ESG in 2023

A reckoning is coming

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ESG - Global

- Anti-ESG sentiment remains in 2023, but tighter regulations and additional greenwashing scrutiny should prioritise quality
- Look out for more on biodiversity & oceans, heat stress & supply chains, as well as succession & pension planning
- Investors should have more clarity as disclosures improve and green taxonomies evolve to refine the ESG ecosystem

This report looks at the broader ESG landscape, excluding climate. For climate change specifically, please see The climate in 2023 (4 January 2023).

Identity crisis: Having come of age, ESG underwent a bit of an identity crisis in 2022 as it wrestled with the Russia-Ukraine war, global inflation and rising geopolitical tensions – which in turn fuelled debate around weapons, fossil fuels and human rights. At the same time, anti-ESG sentiment grew from the ashes, though most prominently in the US. We expect this to continue in 2023, yet set alongside ongoing regulator efforts to tighten ESG regulations and better scrutinise ratings and indices.

Standard compatibility: As the ESG regulatory microscope moves through the ecosystem: corporates, investors, and services providers, the question turns to compatibility. The International Sustainability Standards Board (ISSB) will finalise its initial two standards this year. Meanwhile, the Taskforce on Nature-related Financial Disclosures (TNFD) should launch the first version of its reporting framework in 2023. We should also see adoption of the final set of standards in the EU as others work to develop their own standards. In some markets, it is akin to an **ESG race**; in others, it is about keeping the **ESG pace** and not fall too far behind in sustainability integrity.

The greenwashing screw is still turning: Anti-greenwashing measures have been proliferating in the EU and we expect more to come in 2023 (e.g. rules requiring companies to justify environmental claims). Additionally, reporting under the EU Sustainable Finance Disclosure Regulation (SFDR) kicks in this year – which has already led many asset managers to reclassify Article 9 funds to Article 8. More countries may follow suit, including China and the UK. Green taxonomies are also growing, putting pressure on funds and institutions to disclose their alignment.

Issues to watch: We expect **biodiversity** to retain its newfound prominence, with the role of **oceans** and **nature-based solutions** (NbS) being increasingly recognised. On the corporate side, **supply chain** due diligence and reporting requirements will continue to advance; we see workplace **heat stress** as a key emerging risk. We also expect the focus on **diversity and inclusion** to widen to lagging markets, e.g. in central Europe and LatAm. Other governance issues to watch will be **succession planning** (new rules), **sustainability expertise** (how big is the gap), **pensions** (gender differences and contribution inequalities), and **executive pay** (back in focus as the wider workforce suffers from the impact of high inflation).

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2022 in review

In terms of ESG issues, these tend to be long term in nature and, although they may be more in focus in certain years, they tend to be multi-year issues and, as such, ongoing. Here we look at developments across the ESG agenda in 2022.

War, inflation, and geopolitical tension have no clear ESG answer…

An identity crisis

Having come of age, ESG underwent a bit of an identity crisis in 2022. There was a considerable amount of self-reflection within the industry as it dealt with many issues that were broadly off the radar heading into the year – the Russia-Ukraine war, global inflation and rising geopolitical tension – issues that do not have a clear answer when it comes to ESG.

- **The war** led some to consider weapons in their portfolios – justified by the argument that "defence" is appropriate; not everyone agrees this is the case.
- **Inflation**, especially in energy, led many to invest more in fossil fuels, given the profits generated from the spike in energy prices, and the need to keep up with benchmarks.
- **Geopolitical tensions** – and the gulf in beliefs in human rights, etc. – pushed many investors behind national lines when it came to values.

…as values diverge across cultures and markets

None of this was easy to navigate. It is unhelpful to call anyone wrong as values diverge. We have always stated that ***ESG is an analytical framework that enhances the existing investment decision-making process*.** It should not be a dividing line between right and wrong. Instead, we believe it is astute to consider a wide range of different issues – beyond just pure business and economics – insofar as it helps to make better decisions.

How did ESG sentiment fare in 2022?

Sentiment shifted with the progress of the war and other global events

We conducted three ESG Sentiment Surveys in 2022, capturing the mood among investors pre-war, after the (ongoing) war, and as things settle into a new normal.

1st edition

Our first ESG survey shows wide regional differences in terms of ESG understanding, incorporation and perception. Climate change took the fore, but a wide range of social issues matter to respondents, as does board and culture in governance. Regulations are important, but investors believe they themselves will move most quickly to drive sustainability.

2nd edition

Our second ESG survey captures the shift in sentiment following the beginning of the Russia-Ukraine war, the energy crisis and the rising cost of living. The war has accelerated the energy transition over the medium to long term, with the majority of respondents intending to invest in renewables over other forms of energy. More respondents intend to develop their ESG processes over hiring specialists or purchasing external data – in our view, a sign that scrutiny is increasing.

3rd edition

Our third ESG survey captures the subtle shifts in sentiment following ongoing global events and the tightening of the ESG regulatory landscape. The intention to incorporate ESG has reached an inflection point as it is now so embedded that there is less to incorporate in the future. Almost three-fifths of respondents believe that rising costs will be a hindrance to the sustainability strategies of the businesses they invest in.

The politics of ESG – and the rise of anti-ESG

More focus required on quality (vs quantity) in order to combat the anti-ESG mood

The rise in ESG assets in recent years has not always been one of quality. There were a number of “bad apple” funds that were ESG in name. *Quality* is slower and more difficult to achieve than *quantity*. The divisions arise from a dislike of having “values imposed from above”, either through regulation or general public sentiment. This was particularly prevalent in the US, where ‘to ESG or not to ESG’ is falling behind political lines with certain US states trying to pass legislation to discourage ESG considerations.

At the same time, we believe there is ample room for “refining” the ESG ecosystem. By this we mean where the frameworks, processes, people, disclosures, etc. are distilled and trimmed such that we are left with a more quality ESG ecosystem – even if that means it is smaller in size. In our view, a more efficient, higher quality but smaller ESG ecosystem is better.

Tightening regulations and greater scrutiny of ESG

The refining process is happening across all stakeholders. In 2022, ESG regulations were tightened (or will be tightened – the consultations have begun) across many jurisdictions. The patterns of convergence are apparent even if regulators may take many years to get there. There were many updated codes and disclosure frameworks in 2022, but it was not uniform across topics or in their degree of regulation.

Funds now find themselves in the regulatory crosshairs

Scrutiny broadens: We observed a trend in ESG regulations through 2022 and expect this to continue in 2023 and beyond. First, regulators address the *corporate* disclosure landscape, then they move on to the *funds* themselves; we have seen additional scrutiny on *ESG ratings* providers and have begun to see questions around *ESG indices*.

Figure 1: Regulations on ESG incorporation and disclosure, 2022

EU: Sustainable Finance framework The regulation required application of the EU Taxonomy Climate objectives from January 2022 along with application of sustainability-related provisions under MiFID II & IDD from August 2022
USA: NASDAQ diversity disclosures Corporations listed on the U.S. exchange NASDAQ will be required to disclose the ethnic and gender makeup of their boards starting from August 2022
German Corporate Governance code The new German CG code focuses on the importance of supervisory board's oversight of sustainability risks and impacts
Canadian ESG investment funds disclosures The Canadian Securities Administrators (CSA) published disclosure practices for investment funds whose objectives reference ESG factors and other funds that use ESG strategies.
ESG risks and climate disclosure in Australia The Australia Stock Exchange (ASX) required listed entities to disclose any material exposure to economic, environmental and social sustainability risks. The Australian Securities Commissions mandated climate disclosure as its priority in 2022.
Business Responsibility and Sustainability Report for Indian companies The Securities and Exchange Board of India (SEBI) requires the largest 1,000 listed companies to publish Business Responsibility and Sustainability Reporting (BRSR) on a mandatory basis from starting from FY2022–23
ESG disclosures in Thailand The Securities and Exchange Commission of Thailand amended the regulations on ESG disclosure in 2020. Listed companies will have to disclose ESG-related information in the 56-1 One Report as from 1 January 2022.
TCFD-aligned disclosures in the Malaysia The Malaysian Joint Committee on Climate Change facilitated the adoption of TCFD for the financial industry on June 2022

Source: HSBC

ESG issues to watch in 2023

- ESG disclosures now firmly in the 'tightening and refining' phase; convergence across geographies and topics will pick up pace
- All eyes will be on the ISSB and indications that markets will adopt – or at least be compatible with – the new sustainability standards
- Despite anti-ESG in the US, tackling greenwashing will be high on the agenda as legal issues and sovereign ESG risks are explored

