10 ESG themes for 2020

What will influence investors now?

Over the past two years, Environmental, Social and Governance factors have raced to the top of the agenda for companies and investors. In this slideshow, our Research analysts identify ten key ESG themes that are set to have a direct impact on equity and credit markets in 2020.
Trend 1
COVID-19 will fast-track some ESG issues

For some investors and companies, the spread of COVID-19 will mean ESG activities take a backseat for months if not years. But for others, the pandemic will shine a critical light on ESG behaviours – and could even speed up certain sustainability trends.

In the short to medium term, our analysts think COVID-19 could serve to:

1. Highlight those companies committed to high ESG standards
2. Accelerate sustainability trends like remote schooling and reduced travel
3. Encourage governments to ‘green’ the recovery – e.g. ESG-contingent bailouts
4. Digitise shareholder engagement – e.g. virtual Annual General Meetings
Trend 2

ESG investing to grow at a firm-wide level

2018 to 2020 saw over $100 billion flow into specialist ESG funds globally.* Our analysts believe growth in ESG investments at the firm – not just the fund – level could now accelerate especially as investors scramble to adhere to codes like the UN Principles for Responsible Investment.

*Source: EPFR, Barclays Research

UN PRI timelines could accelerate firm-wide commitments in 2020

Around 2,400 major investors have signed up to the UN Principles for Responsible Investment (PRI)

In 2018, the PRI said signatories must have a responsible investment policy covering at least 50% of their total AUM

Signatories who fail to meet the PRI’s requirements could start to be delisted from June 2020
Trend 3

ESG investing in emerging markets to grow

ESG investments in emerging markets (EMs) have seen promising growth in the past three years, with EM green bonds, for example, seeing a record $19 billion in issuance in 2019. In fact, while inflows into ESG-labelled bond funds have seen a clear drop-off since the start of 2020, it hasn’t been as sharp as for non-ESG funds.*

*(EM Fixed Income) Source: EPFR, Barclays Research

What’s driving ESG investment in emerging markets?

- Improving coverage of EM companies amongst ESG score providers
- Regulators (e.g. in Hong Kong) starting to require corporate sustainability data
- Growing number of environmental projects that need funding
- EM investors viewing ESG factors as a source of alpha
Trend 4
Regulators influencing ESG activity

As ESG issues – and climate change in particular – climb up government agendas, regulation will, we believe, have a growing influence on the market. Notably, voluntary guidelines are increasingly likely to become mandatory.

**ESG regulation**
- In action
- In the pipeline

**UK**
Defined Benefit pension funds must now include ESG policies

**The US**
SEC developing standards for ESG funds

**The EU**
Developing a green bond standard

**China**
HK-listed companies must now report on their actions to improve sustainability
**Trend 5**

**Corporate ESG security issuance to grow**

Corporates have been increasingly active in issuing green bonds to fund environmental projects. With major institutional investors under increasing pressure to integrate ESG into their investment decisions (see Trend 2), our analysts believe additional supply of ESG securities will be balanced by increased demand.

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Corporate green bond issuance now accounts for 60% of all green bond issuance.*

<table>
<thead>
<tr>
<th>Year</th>
<th>Issuance, $bn</th>
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<tbody>
<tr>
<td>2013</td>
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<td>'14</td>
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<td>'15</td>
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<td>'18</td>
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*As of 2019. DM hard currency only. Source: Dealogic, Barclays Research
Companies disclosing their ESG credentials have multiple reporting frameworks to choose from. There is now strong demand for reporting standardisation from companies and investors. To this end, we believe the ESG framework launched by the World Economic Forum’s International Business Council (IBC) has a strong chance of rapid global take-up.

**Why the IBC ESG framework should gain global traction**

- Aligned with the UN Sustainable Development Goals – and other global standards
- Not just limited to factors deemed to be financially material
- Participation of all ‘Big Four’ accountancy firms should facilitate corporate take-up
- Two-thirds of WEF members at Davos 2020 said they were ready to embrace the initiative
Trend 7

Reduction in CO₂ emissions across supply chains

A company’s indirect CO₂ emissions can be over five times as high as its direct emissions. As awareness of this grows, increased pressure will likely be put on corporates to reduce CO₂ generation right across their supply chain. This is likely to lead to greater discussion of carbon taxes and sectors with ‘carbon-heavy’ supply chains being screened out of investment portfolios.
Growing concern over stranded assets

The global focus on reducing carbon emissions has increased the risk of assets being stranded as investors seek to divest out of fossil fuels. But simply divesting could exacerbate the concerns investors want to avoid – such as reduced oversight.

Our analysts believe new questions will be asked about the best way to ensure goals to reduce emissions can be met, including:

- Should a company keep a ‘bad’ asset in its portfolio and run it sustainably – or should it be forced to divest?
- How responsible are the entities buying divested assets and to what standards are they running these assets?
- Is divestment or engagement best to encourage companies with ‘at risk’ assets to contribute to lowering greenhouse gas emissions?
- What’s the most effective method for governments to aid the move towards a lower-emissions planet?
Despite growing interest in ESG, corporate reporting of ‘social’ factors has failed to keep up with ‘environmental’ and ‘governance’ disclosure. Given growing consumer focus on, for example, workers’ rights and the UN PRI calling on signatories to address the impact of COVID-19 on health and social inequality, we think social factors are now set to be a core risk consideration.

Social
- Gender & diversity policies
- Human rights
- Labour standards
- Employee engagement
- Customer satisfaction
- Community relations
Private equity funds are recognising the impact that ESG factors can have on valuations and the need to embed them into all stages of the deal process.

*Source: PWC Private Equity Responsible Investment Survey 2019, based on responses from 162 private equity firms in 35 countries, Barclays Research

Private equity firms with teams dedicated to responsible investment*

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>2016</td>
<td>27%</td>
</tr>
<tr>
<td>2019</td>
<td>35%</td>
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Private equity firms prioritising UN Sustainable Development Goals that are relevant to their investments*

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<th>Year</th>
<th>Percentage</th>
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<tr>
<td>2016</td>
<td>38%</td>
</tr>
<tr>
<td>2019</td>
<td>67%</td>
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*Source: PWC Private Equity Responsible Investment Survey 2019, based on responses from 162 private equity firms in 35 countries, Barclays Research
Our Research analysts’ view

Prior to the global outbreak of COVID-19, Environmental, Social and Governance issues were the ‘hot topic’ in financial markets, leading to increasing investor commitments to ESG integration and record levels of green and ESG-linked security issuance.

ESG may take a backseat for many investors in the current market conditions, however investors and companies should still be prepared for further developments in the ESG investing space as the world emerges from the crisis.
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