HSBC Global Research

5 January 2022

ESG in 2022

Avoiding the (green) wash

Free to View
ESG - Global

- ESG development should accelerate in 2022, as all stakeholders want (to be seen) to be sustainable – progress will be uneven
- Will disclosures dispel greenwashing? Beware – *corporate* sustainability disclosure is distinct from *fund* disclosure
- The ESG telescope will tune in to biodiversity, supply chains, social diversity, migrant workers, labour rights, and purpose

This report looks at the broader ESG landscape excluding climate. For climate change specifically, please see The climate in 2022 (4 January 2022).

From Hubble to James Webb: ESG will continue its rapid evolution in 2022 as business, regulators and investors move further along their journeys. Progress is likely to be uneven given the various stages of market development globally. **ESG disclosures will be a key focus** area everywhere and should enhance the ability to peer further into a business. We note the distinction between *corporate* disclosure and *fund* disclosure – as regulators seek to avoid greenwashing.

Changes afoot: There are a myriad of upcoming changes to disclosure rules across India (sustainability), EU (sustainability), Thailand (ESG), Singapore (listing and funds), HK (ESG), and possibly the US. We expect to see the introduction of **assurance** (process and integrity) across some markets (to avoid greenwashing), as well as the continued **convergence of ESG standards** (starting with climate, but branching out to other issues). In our view, it will be a continuum of longer-term development rather than a short term step change – such that 2022 will focus on many of the same issues as the prior year, with a variable pace across regions.

Behind ESG: Besides the ESG issues themselves, the ongoing discussion over ESG and its influence over performance (corporate / fund) rages on in the background, as does the usefulness of scoring/rating when ESG issues are so qualitative (*HSBC advocates ESG integration*). We also anticipate continued activism (diversity-related shareholder resolutions were up 20% last year in the US alone) although not to the same degree in different markets – more so in western developed markets.

Issues to watch: The spotlight will continue to shine on **diversity,** in our view, as it *broadens out from gender and race*. **Biodiversity** will build up towards COP15 in May, although we think it is more of a 'beginning' for this important issue. Corporates will need to be much more aware of the goings on along **supply chains** while at the same time being conscious of **cybersecurity**. Regulators will try to keep up the pace by requiring more diversity and inclusion on boards and senior management through governance rules as the purpose of companies comes under the telescope.

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This is an abridged version of a report by the same title published on 05-Jan-22. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

2021 in review

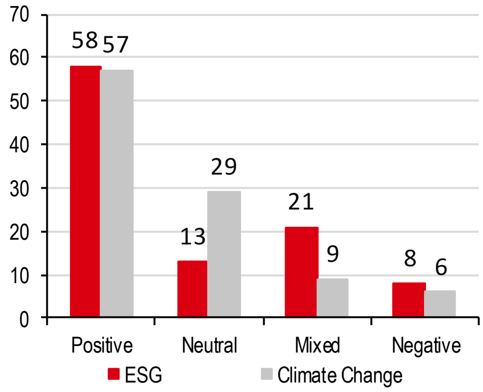
Distinguish between *corporate* performance and *investment* performance

ESG signal in performance

The relationship between ESG and performance is not straightforward due to the lack of agreed definitions and the wide range of time horizons chosen for studies. There have been many academic papers written on the subject. A recent meta-study by *Whelan, et al (2021)* looked at research articles published between 2015 and 2020. The studies that form the foundation of this meta-analysis were divided into two categories:

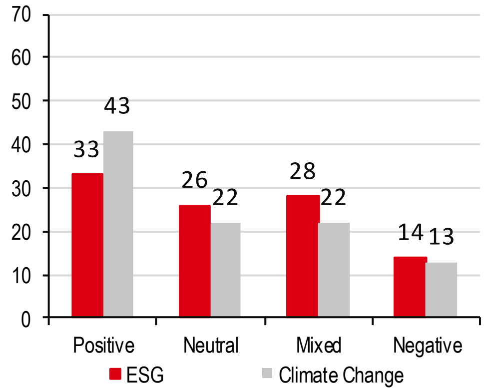
- **Corporate performance** (e.g. ROA, ROE among other metrics)
- **Investment performance** (e.g. returns using Sharpe ratio etc.)

Figure 1: Frequency of conclusion of studies that focus on Corporate financial performance (in percentage)



Source: Whelan, et al (2021)

Figure 2 Frequency of conclusion of studies that focus on investment performance (in percentage)



Source: Whelan, et al (2021)

There is a positive signal – but with many caveats

The meta-analysis shows a positive signal but comes with many caveats about how to interpret the data such as “inconstant terminology”, “ESG data shortcomings” and varying investment strategies. The paper’s main conclusion can be found in Figure 3.

Figure 3: Conclusions on ESG and performance from a meta-analysis by Whelan et al

Improved financial performance due to ESG becomes more marked over longer time horizons	ESG integration seems to perform better than negative screening approaches
ESG investing appears to provide downside protection, especially during a social or economic crisis	Sustainability initiatives at corporations appear to drive better financial performance due to mediating factors such as improved risk management and more innovation
Studies indicate that managing for a low carbon future improves financial performance	ESG disclosure on its own does not drive financial performance

Source: Whelan, et al (2021)

With more funds claiming ESG strategies, there will be a dash to "prove the relationship" between ESG and performance. In our view, statistically significant relationships do not necessarily imply causation. We think **there is an ESG signal** – one that becomes clearer over longer time horizons, but that can also be drowned out by standard market noise. The debate will no doubt rage on in 2022.

