTRATIONS:**

Consistent with every ESG research report that we have authored, the issue of data quality, consistency and comparability continues to loom large. The most-cited hurdle to investors integrating social considerations into their strategies is that corporate ESG disclosures primarily focus on the more empirically grounded environmental aspects, favouring more commonly adopted indicators, methodologies, and reporting guidance. This results in a skewed data set at a time when both elements require equal billing and consideration.

→ **A FAIR COP?:**

We review the latest 'Conference of the Parties' and find cause for both optimism and frustration. Through much of the Conference concerns over backsliding were prevalent and the cost-of-living crisis at times threatened to supersede commitments to avert the more existential challenges. However, the last-minute agreement over a Loss & Damage Fund brought with it a level of 'blame acceptance' previously unseen. It is not without its own shortcomings (such as the exemption of China and Russia) but it is, nonetheless an undeniably profound and historical step forward.

→ **REGULATION REVOLUTION:**

Our research highlights the importance of public policy and regulation in ensuring that transparent and accountable progress is made. We have taken a uniquely global view of the regulatory trends in ESG, reviewing the current developments in Europe, the UK, the USA, India and Japan with an additional spotlight on Switzerland. We experienced widespread dissatisfaction with the evident lack of unified regulation on both global and local scales as well, compounded by a lack of support from federal, state and local governments in accelerating the transition and the associated required disclosures. At the top of many contributors' wish-list was a desire for regulation that is more market responsive, inclusive, transparent and cohesive.

→ **REAPING THE WHIRLWIND:**

Often used in legal circles, "*Fiat justitia ruat caelum*" translates to "Let justice be done though the heavens may fall." If we, as a global commercial community, can interlace our collective efforts to decarbonise with a sense of universal justice, we may be able to prevent the heavens falling in both an environmental and societal sense. Conversely, should we fail to recognise the need for regionally inclusive solutions, we may well find ourselves reaping a whirlwind of our own making.

INVESTOR UPDATE
MARKET INTELLIGENCE

Contributors

Company	*Participant*	*Title*	*Sustainability Reports*
AB InBev	Katie Hoard	Global VP ESG Strategy & Engagement	Link
Abrdn	Elizabeth Chiweshenga	Senior Sustainability Analyst	Link
B3	Gabriel Santana do Nascimento	Sustainability Team	Link
BlackRock	Curtis Chou	Corporate Communications	Link
Cancer Research UK	Alex Davies	Senior Sustainability Manager	Link
Capital Group	Jessica Ground	Global Head of ESG	Link
Coca-Cola	Jorge Alejandro	Investor Relations Director	Link
Cowen	Armando Lopez	Managing Director Marketing	Link
Crossflow Payments	Kevin Hayden	Commercial Director	Link
Hope for Justice / Slavery Free Alliance	Liz Taylor	Executive Assistant to CEO	Link
HSBC Asset Management	Richard J Oconnor	Global Head of Investor Relations	Link
Invesco	Cathrine de Connick-Lopez	Global Head of ESG	Link
KPMG	John Kjorstad	COO for KPMG Impact	Link
	Richard Threlfall	Global Head of Infrastructure, Government and Healthcare	
L&W	Sarah Fortt	Global Co-Chair of ESG Practice	Link
	Betty Huber	Global Co-Chair of ESG Practice	
M&G	Rupert Krefting	Head of Corporate Finance and Stewardship	Link
National Grid	Alexandra Bateman	Investor Relations Manager	Link
Oatly	Ashley Allen	Chief Sustainability Officer	Link
Oerlikon	Peter Dickson	Senior Manager ESG & Investor Relations	Link
Orange	Karine Fourneron	Sustainability Reporting & SRI	Link
Sanofi	Corentine Driancourt	Investor Relations	Link
Schroders	Rebecca Dwyer	Corporate Communications Content Lead	Link
Shell	Andreas Bork	Investor Relations RDS	Link
Standard Chartered	Maria Lombardo	Head of ESG Advisory	Link
Telefónica	Catherine Bohill	ESG Development & Impact Director	Link
TotalEnergies	Benoit Ribaud	ESG Investor Relations Manager	Link
UBS	Laurent Bouvier	Managing Director, Global Head of ESG Advisory in Global Banking	Link
Walmart	Stephanie Schiller Wissink	SVP and Head of Investor Relations	Link

INVESTOR UPDATE
MARKET INTELLIGENCE

THE CORPORATE ESG GUIDE

The Unjust Transition — Reaping The Whirwind

TABLE OF CONTENTS

Part 1: Developments in the ESG Landscape

1.0 Introduction 11

1a. The Just Transition 12

2.0 Laws and frameworks relating to the private sector and Just Transition responsibilities, including SDGs 12

2a. The role of the private sector in the Just Transition: Corporate responsibility and the rise of ESG investment 13

2b. Global corporates: human rights, supply chain, and the responsible decarbonisation strategy 13

3.0 Is ESG investment helping to achieve the Just Transition? 15

4.0 Beyond Europe: Environmental and Social Priorities in the APAC 17

4a. ESG investment trends in the region 18

4b. Global capital contributions 20

4c. Investing in climate adaptation 20

5.0 Legal Trends and Behaviours in relation to the Just Transition 21

5a. European Union 22

5b. United Kingdom 27

5c. United States of America 29

5d. India 30

5e. Japan 44 31

5f. Regulation Review — Conclusion 33

6.0 COP — 27 Spotlight 48 35

Part 2: The ESG Experience – Perspectives of Industry and Investors

1.0 The role of the private sector 44

2.0 The integration of physical climate risk into strategic planning 48

3.0 The value of the UN SDGs 53

4.0 ESG Regulation and the Just Transition 56

5.0 Awareness and consequences of the ‘Just Transition’ 59

6.0 Investor pressure as a driver of physical climate risk-management 66

7.0 Protecting Human Rights in Complex Supply Chains 71

7a. Spotlight on Hope for Justice 77

8.0 Conclusion 80

Developments in The ESG Landscape

1.0 Introduction

UN secretary-general António Guterres said at the start of COP27 that this must be "the place to close the ambition gap, the credibility gap and the solidarity gap" and if not we will be "doomed". His comments preceded similar clamour for action and commitment from those nations who turned up and those that did not - notably China, India and Canada, three of the top five emitters on the planet. At the time of publication, our world is on target for a 2.8C warming which would spell accelerated climate disaster for all of us in the northern and southern hemispheres and the East and the West.

The UN Emission Gap Report has found that nation's commitments post COP26 cut less than one per cent of projected global emissions by 2030 — that's 'near-zero' rather than 'net-zero'… Many corporations and countries have made ambitious targets but have not provided the plans or the funding required to stand a chance of achieving them. This is the credibility gap that Guterres is pointing to — baseless promises are the collective deception that could result in existential failure.

However, Mr Guterres' solidarity challenge is also of critical importance, since failure on this front would be to abandon societies, countries and regions that are already experiencing the worst of the physical and social consequences of an overheating planet. Solidarity in the context means taking a world view of the environmental challenges and solving them in partnership with and with respect for the people and societies those very solutions affect.

In this paper, we demonstrate the interdependence of Environmental and Societal considerations while examining the causes, risks and opportunities and relative urgency of each element. Our findings are daunting and yet with room for optimism, subject to the collective commitment that we need to see from COP 27 and the COPs that are yet to come. Perhaps more importantly we have identified the shared experiences and the individual initiatives of some of the largest and most influential companies, investors and charities. Collectively they see ESG as an essential element of corporate or investment strategy, as a facilitator of the change in the world that we want to see, and as a challenge to carry societies near and far through that change in an equitable and just manner.

1a. The Just Transition

As the global community continues with the efforts to lower its carbon emission levels, the negative effects caused by the global temperature increase have already resulted in growing heat-related deaths, extreme weather events and the ongoing biodiversity crisis.

During COP26 in 2021, public and private stakeholders reinforced their dedication to achieving net zero with another round of commitments, including the mandatory decarbonisation roadmaps from over 450 institutions comprising the Glasgow Financial Alliance for Net Zero (GFanz)[1]. Achieving these goals and moving towards the low-carbon economy will involve fundamental changes to many sectors, with energy, agriculture, construction and apparel being the industries at the frontline of disruptions.

Achieving these goals and moving towards the low-carbon economy will involve fundamental changes to many sectors, with energy, agriculture, construction and apparel being the industries at the frontline of disruptions.

While disruption will be necessary in order to secure a significant reduction in GHG emissions, if the transition away from fossil fuels is conducted without due consideration for the societal consequences it would bring, the resulting negative impacts on the lives of individuals and communities dependent on the carbon-reliant sectors could be severe. Similarly, the potential job losses and deterioration of local economies would likely lead to societal discontent and negative perception of climate mitigation policies, undermining the implementation of the transition to a more sustainably structured economy.

2.0 Laws and frameworks relating to the private sector and Just Transition responsibilities, including the UN SDGs

Societal effects of decarbonisation are commonly discussed under the term ‘The Just Transition’. The need to consider the social impact of low-carbon transition is enshrined in prominent international frameworks, including the guidelines adopted by the International Labour Organisation in 2015, the Paris Agreement, to the Silesia Declaration on the Solidarity and Just Transition in 2018[2]. During the COP26 in 2021, Just Transition was reaffirmed as one of the key requirements for a successful shift towards a low-carbon economy with a new Just Transition Declaration. This was signed by over 30 countries and focused on social dialogue, supporting workers, job creation and observing human rights within supply chains[3]. The ongoing discourse on climate change increasingly highlights the interdependence of environmental and social factors and the need to consider those issues simultaneously[4]. These concerns are also being integrated into policymaking. One prominent example of this is the EU’s Just Transition Mechanism which aims to mobilise €55 billion to mitigate the social impact of the low-carbon transition. Several European jurisdictions have implemented national legislation requiring investors and corporates to consider and disclose the environmental and social impacts of their activities (e.g. France, Germany). In addition, the business community’s responsibility in relation to Human Rights is also established in the ‘UN Guiding Principles on Business and Human Rights and OECD Guidelines’.

1 https://www.gfanzero.com/

INVESTOR UPDATE
MARKET INTELLIGENCE

The Sustainable Development Goals, which underpin the 2030 Agenda for Sustainable Development adopted by the UN, is another prominent global framework often employed in the context of social and environmental impacts of the private sector. The SDGs combine economic, social and environmental angles, with the overall focus on building resilience and reducing inequalities. While the SDGs were created in order to facilitate state action, this framework has been increasingly adopted by the private sector as a way to articulate and define positive societal impacts of business activities or investments. As a natural development of their utilisation, the UN SDGs are increasingly being used as a contextual narrative to corporations’ efforts to address, augment and accommodate their impact on the Just Transition.

2a. The role of the private sector in the Just Transition: Corporate responsibility and the rise of ESG investment

One of the prominent topics at COP26 and COP27 was the significant gap in the green funding experienced by developing countries. The responsibility of the governments of developed countries and the global funding bodies in plugging that gap has been repeatedly recognised, with the developed countries reconfirming their commitment to providing financial support towards climate mitigation and adaptation needs of the most affected regions[2]. However, it is overwhelmingly evident that the Just Transition (or indeed any transition) cannot be achieved without the proactive and persistent participation of the private sector.

2b. Global corporates: human rights, supply chain, and the responsible decarbonisation strategy

The social concerns, including human rights in the supply chain, have been moving up the agenda of many of the global corporates, in addition to the carbon emissions and climate action which remain the primary focus of the pressure being brought by their stakeholders.

Concerns related to harmful environmental and human rights practices in the supply chain are a long-standing issue, which has been under an increasing spotlight in discussions of corporate impact. Modern slavery, child labour, and unethical working practices in supply chains present a reoccurring problem for multinationals in fashion, food, tech, and many other industries. The environmental concerns of the global supply chains range from significant reliance on fossil fuels to water pollution, deforestation, and biodiversity loss. According to research produced by McKinsey, food and beverage, consumer goods, retail, and manufacturing are among the sectors with the highest level of environmental impact rooted in the supply chain[3].

2 https://unfccc.int/news/us-413-million-pledged-for-most-vulnerable-countries-at-cop26
3 https://www.mckinsey.com/business-functions/sustainability/our-insights/starting-at-the-source-sustainability-in-supply-chains#:~:text=The%20typical%20consumer%20company's%20supply,geological%20resources%20(Exhibit%203)

INVESTOR UPDATE
MARKET INTELLIGENCE

Traditional carbon-reliant industries are not the only ones exposed to these supply chain issues — those sectors key to climate action are also affected. A prominent example is the mining of cobalt — a mineral used in batteries powering electric vehicles, which has been linked to human rights abuses including child labour and dangerous working conditions in Congo[4]. Wind and solar power generation have also been recently linked to breaches of human rights of Indigenous communities in Mexico[5]. Those are not isolated incidents — in the period from 2010 to 2021, the Business and Human Rights Resource Centre (BHRRC) recorded over 200 allegations of human rights violations in the renewables sector. The violations ranged from land and water grabs to infringements of the Indigenous nations' rights, and harmful working and remuneration practices[6]. This background emphasises that an exclusive focus on climate can lead to repeating, or even deepening the social ills often associated with the traditional carbon-heavy industries.

In the context of the Just Transition, ensuring best practice on environmental and social issues throughout the supply chain can be a key mechanism for investors and corporates in the developed countries to contribute to the Just Transition across the world. This represents a notably polarised risk dynamic whereby zero action clearly maximises all possible risk scenarios. Conversely, considered action can positively impact each element of identifiable risk, be it across commercial, reputational, legal and economic.

Increasing market and regulatory attention as well as specific high-profile scandals have added urgency to the multinational companies' quest to address social and environmental concerns in their supply chains. Some recent examples include Nestle's extensive program to eliminate the risk of child labour in the supply chain (including income acceleration efforts to support cocoa farmers)[7], and Shiseido (the Japanese Cosmetic giant) introducing the new sustainable procurement policy with ESG requirements for suppliers and risk assessment processes. However, while strengthening supply chain sustainability policies is an essential step, it is key to ensure that those policies translate to tangible action. [*Section II of this paper includes detailed analysis of the experiences, and perspectives of global corporations, investors and charities in relation to supply chain integrity along with specific examples of the actions being taken.*]

In addition to these supply chain considerations, corporates must integrate potential societal impacts into their decarbonisation strategies. The recent study of corporate efforts on the Just Transition path, published by the World Benchmarking Alliance, indicates that most companies do not measure up to the actions needed to mitigate the negative social impacts of decarbonisation. It means that most corporates do not engage with the social stakeholders to plan out their Just Transition strategies, commit to reskilling their workers, or advocate for Just Transition policies through lobbying.

The efforts around human rights due diligence are similarly underdeveloped, with companies lacking processes and procedures to identify human rights risks within their supply chains[8].

4 Raid, The Road to Ruin: Electric vehicles and workers' rights abuses at DR Congo's industrial cobalt mines, November 2021 https://www.raid-uk.org/sites/default/files/report_road_to_ruin_evs_cobalt_workers_nov_2021.pdf
5 https://www.ecchr.eu/en/case/wind-park-in-mexico-french-firm-disregards-indigenous-rights/
6 Business & Human Rights Resource Centre, Renewable Energy & Human Rights Benchmark, 2021 edition https://media.business-humanrights.org/media/documents/2021_Renewable_Energy_Benchmark_v5.pdf
7 https://www.nestle.com/media/pressreleases/allpressreleases/tackle-child-labor-risks-farmer-income-cocoa-traceability
8 World Benchmarking Alliance, Just Transition Assessment 2021, 1 November 2021

A similar 2021 assessment by Moody's highlights a lack of responsible management of company reorganisations caused by low-carbon transition, which includes measures to limit layoffs, consultation and restructuring[9]. This is a tragic omission on multiple fronts. First and foremost in terms of the incalculable human cost but it is also a chronic wasted opportunity given the increasing focus on and demand for companies that lead in this area.

3.0 Is ESG investment helping to achieve the Just Transition?

The question of whether the ESG investment industry is able to make a positive difference in the environmental and (or) social context is a matter of ongoing industry and public debate, complicated by the persistent lack of common approaches or definitions. Currently, most of the global investment community is mostly focused on climate, with the primary objective of reducing GHG emissions with a view to achieve net zero by 2050. The last two years brought greater attention to biodiversity and social elements such as diversity and inclusion, health and safety, in part prompted by the COVID-19 pandemic. However, the investment community is still far from achieving a widespread recognition of the societal impacts brought by climate change and the impending effects of decarbonisation.

Currently, most ESG-mandated funds are invested in large companies in tech, industrial or healthcare sectors, with Alphabet being the most widely held stock (other commonly held companies include Ecolab, Thermo Fisher Scientific and Microsoft). Geographically, the largest ESG funds mostly focus on US equities[10]. Similarly, most SDG-focused impact investments flow into companies in the developed markets. This highlights a stark imbalance between the targets of sustainability-conscious capital (large companies in high-income countries) and the enterprises that need it the most (companies with a high potential for positive social contributions located in the developing markets).

Many of the social factors are not easily quantifiable and therefore difficult to integrate alongside traditional financial metrics.

One of the most prominent challenges for investors wanting to integrate social considerations into their strategies is data availability. Currently, corporate ESG disclosures mostly focus on the environmental aspect due to the greater availability of commonly adopted indicators, methodologies, and reporting guidance. Another obstacle is presented by investors' lack of experience in integrating social consideration into investment decisions — many of the social factors are not easily quantifiable and therefore difficult to integrate alongside traditional financial metrics.

Another complicating factor is a conflict between the long-term horizon of most Environmental & Societal objectives, including the Just Transition, and the overarching managers' fiduciary duty to maximise investment returns for their end-clients. While the value-enhancing qualities of ESG strategies have been largely accepted as a mainstream opinion by the financial industry, many market participants still find the achievement of net-zero by 2050 goals and the delivery on clients' mandates difficult to reconcile. The underlying clash between the systemic short-termism of the financial industry and the increasing pressure to contribute to the long-term environmental and social objectives was evident in many of the participant responses to our 2021 White Paper. (LINK). These market conditions complicate the task of integrating Just Transition considerations into investment decision-making and engagement strategies. In the context of the diverse economic and social circumstances of developing countries, this becomes even more difficult.

9 Moody's, Rising focus on Just Transition will raise risks for most exposed companies, 13 December 2021
10 Rumi Mahmood, MSCI, The Top 20 Largest ESG Funds — Under the Hood, April 2021

The increasing focus on ESG investing and especially the growing engagement of the Sustainable Development Goals represent a step in the right direction in terms of capital allocation aligned with Just Transition goals (for example, SDG 13 on Climate Action and SDG 8 on Decent Work for All)[11]. At the same time, most global investors are in the early stages of developing a consistent approach to considering SDGs in capital allocation decisions. The broad scope of Sustainable Development Goals, a lack of measurement methodologies and data availability present a significant obstacle to the accelerated development of SDG-led investment strategies.

The expectations have already been set by such frameworks as UN Guiding Principles on Business and Human Rights.

Despite the existing challenges, investors have a clear role in the Just Transition which can be fulfilled through capital allocation and engagement strategies that meaningfully consider the human rights impacts of their investments. Requirements to address social issues are not a recent development for the investment and business community — the expectations have already been set by such frameworks as UN Guiding Principles on Business and Human Rights, OECD Guidelines and PRI guidance. In recent years, these concerns became underscored by the growing awareness of the impact on the workforce and local communities brought by climate change and adaptation to the low-carbon economy[12].

