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Environmental,  
social and  
governance

# Key ESG trends

2023



# Environmental, Social and Governance (ESG) promises to drive business decision making in 2023 and impact how companies plan, operate and report.

The complex and rapidly-evolving world of ESG is set to remain a priority for governments, corporate boards, investors and consumers and have unprecedented importance for businesses. Driven by regulatory change and a growing awareness among institutions, their boards, employees and other stakeholders, companies are increasingly making these issues central to core strategic decision-making.

This is a global trend: from **COP27 and COP15**, the rapid growth in impact financing and investing, to the continued dialogue about diversity and inclusion, ESG ripples are being felt across all industries, sectors and geographies.



Below we set out the **five key ESG trends** we expect to see in 2023 and some thoughts on how businesses should prepare to respond to the rapidly increasing demands for stronger ESG performance from consumers, investors and regulators.



# 1. Reporting, disclosure and the importance of data

2023 will be the year global financial regulators and voluntary standard frameworks converge around concrete measures to improve data quality and coverage. These requirements go beyond climate-related reporting and also incorporate wider environmental and social factors.

Investor-grade, high-quality ESG disclosure will drive investment decisions, consumer spending habits and regulatory compliance. This data is not only important in order to access finance and comply with regulations; reliable data will also show a company its risks and opportunities and allow it to facilitate a robust business strategy featuring ESG risk-management.

There is a growing body of laws and regulations governing disclosure of environment and climate-related data which increasingly aim to scrutinise green claims and require the true integration of sustainability into investment decision-making.

- a) In the UK, reporting in accordance with the Task Force on Climate-related Financial Disclosures (TCFD), the FCA proposed general anti-greenwashing rule (applicable to all regulated firms), the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022, the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 and the UK Stewardship Code require businesses to disclose data relating to sustainability considerations.
- b) In the EU, asset managers and other financial market participants must disclose an array of new sustainability data under the Sustainable Finance Disclosure Regulation. The Corporate Sustainability Reporting Directive (CSRD) captures a much wider range of entities and requires reporting on a broad range of ESG topics. ESG related disclosures are also required under the EU Taxonomy Regulations.
- c) The US's Securities and Exchange Commission (SEC) rules provide investors with decision-useful qualitative and quantitative information by applying existing anti-fraud and marketing rules and regulations that apply to all disclosures, including ESG matters.
- d) For more information on other jurisdictions that are also making changes to their climate-related disclosure regimes, see our Global Vision tool.



For more information, see our guide to [New and Emerging ESG Legislation](#).



These hard-law requirements are overlaid with investor expectations, market best-practices and “soft law” voluntary reporting standards, such as the UN Global Compact, the Extractive Industry Transparency Initiative and UNPRI.

Whether required by law to disclose, or encouraged to do so by investors and stakeholders, Boards must ensure they are in a position to manage ESG disclosures. As disclosure requirements become more onerous, current ESG policies should be reviewed, responsibility for ESG performance should be clearly delegated and Boards should consider whether their current reporting practices adequately support legal obligations, branding and wider ESG commitments.

The increase of data gathering and disclosure has a correlative effect. Companies and governments are using data driven technologies like artificial intelligence, machine learning, and the internet of things to monitor and improve environmental compliance and worker safety, while also increasing operational efficiency.

At Hogan Lovells, our team includes both lawyers and scientists, advising on:

Development and publication of standards for ESG-related due diligence, disclosure and contractual provisions;

Governance mechanisms that incorporate consideration of this data; and

ESG policies and ESG investment policies.



## 2. The rise of social and governance issues, with a focus on diversity and inclusion (D&I), and human rights

Events such as the COVID-19 pandemic and the Black Lives Matter movement have generated unprecedented momentum for company stakeholders to demand that Boards take action on a broad range of social and governance issues. Two areas – [human rights](#) and [diversity and inclusion](#) (DE&I) – warrant particular focus for businesses.

Human rights and the responsibility of businesses for the impacts they have through their sales, supply-chain and operations are likely to be the subject of new European laws which may change the boundaries of corporate responsibility in the social arena.

The focus on social issues will increasingly become a bankability issue: major investment firms and asset managers have signaled that they will require companies to disclose diversity data. There is a corresponding rise in shareholder activism relating to diversity and work culture in large organisations. Shareholder activism, along with pressure from employees amid the 2022 “war on talent”, resulted in companies introducing new incentives and policies aimed at promoting the employee experience. With increased economic and labor-market uncertainty, companies will have to honour their prior commitments to avoid accusations of inauthenticity.