Regulators required more ESG disclosure last year

Transparency is enhanced with ESG disclosure requirements

Many regulators updated their ESG disclosure regulations in 2021. We note that this is not uniform across topics (climate vs governance), nor in their degree of regulation (voluntary vs mandatory). Some highlights in Figure 4.

Figure 4: Regulations on ESG incorporation and disclosure, 2021

EU's Regulation on sustainability-related disclosure in the financial services sector
The regulation requires financial market participants and advisers such as AIFMs and portfolio managers to implement policies and ensure disclosure on a comply-or-explain basis with regards to sustainability-related risks and factors relevant to their investment activities. The regulation became effective from 10 March 2021. The first reference period starts from July 1, 2022

EU's Non-financial reporting directive (NFRD)
On 21 April 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which would amend the existing reporting requirements of the NFRD. The EU Commission published the EU Taxonomy Climate Delegated Act on 4 June 2021

TCFD-aligned disclosures in the UK
On 22June 2021, FCA proposed rules on mandatory climate-related disclosures based on TCFD recommendations.
From April 2022, UK will become the first G-20 to enshrine in law mandatory TCFD-aligned requirements to report on climate-related risks and opportunities for Britain's largest companies and financial institutions.

Business Responsibility and Sustainability Report for Indian companies
India's SEBI has proposed a new Business Responsibility and Sustainability Report for the top 1000 listed entities by market cap, which is on a voluntary basis for FY 2021 – 22 and mandatory from FY 2022 – 23.

In April 2021, Japan revised its Corporate Governance Code and Guidelines for investor and company engagement.

The **Securities Commission Malaysia** (SCM) in April, 2021, updated the Malaysian Code on Corporate Governance (MCCG) for Malaysian listed companies to strengthen the corporate governance culture. The SCM also published its Corporate Governance Strategies in November 2021, which highlighted the potential update of the sustainability reporting requirements

The Hong Kong Stock Exchange revised the Corporate Governance Code in 2021. The revision enhances the disclosure requirements on diversity and reporting timeline, which will come into effect on 1 January 2022.

The Singapore Exchange, updated its listing rules in 2021. Listed companies are required to disclosure diversity and climate-related information from financial year 2022.

Source: HSBC (based on European Commission, FCA, SEBI, Sustainable stock exchange initiative [SSE], Bursa Malaysia, FSA Japan, HKEX, SGX)

Surging investor focus on ESG and shareholder activism

Increasing pressures from investors on ESG practices

The investors and asset managers have been exhibiting significant ESG concerns and acting on them. Although the overall magnitude of activist campaigns declined in 2021 in contrast to 2020, the campaigns on Environment and Social issues along with their impact and success of these campaigns escalated last year.

During this period, the odds of having a successful activist campaign improved as well – 1 in 8 activist campaigns were successful whereas the corresponding number in 2020 was 1 out of every 9 – an 11% increase this year.[1]

Activist fund, Engine No. 1 won three board seats at ExxonMobil in 2021

Climate focus: The most notable evidence of shareholder activism in 2021 was the conquest of three board seats of ExxonMobil by a small hedge fund, Engine No.1. While Engine no. 1 holds less than 1% of the shares, the resolution was supported by large asset managers. Since then, ExxonMobil announced USD15bn in spending for emission reduction projects and meeting its 2025 emission reduction targets by end of 2021.[2]

[1] Diligence institute, Activist Investors: Setting the Pace on ESG, 25 October 2021
[2] Business Standard, ExxonMobil lifts spending on emission reduction plan to $15 bln, 01 December 2021

Investors speak up more on executive compensation

Executive pay: Investors also challenged ballooning executive pay last year. In the US, for the Russell 3000 and S&P500, a record number of 'say on pay' votes went *against* companies in 2021, according to Institutional Shareholder Services (ISS).

1/3

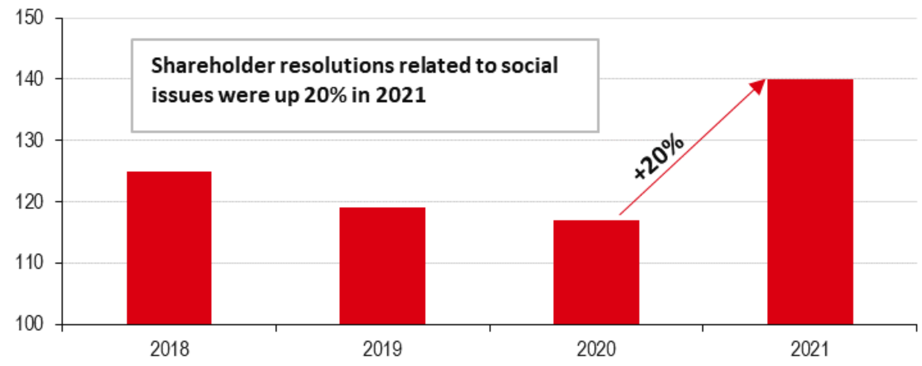
Of shareholder resolutions were focused on social issues in 2021

Discussions on social issues are evolving

Awareness on social and human capital is catching up

Although environmental issues tend to be the most prominent, investor awareness of social and human capital issues rose sharply in 2021. According to Proxy Review 2021, at least 435 shareholder resolutions on ESG issues were filed for the 2021 proxy season in the US. One-third of the resolutions were on social issues (including diversity and human rights) which is around 20% higher than 2020.

