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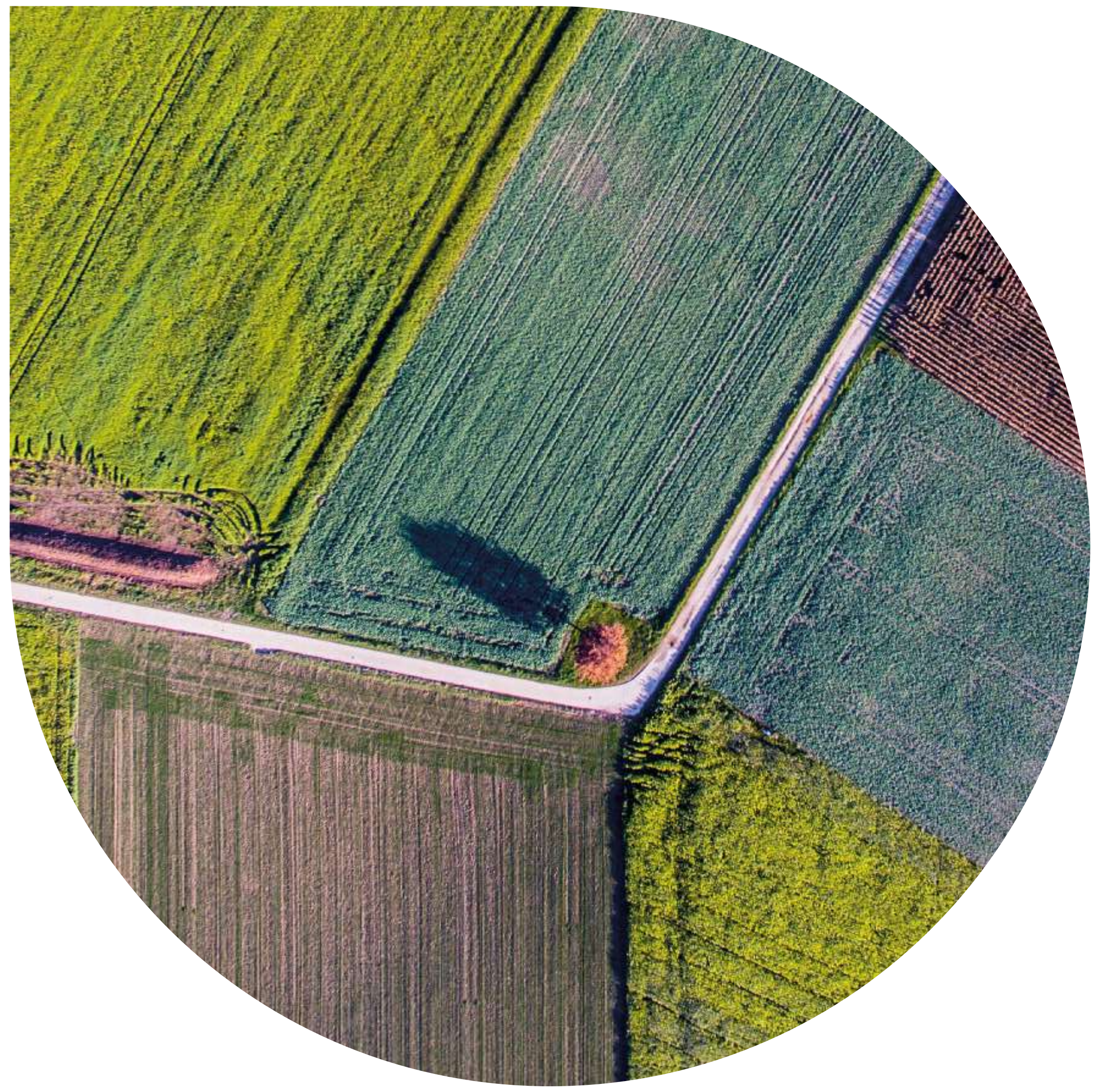

ESG Legal Outlook 2021

ESG Outlook 2021

If 2020 was marked by Covid-19, an uptick in geopolitical tensions, the Black Lives Matter movement, and an extraordinarily eventful US election, 2021 is likely to be all about the roll out of Covid vaccines, programmes for economic recovery that focus on "building back better" and the continued focus on long-term sustainable growth.

We expect the pace of change on all matters environmental, social and governance (ESG) to continue accelerating in 2021. A new US administration and Congress, COP26, growing investor pressure on corporates to address ESG issues, and new disclosure requirements taking effect across the UK and Europe all point to 2021 being a critical year. Human rights and the responsibility of large commercial organisations for impacts arising from their business relationships (both supply chain and customer facing) also continue to rise up the European legislative agenda.

For financial institutions and corporates the challenge is that of integrating these changes into business as usual. Work remains to transform net zero and other ESG targets into robust, realisable short and medium term plans and to ensure diversity and inclusion strategies continue to be implemented and improved. ESG factors also need to be incorporated into transactional activity and business decision making as a matter of course.

Listed companies who do not actively manage their investor engagement on these issues can expect a lively AGM season, as activist shareholders are increasingly keen to promote resolutions on improved ESG performance and disclosure. In essence, 2021 marks the start of a period of major change that is likely to continue over the next decade, throughout which business and financial institutions will be judged on how well they adapt and how we all walk the talk.

In this outlook we provide an overview of some of these key global ESG legal themes for 2021 and the trends we see in different countries around the world.

Vanessa Havard-Williams – Global Head of ESG, London

For more information visit our global ESG homepage

Global themes

- Building back better and greener
- Climate change will remain high on the investor and regulatory agenda
- Moving towards mandatory TCFD-aligned climate disclosure
- Getting closer to a single global ESG reporting standard
- Greater regulation of ESG data and ratings providers
- Combatting greenwash: taxonomies and the many shades of green
- Increased investor engagement: turning talk into action
- Regulations around business and human rights on the rise
- Continued growth in green, sustainability-linked and social bonds
- Volume and variety of sustainable derivatives and structured products to grow
- Boost in global carbon markets
- Litigation claims will broaden to include all aspects of ESG

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Global themes

Building back better and greener

At the start of the Covid-19 pandemic in 2020, many questioned whether the resulting economic turmoil would result once again in climate change and other ESG issues being relegated to the back burner.

In fact, what we have seen is the exact opposite. Both Covid-19 and the Black Lives Matter movement have acted as "ESG accelerants", shining a brighter light on the "S" in ESG in particular.

Not surprisingly, corporates and the financial sector alike are increasingly considering the environmental, social, human and economic impact of their business decisions and focusing more on long-term sustainable value creation. There is also a growing realisation that healthy corporate culture, and maintaining an engaged workforce which is brought into a business's purpose and values is critical to its ability to survive and thrive, especially during challenging times.

There have been repeated calls across the globe for economic recovery packages to be linked to climate change and wider sustainability and social objectives. The EU's recovery plan is the standout example, with green conditions attached to the funds that will be made available to member states. An equally important link has been made more broadly between economic growth and the sustainability agenda – with the EU, China, US, UK and many others proclaiming that pursuing a low carbon agenda can be an opportunity for job creation and economic recovery.

Climate change will remain high on the investor and regulatory agenda

The Covid-19 pandemic has sharpened everyone's perception of risk, leading some to question whether the health crisis is just a "dress rehearsal" for the climate crisis.

As the current governor of the Bank of England, Andrew Bailey put it:

> "…what is different with climate change is that we know now it is coming, so we can identify where risks will arise and start managing them in advance. Compared to the financial crisis and the pandemic, the risks from climate change are even bigger and more complex to manage. And acting now gives us the best opportunity to manage those risks."

2020 saw a spate of high-profile climate pledges – from governments, banks, asset managers, pension schemes and corporates alike. The emphasis in 2021 will be on turning these announcements into credible action plans. Those who don't, run the risk of being accused of greenwashing.

The global climate summit, COP26, which is scheduled for November 2021, is acting as a beacon for more ambitious climate strategies and regulatory action from a number of countries. The UK government, which will be hosting

> "A strong corporate culture, underpinned by effective corporate purpose and values is key at any time. The pandemic has forced organisations to adapt to new ways of working, communicating and living. Now is probably the right time for organisations to begin to assess where they think their corporate culture is at, how it interplays with their values and purpose, and embrace the opportunity to do things differently than in the past."

Sarah Wiggins – Partner, Corporate/M&A, London

For more information, read the latest Guide for General Counsel on Corporate Sustainability we prepared with the United Nations Global Compact

Global themes

COP26, has also announced plans for a "green industrial revolution" and a 68% greenhouse gas reduction target for 2030 (against 1990 levels). All of these pledges and announcements will now need to be translated into action. The EU is perhaps the most advanced, so far, in terms of a climate action plan, with 2021 being a key year for the implementation of its flagship European Green Deal.

We should not underestimate how difficult the "transition to net zero" is likely to be. According to the World Meteorological Organization, although carbon emissions fell dramatically in 2020 due to widespread national lockdowns which curbed transport and industry severely, this has only marginally slowed the overall rise in carbon dioxide concentrations globally. This puts in stark relief the level of effort that will be needed to curb greenhouse gas emissions in key sectors such as power generation, industry, transport and buildings – without bringing whole swathes of the global economy to a complete standstill again.

Moving towards mandatory TCFD-aligned climate disclosure

Investors and other stakeholders globally continue to press for more and better ESG data that is relevant, reliable and comparable. This in turn is leading to the roll out of mandatory climate-related disclosure regimes in some jurisdictions.

The Task Force on Climate-related Financial Disclosures (TCFD) has become the global gold standard for climate disclosures. For example, the UK plans to take a phased approach to making climate-related disclosures under TCFD mandatory by 2025 for corporates, banks, asset managers and pension schemes – with premium listed companies required to report first in respect of the reporting periods starting after 1 January 2021. In the EU, asset managers and other financial market participants will have to disclose a whole array of new sustainability data under the Sustainable Finance Disclosure Regulation, which in turn will mean investee companies will be under pressure to provide this information to their investors. The US and various other jurisdictions are also considering changes to their climate-related disclosure regimes.

Central banks and prudential regulators (such as the European Central Bank and the Bank of England) are also increasingly asking banks and insurers to measure and disclose climate-related risks and opportunities. And the climate stress tests that are scheduled in the UK and the EU are going to really focus minds on whether banks and insurers have the right systems and processes in place, and the right skills, to assess and manage these risks. Even if climate-related disclosure is not yet a regulatory requirement in your jurisdiction, the chances are that investors are asking investee companies to disclose this information nonetheless.

Global stock exchanges are also coming together to discuss how to encourage climate disclosure best practice amongst their issuers under the auspices of the UN Sustainable Stock Exchanges Initiative.

Whether you are required by law to disclose in line with the TCFD or are just being "encouraged" to do so by investors, you should not underestimate the effort and upskilling required. If you have not yet embarked on the "TCFD journey", expect it to take at least a year and start the process sooner rather than later.

Getting closer to a single global ESG reporting standard

Pressure is mounting to agree on a single global ESG reporting methodology. Although the TCFD is now widely accepted as the global gold standard for climate-related disclosures, the same cannot be said for the rest of the ESG "alphabet soup" – where there is a plethora of ESG reporting frameworks, standards and metrics.

2020 saw several high-profile announcements on this front. The Big Four accounting firms, under the auspices of the WEF's International Business Council and backed by the Bank of America, released a new set of ESG reporting standards. Then five of the main ESG standard setters – the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), the Climate Disclosure Standards Board (CDSB) and the CDP – issued a statement of intent to work together towards comprehensive corporate reporting. This was followed by a consultation from the IFRS on whether it should develop a Sustainability Standards Board to develop climate-related financial disclosures initially, before potentially broadening its remit into other areas of sustainability reporting. We expect this IFRS initiative to be particularly impactful.

Global themes

The EU is also thinking about developing its own ESG reporting standard as part of its review of the Non-Financial Reporting Directive.

It is still a little too early to tell which of these various initiatives will have the greatest chance of success in 2021. What is clear is that, now more than ever, there is increased momentum for the existing ESG standards and frameworks to coalesce into a single globally accepted one.

Interest in data on the financial impact of biodiversity loss and nature is also growing and we can expect to hear more from the newly-created Task Force on Nature-related Financial Disclosures (TNFD) in 2021.

But the call for increased transparency and more and better data is not limited to climate and sustainability issues. We also expect to see increased calls for more and better data on diversity throughout 2021, in particular as investors increase their engagement efforts in this space. However, the regulatory frameworks for disclosure of this type of data are still at an early stage.

Greater regulation of ESG data and ratings providers

ESG data and service providers play an important role in the investment process. The quality and reliability of these data, ratings and scores are vital for investors. However, there are serious questions about how the data is compiled and assessed and how ratings are derived, with correlation between scores ascribed by different providers varying widely. Up until now, providers of sustainability-related data and services have remained largely unregulated. However, this may be about to change.

For example, French and Dutch regulators (Autorité des Marchés Financiers and Autoriteit Financiële Markten) have called on the European Commission to propose an EU regulatory framework for providers of sustainability-related services. This may well form part of the Commission's Renewed Sustainable Finance Strategy, which is expected in Q1 2021. We may well see similar moves in other parts of the globe.

Combatting greenwash: taxonomies and the many shades of green

As the interest in sustainable investment and ESG products continues to increase at pace, so too does the fear of "greenwash", and its younger sibling "social wash".

Achieving net zero by 2050 will require a significant re-allocation of capital towards low carbon/more sustainable investments. But to do that investors need to feel confident that what they are investing in is indeed as green or as sustainable as it claims to be and not just the product of greenwash.

The EU and a number of countries (including the UK, China, Canada, Mexico and others) are in the process of developing green "taxonomies" – a classification system to help identify how green or sustainable an investment or economic activity really is. This in turn is also driving the push (from regulators and investors) for enhanced or mandatory ESG disclosures as taxonomies need data in order to be effective (see above). The EU green taxonomy, which so far is the most advanced in terms of its development, has elicited both praise and a healthy dose of criticism. We should not underestimate the impact that the EU taxonomy will have in terms of driving greater disclosure of a wider range of sustainability data by corporates and the financial sector and in helping to reshape business strategies. We are also starting to see financiers benchmarking new investments against the taxonomy, which in due course is likely to have a significant impact on access to finance, particularly for fossil fuel projects. Be prepared to hear much about "taxonomy-aligned" and "Paris-aligned" investment portfolios and business models throughout 2021.

Concerns about greenwash are not limited to the financial sector; corporates too are becoming increasingly aware of the pitfalls. As companies align themselves with the net zero transition, they will need to ensure that their climate pledges are backed up by credible transition strategies with science-based targets and metrics and that they are making the necessary disclosures against those targets and metrics. Core to the successful development and implementation of transition strategies is good governance and focused board oversight, as foreshadowed in the TCFD's approach. Take for example a fund or a lender which has pledged to reduce the carbon intensity of its portfolio – when choosing

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their investment targets, they will be on the look-out for the companies and projects that have credible low carbon credentials. It is fair to say that everyone's "greenwash radars" are set to high at the moment; a trend which is unlikely to diminish in 2021. And for those able and willing to obtain and maintain a "green badge", there are significant opportunities to be had.

There is also a growing realisation that not everyone can be "dark green" and that serious questions need to be asked, by both regulators and investors, about the role of transition fuels and technologies. As Mark Carney is fond of saying, we're going to need many shades of green.

Increased investor engagement: turning talk into action

Investors – including influential groups such as Climate Action 100+, the Institutional Investors Group on Climate Change (IIGCC) and activist investors such as Chris Hohn – have warned that they do not intend to ease up on engagement with investee companies in 2021, in particular on climate change and diversity issues.

Investors have warned that, where their expectations are not met, there are three courses of action: engagement, voting and divestment. Some may have to brace themselves for a bumpier ride in the 2021 AGM season.
A number of forward-thinking companies have sought to get ahead of the curve by proactively tabling climate and transition strategies for investor scrutiny. Whether this will meet investor expectations, and put corporates back in the driving seat, remains to be seen. Keep your eyes peeled for more action in this area as the AGM season approaches in 2021.

Regulations around business and human rights on the rise

With Covid-19 and Black Lives Matter bringing the social limb of ESG to the fore, there has been unprecedented momentum behind developments in the business and human rights space.

Previously viewed as the realm of NGO campaigns and CSR initiatives, legislation is now on the statute books in a number of jurisdictions, and regulators and industry alike are now working on numerous different proposals to step up efforts in this area.

This includes proposed new EU-level mandatory human rights due diligence legislation (backed by a number of corporates and bringing harmonisation to the array of national level regulations already in place or being put in place), work on the proposed UN Treaty on Business and Human Rights and the UN PRI announcing a four-year programme to have its signatories fully implement the UN Guiding Principles on Business and Human Rights. We can expect to see further progress made on these initiatives over the course of 2021.

"As organizations reshape their strategy to respond to the social and environmental opportunities and challenges we face, good governance is critical to effective corporate implementation and oversight of change."

Tom Shropshire – Global Head of the US Practice, New York

Global themes

Continued growth in green, sustainability-linked and social bonds

Green bonds alone raised $210.2 billion in 2020, surpassing the $188.3 billion for 2019. Social bond issuance raised more than $163 billion in 2020, more than 10 times the $13 billion raised in 2019.

In fact, the growth of social bonds precipitated by the pandemic is outpacing that of green bonds. The market response to the issue by the European Commission in October 2020 of its largest-ever social bond (on which we advised the underwriters), as part of its Covid-related financial support programme, is further indication of the growing demand from investors to align their investment strategies to a more sustainable future, particularly in these extraordinary times.

Linklaters has acted on over 100 green, social and sustainability-linked bonds (SLBs) in 2020. In particular, we have led the development of the SLB market, advising on recent issues by LafargeHolcim (the first of its kind in the building materials industry), Schneider Electric (the first ever SLB in the equity-linked market), Suzano (the first bond of its kind to be aligned with the International Capital Market Association's (ICMA) Sustainability-Linked Bond Principles), Novartis (the first SLB to incorporate social rather than environmental targets and the first offering of SLBs in the healthcare sector) and ENEL (the first SLB in Europe).

With the favourable announcement by the European Central Bank that bonds with coupons linked to sustainability performance targets will become eligible central bank collateral (subject to compliance with programme-specific eligibility criteria) from 1 January 2021, the signs are that this product has strong growth potential for 2021. The launch of ICMA's Climate Transition Finance Handbook in December 2020 could also help extend the range of issuers for whom green, social or sustainability bond financing could become a credible option by building confidence in transition finance disclosures. The emergence of SLBs also presents an exciting opportunity for Asian issuers looking for innovative ways to tap into the sustainable bonds market.

