

Now or never

A new bar for sustainability

How companies and investors are rethinking sustainability strategy in the post-pandemic landscape



do your thing





About this report

2020 was the year the far-fetched Hollywood disaster movie became reality. Most of the world was plunged by the Covid-19 pandemic into a world of lockdowns, empty cities and social distancing. Parts of the US and Australia, meanwhile, experienced the most catastrophic wildfire seasons in history, and Europe was hit by record-breaking floods.¹ There was social unrest, too, as millions of Americans took to the streets to protest against racial inequality.²

It was a dramatic wake-up call for companies, investors and governments: systemic risks that could have been foreseen were spiralling out of control – and most were woefully ill-prepared. Now, as they look to rebuild, stronger measures need to be taken to protect against future environmental and social threats. And so, even as they grapple with a crippling health and economic crisis, it is imperative that they move faster and further on sustainability initiatives.

This report, produced by ING in collaboration with Longitude, a Financial Times company, brings together corporate and investment leaders to answer three questions as we investigate what comes next for the sustainability agenda:

- How have the events of 2020 affected sustainability priorities, and will ambition increase against such a challenging backdrop?
- How can target-setting and accountability be improved to ensure faster progress?
- How can capital markets support an inclusive transition across industries, even as the stakes for progress are raised?

¹ 2020 was Europe's hottest, weirdest year, Politico, January 2021

² Black Lives Matter May Be the Largest Movement in US History, The New York Times, July 2020

Time to paddle faster

Lessons from a white swan

It was former Wall Street trader, Nassim Taleb, who first coined the term, 'black swan', to describe a rare, unforeseen event with extreme consequences.

Such events – from world wars to financial crises – can derail capital markets, and have far-reaching economic and social consequences that are impossible to predict.

Many commentators rushed to give the Covid-19 pandemic this label, but in a recent interview Taleb argues that it is instead a 'white swan' – an event that was certain to occur at some point.¹ Increased global travel and interconnectedness, he says, were always going to increase the risks of an acute virus spreading across the globe – and governments and corporations should have been better prepared.

Some may question whether this is entirely fair, but the pandemic is undoubtedly a wake-up call for political, corporate and investment leaders. In an increasingly interconnected and complex world, they must step up their actions to mitigate global systemic risk, or face disastrous consequences.

And as they look to be better prepared for the risks ahead – future pandemics, climate change, social turbulence – their progress on sustainability practices is under the microscope like never before. It is time to raise the bar.

Companies recognize the need to reassess their health and wellbeing practices and supply chain resilience, and accelerate their climate action. Institutional investors, meanwhile, whose environmental, social and governance (ESG) strategies provided some shelter amid the pandemic-driven market turbulence,² are clear they must move faster and further in stripping out ESG risk from their portfolios.

Companies and investors are starting to sing from the same hymn sheet, but are they on the same page? This research brings together the views of 100

institutional investors and 450 companies globally to look at what needs to happen next to forge closer alignment and accelerate progress as the pandemic raises the bar for ambition.

About the Research

Since 2017, ING has partnered with Longitude, a Financial Times company, to investigate sustainability and circular economy trends among companies and consumers.^{3,4,5} This year, in order to explore the influence of capital markets on corporate sustainability, we have surveyed a global audience of 100 institutional investors and 450 companies across seven sectors.

We asked respondents at executive or senior management level about their organisation's ESG priorities, how they are embedding accountability for progress and performance, and the evolving influence of capital markets on sustainable transition.

1 Taleb Says 'White Swan' Coronavirus Was Preventable, Bloomberg TV, March 2020

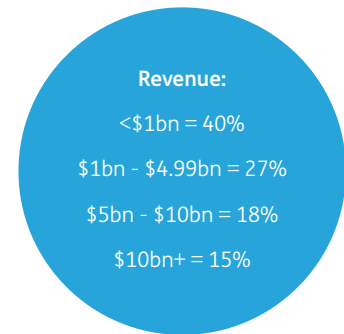
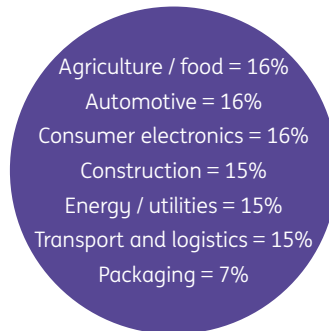
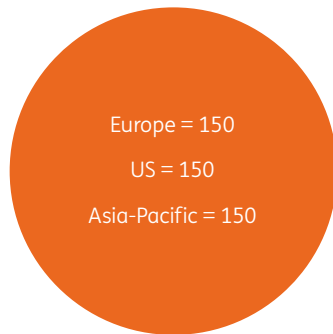
2 Sustainable investing: Resilience amid uncertainty, BlackRock, 2020