Figure 5: Number of shareholder resolutions on social issues filed in the US



Source: Proxy Review 2021

More regulators are proposing diversity initiatives

A flurry of diversity-related initiatives

More governments are putting more focus on diversity issues (racial, gender and sexual orientation). In 2021, a wide range of jurisdictions including the UK, Hong Kong, Singapore, UAE and Japan, implemented or proposed diversity initiatives such as mandatory diversity targets, disclosure of diversity metrics and development of relevant policies. At this stage, gender diversity is still the most common diversity issue but we see the awareness of ethnicity and racial diversity increasing. For investors, we think diversity will still be the main focus for social issues. The conversation is different across various regions however. As public attention ventures into other diversity topics, we think investors should also look out for the development of issues such as neurodiversity, age diversity and cognitive diversity.

Protection of contract workers is progressing

Slowly improving labour rights

As the number of contract workers (or 'gig' workers) continues to increase with the rapid growth of the platform economy, there is a growing focus on labour rights – played out through discussions, lawsuits and strikes. There were modest reforms from major economies in 2021, such as the **US** withdrawal of the independent contract worker rule to make it tougher to classify workers as independent contractors and the **EU** proposing *a set of rules* to improve the working conditions of contract workers, including granting them legal employment status in December 2021.

Labour rights are improving in the MENA region too

The reforms were not limited to contract workers. Last year, Qatar introduced a non-discriminatory minimum wage – the equivalent of USD275 per month (plus cUSD80 and cUSD135 for food and housing, respectively, if these are not provided by the employer). More than 400,000 workers or 20% of the private sector are expected to benefit from this move. Also, Qatar shortened the working hours during summer by extending the summer work ban periods. The new measure prohibits work under extremely hot and humid weather (wet-bulb globe temperature rises above 32.1°C) in a particular workplace.

International Migration Review Forum will take place in 2022

Migration and migrant workers

Nearing the end of 2021, there were headlines from Belarus and Poland to France and the UK, regarding migrants and the struggles faced. Entering 2022, the migrant crisis remains and although there is no short term solution for those fleeing war or even climate challenges, there is hope of development with the **International Migration Review Forum (IMRF)** starting in 2022. In May 2022, the first roundtable will take place in New York. The discussion will include member states and relevant stakeholders, and serve as a primary intergovernmental global platform. The forum will be held every year for 4 years starting in 2022, with the first including objectives such as minimizing adverse drivers, providing recruitment and decent work and enhancing skill development.

For investors, the conversation around companies and increased scrutiny of their use of migrants and migrant workers is ongoing. The World Cup in Qatar this year has already put a spotlight on these issues within the construction industry. Some countries may re-examine existing legislation to better protect migrants – with potential cost implications for businesses. We think this is a social issue to watch, although not specifically a 2022 issue.

Anushua Chowdhury*, Payal Negi and Sanchit Sethi contributed to this report (all employed by a non-US affiliate of HSBC Securities (USA) Inc. and not registered/qualified pursuant to FINRA regulations).*

ESG issues to watch in 2022

- More regulators will require ESG disclosure from corporates and funds, we also expect to see assurance requirements develop
- The EU will maintain ESG leadership as ASEAN seeks to make its own mark; developments in China and the US will remain distinct
- Other issues to watch include COP15 (biodiversity), a broadening of diversity, supply chain management and more purposeful governance

Figure 6: Upcoming ESG events

14-17 February	1-3, March	25 April -8 May	15-17, June	June	12-13, October	7-18 November
Sustainability Week Asia by *Economist Impact*	9th annual World **Ocean Summit** & Expo - Achieving 2030 targets	UN Biodiversity Conference (**CBD COP 15**) (Part 2)	2022 IEEE/AIAA Transportation Electrification Conference And Electric Aircraft Technologies Symposium	Consolidation of Climate Disclosure Standards Board and Value Reporting Foundation	2022 Global Impact Investing Network Investor Forum	**COP 27**, Egypt

Source: HSBC

ESG disclosure

More regulations on ESG disclosures

Over the past year, we have seen a number of regulators update their disclosure requirements – however, we need to distinguish between the disclosure of ESG information by listed companies, and the disclosure of 'how ESG is taken into account' by funds /fund managers.