Volume and variety of sustainable derivatives and structured products to grow

We have seen a wide range of sustainable derivatives and structured products being issued over the last couple of years and expect the volume and variety to increase further in 2021 as investors actively seek more sustainable investment opportunities. These types of products include "green" regulatory capital transactions and synthetic securitisations (where the regulatory capital saving is used for sustainable lending), "green" securitisations and CLOs (where the underlying loans are green or sustainable), sustainable swaps (where the price of the hedge goes up or down depending on the counterparty's ESG performance), "green" structured and repackaged notes and complex structures providing financing to developing countries designed to address the "S" element.

Boost in global carbon markets

The world's largest carbon market, the EU Emissions Trading System (EU ETS), has continued to reflect the EU's increasing green ambitions, notwithstanding the pandemic-related global shutdown. EU ETS carbon prices have increased during 2020, and Phase IV (2021-2030) of the EU ETS will see changes introduced which will effectively tighten the system. The European Commission is consulting on yet further changes which will be introduced during Phase IV, including an expansion of the system to cover new sectors of the economy such as shipping. The EU ETS remains a central tool for the EU to reach its net zero target.

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From 31 December 2020, the end of the Brexit transition period, the UK will no longer participate in the EU ETS. There had been considerable uncertainty in the market as to the UK's replacement carbon pricing mechanism following that deadline, with the government only confirming its position on a stand-alone UK ETS versus a carbon tax in December 2020. With only two weeks to go before the cut-off date, the government finally confirmed that the UK will introduce a stand-alone UK ETS rather than a carbon tax. The UK ETS will closely mirror the EU ETS in design but includes several features which aim to make the system more ambitious than the EU ETS. The government has not confirmed whether the UK ETS will link with the EU ETS, but this is at least contemplated.

In international carbon markets, the delay in COP26 to November 2021 has meant that progress in agreeing the so-called "Article 6 rule book", which is required to fully implement the Paris Agreement's market mechanism, has stagnated. Whilst 2020 saw a few bilateral Article 6 "co-operative approaches" being agreed between nations under the guidance of the World Bank, the challenges faced by the COP negotiators in agreeing the rule book have been mirrored by those seeking to participate in this new market. In addition, the delay in agreeing the Paris Agreement's market mechanism and how the Kyoto Protocol's CDM might transition to or co-exist with such new mechanism, has deeply challenged participation in the existing international carbon market. Up until mid-December 2020, there was no certainty that the CDM would continue past 2020, the end of the second Kyoto Protocol commitment period. The CDM has now finally received a temporary reprieve: the CDM Executive Board confirmed in December 2020 that it will continue to function on a temporary basis and (importantly) will continue to issue CERs for emission reductions achieved by CDM projects and POAs from January 2021 up until a final decision is made at COP26 in November 2021.

The voluntary carbon market continued to grow during 2020, which also welcomed the Taskforce on Scaling Voluntary Carbon Markets (a private sector-led initiative working to scale an effective, efficient and functioning voluntary carbon market to help meet the goals of the Paris Agreement). An increasing number of domestic emissions trading schemes, as well as international compliance schemes such as CORSAIR, have continued to signal future demand sources for voluntary market credits. However, the critical issue of double counting or claiming by host governments (an issue which results from the Paris Agreement's bottom-up approach, whereby all countries including any host country have adopted targets in the form of a Nationally Determined Contribution) remains unresolved.

Litigation claims will broaden to include all aspects of ESG

ESG litigation is starting to develop beyond pure activist challenges and companies need to consider this area from a risk management perspective. For example, various civil claims are ongoing in which it is alleged that multinational parent companies should be held responsible for the conduct of foreign subsidiaries/joint ventures in connection with adverse environmental and/or human rights impacts. This is a trend that looks set to continue into 2021. Separately there is existing law in France, and proposals in a number of European countries and at EU level to impose parent company duties of vigilance in respect of environmental and human rights issues in group and in respect of business relationships.

> "Litigation and complaints to regulators are becoming a more frequently used tool to push organisations to improve their ESG performance. We expect a particular focus on corporate disclosures and product claims as requirements tighten."
>
> **Nick Porter** – Partner, Dispute Resolution, London

Global themes

Since the landmark decision of the Dutch Supreme Court in *Urgenda* in December 2019, further challenges of various forms have been pursued against State governments concerning climate change. We have seen challenges under administrative and planning laws to government approvals of projects that would significantly contribute to greenhouse gas emissions.

Civil litigation against corporates for allegedly causing climate change-related harm has been on the rise, with notable cases in Germany and the US. There have also been instances of claims brought by or on behalf of shareholders/investors regarding allegedly misleading or inadequate disclosures relating to climate change. Expect disclosure-related claims to rise as awareness of greenwashing becomes more acute. Certain legislative or regulatory changes adversely affecting foreign investors in the energy sector have given rise to investment arbitration claims against states. Look out for more of these claims as energy policy and regulatory frameworks continue evolving.

European Union

European Green Deal and green recovery

2021 will be a key year for implementation of the European Green Deal. The climate law will enshrine the EU's climate targets of net zero by 2050 and a new 2030 target. The Council has agreed a 55% reduction in greenhouse gas emissions by 2030 but the European Parliament wants a 60% reduction so it remains to been seen what the final agreement on this will be. Formal negotiations on the detail of the draft EU climate law will take place during the course of 2021. The Commission has said it will review all relevant climate and energy policy instruments with a view to publishing, by June 2021, detailed legislative proposals to implement the new 2030 target. This includes changes to legislation on renewable energy, energy efficiency, vehicle emissions, and the EU ETS.

The Council summit in December 2020 helped to unblock negotiations on the €1.074 trillion EU budget for 2021-2027 and the €750 billion EU recovery fund. Formal adoption of the necessary legislation will now take place in early 2021. This is key to the EU's green recovery as money disbursed under the new budget and Next Generation EU recovery fund will need to comply with the EU's climate targets and the "do no significant harm" principle in the EU taxonomy – with 30% of the total expenditure aimed at climate-related projects. Agreement has also been reached on an indicative roadmap for "new own resources" to help repay the borrowing that will need to be made under the Next Generation EU package. The new own resources will include revenue from a carbon border adjustment mechanism and from the sale of allowances under the EU ETS, as well as a new plastics tax. The Commission is expected to publish proposals in respect of these in 2021.

Read more: EU blueprint for net zero by 2050

Read more: Commission Work Programme 2021

Read more: A Net Zero System

Renewed Sustainable Finance Strategy

In 2020, the Commission consulted on a Renewed Sustainable Finance Strategy, which builds on the 2018 Action Plan on Financing Sustainable Growth. The Renewed Sustainable Finance Strategy is intended to provide a roadmap of new actions to increase private investment in sustainable products and activities and support the objectives of the European Green Deal. The Strategy is likely to focus on three broad areas: strengthening the foundations for sustainable finance, increasing opportunities, and managing risks. Publication of the Strategy has been delayed to late Q1 2021.

Read more: European Commission consults on Renewed Sustainable Finance Strategy

Non-Financial Reporting Directive

The European Commission is conducting a review of the Non-Financial Reporting Directive (NFRD), with a view to possibly making the disclosure guidelines mandatory, extending the scope of the NFRD to a broader range of companies and organisations, requiring some form of assurance for climate disclosures and developing an EU-wide ESG reporting standard in the absence of a globally agreed one. The Commission has not yet announced exactly what changes it proposes to make to the NFRD but a draft legislative proposal is expected in March 2021.

Read more: Non-Financial Reporting Directive: the pursuit of data that is relevant, reliable and comparable

European Union

Taxonomy Regulation

The technical screening criteria (TSC) for the first two environmental objectives in the Taxonomy Regulation (climate change mitigation and adaptation) will come into force on 1 January 2022 but work on aligning investment portfolios and business strategies with the taxonomy has already begun and will no doubt speed up during the course of 2021. The Commission was expected to adopt, by 31 December 2020, delegated acts containing the TSC for climate mitigation and adaption but the process is delayed. At the time of writing, it is still not clear when in 2021 the delegated acts will be adopted.

There is also a question mark at present as to whether nuclear power will be included in the taxonomy. The EU's Joint Research Centre is expected to submit a technical report on nuclear energy in 2021 and the Commission has said it would consider amending the delegated act containing the TSC for the first two environmental objectives to include nuclear by the end of 2021.

The Platform on Sustainable Finance will develop the TSC for the other four environmental objectives (water, circular economy, pollution control, and biodiversity) during the course of 2021. The delegated act containing the TSC for those four environmental objectives will need to be adopted by 31 December 2021 so that it can come into force on 1 January 2023.

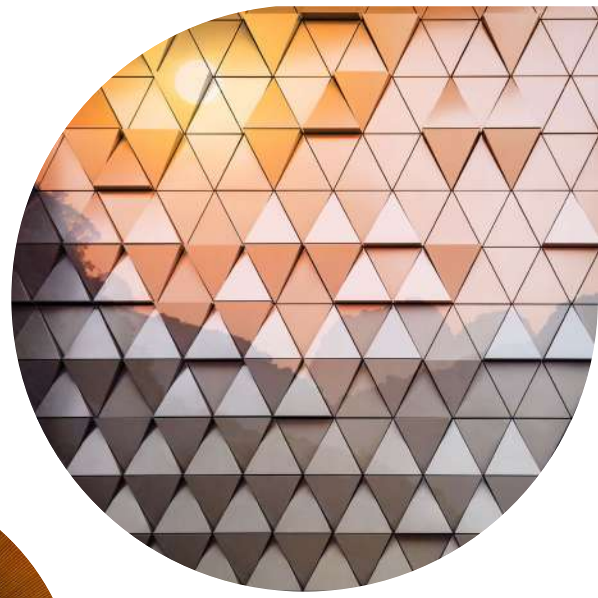
The Taxonomy Regulation requires the Commission to publish a report by 31 December 2021 on extending the scope of the taxonomy to social objectives. The Commission will seek advice from the Platform on Sustainable Finance on this.

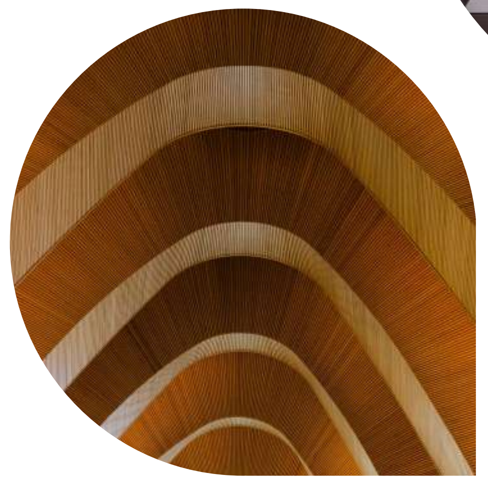
The Regulation also requires financial and non-financial organisations covered by the NFRD to include information in their non-financial information statements on how, and to what extent, their activities are associated with environmentally sustainable economic activities. The Commission is required to adopt, by 1 June 2021, a delegated act specifying the content and presentation of the information to be disclosed, including the methodology to be used. The Commission has asked ESMA, EIOPA and the EBA to provide advice on this by the end of February 2021. The delegated regulation is expected to be adopted in Q2 2021.

Although the Taxonomy Regulation does not mandate investment in low-carbon/sustainable activities, it is driving a significant shift in business strategies by the financial sector and corporates, as well as driving the need for better data on a very wide range of sustainability factors. The Taxonomy Regulation, combined with the Disclosure Regulation (see below), is having a profound effect on how ESG risks are assessed, disclosed and managed. Whilst some may view the EU's new sustainable finance package as an additional regulatory burden, others see this as a significant business opportunity.

Read more: European Commission consults on draft EU taxonomy delegated act for climate change mitigation and adaptation

Read more: European Commission seeks advice from ESMA, EIOPA and EBA on disclosures from financial and non-financial undertakings under Article 8 of Taxonomy Regulation





"A truly new era for transparency is at our doorstep as ESG reporting and disclosure obligations for financial and non-financial companies with listed securities phase in as from 2021 and 2022 under various EU regulations."

David Ballegeer – Partner, Corporate & Finance, Brussels

European Union

Disclosure Regulation, MiFID II, AIFMD and UCITS

From 10 March 2021, EU buyside investors such as asset managers and advisers will be expected to comply with the Level 1 “high-level and principles-based requirements” in the Sustainable Finance Disclosure Regulation (SFDR) without the detail of the Level 2 regulatory technical standards (RTS). The impact of the Level 2 RTS, which is likely to apply from Q1 2022 and will set out granular disclosure obligations, is still uncertain since we still await the final version. Following industry feedback, we may see a decrease in the number of mandatory principal adverse sustainability (PASI) indicators, as well as further detail on the Article 8/Article 9 product distinction, which could have an impact on the product classifications already undertaken by firms. Asset managers, insurers and pension providers should regard 2021 as a soft launch: organisations should review and enhance internal policies and procedures, and their investment due diligence procedures, engagements with investee companies and relevant service providers such as data providers. It is hoped that the ESAs Joint Committee will come forward with their anticipated statement sometime in January 2021 clarifying the implementation of the SFDR Level 1 and Level 2 measures.

Firms will also need to keep an eye on the ESG amendments to sectoral legislation such as MiFID II, AIFMD and UCITS. These amendments expand upon existing conflicts, suitability and governance requirements by making express the need to take ESG considerations into account. Delegated acts amending MiFID II, AIFMD and UCITS are expected to be published in January 2021 (at the earliest) and are expected to apply from late 2021. In-scope firms should take time in the earlier part of 2021 to review where and how ESG risks and considerations should be integrated into their governance framework, and align internal and client-facing processes.

Although the obligations in the SFDR (and associated changes to MiFID II, AIFMD and UCITS) are directed at buyside investors, all these developments will have a significant indirect impact on corporates, as the wide array of sustainability-related information that the buyside will need to disclose to meet their obligations rests with investee companies and is not currently widely available through annual and sustainability reports. There is also a disconnect between the type of sustainability data needed to be disclosed under the SFDR and that needed to be disclosed under the Taxonomy Regulation and the NFRD.

Read more: ESG Disclosure Regulation: delving into the Level 2 detail

Read more: EU Commission confirms delay to SFDR Level 2 rules

Read more: Sustainable Finance Sources: survival guide

Low Carbon Benchmarks Regulation

The Low Carbon Benchmarks Regulation came into force at the end of 2019 and administrators of benchmarks were required to disclose ESG factors in their methodology documents and benchmark statements by 30 April 2020. However, in practice very few parties met this deadline as the delegated acts providing detailed minimum requirements for the disclosure were only in draft form at that stage, and ESMA issued a no action letter on 29 April 2020 encouraging national competent authorities not to enforce the Level 1 requirements until the delegated acts were finalised. The delegated acts were adopted by the European Commission on 17 July 2020 and, after much anticipation, published in the Official Journal of the EU on 3 December 2020. They entered into force on 23 December 2020. Benchmark administrators will therefore need to include the relevant amendments to their benchmark statements and methodologies to comply with the Level 1 text, and we expect parties to be busy addressing this in early 2021.

As well as the general requirement to disclose ESG factors, there is a further requirement under the Low Carbon Benchmarks Regulation for administrators to include disclosure in their benchmark statement on how their methodology aligns with the target of carbon emissions reduction or attains the objectives of the Paris Agreement. This needs to be done by the end of 2021. Administrators of significant benchmarks located in the EU must also “endeavour” to provide at least one EU Climate Transition Benchmark by 1 January 2022, so will need to put this in place during 2021.

We expect listed companies to focus on their eligibility for inclusion in the low carbon benchmark in 2021 and to consider shaping their climate transition plans to meet the benchmark criteria.

Read more: An overview of EU ESG regulation and its impact on derivatives and structured products

European Union

Banks – supervisory expectations and climate stress test

The European Central Bank (ECB) expects banks to consider the extent to which their current management and disclosure practices for climate and environmental risks are sound, effective and comprehensive. Where needed, banks are expected to start enhancing their practices promptly. The ECB will ask banks to conduct a self-assessment in light of the supervisory expectations outlined in the ECB guide and draw up action plans in early 2021. The ECB will then benchmark the self-assessments and plans and will challenge them if necessary. Banks will need to make significant efforts to better support their disclosure statements with relevant quantitative and qualitative information.

The ECB will also carry out its supervisory stress test on climate-related risks in 2022 and expects to provide further details in the course of 2021.

Read more: ECB publishes final guide on climate-related and environmental risks for banks

Read more: Guide on climate-related and environmental risks

Green and sustainability-linked bonds

The Commission has been consulting on a possible EU Green Bond Standard and is expected to publish a legal proposal by June 2021. Watch this space for new requirements which are likely to tighten up what it means to be green.

The ECB has announced that bonds with coupons linked to certain sustainability performance targets will be eligible as central bank collateral from 1 January 2021. The coupons must be linked to a performance target referring to one or more of the environmental objectives set out in the Taxonomy Regulation and/or to one or more of the UN Sustainable Development Goals relating to climate change or environmental degradation.

The Commission has indicated that 30% of the EU's €750 billion recovery fund (known as Next Generation EU) will be raised through green bonds.

Read more: EU Green Bond Standard

Read more: FAQ on sustainability-linked bonds

Read more: ECB to accept sustainability-linked bonds as collateral

Competition

2020 saw active debate among European competition authorities about the scope of lawful business co-ordination to achieve meaningful progress on sustainability in line with the European Green Deal objectives. The Commission is now under pressure to issue clear guidelines to give companies greater confidence about what they can lawfully do under the existing competition rules. We hope that 2021 will be the year for action. All eyes will be on the Commission's sustainability conference in February 2021, when Linklaters' Head of UK Competition, Nicole Kar, will join EU Executive Vice President Vestager and others to debate the issues. While we await more guidance, businesses should assess and manage the antitrust risks of planned collaborations – many of which will be possible under the existing rules.

On the M&A front, as a company's environmental profile fast becomes a core strategic driver – whether exit from "dirty" industries or investment in green technology – merger control has a role to play in supporting sustainability. Dealmakers should bring forward their green deals to test the authorities, with clearly articulated business rationales (supported by consistent internal documents) and well-evidenced efficiency analyses. But it won't all be about clearances: after agency scrutiny in the tech and pharmaceutical spaces, so-called "sustainability killer acquisitions" to remove nascent green competitors will likely be the next frontier.

> "Development by competition regulators of a framework for considering bona fide sustainability initiatives between businesses in the same or neighbouring sectors in terms of efficiency/benefit would be very welcome. In the meantime, clients should be mindful of their anti-trust responsibilities in relation to information sharing and other collaborative initiatives."

Nicole Kar – Head of UK Competition, London

European Union

Finally, the Commission wants to ensure that the huge public funding needed to deliver the Green Deal is cost-effective and preserves the EU internal market, and this is where the State aid rules come in. So the ongoing changes to the rules will be a key area to watch in 2021 – and businesses should consider engaging with the Commission to help shape them.