11 Nick Robins, Vonda Brunsting, David Wood, Climate change and the Just Transition: A guide for investor action, Grantham Research Institute on Climate Change and the Environment, December 2018
12 The role of investors in addressing the Just Transition, ShareAction, June 2021 https://shareaction.org/policies/laying-the-track-the-race-to-zero-the-role-of-investors-in-addressing-the-just-transition

There are some indications that asset managers are beginning to consider the negative social impacts and possible mitigation strategies alongside pursuing decarbonisation objectives: for example, the explicit acknowledgement of the Just Transition concerns by such industry-wide climate initiatives as the Statement of Investor Commitment to Support a Just Transition on Climate Change, Net Zero Asset Managers Initiative, and the Glasgow Financial Alliance for Net Zero.

There is substantial scope for investors to facilitate the Just Transition by actively engaging their portfolio companies to facilitate social dialogue, incorporate workforce reskilling into their decarbonisation strategies and address environmental and social concerns within their supply chains[13]. A 2021 report by ShareAction highlights how investors can leverage their influence to ensure the prioritisation of wider stakeholder interests in the process of emission reduction and strengthen the approach to human rights in the supply chain, including due diligence processes.

Efforts in this area are accelerating, with AllianceBernstein, L&G, Abrdn and other prominent asset managers committing to take action against modern slavery within their portfolios. However, limited corporate disclosures on human rights within their supply chains present a considerable obstacle. The data availability problem is set to improve in the European jurisdictions in the coming years due to the incoming regulation aiming to improve corporate performance and disclosure on environmental and social considerations in the supply chain, such as the EU's Corporate Sustainability Due Diligence Directive and Germany's Supply Chain Due Diligence Act. The US is following fast in this regard and regulation from the SEC will significantly advance both the behaviours of corporates and the expectations of asset managers and their investor clients.

4.0 Beyond Europe: Environmental and Social Priorities in the APAC

The Asia-Pacific region holds particular significance in terms of addressing the effects of climate change while minimising negative societal externalities. This geographic area has the most extensive and material exposures to the physical climate risk, while also including countries with some of the largest carbon emission counts (e.g. China, India, Japan, Indonesia)[14]. Decarbonisation in the region is moving at a slow pace due to the low level of emission reduction commitments from the states and businesses (less than 25% of Asia Pacific governments)[15]. In terms of the environmental impact, the 2021 BP report shows that coal and oil are the key energy sources in the Asia Pacific[16]. In Southeast Asia, 43% of the electricity on average is sourced from coal[17].

13 Robins N, Muller S and Szwarc K (2021) From the grand to the granular: translating Just Transition ambitions into investor action
14 https://ourworldindata.org/co2-emissions
15 PwC, Core Red — Asia Pacific's time to go green, November 2021
16 BP, Statistical Review of World Energy, 2021 https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2021-full-report.pdf
17 Climate Action Network International, How Asia can achieve a just energy transition in a post-covid world, Sept 2021

The social aspect presents its own difficulties, with many countries in the Asia Pacific being at risk of modern slavery, and other high-income states in the region not taking sufficient preventative action[18]. Workforce gender equality is also a significant concern, evident in the markedly low levels of female participation in skilled labour, senior management, and substantial gender pay gap even in the higher-income countries (for example, 31.5% in South Korea and 22.5% in Japan according to OECD data from 2020[19]).

The relatively slower development speed of legal and regulatory requirements on environmental and social practices in most of the APAC jurisdictions has been rapidly accelerating due to the mounting effects of climate change and the global consensus on the necessity of decarbonisation. This is evident in the growing number of state net zero commitments and regulatory drive to stimulate capital allocation towards green activities (e.g. Chinese green bonds and industry standard frameworks, ASEAN Taxonomy for Sustainable Finance, Indonesia's Green Taxonomy and many others).

While the disclosure levels are rising, corporates in the APAC do not commonly set net-zero targets.

The growing number of regulatory ESG reporting initiatives is gradually affecting corporate disclosure levels. The global voluntary frameworks are also accelerating progress in climate reporting, with TCFD disclosures growing by 15% from 2018 and reaching 34% in the region which is now the second highest after Europe[20]. However, while the disclosure levels are rising, corporates in the APAC do not commonly set net-zero targets or have credible decarbonisation strategies[21].

4a. ESG investment trends in the region

The levels of ESG integration investment are rising, with jurisdictions such as Japan, China and Singapore leading the effort. Asia is predicted to be the biggest driver of growth for the global ESG AUM, with forecasts reaching $500B by 2025[22]. Currently, there is a widespread growing awareness of the benefits of ESG investment, driven by a combination of risk management measures, industry trends, local regulatory pressures and increasing client interest[23]. According to the 2021 survey, 46% of high net-worth investors across mainland China, Hong Kong, Singapore and the UK believe that their portfolio will comprise fully sustainable investments in the next three to five years[24].

The number of Asian investors integrating ESG into their strategies has doubled over the last two years[25]. Data provided by S&P suggests that Asian investors are prioritising clean energy, carbon emissions, transparency, and medical/biotechnology themes for the purposes of ESG-related asset allocation. As a result, climate-focused investment flows in the region are increasing, low-carbon energy assets in ASEAN and East Asia are rapidly appreciating, and green bond issuances experiencing significant growth. Regional financial institutions are also actively focusing on impact investing, with some examples being the issuances of Social Impact Bonds in Japan and South Korea, significant increases in value and volume of impact investing activity in Southeast Asia, and sustainability-linked bond issuance in Singapore in 2021.

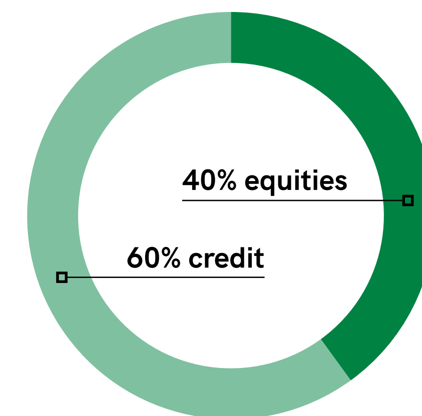
18 https://www.globalslaveryindex.org/2018/findings/regional-analysis/regional-findings/
19 https://data.oecd.org/earnwage/gender-wage-gap.htm
20 TCFD 2021 Status Report, October 2021
21 CDP, Rising to the challenge: How companies in Asia Pacific are preparing for the net-zero economy
22 https://www.invesco.com/apac/en/institutional/insights/esg/esg-opportunities-and-challenges-in-asia.html
23 OECD, Trends in ESG investing in Asia-Pacific, Jan 2022
24 https://www.assetmanagement.hsbc.com.hk/en/intermediary/news-and-insights/hsbc-asset-management-sustainable-investing-survey
25 https://asia.nikkei.com/Opinion/Asia-s-immense-opportunities-for-impact-investing

However, despite the growing appetite for sustainable Asia-focused investments that investors have been demonstrating over recent years, those investments remain at a comparatively low level and are not close to filling the funding gap needed for decarbonisation and the mitigation of consequent social disruption. According to the Asian Development Bank, ASEAN countries, India and China are likely to account for most of the global green energy financing requirements by 2050[26]. Other funding needs depend on the region and country. These include renewable energy infrastructure, reskilling and retraining formal and informal workers employed in the traditional transport, waste, agriculture, and forestry industries, improving financial inclusion, provision of climate insurance and renewable energy loans[27].

The number of Asian investors integrating ESG into their strategies has doubled over the last two years.

According to the Asian Development Bank, 95% of financial sector contributions to green energy projects come from banks, split between 40% equity and 60% credit. Non-bank financing, including institutional investment capital, provides the remaining 5%[28]. The banks face considerable difficulties in providing financing to low-carbon projects related to high credit risks, underdeveloped risk evaluation capacity, long recovery periods, and complex due diligence requirements, compared to traditional projects[29].

95% of financial sector contributions to green energy projects come from banks, split between 40% equity and 60% credit.



Accelerating ESG and impact-focused institutional investment in emerging markets can be one way to help close the existing funding gaps and achieve the Just Transition globally[30]. The urgency of this challenge is reinforced by the fact that progress towards achieving SDGs has been especially slow in the emerging markets, while most of the SDG-focused fund flows are currently directed towards listed companies in developed countries[31].

26 Asian Development Bank, Financing Clean Energy in Developing Asia, Mobilizing Private Finance for Low-Carbon Energy Transition
27 Asian Development Bank, Just Transition Beyond the Energy Sector, Nov 2021
28 Asian Development Bank, Financing Clean Energy in Developing Asia, Mobilizing Private Finance for Low-Carbon Energy Transition
29 Asian Development Bank, Financing Clean Energy in Developing Asia, Mobilizing Private Finance for Low-Carbon Energy Transition
30 Impact Investing Institute, Impact Taskforce, Mobilising institutional capital towards the SDGs and a Just Transition, Dec 2021
31 https://www.top1000funds.com/2022/05/the-transition-from-esg-to-sdg/

4b. Global capital contributions

Increasing the levels of capital allocated to impact strategies in the APAC region gives global investors another avenue for facilitating the Just Transition, however, it is complicated by the traditional challenges of investing in developing markets (such as the risk-return concerns, regulatory requirements, transaction costs and the lack of data). The data availability constitutes a particularly pertinent issue due to limited resources and minimal disclosure of many companies in these jurisdictions. Despite this, international asset managers are increasingly incorporating environmental and social considerations in their investment strategies across different geographies, including APAC countries. They are also integrating these concerns in their industry engagements in the region: in 2021, six international investors (including Fidelity International, Aviva, L&G) with $4 trillion AUM combined committed to increasing climate action engagement with Asian banks and energy producers, encouraging companies to set out credible carbon reduction goals and transition plans.

The data availability constitutes a particularly pertinent issue due to limited resources and minimal disclosure of many companies.

4c. Investing in climate adaptation

While decarbonisation remains a top priority in the context of climate action, adapting to the changing climate conditions is necessary in order to minimise the negative impact on a large proportion of humanity in the affected regions, as well as the consequent cascading effects on the global economy.

For countries in the Asia-Pacific region, implementing climate adaptation measures is especially critical due to the region's significant vulnerability to physical climate risks — extreme weather events, flooding and raising maximum temperatures threaten agriculture-dependent and densely populated coastal areas. The high poverty and gender inequality levels present in many APAC countries serve to exacerbate these risks for the local populations.

Adaptation to the changing environment will be a costly process which could come to $300 billion per year by 2030[32]. Investment flows into climate adaptation and resilience projects are steadily growing with the increasing level of awareness of potentially catastrophic consequences that could be brought by the temperature change. However, they still fall short of what is needed to cover the exponentially increasing adaptation costs. Currently, adaptation financing is largely provided by the public sector — primarily the multilateral development banks, and, to a much smaller extent, governments and multilateral climate funds.

A substantial increase in the private sector adaptation investment is necessary to achieve the required funding levels. Considering the fact that in the time period between 2017-2018, 1.6% of adaptation funding came from private sources, this would require a significant shift in capital allocation trends[33].

32 The World Bank, Enabling Private Investment in Climate Adaptation & Resilience
33 The World Bank, Enabling Private Investment in Climate Adaptation & Resilience

INVESTOR UPDATE
MARKET INTELLIGENCE

As the understanding of climate risk becomes increasingly sophisticated, industry will likely play an important role in facilitating this shift. For global and local asset managers, meaningfully integrating physical climate risk exposures into their capital allocation and portfolio engagement strategy can be the first step to addressing the adaptation concerns. Increasing adoption of TCFD disclosures by the corporates in emerging markets will reduce the current data availability limitations, allowing investors to accurately estimate the climate exposure of their assets and facilitate adaptation measures within their portfolios. Additionally, investors will be able to take advantage of significant financial benefits resulting from successful climate adaptation measures in the long term, including economic growth, innovation, and social and environmental improvements which facilitate business resilience and productivity.

Adaptation financing is largely provided by the public sector — primarily the multilateral development banks.

5.0 Legal Trends and Behaviours in relation to the Just Transition

Over the years, a key part of our ESG Corporate Guide White Papers has been the appraisal of the current and evolving regulatory ecosystem that corporates are navigating as part of the wider challenges of ESG and also specifically in relation to the Just Transition. As we have observed and argued in the past, there is an increasingly aspirational response by companies to the legal challenges presented by the three pillars of E, S & G. What this means is that companies are increasingly prepared to do the minimum required by their regional or domestic jurisdictions and instead look to understand where the highest common denominator is currently and also where it is trending to. We have looked to the leading global regions (Europe, the UK, USA, India and Japan) for the key developments with implications for differently sized companies as follows.

Societal effects of decarbonisation are commonly discussed under the term 'The Just Transition'. The need to consider the social impact of low-carbon transition is enshrined in prominent international frameworks, including the guidelines adopted by the International Labour Organisation in 2015, the Paris Agreement, to the Silesia Declaration on the Solidarity and Just Transition in 2018[34]. During the COP26 in 2021, Just Transition was reaffirmed as one of the key requirements for a successful shift towards a low-carbon economy with a new Just Transition Declaration. This was signed by over 30 countries and focused on social dialogue, supporting workers, job creation and observing human rights within supply chains[35]. The ongoing discourse on climate change increasingly highlights the interdependence of environmental and social factors and the need to consider those issues simultaneously[36]. These concerns are also being integrated into policymaking. One prominent example of this is the EU's Just Transition Mechanism which aims to mobilise €55 billion to mitigate the social impact of the low-carbon transition. Several European jurisdictions have implemented national legislation requiring investors and corporates to consider and disclose the environmental and social impacts of their activities (e.g. France, Germany). In addition, the business community's responsibility in relation to Human Rights is also established in the 'UN Guiding Principles on Business and Human Rights and OECD Guidelines'.

34 ILO, Guidelines for a Just Transition towards environmentally sustainable economies and societies for all, 2015; CO24, Solidarity and Just Transition Silesia Declaration, 2018
35 https://ukcop26.org/supporting-the-conditions-for-a-just-transition-internationally/
36 Impact Investing Institute, Impact Taskforce, Mobilising institutional capital towards the SDGs and a Just Transition, Dec 2021

INVESTOR UPDATE
MARKET INTELLIGENCE

The Sustainable Development Goals, which underpin the 2030 Agenda for Sustainable Development adopted by the UN, is another prominent global framework often employed in the context of social and environmental impacts of the private sector. The SDGs combine economic, social and environmental angles, with the overall focus on building resilience and reducing inequalities. While the SDGs were created in order to facilitate state action, this framework has been increasingly adopted by the private sector as a way to articulate and define positive societal impacts of business activities or investments. As a natural development of their utilisation, the UN SDGs are increasingly being used as a contextual narrative to corporations' efforts to address, augment and accommodate their impact on the Just Transition.

5a. European Union

NFRD — The Non-Financial Reporting Directive

The central part of the European sustainability disclosure framework is the Non-Financial Reporting Directive or NFRD. Since 2018, large European companies have been required to report on the policies, outcomes, risks, and KPIs linked to environmental, social, and employee issues. The NFRD also introduced the double materiality concept, which requires companies to disclose sustainability-related risks to the business and the impact of the company's activities on society and the environment.

The 2020 consultation on the NFRD Review revealed significant deficiencies in the implementation of existing requirements, including the lack of comparability, reliability, and relevance of disclosures. The companies under the scope of NFRD incur significant costs in the process of non-financial reporting, as well as uncertain and conflicting demands on the content and placement of the disclosures. The double materiality approach, while useful in creating a comprehensive picture of ESG performance that is of interest to a wide range of stakeholders, was not effectively translated into corporate disclosures. While there has been progress, the number of companies that disclose the impact of their activities on sustainability factors remains limited with the majority still choosing to provide general policy statements that do not allow stakeholders to form a full picture of their ESG performance[37]. The introduction of additional sustainability disclosure requirements for the financial sector under the SFRD further emphasised this challenge.

The Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) in April 2021. The CSRD would amend the current NFRD requirements, extending the scope to all small and medium-sized companies and therefore adding 40 000 new European enterprises under the umbrella of the CSRD. In addition, the CSRD will introduce an audit requirement for the reported information and mandate companies to follow the mandatory EU sustainability reporting standards, which are currently being developed by the European Financial Reporting Advisory Group (EFRAG) for adoption in October 2022. The revisions proposed by the CSRD aim to ensure greater consistency and quality of sustainability reporting and to align corporate reporting with the investors' needs under the SFDR and will include plans for companies' compatibility with the Paris Agreement and sustainability targets. EFRAG is currently engaging with a range of stakeholders on the potential approaches that could be adopted in Europe-wide sustainability reporting. The CSRD is expected to become effective in 2024-2025.

37 Alliance for Corporate Transparency Report, EFRAG climate reporting report

INVESTOR UPDATE
MARKET INTELLIGENCE

The NFRD requirements apply to any traded company on a regulated market, a banking company or an authorised insurance company with more than 500 employees, a balance sheet total of at least €20 million or a net turnover of more than €40 million per annum. Companies must publish reports (including principal risks and KPIs) on environmental protection, Social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery and diversity on company boards relating to age, gender, educational and professional background.

Failure to comply can bring material sanctions at the level of member states of between €500 and €3 million but there is no sanction risk levelled at the EU level. However, the comply-or-explain principle still prevails which is expected to be increasingly deployed given the lack of universal reporting standards set.

SFRD — The Sustainable Finance Disclosure Regulation

The other pillar of the EU's sustainable regulatory framework is the Sustainable Finance Disclosure Regulation (SFRD) which aims to combat greenwashing and increase transparency around sustainable investment practices. SFRD establishes entity-level and product-level disclosure requirements that apply to most financial institutions in the EU (and the non-EU firms offering products in the EU). Most of these provisions came into effect in March 2021. The entity-level requirements mandate investment firms to disclose how they integrate sustainability risks into their investment decision-making process (Article 3), and how they consider adverse impacts of their investment decisions on sustainability factors (or why they choose not to consider these impacts) (Article 4). Also, firms are required to outline the way that their remuneration policy is aligned with the approach to the integration of sustainability risks (Article 5).

This regulation is far-reaching and designed to permeate the whole financial system under the EU jurisdiction. This applies to AIFMs, UCITS, MiFID investment firms, managers of qualifying VC funds, qualifying social entrepreneurship funds, pan-European personal pension product providers (PEPPs) and manufacturers of pension products.

On the product level, investors have a choice whether to assess the impact of the sustainability risks on the financial returns or provide information on why they deem sustainability risks not relevant for a particular product (Article 6). A firm that discloses adverse impacts on sustainability factors is required to provide this information for each financial product (or disclose why those impacts are not considered) (Article 7). To address the proliferation of ESG-linked products, SFDR requires investors to distinguish between funds that have a sustainable objective (Article 9 funds), and funds that promote environmental or social characteristics among others (Article 8 funds). Depending on the type of fund, information on how sustainable objective is achieved or environmental and social characteristics are met, needs to be disclosed. If these funds reference an index, the disclosure should provide information on how that index is aligned with these goals.

The final version of the Regulatory Technical Standards (RTS), which define the principal adverse impacts to be reported by the financial institutions was published on 6th April 2022 and will come into effect in January 2023, six months later than planned. The RTS provide disclosure templates for Article 8 and 9 funds, which require financial firms to provide the proportion of the portfolio allocated to sustainable investments.

The Taxonomy Regulation supplements the SRFD with regard to the products that promote or contribute to one of the six identified environmental objectives. For those products, investors must disclose the specific environmental characteristics being promoted as well as how and to what extent the portfolio is invested in those environmentally sustainable economic activities (Article 5 of the Taxonomy Regulation).