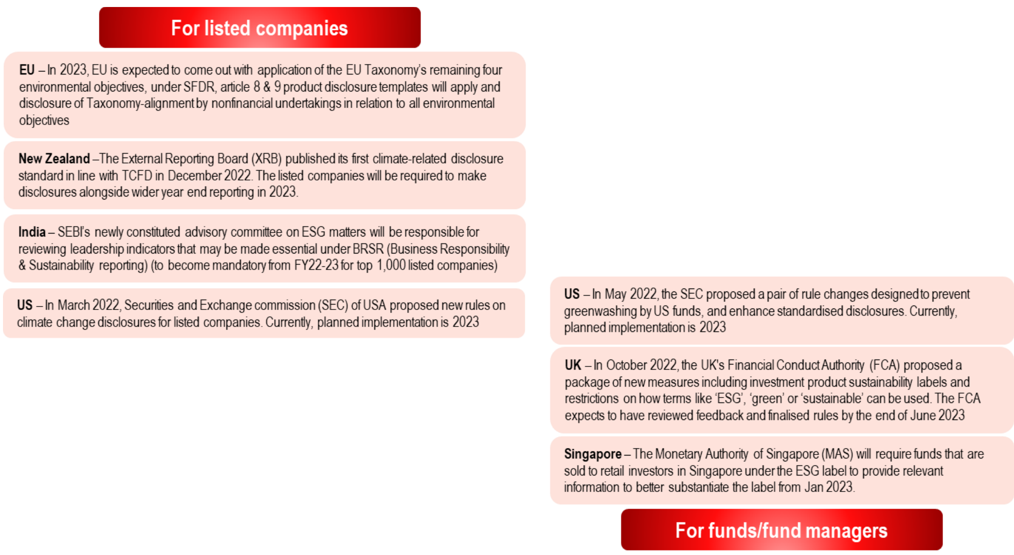
A continuum of issues from 2022, but watch out for emerging legal discussion
2023 should see a continuation of a tightening of ESG disclosures and standards despite the rise of anti-ESG sentiment in some US states. Greenwashing remains firmly on the regulatory radar as markets seek integrity across ESG issues. Emerging from the back burner are the associated legal issues with non-compliance or a lack of sustainability integrity.

ESG Disclosures – evolution in action

Disclosures for both companies and funds will be tightened

Many economies will tweak their ESG regulatory landscape. These will include the continual tightening of ESG disclosures for corporates by various jurisdictions. The nascent nature of these standards means what is required across markets is very varied – a few are just starting out but more have begun to make adjustments. There are plans to make standards more compatible and these will continue to develop, and in some cases, converge, in 2023.

Figure 2: Upcoming changes to ESG disclosure rules



Source: HSBC

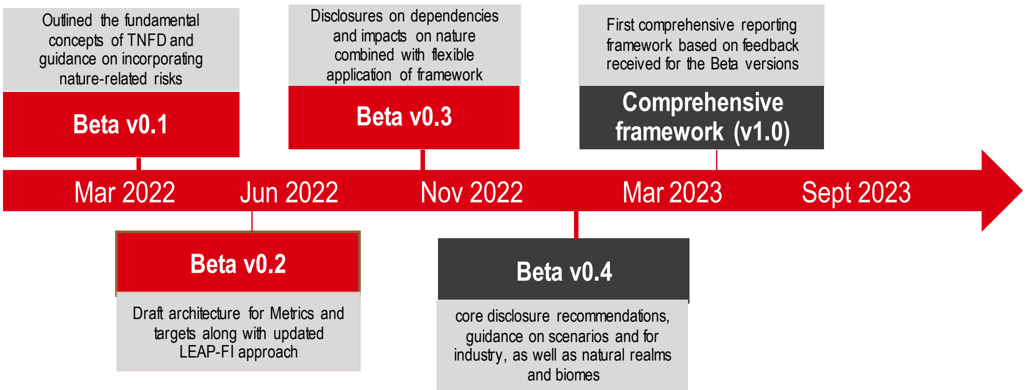
Reporting standards – emerging and converging, but slowly

TNFD to launch its first version this year…

Taskforce on Nature-related Financial Disclosures (TNFD)

Coming in 2023: *TNFD* plans to release a fourth beta version of its recommendations in March 2023, before launching the comprehensive recommendations (v1.0) of the TNFD framework by September 2023. In the next beta version, the focus will be determination of core disclosure recommendations, guidance on scenarios based on feedback of beta v0.3 and lastly, guidance for additional industry sectors, as well as natural realms and biomes. We expect the TNFD framework, following the footsteps of Task Force on Climate-Related Financial Disclosures (TCFD), to be adopted gradually by various jurisdictions, including members of G20 that endorsed TNFD in its initial stages, once the comprehensive recommendations have been released.

Figure 3: A final TNFD recommendation is forthcoming in 2023



Source: TNFD, HSBC

…while the ISSB releases its initial two standards

International Sustainability Standards Board (ISSB)

In 2022, the **International Sustainability Standards Board** (ISSB) released two proposed standards (protocols):

- Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
- Exposure Draft IFRS S2 Climate-related Disclosures

Coming in 2023: These standards will be finalised in 2023 along with the release of new proposals. That being the case, then it is likely that they will have an effective date of 'periods beginning in 2024'. However, whilst the standards may be effective, the ISSB has no authority to impose the standards. That would fall to regulators and legislators in each individual jurisdiction. Therefore, whether and if so, from when, companies will be required to follow the ISSB standards is unknown.

Garnering support: The ISSB continues to gather support from and collaborate with various other reporting standards. Maximising interoperability between the varying national frameworks and the ISSB framework will be key going forward, with alignment of terms and definitions being an important first step. One helpful development has been the decision by the CDP to incorporate the IFRS S2 requirements into its environmental disclosure platform. Another is the collaboration with the GRI (Global Reporting Initiative) to align the two sets of sustainability standards.

The rise of the anti-ESG movement

Anti-ESG movement likely driven by a dislike of "values imposed from above"

ESG means different things to different stakeholders. Given the wide variation in interpretation, it has been challenging to *directly* attribute share price movements to ESG drivers. Moreover, as mentioned above, there has been an identity crisis within ESG, given the events of 2022. This has given rise to an anti-ESG movement, which purposefully and deliberately does not take ESG issues into account in investment decisions. For example, Texas State Senator Bryan Hughes has called out "the harmful effects that ESG policies have on Texas retirees". It is likely that some stakeholders dislike the perception of "values from above", especially when these values differ from another's views (or political disposition).

This is almost in direct contradiction to US federal views on matters of prudence. For instance, in late November 2022, the *US Department of Labor* (DOL) "announced a final rule that allows plan fiduciaries to consider climate change and other environmental, social and governance factors when they select retirement investments and exercise shareholder rights, such as proxy voting." Given that Republicans made gains in the US mid-term elections in November 2022, we expect there to be more noise surrounding "anti-ESG" in the coming year. Again, we note that the notion here is more accurately described as "anti-*certain values or beliefs*".

Scrutiny over greenwashing

A clearer definition of sustainability will be a key issue to resolve in 2023

The greenwashing discussion intensified in 2022 and will only get stronger in 2023, in our view. Governments and their financial market regulators will increasingly scrutinise investors (and companies) for greenwashing. They will introduce new rules and regulations to ensure that ESG claims are credible, consumers are protected, and trust in financial markets is maintained. This process will highlight some very difficult conceptual issues that need to be resolved in 2023, e.g. a clearer definition of sustainability.

This is a messy process, but in some ways it is inevitable as the shift in financial markets towards sustainability accelerates and we "learn-by-doing". Markets will continue to innovate in a sustainable direction, and regulators will then react where they believe that direction is veering off course. A good example that will attract attention in 2023 is the proposal by the *UK Financial Conduct Authority* (FCA) to tighten the rules around greenwashing, including new sustainable investment product labels and various required disclosures (the UK's version of the EU's SFDR).

Legal ramifications

Legal ramifications largely impact a company's resilience as they often pose risks to corporate reputations, relationships and ultimately bottom lines. They can put in question corporate values, purpose, and risk management practices. As ESG-focused disclosures by companies and investors continue to be adopted and refined around the world in 2023, we will likely see more and more legal action taken around ESG, in our view. Litigation around a company's failure to disclose material ESG information and greenwashing allegations will become more common. Additionally, the growing awareness over supply chains means company operations, such as those between suppliers, communities and ecosystems, are more apparent, and could pose legal risks. For investors, how they communicate ESG goals and how they utilise ESG factors to meet their fiduciary responsibility will also be in the spotlight.

The attention on social factors, including, labour rights, inequality, diversity, and environmental justice, prompted by major geopolitical events, including COVID-19, have encouraged stakeholders to hold corporates accountable for social risk, often with the involvement of legal systems. We think litigation surrounding social factors will become more prominent in 2023.

While growing litigation risk can create "fear" among corporate and investors, litigation can also play a crucial role in raising ESG standards and the ambitions of companies. Indeed, litigation can push corporates to think more long term, and reform safety and corporate governance strategies, for instance. Additionally, accurate and comprehensive disclosures, more frequent risk assessments and reachable targets and commitments backed by analysis can result as companies feel pressure to mitigate potential litigation risk.

Sovereign ESG risks

Sovereign-level ESG risk assessment has lagged, but it is now more in the spotlight

Despite its size, the sovereign debt market has historically lagged other asset classes in terms of ESG integration, in part due to the difficulty in defining and measuring material ESG factors.