Read more: Competition Outlook for 2021

Green digital transition

The green and digital transitions are intrinsically linked under the European Green Deal. Low carbon technologies and digital infrastructure will have a critical role in 2021 and beyond in enabling the EU and others globally to "build back better" and in helping the economy transition to net zero by 2050.

Read more: Tech Legal Outlook 2021: Viewing the future through an ESG lens

Human rights due diligence regime

As part of its wider consultation on sustainable corporate governance, the Commission is considering the introduction of a new corporate due diligence duty, which could require companies to implement adequate processes to prevent, mitigate and account for human rights, health and safety, and environmental impacts – both in the company's own operations and in its supply chain. The consultation closes on 8 February 2021 and a legislative proposal is expected in Q2 2021. The European Parliament is in the process of making a number of wide-ranging recommendations to the Commission on what they believe should be included in the proposal. This is an area of increasing focus for businesses which are now alive to the perils of ignoring the social impacts of their decisions, and many of whom are keen to establish a level playing field in this space through regulation. Watch this space for potentially challenging new proposals in 2021.

Read more: EU consults on human rights due diligence plans

Read more: Human rights due diligence: why it matters and how to get started

Human rights sanctions regime

In December 2020, the Council adopted the EU's first global human rights sanctions regime. This new regime allows the EU to impose travel bans and financial sanctions on targeted individuals, entities and bodies (including state and non-state actors) responsible for, involved in or associated with serious human rights violations and abuses worldwide, irrespective of where they occurred. This "horizontal" regime will apply in addition to the existing EU geographical sanctions regimes, which have listed more than 200 individuals and entities for human rights violations. At the time of writing, the sanctions list which appears as an annex to the new Regulation does not yet contain any names. It will be for the Council, acting unanimously upon a proposal from an EU member state or the High Representative, to establish, review and amend the sanctions list.

Read more: European Union adopts its first human rights sanctions regime

"The human rights due diligence initiative has largely been backed by EU businesses as it is expected to help create a level playing field for them. The key point will be to ensure a broad scope of application of this new regime, to cover not only EU-based businesses but also all undertakings selling goods or providing services in the EU."

Xavier Taton – Partner, Dispute Resolution, Brussels

Listen to our "Human rights: What does it mean for businesses?" podcast series

Belgium

ESG Outlook 2021 – Belgium

Sustainability will continue to play a key role in Belgium's policy in the coming years. In its government agreement, the newly established federal government – sworn in on 1 October 2020 – included sustainability as one of the key pillars for action. Through its relaunch plan, Belgium intends to move to a sustainable economy with measures around energy, innovation, technology, digitalisation, construction and mobility. End of last year, the responsible Secretary of State referred to a stimulus plan of between €10 and €20 billion (applying multiplier effects to approximately €6 billion of available EU funding for pandemic relief).

Non-financial disclosures: a carbon emissions balance sheet in the annual report?

According to a new draft law that has been adopted in first reading in the relevant Parliamentary Commission, corporates with more than 500 employees will need to include a carbon balance sheet in their annual report. The carbon balance sheet would include an estimate of the direct and indirect carbon emissions of the relevant company in Belgium, as well as a summary of the planned remediation actions and the expected reduction in emissions. It is unclear whether this draft law will eventually make it through adoption in plenary, also in view of the competing EU law initiatives in this area.

This new obligation regarding carbon emissions would add to existing non-financial reporting obligations for certain public interest entities in the Companies and Associations Code and reiterated in the 2020 Belgian Code on Corporate Governance.

Long-term shareholders' involvement

Long-term shareholders' involvement is an undisputed driver to foster corporate sustainability. The updated Shareholder Rights Directive (SRD II) and the accompanying Belgian transposition law adopted in 2020 aim at encouraging such long-term shareholder engagement. The changes impact listed companies, institutional investors and some other intermediaries in the investor chain. The transposition law brings new rules regarding shareholder identification, shareholders' meetings, remuneration disclosure, related party transactions, the engagement of institutional investors and asset managers, etc. into Belgian law. The new rules entered into force in 2020, with the new rules on the remuneration report applying to the report to be published in 2021. These rules deal with ESG in several ways, with a focus on a longer-term perspective. In the field of remuneration, for example, they encourage the inclusion of non-financial KPIs.

Read more: SRD II implemented in Belgian law – consequences for listed companies, institutional investors and some other intermediaries

Sustainable financial products: private label review and FSMA position

As is the case in other countries, Belgium has seen private labels for sustainable financial products emerge. The "Towards Sustainability" label for financial products, an initiative of financial sector association Febelfin which is now widely used, is currently under review. The label is granted to financial products that (i) do not finance sectors or practices which are widely regarded as unsustainable (such as the weapons industry) and (ii) comply with a set of portfolio and process level requirements. The ongoing biennial revision of the quality standard focuses, among others, on the co-existence of the label with the EU Taxonomy and Disclosure Regulations. The revised quality standard is expected to be published in March 2021. It will be interesting to see how the label develops as the Taxonomy and Disclosure Regulations start to apply and the development of the EU ecolabel for financial products progresses.

"In its declaration, the new Belgian government has made it very clear that it wishes to follow the European path to a strengthening of the ESG objectives in its policies. The pace at which ESG regulation will be issued will certainly pick up."

Charles-Antoine Leunen – Partner, Capital Markets/ Banking, Brussels

Belgium

The Belgian Financial Services and Markets Authority (FMSA) has stressed that it does not verify compliance with any private label. In line with this, the FSMA requires the inclusion of a disclaimer stating that the relevant label has not been approved by the FSMA and that private labels do not necessarily comply with any future obligations stemming from the Taxonomy and Disclosure Regulations.

Financial sector transition risks: monitoring of energy efficiency of real estate exposures

As set out in its circular of 1 December 2020, the National Bank of Belgium (NBB) will require credit and (re)insurance institutions to collect and report information on the energy efficiency of their real estate exposures by the start of 2022. Given the importance of these institutions' exposures on real estate, the energy performance of real estate is a potential risk factor in respect of the climate transition risk of the Belgian financial sector. In order to allow institutions to integrate these risks into their risk management strategy, the institutions will be required to request energy performance certificates from their clients or government institutions.

Building a viable hydrogen use case

Belgium has set up a National Policy Framework "Alternative fuels infrastructure" in which the policies and ambitions of the different government levels are brought together. Nevertheless, progress towards a uniform and clear regulatory framework for alternative fuels, including hydrogen, remains slow and complex.

A key question in the Belgian context is the treatment of hydrogen transportation networks. There is emerging enthusiasm among industry players for a regulated asset base model, under which the regulated network operators are tasked with adapting their existing network and/or developing a new (dedicated) network, to guarantee market participants' open access.

Read more: Getting Hy? Belgium

Rolling out electric vehicle charging infrastructure

Each of the Belgian regional governments has adopted strategies for the rollout of electric vehicles (EV) charging infrastructure. In the Flemish Region, the distribution system operators (DSOs) have an obligation to organise annual and on-demand tenders for the installation, maintenance and commercial operation of publicly assessible charging points (based on agreed local situation plans and a stepped approach to determine the most suitable alternative). The Flemish DSO company Fluvius has awarded a tender for these concessions to EV developer Allego. By the end of 2020, around 5,000 public charging points (2,500 stations) were planned. In its 2030 climate plan, the Walloon government stated the objective to achieve 6,900 public charging points by 2030, requiring an additional investment of 6,000 points (3,000 stations) in the coming years. In the Brussels-Capital Region, a concession was granted to Pitpoint for the realisation of 200 charging stations in 2019 and 2020 (only a small amount of which are currently installed).

Following the implementation of Directive (EU) 2019/944 (the transposition term for which has now expired), the regulatory framework in all three Regions will require amendment, with more restrictive conditions applying to the DSOs' involvement and a (potentially) bigger role for commercial players.

Tendering new offshore wind concessions

According to the federal government agreement, the new Belgian government wants to advance quickly with the rollout of 2.2 GW of additional offshore wind capacity in the North Sea and the development and reinforcement of related grid infrastructure. The new wind parks should be operational and connected by no later than 2026, to be on time to cover the impact from the nuclear phase-out. Potential developers and investors should be quick to act.

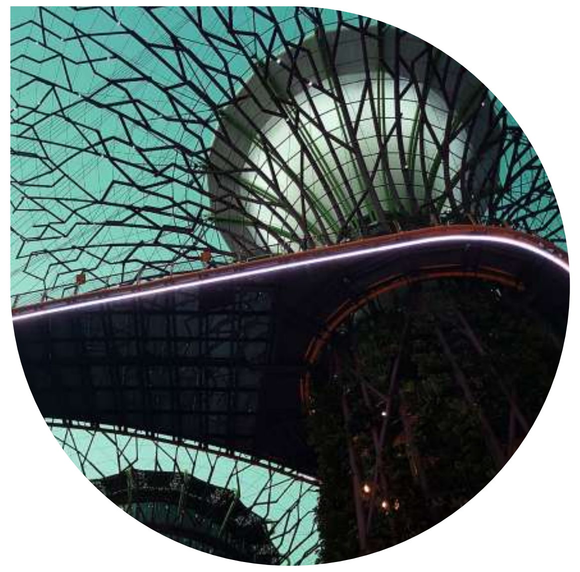
Concessions will be tendered in competitive auctions. Detailed conditions and procedural rules remain to be established. The government will also investigate a further expansion of offshore wind capacity outside the Belgian territorial waters, together with its neighbouring countries.

Read more: New Belgian offshore concessions

Belgium

Business, human rights and due diligence

In 2017, Belgium adopted its first National Action Plan (NAP) on Business and Human Rights. It includes 33 actions aiming to encourage Belgian companies, and international companies active in Belgium, as well as public organisations and authorities, to respect and promote human rights both within their own organisations and in their sphere of influence. Recent actions have mainly been awareness-raising initiatives (workshops, toolboxes, publications, etc.). In 2019, that first NAP was reviewed by a panel of experts who encouraged the adoption of a second NAP. In its 2020 Government declaration, the newly established federal government committed to actively participate in the negotiations on the future UN Convention on Business and Human Rights, and to play a leading role in the development of a European legislative framework on due diligence by implementing, wherever possible, a national supportive framework.



France

Sustainable finance

France has been at the forefront of sustainable finance initiatives, internationally and nationally, and sees real value in becoming a sustainable finance hub. As an early mover in policy terms, the French government has enabled French corporates and financial institutions to be particularly well positioned in respect of ESG.

French ESG funds requirements

The Autorité des Marchés Financiers (AMF) published its ESG Position-Recommendation 2020-03 in March 2020 (which it then updated over the course of the year) for funds that claim to have non-financial / ESG objectives (the AMF Recommendation). This provides national requirements separate from those set out in the EU Sustainable Finance Disclosure Regulation.

The AMF Recommendation applies to French AIFs and UCITS (subject to certain exemptions) and to non-French UCITS that are marketed to French retail investors (any non-French UCITS can either comply with the requirements or include a prominent disclaimer in their marketing documents stating that the fund doesn't comply with the AMF requirements).

In summary, in-scope funds are classified into three categories based on the extent to which any ESG criteria impact on the management of the fund, and the categorisation then impacts on how the fund can be promoted:

> Funds applying a significantly engaging ESG methodology – i.e. where the fund manager can demonstrate that ESG objectives are incorporated in the management of the fund in a significantly engaging manner (e.g. if the ESG criteria would reduce the investible universe by 20%). Only these funds can present ESG objectives as a key feature in their marketing documents and communications (e.g. in the name of the fund, its KIID or any marketing presentations);

> Funds applying a non-significantly engaging ESG methodology – i.e. where the fund manager's ESG criteria meet minimum expectations set by the AMF (e.g. the average ESG rating of the fund must be higher than the rating of the investible universe) but don't have a significant impact on the fund's management. These funds can present ESG objectives in a limited and balanced manner in marketing communications (but not as a key feature – e.g. such a fund should not have "ESG" in its name); and

> All other funds – these should not be promoted or presented as having ESG objectives in marketing communications, which can only be set out in the prospectus in a proportionate manner.

The AMF Recommendation precedes the European Sustainable Finance Disclosure Regulation and actually goes further by mandating minimum standards that funds must meet in order to be presented as sustainable. The response from non-French UCITS managers has been mixed, with some embracing the new requirements whereas others have preferred to use the non-compliance disclaimer.

It needs to be seen whether and how the AMF will update its position once the Sustainable Finance Disclosure Regulation comes into effect on 10 March 2021.

"France continues to take a lead on ESG issues. It is clear based on our interactions with the regulator and clients, that ESG will remain a key focus for the AMF and AFD and that climate in particular will be a key focus for the Banque de France following its pilot climate stress test and for the BPI."

Ngoc-Hong Ma – Counsel, Financial Regulation, Paris

France

Capital markets

French issuers look set to continue their focus on green, social and sustainable bonds over the next year. Additionally, the French government and the French Development Agency have each signalled the intention to issue sustainability-linked bonds in the coming year. The Green Bonds of France (OAT Vertes) for which the first tranche was issued in 2017 for €7 billion, has now reached more than €27 billion.

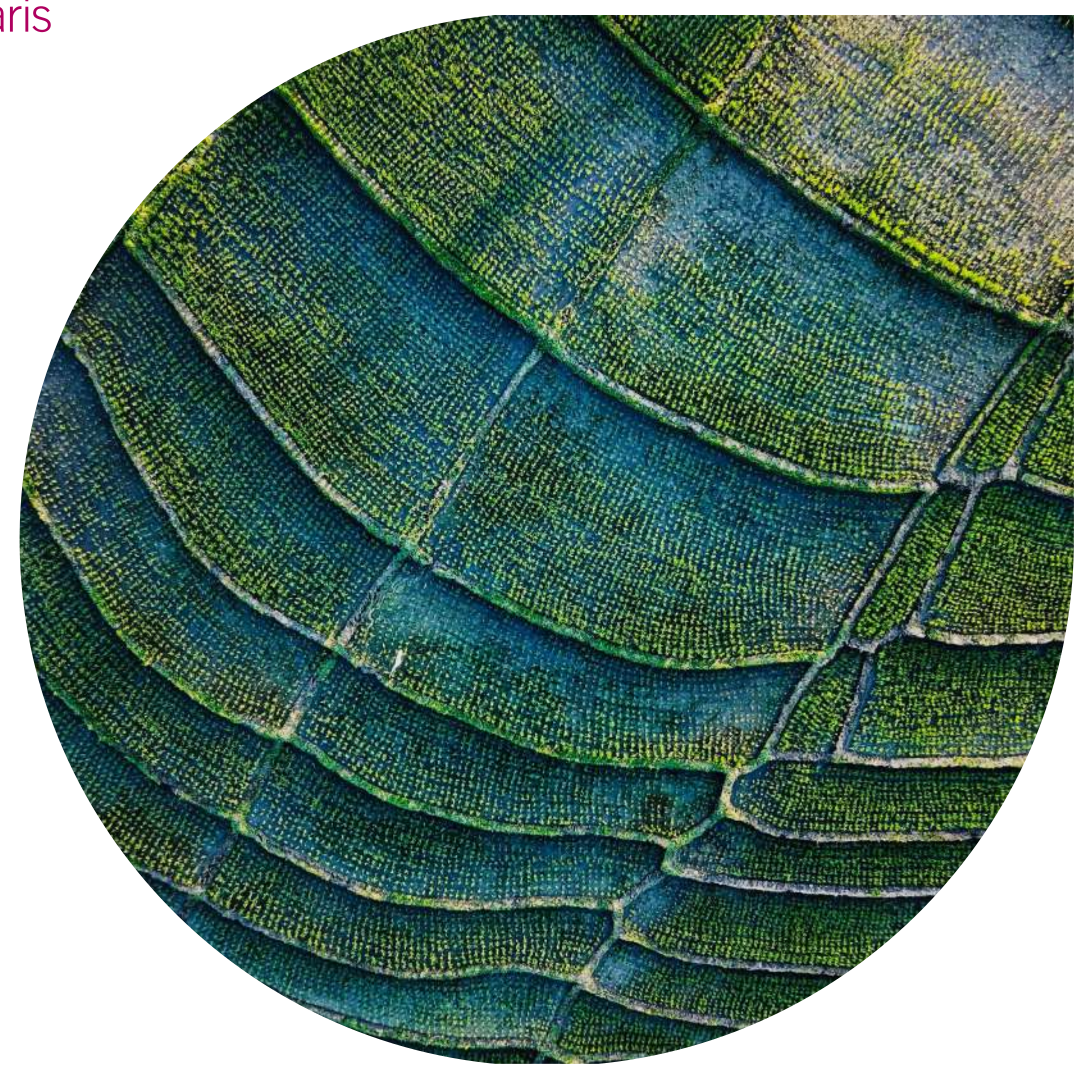
Furthermore, the AMF has clearly stated that one of its priorities for 2021 will be to speed up the transition to sustainable finance by supporting the financial community in the implementation of the regulatory framework and moving towards quality extra-financial information while facilitating innovative approaches.

Hydrogen strategy

More broadly, new hydrogen legislation is expected in 2021 to help meet the targets of the French hydrogen strategy. The French government published its Green Hydrogen Plan in September 2020, providing for a €7 billion national strategy for carbon-free hydrogen with three core objectives: (i) installing enough electrolysers to make a significant contribution to the decarbonation of the economy; (ii) developing clean mobility, particularly for heavy vehicles; and (iii) fostering the development of an H_2 industrial sector in France, creating jobs and guaranteeing France's technological expertise. The Government estimates that this Plan will directly create between 50,000 and 150,000 jobs.

"Green and social issues have probably become some of the most popular asset classes in 2020 in France. The trend is set to continue in 2021 as we begin to see more evolved variations of the products with the emergence of sustainability-linked bonds that provide a higher remuneration for the holders of the bonds if the issuer does not reach one or more of its sustainable objectives. These products derive their popularity from investors who are keen to align their investment strategies to a more sustainable future."

Véronique Delaittre – Partner, Capital Markets, Paris



Germany

Participation of women on management boards

In November 2020, a working group of the German coalition parties agreed on guidelines for the participation of women on management boards. These include a requirement that at least one female member be appointed to the management boards of companies which have at least four board members and are both listed and have equal representation. Different female participation quotas and participation rights are planned for public corporations and companies in which the federal government holds a majority stake. A government draft was adopted with the aim to conclude the legislative procedure before the end of the current legislative period.

Read more: Germany - Zweites Führungspositionen-Gesetz – FüPoG II

Read more: Einigung auf verbindliche Vorgaben für mehr Frauen in Vorständen

Supply chain due diligence

In parallel with the plans at EU level, the German government is discussing a "Due Diligence Act" (*Sorgfaltspflichtengesetz*), which would require companies to assess whether human rights violations occur in their supply chains and take respective prevention measures. An early draft that was leaked in 2020 envisaged both public and private enforcement mechanisms. The lead ministries intend to complete the legislative process during this legislative period (i.e. by autumn 2021) but are experiencing headwind from the Ministry for Economic Affairs.