The requirements to distinguish between Article 8 and Article 9 funds and provide corresponding disclosures are designed to cut through the confusion caused by the proliferation of ESG funds with holdings in high-emissions companies. Detailed disclosures against the indicators included in the RTS will provide stakeholders with greater insight into the impacts of the firms' investment decisions. This insight will allow asset owners to evaluate the depth of the managers' commitment to sustainability, which is especially important in light of the ESG products being predicted to outnumber conventional funds by 2025. At the same time, this outcome assumes a robust industry response to the SFRD requirements, which could be undermined by the historical 'comply or explain' concept. In fact, some parts of the SFRD were mandatory from 2021, with additional mandatory obligations in 2022 and it becoming 'fully' mandatory from 2023. While this is explicit in the regulation, it is the key contributing factor to it being 'a moving regulatory feast' in the eyes of investors and their clients.

The quality and availability of data required for an evaluation of the adverse impacts of a portfolio continue to be a major threat to the efficacy of the SFRD requirements. Data quality has been a major bug-bear of all ESG stakeholders and while improvements have been made, in aggregate the problem remains the same. Conceptually, having some good data and some weak data undermines the integrity and comparability of the whole data set. Scale that inconsistency up to the global reach of financial and corporate reporting and the compounded errors severely undermine the utility of the data being collated, analysed and reported. Throughout the development of the regulation, investors have voiced concerns with regard to the lack of relevant information and even at this late stage, many companies are still not reporting information in line with the SFRD requirements. For some, this translates into the possibility of a green bubble, should the requirements of sustainable investment prove to be too narrow.

Another potential issue is penalising the (presently) high-emissions companies on a transition journey as the EU regulatory push drives investors away from the polluting industries. This runs the risk of undermining the primary transition goals as traditional energy companies have a major role in achieving net zero. Research shows that oil & gas companies are driving green innovation, producing a substantially higher number of green patents than firms highly rated on ESG performance[38]. Reducing the available funding could slow down the progress that those companies could make in changing their business models towards a focus on renewable energy generation.

38 Lauren Cohen, Umit G Gurun, Quoc H. Nguyen, The ESG-Innovation Disconnect: Evidence from Green Patenting, NBER Working Paper Series, N 27990, October 2020

INVESTOR UPDATE
MARKET INTELLIGENCE

EU Taxonomy

The EU Taxonomy provides a common classification of economic activities that can be considered environmentally sustainable for companies that are already covered by SFDR and/or NFRD. The Taxonomy regulation entered into force in July 2020, with the first Climate Delegated Act adopted in June 2021. In providing clear definitions of sustainable activities, the EU aims to minimise greenwashing and facilitate the low-carbon transition by directing capital towards objectively green companies. Such corporates are expected to make a substantial contribution to at least one of the six EU's environmental goals, whilst not significantly harming any of them.

The Taxonomy sets six climate change objectives: (a) climate change mitigation, (b) climate change adaptation enforceable from 2022, (c) sustainable use/protection of water & marine resources, (d) transition to a circular economy, (e) pollution prevention and control, and (f) protection/restoration of biodiversity & ecosystems. All of these objectives will apply from January 2023.

The delay in the adoption of the Climate Delegated Act was caused by the intensity of the stakeholder feedback (the draft delegated acts prompted more than 46,000 consultation responses). Some of the designations caused objections from the EU member states, in particular the omission of natural gas and nuclear energy. The Taxonomy designations have wide-reaching implications, which will impact the financing decisions of the EU investment bodies, national regulators, and the availability of private sector funding. The financing available to the nuclear projects designed to replace coal in the drive to decrease emissions depends on its classification as a transition fuel. The difficulties of reconciling different approaches to climate transition were compounded by the social factor, expressed in the joint statement from thirteen unions representing nuclear workers, calling for the inclusion of nuclear power in the Taxonomy[39]. Following a positive outcome of the Joint Research Centre review, which concluded that nuclear energy does not cause significant harm to any of the Taxonomy objectives, nuclear energy and natural gas now seem to be closer to being included in the scope of the Taxonomy.

The implementation of the Taxonomy is likely to be further complicated by the data availability challenges. A study conducted by the UNEP FI and the European Banking Federation assessed the potential application of Taxonomy to banking products, which highlighted concerns around the availability, quality, and comparability of data, with a specific focus on retail clients, SMEs, and assets based outside the EU. The lack of granular and relevant data made the 'Do No Significant Harm', 'Minimum Social Safeguards', turnover and revenue split assessments especially difficult. Also, the report highlighted operational challenges around mapping the Taxonomy classification to clients' business activities and increasing complexity of the internal processes[40]. This report is indicative of the challenges that will be encountered by many Taxonomy data users, including asset managers.

39 https://world-nuclear-news.org/Articles/Unions-call-for-European-taxonomy-to-include-nucle
40 UNEP FI, EBF, Testing the application of the EU Taxonomy to core banking products, January 2021 https://www.unepfi.org/publications/banking-publications/testing-the-application-of-the-eu-taxonomy-to-core-banking-products-high-level-recommendations/

Spotlight on Switzerland

Demonstrating a rather traditional passion for democracy, Swiss citizens organised a referendum on and voted for opting for the EU's Responsible Business Initiative in 2020. Becoming enforceable from the 2023 financial year, the new law will cover the Swiss listed companies, banks and insurers that have (a) more than 500 FTEs annually and (b) either assets exceeding CHF 20 million or more than CHF 40 million in revenues. In a nutshell, the law will require the abovementioned entities to produce an ESG report that includes the company's business model, main ESG risk and non-financial KPIs on an annual basis.

Diving into operational details, it is important to mention that the ESG report needs to be approved by the board and shareholders and, eventually, shall be made electronically accessible for 10 years. These strict requirements are slightly softened by exemption from auditing for the ESG report. By law, it is prohibited to submit false and/or generic statements, fail to submit the report or keep a record of it, or even fail to publish it on time. Apart from the criminal liability, the companies will be subject to fines ranging from CHF 50,000 for negligent violations to CHF 100,000 for intentional breaches.

5b. United Kingdom

The post-Brexit political landscape left significant uncertainties with regard to the exact shape of the UK regulatory approach to ESG. However, the past year demonstrated that climate considerations are a prominent feature on the government's agenda, with the added urgency brought by the UK hosting COP26 in Glasgow last year. The continuous focus on climate disclosure was evident in the introduction (in April 2022) of the mandatory TCFD reporting obligations across all UK companies by 2025. In addition, the Industrial Decarbonisation Strategy, launched in March 2021, outlines the government's plan to enable net zero transition, which focuses on facilitating investment in low-carbon sectors and consumer demand for low-carbon products[41]. The strategy also sets out approaches to the adaptation of industrial processes and improving energy efficiency. According to this outline, the government expects emissions to reduce by two-thirds by 2035.

In the most recent development, the UK government issued a Roadmap to sustainable investing at the end of last year which announced the Sustainability Disclosure Requirements and the UK Green Taxonomy. The new Sustainability Disclosure Requirements will enhance climate-related reporting in the UK by introducing new rules for companies and the financial sector. The sustainability framework being developed by the IFRS Foundation is said to form a key part of the UK's SDR. The government is expected to consult on the initiatives outlined in the Roadmap in 2022[42]. Notably, the government is also considering bringing ESG rating provider firms under the FCA's scope as part of its strategy to improve the quality of sustainability data. Lastly, starting from January 2023, UK-registered companies with an annual turnover of more than £1 million, which are responsible for over 25 tonnes of packaging per year, will have to pay a waste management fee and report data on waste handling.

41 https://www.gov.uk/government/publications/industrial-decarbonisation-strategy
42 HM Government, Greening Finance: A Roadmap to Sustainable Investing, October 2021 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1026224/CCS0821102722-006_Green_Finance_Paper_2021_v5_Bookmarked_48PP.pdf

INVESTOR UPDATE
MARKET INTELLIGENCE

These wide-ranging measures demonstrate a high level of commitment from the government in addition to already well-established disclosure practices, such as Section 172(1) Statement, Gender Pay Gap and Modern Slavery reporting. At the same time, the UK's efforts have attracted criticism over the lack of binging short-term targets and the lack of strong protections in the delayed Environmental Bill which is supposed to establish the post-Brexit environmental regime in the UK[43].

Recently introduced Non-Financial and Sustainability Information (NFSI) Statement is applicable to the UK-registered entities that have more than 500 employees and are (a) traded, banking, or insurance companies; (b) AIM listed companies; or (c) companies which are not included in the categories above but have a turnover of more than £500m. If the NFSI statement is non-compliant with the Companies Act 2006 requirements, a claim may be brought against the company and the amount of the fine will be determined by a court.

5c. United States of America

In contrast to regulation-focused Europe and the UK, the US has historically been exposed to fragmented voluntary disclosures driven by market demands. In addition to NYSE and NASDAQ ESG guides, Black Rock and State Street recommended that US businesses use the SASB framework for ESG disclosures in 2020. A year later, the Financial Stability Oversight Council (FSOC), a body made up of the heads of the Treasury, SEC and Federal Reserve, deviated from the approach of the asset managers and strongly insisted on adopting the TCFD as the main ESG reporting framework[44].

As a result, the US has lagged behind Europe in recent years in terms of sustainable regulatory development, with senior industry figures expressing scepticism with regard to the materiality of ESG concerns. To illustrate, only NASDAQ has a mandatory board diversity rule that requires NASDAQ-listed companies to have one female director and one director who self-identifies as an underrepresented minority or as LGBTQIA+. This is supplemented with several regulations at the state level, with Washington, Illinois and New York demonstrating leadership in supporting board diversity reporting.

Nevertheless, the Biden administration's early move to re-join the Paris Agreement signified the change of course in the post-Trump US approach to ESG. The current much more proactive regulatory attitude to sustainability issues can be illustrated by the recent Department of Labor's proposal to override the rules limiting non-state pension plans' freedom to invest in ESG products, put in place by the previous administration[45]. The renewed focus on ESG is underscored by the SEC undertaking a review of corporate climate-related disclosures over the course of 2021. The SEC will try to make the US public companies report on ESG, Scope 1, 2, and 3 emissions and climate-related targets. The revisions to the mandatory climate reporting requirements came out in March 2022 and if they are adopted in December 2022, they will become applicable in the 2023-2025 fiscal years[46].

43 https://www.theguardian.com/environment/2021/jan/26/fury-as-long-awaited-uk-environment-bill-is-delayed-for-the-third-time?CMP=twt_a-environment_b-gdneco
44 https://www.globalfinregblog.com/2021/10/fsoc-issues-recommendations-on-climate-related-financial-risk/
45 Department of Labor Proposal: https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021-22263.pdf
46 SEC's Proposal: https://www.sec.gov/rules/proposed/2022/ia-6034.pdf#page=4

The main concern raised by the opponents of the SEC's ESG initiative is related to the lack of authority of the SEC to make such a significant change in the US disclosure landscape. Not only may the SEC lack its own authority to issue rules on such a major issue but also it might overstep the powers of Congress or specific authorities, such as the Environmental Protection Agency. Therefore, having attracted a lot of attention from policymakers and lawyers, the SEC's reform is at great risk to be either overturned or challenged in a court just after adoption.

Lastly, the SEC is about to introduce the '80% name rule' which will oblige the US funds to invest in the types of investments by the name. Thus, if a fund's name contains words like 'ESG', 'green' or 'sustainable', the fund should invest 80% of its funds into respective assets. The main concept behind this rule is to prevent funds from misleading their customers through the naming of the fund and avoid potential greenwashing. Despite the high-minded initial idea, there are three main threats created by this rule. Firstly, because there is no definition of ESG investment (neither qualitative nor quantitative), the ESG term will be open to interpretation by individual funds and will vary from manager to manager, failing to prevent actual greenwashing. Secondly, the strict 80% threshold will deprive fund managers of the flexibility to execute their strategies going below and above the 80% line as might be required by volatile market conditions. Finally, would it be ethical to invest the other 20% into unsustainable sectors, such as oil, tobacco, or the military? There is no clear answer to that which creates a substantive chilling effect on fund managers who will not be sure what they are allowed to invest in.

To conclude, the US has been lagging behind the UK and Europe for years and now it is desperately trying to boost its ESG market. While doing so, the US authorities make prompt, incoherent decisions which lead to unforgivable mistakes that may throw the US back to the initial point, creating new reasons for ESG critics to attack ESG regulations in the future.

5d. India

Despite India's absence at COP27, the Indian Prime Minister made several promising environmental announcements, including a commitment to obtain 50% of its energy from renewable sources by 2030 and achieve net zero by 2070 as declared in November 2021. These pledges have had a positive impact on green finance in India which demonstrated exponential growth in the last four years, mirroring the global capital flows into ESG funds. According to Morningstar, the AUM of ESG funds in India increased from $283.5 million in March 2019 to $1.5 billion in March 2022[47].

47 https://www.business-standard.com/article/markets/assets-of-esg-funds-rise-5x-in-four-years-to-rs-12-450-crore-shows-data-122042400997_1.html

INVESTOR UPDATE
MARKET INTELLIGENCE

Indian ESG laws and regulations are well-known for their fragmented and incoherent nature as there is no unified source of ESG-focused legal rules for Indian businesses. Rather, one can find the rules that cover companies' interactions with the environment in at least five different legal acts, such as Environment Protection Act 1986 as well as the Water, Air, Forest and Wildlife Acts which provide specific rules in the respective natural sectors. As for the 'Social' element, there are twenty-nine labour laws codified into four codes that cover legal norms on wages, working conditions, health and benefits, occupational safety and many others (i.e., Shop and Establishment Act, Contract Labour Act 1970, and Trade Unions Act 1926). The Corporate Governance part is mainly limited to the Companies Act 2013 and Listing Regulations that establish rules on committee formation. To illustrate this, the Companies Act requires corporations with certain thresholds on net worth, turnover or net profit to constitute a Corporate Social Responsibility Committee and annually spend at least 2% of their net profits on CSR[48].

Crucially, the Companies Act provides rigorous sanctions for non-compliance with Financial Statements requirements, Board reporting and violation of director duties (from INR 1 Lakh to INR 5 Lakhs). Nevertheless, the problem with the current legal system around ESG is not only its fragmentation which makes it difficult to comply with, particularly for small under-resourced businesses but also the lack of enforcement which means that only genuinely dedicated corporates will adhere to the numerous laws and regulations for 'E', 'S' & 'G'.

India has recently introduced the Business Responsibility and Sustainability Report (BRSR) which is the only ESG-specific initiative in India, other than a number of voluntary stock exchange ESG guidelines. To understand the trajectory of the future development of the BRSR, it is helpful to recall that it was introduced in 2012 and applied to the top 100 (by market cap) listed companies. Subsequently, it was extended to the top 500 and top 1000 listed entities in 2015 and 2019, respectively. In May 2021, the business responsibility reporting was supplemented with ESG-specific disclosures, broadening the scope of the BRSR[49].

Although 1000 companies may seem to be a large number, it is important to understand that there are over 1.43 million registered companies in India and BRSR applies to less than 0.1% of them. Following the trend of extending the BRSR coverage, it is predicted that, in the near future, BRSR will also apply to unlisted companies, require data on 120 metrics and oblige companies to include historical data for the last 2 years. The main concern here is that Indian businesses may treat the BRSR as a 'box ticking' exercise, diminishing its intended purpose.

Overall, the Indian ESG regulation regime remains uncertain, fragmented and challenging to comply with. Despite this, Indian businesses and ESG funds have to be ready to experience the tightening of the ESG laws and reporting requirements in the next couple of years.

48 Section 135 of the Indian Companies Act 2013: https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf
49 BRSR Circular by SEBI: https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

INVESTOR UPDATE
MARKET INTELLIGENCE

5e. Japan

During the COP27, the Japanese Government, relying on the worldwide energy crisis, announced its decision to delay the introduction of the new carbon tax which was meant to be launched in April 2023. This move is in stark contrast with Japan's COP26 pledge to contribute $10 billion to the Asian zero-emission thermal power initiative that will involve ammonia and hydrogen. In addition to this, Japan introduced the Green Growth Strategy in 2020 and entrenched it in law in 2021 (Act on Promotion of Global Warming Countermeasures). The Strategy is expected to cover 14 growth sectors on Japan's way to net zero by 2050[50].

Japan developed the world's first national strategy on hydrogen ('Basic Hydrogen Strategy') in 2017, expecting it to become a key driver of Japan's energy industry. In December 2021, the Government tried to diversify its energy sources and completed the first auction for promotion areas for offshore wind farms and is expected to conduct another auction round relatively soon. From the financial perspective, Japan puts a strong emphasis on its Joint Crediting Mechanism which allows the Government to count the reduction of GHG emissions from other countries, which Japan supplies with low-carbon technologies and products, towards its own emission targets. This is supplemented with Green (2017) and Social (2021) Bonds Guidelines developed by the Ministry of Environment to prevent greenwashing and provide investors with additional information. This resulted in a nine-fold increase in the total amount of green bonds issued (¥2.86 billion) in Japan between 2017 and 2021.

In terms of 'hard' ESG law, it is evident that Japan does not have many, as it mainly relies on voluntary regulations, gently encouraging companies to follow ESG trends. Japanese companies with more than 300 employees are required by law to set numerical gender targets for the workforce and promote women's participation and advancement in the workplace (Women's Success Promotion Act). If companies perform well, they will be given priority in the public procurement process, whereas, if they fail to comply with the Act, they could be sanctioned with fines ranging between ¥200 000 and ¥1 000 000[51].

The second large piece of mandatory legislation is the Whistleblower Protection Act introduced in 2022, which is very similar to the EU Whistleblowing Directive. It obliges Japanese companies with more than 300 employees to respond to whistle-blowers' reports, set up a dedicated hotline and designate respective personnel who will investigate allegations. The fine for non-compliant businesses may be up to ¥300 000 combined with the public disclosure of the company's name.

Voluntary rules and guidelines have extensive coverage (but not use) in Japan, with the TCFD being the prevailing framework there. This is mainly because the Financial Services Agency and three Ministries of Japan (Economy, Trade, Environment) founded Japan's TCFD Consortium in partnership with large businesses and institutional investors in 2019. It was a clear signal from the Government about which ESG framework they will accept. This leads Japanese businesses to constitute one-fifth of the total participants in the TCFD as of 2021[52]. Moreover, following the EU's lead, Japan has adopted the National Action Plan that expects (but does not oblige) companies to conduct human rights due diligence, showing the Government's interest in enhancing the competitiveness of Japanese businesses in the international ESG arena.

50 https://www.meti.go.jp/english/policy/energy_environment/global_warming/ggs2050/index.html
51 https://www.japaneselawtranslation.go.jp/en/laws/view/4163
52 https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2022/02/insights-into-esg-in-japan.pdf

The Stewardship Code (2020) allows but (again) does not require asset managers to consider sustainability factors in their decision-making[53]. Although the Code's wording is softer than the modest US ERISA equivalent described above, only a few pension funds have adopted it as of 2022. Apart from already mentioned frameworks, Japan has several other less common voluntary ESG initiatives, such as the Code of Conduct for ESG Evaluation and Data Providers (July 2022), the Corporate Governance Code as well as the tandem of ESG Anthology (March 2022) and TSE ESG Reporting Handbook that, in combination, work as reference frameworks for TSE-listed companies.

Despite being held back by the energy crisis, Japan feels that it is lagging and thus actively tries to catch up with the recent EU developments. The Government avoids putting too much pressure on businesses by imposing voluntary rules only. Nevertheless, it is expected that TSE and FSA will adopt new climate disclosure obligations in 2023. While TSE's rules will be based on the 'comply or explain' approach, the FSA's regulations will be hard laws and may lead to significant fines for violators.