3 From Sustainability to Business Value, ING, 2018

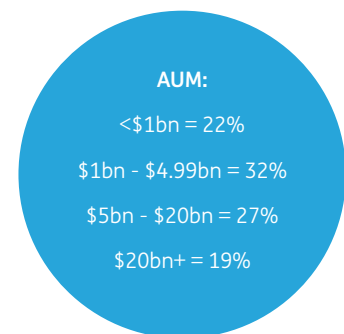
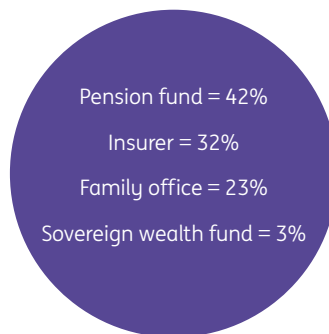
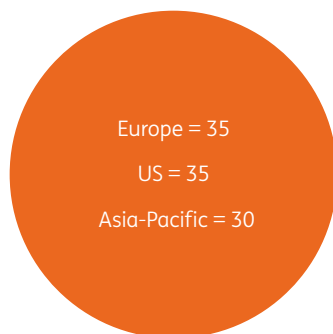
4 How circular thinking could change US business models, ING, 2019

5 Learning from consumers: How shifting demands are shaping companies' circular economy transition, ING, 2020

Corporates Total respondents: 450



Investors Total respondents: 100



Thank you to our expert panel of interviewees for their valuable contributions

- Magali Anderson, Chief Sustainability and Innovation Officer, LafargeHolcim
- Roberta Barbieri, VP Global Sustainability, PepsiCo
- Sean Colvin, Treasurer – North America, Louis Dreyfus Commodities
- Sean Kidney, CEO, Climate Bonds Initiative
- Stephen M. Liberatore, CFA Head of ESG/Impact – Global Fixed Income, Nuveen
- Aisha Mastagni, Portfolio Manager, Sustainable Investment and Stewardship Strategies, CalSTRS
- Ana Carolina Oliveira, Head of Sustainable Finance – Americas, ING
- Steven Stoffer, Group VP Sustainable Development, Smurfit Kappa



The headline findings

The bar is being raised: Covid-19 is a great accelerator of climate action

Even as the pandemic has created financial upheaval for companies, the majority of corporates (57%) say they are now accelerating green transformation plans. The investors surveyed are similar, saying they want to see more hard environmental targets put in place by investee companies this year.

But employee wellbeing is the most urgent ESG priority for the year ahead

Employee health and wellbeing (33%) will take precedence for corporates over the next year, even ahead of emissions reduction (30%). Investors also cite it as a top ESG priority, behind only climate and sustainable supply chains. Companies can expect deeper and broader interrogation of their human capital practices.

Ambition and accountability are under the microscope like never before

Sustainability targets are under scrutiny: 72% of the investors say they are increasing their ambitions when it comes to ESG outcomes in their portfolios. On climate, the debate over Paris alignment rages on, but one thing is certain: companies must provide more transparency to back up their claims.

Greater government intervention is expected in some markets, which may intensify climate transition risk

Three-fifths (61%) of companies in the energy sector expect new government policy action on sustainability-based taxation, such as carbon taxes, which could accelerate climate transition risk. And as the new administration settles in, 54% of companies in the US think changes to policy on ESG issues could have a big impact on their sustainability plans, compared with 41% in Asia-Pacific and 33% in Europe.

Sustainable finance is helping companies improve accountability, and investors say it will accelerate transition

Nearly three-quarters (73%) of companies that have issued sustainable finance instruments say it has improved their ability to put in place robust internal accountability metrics. And 48% of investors think sustainable finance will be more effective than conventional finance in driving the transition of carbon-intensive companies; just 26% disagree.

A person wearing a green knit beanie and a dark jacket is seen from behind, pushing a black shopping cart through a supermarket aisle. The shelves are mostly empty, with only a few items visible in the distance. The lighting is bright, typical of a grocery store.

Section 1

Ambition in the spotlight:

2020 was a wake-up call

2020 was a wake-up call

When ING ran its first corporate sustainability survey back in 2017, 81% of the US companies that took part said their organisation had a formal sustainability strategy in place – but just 34% said that these strategies had been integrated across their operations.¹

Fast forward to today, and this seems utterly inadequate. Company leaders increasingly recognise that environmental and social issues need to be embedded right across their value chains if they want to be around for the long term.

At LafargeHolcim, Chief Sustainability and Innovation Officer Magali Anderson explains that her role was elevated to the group executive committee in 2019 to do just that. “The board recognised that sustainability – from climate and the circular economy to health and safety – had to be at the heart of all our decision-making,” she says.

Companies and investors were already driving this kind of fundamental change before the pandemic. But the disruption inflicted by the global health crisis has injected greater urgency to transform, and it has amplified the link between companies’ social responsibilities and financial performance.