Read more: Unternehmensverantwortung in globalen Lieferketten

Renewable energy and hydrogen strategy

The government continues to implement the measures laid down in its Climate Action Programme 2030. This includes a substantial increase of amounts put to tender for the promotion of electricity from renewable energies in a revamped Renewable Energy Act (EEG 2021). The increased need for renewable electricity is also fostered by the government's hydrogen strategy, aiming to increase production capacity of (wherever possible: green) hydrogen to up to 5 GW in 2030.

Read more: Hy-Politics – political considerations shaping the evolution of clean hydrogen policy

German emission trading system for fuels

Beginning in January 2021, Germany will introduce a national emission trading system for fuels: companies selling fuels must acquire CO_2 certificates at a fixed price of €25 per kg/CO_2. This price will rise to €55 per kg/CO_2 in 2025 and will be determined in tenders as of 2026. The revenues will serve to lower surcharges on electricity prices.

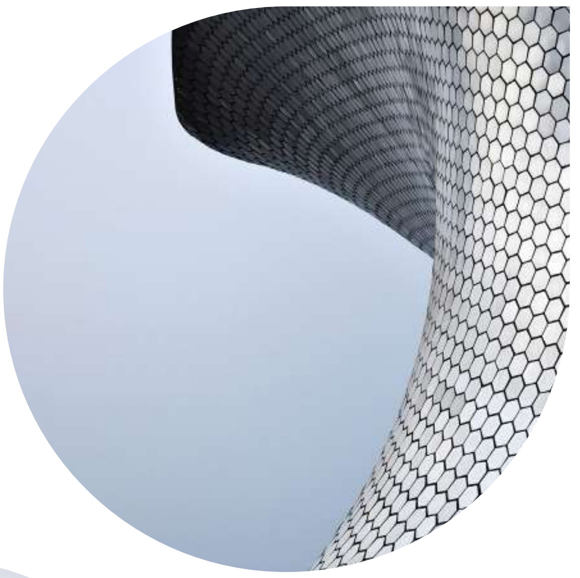
Coal exit by 2038

Germany aims at ending electricity generation from coal-fired power plants by 2038 at the latest. The new Coal Exit Act therefore provides for a gradual shutdown of all German coal-fired power plants. It includes a mix of instruments, voluntary and compulsory, paid and unpaid. This comprises agreements with power plant operators (for large lignite plants) and invitations to tender or legally ordered closures (for hard coal and smaller lignite plants).

Read more: Starting signal for German coal exit

"Sustainability aspects will become increasingly important for the way German companies are governed. Apart from the current legal developments on EU level, the German Corporate Governance Codex 2020 refers to sustainability aspects in several respects and stresses the role of enterprises in the community and their responsibility vis-à-vis society as well as the relevance of social and environmental factors for the success of an enterprise."

Claudia Schneider – Partner, Corporate, Frankfurt



Germany

Law to strengthen Germany as a fund location

In December 2020, a draft of the so-called law to strengthen the German fund location (*Fondsstandortgesetz*) and to adapt German law to the new requirements of the EU Disclosure Regulation and Taxonomy Regulation was published. Both regulations shall contribute to a stronger consideration of sustainability aspects in the investment decisions of financial market players.

With amendments to certain German laws, the German legislator (among other things) stipulates that the Federal Financial Supervisory Authority (BaFin) will be the national competent authority under the Disclosure Regulation and Taxonomy Regulation. Accordingly, the BaFin shall be equipped with new responsibilities and powers under these regulations.

ESG impact on pay for financial services firms

In a consultation document published in November 2020, BaFin announced that banks and financial services providers will be required to establish gender-neutral remuneration systems. Under the relevant draft version of BaFin's revised Regulation on the Supervisory Requirements for Institutions' Remuneration Systems (*Institutsvergütungsverordnung*), remuneration policies shall only be deemed appropriate if they ensure that any gender-based remuneration disadvantages are eliminated.

This aims at implementing remuneration standards which were introduced by the Capital Requirements Directive V (CRD V). However, it should be noted that financial institutions' remuneration policies are also subject to ongoing work conducted by the European Banking Authority (EBA). In its revised "Guidelines on sound remuneration policies" published as a consultation paper in October 2020, the EBA outlines how supervised firms should design and monitor their remuneration policies to ensure that expectations on gender neutrality are being met. In addition, CRD V and the Investment Firm Directive (IFD) require the EBA to produce a report on incorporating ESG risks into governance, risk management and supervision for firms subject to those Directives.

Read more: Referentenentwurf – der Bundesanstalt für Finanzdienstleistungsaufsicht

Update of German sustainable development strategy

The German government is currently updating its Sustainable Development Strategy (*Deutsche Nachhaltigkeitsstrategie*). Taking into account suggestions received in so-called dialogue conferences, a draft of the updated version was published for public consultation in October 2020. The amended strategy is expected to be adopted in spring 2021.

A German sustainability strategy was first published in 2002 and has been developed further over the years. Since 2016, it has been built on the UN Sustainable Development Goals. The updated strategy is, among other things, expected to stress the importance of accelerating implementation steps and the relevance of progress in so-called transformation areas (namely, energy transition and climate protection, circular economy, sustainable building and transportation, sustainable agricultural and nutrition systems, a pollutant-free environment, human well-being and capacities as well as social justice).

Read more: Deutsche Nachhaltigkeitsstrategie – Weiterentwicklung 2021

"The German government has set itself the goal of developing a leading location for sustainable finance in Germany. In this context, we saw the first issues of green state bonds by the German government in 2020. We also expect German public authorities including BaFin to continue to prioritise ESG in its 2021 activities."

Frederik Winter – Partner, Financial Regulation, Frankfurt

For more information visit our German ESG homepage

Italy

National recovery and resilience plan

Italy will have access to €209 billion through the Next Generation EU instrument to help its recovery from the Covid-19 pandemic. The Italian government is currently examining its draft National Recovery and Resilience Plan and has proposed the creation of a task force of technical experts to manage the recovery fund resources as well as the appointment of six Super Managers to ensure the rapid and effective implementation of the plan and the monitoring and verification of compliance. The proposal also provides for a Supervisory Executive Committee that will help with co-ordination and controls. The government is co-ordinating with Regions and Autonomous Provinces to discuss their role and involvement in the programming of resources at a local level.

Read more: Piano nazionale di ripresa e resilienza

Implementation of Disclosure, Taxonomy and Low Carbon Benchmarks Regulations

The Draft European Delegation Law 2019-2020, which is currently under discussion in the Italian parliament, sets out the principles and criteria for how the EU SFDR will be implemented in Italy. In particular, Article 24 provides that implementation will take place through one or more legislative decrees that will be adopted by the Italian government within 18 months from the date of entry into force of the European Delegation Law 2019-2020.

Read more: Senato Della Repubblica – Delega al Governo per il recepimento delle direttive europee e l'attuazione di altri atti dell'Unione europea – Legge di delega - zione europea 2019-2020

Bank of Italy – sustainable investment strategy

The Bank of Italy has issued Guidance outlining the new approach adopted by the Bank in terms of sustainable investments. The new investment strategy integrates the ESG factors into the financial investments of the Bank of Italy's own funds, emphasising the utmost importance of developing its sustainable investment initiatives and raising public awareness, particularly by continuously improving the risk management and portfolio allocation practices in the pursuit of positive outcomes both in financial terms and in terms of social and environmental impact. The Guidance only applies to the Bank of Italy's own investment activities. Further to the publication of the ECB guide on climate-related and environmental risks for banks, no additional local guidelines in terms of climate risk assessment and disclosures or climate stress test have been issued yet by the Bank of Italy.

Read more: The Bank of Italy values sustainability in its financial investments

CONSOB calls for evidence

The Italian Companies and Exchange Commission (CONSOB) is continuing to refine its published analyses on ESG matters, emphasising the significant role that sustainable finance can play in the transition to the green economy. In September 2020, CONSOB launched a call for evidence to evaluate the voluntary adoption of the non-financial reporting regime, and ultimately to extend the regime to the whole business system. The call for evidence highlights how data collected so far suggests there is large approval for broadening of the obligation to report on non-financial information to other types of financial institutions. The non-financial reporting regime is currently mandatory only for "public-interest entities" i.e. companies whose securities are listed on Italian or EU regulated markets, banks and insurance and reinsurance undertakings which meet certain requirements in terms of balance sheet total (€20 million) or net turnover (€40 million) and number of employees (>500). The call for evidence closed on 30 November 2020 but the final report has not yet been published.

Read more: Regime Volontario Di Pubblicazione Della Dichiarazione – Di Carattere Non Finanziario (DNF)

Italy

New Corporate Governance Code

In 2020, Borsa Italiana, the company that manages and organises the Italian stock exchange markets, published an updated Corporate Governance Code. Although the Code is not mandatory (it operates on a "comply or explain" basis), it is expected that many Italian listed (and unlisted) companies will adhere to it in the course of 2021.

The Code:

- focuses on sustainability at board level – management goals are to be measured against sustainable success objectives;
- recommends the integration of sustainable activities through the definition of companies' long-term strategy and business plan, remuneration policies and relevant and non-financial performance goals and risk management systems;
- provides that, starting from the first renewal of the board and the internal controlling bodies, at least one-third of the board's members must belong to the "less represented" gender and that the company must adopt and continually monitor specific measures to promote gender equality and equal opportunities between genders.

Read more: Codice Di Corporate Governance

"Italy is seeing an acceleration in the way ESG factors are being adopted, with ever greater importance being given to the promotion of sustainable growth. New soft and hard law requirements will encourage Italian corporates to change the way they manage their risks and are expected to result in increased resources for entities with the best environmental, social and governance practices."

Tessa Lee – Counsel, Banking and Energy & Infrastructure, Milan

For more information visit our Italian ESG homepage

Luxembourg

Luxembourg, an ESG Nation

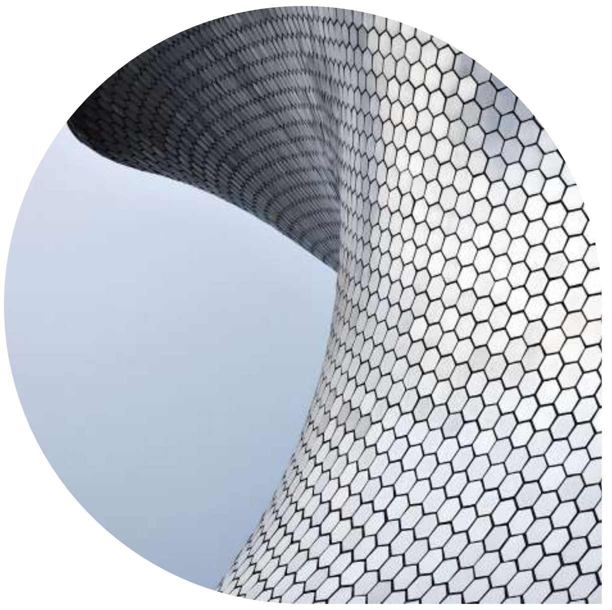
Luxembourg has always been deeply committed to sustainability and has been a forerunner on ESG initiatives long before ESG became a focus area of the larger international political agenda. As early as 2006, seven public and private partners (including the Luxembourg Finance and Environment Ministries) founded LuxFLAG (the "LUXembourg Finance Labelling AGency"), an independent non-profit association based in Luxembourg. LuxFLAG supports the financing of sustainable development by awarding internationally recognised labels (ESG, Climate Finance, Green Bond, Environment, Microfinance) to financial products based on strict quality checks, thus enhancing transparency and helping investor reliability.

In recent years, Luxembourg's financial centre has established itself as the European leader in green and sustainable finance. According to KPMG's report "European Responsible Investing Fund Market" of 2019 and 2016, Luxembourg is the leading domicile for European responsible investment funds. 34% of European responsible investment funds are located in Luxembourg, representing 35% of the assets under management of European responsible investment funds. Luxembourg has also established an ambitious climate finance strategy with the dual objectives of contributing in a meaningful way to the international fight against climate change and strengthening Luxembourg's role as an international centre for climate finance.

Continued Government commitment to sustainability

In September 2020 Luxembourg became the first European state and AAA-rated country worldwide to issue a sustainability bond, raising €1.5 billion for a mix of green bonds earmarked for environment-friendly projects and social bonds to finance public spending intended to achieve socially beneficial outcomes. At the same time, the government published eligibility criteria already in line with the EU's taxonomy for sustainable activities and the draft Green Bond Standard labelling scheme. In the future, Luxembourg may issue standalone green or social bonds via the sustainable bond framework.

Another government initiative enacted in its 2021 budget legislation is a concrete and very tangible measure to encourage sustainable investment by Luxembourg funds, through a progressive reduction in rates of the annual subscription tax on fund assets. Instead of the standard 0.05% rate (applicable to retail funds), funds investing at least 5% of capital in sustainable assets will enjoy a progressive reduction of between 0.01% and 0.04%, depending on the proportion of assets that fit defined sustainability criteria. The budget furthermore introduces a carbon tax of €20 per tonne of carbon dioxide emissions in pursuit of the government's 2030 target to reduce greenhouse gas emissions by up to 55% from their 2005 level.



Luxembourg

Luxembourg regulator offers fast-track SFDR prospectus approval

Fund sponsors with funds or AIFMs domiciled in Luxembourg have been watching closely the approach of the country's financial regulator, the Commission de Surveillance du Secteur Financier (CSSF), to the implementation of the EU's Sustainable Finance Disclosure Regulation (SFDR).

After establishing an internal ESG task force and consulting with industry bodies to help ensure a smooth SFDR transition, the CSSF just before Christmas unveiled a fast-track procedure to facilitate the updating of fund prospectuses and offering documents. Regulated funds can benefit from the fast-track approval process as long as they submit the revised documents meeting the SFDR disclosure requirements by 28 February 2021. The updated prospectus must be accompanied by a self-certification letter issued by the management company, fund board or GP, subject to certain conditions.

The CSSF acknowledges the difficulty stemming from adhering to the 10 March 2021 deadline, particularly in light of the delay to finalising and publishing regulatory technical standards. Once the EU's final SFDR implementing measures are in place, managers may have to update pre-contractual disclosures again over the next 12 months, but the Luxembourg regulator remains committed to finding practical solutions in co-operation with the industry.

Read more: Luxembourg - ESG update

Luxembourg Stock Exchange ESG initiatives

The Luxembourg Stock Exchange has been a pioneer in the development of Europe's green bond market. In 2016 it established the Luxembourg Green Exchange, a dedicated platform for green, social impact, sustainable or ESG-focused securities restricted to issuers that are fully transparent, and which now lists at least 50% of the world's green bonds. These include the €17 billion EU SURE social bond issued in October 2020 to finance measures to safeguard jobs and protect employees throughout the EU as part of its Covid-19 economic protection and recovery strategy. In October 2020, the LGX comprised around 830 securities with a value exceeding €320 billion.

In September 2020, the exchange also launched the LGX DataHub, a centralised database of structured data covering a vast range of sustainable securities to help asset managers and investors find the sustainability data they need. The DataHub includes pre-issuance data on commitments made by issuers on use of proceeds, project selection, and management of proceeds and reporting, as well as data points indicating an investment's contribution to the United Nations' Sustainable Development Goals, such as reduced greenhouse gas emissions.

"We will clearly see a shift in ESG considerations from niche to mainstream – many players consciously decide to position their offering in the 'green' space and no longer wish to be seen as 'ESG neutral'. That trend will clearly increase and the world of asset management may well reach a turning point in 2021."

Silke Bernard – Partner, Investment Funds, Luxembourg

Spain

Recovery, transformation and resilience plan

The Next Generation EU will enable Spain to embark on an unprecedented level of investment to overcome the crisis and enact structural reforms. Of the EU's €750 billion relief fund, it is envisaged that Spain will receive €140 billion between 2021 and 2026, of which approximately €72 billion, according to Spanish government estimates, will take the form of direct support with the rest provided as loans.

The government has announced its plan to target the €72 billion in the next three years (2021-2023) at rapid reconstruction of the economy, leaving the loans as a way of later supplementing projects already underway. Funds will be allocated within Spain's national budget.

In September 2020, the government approved a Recovery, Transformation and Resilience Plan setting out its investments and reforms for the years 2021-2023 and intended to lay the foundations for distribution of the support. The Plan is inspired by the UN's 2030 Agenda and Sustainable Development Goals and in the challenges identified in the context of the European Semester (country-specific recommendations) and focuses on four cross-cutting goals: ecological transition, digital transformation, territorial and social cohesion and gender equality.

Read more: España Puede – Plan De Recuperación, Transformación Y Resiliencia De La Economía

Climate Change Bill

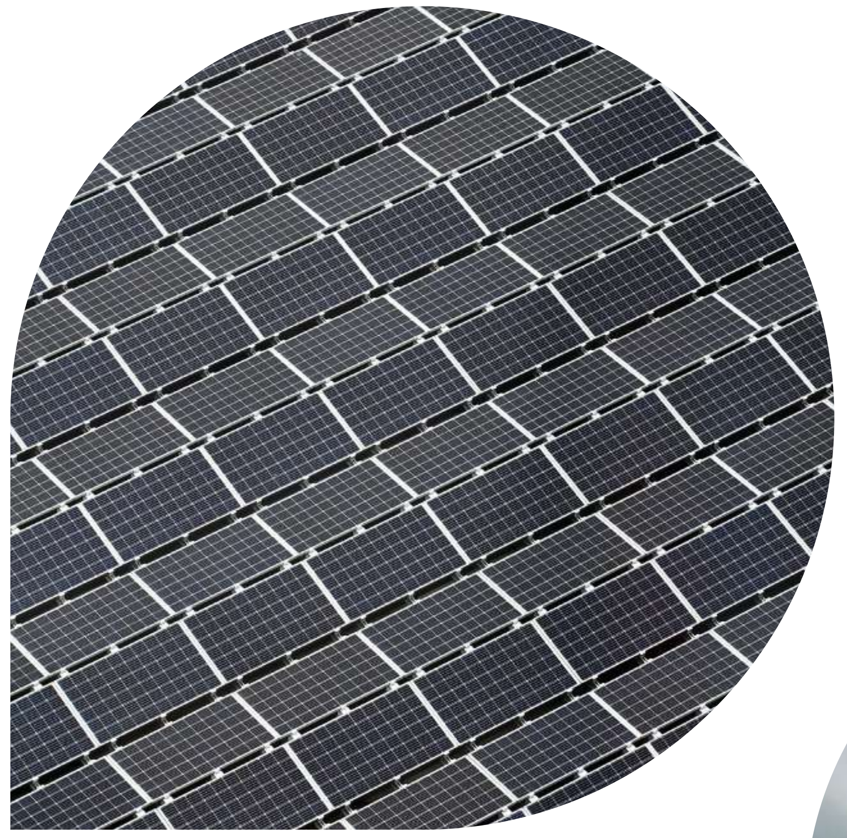
In May 2020, the Spanish government introduced the Climate Change and Energy Transition Bill to parliament for discussion and eventual enactment, expected for 2021. This Bill is part of Spain's policy package against climate change, which includes other instruments such as the Energy and Climate Plan (*Plan Nacional Integrado de Energía y Clima*) for 2021-2030 and the Adaptation to Climate Change Plan (*Plan Nacional de Adaptación al Cambio Climático*).