The unique technological approach to ESG may be witnessed through the new TSE portal that will automatically collect IR, PR and sustainability information from the websites and reports of TSE-listed companies, creating a free unified database for stakeholders in the coming years. Therefore, Japanese business and investor communities must keep an eye on the rapidly developing rules in Japan to navigate the evolving ESG regulatory landscape, avoiding the very real possibility of financial sanction and at the same time, negating the reputational risks.

5f. Regulation Review — Conclusion

It is unsurprising that the regulatory landscape around the world does not remain static. Certain states, such as the US and India, are lagging and trying to catch up with the regulation leaders. Others, mainly the EU and UK, are racing ahead with intimidating speed, pushing the boundaries for ESG disclosure and reporting. At the same time, Japan is carefully introducing ESG to the minds of CEOs and investors through softer, voluntary disclosures. These attitude discrepancies between the countries are frequently mandated by local business culture, investment environment and the frequency of opportunistic political manoeuvres.

It will take a significant amount of resources to adapt to new legal challenges and regulators are aware of that. They usually begin with tightening regulation for the largest market players, determined either by market cap or employee number. Nevertheless, the threats and/or opportunities created by new ESG requirements are imminent for mid-sized and small businesses as shown by the EU's approach. Critically, the new data released into the markets through new ESG disclosure regimes will affect the flows of green capital around the globe. That is why all companies, without exception, need to bear in mind the ESG laws and regulations that they are subject to and endeavour to keep an eye on evolving trends in the countries where the expansion of the current ESG regulatory regime is inevitable.

53 https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/01.pdf

INVESTOR UPDATE
MARKET INTELLIGENCE

6.0 COP – 27 Spotlight

If at first, you don't succeed, try again 27 times or more…

The realities of a growing energy crisis, record high greenhouse gas emissions and increasingly extreme weather patterns, mean that the challenges facing COP 27 were many and varied. COP 27 sought renewed solidarity between countries to deliver on the commitments of the Paris Agreement. The Egyptian city of Sharm El-Sheik played host to the representatives of over 200 countries of which more than 120 countries sent their heads of state to this year's Conference of the Parties. Their goal, as always, was to participate in and oversee negotiations in an effort to mitigate climate change. The UN's warning that the past eight years have been the hottest on record of this planet would have been more than enough to focus the minds of the many on the precarious urgency of the agenda.

One of the priorities for COP 27 was to scrutinise the last year's COP 26 agreements and assess the progress made on those commitments or rather the lack of them. Depressingly, only 29 countries have delivered on their promise of "revisiting and re-strengthening" their climate commitments since last year. The opening days of COP-27 witnessed some big speeches from world leaders which dominated the headlines. Many used their speeches to demand more from other nations as COP27 descended into something of a blame game.

Pakistan — PM Shehbaz Sharif

Months on from the devastating floods in Pakistan, millions of people still remain affected, putting the futures of millions in a state of uncertainty and despair. At COP 27, Pakistan's Prime Minister Shehbaz Sharif called on industrialised countries for their support. Sharif demanded real action and progress on climate change so that Pakistan's disastrous flooding will not be repeated and exacerbated in years to come. According to Pakistan's government, it is estimated that the losses and rebuilding costs currently stand at more than $30bn.

INVESTOR UPDATE
MARKET INTELLIGENCE

United Kingdom — PM Rishi Sunak

U-turning from his initial decision to not attend COP-27, the British prime minister has pledged to triple the UK's climate adaptation budget to £1.5bn. This money is part of a broader £11.6bn commitment to international climate finance. Sunak promised that this money will go to protect the Congo Basin from deforestation, support Indigenous and forest communities, and other biodiversity protection programmes around the world.

India — Environment Minister Bhupender Yadav

The Indian delegation led by the Union Environment Minister Bhupender Yadav highlighted a common but differentiated responsibility, emphasising India's expectations of strategic actions from richer countries. He also sought clarity on the definition of climate finance, citing concerns that loose definitions are allowing developed countries to greenwash their finances and pass off loans as climate-related aid. Finally, he showcased India's "LiFE movement" which stands for Lifestyle for Environment — which is a pro-people, pro-planet movement that seeks to shift the world from mindless and wasteful consumption to mindful and deliberate utilisation of natural resources.

Aside from numerous fiery speeches from world leaders, COP-27 also witnessed some significant developments and outcomes.

A Special Target on Business and Industry:

The United Nations released a report called "Integrity Matters" which includes several recommendations that they want businesses to adopt to safeguard the planet from the climate crisis. The key recommendations from the report include requiring that companies should:

- → Not be able to claim to be net zero while building or investing in new fossil fuel supplies.
- → Not be able to buy cheap, sometimes questionable carbon credits. They should cut their own emissions instead of relying on another organisation to do this work for them.
- → Aim at eradicating their emissions rather than reducing them.
- → Not lobby to undermine a nation's climate goals and policies.
- → Follow certain regulations to meet a net zero greenhouse emissions target by 2050.

Is 1.5 Dead?

In a somewhat controversial and shocking editorial piece, The Economist greeted the start of COP27 by declaring that "1.5 is dead" and that failure to accept this could actually undermine progress on climate change adaptation and mitigation. It is no secret that the pace of global warming has been startling and it is estimated that we are already at 1.2 degrees. The annual global Greenhouse Gas Emissions are at an all-time high, with so-called developed world emissions peaking. Concurrently, emissions from the developing world are also rising uncontrollably, mainly due in part to the West's dismal failure to provide promised finance to support their green transitions. The final blow is the wave of new finance committed to oil and gas, now significantly misaligned with a 1.5°C trajectory, with $742 billion in fossil fuel financing committed globally in 2021 alone. This is consistent with the context for the UNEP to conclude that "we have no credible pathway in place to keep 1.5°C alive".

The New Buzz of "Backsliding"

'Backsliding' emerges as a buzzword in COP27, with numerous political leaders from France, Egypt, the UK, and the UN all warning that this should be avoided at all costs. However, it appears that many attendees are fearful of exactly that happening right now. Negotiators and observers feared that any failure to come to an agreement on loss and damage deals would result in disagreement over other important issues, including the limiting of emissions.

The business community is also concerned, with more than 200 corporate executives from companies like Amazon, Ikea, Microsoft, Nestle, and Unilever releasing a joint statement demanding that the Paris Agreement target is kept. The expectation was that countries would build on existing agreements and indeed go further. Instead, some countries are attempting to walk back previous deals and water down their commitments. Both China and India appear to be trying to emphasise the fact that 2 degrees Celsius was the upper limit of the Paris Agreement, not 1.5.

The Loss and Damage Fund

Perhaps the biggest highlight of COP 27 was that after many years of back and forth, participants finally agreed to set up a "loss and damage fund" to compensate poorer countries suffering from climate change. Many

climate experts and policymakers believe the establishment of this fund is an essential first step in addressing the imbalances of global warming, which disproportionately impacts the poorest and low-emitting countries more than the wealthy and carbon-intensive. In the words of the UN Secretary-General - "establishment of a loss and damage fund is an important step towards justice" and a "much-needed political signal to rebuild the broken trust". While the creation of such a fund is a significant development, it is possible that it may take several years to finalise the finer details of the fund.

Dragon wrangling for a greener future

Despite significant developments in the loss and damage fund, many experts are concerned about the fairness and feasibility of such a fund. The main concern with the criteria of the fund is that it does not consider China. Taking into consideration historical responsibilities, the developed countries may be in the top five emitters. However, in the last two decades the rapid rise of emerging economies specifically China, Russia and Saudi Arabia has meant that they are emitting a lot more than in past with limited effort to contain, let alone reverse that trend. Paul Bledsoe, a former Clinton White House Adviser called this COP something of a failure, as it completely let the world's biggest emitter, China, off the hook. A widely agreed sentiment in climate circles is that global emissions can't fall until China's emissions fall. With the current political developments in Beijing, it is becoming increasingly important and difficult to bring China to the negotiating table putting years of climate progress in jeopardy. The future of climate protection will be dictated by how well the rest of the world decides to deal with an increasingly insulated communist China.

For many observers, the China exemption represents this problematic can being kicked further down a well-trodden road at the exact time that the climate crisis is worsening and time is running out for the people and the planet. However, the creation of the fund remains a crucial statement by the developed world, an admission of culpability and a desire to put it right. Like all good intentions, their worth is to be judged by the actions that follow but this agreement stands as a challenge to those absent as much as to its signatories. Many COPs have achieved far less and this has the potential to restore justice where it has been lacking and as such play a role in realising The Just Transition.

INVESTOR UPDATE
MARKET INTELLIGENCE

ESG Investor Benchmarking & Targeting

Investor Update's ESG Benchmarking provides valuable business intelligence on your true ESG standing, compared on a like-for-like basis with your genuine peers. Given the significant growth in ESG AUM and profile it is crucial that corporates understand the wide range of market expectations of them across each element of E, S and G… but also to understand which specialist ESG investors are already on their register and which to target.

We will identify, track and benchmark ESG focused funds as part of our service, identifying ESG focused funds that are underweight or absent in you compared to your domestic, international and aspirational peers. As part of our analysis, we break down your target list of ESG investors into active and passive pools and identify their investment potential at fund level.

Through this unique approach Investor Update is able to

- Calculate the amount of ESG-mandated capital currently invested in your stock and compare weighted ESG investment levels with a focused peer group
- Quantify the potential value of inward ESG investment in terms of additional purchasing power
- Identify specific ESG funds, active and passive, thematically, by market cap and by geography
- Discover which ESG indices key ESG focused funds benchmark themselves against and the amount of capital backing that each index has
- Deliver your detailed analysis at fund-level via our proprietary visualisation portal and in a board-friendly report

A Differentiated Approach to ESG Advisory

Building on the foundations of our Benchmarking Analysis, **Investor Update's ESG Advisory Team** identifies the gaps between our clients' strategies and choices around ESG and those of the best-in-class peers identified. This evidence-based approach is producing rapid, commercially impactful results for some of the largest companies from all major sectors.

Clear action points are identified and recommendations made ranging from high-level and strategic initiatives through to tactical optimisation ideas, all related to specific examples of excellence with clearly signalled outcomes and benefits presented in a series of board-level reports.

Our ESG Consultancy services include

- Gap Analysis on Reporting & Disclosure, Narrative & Comms and Strategic Priorities
- Deep-Dive into ESG-linked Executive Compensation and Board Competency
- Enhancing Passive Investor inflows by examining Index membership criteria
- Strategies for increased Active ESG Money engagement with buy-side ESG Teams
- Design & execution of Specialist ESG Perception Studies and ESG Roadshows

Part 2: The ESG Experience — Reflections of the Sustainability Executive Community

TABLE OF CONTENTS

1.0	The role of the private sector in regard to the social impacts of climate change and the decarbonisation drive	44
2.0	The extent to which the physical climate risks are being integrated into companies' strategic planning	48
3.0	The value of the UN SDGs as a tool in facilitating the private sector commitment to the Just Transition	53
4.0	How regulation increases awareness and action in Just Transition considerations by the private sector	56
5.0	Understanding, Awareness and Concern about the causes and consequences of the Just Transition	59
6.0	How investor pressure is accelerating the understanding of and response to physical climate risk exposures	66
7.0	The Just Transition: Protecting Human Rights in Complex Supply Chains	71
	7a. Spotlight on Hope for Justice	77
8.0	Conclusion	80

INVESTOR UPDATE
MARKET INTELLIGENCE

The following section of the white paper reflects the perspectives and insights of senior sustainability executives from a cross-section of the world's most influential global entities. The quotes presented are the result of more than thirty interviews with and contributions from those individuals which, in combination, reveal the collective experiences and challenges presented by the drive to decarbonise while ensuring the transition is fair and equitable to all geographies and demographies. While the experiences vary significantly, there is a shared understanding and commitment to working towards a Just Transition on terms broadly consistent by all contributors. Through the interviews conducted, the individual initiatives and creative solutions of the respective organisations were shared with the intention that these may be helpful to the wider corporate and financial community.

1.0 The role of the private sector in regard to the social impacts of climate change and the decarbonisation drive

Addressing climate change is a multifaceted issue and most companies acknowledge the pivotal role that the private sector can play in tackling the social impacts of climate change and the decarbonisation drive. Most interviewees acknowledge the interrelation between innovation by business and a sense of social purpose, while some question if it is the role of the private sector to address these issues. There are conflicting views on the regulations that govern the responsibility of the private sector towards climate change, with some investors highlighting the lack of regulation means there is no uniformity in this aspect which in turn creates pressure on the corporates. Whilst others argue that the absence of regulation means the private sector can take the lead and push the regulation towards a common goal.

The private sector proactively participating in tackling the effects of climate change is a widely aggreged sentiment among many interviewees. B3 has pointed out the key role that the private sector can play in this regard:

> *"The private sector has a key role in working together not only in collaboration with the government but together with investors and/or local communities to mitigate and support the sustainable development of these environments, recognizing the impact of their operations and alternatives to minimize any risks. Thus, the adoption of tools such as the UN SDGs (Sustainable Development Goals), for example, is important to support this discussion." [**Gabriel Santana do Nascimento, Sustainability Team, B3**]"*

The specific role of the private sector in decarbonisation efforts is perceived as a fiduciary role by Blackrock, highlighting that acting to tackle climate change is part of their long-term economic interests. Blackrock further mentions the pivotal role of their engagement strategy that helps in making an informed assessment of the company and drive positive change:

> *"BlackRock's approach to climate risk and opportunities and the global energy transition is based on our fundamental role as a fiduciary to our clients. Our role, on behalf of our clients as long-term shareholders, is to better understand how company leadership is managing risks and capitalizing on opportunities to protect and advance the economic interests of shareholders. Without exception, our decisions are guided by our role as a fiduciary to act in our clients' long-term economic interests. We aim to be a supportive, long-term focused shareholder who takes the context in which a company operates into consideration and makes voting decisions to advance our clients' interests." [**Curtis Chou, Corporate Communications, Blackrock**]*

> *"Engagement enables us to assess a company's approach to material drivers of business risk and opportunity, which in turn helps inform our voting. [...] We understand that the energy transition presents different challenges and potential rates of change for companies across sectors. Our focus is therefore on engaging with companies regarding how they are managing the transition — and how they are factoring it into their long-term business plans and emissions reduction targets. As laid out in 2021, we are focusing our efforts where the transition is likely to most materially impact a company's performance. To that end, the BIS Climate Universe, which includes over 1,000 carbon-intensive public companies, represents nearly 90% of the global scope 1 and 2 GHG emissions of the companies in which BlackRock invests on behalf of our clients." [**Blackrock**]*

Engagement enables us to assess a company's approach to material drivers of business risk and opportunity, which in turn helps inform our voting.

Acknowledging the good intentions of the private sector and their desire to be good corporate citizens to tackle climate change, KPMG has questioned the responsibility of the private sector in the decarbonisation drive:

> *"Is it the private sector that needs to address that or is it the political sphere? Historically speaking, the private sector doesn't necessarily address these issues and instead cut their losses and leave. I do think that more and more companies want to be good corporate citizens, which is intensified by corporate citizenship forming a key part of stakeholder mentality. Corporations really want to thrive and survive and leave something behind which helps the area continue to flourish even after the business concludes its activity in the area." [**John Kjorstad — COO for KPMG Impact and Richard Threlfall — Global Head of Infrastructure, Government and Healthcare, KPMG**]*

KPMG has further pointed out the reasons for the lack of a dramatic improvement in the creation of renewable energy capacity which they believe is primarily due to a lack of robust regulatory push. KPMG highlighted the importance of having regulation in nudging the private sector to promote decarbonisation:

> *"There is an interesting interrelationship between innovation by business and a sense of social purpose and conscience which is coming through more and more strongly over the last years. There is a relationship between that, on one hand, and the willingness of government to turn regulatory screws to force the pace on the other. Why have we seen such a dramatic improvement in the creation of renewable generating capacity over the last 10 years? Well, predominantly we've seen it not because of the regulatory push but rather because of the colossal collapse in the price of both solar and wind energy which has been a consequence of a market that has just reached a scale at which it's been possible to drive the price down. Equally, I wouldn't set aside the importance of a*

INVESTOR UPDATE
MARKET INTELLIGENCE

> *regulatory driver both to help push consumer behaviour as well as to require business laggards to try and move themselves to the position of some of the world's business leaders in the space." [**KPMG**]*

Schroders has pointed out the various mechanisms that fund managers can utilise to influence the social impacts of low-carbon transitions:

> *"Fund managers can address the social impacts of the low carbon transition in three ways: invest, engage, and innovate. First, we can invest in the right companies or assets to put into our portfolio. Second, we can influence the companies we are already invested in through active ownership. This is increasingly critical to our ability to create value for our clients. And third, we can innovate by creating new products that direct capital to the areas that need the most support. And the word transition is key because to drive a transition you must be invested in something which is not there yet, but that you think you can help through your influence. The task for active owners is to sufficiently prioritise the importance companies place on how they will bring all their stakeholders on their transition journey." [**Rebecca Dwyer, Corporate Communications Content Lead, Schroders**]*

Shell has highlighted the difficulties that the private sector faces in addressing social factors due to the lack of uniform regulation:

> *"This whole approach is right. When it comes to social matters in ESG, I think we also need to recognise that it becomes very difficult to be a corporate. Fundamentally, the board and management have a role and obligation towards shareholders which is to create shareholder value, and it is clearly always within the boundary of the law — but now that boundary has been tightened further by "S." That is all good, but it is not regulated or uniform and is not identified, so what we experience is that what is good social behaviour for you may not be good social behaviour for others. This creates a lot of pressure on corporates." [**Andreas Bork, Investor Relations RDS, Shell**]*

In some cases, the private sector is compelled to take the lead in low carbon transition due to the lack of ambition and rigour of certain regulatory standards according to Standard Chartered:

> *"Regulation is low and always slower to react and that's why the private sector is taking the lead. We push the concept of interoperability on the regulatory front to try and find common grounds to speed up regulatory applications. I'm actually very impressed with how corporates are moving the agenda on sustainability especially on transition very quickly everywhere. For example, many commodity trading companies are the companies that, more than others, find the situation advantageous in terms of commodity pricing. Their business model hasn't changed but the velocity at which they're incorporating transition and then also their reconsiderations of the ways that their business model is set to change is incredible." [**Maria Lombardo, Head of ESG Advisory, Standard Chartered**]*

TotalEnergies highlighted that a long-term presence in a particular host country requires the consideration of local expectations and building a reputation of the company's operations in a positive light:

> *"A long-term presence in a host territory means building profitable and sustainable projects that create jobs and develop expertise. Beyond these direct and indirect*

There is an interesting interrelationship between innovation by business and a sense of social purpose and conscience which is coming through more and more strongly over the last years.