However, Russia's invasion of Ukraine last year, and the impact of this on Russian financial assets, brought ESG risk at the sovereign level firmly into the spotlight, especially in the fields of geopolitics and human rights. It also served as a reminder that any assessment of ESG risk at the company level should also take into account ESG risk at the sovereign level. Moreover, the impact of the invasion on energy prices in general, and the availability of Russian energy in particular, brought heightened focus to sovereign-level environmental factors, such as energy transition risk and energy security.

We expect a greater focus on sovereign ESG risks in 2023 – and with it development of investment frameworks

We expect these events to encourage investors to pay greater attention to sovereign ESG risks in 2023 and beyond, as well as act to spur the further development of sovereign ESG investment frameworks and analysis. With regard to the latter, the Principles for Responsible Investment's (PRI) Assessing Sovereign Climate-related Opportunities and Risks (ASCOR) tool should show results from its pilot phase in 2Q23.

Environmental agenda

- Biodiversity remains high on the agenda after COP15 but how to align it with its objectives, and the question of finance remain
- We expect ocean conservation to come into focus – with more legally binding international treaties, and also more "blue" finance
- For investors, NbS should gain greater attention – but finding the right opportunities could be challenging without policy support

Biodiversity – a new 2030 framework, but still lots of uncertainty

Awareness of biodiversity will grow in 2023

COP15 adopted a new **Kunming-Montreal Global biodiversity framework**, including a headline 30x30 target (conserve 30% of land and sea by 2030). However, there are still a lot of uncertainties in terms of the implementation of the objectives. The actual interpretation of the agreed objectives is still up for discussion in 2023; we think conversations will focus on the following areas:

Disclosures: In our view, COP15 garnered more public attention on biodiversity. In Target 15 of the framework, large and transnational companies and financial institutions are encouraged to report their environmental risks. Yet, there is a lack of universal guidelines on disclosure of biodiversity risks and opportunities at the moment. We think nature disclosure rules will be widely discussed, and in some cases, adopted through 2023.

Digital Sequence Information: A decision to launch a multilateral mechanism for benefit sharing from the use of digital sequence information on genetic resources was made at COP15, yet, details are still under discussion. An ad hoc open-ended working group on benefit sharing will be following up the "issues for further consideration" throughout 2023 and aims to finalise its work at COP16 in 2024.

Finance: The Democratic Republic of the Congo (DRC) has expressed "reservations" on financing and resource mobilisation despite its support for the deal (*Reuters*, 20 December 2022). Nonetheless, there were calls for the establishment of a global instrument on biodiversity finance. It is likely that there will be more talks over financing of conservation.

Oceans – from talks to agreements and finance

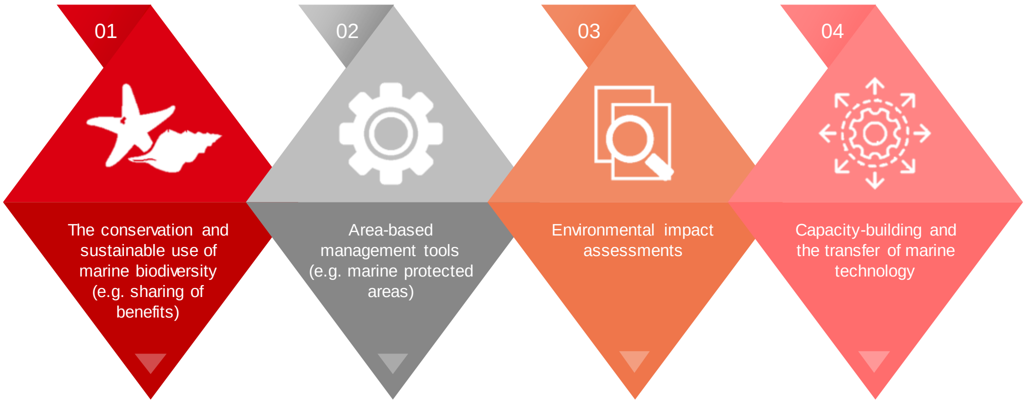
Ocean conservation was mentioned at both COP15 and COP27

COP15 set a target of protecting at least 30% of global marine areas by 2030. Also, the cover decision for COP27 (or Sharm el-Sheikh Implementation Plan) devoted a standalone section to ocean conservation. This was the first separate section on oceans in the cover text of the major conference under the UN Framework Convention on Climate Change (UNFCC). These recognise the significant role of the oceans in tackling climate change and conserving biodiversity. We expect to see more international legally binding agreements on ocean conservation and incorporation into national strategies and action plans coming in 2023.

Deep sea mining: The International Seabed Authority (ISA) should finalise the regulations for deep sea mining by **June 2023** as the Pacific island nation of Nauru triggered the "two-year rule" under the UN Convention on the Law of the Sea (UNCLOS) in 2021. The rule requires the ISA to adopt regulations for deep sea mining within 24 months once it is triggered. Otherwise, the Nauru-supported company could start mining for polymetallic nodules (containing essential metals for batteries, such as cobalt, nickel, copper and manganese) on the seabed. In our view, the regulations will be crucial to marine biodiversity and potentially affect the supply of raw materials for electric vehicle batteries.

High Sea Treaty: In addition to deep sea mining regulation, countries are expected to finalise and adopt the global agreement on the conservation and sustainable use of marine biodiversity of areas beyond National Jurisdiction (BBNJ) (also known as the High Sea Treaty) in 2023. As high sea areas cover more than 90% of global ocean areas, the High Sea Treaty would be essential to achieve the 30x30 target in the Post-2020 Global Biodiversity Framework.

Figure 4: The High Sea Treaty agreement should consist of four elements…



Source: High Sea Treaty agreement, HSBC

Arise, blue finance

Blue finance, an emerging space within sustainability finance, can provide potential solutions by offering the opportunity for capital markets to play a critical role in the environmental stewardship of all waterways. In particular, blue bonds, a fixed-income instrument where proceeds are dedicated to financing activities that protect oceans and improve water management[1], have gained traction in recent years. The introduction of several transparency and integrity principles brought about the growth of green and sustainable finance. The main

1 Eligible projects include water supply and sanitation, reduction of ocean plastic pollution, marine ecosystem restoration, green ports, sustainable shipping and tourism, waste management and offshore renewable energy (adapted from IFC 2022 guidelines).

roadblock for blue bonds should be seen in this context; a lack of globally standardised ways of issuing blue bonds has hindered their development. We believe recent developments will bring about a similar growth trajectory for blue finance.

Proposed blue bond standards should help scale up blue finance

In June 2022, at the UN Ocean Conference in Lisbon, the International Capital Market Association (ICMA), UN Global Compact, the International Financial Corporation (IFC), the Asian Development Bank (ADB) and the UN Environment Finance Initiative, committed to work together to draft a guide to support corporations and financial institutions on the eligibility and processes of blue bond issuances. Given that 98% of all sustainable bond issuances are aligned with ICMA principles, the final proposal will help provide the assurance and clarity currently missing. Therefore, we see such a guide as instrumental in instilling confidence and credibility, resulting in a scaling up of blue finance investments in 2023 and beyond.

Nature-based solutions – inclusion within various agendas

Nature-based solutions (NbS) encompass a proactive approach to protect, manage, and restore ecosystems to solve a range of societal concerns, like food insecurity, climate change, biodiversity, and human wellbeing. NbS have received attention among the climate agenda, where 41% of climate pledges include the term and they are gaining traction within other agendas. In 2023, we think we will see greater engagement by regulators, investors and corporates around NbS strategies.

NbS practices are vast and complex; here, we look at them in different ecosystems.

Forests – this includes conservation, reforestation and natural forest management practices. Examples include *forest thinning* to reduce and manage forest fires. Given that forests hold half of Earth's global carbon, forest NbS play a role in climate change mitigation but also improve air quality, health and recreation.

Soil and agriculture – this includes regenerative agriculture techniques, such as crop rotations, cover crops, no till farming and silvopasture, which help rebuild organic matter and biodiversity in soil. Soil and agriculture NbS help to restore soil biodiversity, mitigate climate change, increase productivity and food security and improve healthy diets.

Urban areas – this can include practices, which can be adapted to developed areas. Examples include *tree canopies*, which can help reduce storm water runoff and urban heat effects, or green roofs, which can reduce runoff and energy costs of buildings. Urban NbS, which integrates nature into these urban environments, has benefits for city dwellers, climate adaptation and mitigation, and biological diversity.

Coasts and oceans – this can include wetland restoration and protection, living shorelines, oyster reefs and dunes. These NbS can help solve flooding and coastal erosion, enhance ocean water quality, improve food security, and human support health and wellbeing.

NbS should garner more interest from investors

While NbS are well positioned to appeal to ESG investors, financial contributions from the private sector have been minimal. Resistance to change, lack of in-house expertise, scalability concerns, and the time lag between investments and returns are barriers that deter large capital investments. In our view, stronger government involvement and incentive programmes, such as subsidies, tax cuts and specific biodiversity incentives, blended finance schemes and R&D grants, will be necessary to encourage and scale up private investments. While many countries showed interest in NbS in 2022, we think more will explore NbS plans in 2023.