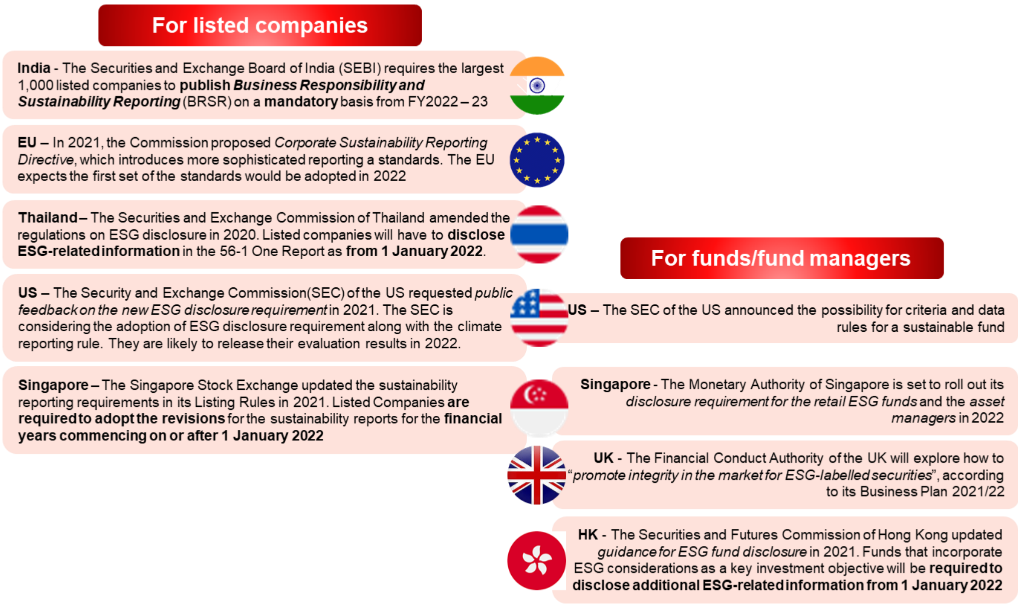
Two types of ESG disclosure

- **Disclosure by listed companies** – the disclosure of ESG information by listed companies (as part of the listing rules) encourages businesses to collect relevant data and information in order to be better equipped to address ESG issues as well as inform investors and other stakeholders of their ESG risks and opportunities faced in both the short and long term.
- **Disclosure by funds/fund managers** – the use of ESG information by investment professionals in order to make more informed investment decisions, but also in some cases, asking funds to disclose their exposure to certain issues e.g. climate change and a portfolio's carbon footprint. Disclosures here inform *potential fund investors* how the fund manager uses ESG information in the investment decision-making framework.

An array of ESG disclosure requirements will be effective in 2022

With strong momentum in ESG fund flows, we believe the scrutiny on ESG funds and asset managers would tighten up to ensure the integrity of ESG objectives and avoid "greenwashing". Following the release of the EU's Sustainable Finance Disclosure Regulation (SFDR), a number of regulators are considering or developing similar standards for ESG-labelled products.

Figure 7: Upcoming changes to ESG disclosure rules in 2022



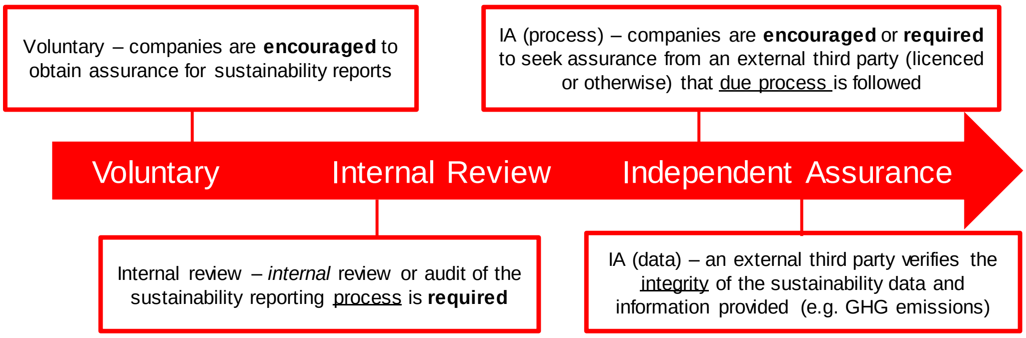
Source: HSBC (based on SEC, FCA, SEBI, Sustainable stock exchange initiative [SSE], HKEX, SGX, Monitory Authority Singapore, Securities and exchange commission Thailand, EU Commission)

More regulators are requiring mandatory assurance on sustainability reports

The rise of assurance

The availability and quality of data is often cited as a barrier to ESG investing. In our view, assurance can contribute to the credibility, comprehensiveness and transparency of data and information. The **EU** and **New Zealand** have already adopted rules for independent sustainability reporting assurance. **Singapore** also requires internal assurance on sustainability reports. Similar to ESG disclosure, we think assurance is a journey for regulators – starting with voluntary and moving to internal and independent assurance requirements. We believe more regulators will shift to internal or independent assurance approaches in the coming years.

Figure 8: Sustainability assurance journey



Source: HSBC

The lack of unified and clear definitions might be a barrier to sustainability assurance

It is however important to distinguish between **assurance of process** – to ensure a set of rules of obtaining and recording information has been followed; and **assurance of data** – to ensure the integrity of the information. We think it is still early days and that this distinction is not always clearly disclosed when businesses obtain assurance.

Fund labelling: We are also seeing the rise of 'assurance for funds' – to ensure that ESG funds follow some form of process. At the moment, this is most evident in the EU with the introduction of the Sustainable Finance Disclosure Regulation (SFDR), and also similar policies from other jurisdictions. We think more regulators will be looking at this area in 2022.

We expect reporting standards to further converge in 2022

Convergence of sustainability reporting standards
There is an array of ESG reporting standards and frameworks across markets. Given the comparability of the ESG data is a concern for many investors, international organisations have been working on unifying the approach to global standards. The International Financial Reporting Standards (IFRS) Foundation aims to issue one final standard by 2022 following the formation of the International Sustainability Standards Board (ISSB) in 2021. In our view, ISSB standards could serve as a common ground for sustainability accounting and reporting. Stakeholders could build up a new standard or propose an advanced approach based on the ISSB standards. Investor would then be better able to compare the sustainability performance of companies with a more similar set of metrics or indicators. We expect a lot more discussion in this area throughout 2022.