INVESTOR UPDATE
MARKET INTELLIGENCE

> *impacts, it also means providing ongoing training and upskilling, if necessary, when demand shifts. Lastly, a sustainable presence involves listening to local expectations and putting the Company's operations in a positive light through dialogue, responsible impact management and socio-economic development initiatives." [**Benoit Ribaud, ESG Investor Relations Manager, TotalEnergies**]*

Cowen Research has highlighted its efforts and commitments to tackling climate change and driving forward the effort to decarbonise:

> *"We are making a conscious effort to make financing available to middle market, unrated companies that have experienced challenges when trying to buy and implement carbon footprint reducing and efficiency increasing technologies." [**Armando Lopez, Managing Director Marketing, Cowen Research**]*

Similarly, AB InBev has highlighted its role and efforts to tackle climate change and drive decarbonisation efforts through its unique approach and disclosure framework:

> *"There is an important role for the private sector in driving decarbonisation efforts. At AB InBev, we focus on the critical topics most material to our stakeholders and that enable our commercial vision. In particular, we consider what is specific to beer and how we show up in the communities and societies where we operate. There are three guiding themes that we focus on: Inclusive, Natural and Local. This framework helps us in our approach to addressing the most pressing sustainability and social topics across our value chain. If you think about how we achieve our sustainability objectives, it's through our value chain. From the farmers who grow our crops to the small retailers who sell our products, it is very important for us to work together and address topics that impact them such as access to finance, digital tools and upskilling. Our company is based in nature with products made from simple ingredients. And with more than 500 local brands across nearly 50 operating countries, we are truly a global local company. Through this lens, we work to build thriving communities and healthy ecosystems, because their success is our success." [**Katie Hoard, Global VP ESG Strategy & Engagement, AB InBev**]*

2.0 The extent to which the physical climate risks are being integrated into companies' strategic planning

Most companies consider physical climate risk as an important risk factor and integrate it into companies' strategic planning. The effect of climate change on companies is said to play an important role in how companies react and integrate climate risk and resilience into their strategic planning, with companies directly affected reacting more strongly. Most companies highlighted their internal capabilities to assess and address physical climate risks, with some companies pointing out the disruption of climate change on their assets and regular operations. Few companies perceive the management of climate change as not just risk management but as an opportunity for strategic development.

The embryonic nature of physical climate risks demands for a comprehensive outlook on climate resilience matters to tackle various events and outcomes, which requires a lot of agility from companies. Evidence points out that approaches such as scenario analysis are an ideal way to deal with any unforeseen events:

> *"Physical climate risks and climate resilience are still evolving. Companies directly affected by climate change are the first ones to introduce mechanisms such as scenario analysis (for example companies in the energy or consumer goods sector), in their strategic planning. In general, mature companies in the sustainability agenda, beyond those ones directly affected, are also already integrated these risks into their strategic planning. Companies at the beginning of the journey are still understanding what this is about and how to start taking action (in this case, they can take some years to start to walk in this agenda)." [**B3**]*

Integrating physical climate risk has become a key part of the decision-making and stewardship activities of companies and investors. Invesco discussed how resilience, and specifically 'climate resilience', has become a core pillar of their ESG framework:

> *"Physical climate risk is included in our investment decision-making and stewardship activities, perhaps most clearly demonstrated through the real estate asset class. In Invesco Real Estates' ESG+R framework, 'R' stands for resilience and physical climate risks are evaluated at the portfolio and asset level. While our process for identifying and managing physical risks is the same globally, the actual physical risks themselves vary considerably by location. Therefore, our local teams' expertise is an important component of the analysis." [**Cathrine de Connick-Lopez, Global head of ESG, Invesco**]*

Companies directly affected by climate change are the first ones to introduce mechanisms such as scenario analysis, in their strategic planning.

KPMG has pointed out the quickly evolving nature of climate risks and the lack of specialist knowledge to keep up with the developments in the area. Combined with this, the absence of consistent methodologies has resulted in different approaches to tackling climate risk:

> *"It [climate risk] absolutely is intensifying. We have a climate risk team here in the UK which started off as a handful of people a few years ago and is now 150 people strong — this is a space which is growing faster than the amount of specialist capability available to address it, which of course creates risks in and of themselves. They cannot get more people into the team fast enough because the number of clients, particularly those who own large chunks of physical assets, is trying to understand the impact climate change will have on their portfolio. Increasingly, from an investor's point of view, it is going to be something that you're going to want to have a strong grip on when conducting your due diligence when acquiring assets. As long as the market can move to some consistency in terms of how these risks will be measured and how portfolios will be looked at then we will get somewhere more predictable. At the moment, however, the consistency of methodologies is fairly diverse and that is part of the competitive advantage which investors might want to address." [**KPMG**]*

The impact of climate risks is widely felt. National Grid described how asset destruction and operational interruption due to climate change has prompted them to act and install mechanisms and tools to address this risk:

> *"We are seeing the increasing frequency and intensity of storms, both in the UK and US, and are continuing to invest in storm hardening across the Group. We have also recently developed a geospatial climate change risk tool which affords us a long-term view of the impact of physical climate change hazards across our business. The tool models 9 different climate hazards (river and coastal flooding, high and low temperatures, compound weather events, lightning, and high winds) under the IPCC's Representative*

INVESTOR UPDATE
MARKET INTELLIGENCE

> *Concentration Pathway scenarios of RCP8.5 (4 degrees) and RCP4.5 (2 degrees)." [**Alexandra Bateman, Investor Relations Manager, National Grid**]*

Scenario analysis remains a common approach utilised by numerous companies to address physical climate risks and Oerlikon has pointed out that tackling physical climate risk is a part of risk management and strategic development:

> *"These are essentially opportunities for strategic developments, but it is also risk management. We are using that accounting tool to think about how we build that into our planning using things like carbon pricing and capital allocation and investigating ways in which we can do this. We are using the TCFD framework because it is very effective, and it is complimentary to the other things we do, and it provides that area for functions to be able to communicate together and then you are able to express it to the outer world in a consistent way that is understood. Many companies are using it as a reporting basis, but what is actually important is that inside the company you actually start to control it that way - you use it as a working tool, and you communicate and think in that way, and you incorporate it into the strategy of a committee does. So, what happens if we have a bit of global warming or water resources get scarce etc.? These are some scenarios that we run, and the outcomes will be built into the business, and I think that it is the same for a lot of companies." [**Peter Dickson, Senior Manager ESG & Investor Relations, Oerlikon**]*

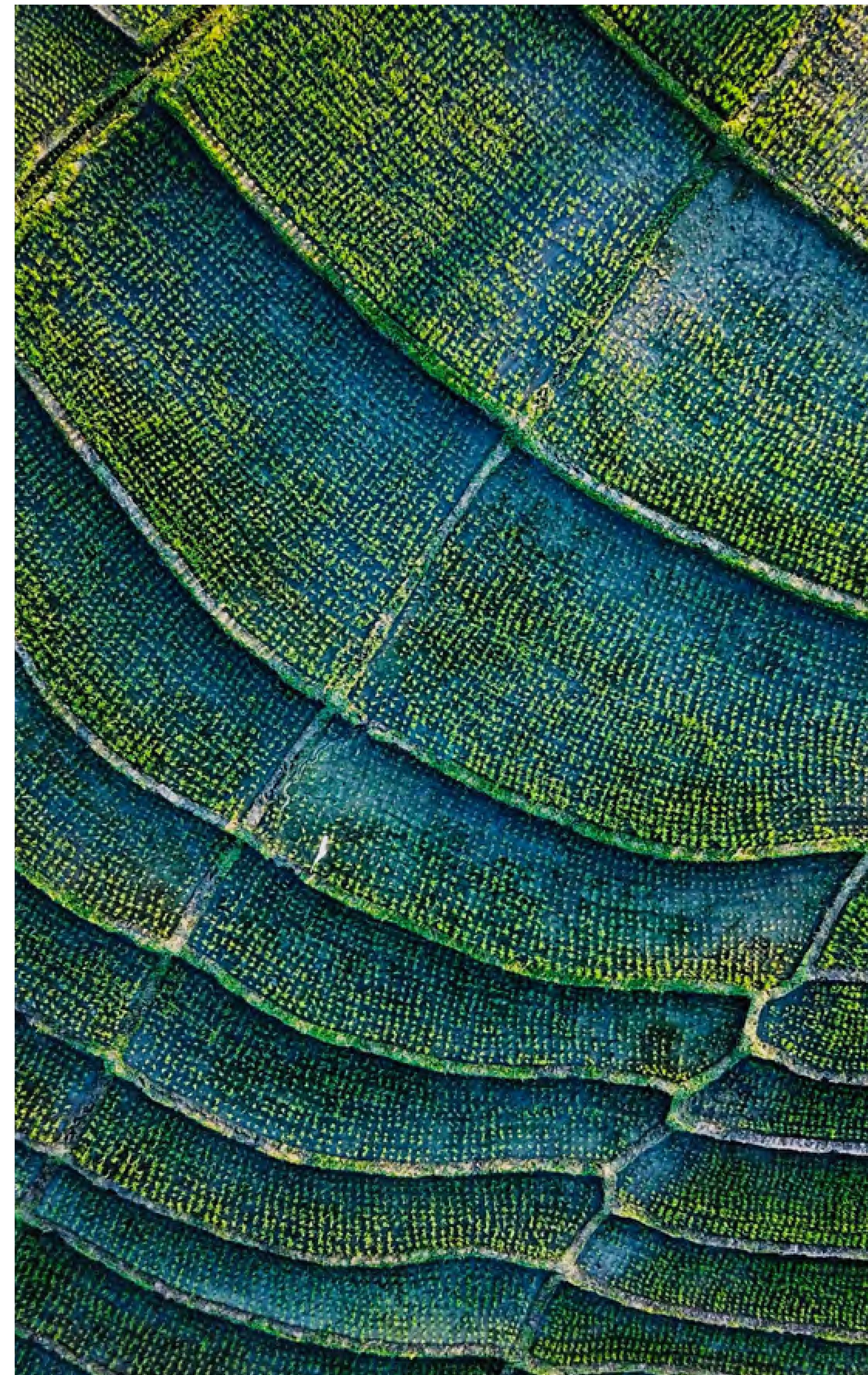
These are essentially opportunities for strategic developments, but it is also risk management.

Telefónica acknowledged the impact of climate change and has been integrating climate risks and scenario analysis approaches into their risk management system for some time:

> *"Risks associated with Climate Change were incorporated into our risk management system years ago. We analyse them in accordance with the recommendations of the TCFD (Task Force on Climate-related Financial Disclosures), covering both the physical risks and those arising from transitioning in the medium and long term, using projections of climate variables for two different CO2 concentration scenarios (RCP, the Representative Concentration Pathway). [...]. In contrast, in the RCP8.5 scenario ("business as usual") the major risks are physical risks, associated with changes to specific climate variables, whether these be temporary (increase in extreme weather events) or chronic (increase in temperature, variation in rainfall). The risk associated with the increase in temperature would entail a great financial impact, as it could increase electricity consumption from cooling our network equipment. In addition, this could be aggravated by the possible increase in the cost of electricity, mainly in countries which are highly reliant on hydropower, in the event of episodes of drought. Our business continuity, energy efficiency and renewable energy plans help us to cut exposure to these risks and adapt to the consequences of climate change." [**Catherine Bohill, ESG Development & Impact Director, Telefonica**]*

Blackrock predicts that climate risk will become a primary financial and audit consideration in the coming years and mentions various guidances that suggest the inclusion of climate risk when preparing financial statements.

> *"We anticipate that climate risk will become an increasingly important financial reporting and audit consideration, particularly at companies with carbon-intensive business models or that otherwise have a material exposure to climate risk. Guidance from each of the three leading organizations working on reporting standards (International*



INVESTOR UPDATE
MARKET INTELLIGENCE

> *Accounting Standards Board (IASB), the Financial Accounting Standards Board (FASB) and the International Audit and Assurance Standards Board (IAASB)) has been clear that under existing standards, companies should prepare to take material impacts of climate risk, including the impact of the energy transition, into consideration when preparing financial statements." [**Blackrock**]*

Betty Huber of L&W has noted the rapid pace of developments which in turn creates its own type of risk and further highlighted the changing expectations of regulators:

> *"The speed at which developments are taking place in this space creates its own type of risk which 100% implicates legal risks beyond simply the risk of potential litigation. ESG can be thought of as a predictive model due to it really seeking to look into the future. That's a real benefit but the associated risks derive from the fact that things can move so quickly that companies can struggle to keep up. There is an expectation on the regulatory side that companies are going to get out in front of ESG trends and developments, even as regulatory bodies do not necessarily hold themselves to that same expectation." [**Betty Huber, Global Co- Chair of ESG, L&W**].*

We anticipate that climate risk will become an increasingly important financial reporting and audit consideration.

The 'Representative Concentration Pathways' (RCP) are a range of scenarios for the possible trajectory of greenhouse gas concentration used by the IPCC, the Intergovernmental Panel on Climate Change. Walmart references the RCP 8.5 scenario in the context of modelling and mitigating climate-related risks. The researchers who developed RCP8.5 intended it to be a "very high baseline emission scenario" representing the 90th percentile of the no-policy baseline scenarios that were available at the time. While modelling potential worst-case outcomes has a value, the RCP 8.5 was not intended to represent a "business as usual" outcome:

> *"Such climate risks and potential impacts are not unique to Walmart; they will affect food and general merchandise retailers as well as other businesses and communities around the world. While the limitations of the analysis mean it cannot be used to predict the net impact on Walmart's financial results of operations or business operations, and the improbable nature of the RCP 8.5 scenario means it cannot be used to determine the materiality of climate-related risks and opportunities to the business, it nevertheless provides helpful insights into the relative impact of various climate effects and the relevance of Walmart's mitigation and adaptation strategies. And while no single climate risk appears to be consequential for Walmart due to the long-term nature of the risks and Walmart's relatively large scale, taken together, they paint a sobering picture of the potential impact on people and the planet and underscore the need for immediate business action to help prevent the worst effects of climate change." [**Stephanie Schiller Wissink, SVP and Head of Investor Relations, Walmart**]*

3.0 The value of the UN SDGs as a tool in facilitating the private sector commitment to the Just Transition

The United Nations Sustainable Development Goals (SDGs) provide a framework for ensuring a more sustainable future for people and the planet across society, the economy and the natural world. These set the agenda for sustainable development to 2030. UN SDGs create a common set of standards and language for communication which, in turn, prompts a coherent action towards a common goal. SDGs are a valuable framework for companies to link their sustainability efforts with the priorities of the broader world. Many experts believe that the SDGs are a good starting point for companies which are unsure about where to focus their ESG actions and help to create awareness around ESG. In short, the SDGs provide a road map for a sustainable future. Many interviewees highlighted that the SDGs help to amplify the ESG narratives while some have pointed out that it can be a box-ticking exercise.

Oatly revealed their mixed feelings about the UN SDGs, expressing optimism about the SDGs being a valuable tool but questioning its relevance due to their ostensively macro nature:

> *"I think that the UN SDGs are a valuable tool for companies to link their sustainability and their ESG actions with the priorities of the broader world. However, I also think that their broad macro-level nature results in them not being particularly useful for more specific issues, like the Just Transition, because the UN SDGs don't provide a playbook for each of the goals." [**Ashley Allen, Chief Sustainability Officer, Oatly**]*

Their broad macro-level nature results in them not being particularly useful for more specific issues, like the Just Transition.

Shell expressed their cautious optimism regarding SDGs pointing out that even though it helps build awareness around ESG, it is easy to selectively prioritise without making any efforts to improve on weaknesses:

> *"I think it is a "Is the glass half full or half empty?" situation. The glass-half-full component is that it has been enormously helpful to create awareness around ESG and social aspects. Many companies have embraced it and I imagine all companies have at least looked at it, including us. From the half-empty perspective, they are not intended for companies, and it is too easy to pick three or four where you make a difference and ignore the rest where you may have issues." [**Shell**]*

UN SDGs have become an industry norm to amplify ESG narratives and awareness according to Oerlikon:

> *"Essentially, one is forced to do this because everybody does it. Everybody sits back and asks, 'How does my materiality fit into the 17 sustainability development goals and how does this piece of materiality fit into each category?'. Essentially, it's like a blunt tool and in my opinion, what it's really about is the amplification of the awareness. We see things like SASB or specific GRI pieces or even if it works the taxonomy as being areas which are more adept at being able to make a difference." [**Oerlikon**]*

Oerlikon further mentions the lack of a need to cover all the 17 UN SDGs and has called for a more simplified approach to SDGs and ESG:

> *"The thing with SDG labelling is that I don't necessarily have to cover all 17 to be effective at sustainability. I think that the real value of it is that at some level we still need a way*

INVESTOR UPDATE
MARKET INTELLIGENCE

> *to simplify the whole space in a way that anyone can understand it, as not everybody can have a PhD or an industry specialism in sustainability. The SDGs have a simplicity that makes it easy to communicate even though the reality is horrendously complex." [**Oerlikon**]*

In this topic, the perspective of charities is an important counter-balance to the priorities of corporates with one believing that the UN SDGs help reflect the sophisticated narratives in their ESG disclosure to complement the work of their corporate partners:

> *"Charities are so focused on their own positive impacts that they do not analyse where their negative impacts are. Even though a lot of organisations use UN SDGs as a tick box exercise, there are still a lot of merits in using UN SDGs. I would prefer an approach where organisation highlight SDGs based on their level of impact (high impact/low impact). Alignment to SDGs is also driven by the interests of corporate partners where they expect their charity partners to reflect the sophisticated language in their disclosure and complement the work of corporate partners." [**UK Charity**]*

The UN SDGs describe global sustainability priorities which are useful for aligning how people describe what they're doing and help create consistency around reporting and measurement.