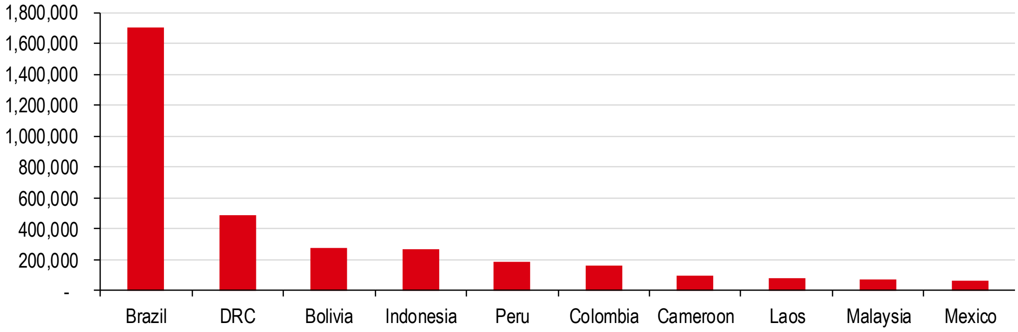
On the **corporate side**, we are seeing businesses implementing NbS within their supply chains and making NbS targets. As corporations are increasingly being asked how they consider ESG factors, including climate change and biodiversity, NbS can be used as a tool to synergise social and environmental benefits with bottom-line growth. We believe corporates have a role to play in driving NbS in 2023.

Deforestation – a change in the landscape

Pressure is mounting for finance to fund forest conservation

In 2022, **Brazil**, **Indonesia** and the **Democratic Republic of the Congo** formed an alliance to cooperate on forest preservation. The three countries own collectively 52% of the world's primary tropical forests. The countries are likely to work towards "a sustainable funding mechanism" to pressure developed countries to finance forest and biodiversity conservation in developed countries. We think concrete investment plans and goals on reducing deforestation will be provided by Brazil after President, Lula, came to office in January 2023.

Figure 5: Deforestation is concentrated in a handful of countries (hectares/year; 2020)



Source: Primary forest loss by World Resources Institute Global Forest Review

Trade in deforestation-linked goods likely to become increasingly restricted

The EU announced a new law on deforestation to ensure the bloc is not exporting or importing commodities that are drivers of deforestation. In 2023, we expect exporting countries to strengthen their policies concerning deforested goods. Government agencies will likely to step up efforts, including providing the technological support or subsidies for sustainable production, to help ensure local companies become compliant with the law. For example, Indonesia is planning to step up efforts in ensuring timber production is both legal and sustainable by incorporating the sustainability aspect in the verification process[2].

2 Mongabay, With new EU rules ahead, Indonesia adds sustainability to its timber legality system, 14 November 2022

Social matters to watch

- We expect more progress on ethnic, cultural and socio-economic diversity, and more focus on gender-biased pricing ('pink tax')
- Regulation and consumer attitudes will drive ever more disclosure on supply chains, especially labour rights and working conditions
- Heat stress is emerging as a key workplace risk, given the increasing frequency of extreme heat events, and growing calls for regulation

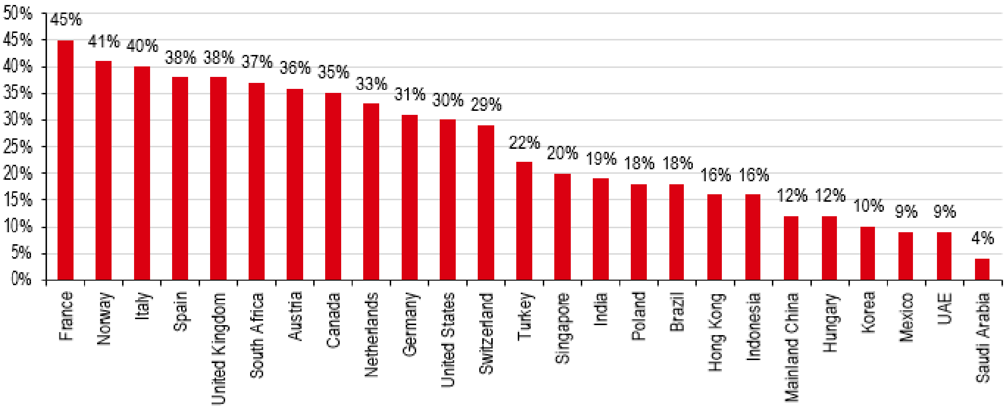
Diversity and inclusion – more awareness, more policy

Progress on gender diversity in all markets is expected

Gender diversity

Diversity and inclusion will continue to be in the spotlight in 2023, with the main focus being on board and senior management gender diversity. We expect gender diversity conversations to increase rapidly in **central European** markets as **EU** boards are mandated to meet a 40% non-executive gender quota by mid-2026 or 33% of all directors. This will be a challenge for many boards, especially in **Hungary** and **Poland**, which significantly lag European peers.

Figure 6: Percentage of board seats held by women per market, large companies



Source: EgonZehnder 2022
*Analysis covers all publicly traded companies with a market cap of EUR8bn or the largest six in each market.

We also anticipate regulatory developments on gender diversity in **Latin American markets**, which currently lag behind others on legislative initiatives, as well as gender diversity progress: only 13% of board seats in the region are held by women[3]. In our view, investors should also consider how companies improve gender diversity and develop talent in **MENA** and **Asian**

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markets, as we think boards in these regions may take a 'tick the box' approach by simply focusing on meeting recently introduced minimum requirements.

Gender-biased pricing

Policy to tackle gender-biased pricing could become more widespread

Pink tax generally refers to the price premium of products marketed to women. The New York City Department of Consumer Affairs[4] found that women's products cost 7% more than similar products for men. Considering the long-standing gender pay gap, the pink tax would be a financial burden on women and hinder social mobility. In **the US**, some states (e.g. California and New York) have already made gender-based price discrimination illegal. We anticipate more countries to look into gender-biased pricing while retailers would be acting on eliminating the mark-up.

Ethnic, cultural and socio-economic diversity

Ethnic, socio-economic and cultural diversity will be in the spotlight in the UK and US

In **the US** and **the UK**, we expect more progress on underrepresented minority background and ethnic diversity on boards to meet NASDAQ and the FCA's new targets and disclosure rules for listed companies. We also think that this upward trend will extend to cultural and socio-economic diversity due to stakeholder pressure. For example, in **Australia**, the focus recently has been on limited cultural diversity, as 90% of directors have come from Anglo-Celtic backgrounds;[5] and in the **UK** the attention has shifted to socio-economic diversity on boards due to a concern that boards may be appointing more women from a high socio-economic status in place of low socio-economic status men.[6]

Supply chains – regulation driving greater transparency

Disruption across all sectors has been high in recent years, from labour shortages to grounded traffic, and the flexibility of the supply chain has been stretched. New supply chain management models are expected to appear as companies and organisations work to develop reliable and sustainable systems amongst uncertainty across prices, geopolitics, industries and climate.

Technology integration, transparency and shifting consumer demand

The digitalisation of the supply chain has already begun with blockchain and the internet of things (IoT) leading the way; however, we expect a greater level of **technology integration** to enable flexibility and efficiency gains. Driving this change are costs efficiencies, greater insight into operations, improved decision making, and **ESG disclosures**.

Social and environmental factors have become more easily identifiable as companies reveal a greater complexity of their supply chains. Regulation and consumer attitudes are driving the commitment of companies to **transparency pledges**. We expect to see greater volumes of ESG data from across the supply chain throughout the year as companies continue to integrate technology and reporting regulations increase in number. Increased local production and greener supply chains are increasingly a vision of **shifting consumer demands –** requiring companies to produce sustainable goods closer to the end-customer with circularity considerations.

Social aspects and regulation developments

Identifying poor **labour rights** and **working conditions** is critical across all sectors and we expect greater consideration and monitoring as regulations come into force and transparency pledges are examined in 2023. Transparency pledges and regulations are the driving force as companies commit to providing information on social aspects. We see areas, such as health and safety (heat stress and workplace injuries), women's rights and workers' protection, to see increased attention.

4 New York City Department of Consumer Affairs (2015), From Cradle to Cane: The Cost of Being a Female Consumer
5 The Governance Institute of Australia and Watermark Search International, 2022 Board Diversity Index
6 The Financial Reporting Council, Board Diversity and Effectiveness in FTSE350 Companies

Europe's SFDR and **Germany's Supply Chain Due Diligence Act** bring focus to human rights issues. Countries with pending supply chain legislation that we expect to advance in the next year include Finland, Belgium, Romania and the Netherlands. Additionally, the European Union has passed its **Corporate Sustainability Reporting Directive (CSRD)** – companies will begin applying this year for its implementation from January 2024.

Geopolitical uncertainty, price volatility and de-globalisation?