A spotlight on ratings, funds and greenwashing

Scrutiny on ESG ratings and data providers is increasing

In 2021, the International Organization of Securities Commissions (IOSCO) released a set of *recommendations* for ESG Ratings and Data Product Providers, recognizing the increasing use of largely unregulated ESG products. The recommendations suggest securities market regulators should be aware of a wide range of factors related to ESG ratings including **reliability of raw ESG data**, **transparency of methodology**, **potential conflict of interest** and **communication between rating providers and entities**.

In addition to IOSCO, the UK's Financial Conduct Authority (FCA) expressed its concern over the relationship between greenwashing practices and ESG ratings and data. As stated in its *Business plan 2021/22*, the FCA will gather market opinion on regulating ESG rating providers in 2022. With the rising risks and challenges raised by users of ESG ratings and data products, we believe regulations on ESG products are on the horizon.

The UK government will update its Green Finance Strategy in 2022

In October 2021, the UK Treasury released *Greening Finance: A Roadmap to Sustainable Investing*, covering: sustainability disclosure requirements, UK green taxonomy, expectations of green finance and its importance to investors and UK leadership on green finance. It is expected that the 2022 update of the Green Finance Strategy will provide a clearer pathway to align financial systems to the net zero transition.

What to look out for across regions in terms of ESG

Europe – trendsetters as ESG regulations begin to mature
EU Taxonomy: Europe sees its Taxonomy come into force in January. This is a classification system that recognises environmentally sustainable economic activities and provides "a list of economic activities assessed and classified based on their contribution to EU sustainability related policy objectives". This applies to both companies and investors, and aims to increase transparency and the clarity of ESG objectives. The taxonomy is not perfect however, with certain activities, such as nuclear and gas, subject to intense debate over inclusion.

Figure 9: Environmental objectives of taxonomy development

Source: Taxonomy Technical Report, EC, 18 June 2019

The EU's SFDR should set the trend …

SFDR: Effective since March 2021, the EU's Sustainable Finance Disclosure Regulation (SFDR) requires financial market participants and advisers to implement policies and ensure disclosure on a comply-or-explain basis with relation to sustainability-related risks and factors relevant to their investment activities. In order to unify the disclosure, the European Supervisory Authorities is developing regulatory technical standards, which will specify the details of the content and presentation of the disclosure requirement under SFDR.

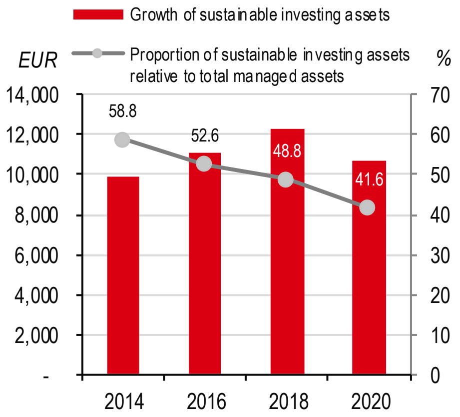
… though technicalities may delay the implementation

In November 2021, The European Commission published a *letter* to the European Parliament and the Council of the EU, stating a delay in the date of application of the regulatory technical standards from 1 January 2022 to 1 January 2023 due to "*the length and technical detail"*. Each year, the Principle adverse impacts statement (PAI) needs to be reported no later than June 30th, with a reference period of the previous calendar year. As per the letter, compliance with the delayed disclosure requirements on PAI laid down in the delegated act will now be done for the first time by **30 June 2023** (with the reference period under the regulatory technical standards being the prior year, that is, from 1 January 2022 to 31 December 2022).

Proper definitions result in more accurate labelling

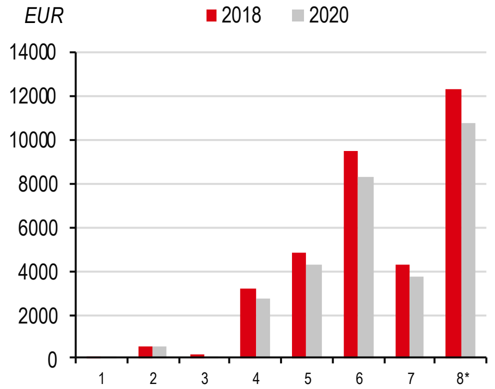
Figures 10 & 11 from the GSIA show a decline in ESG assets – as a result of tighter definitions from SFDR i.e. some "loosely-defined" ESG funds can no longer label themselves as such.

Figure 10: Europe, Sustainable investing assets, Growth vs. proportion



Source: Global Sustainable Investment Review, 2020

Figure 11: Assets in each sustainable investment strategy, Europe



*The totals shown are net values after adjustments to remove double-counting, since managers may apply more than one strategy to a given pool of assets
Key: (1) Impact/community investing, (2) Positive/best-in-class-screening, (3) Sustainability-themed investing, (4) Norms-based screening, (5) Corporate engagement and shareholder action, (6) Negative/exclusionary screening, (7) ESG integration, (8) Total Sustainable Investing
Source: Global Sustainable Investment Review, 2020

UK – implementation of policies is the key

The UK plans to introduce a number of environmental policies in 2022. This includes the long-awaited ***plastic packaging tax from April*** which will charge a tax on plastic packaging manufactured in or imported into the UK where the plastic used contains less than 30% recycled content. The rate will be set at GBP200 per metric tonne of plastic packaging and, while we caution that it may take time for the optimal level of tax to be found such that it creates the right incentives, we think the overarching aim to penalise the use of virgin plastics is a step in the right direction towards minimising waste, and one of few such policies in the world.