- a) D&I objectives have become a measure of an organisation’s values and regulators are responding to the need for greater transparency on these issues. The UK has implemented gender pay gap reporting for companies since 2017 (albeit with a pause during the COVID-19 pandemic) and some businesses are disclosing ethnicity pay data on a voluntary basis, with calls for this to be made mandatory. Broader reporting requirements are being rolled out; subject to transition periods, companies listed on the Nasdaq Capital Market must have, or explain why they do not have, one diverse director by 31 December 2023, and two diverse directors by 31 December 2026.



- b) Previously viewed by some as a task for NGO campaigns and CSR initiatives, the prevention of adverse human rights impacts in the context of global business is increasingly being tackled by legislation, including: the Corporate Sustainability Due Diligence Directive (CSDDD) which enhances the protection of the environment and human rights and will require businesses both within and outside of the EU to monitor their supply chains for the risk of adverse impacts on human rights and the environment; the EU human rights sanctions regime, which enables the EU to target natural and legal persons, entities and bodies responsible for, involved in or associated with serious human rights violations and abuses worldwide; the German Act of Corporate Due Diligence in Supply chains, one of the most significant human rights due diligence statutes, which requires large companies to make sure social and environmental standards are observed in their supply chain. In the US, Section 307 of the Tariff Act of 1930 (19 U.S.C. §1307) prohibits importing any product that was mined, produced, or manufactured wholly or in part by forced labor. Companies must monitor their own operations and their direct suppliers worldwide, and take action if they find violations.



### 3. The shifting discussion about biodiversity and the environment

Businesses and governments continue to shift their focus on growing threats to nature and biodiversity. The World Economic Forum estimates that \$44 trillion of economic value generation, representing more than half of the world's GDP, is moderately or highly dependent on nature and exposed to risks from nature loss. As the planet looks to “build back better” in the aftermath of the COVID-19 pandemic, we are seeing increasingly complex conversations about [biodiversity and nature loss, and the importance of adaptation and climate resilience](#).

The Taskforce on Nature-related Financial Disclosures (TNFD) calls nature loss “a planetary emergency” and aims to create a framework for corporates and financial institutions to assess, manage and report on their dependencies and impacts on nature.

In response to the risk to nature, we have seen an increase in commitments from governments and societies. World leaders have pledged to undertake urgent actions to reverse biodiversity loss over the next ten years as part of the UN Decade of Action to achieve Sustainable Development. COP15 saw the adoption of a new set of international goals for biodiversity called the Kunming-Montreal Global Biodiversity Framework (“GBF”). A total of 188 governments agreed to the GBF and committed to halt and reverse the loss of terrestrial and marine biodiversity by 2030. Following this growing number of commitments, legislators across the world are increasingly recognising the potential of a nature positive economy, including the potential creation of 395 million jobs worldwide.

Businesses and organisations are also pledging to help reverse the decline in nature and biodiversity. Nature Action 100, a global investor engagement initiative, focuses on driving greater corporate ambition and action in key sectors that are deemed to be systemically important in reversing nature and biodiversity loss by 2030. Meanwhile, 126 financial institutions – representing 21 countries and over €18.8 trillion in assets – have convened to create the Finance for Biodiversity Foundation, which aims to protect and restore biodiversity through finance activity. Businesses must consider nature-positive solutions as part of their operating practices and should expect reporting requirements to expand to include disclosure on the impact of their activities on land and under water.



Numerous countries have now also made historic commitments to achieve carbon neutrality or net zero emissions – to emit no more carbon dioxide than they remove from the atmosphere – by 2050. The United Nations now estimates that countries representing around 90% of global CO<sub>2</sub> emissions and around 70% of the world's economy have committed to or are considering net-zero emissions or carbon neutrality targets. China, which represents nearly 30% of global CO<sub>2</sub> emissions, committed to become carbon-neutral by 2060. As fossil fuels currently account for 85% of China's energy consumption, meeting that target will require a radical overhaul of its energy profile.

In November 2022, Egypt hosted the UN's COP27. COP27 was an important opportunity for businesses, governments, international organisations, businesses, and societies to discuss the latest science and how to collaborate to tackle the climate crisis.