Although 53% of companies in our survey suffered budget cuts in the fallout from the pandemic, 57% are managing to accelerate their green transformation plans, and 37% are moving faster on social targets such as diversity and workforce standards

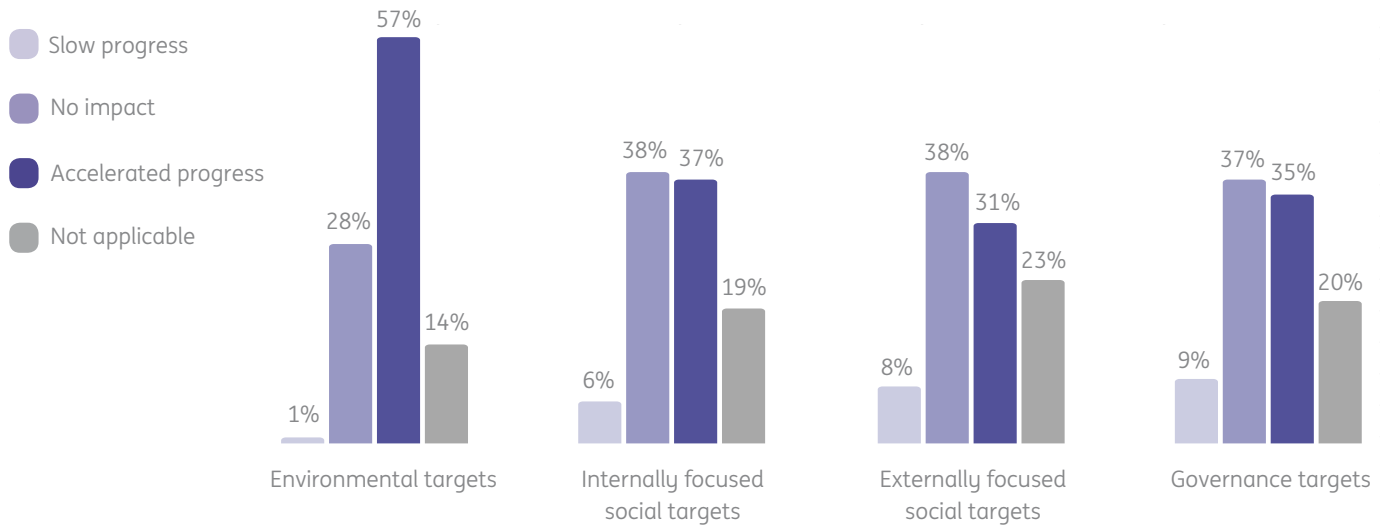
“It is now or never for the world to solve the climate crisis. We have 10 years, at best, and that is not a lot of time. The pandemic has only reinforced our resolve for the speed and breadth of what we need to do on sustainability.”

Roberta Barbieri, VP Global Sustainability, PepsiCo



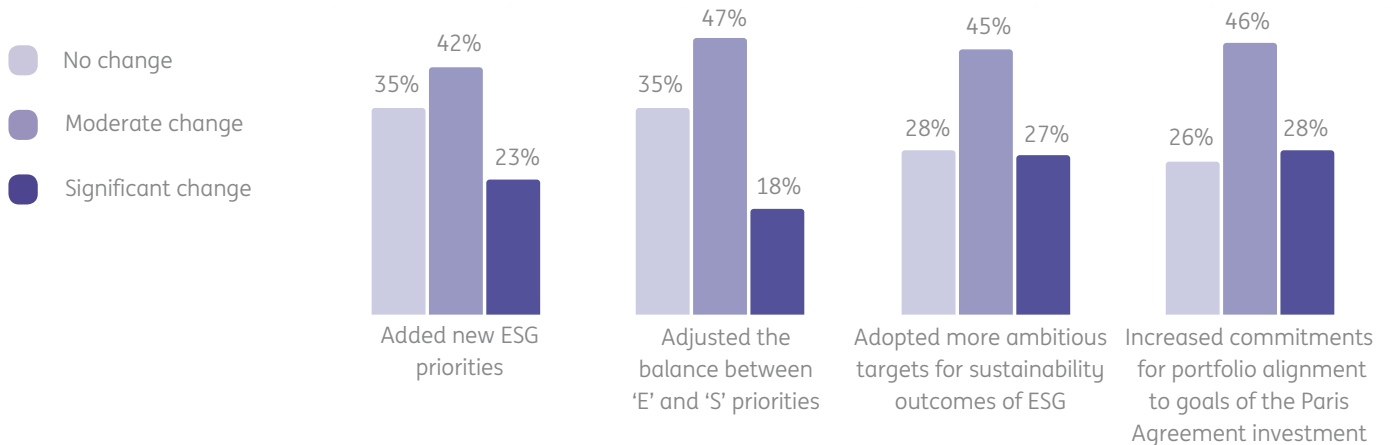
¹ From sustainability to business value, ING, February 2018

Figure 1. How the events of 2020 have affected companies' progress on sustainability targets



Investors are seeking to raise the bar for their ESG commitments too, with 72% becoming more ambitious about sustainability outcomes and 65% scrutinising a wider set of issues (see Figure 2).