The objective of the Bill and these other instruments is to comply with the Paris Agreement and achieve climate neutrality in Spain by 2050. Specific targets in the Bill are: (i) to reduce greenhouse gas emissions in the Spanish economy by at least 20% by 2030 compared to 1990; (ii) to achieve a level of integration of renewable energies in final energy consumption of at least 35% by 2030; (iii) for at least 70% of electricity in Spain to be generated from renewable energies by 2030; and (iv) to improve energy efficiency by reducing primary energy consumption by at least 35% compared to the EU legislation.

Renewable energy

The Spanish government approved a legislative package in 2020 to drive forward the mass use of energy from renewable sources. The central legislation is Royal Decree 23/2020, which authorised the government to develop a new revenue framework for electricity production from renewable sources, based on a long-term fixed price for energy.

In December 2020, the starting gun was fired for the first auction process for allocating renewable energy capacity



Spain

and an indicative timetable has been set for the period 2020-2025, stating the minimum volumes of aggregate capacity for each technology for that period. The first auction was announced on 12 December, for 3,000 MW of capacity, to take place on 26 January 2021.

Repowering, hybridisation, storage, aggregation of demand and other concepts transposed from the EU Directives were also introduced in Spain in 2020.

In October 2020, the Spanish government released the Hydrogen Roadmap: a commitment to renewable hydrogen, which sets out a plan and measures to implement hydrogen-based projects in Spain. The Roadmap, which derives from and is in line with the measures and targets contemplated in the Energy and Climate Plan (*Plan Nacional Integrado de Energía y Clima*) for 2021-2030, will be updated every three years. Some of the measures contemplated in the Roadmap include regulatory changes to eliminate barriers to hydrogen production and setting up a system of guarantees of origin, as well as financial support and potential tax schemes to foster the development of hydrogen projects.

The main renewables support scheme in Spain, the annual cost of which amounts to around €7 billion, is currently funded by electricity customers. According to a recently published draft Bill, the Spanish government will create a national fund for electricity sustainability, which will be responsible for paying said costs associated with the support scheme. This fund will be funded by the supply companies and direct consumers in all different energy sectors (electricity, gas, petroleum products, etc.), rather than by electricity customers, amongst other sources (energy-related taxes already in place, State budget, CO_2 allowances auction proceeds and EU funds).

Finally, both the Spanish government and the regulator will soon approve further regulations to regulate the grid access process for new power generation facilities, providing for a clear framework which enhances serious renewables projects against purely speculative initiatives.

Read more: Spanish government passes new energy-related measures: particular impact on renewables projects

Climate change risks disclosure

The Climate Change and Energy Transition Bill (see above) includes a requirement for issuers, credit institutions, insurers, reinsurers and other "large" companies (companies required to include non-financial information in consolidated or individual management reports) to draft an annual report on the financial impact of climate-change-related risks, including the transition to a sustainable economy, and measures taken to address those financial risks.

Credit institutions would also be required to publish concrete investment and portfolio decarbonisation targets in line with the Paris Agreement from 2023.

Corporate Governance Code

In June 2020, the Spanish Securities Market Commission (CNMV) amended its Corporate Governance Code for listed companies. As well as adapting it to changes in the law since 2015, certain recommendations were modernised and clarified in significant areas, such as gender diversity on boards, non-financial information and risks, sustainability and remuneration. Other recommendations have been beefed up to guarantee effective oversight and supervision where practices or situations could affect firms' risk profiles or governance.

Read more: The Spanish financial regulator (CNMV) amends the corporate governance code for listed companies (Código de Buen Gobierno de sociedades cotizadas)

"Ecological transition and gender equality together with digital transformation and territorial and social cohesion are the four cross-cutting goals that will drive the recovery process and structural reforms in Spain in the coming years. This is a crucial moment where ESG factors are going to play a key role in investment decisions and be at the top of the agenda for boards and market players."

José Gimenez – Partner, Corporate, Madrid

United Kingdom

Climate strategy and targets

As co-host with Italy of COP26 in November 2021, the UK government is under pressure to show international leadership on climate. The government has announced a new interim target to reduce greenhouse gas emissions by 68% by 2030 and a commitment to end support for the fossil fuel sector overseas. It has also published a Ten Point Plan heralding a "green industrial revolution", with plans to mobilise £12 billion of government investment to contribute to meeting its net zero targets, to create 250,000 jobs and to drive green economic growth. This includes targets for offshore wind, hydrogen, nuclear, electric vehicles and carbon capture storage and utilisation. The Ten Point Plan was supplemented by the Spending Review and National Infrastructure Strategy, which announced the next phase of the government's "infrastructure revolution", with £100 billion of capital expenditure in 2020-21 to kickstart growth and support jobs. It announced the creation of a new UK National Infrastructure Bank to co-invest alongside the private sector in infrastructure projects, to be operational from spring 2021. The government has also published the long-awaited Energy White Paper and an interim net zero strategy, which set out (among other things) the government's aim for emissions-free electricity by 2050 with the majority of decarbonised power happening in the 2030s.

We can, hopefully, expect to see further detail in 2021 of how the UK government intends to implement its climate strategy in practice, including a final Net Zero Strategy and a decarbonisation plan for transport. COP26, which is due to take place in Glasgow, will no doubt help to focus everyone's minds on what is needed to turn climate ambition into real action.

Read more: UK's Green Industrial Revolution

Read more: National Infrastructure Strategy

Read more: Government sets out plans for clean energy system and green jobs boom to build back greener

Mandatory climate disclosures

The government has announced that the UK will become the first country in the world to make TCFD-aligned disclosures fully mandatory on a phased basis across the economy by 2025. It has published an indicative timeline showing the roll out of the rules to different types of organisations.

For reporting periods commencing from 1 January 2021, premium listed companies will be required to disclose how climate change affects their business, in line with the TCFD on a "comply or explain" basis. The FCA will consult, in 2021, on moving to mandatory disclosures for premium listed companies and extending the obligation to other listed companies.

The Department for Business, Energy & Industrial Strategy will consult in early 2021 on requiring companies registered in the UK, including very large private companies, to make TCFD-aligned disclosures in their annual report and accounts, with the regulations expected to be made in mid-2021 and to come into force in 2022.

The FCA will also consult in the first half of 2021 on introducing TCFD-aligned disclosures for asset managers, life insurers and pension providers. It aims to bring in those rules for the largest firms by 2022.

In the meantime, the Financial Reporting Council (FRC) is encouraging UK public interest entities to report voluntarily in line with the TCFD and the SASB metrics for their sector. The FRC concluded, in its climate thematic study in 2020, that corporate reporting on climate change needs to improve to meet the expectations of investors and other users and that investors expect to see disclosures regarding the future financial implications of climate change. The FRC has provided further detail of what it expects from climate reporting in 2021 in annual reports in its letter to CEOs, CFOs and Audit Committee Chairs.

Read more: UK paves way for mandatory TCFD climate disclosure for companies and other organisations by 2025

Read more: UK: FRC review of corporate climate reporting concludes more needs to be done to meet investor expectations

United Kingdom

Banks – supervisory expectations and climate stress test

The Prudential Regulation Authority (PRA) has made it clear that it expects banks and other regulated firms to fully implement the supervisory expectations in Supervisory Statement 3/19 by the end of 2021. The PRA will be paying particular attention to the metrics and targets that firms are using, their comparability and how they are incorporated into risk and governance frameworks. The PRA recognises that data limitations mean that firms will not be able to embed an end-state analysis of climate-related financial risks within their capital frameworks by the end of 2021. However, organisations should be able to explain what steps they have taken to ensure that, where appropriate, capital levels adequately cover the risks to which the firm is, or might be, exposed.

The Bank of England will be launching its climate stress test in June 2021. Participant firms will then have 3-4 months to make initial submissions, with results published in Q1/Q2 2022. Participants include seven large UK banks and building societies, five large life insurers and six large general insurers.

Read more: Guidance on PRA's expectations on approach to managing climate related financial risks - UK

Read more: Bank of England provides more detail on next year's climate stress test

Green bonds

The UK government has said it will issue its first sovereign green bond in 2021, subject to market conditions. It intends to follow up with a series of further issuances to meet growing investor demand for these instruments. These bonds will help finance projects to tackle climate change, finance infrastructure investment and create green jobs.

Read more: Chancellor sets out ambition for future of UK financial services

Pensions

The Pension Schemes Bill, which is expected to become law in early 2021, includes provisions intended to strengthen the obligations of occupational pension schemes in relation to climate change risk. Under these provisions, trustees may be required by regulations to take steps to ensure there is effective governance of the scheme with respect to the effects of climate change.

The government has published a detailed consultation on the requirements to be included in the regulations made under the Bill. It is proposing to require trustees of schemes with £5 billion or more in assets (as well as authorised master trusts and collective money purchase schemes) to have effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate risks and opportunities from October 2021. It is also proposing that they would be required to report on these in line with the TCFD recommendations by the end of 2022. Schemes with £1 billion or more in assets would be subject to the same requirements from October 2022.

Although the requirements would initially apply only to larger pension schemes, smaller pension schemes should expect similar requirements to extend to them in the coming years. The government has said it intends to "take stock" in 2024 and consult on the extension of the requirements to all other schemes.

Read more: Pensions and ESG: where are we now and what can we expect in the future?

"For UK banks and asset managers, the ESG agenda represents both a major shift in regulatory expectations and a significant new market of client opportunities. Firms will need to look not only at product design and disclosure, but also the prudential risks within their businesses, with a focus on individual accountability and regulatory reporting."

Peter Bevan – Partner, Financial Regulation, London

United Kingdom

Brexit - implementation of EU Taxonomy and Disclosure Regulations

The UK government has said it will implement its own green taxonomy, which will take the scientific metrics in the EU taxonomy as its basis. A UK Green Technical Advisory Group will be established to review these metrics to ensure they are right for the UK market.

The FCA has also indicated that it will not be onshoring the EU SFDR and that it will consult in 2021 on a new FCA regime for sustainable finance disclosures in the UK. This means that UK firms marketing their funds outside the EU will not need to comply with the SFDR. However, UK firms will likely be indirectly impacted if they have affiliates or clients that are subject to the EU rules and will be directly impacted if they market their funds into the EU.

Read more: Chancellor sets out ambition for future of UK financial services

Read more: Building trust in sustainable investments

FCA greenwashing principles

We are expecting a consultation from the FCA in the first half of 2021, on their proposed principles to help firms be "fair, clear and not misleading" in the design and promotion of their products from an ESG perspective, including when they submit new products to the FCA for authorisation. Our expectation is that the guidance will be reflective of the overall principles based approach that the FCA appears to be favouring in this area (as highlighted in a speech by Richard Monks in October 2020), in contrast to the prescription of the EU Sustainable Finance Disclosure Regulation.

Read more: Building trust in sustainable investments

Brexit – Environment Bill and carbon strategy

The Environment Bill, which will put on a statutory footing a number of environmental targets and principles in the UK after the end of the Brexit transition period, is expected to receive Royal Assent in the first half of 2021. The Bill will create a new environmental watchdog for England, the Office for Environmental Protection, to oversee how central government and public authorities implement environmental law. The Scottish and Welsh governments are planning to create separate environmental watchdogs.

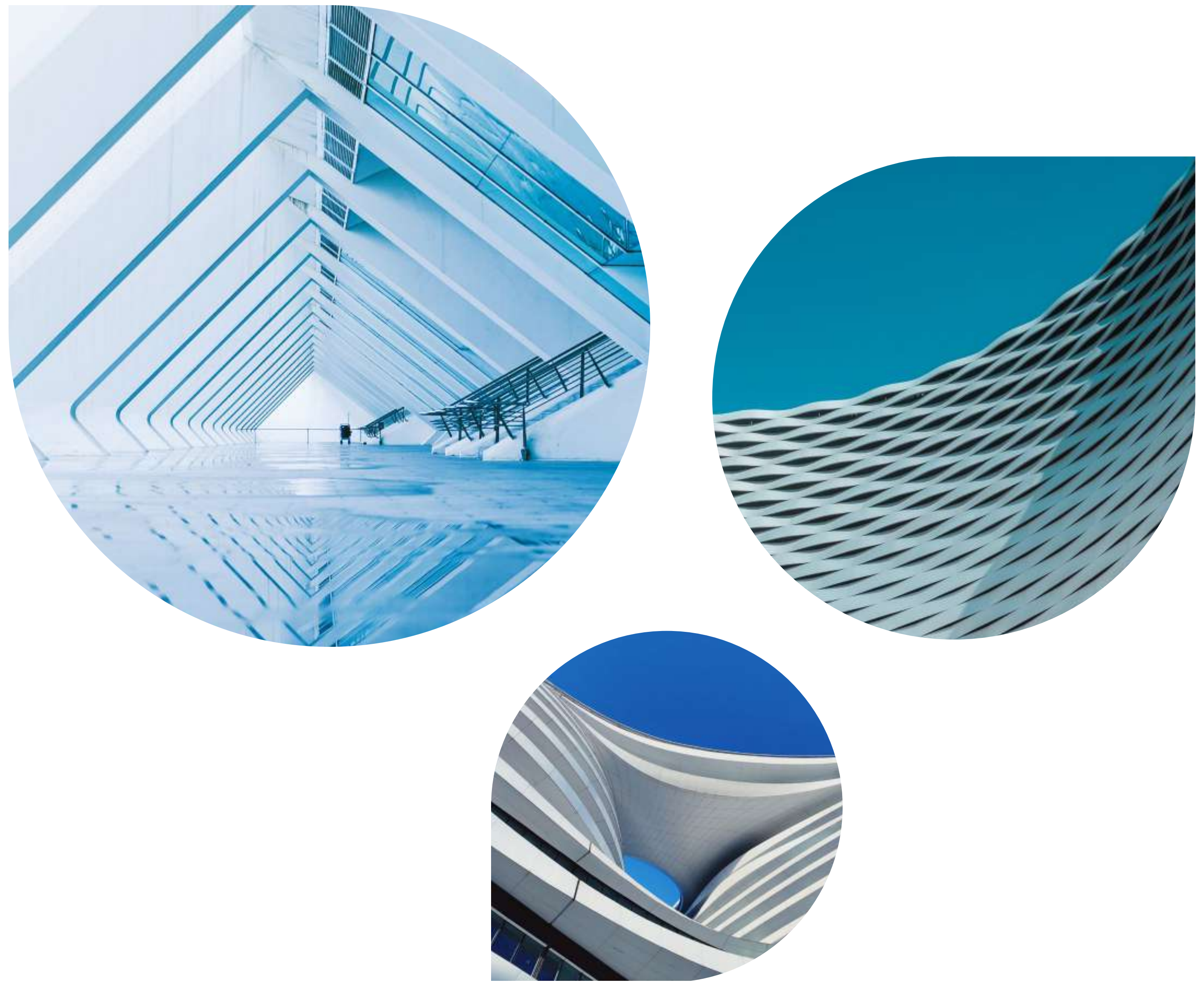
The UK government has also confirmed that it will be introducing a new UK Emissions Trading Scheme (UK ETS), as the UK will no longer be able to participate in the EU ETS after the end of the transition period. The Greenhouse Gas Emissions Trading Scheme Order was made in November 2020 and establishes a UK ETS. The scheme, which is intended to be operational from 1 January 2021, is expected to have an overall allowances cap 5% lower than the EU ETS.

Read more: Environment Bill 2019-21

Read more: UK Emissions Trading Scheme Order made

"The UK is making its mark, demonstrating that it plans to remain a key player on the world stage when it comes to tackling climate change, particularly with COP26 on the horizon. Expect incoming initiatives, such as mandatory climate risk disclosures, to start shaping corporate strategy and the allocation of capital, transforming the way businesses plan for the future."

Rachel Barrett – Partner, Environment & Climate Change and Co-Head of Business and Human Rights, London



United States

Ambitious Biden administration plans

The US is expected to rejoin the Paris Climate Agreement when President-elect Biden's administration takes over in 2021. Taking a step in this direction, Biden has appointed John Kerry, who had played a key role in negotiating the Agreement back in 2015, as a special presidential envoy for climate. Biden has also announced ambitious plans for the US to achieve a 100% clean energy economy and net-zero emissions no later than 2050. His administration may also stop leasing any new oil and gas rights on federal land and water, tighten emissions standards and raise fuel economy standards. We expect to see swift action, as the incoming administration's chances of passing major legislations in line with his climate agenda received a significant boost from the Democrats securing both Georgia Senate seats.

Read more: Here are 10 climate executive actions Biden says he will take on day one

Read more: The Biden Plan For A Clean Energy Revolution And Environmental Justice

Read more: Democrats win both Ga. runoffs, seizing control of Congress

ESG disclosures

President-elect Biden will take action to require public companies to disclose climate risks and greenhouse gas emissions in their operations and supply chains. Former SEC Chairman Jay Clayton took a principles-based approach to recent amendments to the SEC's disclosure rules, generally avoiding mandating ESG disclosures. However, it is expected that the SEC will institute broader rulemaking and guidance on the federal monitoring of ESG Issues under the new administration. The new SEC chair has not yet been named, but they may be more open to mandatory ESG disclosures and could join the other two SEC Commissioners who have already expressed their support for such action to form a majority at the SEC to push such disclosures.

Read more: Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information

Read more: During Biden Administration, SEC will require Climate Change Risk and ESG Disclosure

Department of Labor fund investment rule

The Biden administration may also reverse the recent Department of Labor rule preventing certain employee benefit plans from investing in "non-pecuniary" vehicles, which could discourage investment in ESG funds. Unless it does so, institutions marketing financial products into both the US and the EU will have to tread a delicate line in order to satisfy the US rules, those of the SFDR and the commercial appetite for ESG products.

Read more: Final Rule on Financial Factors in Selecting Plan Investments

Read more: U.S. Department of Labor proposes new rule that may impact ERISA plans and fund sponsors pursuing ESG

Department of Labor proxy voting and shareholder rights rule

The Department of Labor (DOL) also squeezed in a final rule on proxy voting before the end of 2020, which establishes a regulatory framework for exercising shareholder rights by private employee benefit plans' fiduciaries. In line with the DOL's recent investment rule prescribing investment considerations by plan fiduciaries to only "pecuniary factors", this final rule directs plan fiduciaries to only engage in a proxy voting decision when such a decision could have a financial impact on the retirement plan. Notably, however, any rule that has not been published in its final version in the Federal Register within 60 days of the inauguration (20 January 2021) can be reversed by Congress relatively easily through the Congressional Review Act.