Finally, **price volatility** and **geopolitical uncertainty** continue to be a challenge globally – impacting supply chains and trade directly. The prices of raw materials have seen great volatility with geopolitical tensions and inflation globally, which isn't expected to be abate soon. The impact this has on trade, the cost of producing and prices for consumers should be considered with the aim of being flexible and avoiding disruptions in supply chain operations.

Vertical integration is a key trend across industries as efficiency gains and technology investment across the supply chain become easier. We additionally bring attention to defensive global moves – the share of European corporates' local asset bases is rising and this could be a continuing trend we see throughout the year, especially considering shifting consumer preferences for local production and products.

Heat stress – awareness rising fast as the planet warms

Workplace heat stress risk to gain increasing prominence in a warming world

Heat stress risk in the workplace is a growing issue (including a supply chain issue) that we expect to see gaining increasing prominence. Immediate drivers include:

Figure 7: Some of the heat stress drivers

- Increasing frequency and severity of heatwaves (including the UK, China and India heatwaves in 2022 alone);
- Proliferation and tightening of workplace heat stress regulations globally, including growing calls for their introduction where they are not yet in place (e.g. in the UK); and
- Increasing disclosure requirements.

Source: HSBC

In this latter regard, the proposed EU Sustainability Reporting Standards (ESRS) will play an important role: under the ESRS, where workplace heat stress is identified as a material issue, its actual and potential impact on the workforce – including workers within the supply chain – should be disclosed, along with actions to prevent, mitigate or remedy it, and any targets related to reducing the negative impact. These should be adopted in mid-2023 (and come into play in subsequent years).

Agriculture and construction most affected, but also textile operations

Agriculture and construction are the sectors most affected as outdoor work is most prevalent here, and often involves high levels of physical exertion. However, **indoor workplaces** can also be problematic (and subject to separate heat stress regulations, where these exist). For example, textile manufacturing operations in places, such as China, India and Turkey – where temperatures are high and air conditioning may be non-existent or sub-optimal – are likely to be sources of indoor heat stress risk (which has implications for the global fashion industry from a supply chain point of view).

e-tailer warehouses pose indoor heat stress risk

e-tailer warehouses are another likely source of indoor risk, even in relatively cooler locations such as the UK. This is in part driven by working conditions that require stock pickers to spend long hours walking at a brisk pace to achieve specified pick rates. Once again, there may be little or no air conditioning in place, and the media (e.g. *The Times*, 22 November 2022) has already started focusing on the potential heat stress impact in this sector. We anticipate ongoing media coverage throughout the year, but more so in the northern summer.

Employers should also focus on the productivity (i.e. economic) impact of not addressing heat stress risk

Corporate productivity: Aside from the need to address heat stress risk from a Health & Safety point of view, we think employers should also begin to focus more on addressing it for productivity reasons. The impact of heat stress on labour productivity is likely to be among the most serious economic consequences of climate change, with reduced productivity starting to kick in at temperatures above 24-26°C and a 50% reduction being seen at 33-34°C (according to the ILO).

Productivity losses are, therefore, only set to increase as the planet continues to warm, thereby strengthening the economic case for installing air conditioning (for example). Even in an outdoor setting, better treatment of workers – including more water, more rest and more shade, alongside better equipment – can have a dramatic impact on productivity (e.g. a c45% increase in one study conducted among sugarcane workers in El Salvador). There is likely to be growing pressure for employers to discuss these issues in 2023 and beyond as extreme heat events and also awareness increase.

Governance topics of note

- Board-level gender diversity will remain in focus as new quotas need to be met (EU) or new regulations developed (e.g. LatAm)
- We also expect new rules around succession planning, as well as growing pressure for greater sustainability expertise on boards
- Greater consideration will be given to corporate culture, purpose and board effectiveness, particularly in North America and Europe

Succession planning as a strategic tool

Rules on succession planning will be the norm globally

We expect regulators globally to introduce new rules on board and senior management succession planning following the OECD's amendments to the Principles of Corporate Governance in 2023, adding a greater emphasis on this 'long-term strategic tool'[7]. Although the Principles are non-binding, they are widely used as a benchmark by advanced and emerging markets around the world. Currently, reporting on succession planning is not a common requirement, but we think investors will see more disclosures soon.

Sustainability expertise gap becomes evident

Lack of in-depth sustainability expertise becomes a major concern

We anticipate that the focus on sustainable governance will continue to increase globally; as markets progress with the implementation of different regulations and initiatives, the lack of in-depth sustainability expertise on corporate boards in all sectors will be in the spotlight. For example, according to EY's Boardroom Monitor, in the financial sector, only 1% of board members in **Germany**, 3% in **France** and **the UK**, and 5% in **Denmark** have any professional experience in sustainability. The regulator in Germany made a first step to address this issue by introducing a requirement in the revised Corporate Governance Code for boards to include relevant expertise. In 2023, we expect other markets to follow this German initiative due to stakeholder pressure.

Addressing pension issues

Pension issues will be at the top of the governance agenda

We think that rising global concerns around gender pension gaps will be coupled with considerations on aligning director pension contributions with the wider workforce. Women in the **EU**, for example, aged over 65 receive a pension that is, on average, 29% lower than that of men.[8] And in **the UK**, for example, alignment between executive and workforce pension contributions is the top provision for non-compliance with the UK Corporate Governance Code.[9]

Executive pay moves back on a radar

Excessive pay levels, ESG linked-pay, malus and clawback rules will be among key considerations in 2023

Concerns over excessive pay levels (as these have recovered to pre-pandemic levels) and remuneration designs not being reflective of corporate strategic objectives and shareholder interests reappeared on a radar last year. We think these issues will further intensify in 2023 with varying degrees in different markets.

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7 OECD, Public Consultation on Draft Revisions to the G20/OECD Principles of Corporate Governance, 2022
8 European Commission, Closing the gender pension gap?, 2021
9 FRC, Review of corporate governance reporting, 2022

In **Singapore**, we expect mandatory executive remuneration disclosure rules to be introduced following *a recent consultation*. In our view, this will bring improved transparency in the market regarding the amounts and types of compensation paid to executives. In **the US**, after the introduction of the rules on pay versus performance disclosure and clawback provisions, we expect the focus to shift to variable pay measures, especially ESG-linked metrics. The debate on standardisation and avoiding greenwashing in ESG-linked pay is likely to penetrate the agendas of regulators in other markets, including **Europe**. We think a clearer insight into the methodology behind variable pay metrics will allow to better assess their rationale and whether targets have been satisfied. In **the UK,** in addition to these considerations, we expect strengthening of the rules on malus and clawback arrangements, following the *FRC's consultation* in 1Q23.

Regional differences

We anticipate that regional differences in governance will continue in 2023

In markets with more advanced governance practices, mainly in **North America** and **Europe**, we expect shareholder resolutions on social issues and engagement on corporate culture, purpose and board effectiveness to increase in 2023. At the same time, we anticipate that in other markets, including many in **Asia**, where board effectiveness is not well-understood and investors face cultural misunderstandings on their resolutions, the focus will be on director length of tenure, independence, gender and functional diversity on boards.

Markets: ESG race or pace?

- The EU will try to maintain its leadership position as key disclosure requirements come into play, but the UK is looking to catch up
- China and India should move forward in ESG; the US will try, but it faces an increasingly hostile political (anti-ESG) environment
- The focus on migrant workers will widen to include ASEAN; MENA and LatAm will continue to play catch-up on disclosures

We expect more countries to start introducing anti-greenwashing measures. We also anticipate the launching or enhancement of green taxonomies. Meanwhile, mandatory ESG disclosure requirements will continue their inexorable march across the globe.

EU – still leading in sustainability

The EU is unlikely to curb its enthusiasm for sustainability

Markets will be watching for any shift in the EU's enthusiasm for its ambitious sustainability agenda in 2023. We expect the momentum to be maintained or accelerated for a number of reasons, including growing concerns around greenwashing. In addition to major climate announcements, the following are other key sustainability and ESG initiatives that investors will need to follow in 2023:

Corporate Sustainability Reporting Directive (CSRD)

ESRS will set a high bar for disclosure requirements

The European Parliament *adopted* the European Commission's proposal for the Corporate Sustainability Reporting Directive (CSRD) in November 2022. The Directive requires all large companies and listed SMEs to report sustainability-related information against the European Sustainability Reporting Standards (ESRS) from 2024. The **first set of the ESRS** is set to be adopted by the Commission by **June 2023**, with a view to being applied to reports published in 2025. As per the draft standards, we think the EU standards would set a high bar for disclosure requirements and drive enhancement of global disclosure rules.

Anti-greenwashing rules

Anti-greenwashing rules target funds and corporates, as well as ratings providers

In 2022, the EU initiated a number of anti-greenwashing measures, including seeking public opinion on the ESG ratings market. We expect the increasing scrutiny over greenwashing to continue in 2023. The European Securities and Markets Authority (ESMA) launched a *consultation* on guidelines for sustainable fund naming in November 2022 and aimed to finalise the guidelines in 2023.