Figure 2. How the events of 2020 have affected investors' ESG investment practices



The social agenda became a more urgent priority

The pandemic changed the stakes for companies' performance on social issues: it was no longer about maintaining their 'license to operate', but about whether they had the means to operate at all. The support they gave their employees – and even their wider communities – became critical to operational resilience.

It is no surprise, then, that corporates cite employee wellbeing as their most urgent sustainability priority for the next 12 months, and investors put health and safety near the top of their overall ESG agenda (see Figures 3a and 3b).

Figure 3a. Companies' most urgent sustainability priorities for the next 12 months

Percentage of companies rating these issues as 9 or 10 on a 0–10 scale, i.e. 'A very high priority to address'

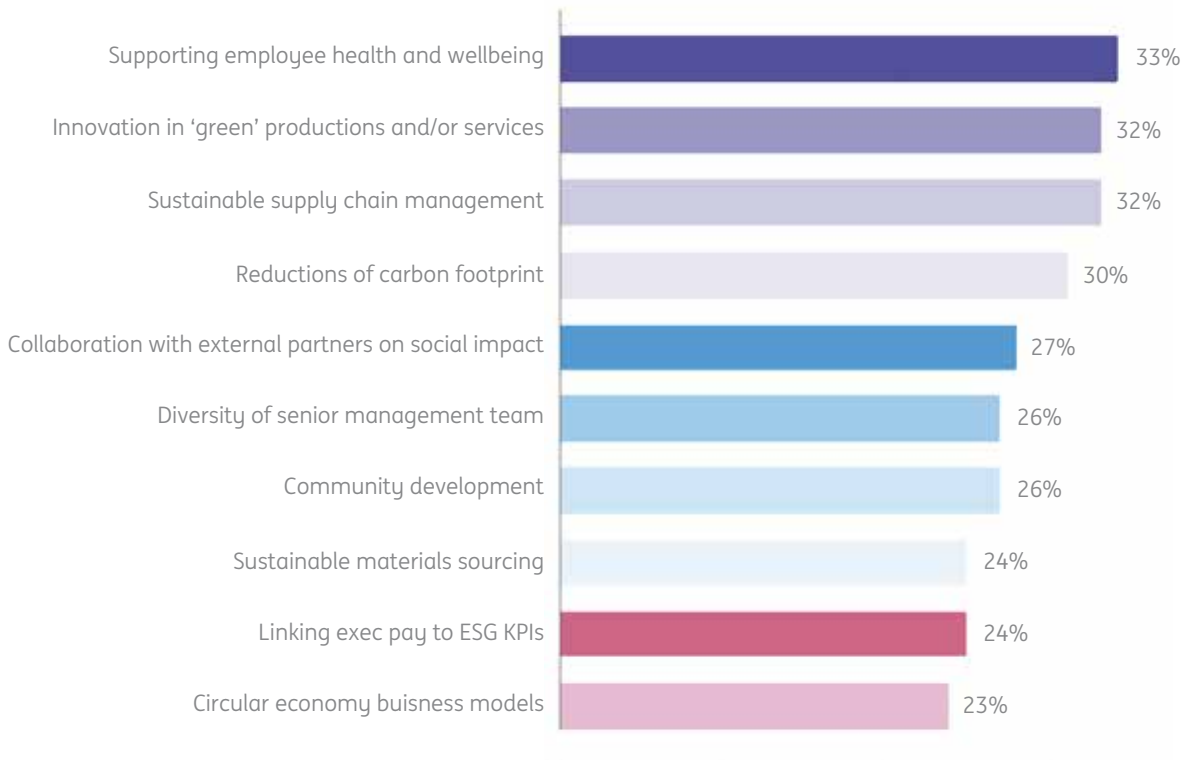
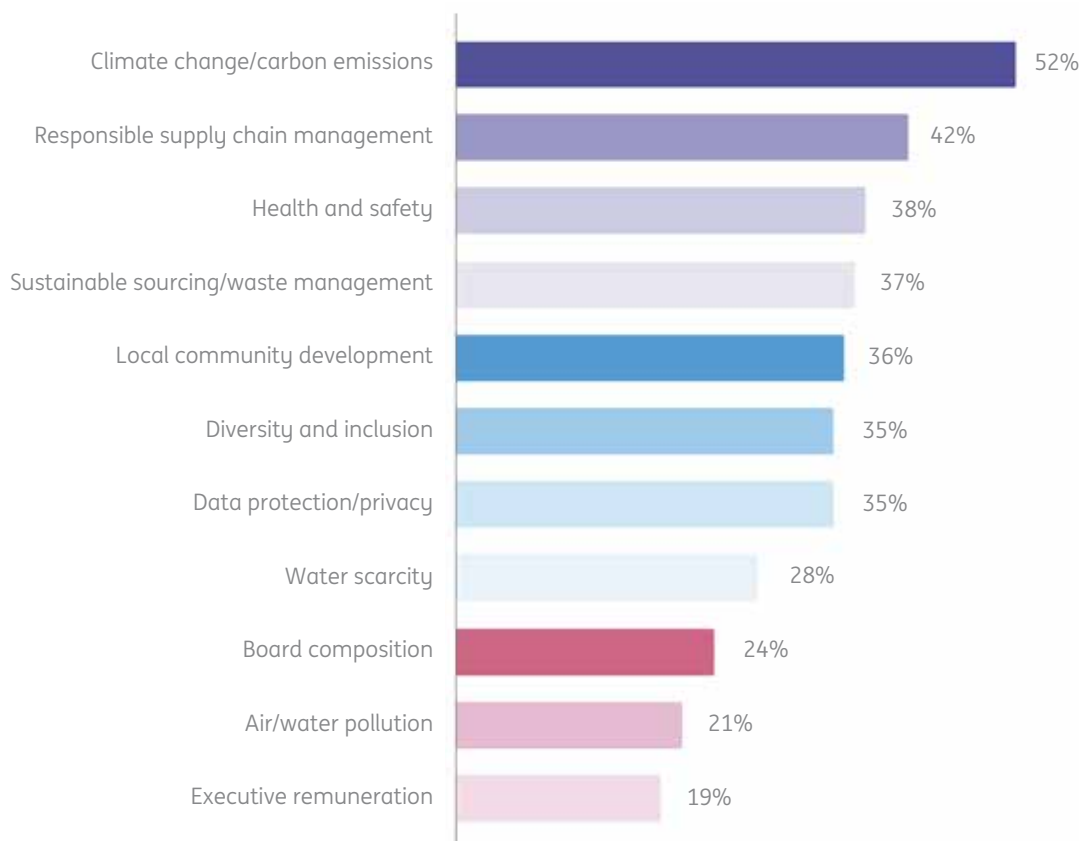