Read more: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

Read more: DOL Issues Final Rule on Proxy Voting and Shareholder Rights

Read more: What the DOL could look like under Biden

> "Investors and regulators are focusing on ESG. It is one of the hottest areas in the US in terms of regulatory but also opportunities for investment managers to launch new products!"

Brad Caswell – Partner, Investment Funds, New York

United States

Carbon tax

Biden's climate change plan also supports international carbon taxes that would impose carbon adjustment fees or quotas on carbon-intensive goods from countries that are failing to meet their climate and environmental obligations.

Read more: France sees EU-US push for carbon tax under Biden

Department of Justice enforcement

Consistent with Biden identifying climate change as an "existential threat," he is expected to establish an Environmental and Climate Justice Division within the Department of Justice (DOJ). This unit will drive government enforcement efforts, and will be tasked with strategically supporting ongoing plaintiff-driven climate litigation.

Read more: The Biden Plan To Secure Environmental Justice And Equitable Economic Opportunity

Nasdaq board diversity proposal

Nasdaq has proposed requiring its listed companies to have, or explain why they do not have, at least two board of directors members who are diverse (i.e. female, an underrepresented minority or LGBTQ+), including (i) at least one female director; and (ii) at least one underrepresented minority or LGBTQ+ director. Companies would also have to provide annual board diversity statistics. However, it is not clear when or whether the SEC will approve Nasdaq's proposal.

Read more: Nasdaq proposes comply-or-explain board diversity requirement for listed companies

Launch of One Planet Private Equity Funds

Five global private equity firms joined forces to form the One Planet Private Equity Funds (OPPEF) initiative, which will aim to "advance the understanding of climate-related risks and opportunities" within portfolios companies so that they can "build better and more sustainable business". OPPEF will be joining two other groups under the One Planet initiative, one for sovereign wealth funds and the other for asset managers. In their joint statement announcing the launch of OPPEF, the founding members added that they will commit to "the sharing of our investment best practices with the members of the OPSWF and OPAN, and to develop a sectoral agenda, namely on energy transition and renewable energy, technology and innovation, utilities, real estate, transport and infrastructure".

Read more: Private equity giants join forces to fight climate change

Read more: Eight asset managers unite for One Planet initiative

Proposed rule by the Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency (OCC), a major bank regulator, proposed a rule on 20 November 2020 that would prohibit banks from turning away certain industries (such as fossil fuel, prison and gun manufacturing) under certain circumstances. This appears to be a reaction to major banks' policies for stopping or limiting lending practices in areas such as Arctic drilling and coal mines. The banks responded that their recent policies are not political but based on determination that such areas are not likely to be profitable. The OCC will have an extremely small window to review 4,000 comments and pass the final rule before the new Biden administration takes office. However, even if the final rule is passed at lightning speed, the new administration will be able to appoint a new head of the OCC, who may reverse its course.

Read more: Major regulator makes 11th-hour move to sink banks' oil limits

Read more: US aims to put pressure on banks to keep up fossil fuel lending

> "All signs are that the new U.S. administration is set to put combatting climate change and social issues at the center of its policy initiatives, and market participants already under pressure by stakeholders on these matters should be closely watching how these fast-changing developments affect the regulatory landscape."

Doug Davison – Partner, Dispute Resolution, Washington, D.C.

United States

US authorities focus on business and human rights impacts

US authorities are increasing scrutiny of the potential presence of forced labour in companies' supply chains. This pressure has been accompanied by increased enforcement actions by the US Customs and Border Protection agency in relation to goods imported into the US and concerns that they were manufactured using forced labour.

Read more: Supply Chain Management Reminder as US Blocks Imports Due to Forced Labor

Supreme Court set to weigh in on rising tide of ESG-related lawsuits

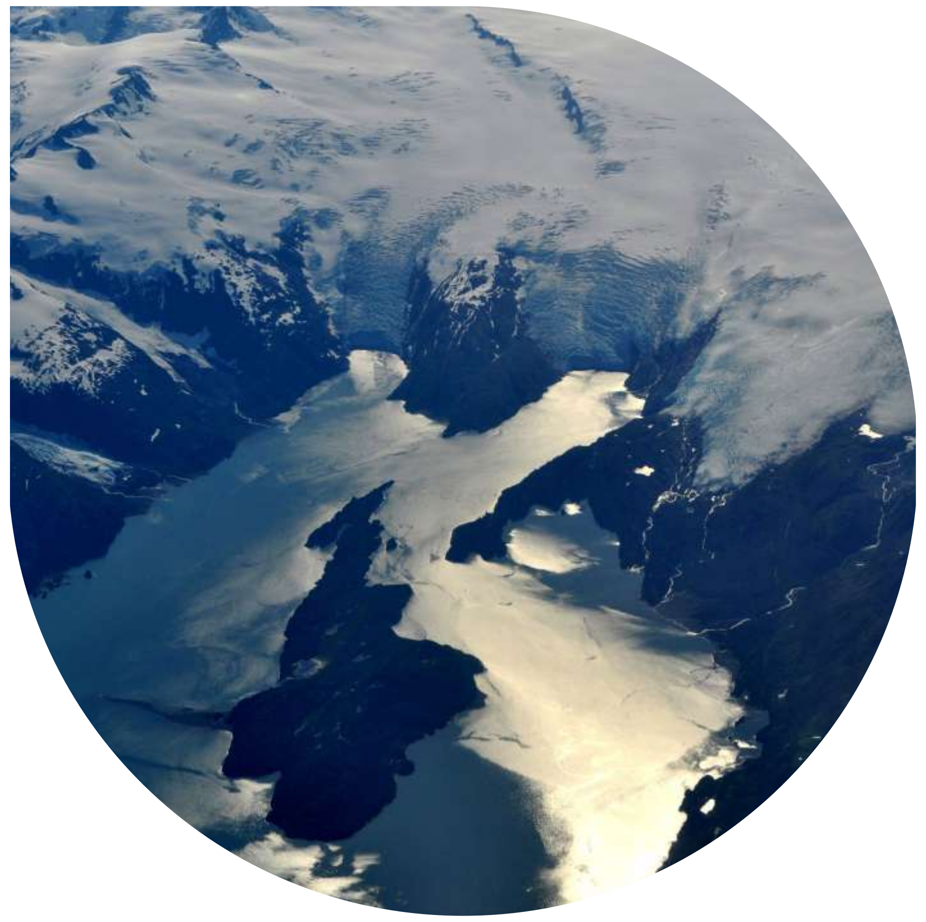
In addition, the U.S. Supreme Court is considering cases raising ESG issues. In particular, in the 2020-2021 term the Court agreed to hear an appeal filed by certain energy companies sued by the city of Baltimore for alleged climate change impacts. The Baltimore case is one of many others, including suits filed by Maui, Hoboken, Honolulu, the District of Columbia, San Mateo, San Francisco, Oakland and the State of Delaware, asserting common law and state law claims for damages arising from adverse climate impacts from fossil fuels. The Court also heard arguments in December 2020 in a case against food manufacturers relating to alleged human rights abuses and child slavery in the supply chain, an issue which has also arisen in suits filed against various technology companies reliant on the mining sector for key inputs. Decisions are likely to be forthcoming in 2021.

Latin America

Developments in Latin America have typically lagged behind those in more developed countries by several years. With respect to ESG matters, it has not helped that Latin America has traditionally looked towards the United States as a source of legal, market and business inspiration. Similar to the United States, the main drivers for ESG in Latin America comes from the private and business sectors, with regulators following behind. ESG has become a prominent area of focus in recent years nonetheless, with a high level of public awareness and a momentum of its own. We expect to see further ESG developments in the region in 2021, including increased interest from regulators, market participants, businesses and the general public. In particular, there should be more ESG-debt issuances, more corporates adopting international ESG principles, including in their reporting, and governments progressively enacting more ESG-related regulations.

"With or without government encouragement, market participants in Latin America are seizing the initiative in the ESG space, reporting on the basis of relevant performance indicators internationally used and increasingly raising sustainable finance linked to them. As we have seen in other areas, once the main countries in the region embrace a global trend, it becomes unstoppable and that is exactly what we are seeing with ESG."

Andrew Compton – Partner, Finance, New York
Alejandro Gordano – Counsel, Finance, New York



Brazil

Drivers of ESG transactions

ESG transactions in Brazil are largely driven by a blend of foreign investors, multilateral development finance providers and local financial institutions. Brazilian corporates are also playing an important role in the ESG space. While there is currently no carbon tax or carbon trading scheme in Brazil, some Brazilian corporates have started to set self-imposed carbon reduction goals. An evolving voluntary market has resulted from such self-imposed corporate goals and the use of voluntary carbon credits to achieve them. While this is not permitted under the Science Based Targets initiative, it has been incentivised by the Brazilian government and is consistent with the practice in other jurisdictions.

Growth in green, sustainability-linked and social bonds

The market for green, sustainability-linked and social bonds continues to grow in Brazil. Some estimate that the market for these bonds in Brazil is approximately $110 billion. While the greatest focus has been on green bonds applying the Climate Bonds Initiative standard, there is also a growing market for social bonds which apply the ICMA social bond principles. In September 2020, Suzano, the Brazilian pulp and paper company, issued the first sustainability-linked bond in an emerging market applying the ICMA principles published in June 2020.

CVM sustainability requirements

Brazilian corporates are working to improve their reporting and enhance transparency to anticipate reporting requirements on sustainability being developed by the Securities and Exchange Commission of Brazil (CVM). Originally, corporate policies were based on compliance with Brazilian law, but now Brazilian corporate compliance is extending to international standards. In addition, approximately 40% of all companies listed on the Brazilian stock exchange are included in a special ESG listing segment.

Local interest in ESG issues

Following a series of major mining accidents in Brazil, international investors have blacklisted certain Brazilian companies resulting in corporates taking environmental and sustainability issues more seriously. The accidents have called attention to the litigation and investment risks associated with environmental malfeasance. Local public opinion is particularly sensitised to environmental topics.

Opportunity for international investment

The Brazilian Development Bank (BNDES) is moving away from funding green infrastructure projects in Brazil and is instead focusing on modelling projects. International investors are expected to step in and play a larger role in green infrastructure projects in the future, which will lead to an enhanced focus on ESG considerations.

Central Bank of Brazil's environmental policies

The Central Bank of Brazil has established rules that apply mandatory environmental policies to financing decisions made by local banks. BNDES is also planning to introduce recommendations on climate-related financial disclosures by the TCFD. As a result, local banks are also starting to focus on environmental and sustainability issues, complementing work already done in the space by international participants.

Note: We'd like to thank Brazilian law firm Machado, Meyer, Sendacz e Opice Advogados who contributed to this section.

Peru

Increase in ESG-related securities issuances

During 2020, the Lima Stock Exchange increased its efforts to promote thematic bond issuances, including green, social and sustainable bonds. The Lima Stock Exchange has published general guidelines for these issuances and actively engages in activities to increase market awareness regarding the benefits of issuing ESG securities under international standards (as there is no Peruvian regulation applicable to ESG securities).

Since the publication of the Guidelines for the Issuance of Green Bonds by the Lima Stock Exchange in 2018, there has been a noticeable positive trend for green bond issuances that has been followed by the issuance of social and sustainable bonds both by local private and state-owned companies.

It is expected that certain Peruvian issuers will seek to issue sustainability-linked bonds in order to eventually transition into better ESG practices.

Implementation of ESG guidelines by large investors and local debtors

In the absence of government regulations regarding sustainable investments, private actors such as the Responsible Investment Program (*Programa de Inversión Responsable*), comprising the largest Peruvian market participants, including pension funds, financial entities and investment funds, have begun to issue voluntary guidelines to promote sustainable investments among its members. Such guidelines include concrete actions that companies may take in order to effectively adopt policies promoting sustainability regarding their internal management and investment criteria, including investment screening tests.

Even though the guidelines are voluntary, since the Peruvian market makers are aligned (or expected to become aligned) with them, it is likely that local companies will begin to take notice and adapt their practices to the guidelines to avoid increasing their financing costs and be sustainable over time.

Development of a local carbon market

During the Climate Week 2020 conference in New York, Peruvian authorities announced the creation of the National Registry of Mitigation Measures (*Registro Nacional de Medidas de Mitigación*), which is expected to quantify and keep track of carbon emission mitigation efforts by local entities. Subsequently, a ministry resolution approved the guidelines for the National Carbon Tracking Tool.

The active participation of the government in tracking and accounting carbon emission reductions is expected to contribute to the creation and development of a Peruvian carbon market.

It is expected that more regulation will be approved to foster carbon trading locally and internationally.

Disclosure regarding ESG practices by local issuers

In February 2020, the Peruvian Securities Market Regulator approved a new Corporate Sustainability Report. The new report increases the number of questions and definitions regarding the policies, standards and actions implemented by issuers regarding environmental matters and their business model regarding sustainability.

Issuers must publish such a report during the first quarter of 2021, alongside the customary annual financial statements. As such, it is expected that the publication of such report and the related market scrutiny will help drive issuers to implement better ESG practices, in order to match the increased appetite of investors for ESG-aligned companies.

Certified B corporations

In November 2020, a law approved a new regime under which existing companies incorporated in Peru may opt to become certified as “B corporations” (without changing their corporate form) by adapting their articles of association (*estatutos*) so that their corporate purpose expressly includes the obligation to generate a positive impact on society, which includes generating positive social and environmental impact through business activities.

Such companies will have disclosure obligations and be subject to review from independent third parties to verify and measure their environmental and social impact.

It is expected that such companies will be able to access better financing conditions and maintain a sustainability-driven competitiveness in the local market.

Peru

Banking green protocol

In October 2020, the Ministry of the Environment, the National Banking Association and the National Microfinance Association, among other large financial institutions, entered into the Green Protocol, which seeks to incorporate environmental sustainability criteria regarding risk and portfolio management by financial entities.

It remains to be seen to what extent the market will adopt these new standards or what impact it will have on the local credit market. During 2015, a similar protocol was approved, but it was not widely adopted and was eventually discontinued.

Increase in Peru's Nationally Determined Contribution

In December 2020, recently appointed President Francisco Sagasti announced that Peru would be formally increasing its obligations to reduce carbon emissions from 30% to 40% by 2030 as part of Peru's Nationally Determined Contribution under the Paris Agreement.

This is expected to be followed by measures to promote a transition to greener practices by local companies.

Note: We'd like to thank Peruvian law firm Rubio Leguía Normand who contributed to this section.

Chile

ESG drivers

Until 2019, there had been limited ESG activity in Chile. However, social unrest and street violence in 2019, mainly triggered by widespread dissatisfaction with the education, healthcare and pension systems, shifted the focus on ESG and increased the general awareness across Chile of its importance. Political and business leaders subsequently realised that it was crucial to improve the relationship with both the community and the environment.

In addition to this political driver, foreign commodities buyers have started to require Chilean suppliers and producers to certify ESG compliance across the value chain for commodities sourced in-country. This is evidenced by required certifications for human rights and business/operational practices, as recently seen in the salmon farming industry.

As of a result of the political unrest and following a referendum in 2020, the Chilean constitution will be amended in 2021. An important topic of the constitutional amendment will be capitalism and its relationship with society. Other ESG drivers include international NGOs that promote and try to influence outcomes in Chile and multilateral financial institutions.

Growth in green, sustainable and social bonds

The market for green, sustainability-linked and social bonds continues to grow in Chile. The Republic of Chile issued several series of green and social bonds, including with second party opinions, in the international capital markets during 2020. In November 2020, it approved a sustainable framework pursuant to which it expects to issue further green, social and sustainable bonds. Additionally, several Chilean corporates have issued green bonds, such as energy producer AES Gener and pulp and paper giant CMPC. Many Chilean companies already have a department dedicated to sustainability, which reflects the allocation of resources to this area. Finally, the Dow Jones Sustainability Chile Index now includes about 50 Chilean companies. Although the number of companies included in the index is high, the score for certain ESG aspects is low, for example regarding governance, as many Chilean boards of directors lack diversity.

Disclosure requirements

Although a new administrative regulation requiring certain disclosures relating to investments by the pension fund managers or AFPs (*administradoras de fondos de pensiones*) was issued in November 2020, it was only to increase transparency and it did not mandate any specific ESG investment considerations. The expectation is that transparency will motivate improved ESG-related behavior by pension managers. Additionally, the Comisión para el Mercado Financiero (Financial Market Commission or FMC) started a public consultation regarding ESG disclosure in 2020, but the process has largely not progressed since then.

Financings, carbon trading and water

The Chilean Central Bank has not issued any ESG-related financing regulations and the local banking industry seems reluctant to take the lead in this space on its own. That said, some international banks and multilaterals have driven the ESG movement in Chile by applying international standards to financing transactions.

In the energy space, consistent with trends being seen around the globe, legacy coal-fired plants in Chile are being phased out or sold. Chilean mining companies that contract energy directly from power generation plants have also recently terminated supply contracts with coal-fired plants, even at significant cost, and contracted with green generators.

Water regulation and management is also expected to be an important topic in 2021 in Chile, as the country has recently faced significant droughts and water access issues. This topic is particularly relevant for mining companies, hydroelectric power producers and fresh fruit producers, which consume large quantities of water. Judicial activism and lawsuits have been used in the past to stop or restrict water usage by such corporate actors, and the Chilean Supreme Court has confirmed the annulment of certain corporate environmental permits, for example for the development of a hydroelectric power plant, where the neighbouring population was at risk.

Note: We'd like to thank Juan Eduardo Ibanez Gomien, Director of the Graduate School of Law and of the Corporate Sustainability Program at the Catholic University of Chile, who contributed to this section.

Asia

Green and sustainable finance in Asia

Overview

Green and sustainability-linked lending is attracting considerable attention in the Asia Pacific markets, with year-on-year volumes increasing since the first Asian sustainability-linked loan in 2018. Singapore is now one of the top 10 countries globally by aggregate for sustainability-linked loan volumes.

In May 2020, the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) established the green and sustainable finance steering group with the aim of co-ordinating between different financial sectors and ensuring disclosure of ESG matters in investment processes (see Hong Kong SAR section below).

In November 2020, the Monetary Authority of Singapore (MAS) announced the launch of the Green and Sustainability-Linked Loan Grant Scheme (GSLS), which will be effective as of 1 January 2021. The first of its kind globally, the GSLS aims to enhance corporates' ability to obtain green and sustainability-linked financing and encourage lenders to develop green and sustainable financing products, particularly for SMEs.

