INSTITUTO GOBERNANZA Y SOCIEDAD
Febrero 2022 - Artículo del mes

ESG: 2021 Trends and Expectations for 2022

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Throughout 2021, the importance of environmental, social and governance (ESG) matters proved to be even greater than many had expected, with ESG becoming a key area of focus for a range of stakeholders, particularly in the boardroom. The rise and rise of ESG that we have seen over the past few years is likely to continue in 2022, as ESG remains a priority in the corporate sphere. In our 1 September 2021 client alert "ESG in 2021 So Far: An Update," we discussed the trends we had predicted for the year as well as the emerging developments in ESG. In this article, we look back at our predictions for 2021 and assess factors that will likely shape 2022.

Looking Back: What We Saw in 2021

Continued Inflows Into ESG Funds

Inflows into ESG funds continued to grow in 2021, surpassing 2020's total inflows of $51.1 billion before the end of Q3 in 2021. Current assessments estimate that there are more than $330 billion in assets under management in ESG funds, with the creation of more ESG funds expected in 2022. However, some funds have experienced difficulty adapting to comply with ESG standards. Passive funds such as ETFs have struggled to respond to new "green regulations," such as the introduction of the EU's Sustainable Finance Disclosure Regulation (SFDR). Without mandates to effect short-term changes to their fund's strategies, conforming to rapidly evolving green standards will be a key challenge faced by passive managers.

Additionally, "greenwashing" became a priority concern to regulators in 2021. Regulatory scrutiny intensified in September 2021 when BaFin, the German financial regulator, and the U.S. Securities and Exchange Commission (SEC) initiated an investigation into allegations that Deutsche Bank's asset management arm had been misstating the environmental credentials of some of its green-labelled products.

A recent study by a shareholder advocacy group found that 60 of 94 ESG funds failed to adhere closely to the principles of ESG investing. This trend has led both ESG investors and regulators to exert pressure on companies to substantiate their claims with metrics of environmental impact. Currently, there is no regulatory green taxonomy for ESG products in the U.K., as the EU's taxonomy regulation (Taxonomy Regulation) was not onshored following Brexit. We await the developments of the Green Technical Advisory Group, a multistakeholder organisation comprising the public and private sector, which is currently advising the U.K. government on the development of a green taxonomy that will build on existing systems, including the Taxonomy Regulation.

To combat greenwashing, the U.K.'s Financial Conduct Authority (FCA) released a policy statement in December 2021 on enhancing climate-related disclosures by managers. In response to a number of concerns about the scope of products and green certifications covered by new regulations, the FCA issued guidance that firms would not have to disclose information if data gaps or methodological challenges could not be addressed through proxies and assumptions, or if doing so would lead to misleading disclosures. Firms are required to explain where and why they have not been able to disclose, as well as steps they will take to improve the completeness and quality of disclosure.

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