Figure 3b. Investors' top ESG priorities

Percentage of investors ranking these issues among their top four ESG priorities





What does prioritising social issues mean in practice?

Two things are immediately clear:

1. Investor scrutiny of social issues will be broader and deeper

The 'S' in ESG has always been important, with many studies drawing clear links between companies' diversity and financial performance.¹ But the financial materiality of other social issues has now been thrust firmly under the microscope.

"It has moved far beyond assessing the diversity of the leadership team to digging into companies' work-from-home policies, flexibility to retain top performers and how their healthcare programs stack up against the norms for their industry," says Stephen M. Liberatore, CFA Head of ESG/Impact – Global Fixed Income at Nuveen. "And as a result, are they improving productivity and maximising the value of their human capital?"

2. Supply chains will be in the spotlight

Large companies are under growing pressure to address the environmental impact of their supply chains, but there will also be more focus on how they spread their social standards among their partners.

Magali Anderson says that LafargeHolcim has a sustainable supply chain standard that it uses to evaluate its partners, and this includes a detailed methodology for human rights assessments. For several years, the company has also been operating schools and medical clinics in the developing markets it operates in, but it is striving to go further.

"We have been donating cement to build emergency hospitals, using our trucks to sanitize community areas in Latin America, and donating food and protective equipment. We have been revising our social strategy to make sure we remain involved in this wider range of activities, with more robust KPIs and better evaluation of impacts."

1 Women on Boards and Firm Financial Performance: A Meta-Analysis, Academy of Management Journal, Vol. 58, No. 5, November 2014

Climate ambition was called into question

As governments and companies swung into crisis-management mode last year, agility was essential – they had to change their operating models at great speed. In the research, 72% of companies rate themselves as effective in adapting their distribution models, and 62% in mobilising their supply chains to meet fast-changing customer demands.

There is a growing consensus that similar speed must now be injected into climate action. In 2020, there was a threefold increase in the number of companies committing to net-zero emissions by the end of the century, up to 1,541 from about 500 in 2019.¹

Six countries – Denmark, France, Hungary, New Zealand, Sweden and the UK – have now passed net-zero legislation,² and a group of global asset managers, who between them oversee more than \$9 trillion of assets, have signed a pledge aiming for all companies in their portfolios to have net-zero emissions by 2050.³

Which road to Paris?

Although progress is being made, companies and investors are still grappling with the need to balance ambition and speed of action with credibility.

Sean Kidney, CEO of the Climate Bonds Initiative, says that alignment with the 2015 Paris Agreement has to be the goal – even for the most carbon-intensive sectors. “Supporting these companies to transition is really important, but investors need to have confidence in a company’s plan,” he says. “Their transition plans need a destination, and let’s face it, the destination has to be the Paris Agreement.”

The Paris Agreement set a goal to limit global warming to no more than 2°C, and preferably 1.5°C, above pre-industrial levels. And in 2018, the Intergovernmental Panel on Climate Change (IPCC) said the world needs to halve CO2 emissions by 2030

and reach net-zero CO2 emissions by 2050 to limit global warming to 1.5°C.