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GBP200

Tax per tonne of plastic packaging in the UK from April

We also expect environmental and biodiversity policies to play an important role in investor, company and policy discussions throughout 2022. The UK's Environment Act was enshrined into law in November 2021, which aims to halt the decline in species and create new habitats by 2030. Specific, time bound targets across biodiversity, air quality, water and waste will be introduced by October.

Sustainability will be further integrated in the board meetings

Environmental issues will be high on the agenda of boards. We expect investors to see higher-quality financial disclosures by listed companies in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) as required by the new listing rule. We also expect increased efforts on improving gender and ethnic diversity in boardrooms in-line with potential diversity targets announced by the FCA in August 2021. We think that ethnicity pay gap reporting for large companies is likely to be introduced by the Government next year. Also the focus will be on the implementation of the corporate governance and audit reforms, which will be shortly finalised by the Government.

Sustainable finance market in ASEAN is expected to grow as a clearer definition of sustainable finance

> **"Indonesia, Thailand and Singapore are expected to finalise and issue their own principles or definitions for sustainable financing in 2022.**

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ASEAN – potential boom in sustainable finance

The ASEAN region released *the first draft of the ASEAN Taxonomy for Sustainable Finance* in 2021. The draft will serve as a framework for further discussion with stakeholders to expand objectives such as climate mitigation and other environmental issues in the next phase of the Taxonomy development. The Taxonomy will define the sustainable activities in the region with a view to avoid 'greenwashing' when investors engage in sustainable projects in the region. **Individual member states will also work on their own taxonomy based on the ASEAN taxonomy**. *Indonesia*, *Thailand* and *Singapore* are expected to finalise and issue their own principles or definitions for sustainable financing in 2022. We believe clearer sustainable finance definitions could stimulate the growth of the market as well as improve the quality and integrity of sustainable issuance.

China – it's about walking the talk

China is hosting Biodiversity COP15 in April 2022

As the host of the upcoming *UN Biodiversity Conference (COP15)*, biodiversity conservation and restoration are expected to be high on China's agenda in 2022. According to the *Opinions on Further Strengthening Biodiversity Conservation* issued by the State Council, China will develop a ten-year national biodiversity conservation strategic plan and require provincial governments to include biodiversity in their development plans. We believe private companies and investors would not be required to develop biodiversity targets and plans over the short term. However, investors and companies may prepare for potential regulations which might affect longer-term profitability and/or business models.

4 February

Start of the Winter Olympics – air pollution curbs likely to begin in the weeks prior

Factories near Beijing might face mandatory shutdown in early 2022

We think air pollution could re-emerge as a focus in China in 2022, especially as corporates face the potential for mandatory shutdowns in early 2022 to curb pollution levels for the Beijing Winter Olympics (4-20 February 2022). When China hosted Summer Olympics in 2008 and the Asia-Pacific Economic Cooperation forum in 2014, many factories nearby were forced to close for 'blue skies'. In October 2021, the Ministry of Ecology and Environment released an *Action Plan for Air Pollution Management in winter 2021/22* (1 October 2021 to 31 March 2022). The regulator extended the pollution target coverage from the Beijing-Tianjin-Hebei region (28 cities) to the Henan and Shanxi regions (64 cities), the major steel and aluminium manufacturing hubs.

China is improving its corporate governance practices

Investors should also be aware of corporate governance developments in China this year. In late 2021, the Shanghai Stock Exchange and Shenzhen Stock Exchange proposed updates to their respective listing rules. The proposals include a new "corporate governance" section that clarifies practice requirements and asks companies to "develop and disclosure social responsibility reports and relevant documents based on the regulations".

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MENA – ESG ecosystem is shaping up

For the GCC states, we expect 2022 to bring a continuation of the rapid pace of reform, particularly in relation to labour laws and broader social considerations. We also expect media and investor focus to increasingly shift towards assessing the extent to which these reforms are being implemented and enforced at the company level. The football world cup will bring the spotlight to Qatar and the region more widely.

The ESG awareness of GCC states is increasing

In addition, for the region as a whole, we see 2022 as shaping up to deliver significant progress in terms of ESG disclosure requirements for listed companies. For example, we should see the first applications of the recently-issued *Saudi ESG guideline*s, as well as mandatory *ESG disclosures in Egypt* and potentially mandatory disclosures in Qatar as well.

Other environmental issues to watch in 2022

Biodiversity COP15 (2021 & 2022) – in two halves

Part One: Virtual Meetings 11 to 15 October 2021 – The virtual meeting held in October released a draft of the guidelines of a Strategic Plan for Biodiversity 2011-2020 and Aichi Biodiversity Targets. The leaders in the conference stated biodiversity recovery as an underpinning challenge and hence adopted the Kunming declaration, which also called for 30 by 30 targets (conserving 30% of Earth's land and sea areas by 2030).

The finalisation of Post-2020 Global Biodiversity framework

Part Two: Face-to-Face Meetings 25 April to 8 May 2022 – The second half of COP15 is expected to address the remaining agenda items, including a review of 2011-20 biodiversity targets. One of the most important tasks is to finalise **Post-2020 Global Biodiversity framework**, addressing issues like resource mobilisation and capacity building.