Key topics discussed at COP27 affect all businesses and their stakeholders and the key learnings from the conference should be considered in any target-setting and business strategies going forward. The four main priority areas addressed were:

- Establishing a loss and damage fund to help developing countries respond to loss and damage caused by climate change.
- Discussions about climate finance dealt with how the international community might meet the costs of mitigation and adaptation.
- For the first time, COP27 saw equal attention given to adaptation with the acceptance of the global 1.5°C temperature rise. Attendees considered how to allocate funding, create frameworks, and develop technologies to minimize the impact of that temperature increase on especially vulnerable communities across the world.
- Food and water security became an urgent issue, recognizing the effects climate change has on food shortages and freshwater scarcity.

As a result of these discussions, some pressure will be felt by private companies as they are also expected to form part of the solution for tackling climate change. Businesses must therefore be in a position to respond effectively to the outcomes of COP27, policy changes, social shifts and accelerating stakeholder scrutiny.

Following the global energy landscape shift in 2023 in response to the Russia-Ukraine war, companies will also have to consider balancing their commitments to the environment and nature, the energy transition, energy affordability and energy security. Some governments have responded to this uncertainty with new support packages, such as the U.S Inflation Reduction Act and Europe's REPowerEU, to incentivize renewable energy development and provide greater energy security. We expect to see these packages impact investment towards environmentally friendly opportunities, with countries offering these incentives becoming far more attractive than their counterparts.



## 4. The Green Finance Boom

Green Finance signifies the world is moving away from the fossil fuel era and is instead investing in the green economy, tackling environmental challenges and creating green jobs. **Green Finance** is a major driver of **the energy transition**, and is central to the delivery of key climate sustainability development goals, to finance long-term sustainable growth and build a low-carbon, climate-resilient and circular economy.

In recent years we have seen a proliferation of financial net-zero commitments from companies and countries. The Glasgow Financial Alliance for Net Zero (formed of over 450 firms representing ~\$130 trillion, or 40% of the world's financial assets under management) signed up to achieve and deliver net zero by 2050, and marked a significant shift towards private funds forming part of the climate crisis solution. With the increase in companies and governments making net-zero commitments in recent years, sustainable and green bonds are set to boom as carbon-intensive companies issue debt to raise capital and use the proceeds for carbon-reduction activities.

More generally, we also see opportunities for capital markets. In Europe, for example, 30% of the €800 billion recovery fund is dedicated to **green and sustainable finance**. With so much government-issued debt that will be tagged to sustainability, and significant interest from private markets, the already booming sustainable finance market is set for even greater growth.

In order to access this finance, businesses must evidence a credible transition plan which includes suitably ambitious targets and is innovative in its approach to tackling climate change and biodiversity loss. To meet the demands of investors, stakeholders and regulators, companies must apply a green lens across their business activities, consider science and nature-based solutions and use technology and to cement their place within circular economies.



## 5. Strong governance and legally walking the talk

Good [governance](#) underpins all ESG activities. Boards should ensure they are aware of legislative developments, align their legal frameworks with any public statements and protect themselves against accusations of greenwashing. In a world of “[crowd-reg](#)” and increasing shareholder activism, governance structures should promote transparency, trust, diversity and integrity. Companies and investors will have to navigate the increasing risk of litigation related to sustainability (in)actions. Investors and consumers expect companies to set ambitious targets, particularly relating to climate and D&I strategies. Companies must meet these expectations whilst not over-reaching and failing to deliver on their promises.

Accusations of [green-washing](#) or lack of authenticity can derail a company, so robust systems which produce reliable, science-based data should be an essential part of any Board’s target setting and reporting processes. [Shareholder activism and class actions](#) can result in serious reputational harm, divert management time and limit investment; so companies should be proactive in engaging with stakeholders and managing their ESG journey.

It is no longer sufficient for a company to consider only its own corporate commitments to environmental and social issues. These issues should be integrated into the wider legal framework, including in its supply-chain, contractual precedents, and recruitment, retention, payment and promotion practices. Policies alone are not sufficient; best practice is now for clear KPIs, reporting and audits on this information.

Speak to a member of our [Business Integrity Group \(BiG\)](#) about the “health-check” and ESG 360° Assessment we offer to review whether your business infrastructure is delivering on your ESG commitments and suggest how changes to your legal and contractual frameworks can be implemented to drive your purpose and performance. To get started, try our [app](#) to see if your legal frameworks are driving your business purpose.



With so many powerful forces in play, it is clear that the ESG issues will be a priority for corporate boards, investors and governments in 2023 and beyond. Alongside that growth will come opportunities and challenges that will need to be addressed through the law, so it is critical that in-house teams respond accordingly.

Contact us for more information and to help you navigate.



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