This creates grey areas for companies and investors. Should they align their plans to a scenario of below 2°C or to 1.5°C? And when setting net-zero emissions targets, what timeline should they aim for, and what range of emissions sources and activities should they include?

At LafargeHolcim, which in 2020 became the first global building materials company to sign the UN Global Compact ‘Business Ambition for 1.5°C’ pledge with targets approved by the Science-Based Targets initiative (SBTi), Magali Anderson says investors want a deeper understanding of the plan and its feasibility.

“It is about being ambitious but also credible,” she says. “You could set a 1.5°C target tomorrow if you wanted to, and then come up with your own roadmap, but I really wanted a strong collaboration with SBTi, to build a solid and externally verified pathway to net zero – for ourselves and to communicate to investors. Investors will increasingly test you on your roadmap, but they also want to make sure it is achievable without creating excessive financial risk for the business.”

Another way companies need to raise the bar on climate strategy is to address the emissions that fall outside of their direct control.

In January, PepsiCo announced plans to more than double its science-based climate goal, aiming by 2030 to reduce absolute greenhouse gas emissions across its direct operations (scope one and two emissions) by 75%, and its indirect value chain (scope three emissions) by 40%.⁴

“There is a very well-defined methodology for achieving this now,” says PepsiCo’s Roberta Barbieri. “So I would argue that companies need to get to a science-based target that reflects what is required of their supply chain to keep global warming aligned to the 1.5°C trajectory.”

1 Commitments to Net Zero Double in Less Than a Year, UN Framework Convention on Climate Change, September 2020

2 Why is ‘net-zero’ so important in the fight against climate change?, LSE, January 2021

3 Investor group makes net-zero carbon pledge to tackle climate crisis, The Guardian, December 2020

4 PepsiCo Doubles Down on Climate Goal and Pledges Net-Zero Emissions by 2040, PepsiCo, January 2021

ESG and the recovery: Will governments raise the bar on sustainability policy and regulation?



As they convened virtually for the first time, leaders at November's G20 Riyadh Summit called for a sustainable and inclusive recovery.¹

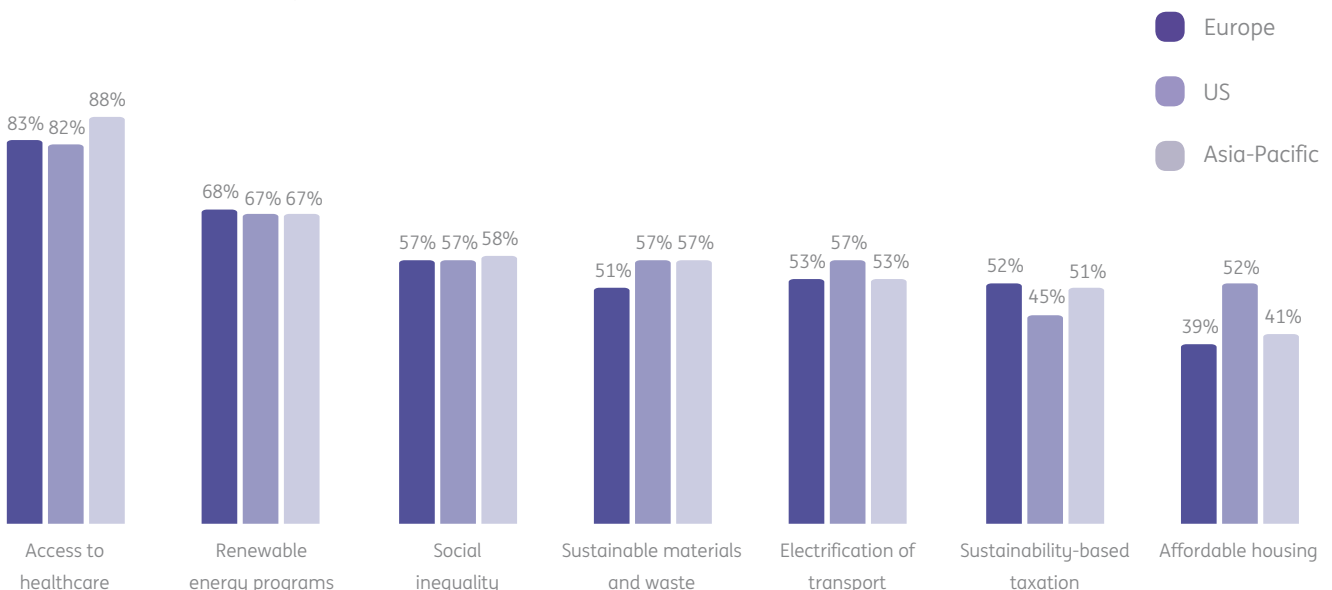
With the pandemic exposing shortcomings in healthcare, inequality and climate action, governments around the world are making bold statements about their policy efforts for the coming year.