Additionally, the European Commission was expected to release a legislative proposal for substantiating green claims in 2022, but it was postponed to 2023. It would require companies to justify their advertised environmental credential of their products/services. Also, the Commission is exploring the feasibility of introducing a new EU ESG benchmark label.

SFDR Level 2: The EU's Sustainable Finance Disclosure Regulation (SFDR) requires financial market participants and advisers to disclose sustainability-related risks and factors to their investments. Although the SFDR became effective in March 2021, the application of the regulatory technical standards (RTS, or known as SFDR Level 2) was deferred to 1 January 2023. The RTS specifies the details of disclosure requirements, including sustainability impact metrics and exposure to gas and nuclear investment. Participants are required to publish the **first statement on principal adverse sustainability impacts by 30 June 2023.**

SFDR-driven downgrades of Article 9 funds improve the credibility of remaining vehicles

Impact on Funds: We have already seen the impact of the SFDR in Europe where many funds are having to downgrade from Article 9 to Article 8, claiming the EU's definition of sustainability is unclear. It also adds to the refining process of ensuring the quality of the ESG ecosystem. For example, some funds had merely introduced the ESG label into the name of the fund for marketing purposes (without changing any part of the investment decision-making process) – stricter rules will indeed reduce this greenwashing, in our view.

The RTS are perceived to set a higher threshold for Article 8/9 fund classification – therefore, many asset managers reclassified their Article 9 funds to Article 8 in recent quarters (*Bloomberg*, 6 December 2022). However, we don't think these reclassifications have weakened the market sentiment towards sustainable investment. On the contrary, the remaining Article 8 and 9 funds would be more credible on sustainability grounds with lower greenwashing risks, which is more beneficial to long-term growth.

Circular economy plan

Plastic packaging and plastic waste both in focus this year

In November 2022, the European Commission proposed a revision of packaging waste regulation, which bans unnecessary packaging, such as single-use ketchup sachets and hotel shampoo bottles, and increases recycled content in plastic packaging. The European Parliament and Council will vote on the proposal this year. In addition to reducing plastic waste, the Commission proposed to phase out the export of plastic waste to OECD countries within four years and ban export of hazardous waste to non-OECD countries. In light of this, we think waste management could be a key sustainability topic in 2023.

Figure 8: Status of key ESG-related regulations in the EU

Regulation	Status	Action in 2023
Corporate Sustainability Reporting Directive (CSRD)	Adopted by the Parliament	The Commission aims to adopt the reporting standard by June 2023
Guideline for sustainable fund naming	Consultation ongoing	The ESMA will finalise the guidelines
Green claim directive	Closed consultation	The Commission will release a proposal
EU Green Bond Standard	Adopted by the EMA Committee of the Parliament and the European Council	The European Parliament will vote on the proposal in plenary
Revision on packaging waste rules	Proposed by the European Commission	The European Council and Parliament will consider the proposal
Revision on waste shipment regulation	Adopted by the ENVI Committee of the Parliament	The European Parliament will vote on the proposal in plenary

Source: European Commission, European Parliament, HSBC

EU Green Bond Standard

The Economic and Monetary Affairs Committee of the European Parliament approved the proposal for developing the EU Green Bond Standard (EUGBS) in 2022 and the Standard will be voted in the plenary Parliament this year. The proposed EUGBS suggests a list of criteria and guidance for green bond issuance, including EU Taxonomy alignment, disclosure and external review. We believe the EUGBS would enhance the transparency, comparability and integrity of global green bonds.

UK – hot on the EU's heels or forging its own path?

The UK's SDR expected to include Scope 3 emissions

The proposed **Sustainable Disclosure Requirement (SDR)** works to centralise the UK's climate and ESG reporting. The SDR and sustainable investment labels are part of the Financial Conduct Authority's (FCA) new package to tackle greenwashing; the FCA expects to have reviewed feedback and finalised the rules by the end of June 2023[10].

The SDR will align with work by the **ISSB** and the **UK's Green Taxonomy**. This is expected to require answers to the 11 core TCFD questions (SDR is expected to require Scope 3 supplier emissions), answers to non-climate ESG questions and a detailed transition plan for the path to net zero.

Figure 9: FCA proposed rules and guidance to tackle greenwashing

Measures	Description
Sustainable investment labels	Classification and labelling of products to help consumers navigate a complex product landscape and give them confidence in the integrity of the sustainable investment products they are offered. Proposed labelling categories include **Sustainable Focus, Sustainable Improvers** and **Sustainable Impact**, which are mutually exclusive.
Consumer-facing product-level disclosures	Consumer-friendly, accessible disclosures to help consumers understand the **key sustainability-related features** of an investment product. This includes its sustainability objective, investment approach, and performance against the objective – these must be produced for products with or without the sustainable investment label.
More detailed disclosures at the product and entity level	Granular disclosures targeted at a **broader range of stakeholders, including institutional investors or retail investors** seeking more information. These include pre-contractual disclosures setting out the sustainability-related features of an investment product, ongoing sustainability-related performance information in a **'sustainability product-level report'** and entity-level disclosures.
Naming and marketing rules	This includes a general **'anti-greenwashing' rule** clarifying that sustainability-related claims must be clear, fair and not misleading.
Requirements for distributors	Requirements for **distributors of in-scope investment products** to retail investors in the UK to make the sustainable investment label and consumer-facing disclosures available to those investors.

Source: Financial Conduct Authority, HSBC

A UK Green taxonomy

Development of the UK Green Taxonomy

Drawing on the EU Green Taxonomy, the **UK Green Taxonomy** is in development, which includes disclosures that are intended to help investors understand and compare the environmental performance of investment products. In October 2022, the **Green Technical Advisory Group (GTAG)** published its independent advice to the UK Government, including advice on on-shoring the EU Taxonomy with an "adopt some and revise some" approach[11]. Currently, there is no update to when to expect the UK Green Taxonomy.

Extending energy assessments

The UK's energy assessment scheme, namely the **Energy Savings Opportunity Scheme (ESOS)**, is mandatory for organisations to measure and document total energy consumption across buildings, transport and industrial operations. This year brings the filing of Phase 3 with the requirement of an energy audit. It is expected that the scheme will be extended to a broader range of companies and require additional disclosures, including a net-zero element and decarbonisation focus – rather than simply driving energy efficiency.

10 ' Sustainability Disclosure Requirements (SDR) and investment labels', FCA, October 2022
11 'GTAG: Advice on the development of a UK Green Taxonomy', GTAG, October 2022

US – navigating an increasingly complex environment

Community needs will be a focus in implementing the IRA and infrastructure

ESG in the United States has become more top of mind in the face of growing inequality concerns, diversity and environmental justice. As the US works to build resilience in 2023 through the **Inflation Reduction Act (IRA)** and **Infrastructure Act**, we think efforts will be seen by communities to embed social equality into their decision-making process and to help deliver programmes that best meet the needs of diverse communities. At the same time, the lack of regulation over "ESG" in the US has left the term open for interpretation and vulnerable to criticism.

Diversity and corporate culture

2023 will bring more conversations around diversity, corporate culture and human capital

In August 2023, Nasdaq will require one diverse director on the board of listed companies. Additionally, 2023 will be the first year of consistent diversity data collected by Nasdaq in the Diversity Matrix template. While the US has not pushed any quotas and targets, like other jurisdictions, we think Nasdaq's diversity rule will be influential in driving corporate diversity progress in 2023. Additionally, we think the diversity rule will open more conversations around connections between diversity, corporate culture, human capital and performance.

While human capital had been an early priority for SEC Chair Gary Gensler, little conversation around human capital was seen in 2022. Nonetheless, the profound impact that corporate culture and human capital have on businesses is more and more recognised, and we think greater attention around the disclosure or human capital metrics will be seen in 2023.

Disclosures still delayed

…and ESG disclosures, as the US plays catch-up with other jurisdictions

As funds grow across sustainable investments in the US, regulating the words sustainability and ESG is becoming more pertinent. Securities and Exchange Commission (SEC) Chair Gary Gensler proposed enhanced disclosure rules for sustainable funds in early 2022, along the lines of the EU's Sustainable Finance Disclosure Regulation (SFDR), but a decision has not been made. For investors this could mean better informed decisions, but also cross-border complexity. Additionally, as jurisdictions around the world mandate climate disclosures, the SEC's proposed climate risk disclosures are also yet to be implemented. We think disclosures will be a key conversation in 2023.

Political sphere of influence

The Biden administration has prioritised the "S" and specifically inequality in 2022 by expanding the Justice40 programme to direct 40% of climate and infrastructure investment benefits to disadvantaged communities, and lowering prescription drug prices, among other measures. While 2022 was a successful year for US climate policy, the Biden administration failed to reach many social promises, such as those around paid family leave, universal pre-school and student debt.