Most Asia Pacific banks are now actively offering, or looking to offer green and sustainability-linked products, with a particular focus on the utilities, transport, commodities and consumer sectors. For sustainability-linked financings, Asian lenders and borrowers continue to be enterprising in developing bespoke products, with interest reductions for meeting green targets now being complemented with "sustainability premiums" (interest increases for failing to meet green targets) payable, for example, to green and charitable projects.

Sustainable bonds and the launch of Asia's Sustainable and Green Exchange

The emergence of sustainability-linked bonds presents an exciting opportunity for Asian issuers looking for innovative ways to tap into the sustainable bonds market. An example of this includes Bank of China Macau Branch, which became the first Asian issuer of blue bonds in September 2020. Proceeds from the issuance will be used to promote renewable energy, sustainable water and waste-water management, with the bonds issued in accordance with ICMA's Green Bond Principles. Other issuers in the region, including ReNew Power and BTS Group Holdings, have also tapped the sustainable bonds market this year with considerable success.

Likewise, a number of regulators in Asia have shown strong support for developing the sustainable bonds sector, including through the introduction of bond grant schemes and consultation with market participants to formulate standardised frameworks and taxonomies for green and sustainable finance, with a view to ensuring ESG remains a core principle of good corporate governance for companies.

In its bid to support the fast-growing interest among issuers and investors for sustainable finance products, the Hong Kong Stock Exchange (HKEX) launched Asia's first ever multi-asset product portal for sustainable investments, the Sustainable and Green Exchange (STAGE), in December 2020. STAGE is an online portal that provides a wide variety of information on sustainable-themed products listed on the HKEX. At launch, STAGE included 29 products under the following themes: blue, green, social, sustainability and transition bonds, in addition to clean energy and ESG exchange traded funds. It is anticipated that over time, the range of asset classes and product types will continue to grow.

The HKEX admits issuers with products that meet "international standards or principles" for inclusion in STAGE. We await elaboration from the HKEX as to the standards and principles it recognises, but expect that those published by international bodies such as the ICMA and the Climate Bonds Initiative will be recognised.

STAGE acts as a central hub for data and information on sustainable and green finance investment in the Asia region and promotes the visibility, transparency and accessibility of sustainable financing by assisting issuers in raising investors' awareness of their sustainable and green financial products, as well as offering investors easy access to information for product selection and monitoring. Issuers included in STAGE are required to publish additional information such as use of proceeds reports and post-issuance reports.

Hong Kong SAR and Mainland China

Regulatory expectations on sustainable finance in Hong Kong SAR

Over the course of 2020, sustainable finance has raced to the top of the agenda for both the banking regulators, the HKMA and the SFC, with both bodies setting out expectations for the firms they supervise and promising further developments.

2020 has seen the publication of the HKMA's white paper on its initial thinking on how it will supervise banks in relation to climate-related issues. The paper includes some practical actions that banks can take. This period of development of supervisory expectations is the second phase of the HKMA's three phased approach to promoting green and sustainable banking. The continuation of phase two will see the HKMA consulting the industry in early 2021 on what its supervisory expectations will be. The HKMA has said it intends to adopt a proportionate approach in the development of the supervisory expectations, as well as looking at ways to help banks in the management of climate-related risks and business. The third and final phase (currently targeted for 2022) will involve setting green and sustainable targets and implementing, monitoring and evaluating the progress of banks toward these targets.

The SFC meanwhile took the latest step in one of its priority areas in developing green finance in Hong Kong. In October 2020, it published its 'Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers' proposing amendments which would require fund managers to take climate-related risks into consideration in their investment and risk management processes and make appropriate disclosures on climate risk information. The consultation closes on 15 January 2021, so later in 2021 we should see the rules for fund managers finalised, with a transition period of between nine and 12 months for compliance.

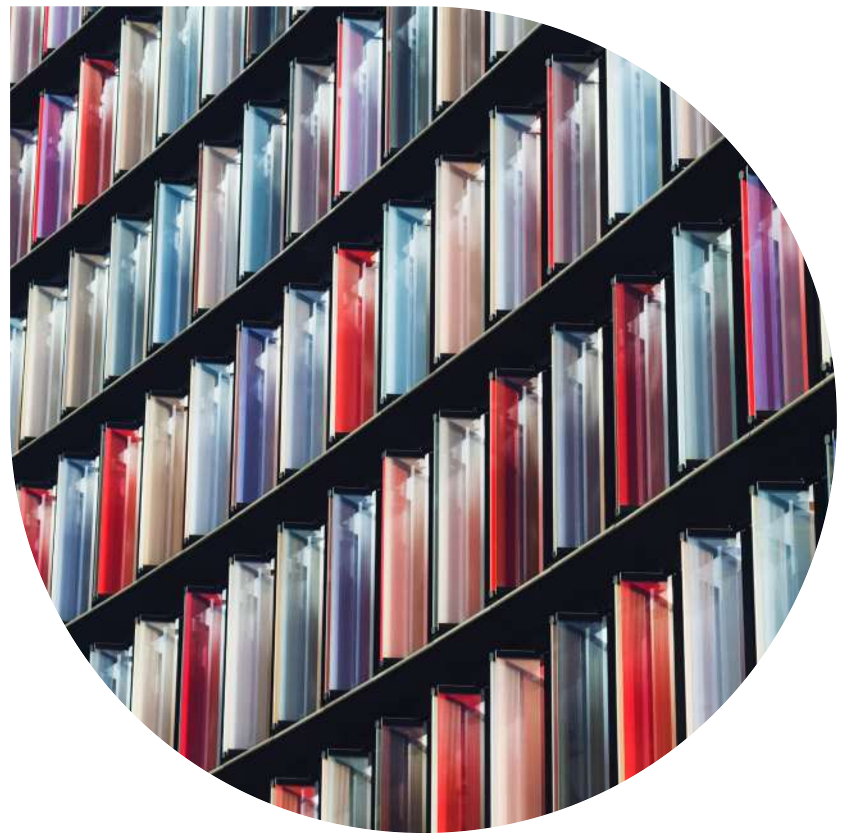
Further change on the disclosure front is expected in relation to the list of SFC-authorised funds which incorporate globally recognised green or ESG criteria or principles and reflect this in their name and investment objective/strategy. The SFC has said that further guidance on this may be issued in due course to, for example, further reduce the risk of "greenwashing".

Placing this within the context of the SFC's existing investor protection priorities, organisations seeking to capitalise on investor interest in ESG will need to be cognisant of the regulatory risks that can arise as the SFC (and other regulators globally) works to integrate ESG into their supervision of suitability matters, as well as the risks of investor mis-selling claims that can arise in such circumstances. Potential for civil liability may also arise in the form of disclosure-related litigation – similar to cases seen in the US, Europe and Australia – following enhanced ESG reporting requirements imposed on listed companies by the HKEX.

Finally, a major step in 2020 was the formation of the Green and Sustainable Finance Cross-Agency Steering Group, whose members include the SFC and HKMA, among

"In 2020, Hong Kong regulators made it clear that sustainable finance is a top priority as they look to position the city as a green hub both in the region and globally. Going forward, we expect the focus to extend to the 'S' and 'G' aspects of ESG as well."

Alex Bidlake – Partner, Corporate, Hong Kong SAR



Hong Kong SAR and Mainland China

others. The group aims to co-ordinate the management of climate and environmental risks in the financial sector, accelerate the growth of green and sustainable finance in Hong Kong, and support the government's climate strategies, and published its Strategic Plan in December 2020. The Strategic Plan's six focus areas include strengthening climate-related financial risk management, promoting the flow of climate-related information and raising public awareness, as well as encouraging innovation and exploring initiatives to facilitate capital flows towards green and sustainable causes. The establishment of this group is promising and should ensure a joined-up approach to ESG direction in the financial sector in Hong Kong.

Read more: The Securities and Futures Commission ("SFC") Consultation on Climate–related Risks for Fund Managers

Mainland China: setting the scene for the next five years

The ESG-related regimes in mainland China are still at a relatively early stage of development, but the potential for growth is immense if given the right push from targeted government policies. We have witnessed meaningful developments in 2020, highlighted by the announcement in September by Chinese President Xi Jinping that mainland China would strive to hit peak carbon emissions by 2030, and achieve carbon neutrality by 2060. For a country generating the most carbon emissions in the world, this target is perceived to be ambitious and should, in particular, boost investment in "green" industries such as renewable energy, waste treatment, and/or related technologies. We therefore anticipate further regulatory movements in 2021, in response to this target. In fact, regulators have already echoed this directive, as evidenced by guidance issued from various ministerial level authorities in October 2020 to promote investment and financing to address climate change, setting out targets for 2022 and 2025 respectively.

On 5 January 2021, the environmental authority published pilot rules for carbon emission trading management, which aims to regulate the carbon trade and related activities within China. Following this move, the environmental authority is also expected to formulate and publish regulatory documents on greenhouse gas accounting reports and verification, carbon emission rights registration and transaction settlement with a view to establishing the regulatory framework for the national carbon market.

Unlike some other jurisdictions which have introduced mandatory disclosure requirements for listed companies concerning ESG, the development in this regard so far remains limited, but 2020 still witnessed some exciting regulatory changes. Following the requirement in 2019 for mandatory social responsibilities disclosure in annual reports of the companies listed on the Science and Technology Board (STAR Market), the Shanghai Stock Exchange established a voluntary disclosure mechanism concerning, among others, ESG for the STAR Market in September 2020. In the same month the Shenzhen Stock Exchange introduced voluntary ESG disclosure in its assessment of the overall disclosure quality of listed companies. In light of these moves, mandatory ESG disclosure may be on its way for all listed companies in China.

2021 also marks the beginning of the 14th five-year development period. The latest iteration of mainland China's 14th Five-Year Plan, to be released in early 2021, is expected to set the course for a landmark period for developing, among other things, a nationwide and unified carbon market and the Plan will outline the energy and environment related development guidelines for the following five years.

Japan

2020 was a turning point for Japan

Prime Minister Suga announced Japan's commitment to reach net zero by 2050 in his inauguration address at the end of October. This announcement was unexpected but, in general, it was received as a welcome surprise followed by ambitious commitments made by some influential business executives. According to the Nikkei[1], 39 companies of the Nikkei 225 index (representing approximately 20% of the total market capitalisation of the Nikkei 225 companies) committed to net zero and many executives' New Year's interviews referred to growth opportunities associated with the nation's net zero commitment. 2021 will be a year to further deliberate the growth strategy based on a longer-term vision and, in some areas, take the first step towards the net zero goal.

Following the nation's net zero announcement, the government released the first iteration of its Green Growth Strategy on 25 December 2020. This sets out a roadmap to 2050 and recognises the scale of the challenge and the significance of the transformation required for the nation's industry, society and economy. It indicates that there are many companies that require fundamental changes in their corporate strategy and business models but, at the same time, the transition presents tremendous growth opportunities. The Green Growth Strategy is designed to create jobs and grow the economy by (i) encouraging private sector investment, (ii) mobilising $2.2 trillion cash held in bank accounts, and (iii) attracting global investment funds earmarked for ESG (which are reported to be $30 trillion).

Encouraging private investment

To encourage private investment for the transition, the government acknowledges the importance of predictability and therefore indicates specific (and ambitious) provisional numerical targets in the Green Growth Strategy for 14 priority industries. These include offshore wind, hydrogen, ammonia, nuclear, automotive, digital infrastructure, shipping, agriculture, aviation and carbon recycling. Decarbonisation of the electricity sector by 2050 is a must (despite the expected 30-50% increase in electricity demand). The proposed energy mix in 2050 (with a caveat that is subject to further discussion) is to be: (i) 50-60% renewables[2], (ii) 30-40% nuclear, CCUS and/or carbon recycling and (iii) 10% hydrogen and/or ammonia. For the automotive sector, the government is aiming to end new sales of internal combustion engine vehicles by mid-2030s.

The government has said it will fully support private companies' challenging endeavours by providing budgetary support (for example, a $19 billion government fund for decarbonisation technology), tax benefits, finance, deregulation and regulatory reforms and international co-operation. Hydrogen and battery storage have been highlighted as priority areas of investment and development as well as carbon recycling.

Facilitating sustainable finance

On the finance side, new facilities will be set up by government owned entities (e.g. Japan Investment Corporation, Development Bank of Japan and Japan Bank for International Cooperation) to provide transition finance.

"Government reforms and corporate improvements backed by a commitment to reach net zero by 2050 means that Japan is taking ESG very seriously. An increased focus on governance and more disclosure tools means that ESG issues will become more embedded within the strategy and risk management frameworks of Japanese companies."

Hirofumi Taba – Partner, Energy & Infrastructure, Tokyo

Japan

Further, Japan's Financial Services Agency will form an expert panel on sustainable finance to look to develop guidelines around investment in Japanese companies that have advanced technologies and to fully leverage their potential to substantially contribute to decarbonisation.

It is notable that over 300 companies in Japan have expressed their support for the TCFD (more than any other country) and in 2019 and 2020 Japan chaired the TCFD Summit. Despite this, some companies that have made significant commitments to ESG issues have not necessarily focused on disclosing this or their adherence to ESG goals. This may be because of the lack of practical guidelines on the extent and quality of information expected in Japan for active investor engagement. There is business community expectation for the government to lead the discussion in G7 and G20 to agree consistent practical guidelines and/or disclosure requirements.

By way of broader context, the cross-shareholding structure between banks and corporations (and within corporations) that has been prevalent in Japan since the 1960s can function to dilute the impact of any potential shareholder activism, including in relation to ESG issues. However, we are likely to see a shift going forward; there will continue to be an increased focus on governance, particularly in light of the (i) expected amendments to the Tokyo Stock Exchange's Corporate Governance Code and (ii) March 2020 amendments to Japan's Stewardship Code to build into the definition of "stewardship responsibilities" of institutional investors a consideration of the sustainability (including ESG factors) of investee companies consistent with their investment management strategies. And with more disclosure tools, it is likely to become clearer how ESG issues are already embedded within the strategy and risk management frameworks of many Japanese companies.

1 Nihon Keizai Shimbun 3 January 2021

2 The Green Growth Strategy notes that given the intermittency, grid capacity, lack of inertia force, natural and social economic limitations, it is unrealistic to source 100% of the power demand from renewables.

Singapore

Issuance of environmental risk management guidelines

In December 2020, the MAS issued environmental risk management guidelines in respect of banks, asset managers and insurers. The guidelines aim to enhance these financial institutions' (FIs) resilience to environmental risk and strengthen the financial sector's role in supporting Singapore's transition to an environmentally sustainable economy.

The guidelines set out sound practices in relation to an FI's governance, risk management and disclosure of environmental risk. These include:

> Governance and strategy – Board and senior management should exercise oversight of their FI's environmental risk management and take environmental considerations into account regarding their FI's risk appetite, overall strategy and business plans.

> Management and monitoring of environmental risk exposures – FIs should develop capabilities in scenario analysis and stress testing (the latter in respect of banks and insurers) to assess resilience to financial losses. FIs are generally expected to engage with higher-risk customers to support their transition to sustainable business practices (e.g. ranging from sector collaboration to the use of financing conditions in loan agreements). FIs should also train staff to assess, manage and monitor environmental risk.

> Disclosure – FIs should disclose their approach to environmental risk management, with reference to international reporting frameworks such as the TCFD recommendations.

FIs have been granted a period of 18 months to implement the guidelines.

Read more: Green expectations: The MAS consults on environmental risk management guidelines

"Singapore is following the same path as many other countries in asking financial institutions and asset managers to assess and disclose their exposure to risks posed by climate change. Going forward, they will need to explain how they are factoring these risks into their operations and business plans. Corporates should also start looking at this proactively to identify and mitigate risks as they formulate their wider business strategies."

Rob Elliot – Partner, Corporate, Singapore

South Africa

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Mining focus

Historically the backbone of South Africa's economy, the metals and mining sector is seen to have unprecedented opportunity, resources and responsibility to drive the sustainability agenda. The metals and mining sector is increasingly exposed to ESG risks, including concerns around emissions, water use, deforestation and community relations. As emerging societal pressure grows for companies to act responsibly in tackling priorities such as climate change, the mining industry response is critical for investor confidence.

The UN's 2030 Agenda for Sustainable Development and private institutions' contribution towards the fulfilment of the Sustainable Development Goals has resulted in ESG standards having a more prominent and actionable impact. Member companies of the International Council on Mining and Metals are further required to apply and report against a set of Mining Principles covering a range of ESG issues.

The progressive investment agenda termed 'impact investing' is increasingly seeking value beyond compliance, creating a fundamental synergy between economic performance and social progress. Companies have thus been encouraged to move away from seeing ESG as a reporting and data gathering exercise, to extracting value from it, acknowledging that ESG components can add value and make a company risk-resilient.

Read more: The mining sector is evolving in line with global demand for increased responsibility and sustainability

Shareholder activism

AGMs have become the new battleground for climate justice, as ethically-aware shareholders ramp up their demands for companies to acknowledge climate change. In 2019, environmental and shareholder activists tabled the first climate change-related resolution in South Africa, which if passed would have seen a bank required to report to shareholders on its exposure to climate risk. The resolution received support from a significant 38% of its shareholders, and although not passed, the amount of support indicated there could be more to come as pressure mounts for corporates to place climate change issues higher on the agenda. In 2020, after Standard Bank declined to table the latest climate-related resolutions put forward by activist shareholders, there were calls to vote against the re-election of five of its non-executive directors due to perceived conflicts of interest. In July 2020, a steel company, the country's third largest emitter of greenhouse gases, became the latest major corporate targeted at its annual shareholders meeting, as activists flagged alleged environmental transgressions and demanded action.

These governance actions can be precursors to climate change litigation, which is also on the rise in South Africa since the landmark judgment of *Earthlife Africa Johannesburg v Minister of Environmental Affairs and others* in 2017. Companies are now, as result of shareholder activism, starting to develop comprehensive policies on climate change risk management.

Carbon tax and climate change legislation

Various climate change regulatory frameworks have also been promulgated in South Africa to oversee the mandatory reporting of greenhouse gases and priority air pollutants. More recently, a carbon tax was imposed on fossil fuel use. A draft Climate Change Bill, 2018 has also been published for public comment, which constitutes the next legislative step towards actioning South Africa's National Climate Change Response Policy and international commitments under the 2016 Paris Agreement on Climate Change. The primary objective of the Climate Change Bill is to build South Africa's effective climate change response (CCR) and the long term, Just Transition to a climate resilient and lower carbon economy and society in the context of an environmentally sustainable framework.

The National Climate Change Adaptation Strategy (NCCAS) was finally approved in August 2020. This Strategy supports the country's ability to meet its obligations (NDCs) in terms of the Paris Agreement, and is seen as adopting a common reference point for climate change adaptation efforts in South Africa in the short- to medium-term, providing guidance across all levels of government, sectors and stakeholders affected by climate variability and change. In September 2020, Cabinet also approved the Presidential Climate Change Co-ordinating Commission to co-ordinate and oversee the Just Transition, which will be established through the Climate Change Bill, once finalised.