If they are true to their word, the ramifications for companies and investors will be significant. With that in mind, we asked the companies in our survey where they expect policymakers to intensify action on sustainability.

¹ G20 Riyadh Summit: Release of Leaders' Declaration, PR Newswire, November 2020

Where companies expect new government sustainability policy and investment to be concentrated

Percentage of companies expecting moderately or significantly increased action by national governments in the market where they are based



An aerial photograph of a dense, lush green forest. The trees are tightly packed, creating a vibrant green canopy. The lighting is bright, casting soft shadows between the trees. Three orange text boxes are overlaid on the left side of the image, containing white text.

Section 2

Time to deliver:

Accountability takes centre stage



“With the sustainability-linked bond, we have put money on the table against our 2030 targets. If we do not reach them it will cost us, so we had better do it.”

Magali Anderson
Chief Sustainability and Innovation Officer
LafargeHolcim

The mantra of ‘doing well by doing good’ has been an attractive story for capital markets participants. But make no mistake: the real attraction of ESG and impact investing is that it mitigates portfolio risk, and should enhance long-term returns.

The pandemic was the first major test of the resilience of many of the ESG strategies that institutional investors have piled into in recent years – and they did not disappoint. Morningstar’s analysis of 4,900 funds in Q1 2020 found they outperformed their traditional counterparts in all but one category.¹

For companies, sustainability is also about identifying material risks to business performance, and finding new opportunities for growth. But for ESG and corporate sustainability strategies to be effective in the long term, investors and companies need real transparency. What are the material ESG risks? Is there tangible evidence of progress? And how exactly is ESG tied to growth and financial performance?

These issues can only be resolved with better accountability, which means setting the right targets, disclosing more relevant and comparable information, and ensuring there are consequences if organisations fail to make real progress.

¹ Do Sustainable Funds Beat their Rivals?, Morningstar, June 2020

Get the metrics right

Identifying the right metrics to track is a fundamental step in improving accountability. But it is not always straightforward.

For the companies in our survey, two of the most common challenges are capturing reliable and comparable ESG data, and frequent changes to KPIs (see Figure 4).

The emergence of well-defined methodologies for measuring progress on climate and emissions reduction is helping to alleviate challenges there, but there are no science-based target-setting methodologies for issues such as water scarcity or biodiversity yet.

“They are starting to be developed, and we are going to be piloting the first methodology on science-based targets for water scarcity – but there is still a way to go,” says PepsiCo’s Roberta Barbieri. “In the absence of a science-based methodology, we are working with internal and external experts to prioritise

high-risk watersheds and communities where we operate that are already experiencing some level of water insecurity. We are also benchmarking against competitors to ensure that we are at least peer-aligned – if not better.”

Investors will increasingly be demanding more quantitative data related to social performance, too. Historically, investors have found it easier to set environmental and governance metrics that enable a more objective evaluation, while many social issues have been more subjective, which creates challenges for setting KPIs.

As companies re-evaluate their social KPIs, a key starting point will be to emphasise those issues most relevant at industry level. For instance, investors may pay closer attention to workforce metrics in knowledge sectors where human capital is dominant, while in heavy industry the more material social risks and impact may be in the supply chain.

Figure 4. The top challenges for companies trying to improve ESG accountability
Percentage of companies ranking these issues among their top three challenges



Align disclosure expectations

Companies trying to accelerate their progress on sustainability and investors seeking to mitigate ESG risks in their portfolios need access to data that sheds light on financially material issues, and allows comparability.

Most large companies have made huge strides in the disclosure of sustainability-related information in recent years, reporting a wealth of data via integrated reporting or producing standalone sustainability reports.

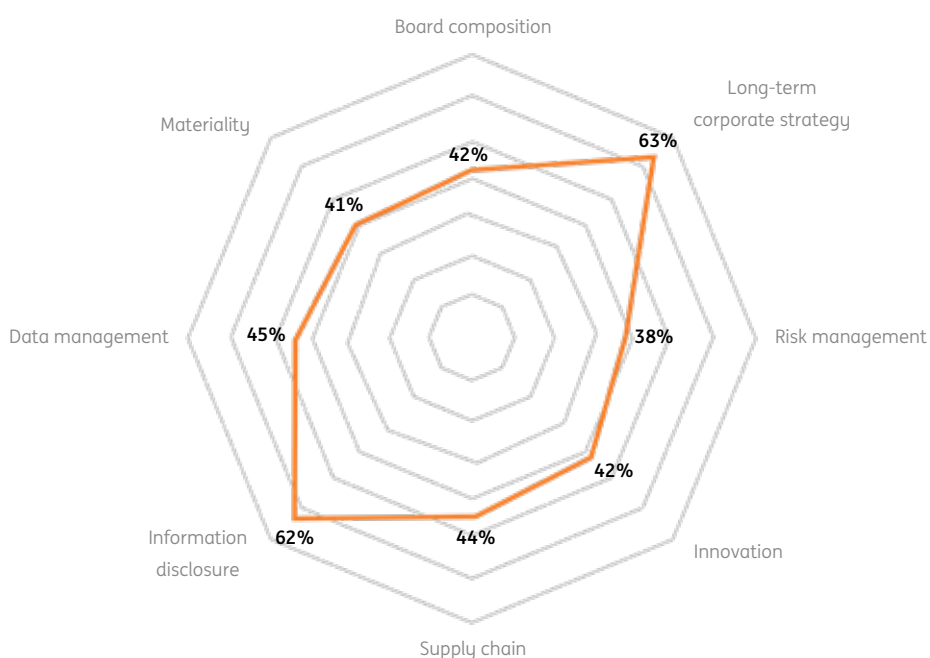
The companies we surveyed say they have made significant progress here: 62% say ESG information is strongly integrated within corporate reporting (see Figure 5).