Bipartisan politics around ESG issues, and "ESG" itself will persist

The political polarisation that exists between the two parties, Democrats and Republicans, surrounding ESG issues like climate change, voting rights, healthcare, oil and gas, family, religion and immigration to name a few, we believe will continue into 2023. Businesses are feeling pressure by both consumers and politicians to have a voice on these issues, and action taken can impact customer loyalty and bottom line.

Additionally, 2022 brought about a bipartisan political debate around the term "ESG" itself. In our view, it is difficult to be political about material risk factors; ESG factors, such as those surrounding energy security, employment and living standards, to name a few, are the "bread and butter" of America, and their understanding is essential in fulfilling fiduciary responsibilities. Nonetheless, we believe an ESG "backlash" will continue in 2023; however, it can provide some positivity in weeding out greenwashing through corporate awareness for long-term value creations, and in identifying policy gaps, such as disclosure needs.

China – potential anti-greenwashing rules

Lack of clear definitions and disclosure requirements raises risks of greenwashing

As stated in the *20th Party Congress Report* from October 2022, green development will remain a key focus of the central government. In our view, the support could boost investment in green projects and other sustainable assets, but the growth might come with greenwashing practices. As other jurisdictions, such as the EU and India, have imposed different forms of anti-greenwashing rules, we believe China may also increase its scrutiny over the ESG integrity of corporates and financial institutions in the coming years. Notably, ESG or sustainable funds in China are still not clearly defined nor obligated to disclose unlike many other markets.

Corporate ESG disclosures first in line for development

Mandatory corporate disclosure

As a first step in tackling greenwashing, we expect to see more development on corporate disclosure requirements in mainland China in 2023. As stated in the *14th Five Year Development Plan for Finance Standardisation*, central regulators, including the China Securities Regulatory Commission and the State Administration for Market Regulation, committed to developing a set of environmental disclosure standards for listed companies (before the end of the 14FYP in 2025). It is, however, unclear when this will materialise.

In May 2022, a subsidiary of the State Council released a Work Plan for Improving Quality of Listed Central SOEs, which urges them to issue ESG reports by 2023. Also, a State Council-backed think tank, China Enterprise Reform and Development Society, released the first Chinese laws and regulation-based guidance for enterprise ESG disclosure last year[12]. We believe the Work Plan and guidance show a positive attitude of the government to developing ESG disclosure requirements and standards for corporates and financial market participants.

India – also targeting ESG ratings providers

Rules on accreditation of ratings providers in India to be finalised this year

After the mandatory implementation of **Business Responsibility and Sustainability Reporting (BRSR)** by March 2023, the regulatory authorities are now targeting ESG ratings providers and related third-party products. Last year, the SEBI put out a consultation paper proposing accreditation of ratings providers to assign ESG ratings to listed entities and securities. Based on public feedback, we expect the SEBI to finalise the rules in the coming year. In addition to ESG ratings, the SEBI is also expected to simplify the rules and framework of BRSR, while ensuring alignment with internationally accepted standards.

ASEAN – supply chains under scrutiny; taxonomies on the rise

Expect more regulations to protect workers' rights in ASEAN

Supply chain scrutiny to migrant worker protection

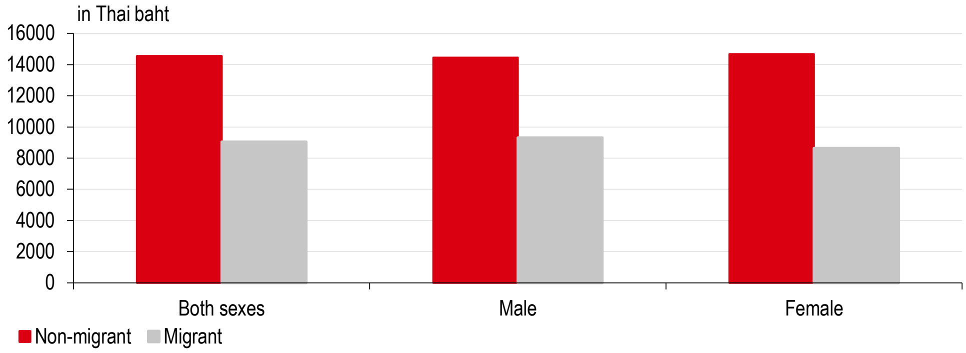
As developed countries become more aware – and, therefore, concerned – over labour standards and worker rights in the global supply chain, we think this concern will crystallise into regulations across parts of **ASEAN** this year. For instance, in 2022, US Customs and Border Protection banned imports from Malaysian companies due to suspected forced labour practices.[13] There will be a review on the implementation of **Malaysia**'s National Action Plan on Forced Labour in 2023 and we think comprehensive guidelines will be given to corporates to avoid confusion.

Inequality in pay will also be a focus. The salary of a migrant worker is significantly lower than a non-migrant worker within the same sector in **Thailand**. The difference is more pronounced when we compare across gender. We expect other authorities in **ASEAN** to be more stringent over labour rights and inequalities and to look into developing policies in 2023.

12 China Enterprise Reform and Development Society (2022), Guidance for enterprise ESG disclosure
13 Reuters, Malaysian firms facing U.S. bans over forced labour summoned by ministry, 30 January 2022

Intra-ASEAN: There are also increasing talks over employee protection between source and host country. **Indonesia** stopped sending migrant workers to **Malaysia** in July 2022 due to allegations of trafficking and forced labour. The return of workers only resumed when an agreement was signed on protecting labour rights (*Reuters*, 28 July 2022). We think that source countries will be playing an increasingly important role in securing the rights of domestic labour.

Figure 10: Average wages in Thailand by migration status and gender within the same sector in 2019



Source: International Labour Migration Statistics Database, HSBC

Taxonomy updates in ASEAN

New taxonomies to be launched, and existing taxonomies refined

Indonesia launched Indonesia Green Taxonomy 1.0, which provides guidance on sustainable business activities, in early 2022. Agus Siregar, Deputy Commissioner for Financial System Stability at OJK, said that "provisions and guidelines can still develop, depending on technological developments and climate change." As such, we anticipate ongoing developments in 2023.

Figure 11: Taxonomy across the region

	EU	ASEAN	China	Singapore	Malaysia	Indonesia	Thailand (planned)
Environmental objective							
Climate change mitigation	Yes	Yes	Yes	Yes	Yes	Yes	Yes (early 2023)
Climate change adaptation	Yes	Yes	Yes	Yes	Yes	Yes	Yes (later phase)
Protection of biodiversity	Yes	Yes		Yes	Yes		Yes (later phase)
Pollution prevention and control	Yes		Yes				Yes (later phase)
Transition to circular economy	Yes		Yes				
Implementation method							
Mandatory enforcement	Yes		Yes*				
Voluntary basis		Yes		Yes	Yes	Yes	Yes

Source: Source: BOT, HSBC
*Currently only applies to Green Bonds and Green Credit.

In **Malaysia**, the Securities Commission unveiled the principles-based Sustainable and Responsible Investment Taxonomy for the Malaysian market on 12 December 2022. And **Thailand** is planning to announce a transition-focused green taxonomy that builds up on the ASEAN taxonomy in early 2023.

In **Singapore**, there will be more refinement on the taxonomy in 2023. The Green Finance Industry Taskforce will finalise the Green and Transition Taxonomy and financial institutions will require to report their taxonomy alignment from 2023 onwards. The Monetary Authority of Singapore (MAS) published a circular on Disclosure and Reporting Guidelines for Retail ESG Funds in July 2022 and retail ESG funds are required to provide clear disclosures on their ESG investment objective and approach starting from 1 January 2023.

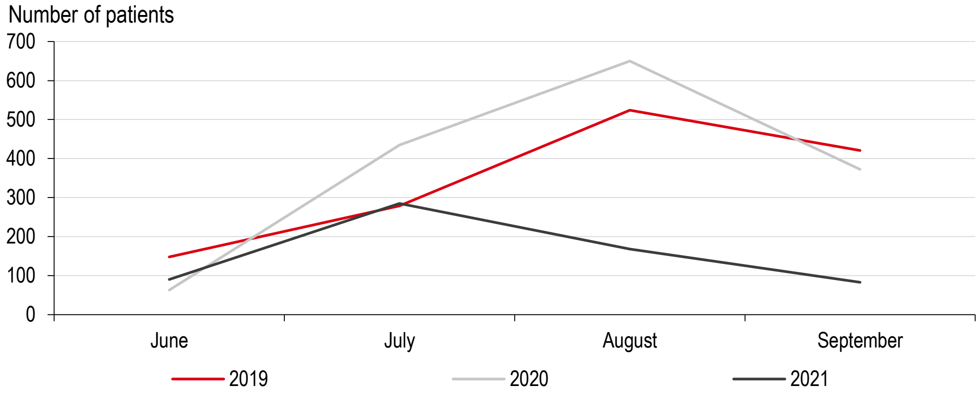
MENA – outstanding issues post the World Cup

Focus on labour law enforcement likely to broaden from Qatar, with heat stress risk to the fore

Reform of labour laws

With the FIFA World Cup now over, we think the focus on implementation and enforcement of recent labour law reforms may broaden from **Qatar**, in particular to other countries undertaking significant tourist-related build-outs – **Saudi Arabia** is a notable example here. In addition, with heat stress rising up the ESG agenda globally, this element of workplace health and safety is likely to rank high among investor concerns for this already hot region – especially in the construction sector. Following changes in 2021, Qatar now has the longest summer work ban period in the GCC (Gulf Cooperation Council) (in terms of both dates and hours of the day), as well as a prohibition on work above a certain temperature regardless of the time of day or year. These changes are already having a positive effect on the incidence of heat-related disorders in Qatar (see chart below) and could prompt other states to follow suit in the coming year.