Draft of the TNFD framework will be released in 2022

The Taskforce on Nature-related Financial Disclosures (TNFD) was officially launched in 2021 and models itself on the climate equivalent (TCFD). The TNFD will unveil a draft nature-related disclosure framework early 2022. The development of the framework encourages more corporate disclosures hence could enhance the availability and comparability of relevant data.

The Kunming declaration has more than 100 country signatories. It calls for an *"urgent and integrated action"* across economic sectors in considering biodiversity. The financial community and investors also play a role in implementing the framework hence the TNFD could give more colour to investors looking for data and information on biodiversity and nature-based solutions.

Other social issues to watch in 2022

Increased scrutiny of retail supply chains

As has been the focus over the last decade, concerns with the social aspect of retail supply chains is ever dominant in consumer interests. An important ESG aspect of retail firms is their tier supplier lists, this metric is expected to become a growing focus over the next few years, amplified by the pandemic. Those without disclosures face scrutiny over the transparency of their supply chains and often receive negative media coverage, potentially damaging reputation.

We see greater deployment of technologies across supply chain

Into 2022, we see trends emerging across supply chains. The impacts of COVID-19 and the Suez Canal disruption across 2020 and 2021 provides a basis for change globally. Albeit, developments for a supply chain with greater flexibility are a long term trend. Over the next year, we see greater adoption of technology such as IoT and blockchain. As well as the deployment of automation in regards to robotics, artificial intelligence (AI), and virtual reality (VR) playing an important role in the consumer facing division of the retail industry.

The development of the cyclical economy and locally produced products has been accelerated by the supply chain disruption and port congestion last year, and brought the ESG issues surrounding supply chains to the forefront of considerations by consumers. Additionally, the ability to respond quickly to consumer demand and provide products reliably, especially when competitors can't, is likely to be critical in the near future.

Still way to go to mitigate ESG risks along the supply chain

Providing social data across the supply chain is an additional challenge, with only 2% of retailers publishing data on the percentage above minimum wage rate that workers are paid. As investors build trust with brands that provide a greater range of ESG information, the standard of reporting should improve across the industry. In 2022, we expect more discussion of these issues, though, for example, forums such as the **Retail Supply Chain Conference** from 20-23 February 2022, in Dallas Texas, has planned discussions on blockchain, automation as well as cultures of safety and women in supply chain, etc.

Cybersecurity and data protection

We expect cybersecurity and data protection regulations to rise in 2022. Issues such as breach notifications, ransomware cyber insurance, supply chain attacks and fines increasing globally as well as the personal liability of directors and executives.

Cybersecurity is a governance concern for businesses but also a social concern, with attacks being aimed at vulnerable individuals and companies. Cyberattacks such as ransomware have increased in recent years (Figure 13) leading to an uptake in cyber insurance by firms to cushion the impact of potential attacks. Cybersecurity spend is expected to rise as we enter 2022.

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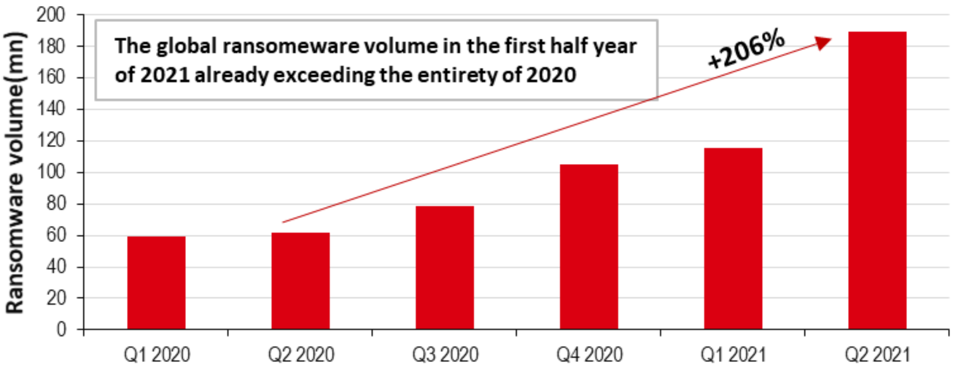
Figure 13: Ransomware attacks on the rise (millions)



Source: SonicWall

Scrutiny over cybersecurity is increasing globally with the rising number of ransomware attacks

Regulations relating to breach notifications (that aim to inform authorities of data breaches to lessen the impact and spread), could be enhanced in 2022, especially given the increasing interdependence of companies along the supply chain. We anticipate more focus on developing regulations and practices as adoption of technology rises. *The European Data Protection Supervisor* will host a conference (16-17 June 2022) to discuss approaches to enforcement and cooperation of data protection across Europe in regards to the digital future.

Box 1: Colonial Pipeline ransomware attack in 2021

In May 2021, the US fuel pipeline operator, Colonial Pipeline became a victim of a major ransomware attack. The attack infected the digital operation systems of the fuel pipeline network. All pipeline operations were shut down until the company paid a ransom of 75 bitcoins (approximately USD4.4 million) to the hackers. The halt heavily affected consumers and airlines across the East Coast of the States. This attack was deemed a national-level security threat and the largest publicly disclosed cyber-attack against critical infrastructure in the US.

Governance issues to watch in 2022

Yaryna Kobel
Corporate Governance Analyst
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Increasingly complex pressures and demands from various stakeholder groups, especially governments, employees and customers in relation to the pandemic, will continue to dominate the governance agenda in 2022. Board diversity, sustainable governance, organisational culture and audit reforms are the key areas to watch this year.

