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ESG: What's Trending In 2022

2021 proved to be an unprecedented year on many fronts, not the least of which was the explosion of ESG, in both urgency and visibility. Companies face changing expectations, not only from investors and regulators but from customers, employees and lenders, who are demanding greater accountability and transparency around ESG factors.

The big question now is whether that momentum will continue. ESG remains a growing force and continues to be further embedded into both regulatory and corporate culture. Given the convergence of stakeholder demands, reporting expectations and anticipated regulation, ESG appears to be solidifying its place on the strategic business agenda. As such, there are several key trends that will be important to pay attention to in the coming months.

1. Climate will continue to dominate the global ESG agenda.

2021 saw the release of a new report from the Intergovernmental Panel on Climate Change (IPCC). The report stated unequivocally humanity is at the highest level of risk and urgency regarding the need for drastic climate action. This call to action was followed by COP26, the Glasgow Pact, and a landmark agreement between the US and China to work together on global climate change.

Additionally, a second installment of the same IPCC report was released in February of this year, which dove deeper into the physical science of climate change and the dire and imminent impacts on society as we know it. Additionally, the Securities and Exchange Commission (SEC) recently released its proposed rules making climate reporting mandatory for publicly traded companies – aligning the U.S with the European Union (EU) and other countries like the UK, Canada, Brazil, and India. And with 2022 projected to be the hottest year on record and forecasts for severe weather such as wildfires, tornadoes, hurricanes, and droughts expected to increase in both severity and frequency, climate continues to be top of mind for the public.

In response to the global push to address climate change, there will continue to be a heightened focus on the need for companies to set net zero goals. Investors like Blackrock have made their commitment to advancing net zero clear and global institutions have reinforced the importance of net zero ambitions. The Glasgow Financial Alliance for Net Zero, of which BDO is a sub-sector member, brought together over 450 financial institutions across 45 countries representing $130 trillion in private capital, to advance commitments connecting the delivery of financial services and access to capital with the acceleration of net zero ambitions. Alliances like these, along with the growing call for science-based targets, will continue to drive the importance of net zero commitments forward in 2022.

2. Standards will align, but voluntary reporting will continue to add value.

At COP26, the International Financial Reporting Standards Foundation (IFRS) announced the creation of The International Sustainability Standards Board (ISSB), which includes the consolidation of the Climate Disclosure Standards Board and the Value Reporting Foundation and a significant step towards a single global standard. The ISSB has the support of 40 of the world's leading finance ministers aiming to bring greater alignment and structure to global ESG reporting and disclosure. Further, the European Commission's proposal for a Corporate Sustainability Reporting Directive (CSRD) envisions the adoption of broad sustainability reporting requirements for public and private companies that meet certain size requirements. Despite this alignment, voluntary reporting and disclosure will continue to add value. This will be particularly true for private companies that increasingly recognize the importance of leveraging ESG reporting for reputation and risk management while being less subject to global financial standards.

3. Among investors, the social factors of ESG will continue to grow in importance, with more attention to diversity and social justice.

A 2021 study done by Schroder's indicated that 57% of investors globally said social issues had become more important to them and their investment decisions during the pandemic. This focus on social will build on the momentum from the social justice movements that brought the need for action to the forefront over the past several years. This shift will call greater attention to issues such as pay equity, diversity, equity and inclusion, forced labor and human rights, supply chain sustainability, and environmental and social justice for businesses. It will continue to demand that companies place great emphasis on how they treat their employees, how they impact and interact with their customers, and how they impact the communities in which they operate. Businesses will also need to provide greater transparency around their progress on these efforts through effective reporting and disclosure.

4. Tax compliance will become tax fairness.

As the focus on ethical corporate behavior by activist shareholders tightens, and board-level interest in ESG continues to increase, companies will be expected to not only comply with tax law but also ensure that they are paying their perceived "fair share" of taxes. Advancing corporate tax transparency has emerged as a central ESG issue, long a focus of the OECD and recently the subject of a new standard from the Global Sustainability Standards Board. It's also a clear mandate for tax executives. According to BDO's 2022 Tax Outlook Survey Report, which polled 150 tax executives, 95% said their department played a role in developing tax transparency reporting programs. Fifty-three percent believe they should be very involved in strategic conversations on their organization's ESG program and nearly half (49%) are already involved. Companies that view their tax strategy through an ESG lens will be best positioned to see maximum impact while at the same time mitigating reputational risk.

5. The focus on greenwashing will intensify.

As ESG reporting and disclosure continue to grow, the focus on transparency and accuracy will intensify. Regulators in the U.S and Europe have indicated an interest in ensuring that ESG reporting does not become green PR or marketing and that reporting provides clear and relevant insight into ESG performance. The concern over greenwashing will likely translate into greater demand for third party assurance services to help companies demonstrate the accuracy of their reporting. This increased attention on greenwashing comes with a need for companies to ensure that they are authentic in their approach to ESG, that they "walk the walk" and are doing the work to demonstrate their active investment in ESG performance.

6. Biodiversity will have its moment.

$44T in global GDP is tied to the natural world. The risks to biodiversity, or the diversity of plant and animal life on earth and the health of our ecosystems, presents a serious economic threat to the global economy. This threat is a risk expected to increase as a priority for investors. To help address growing awareness, the Task Force on Nature Related Financial Disclosure (TFND) has been created to provide a framework for assessing biodiversity-related risk and a means for reporting on how companies are identifying and addressing that risk. As a result, the push for increased reporting and disclosure of biodiversity risk and action in 2022 is expected to increase.

Insights

One thing is clear: companies cannot wait for regulation to begin considering the impact that ESG will have on their ability to do business in the future. Investors, customers and employees alike are demanding that companies – both public and private – do more to operate within the limits of the world's ecosystems and advance social justice – and disclose those actions. The risk related to inaction around ESG factors is very real-- however, so are the opportunities to create value across organizations. Those that integrate ESG into their business strategies, operations and company cultures will be far more resilient and far better positioned in the eyes of all stakeholders.

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