Figure 12: Number of patients with heat-related disorders in Qatar



Source: ILO

More, and better, corporate ESG disclosures as stock exchanges push, SWFs pull

ESG disclosure evolution in MENA

At the company level, we expect a growing number of listed companies to begin making ESG disclosures this year, even where these are not yet mandatory. In addition to the regulatory 'push' for more disclosure we also see a strong 'pull' from regional sovereign wealth funds (SWFs, as well as local pension and insurance funds) that are increasingly looking to make their portfolios ESG compliant. As a result, investors will have access to more, and better, ESG data, which should enable them to both deepen their ESG conversations with management and integrate ESG considerations more effectively into their MENA portfolios.

Gender diversity and emissions reduction targets likely the key metrics in focus

Gender on the agenda? In terms of specific metrics, we would expect progress on board-level gender diversity to remain in focus through 2023, especially for those countries where it remains in the low single digits, and where the introduction of targets or quotas may be considered as a means of accelerating the process. Emissions reduction targets may also come under closer scrutiny (given another climate COP for the region at the end of the year), especially for those sectors where there are specific near-term country-level targets, the number of which is proliferating as regional NDCs are repeatedly upgraded.

Figure 13: Summary of ESG disclosure requirements across select MENA capital markets

Market	ESG rule	ESG guidance	Details
Egypt	Mandatory	Yes	The EGX issued ESG guidelines in 2016 and in 2021 the FRA required that ESG disclosure become mandatory starting with FY 2022 financials. Larger listed companies will also be required to report on certain TCFD performance indicators on a comply or explain basis.
UAE – Abu Dhabi	Mandatory	Yes	In 2021, the Securities and Commodity Authority (SCA) required all companies listed on UAE exchanges to disclose a sustainability report in accordance with GRI Standards and any requirements issued by the respective stock exchanges.
UAE – Dubai	Mandatory	Yes	In 2021, the Securities and Commodity Authority (SCA) required all companies listed on UAE exchanges to disclose a sustainability report in accordance with GRI Standards and any requirements issued by the respective stock exchanges.
Kuwait	Voluntary	Yes	Boursa Kuwait introduced a Sustainability Disclosure Guide in 2017 and effectively upgraded this into its ESG Reporting Guide in 2021.
Qatar	Voluntary (expected to become mandatory in 2023-24)	Yes	The Qatar Stock Exchange introduced ESG guidance in December 2016 and plans to make ESG disclosure mandatory in the next 1-2 years.
Saudi Arabia	Voluntary	Yes	The Saudi Exchange issued its ESG Disclosure Guidelines in 2021.
Bahrain	No	Yes	The Bahrain Bourse issued its ESG Reporting Guide in 2020.
Oman	No	Expected	While the MSX has not yet issued any ESG guidance, in 2021 it announced the establishment of a new section to focus on ESG issues, as well as Diversity and Inclusion. In 2022, the Oman CMA (Capital Market Authority) stated that it is committed to introducing ESG guidelines for MSX-listed companies.

Source: Stock Exchanges and Regulators

LatAm – disclosure momentum kicking in

Tightening regulations targeting investors as well as corporates

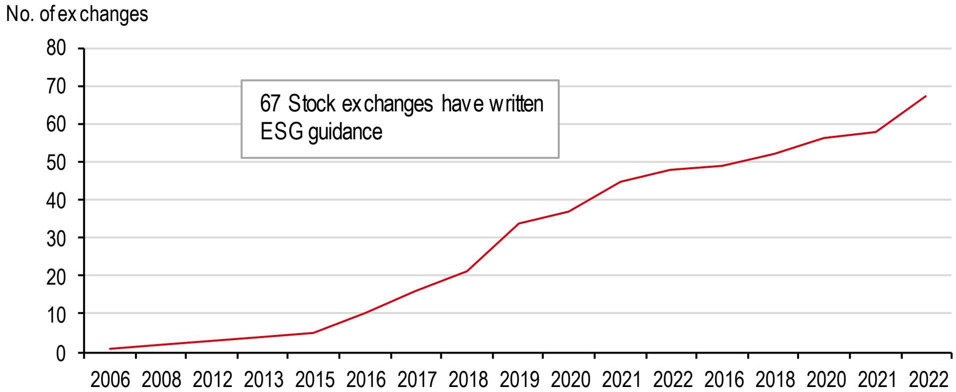
Local investors demand ESG: Global and local investors are increasingly demanding more transparency on ESG, as they try to satisfy rising due diligence requirements, to navigate uncertainties, and to mitigate the risks of their investments. As we look into 2023, we think ESG criteria will be increasingly taken into account in investment assessments of the region. In **Brazil**, **Mexico** and **Chile**, investors are now required to incorporate sustainability criteria in their investment processes; in **Colombia**, investors must disclose how they evaluate ESG factors. A lot of these regulatory changes are kicking in throughout the year.

Corporates begin to disclose: Corporates are only getting started to avail themselves of these opportunities. Executed properly, ESG disclosures can allow corporates to lower their cost of capital, increase their access to capital, and accelerate long-term growth. The region is experiencing historically low PE multiples and PB multiples despite particularly high returns on equity (ROE). The reason for part of this disconnect is arguably non-financial. Those that do not respond to the growing demand for ESG considerations run the risk of being left behind.

Regulations are picking up: ESG disclosure requirements are quickly tightening on the back of regulatory and exchange-led initiatives. **Brazil**, **Colombia** and **Chile** stand out in the region as they are already pushing mandatory corporate disclosure guidelines.

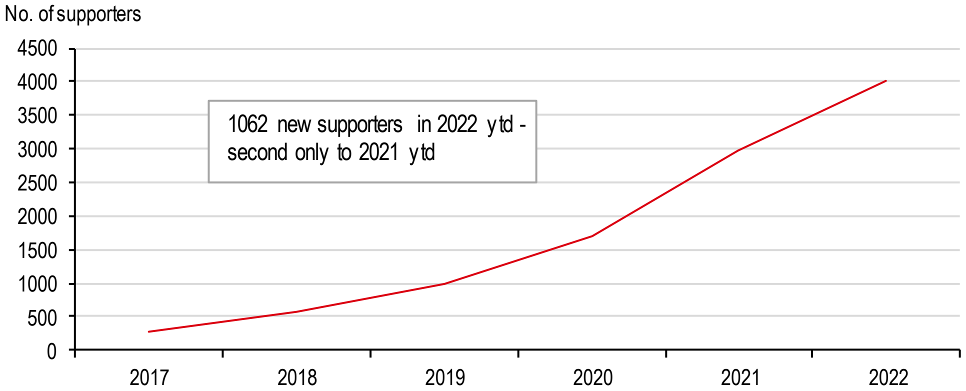
Indicators of the advance of ESG

Figure 14: Stock exchanges with ESG guidance documents



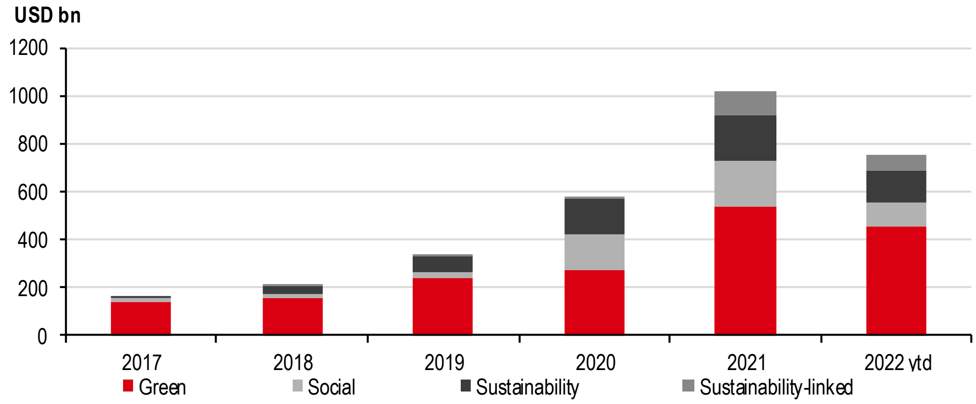
Source: SSE. Note: Updated versions have been included in the year of release of updated guidance versions

Figure 15: TCFD – the number of organisations that are supporting the disclosures



Source: TCFD

Figure 16: Global issuance of Green, Social and Sustainable bonds



Source: HSBC report – Green Bond Outlook: The quality of ambition, 18 November 2022

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