Telefonica has reiterated its commitment to UN SDGs and has highlighted that they utilise UN SDGs on a regular basis to demonstrate its accomplishments:

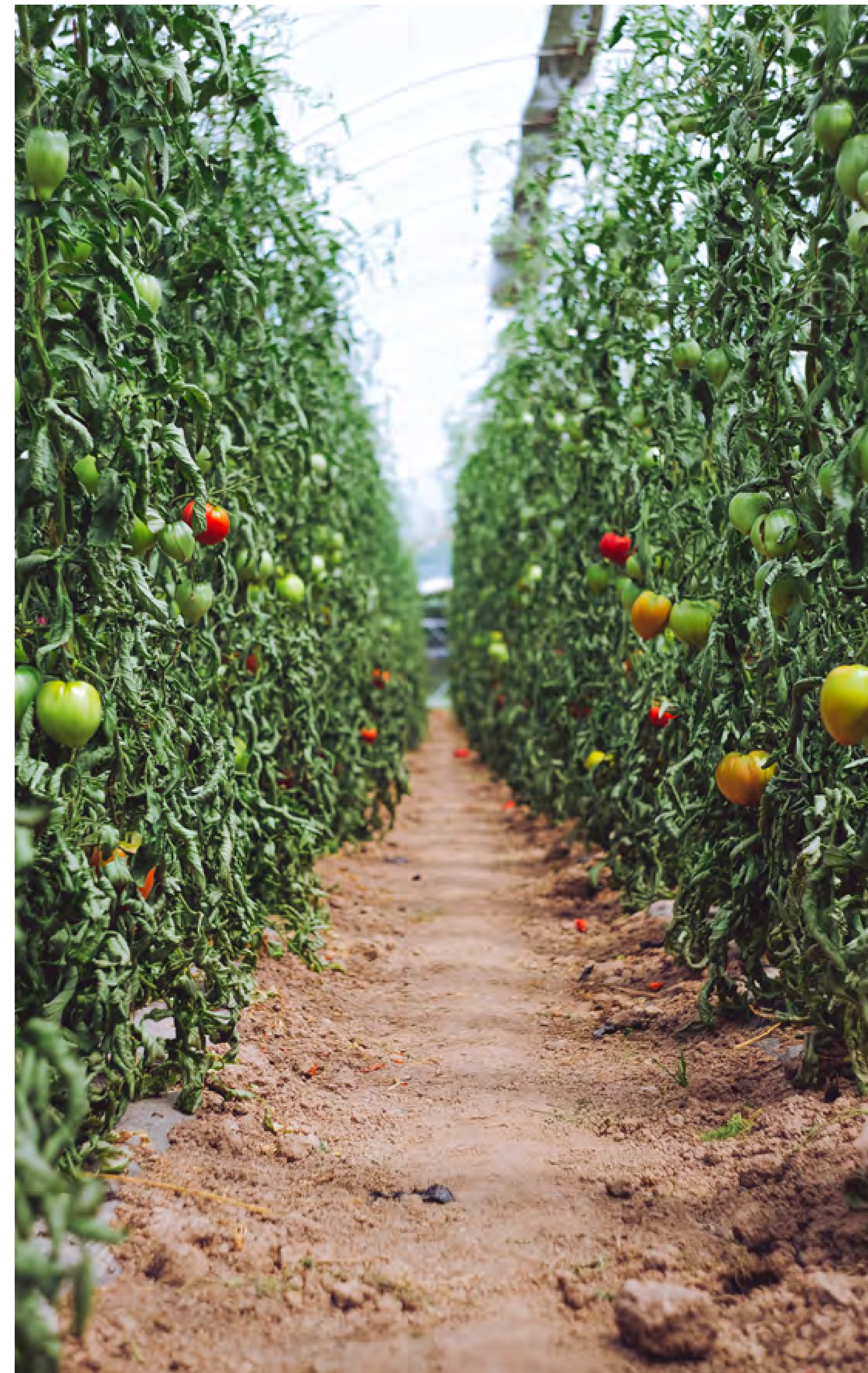
> *"At Telefónica, we use the Sustainable Development Goals (SDGs) defined in the UN's 2030 Agenda as a strategic framework for our commitment to society and environmental protection, and as a base for analysing and evaluating our contribution to socio-economic development. Every quarter we report our SDG alignment by exemplifying projects, initiatives and accomplishments realized during the period." [**Telefonica**]*

Acknowledging the pivotal role, the UN SDGs play in assisting the transition, companies are expected to disclose material SDG considerations and their actions to address them according to B3:

> *"The UN SDGs are an important tool to help the private sector to foment this transition. It is absolutely clear that companies must take action considering all material SDGs to their businesses (this should appear during the company materiality analysis, for example). If we look closely at the 2021 results of B3's Corporate Sustainability Index (ISE B3) there are some questions related to UN SDGs and environmental practices, seeking to disclose to the market how companies are working at all the material SDGs (considering their materiality analysis) and if they are not taking action, they must explain why and ticking the questionnaire options to show this." [**B3**]*

According to Schroders, the SDGs help create consistency around reporting and measurement which creates a common ground for all the players in ESG. They further mentioned that they utilise SDGs as a framework to inform and describe their product strategy:

> *"The UN SDGs describe global sustainability priorities which are useful for aligning how people describe what they're doing and help create consistency around reporting and measurement. One of the ways that we have used the SDGs as a framework is to inform and describe our product strategy. For example, our climate mitigation portfolios have specific objectives to contribute to environmental solutions and connect to SDG 7 (Affordable and Clean Energy) and, to some extent, SDG 13 (Climate Action)." [**Schroders**]*



Standard Chartered highlighted the primary purpose of the creation of the UN SDGs which is to divert capital to emerging markets and create measurable impact:

> *"When you look at the SDGs from a corporate point of view, they are very easy and relatable labels but when you use them from a bank perspective, they take on their own meaning. They were created because the UN wanted $30 trillion to go into alleviating those 17 points, especially in emerging economies, by 2030. This quantification of how much money is really going into this alleviation, which itself is a quantified measure of impact, means that from the bank's perspective we have an impact framework. Standard Chartered has launched two bond products based on financing for the SDGs and we measure this impact across the different SDGs." [**Standard Chartered**]*

There needs to be further policy support from federal, state and local government entities enabling those from disadvantaged or under-represented groups to be involved in achieving net zero.

4.0 How regulation increases awareness and action in Just Transition considerations by the private sector

There is a widespread consensus regarding the important role regulators play in encouraging positive ESG behaviours and actions. Many interviewees have pointed out that the everchanging nature of public policy and regulation has a critical role to ensure there is an equilibrium between demand and supply, while some have mentioned the lack of standardised regulation on a global scale. The lack of a cohesive global regulatory system coupled with inadequate support from the federal, state and local governments to disadvantaged groups makes it difficult to accelerate Just Transition considerations. The best way to accelerate Just Transition considerations in the private sector is through an effective public-private partnership that is based on inclusive, transparent and cohesive regulation that is market responsive.

The need for regulation to be broad and inclusive is highlighted to not specifically emphasise the climate transition but also include various facets of ESG:

> *"We need to avoid the risk that we focus on climate transition to the exclusion of all else. The easiest way of resolving that is to ensure that sustainable investment policy and regulation remain broad and inclusive of the whole spectrum of E, S and G topics. Regulators play a very important role in encouraging specific behaviours and actions, otherwise there is a danger that we, and our economies, suffer from carbon tunnel vision, concentrating on reducing carbon emissions without considering the many other sustainability challenges facing economies and industries, such as natural capital depletion, overconsumption or inequality." [**Schroders**]*

The role of the regulator is to create an environment of transparency, accountability and consistency and to establish a starting point where the transition is facilitated in an efficient and transparent manner:

> *"The stakeholders are the politicians that get up in Glasgow COP 26 and say that they're making these promises and that the regulators will do what they tell them to do and then the regulators find a way to put that into practice. The main issue with the regulators is establishing at which point you start to throw laws and fines at everybody and knowing whether it is an efficient facilitator for the framework of transparency of action that can create an efficient market-based response. For me, the regulator's role was always about stopping the other competition on one side but on the other side actually creating an environment in which people can succeed and can meet objectives by being a facilitator and by bringing companies together to manage a transition of a client." [**Oerlikon**]*

National Grid suggested increased support from the public sector and its institutions to enable certain communities to realise net zero goals:

> *"We believe there needs to be further policy support from federal, state and local government entities enabling those from disadvantaged or underrepresented groups to be involved in achieving net zero, both now and longer term. Policies need to support affordability, equity, and access to low-carbon, energy-efficient (and therefore lower running cost) solutions. For example, in the US, we support the plans laid out in the Infrastructure Investment and Jobs Act and the Inflation Reduction Act to defend vulnerable communities to ensure no one is left behind in the energy transition. We see these as positive steps and look forward to working with our states and communities on implementing the forthcoming guidance and regulations." [**National Grid**]*

There is also a widespread interest in and appetite for a more uniform regulation globally with a uniform and transparent approach:

From a business perspective, there is a strong demand for the regulatory position to be as consistent as possible globally.

> *"From a business perspective, there is a strong demand for the regulatory position to be as consistent as possible globally. KPMG has been very clear with its clients that a good outcome in terms of ESG disclosure regulations is best enabled by a single cohesive system — we think it's only going to create cost and confusion for businesses as well as less transparency for customers and regulators if we end up for different systems for disclosure in different regions of the world." [**KPMG**]*

Blackrock acknowledged the critical role that public policy plays in shaping and realising net zero goals. They have also called for regulation to strive and achieve equilibrium in their approach:

> *"Public policy and regulation, while constantly evolving, will play a critical role in an orderly transition. A range of stakeholders, including policymakers and consumers, have a role to play to ensure a better equilibrium between supply and demand, given the global economy's current dependence on traditional energy sources and the parallel need to invest in cleaner energy alternatives and other technologies." [**BlackRock**]*

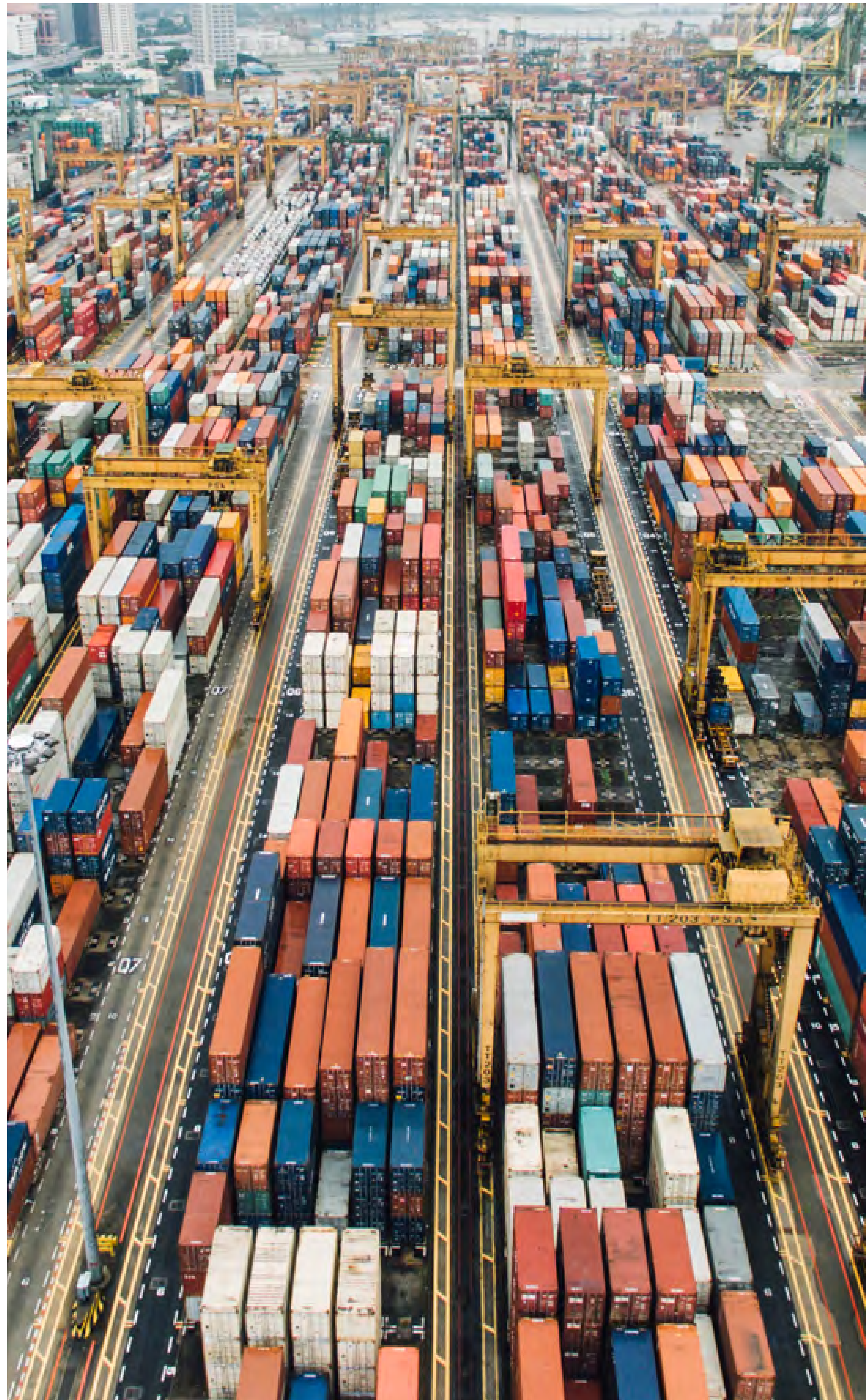
Capital Group believes the best way to tackle greenwashing is through better regulatory procedures and prefers to have a minimum regulatory standard in this regard:

> *"More than four in 10 (42%) investors think that better regulatory enforcement is one of the best ways to tackle greenwashing, with this figure rising to 48% of Asia-Pacific investors. The same percentage of global investors (42%) think setting minimum regulatory standards for investment products and services would help tackle greenwashing."[54] [**Jessica Ground, Global Head of ESG, Capital Group**]*

M&G has mentioned about lack of an industry standard on regulation. They pointed out that there is a lack of regulatory standards in the US and have also mentioned optimism in the EU in this regard:

54 https://www.capitalgroup.com/content/dam/cgc/tenants/eacg/esg/global-study/esg-global-study-2022-full-report(en).pdf

INVESTOR UPDATE
MARKET INTELLIGENCE



> *"I think that the EU taxonomy will be a game changer and that the US is miles away from this. We've now got the ISSB, which is the first attempt at creating some standardisation for reporting on ESG-related issues and when this is implemented, we'll have proper standards that businesses can comply with and which ensure the 'Big Four' [governance, planet, people and prosperity] is prioritised. There are currently so many different frameworks to report under (GRI, IRC, etc.) that it becomes very confusing. Some of the industry leaders are having to report under all these frameworks, which means they end up producing a 500-page document." [**Rupert Krefting, Head of Corporate Finance and Stewardship, M&G**]*

Oatly has pointed out that regulation is only needed in areas where it is vital to ensure the health and well-being of people. They suggest the utilization of nudges, guidances and incentives in areas where regulation is not necessary:

> *"There are definitely areas where regulation makes sense and where there are regulatory gaps that ought to be filled, especially on things that are harmful to the health and well-being of people. There are going to be places where regulation is absolutely needed, but there are other places where this work can be done through guidance or guidelines or incentives. There are a lot of policy and economic tools that can get us where we need to go, and we most definitely need a portfolio of all of them. Companies can probably play a role in the development and implementation of all these different tools as well." [**Oatly**]*

Some charities have highlighted that due to the leanness of profits and financial circumstances, charities may fail to keep any further legislation. However, they acknowledge that having regulation will help charities understand the baseline for ESG:

> *"I think standards help us understand what good looks like, so I would say regulation can give a good baseline for what you should be doing. However, the leanness of profits and the financial circumstances in which charities operate cannot keep up with more legislation in this area. Henceforth, voluntary initiatives by charities in this regard are more helpful." [**UK Charity**]*

Standards help us understand what good looks like, so I would say regulation can give a good baseline for what you should be doing.

5.0 Understanding, Awareness and Concern about the causes and consequences of the Just Transition

As the devastating impact of climate change is widely felt across the world, the concept of Just Transition came into prominence to understand and ascertain the levels of consequences of climate change felt by different social groups. It is undeniable that certain social groups are disproportionately affected by the devastating consequences of climate change and henceforth a systematic structural change that focuses on taking together all the sections of society in achieving the goals of decarbonisation and transition into net zero is vital. Overall, most companies have stated that Just Transition is an important consideration for their business operations, however, the drivers for prompting companies to consider Just Transition are diverse and varied ranging from regulation to investor pressure.

The level of awareness tends to diverge based on the type of business operations, with corporates having much higher awareness regarding issues related to the Just Transition

INVESTOR UPDATE
MARKET INTELLIGENCE

than that of charities. Some have argued that the level of awareness and recognition of Just Transition issues is directly proportional to the amount of impact experienced due to climate change by a certain social group. Many regard training employees and addressing supply chain issues as two fundamental action points that help address Just Transition issues.

The concept of the Just Transition is evolving and many companies are striving to integrate the "just" component into their transition effort. Standard Chartered has made the Just Transition a strategic priority and is shaping the way its business is done:

> *"It is a topic which is getting much more understanding but what I think is difficult to understand is how to implement the transition with the "Just" attached to it. At Standard Chartered, supporting a Just Transition is a strategic priority for us. Sustainability is our strategic priority and Just Transition is what drives us because of our footprint. We work across emerging, low-income economies in which the priority is economic development and if we are enabling transition, it, therefore, needs to support economic growth, and a Just Transition is an essential component to this. This means that every single company we advise and work with on transition and finance their transition, we need to make sure that there is a 'just' component." [**Standard Chartered**]*

Sanofi has suggested that local regulation directly contributes to companies' consideration of the Just Transition and how to achieve it:

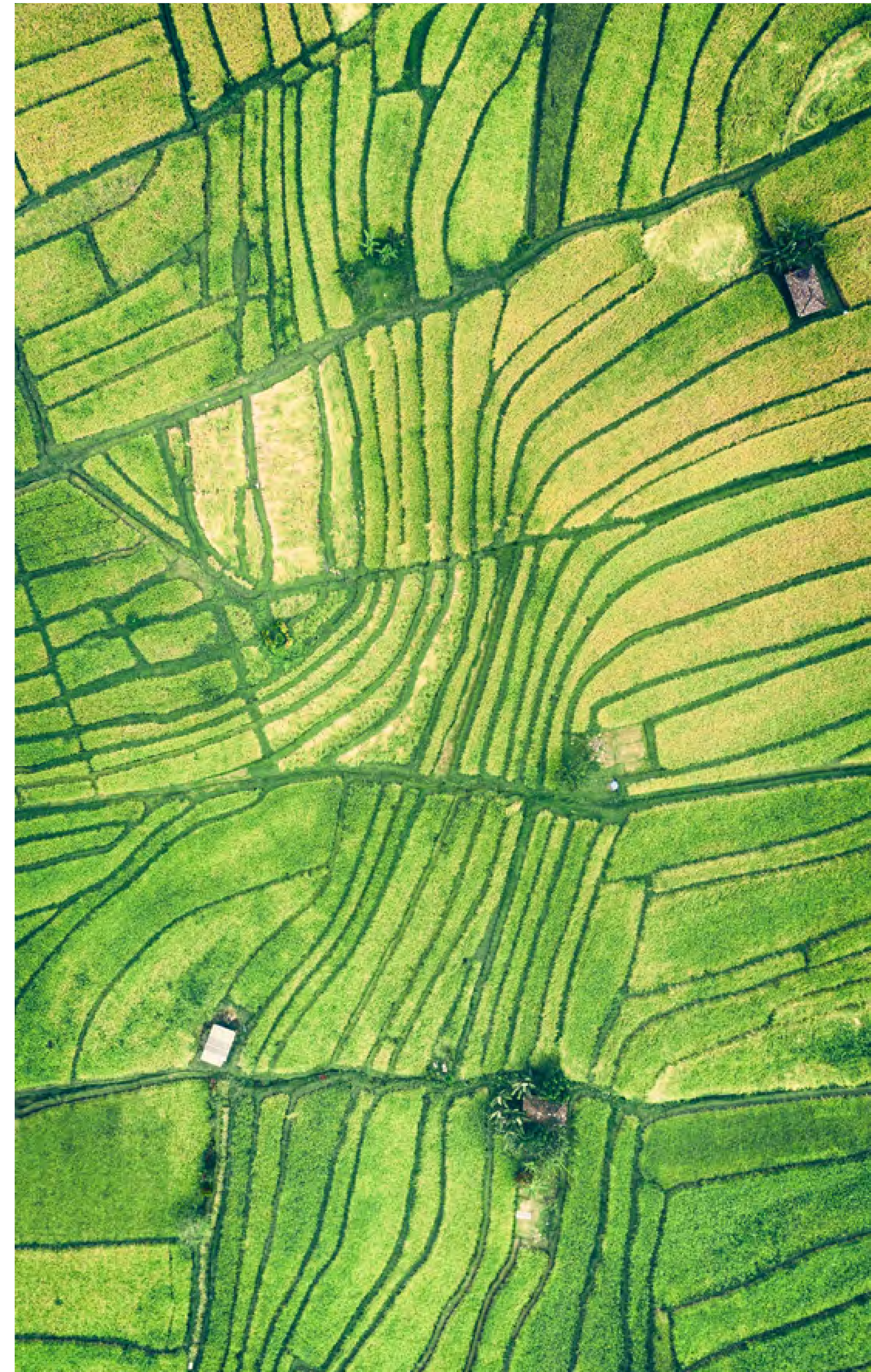
> *"As we are a French company, we are obliged by a specific French regulation since 2017, called duty of vigilance. This requires us to come up with a public vigilance plan, showing how we address human rights, environment, and health and safety impacts on third parties — on ourselves and our worldwide supply chain. Since 2017 this has been included in our Annual Report, and this vigilance plan addresses the impact part of the double materiality." [**Corentine Driancourt, Investor Relations, Sanofi**]*