Read more: National Treasury's review of the carbon tax

South Africa

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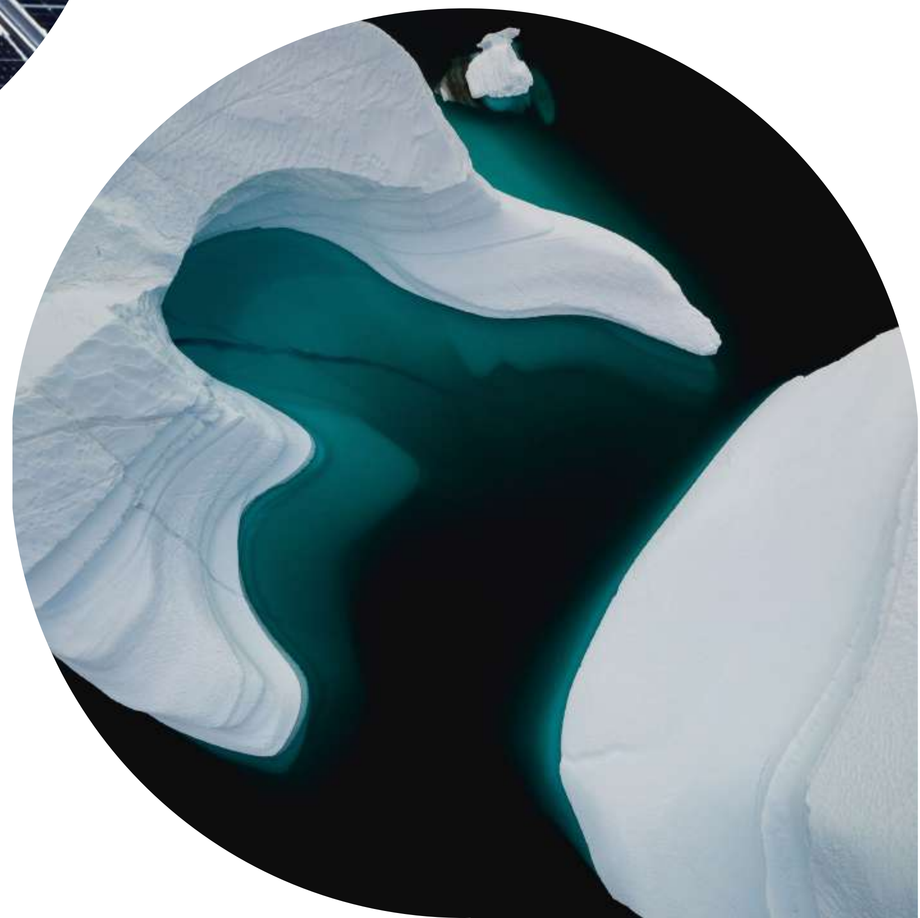
Renewable Energy IPP Programme

In line with global trends, the government is punting the rapid expansion of electricity generation, primarily through the building of additional renewable-energy capacity, as a key priority in its 'Reconstruction and Recovery Plan'. President Cyril Ramaphosa has indicated that an accelerated implementation of the Integrated Resource Plan should bring around 11,800 MW of new generation capacity into the system by 2022, with more than half of that energy generated from renewable sources. Implementation of the fifth bid window, or BW5, of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) is set to commence in early 2021.

Read more: Independent Power Producer Procurement Programme

"Companies need to build a culture of understanding sustainability across all aspects and units of the business. ESG is not only about profitability, but also risk management, talent retention and innovation opportunities in order to create long-term value (financially, socially and ecologically). While climate change impacts and developments fast outrun regulatory developments, legal frameworks are being adapted for the achievement of sustainable development in lower carbon economies."

Garyn Rapson – Partner (Webber Wentzel), Environmental, South Africa



Australia

Allens › ‹ Linklaters

Climate change litigation

Activists and individuals are increasingly turning to litigation to seek to compel the Australian government and business to take action on climate change and climate-related risks. Claimants are testing numerous litigation pathways, including claims based in human rights, tort law, consumer laws and corporate disclosure laws. The Covid-19 pandemic has done nothing to dampen this trend. In 2020, four new pieces of significant climate-related litigation were commenced in Australia.

Read more: Climate change is one of the defining issues of our generation

Read more: A growing tide? Climate change class action proceedings issued against the Federal Treasury

Read more: Climate change litigation in Australia

Cultural heritage

In May 2020, two aboriginal rock shelters located in Juukan Gorge in the Pilbara region of Western Australia were blasted by Rio Tinto. According to archaeological studies, the rock shelters were among the oldest in Australia. Key indigenous and human rights issues at play included cultural heritage and whether Rio Tinto had the Free Prior and Informed Consent (FPIC) of indigenous peoples to destroy the rock shelters. A Senate Inquiry was established to investigate and report on the destruction of the shelters, with particular reference to the consultation that Rio Tinto engaged in with the Traditional Owners, the sequence of events and decision-making process that led to the destruction, and the adequacy of Australian State and Federal laws, under which the blast appears to have been permitted. Over 100 submissions were filed. In the wake of the Juukan Gorge incident, there is a clear trend in stakeholder expectations that compliance with planning and other regulatory obligations is not always enough. Companies must ask themselves not just whether they can do something, but whether they should do so.

Non-judicial dispute resolution

Australian claimant groups, often supported by NGOs and claimant law firms, are increasingly taking a multi-tooled advocacy approach to dispute resolution, which can involve shareholder activism, the use of non-judicial dispute fora, advocacy campaigns and traditional litigation and arbitration. Common to a number of recent NGO and civil society campaigns have been complaints to non-judicial forums. There is a multitude of such forums available, but perhaps the most prominent examples are the OECD National Contact Points, commonly referred to as the "NCPs", set up pursuant to the OECD Guidelines for Multinational Enterprises, and the UN Special Procedures mechanisms.

These forums are attractive to claimant groups as they can be low cost and high profile. The absence of jurisdictional and standing issues also means they are available to claimant groups where domestic remedies may have been denied. In this way, they can overcome obstacles for claimants that may arise due to the complexities of modern international business and corporate structures.

Significant cases in 2020 in Australia have included a complaint against a national bank in the Australian NCP by environmental group Friends of the Earth Australia, along with a group of bushfire survivors, that the bank breached the OECD Guidelines by failing to prevent or mitigate the adverse environmental impacts of its investments in coal and fossil fuel projects. The complaint also alleges that the bank has failed to adhere to the Paris Agreement reduction targets across its lending portfolio. A complaint has also been brought to the Australian NCP against Rio Tinto in relation to alleged legacy impacts at a mining site in Papua New Guinea.

Read more: Private parties in the UN – a new remedy ecosystem for alleged human rights and environmental impacts

Read more: The new Hague Rules on Business and Human Rights Arbitration – effective remedy or strange chimera?

"Australia is becoming front and centre as a forum for activist ESG litigation against corporates, financial institutions and government. Activists are using litigation and non-judicial complaints to drive behavioural change by companies and government, as much as to direct development of the law."

Rachel Nicolson – Partner (Allens), Disputes & Investigations, Melbourne

Australia

Allens › ‹ Linklaters

Investor engagement and activism

We are seeing an increase in structured and comprehensive investor engagement and activism on ESG issues. An example of this is the response from investors to the Juukan Gorge Inquiry above. In response, companies are increasingly focused on embedding soft law frameworks into their mainstream risk and compliance controls.

Corporate crime and human rights

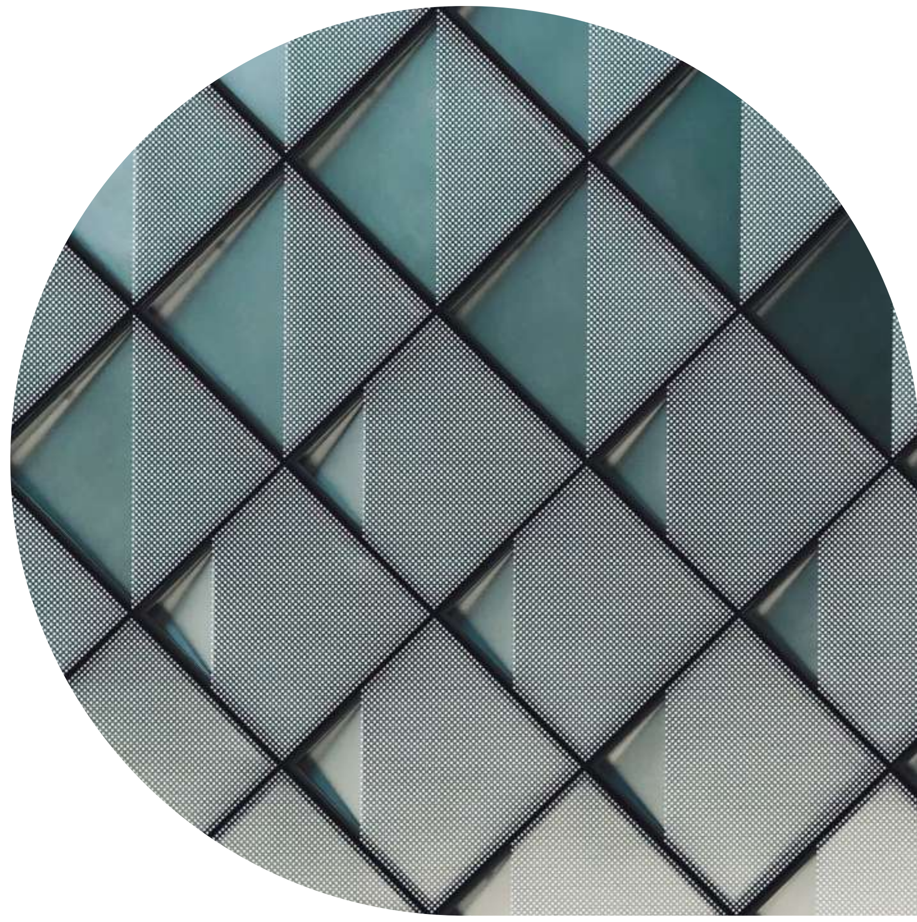
In August 2020, the Australian Law Reform Commission (ALRC) published a landmark report on the country's corporate criminal responsibility regime. It proposes an ambitious reform agenda to recalibrate the role that criminal law plays in the overall regulation of companies and better align corporate liability with corporate culpability. It also indicated ALRC's view that federal criminal law may have a role to play in the regulation of human rights impacts arising in the context of international operations of Australian corporations. The ALRC report contains a stocktake of the wide array of existing regulatory measures in place in Australia and abroad designed to mitigate the human rights impact associated with the conduct of corporates. It also contains a recommendation to consider the introduction of a "failure to prevent" model of criminal attribution to encompass certain transnational crimes involving the most egregious human rights violations.

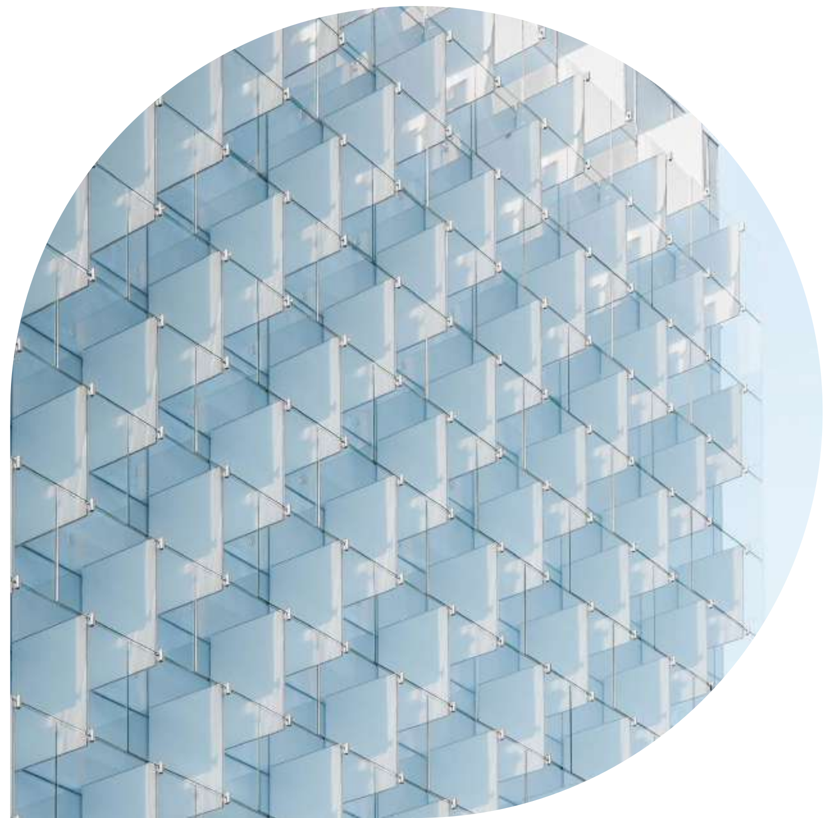
Read more: ALRC recommends broad changes to Australia's corporate criminal responsibility regime

Read more: The ALRC recommendations on criminal responsibility and transnational offending – a sign of things to come?

"We are seeing an increasing convergence of ESG factors, in terms of stakeholder expectations, governance and risk. Environment and climate change is no longer considered distinct from social issues, such as human rights impacts, for example. Businesses which are successfully navigating emerging stakeholder expectations in this area are taking an integrated response to the full spectrum of ESG risk and opportunity."

Jill Button – Partner and Head of Climate Change (Allens), Melbourne





ESG resources

Linklaters ESG global homepage

Sustainable Futures blog

Linklaters ESG Newsletters

In conversation with the ESG team – media hub

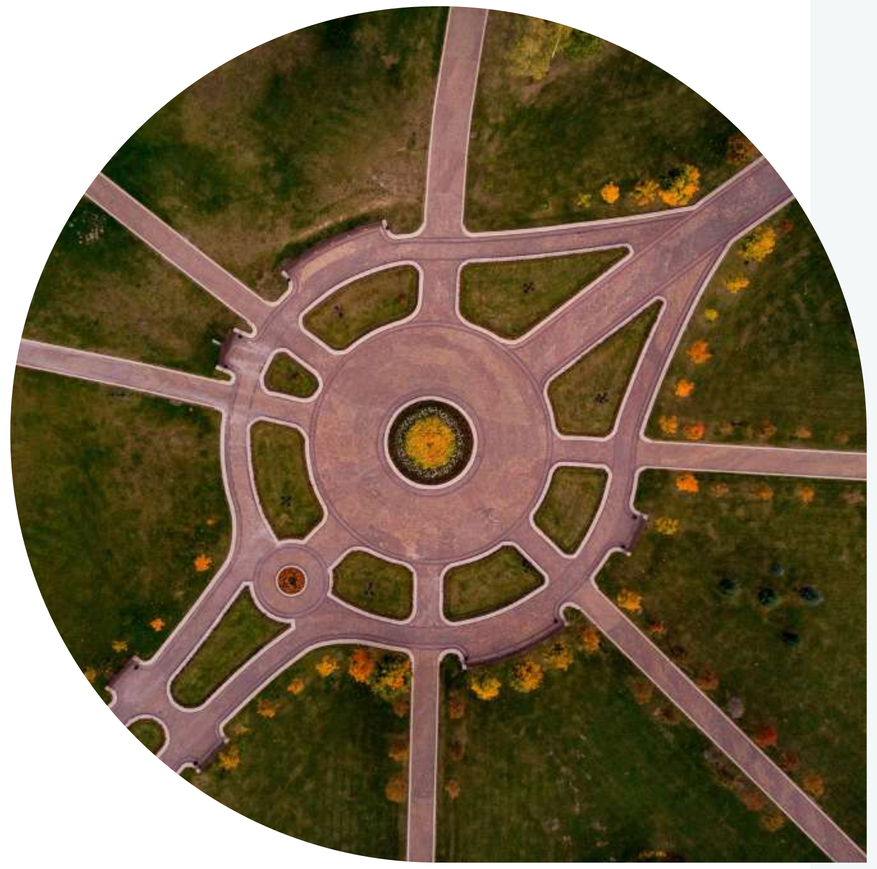
UNGC – Guide for General Counsel on Corporate Sustainability 2.0 (report)

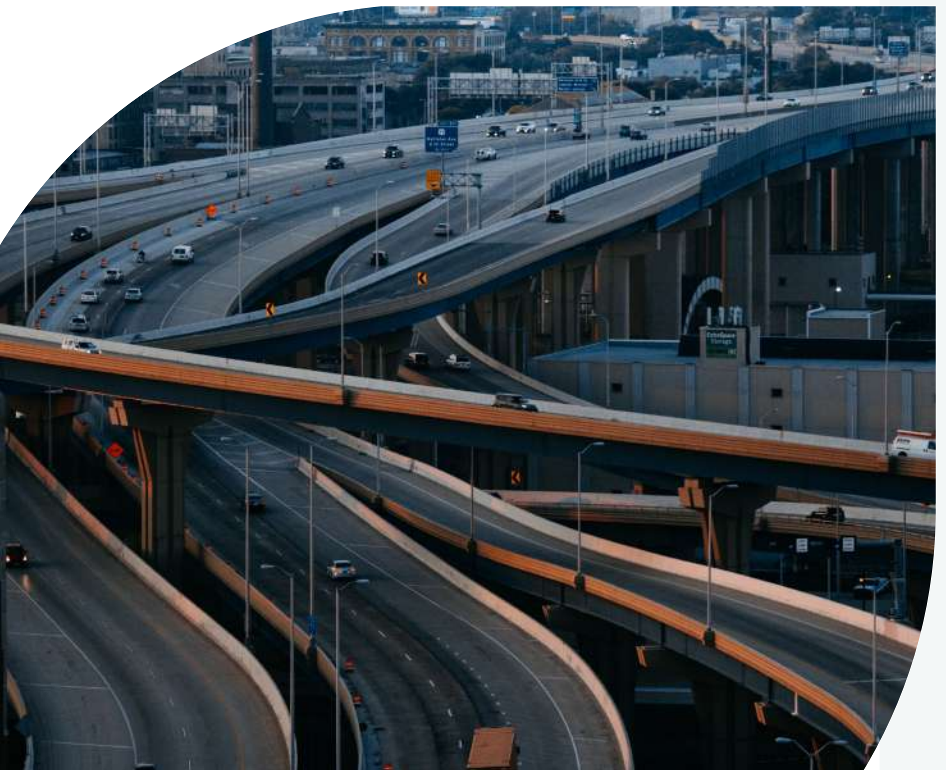
Sustainable Finance Sources: Survival guide (publication)

Risk and opportunities in the infrastructure investment cycle (report)

EU Taxonomy Regulation – A detailed analysis (publication)

The ESG landscape and opportunities on both sides of the Atlantic





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