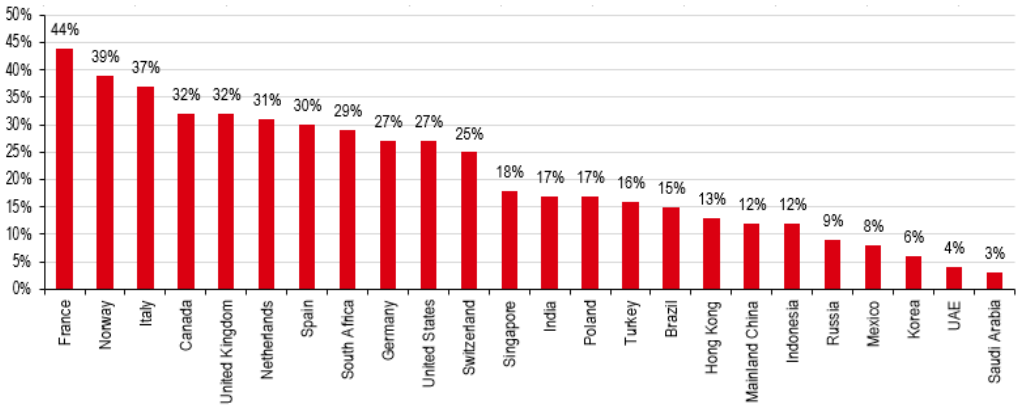
More diversity-related regulation is rolling out

Much more on diversity and inclusion

Many markets have set diversity disclosure and quota requirements for boards and senior management, and we think this trend will increase in 2022. However, there will be significant differences between the markets in terms of board diversity considerations. For markets, which lag behind others in their gender diversity progress (Figure 14), we think an emphasis on gender to be the foremost focus of their diversity initiatives. More specifically, we expect regulatory developments on board gender diversity in **Malaysia**, **Hong Kong** and **Russia**.

For those (mainly developed) markets that have made advances on gender diversity, we expect them to look beyond gender and consider other diversity characteristics, for example socioeconomic status, sexual orientation, age and personality. Going forward, for the **US** and **UK** a significant focus will be on ethnic and racial diversity, including potential new targets.

Figure 14: Percentage of board seats held by women per market, large companies*



*Analysis covers all publicly traded companies with market cap USD6bn or the largest six in each market
Source: EgonZehnder

The EU is likely to publish a new sustainable corporate governance framework

Integrating sustainability into board decision-making

We expect sustainability considerations to be better implemented into board decision-making in many markets in 2022. We expect the **EU** to introduce a new sustainable corporate governance framework following *its consultation* in early 2021. There could be new requirements for boards on sustainability expertise, due diligence information and sustainability metrics within variable executive pay in early 2022.

Setting the tone from the top

While the pandemic brought employee health and safety to the forefront, it also reinforced the need for a positive organisational ***culture-linked purpose***.

> **"Corporate purpose is about producing profitable solutions for problems of people and planet and not profiting from producing problems."**
>
> **The British Academy**

This year, investors should be able to see more market-wide developments in these areas. We expect companies in **Hong Kong** to lead the efforts in the Asian region and focus on aligning their purpose with culture, as required by the revised corporate governance code and listing rules.[3] And those markets, including the **UK**[4] and **France**, which have been leading the way, are likely to focus on monitoring organisational culture and assessing the progress against their purpose. We also expect a growing number of initiatives and discussions on corporate purpose and culture in other regions.

We anticipate more initiative to improve reporting quality and effectiveness of internal control

Corporate reporting, internal controls and audit reforms

In 2022 we expect some markets to address the concerns around the effectiveness of the internal controls of companies, reporting and the quality of the external audit process. Following the **UK**, which looked at introducing significant changes to its auditing and governance regimes, the **EU** launched *a consultation* onto corporate reporting. New requirements on statutory audits, internal controls, responsibilities of the audit committees and corporate reporting are likely to be proposed later this year. We expect similar developments in other markets globally.

The global ESG calendar: upcoming events

2022	Location	Event
17-19 January	Abu Dhabi, United Arab Emirates	Abu Dhabi Sustainability Week
14-17 February	Virtual	Sustainability Week Asia
20-23 February	Dallas, Texas, US	The Retail Supply Chain Conference: Navigating supply chain challenges
1-3 March	Lisbon	9th annual World Ocean Summit & Expo – Achieving 2030 targets
7-12 March	Kigali, Rwanda	1st IUCN Africa Protected Areas Congress
8-10 March	Rotterdam Ahoy	World Hydrogen Summit 2022
21-24 March	Berlin, Germany	ESG & Sustainability Forum Global Summit 2022
22-24 April	Virtual and in-person (Oregon)	The Sustainable Fashion Forum
17-19 May	Buckhead, Atlanta	Accelerating The Circular Economy
25 April–8 May	Kunming, China	UN Biodiversity Conference (CBD COP 15) (Part 2)
15-17 June	California, USA	2022 IEEE/AIAA Transportation Electrification Conference And Electric Aircraft Technologies Symposium
12-13 October	The Hague, Netherlands	2022 Global Impact Investing Network Investor Forum
6-7 December	Virtual	Accelerating The Transition To A Climate-Positive Future

Source: HSBC

3 HKEX, Exchange Publishes Conclusions on Review of Corporate Governance Code, 10 December 2021
4 For more information, see for example, FRC, Creating positive culture, December 2021

Disclosure appendix

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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