M&G has suggested that the Just Transition is important to them and while it is not yet embedded into their systems, they tend to deal with Just Transition issues on a case-by-case basis:

> *"The whole 'just' side of the transition is very important, and we have begun to think about it and discuss it with investee companies, but I wouldn't say that it is embedded in everything that we do, though, because it's not necessarily relevant in every situation. We've had discussions with Volkswagen, for example, where the company has highlighted its plans for every employee over the next decade, in terms of transitioning away from combustion engines to electric. The big thing that we're concentrating on is coal power plants, but you have to deal with it case by case." [**M&G**]*

Acknowledging the importance of the Just Transition, Invesco has started conducting benchmark assessments to develop roadmaps and policy frameworks to address the immediate issues around the topics of Just Transition:

> *"The level of awareness around Just Transition issues is increasing within the investor community. For the first time in 2022, Climate Action 100+ integrated a Just Transition indicator into their Net Zero Company benchmark ("Benchmark") assessments which call for companies to collaborate with relevant stakeholders to develop a Just Transition*



INVESTOR UPDATE
MARKET INTELLIGENCE

> *plan or policy. The most immediate issue around the Just Transition is how to reskill and train the current employee base of companies as they transition to low carbon. The second issue is within supply chains. At Invesco, we've engaged with companies on both topics." [**Invesco**]*

Investor interest in the Just Transition has intensified and this has been mirrored by an increase in the integration of ESG into the investment processes of the active investor community. This strong interest from investors translates into engagement and influencing activities of investee companies:

> *"The strong bias towards active strategies when investing in ESG is (again) noticeable this year. Nearly two-thirds (63%) of global investors prefer active funds to integrate ESG. This demonstrates how investors want active managers to identify and manage ESG opportunities and risks through bottom-up security selection and fundamental analysis. It also shows how investors see active ownership as key to engaging with and influencing the activities of, investee companies." [**Capital Group**]*

The level of awareness of the Just Transition differs from the nature of business with charities having a very low level of awareness on ESG matters:

> *"The level of ESG knowledge maturity is very low among charities compared to corporates. ESG is seen from a very basic lens such as recycling. Charities still fail to acknowledge the various benefits to the business from ESG whereas corporates have gone through this process of realisation of the importance of ESG through their research and business practice a long time ago." [**UK Charity**]*

The awareness and recognition of Just Transition matters tend to be higher among social groups who are disproportionately affected by climate change mostly residing in developing countries. The government plays an important role in forging a path forward to address social issues and ensure that no social group is left behind in the transition journey:

> *"There are lots of different perspectives on this—you can think about the social impacts of climate change itself as it advances and how it's disproportionately affecting developing countries. The necessary pace at which we need to move may cause a significant disruption of markets and institutions and such institutions might not be socially ready from a social perspective. I think there is much more recognition that they are quite interlinked. If you speak to some people who have been environmental justice activists, they'll say that this has been obvious for ages, but I think that it is something that we are starting to recognise more clearly on a larger scale. I think when it comes to social issues, it is very clear that there is a role for government as well as the businesses in forging a path forwards." [**Elizabeth Chiweshenga, Senior Sustainability Analyst, Abrdn**]*

A fair transition means that no one is left behind as the world transitions to a clean energy future… everyone should share in the benefits of the clean energy future.

Shell has also highlighted that the lack of visibility around the consequences of the Just Transition is a material challenge in achieving it:

> *"The challenge with the Just Transition is that its consequences are not yet visible. When you compare it to the negativities around climate change like extreme weather and storms, I think we can say yes, we have started to see the impact. We have started to see people getting into trouble because of it, but I'm not really*

INVESTOR UPDATE
MARKET INTELLIGENCE

> *sure we have seen massive consequences yet for the Just Transition, in terms of social consequences for the labour force or even big geographical investment movements." [**Shell**]*

National Grid pointed out the subjective nature of Just Transition and has highlighted their understanding of what it means to achieve a Just Transition:

> *"In the energy sector, there is a growing awareness of Just Transition issues, with a few companies publishing strategies in this field. National Grid is committed to leading a fair transition in the areas we control, as well as advocating for change in the areas we do not. There is no universally agreed definition of a fair transition, and it has many different names (e.g., Just Transition, climate justice, environmental justice). For us, a fair transition means that no one is left behind as the world transitions to a clean energy future. No matter who or where you are, your income or background, everyone should share in the benefits of the clean energy future: access to clean energy, health, job opportunities and economic development. There has been progress on this issue in both the UK and the US, but there is still a long road ahead. The world must accelerate pace and scale to net zero to ensure the worst effects of climate change are not felt." [**National Grid**]*

The pandemic put the human element into the spotlight. Prior to the pandemic, the conversation with investors was primarily focused on climate.

Sarah Fortt of Latham & Watkins (L&W) talked about the climate crisis in general and specifically the Just Transition and how it should be considered a legal risk:

> *"The reality is that a Just Transition is a series of questions about how we should treat each other as human beings, given the limited resources we have. Given that we are facing the early stages of a serious climate crisis that will impact human health and our ability to access goods and services, we must look at these issues through the lenses of legal as well as other types of risk. The key question is, 'How does one define a legal risk?'. I would say that this definition has broadened from just litigation risks and asking 'Okay, am I going to get sued?', but also now includes financial and reputational risks. If we adopt this broad definition then the legal risks surrounding ESG are clearly prominent in minds of our clients because they are seeking to protect their financials, their reputation, and ensure they are viewed positively by their stakeholders." [**Sarah Fortt, Global Co-chair of ESG, L&W**]*

Crossflow Payments highlighted that all their customers focus on ESG and sustainability issues and further mentions that Crossflow incentivises and rewards corporates who take their ESG commitments seriously:

> *"All our corporates are ESG driven. Many have their own set of ESG values alongside that of their key investors which dictate the ethical KPIs applied. Some corporates have been called out by investors as being too ethical in their ESG values often driven by consumers that have led to the corporate making less margin due to the cost of such a programme. Others have been called out for Greenwashing, where paying lip service to ESG values has led to regulatory investigation of the Corporate. Almost everyone now has an ESG & Sustainability team on board using software and data systems to measure their KPIs. Crossflow plays its part by offering mechanisms that can reward suppliers who take their ESG commitments seriously by offering staged and cheaper finance to suppliers assisting them to make the investments needed to align with Corporate and*

*investor values. This reflects the reality that there is no point in asking a supplier to make an investment in anti-pollution equipment if they don't have working capital to them." [**Kevin Hayden, Commercial Director, Crossflow Payments**]*

AB InBev highlighted the important role that the pandemic played in putting the social and human elements into the spotlight:

*"The pandemic put the human element into the spotlight. Prior to the pandemic, the conversation with investors was primarily focused on climate. However, we since have witnessed that social topics have become a more central part of our conversations with the investors. People are realising that environment and social are inter-connected and are no longer settling for a siloed approach." [**AB InBev**]*

The problem is that CEOs are delegating responsibility for ESG to others while it should be driven by CEOs themselves.

6.0 How investor pressure is accelerating the understanding of and response to physical climate risk exposures

As climate change presents new business threats, it also poses significant operational and financial challenges for companies and investors. Most interviewees recognise that there is a growing investor expectation and pressure on investee companies to act upon the physical climate risk exposures. Investors have pointed out that there are certain minimum standards that companies must fulfil without fail to continue having engagement. Many interviewees highlighted their aims and processes in place to promote positive change and support long-term sustainable outcomes. Some interviewees have also pointed out the importance of dissociating ESG efforts from public relations and marketing departments to mitigate the risks of overtly corporate speech and presentation. The responses from the interviews conducted confirmed an increased awareness of the growing threat and an accelerated interest in addressing and mitigating physical climate risks.

UBS mentions the problems of delaying ESG efforts to others and has called for the top management and the CEO to take responsibility for their ESG:

*"The problem is that CEOs are delegating responsibility for ESG to others while it should be driven by CEOs themselves. This is a topic which must emanate from the top - there is no debate or discussion about it. They cannot delegate it to IR, PR, CFOs or Chief Sustainability Officers — but I'm pretty sure they typically do so at this juncture. It has to change." [**Laurent Bouvier, Managing Director, Global Head of ESG Advisory in Global Banking, UBS**]*

Schroders highlighted the influential role they play in determining a path for sustainable future growth. They highlighted the various themes of engagement that will enable a transition inclusive of all the stakeholders:

*"The most important role that we can play, and the most significant exposure that we have, is through the investments that we're managing. As an active investor, we need to use a broad sustainability lens when we're engaging with companies. Our analytical tools look at many different areas and our Engagement Blueprint covers six themes, of which climate change is just one. So, we are not asking companies to commit to emission reductions in isolation. We are asking them to do that, but also to tell us how they're going to get there and what other impacts they will have. We want to ensure that that transition is sustainable and rewarding for all stakeholders." [**Schroders**]*

Oatly acknowledged the growing investor pressure, but questioned the way in which the information is used and interpreted:

*"There is a growing level of investor expectation and pressure now about ensuring the transition is just. Currently, it feels like there is a helpful level of asking questions, requesting more information, and expecting better reporting on some of these issues. I do expect that pressure to increase, and I think the challenge will then be finding the right balance between what investors want to know, but also being clear about the value that addressing these issues brings to companies. But I don't think that investors are recognising the value of such work in a systemic way; rather it is happening in a much more informational way." [**Oatly**]*

Oatly further highlighted the constraints of having a broad scope and definition of ESG. Oatly suggested having a more specific definition of ESG, focusing on important issues for the investor community:

The most important role that we can play, and the most significant exposure that we have, is through the investments that we're managing.

*"The current investor-side scope and definition of ESG is too broad to be helpful. I think that we need to refine the focus of ESG by asking 'What is important to the investor community and why?', and 'What is important and why is it different depending on the sector you're in or the type of company you are?'. What's not helpful about the current scenario is the lack of clarity about why ESG issues are important to the investor community. There's a lot of effort, a lot of resources, and a lot of work put into these very big and broad disclosures, and not a lot of return for companies that equates to the level of effort they've put in." [**Oatly**]*

Sarah Fortt from L&W has pointed out the risks of integrating ESG efforts into marketing and public relations campaign efforts, which can have dire consequences for companies:

*"One common issue is that because for many companies their ESG efforts have 'grown up' in PR, IR or marketing departments, these efforts may not be fully visible or have full operational credulity in the eyes of those charged with the company's financial reporting, risk reporting, and strategic, and legal functions. Very often, therefore, it comes from a place of innocence: it comes from a desire to be responsive to stakeholders, to say and do the right thing, but perhaps not understanding the full scope of the potential risks associated with corporate speech, and companies can get caught up in that." [**Sarah Fortt, Global Co-chair of ESG practice, L&W**]*

Investors utilise various assessment techniques to determine the type of engagement with the investee companies. HSBC Asset Management has pointed out various important factors that they take into consideration in their engagement with their companies:

"Our stewardship aims to improve the risk-adjusted return of investment through positive change outcomes. We engage with a range of stakeholders in society to support better long-term sustainable outcomes for the investors we serve. We critically analyse companies through three key lenses (growth, risk and disclosure) that cover material and

INVESTOR UPDATE
MARKET INTELLIGENCE

> *salient environmental, social and governance issues. We engage with policymakers and standard setters to support the integrity of the market and share industry best practices. We set stretching targets for board diversity in key markets. In addition to gender and ethnic diversity at the board level, we engage with companies on improving diversity throughout the organisation, from the executive team to the way hiring is conducted at the entry-level. We engage with investee companies to better understand and support their disclosure and management of the risks and opportunities presented by climate change and climate policy. We engage directly and collaboratively, using our voting decisions to escalate issues where appropriate." [**Richard J Oconnor, Global Head of Investor Relations, HSBC Asset Management**]*

The current investor-side scope and definition of ESG is too broad to be helpful. We need to refine the focus of ESG by asking 'What is important to the investor community and why?

One contributing Charity highlighted that due to the nature of their operations as a charity, they are usually insulated from external pressures, but the groundswell of employees can influence opinion and is capable of driving significant change within the organisation:

> *"I think our organisation is insulated from external pressure. We don't have ESG standards mainly due to the sector that we operate in. We have over 4000 employees, but we operate as an SME where you are sort of insulated from direct investment questions on this. The ground swell of employees drove the issue internally." [**UK Charity**]*

M&G mentions the importance of having a transition plan in case satisfactory expectations are not met:

> *"If a coal mining or coal-fired utility company cannot satisfy our expectations, and they don't have a transition plan, then they would be excluded. However, divesting alone is not going to help the world. We need to use our influence positively to try and accelerate the transition in a just manner. We have the ability to create exceptions in some instances, but you've got to draw the line somewhere. I think that companies now realise they have a social duty, as well as everything else. The transition is the priority, but once companies embark on this journey, the inevitable question arises: 'What is this journey going to look like?'. " [**M&G**]*

TotalEnergies highlights the urgency to respond to the climate crisis and has mentioned its efforts to tackle the climate crisis:

> *"The urgency of the climate crisis is speeding the development of alternatives to fossil energies. Steps must be taken to manage the risk to biodiversity stemming from the development of renewables and biomass. The Company pays special attention to protecting marine habitats, notably for offshore wind projects, as well as terrestrial habitats for renewable and bioenergy projects. These issues are integrated into its investment criteria." [**TotalEnergies**]*

INVESTOR UPDATE
MARKET INTELLIGENCE

7.0 The Just Transition: Protecting Human Rights in Complex Supply Chains

The establishment of strong, efficient, and robust supply chains is essential in the transition to a carbon-free economy, as has been demonstrated in reverse by the recent increase in demand for fossil fuels following Russia's unjust invasion of Ukraine. To ensure though that the transition toward a net-zero world is just, it must be guaranteed that human rights are safeguarded throughout every step of companies' supply chains. Such risks to human rights include, but are not limited to, ethical sourcing, labour rights, and modern slavery.

The discussions with the interviewees illuminated their unilateral commitment to ensuring the enshrinement of human rights, through all levels of their supply chains, due to the evident moral, commercial, and financial imperatives. There are, however, multiple challenges facing companies, investors, and banks in their endeavour to do so, with interviewees highlighting issues stemming from a lack of transparency, a lack of access to the deeper layers of their supply chains, and an asymmetry of approaches and information. In spite of these obstacles, all interviewees underlined that they employ and utilise various tools and measures that exist to help in exposing human rights violations throughout their supply chains and eradicating such injustices where they arise. These include the publishing of transparent disclosures, calling CEOs and executives to task, implementing comprehensive audits and screening procedures, as well as providing financing to companies to enable them to address such concerns.

Human rights controversies pose both business and reputational risks to companies.

In addition to the various moral and ethical obligations to protect human rights risks in supply chains, it was also emphasized that various other motivators exist, including increased scrutiny of businesses:

> *"In a highly interconnected global economy, companies face increasing scrutiny regarding how they address human rights issues that may arise from their business practices." [**BlackRock**]"*

Failure to address such concerns in proper ways was stated to have damaging effects, as reflected by the following thoughts, from Invesco and Oerlikon:

> *"Human rights controversies pose both business and reputational risks to companies." [**Invesco**]*

And Oerlikon:

> *"With the supply chain, it is very clear that you can't be in business anymore without doing a screening of your supply chain. It's a huge business risk but it is also something significant in terms of our identity and who we want to be that we have to engage with." [**Oerlikon**]*

However, the greater scrutiny of supply chains was suggested to be a double-edged sword, posing great danger but also providing great opportunities:

> *"There exists a strong business case for being a "good corporate citizen" as it is a highly valuable brand which you want to protect so that, as a business, you can be on the right side of history." [**Shell**]*

INVESTOR UPDATE
MARKET INTELLIGENCE

In turn, the rewards which companies and corporations can reap for ensuring proper ethics throughout all levels of their company can be shared in turn with both investors and shareholders:

> *"It is our conviction that clients, as long-term shareholders, benefit when companies operate their businesses responsibly. [...] A company that addresses human rights issues in a proactive and effective manner can [...] have a positive effect on a company's long-term value and may position them to attract lower cost capital." [**BlackRock**]*

There do, however, exist multiple challenges providing obstacles for companies' endeavouring to promote such values and protect all individuals. Primary amongst these is a lack of transparency on such issues:

There exists a strong business case for being a "good corporate citizen".

> *"There is often a lack of transparency around human rights issues within supply chains. The perpetrators of human rights attacks, especially when they do not often directly occur at the enterprise at the top of the supply chain, may involve business partners, local police groups, or local governments." [**Invesco**]*

In addition, there appears to be a reluctance to concede such issues may exist, for reputational reasons among others:

> *"This can be a difficult area, as a lot of companies don't know whether it exists or not and if they do discover evidence of its existence they are hesitant to disclose it." [**M&G**]*

Another central issue raised was the lack of a consensus on how such concerns can be addressed, as:

> *"Everyone is coming to this from different perspectives, and it is a very difficult thing for corporate to get its head around because you have a massive asymmetry of information between a customer-supplier relationship." [**Oerlikon**]*

A number of interviewees highlighted the significant challenge faced by companies as a consequence of the multi-layered nature of global supply chains, making it difficult to address specific and urgent concerns:

> *"The problem is that if you have a deep supply chain — for example if you have many layers beneath yourself — then it becomes increasingly difficult to manage all the tiers." [**Shell**]*

Despite the various challenges highlighted, the opinions reflected by most interviewees suggest that there ought to be cause for optimism, with multiple companies believing that improving supply chain efficiency and functionality goes hand in hand with improving sustainability:

> *"The way we've been approaching the supply chain is continuously looking for more efficiency. Sustainability is so intertwined with our strategy that we are always looking at this — the stronger our supply chain is, the more prepared we are to deal with risks, and it also becomes more sustainable." [**Jorge Alejandro, Investor Relations Director, Coca-Cola**]*

Meanwhile, others argue that the same tools and approaches necessary for improving the financial part of supply chains are transferable to reducing human rights violations:

> *"The initial focus on the supply chain was about business continuity because it is essential in our business. [...] Basically, we leveraged that essential business continuity aspect of our supply chains to include more ESG focus, and the switch was very easy. The initial idea was that we don't want a supplier factory to explode because we want to make sure that we get the products. Now it also means that we want to make sure that employees at our suppliers have a safe working environment." [**Sanofi**]*

Being inquisitive and actively searching for issues relating to human rights and then subsequently disclosing what is found was deemed to be essential by multiple interviewees:

> *"Our position is that discovering and disclosing is a positive thing, and is the starting point for mitigation. Our message is: 'Ask the questions and investigate diligently within your company and supply chain. If you don't find any evidence of modern slavery, then you're probably not asking the right questions, because the likelihood is that it will be present to one degree or another.'" [**M&G**]*

> *"We may withhold support for the re-election of directors if, in our assessment, a company is not effectively addressing or disclosing material human rights-related risks or impacts." [**BlackRock**]*

In a similar vein to this, HSBC AM stated that they:

> *"Encourage companies to systematically ensure that Research and Development (R&D) projects are paired with plans to increase access in developing countries, ensure responsible promotional practices and that policies are in place to address anti-bribery and corruption risks, product safety and supply chain management issues." [**HSBC Asset Management**]*

Perhaps most central to removing instances of violations of human rights throughout a company's supply chain, due to the prevalence with which the interviewees underlined the importance of them, is the conducting of comprehensive audits and screenings. National Grid highlighted that they:

> *"Require contractors to undertake a risk assessment at the start of any new project to understand the potential exploitation risk areas in relation to low skill/low wage and mitigate these risks through the delivery of the project" and have also "developed a sustainability assessment tool using our modern slavery risk assessment criteria." [**National Grid**]*

Orange takes a similar line, emphasising, in addition, the merits that can stem from collaborating with both peers and competitors to remove such problems:

> *"We have teamed up with other operators to make common audits of our suppliers [...]. We built a common audit methodology — this alliance is composed of more than 15 operators, such as Verizon — and joining forces allows us to reach the fourth tier of our*

INVESTOR UPDATE
MARKET INTELLIGENCE

> *supply chain. It allows the supplier of the supplier of the supplier of our supplier to go into the factories to check what is really being done." [**Karine Fourneron, Sustainability Reporting & SRI, Orange**]*

Despite the various challenges posed in assessing supply chains, some interviewees highlighted that full comprehensive screening is both possible:

> *"If companies are willing to put their resources into doing so, they definitely have the ability to look at their entire supply chain in a more comprehensive way." [**Oatly**]*

And absolutely necessary:

> *"We previously had a code of conduct with our suppliers but that wasn't enough. It's not just about saying, 'sign this document to say that you're compliant', because you have unscrupulous people that don't do anything. Now there exists a due diligence requirement of a company, conducted by either themselves or someone who is an exterior expert. We're using EcoVadis, one of the ratings agencies, as a tool moving forward and we use them to screen our suppliers, not just when outsourcing to them but also through the system which we used to do it. We use it to identify, track and manage and then use our own people to go deeper down the chain." [**Oerlikon**]*

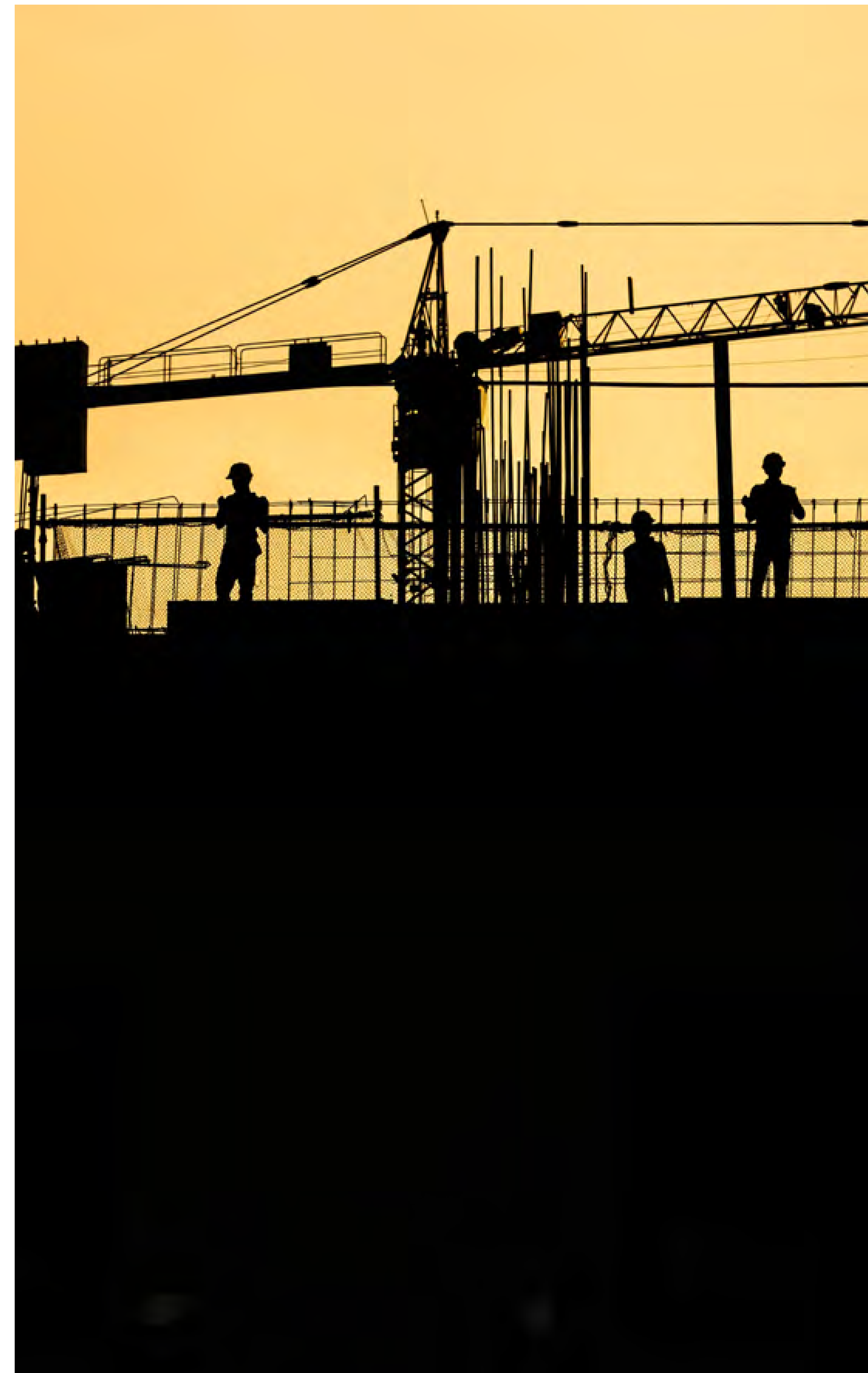
Some interviewees went on to illustrate how such comprehensive auditing can have positively meaningful impacts on removing such violations:

> *"In the case of suppliers (upstream), we ensure that they comply with their obligations on that matter, among other things, through audits. Some of the issues that are reviewed in these audits are: health and safety, freedom of association, working conditions and wages, discrimination, forced labour or child labour. Audits help us to identify potential non-compliance with human rights by our direct and indirect suppliers (Tier 2 and above). A concrete example in 2021 was the identification of overtime hours exceeding legal requirements at a factory of one of our electronics manufacturers in Asia. As a corrective action, it was agreed that employment contracts should require the signing of working hours so that overtime hours cannot exceed 36 hours per month. With this corrective action implemented, workers' overtime now complies with the regulation." [**Telefonica**]*

Multiple interviewees also underscored the vital role that supply chain financing can play a vital role in ensuring supply chains are free from human rights violations:

> *"Access to working capital is the key to growth, security and business alignment that will deliver transparency. Our legal agreement with the corporate, vendors and suppliers allows financing to be available upstream and downstream supporting really dynamic ESG support, and creating conditions for success. This also gives you complete transparency of the supply chain and cost-effective working capital finance for everyone in it." [**Crossflow Payments**]*

> *"We have a section called supply chain financing and have been working on sustainable supply chain financing and trade financing within that. By being the agent that can provide a bigger incentive to create sustainable supply chains, we can be more rigorous in how they are organised, in the way the procurement is happening, and in the way the corporates are disputing the risk of the supply chain" [**Standard Chartered**]*



Cowen Research suggested having a collaborative approach in tackling pressing environmental and social problems that the world currently faces:

> *"Minimizing and addressing issues related to human rights, environmental responsibility, labour practices, and ethics and corruption created by suppliers [and is achieved by] screening and engaging with suppliers on key potential issues. As society navigates its response to COVID-19 and the war between Russia and Ukraine, there is a compelling opportunity for environmentalists and people working on social problems in global supply chains to come together more." [**Cowen Research**]*

Progress in addressing human rights issues is dependent on the maturity, rigour and efficacy of third-party standards and initiatives.

Walmart highlighted the importance of having third-party standards and certifications beyond the law to make progress in addressing human rights:

> *"Progress in addressing human rights issues is dependent on the maturity, rigour and efficacy of third-party standards and initiatives, which requires a critical mass of suppliers and other businesses to align on common standards and best practices. For certain practices, there currently is no universal set of standards for responsible or sustainable production and/or certification beyond compliance with the law (e.g., responsible recruitment, wage/hour)." [**Walmart**]*

Abrdn highlighted the ethical consequences of volume of orders, the time frame for delivery and the cost of execution:

> *"Supply chains can be highly complex but one key question we consider is 'what can the buyer do from their position?'. Consumers are often not considering the ethical consequences of the volume of their orders, the timeframe for delivery and the cost of execution. Demanding very high volumes in a really short time frame is likely to lead to people being overworked and not getting appropriate rest time. Trying to help companies consider that perspective and making sure that is reflected in their own practices is imperative." [**Abrdn**]*

INVESTOR UPDATE
MARKET INTELLIGENCE

7a. Spotlight on Hope for Justice

Hope for Justice is a charity working to bring an end to modern slavery and human trafficking, and to protect the human rights of victims and survivors. Founded in the UK in 2008, Hope for Justice is now an international charity working across five continents. They help victims and survivors directly and also bring about long-term change through our work with governments, law enforcement, the business community and the general public. Slave-Free Alliance — which is a wholly owned social enterprise by Hope for Justice — provides services to other organisations that wish to protect their own operations and supply chains from modern slavery.

Tim Nelson is the CEO and Co-Founder of Hope for Justice and is an extremely knowledgeable, experienced, and well-qualified source on the issues, challenges, and solutions discussed in this chapter. The following insights on these topics are independently invaluable but they also serve to validate many of the views expressed by the other interviewees and contributors to this paper.

On the subject of the non-ethical imperative to protect human rights, Tim states that:

> *"With global legislation and stakeholder focus on business and human rights, organisations need to be on top of their modern slavery risks."*

Talking about how change and reform can be brought about, Tim believes that:

> *"Reform is a process that involves initiating and strengthening legislation, policy, practices, standards, structures, knowledge, beliefs and behaviour. Collectively, as an organisation, we drive change by increasing awareness and understanding of modern slavery and influencing society to take action. Through training, advocacy and collaboration, we promote best practice, ensuring that knowledge is passed on and can be developed."*

In regard to the utility of audits in screening for modern slavery, Tim points out that:

> *"A Slave-Free Alliance Site Assessment goes beyond an audit: it appraises a site's effectiveness in addressing its risk of modern slavery and labour exploitation. The assessment also identifies any best practice or indicators and/or issues of modern slavery. [...] They are customisable: we can assess sites in view of internationally recognised standards, local law and our indicators of modern slavery and labour exploitation."*

INVESTOR UPDATE
MARKET INTELLIGENCE

On the subject of the need for a consistent and standardised approach:

> *"The British Red Cross, Hope for Justice and the Snowdrop Project have been developing our partnership aimed at helping survivors of modern slavery to rebuild and regain control of their lives. Recognising the need for a more standardised, professional and consistent approach to care for survivors, the three organisations are developing a framework for the accreditation of Independent Modern Slavery Advocates (IMSAs) in the UK."*

Considering the role that technology can play in eradicating modern slavery, Tim highlights:

> *"During 2021-22, Slave-Free Alliance has been working with a partner to develop a new technology solution known as SC3, which [...] provides integrated services for effective and efficient modern slavery risk management. It will be a platform for continuous improvement and remediation. These automated services provide organisations with the tools and information to take decisive action, including 'Gap Lite' self-assessment; supply chain risk assessment; media scanning; guides, references and briefings; and training videos and resources. SC3 will be a platform for action, helping organisations to protect their operations, supply chain and people from modern slavery through automated analysis and tailored information." "With global legislation and stakeholder focus on business and human rights, organisations need to be on top of their modern slavery risks."*

INVESTOR UPDATE
MARKET INTELLIGENCE

8.0 Conclusion

The Part II of the white paper explored the reflections of some of the most influential global entities. Most interviewees acknowledged the multifaceted and intersectional nature of climate change and agreed on the pivotal role for the private sector needs to play in driving the decarbonisation efforts. Companies directly affected by climate change are the first ones to act and step up their decarbonisation efforts by introducing mechanisms such as scenario analysis. The inclusion of physical climate risk into the investment process has become an important consideration in decision-making and stewardship activities. Companies have pointed out that they have experienced the destruction of assets and interruptions in operations due to climate change which has prompted them to install risk management mechanisms. Standard Chartered expressed their views that the private sector is compelled to take the lead in low carbon transition due to lackadaisical regulatory standards mandating such efforts.

It is evident that the loss of property value from catastrophic events linked to climate change has become more and more common. It is increasingly becoming important for investors to learn from this and to try to calculate the probability of extreme climate events happening. This is aptly reflected in our research with many interviewees talking about embedding mechanisms to tackle any such risks. It is safe to conclude that addressing physical climate risk is not only risk management but also strategic development. Blackrock predicts that climate risk will become a primary financial and audit consideration in the coming years.

The UN SDGs are increasingly becoming an important tool for the private sector to facilitate their commitments to the Just Transition. The SDGs are a valuable framework for companies to link their sustainability efforts with the priorities of the broader world. Many experts believe that the SDGs are a good starting point for companies that are unsure about where to focus their ESG actions and they can also help to create awareness around ESG. Our research uncovered the widespread utilisation of the UN SDGs in corporate communications, but many interviewees highlighted mixed feelings about the precise utility of SDGs as a tool to enhance and promote ESG efforts at a company level. These mixed feelings about the SDGs are particularly evident among Interviewees such as Oatly and Shell who mentioned their cautious optimism for SDGs. An interesting perspective from the charity sector is that SDGs help them to reflect the sophisticated narratives of their corporate partners.

The importance of the role of regulators in encouraging positive ESG behaviours and actions cannot be overstated. Our research has highlighted the importance of public policy and regulation to ensure an equilibrium between demand and supply. There is also a colossal dissatisfaction with the lack of unified regulation on a global and local scale. Many interviewees have pointed out challenges in accelerating their transition due to incohesive global regulation and appalling lack of support from the federal, state and local governments. Many of our interviewees have called for an inclusive, transparent and cohesive regulation that is market responsive.

With the devastating impact of climate change widely felt across the world, the concept of the Just Transition now takes a centre stage. This paper has highlighted that there is a growing debate and conversation regarding how certain social groups are disproportionately affected by the devastating consequences of climate change. Our research has overwhelmingly pointed towards the importance of Just Transition considerations for business operations. However as highlighted in Part II, section 6, the drivers for prompting companies to consider Just Transition are diverse and varied, ranging from regulation to investor pressure. According to our research, it is imperative that a systematic structural change is needed that focuses on unifying all sections of society in achieving the goals of decarbonisation and transition into net zero.

The recent developments in climate change made it very evident that climate change not only poses business threats but significant operational and financial challenges for companies and investors. Most interviewees recognise that there is a growing investor expectation and pressure on investee companies to act upon the physical climate risk exposures. Investors have pointed out there are certain minimum standards that companies must fulfil without fail to continue having engagement. All in all, there is an accelerated awareness and interest in addressing and mitigating physical climate risks.

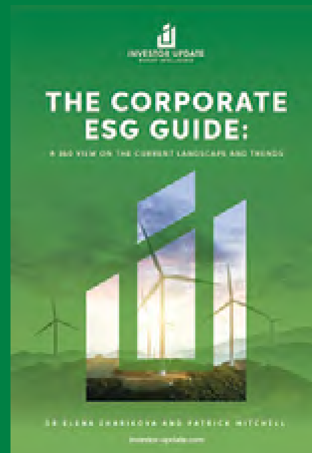
Our research also highlights the view held by many companies that global supply chains need to be approached from a human rights management perspective, despite the daunting nature of this challenge. Implementing a human rights program within the "four walls" of our own companies can be difficult enough, let alone extending such oversight programs beyond the first tier of suppliers—which may include tens of thousands of entities across the globe, affecting potentially hundreds of thousands of people and communities. However, recent geopolitical events such as the brutal invasion of Ukraine by Russia highlight the importance of having a strong, efficient and robust supply chain for a transition to a carbon-free economy.

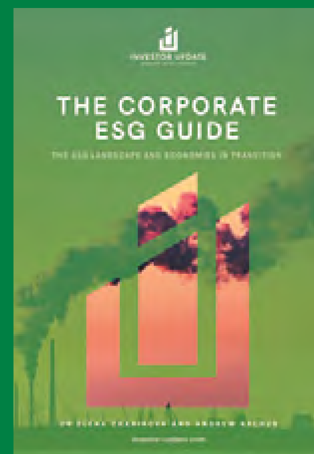
"The Unjust Transition — Reaping the Whirlwind"

"Fiat justitia ruat caelum" is a Latin phrase used in legal circles meaning "Let justice be done though the heavens may fall." If we, as a global commercial community, can interlace our collective efforts to decarbonise with a sense of universal justice, we may be able to prevent the heavens falling in both an environmental and societal sense. Conversely, should we fail to recognise the need for regionally inclusive solutions, we may well find ourselves reaping the whirlwind of our own making.

INVESTOR UPDATE
MARKET INTELLIGENCE

Ongoing ESG Thought Leadership





Click the report to download or get in touch at

contact@investor-update.com

About the Authors

Andrew Archer
Partner — Head of ESG Advisory

Andrew joined Investor Update after spending over 25 years in Investment Banking. His experience spans fund management, equity research, specialist sales, equity trading, corporate broking, capital raising and corporate advisory work. He started his career at Mobil Oil before working on the buy-side as a Portfolio Manager, on the sell-side as an Oil & Gas Equity Analyst at Bank of America before being appointed Energy Industry Specialist at Lehman Brothers and then Barclays where he led the Industry Specialists Team as a Managing Director. Andrew has since worked with and advised the senior management and investor relations of many public and private corporates with a focus on Investor Engagement and ESG. He has a masters degree in Investment Analysis and is a member of the CFA.

Eleonora Piazza
ESG Specialist

Eleonora Piazza started working at Investor Update in 2021 as an ESG specialist, forming part of the wider ESG Advisory team. She has a finance background with a special focus on financial services industry, banking and capital markets. Eleonora completed her master's degree in Banking and International Finance from Bayes Business School and holds an undergraduate degree in Economics and Management from Italy. Her multidisciplinary background in finance and economics helps clients attract untapped pools of ESG capital and achieve their ESG targets.

Puneeth Parimisetty
ESG Specialist

Puneeth Parimisetty joined Investor Update in early 2022 as an ESG Specialist after extensive experience in delivering evidence based, data driven insights in the consulting industry in Germany and India. He specialises in corporate ESG reporting and disclosure, ESG activism & defence mechanisms, corporate ESG strategy and board/governance advisory. He holds a dual degree in Master of Public Administration (MPA)/ Master of Public Policy (MPP) from London School of Economics (LSE) and Hertie School in Berlin. He is also a Fellow of Royal Society of Arts (FRSA).

Roman Tokaryk
ESG Specialist

Roman Tokaryk joined Investor Update in 2022 as an ESG specialist. He has a legal background with a particular focus on ESG regulation, Corporate Governance and Human Rights. He has more than four years of experience at various institutions, ranging from governments and international organisations to international law firms, including Corporate & Banking practices at Baker McKenzie and Bryan Cave Leighton Paisner. After completing his bachelor's degree in Law in Ukraine, he did his master's degree in Corporate Law at the University of Oxford.

Special thanks to Sam Archer for his significant contribution to the process.

Photo credits: Unsplash.com

INVESTOR UPDATE
MARKET INTELLIGENCE

investor-update.com
contact@investor-update.com

London
+44 20 3371 1177

Head Office
28 King Street, London, EC2V 8EH

©2022 Investor Update - All Rights Reserved
Investor Update is the trading name of Investor Update Limited.
Investor Update Limited is a Limited Liability Company,
Company Registered Number: 10327891 Registered in England.