But when it comes to disclosure, there is still misalignment between the information that is reported and the information that investors believe is most material.

“We have had conversations with issuers who are frustrated because they have put out a detailed sustainability report and are getting pushback,” says Nuveen’s Stephen M. Liberatore. “It is data that their internal teams have picked believing there is value in it, but it may not align with what investors are looking for.”

Figure 5. Companies that cite a high level of sustainability integration across different business areas

Percentage of companies rating the level of sustainability integration in these business areas as 8-10 on a 0-10 scale, i.e. ‘A high level of integration’





Frameworks to help bridge the gap on disclosure expectations, such as those set out by the Sustainability Accounting Standards Board (SASB) – which identifies the most material ESG issues at an industry level – the Task Force on Climate-related Financial Disclosures (TCFD), and the Global Reporting Initiative (GRI), are becoming more widely adopted. But these remain voluntary for now.

It is in companies' interests to embrace these standards now, when investors are becoming more attuned to greenwashing – and some governments are planning to make parts of them mandatory.

“The era where companies could get away with greenwashing is soon to be over, if you look at the EU taxonomy and other regulations in the pipeline,” says Steven Stoffer, Group VP Sustainable Development, Smurfit Kappa. “We already adhere to the most comprehensive GRI standards and get external assurance of our reports. We welcome these regulations and want the wider industry to reach high levels of transparency as soon as possible, because

it is important that investors can get a clear view of which companies are credible in their actions, and which are laggards.”

As the materiality of environmental risks has become better understood, the priority for investors is to ensure companies are disclosing the most relevant information, and that there is greater consistency across companies. For some ESG issues, however, investors are still concerned about a lack of data altogether, and social performance is a top priority in this respect.



Where human capital is concerned, at least, investors believe that significant progress is possible in the immediate term. CalSTRS, which co-chairs the Human Capital Management Coalition (HCMC), a cooperative of 32 institutional investors representing \$6 trillion in assets, wants to see all companies start by publishing data across four metrics:

- Number of employees, broken down into full-time, part-time and contingent workers
- Total cost of the workforce, including wages, benefits, transfer payments and employee expenses
- Employee turnover
- Gender, ethnic and racial diversity across different employment bands and employee levels

“We know companies have this data and that reporting can be implemented at a reasonably low cost,” says Aeisha Mastagni, Portfolio Manager,

Sustainable Investment and Stewardship Strategies, CalSTRS. “There is always room for improvement. But we know that these four areas allow us to identify human capital risks and opportunities and to benchmark companies against one another, which is really the value for the investment team, because without consistent, comparable information it is somewhat useless.”

For companies, the direction of travel on accountability also calls for better data management systems. PepsiCo’s Roberta Barbieri says the company has developed a robust data governance structure for each of its sustainability goals. It collates data at market, regional and global levels, which is used by the executive committee and external stakeholders such as investors and ratings agencies to track PepsiCo’s progress. “Good data systems are the difference between proceeding in a sighted way or in a blind way on your sustainability journey,” she says. “We have a big initiative underway on digitising our sustainability data, because that is how you accelerate your progress.”

Put money on the table

Many studies have now established clear links between companies' investment in sustainability improvements and their financial performance, and this is a fundamental principle underpinning investors' ESG activity. But some companies are now taking additional steps to 'put money on the table' against their sustainability progress, which can reinforce accountability.

One such approach is to introduce sustainability-linked pricing mechanisms into financing structures, so that the cost of financing goes down where KPIs are met – or increases if a company fails to meet its targets.

Louis Dreyfus Commodities took this step in 2019. It built targets on greenhouse gas emissions, electricity consumption, water usage and waste generation into several of its regional syndicated revolving credit facilities (RCFs).

Each year, based on the annual performance of the company on those four KPIs, there is potential for either a price reduction or a price increase on the drawn spread for the RCFs. "The goal for us was to show that we think the sustainability improvements we are making are a worthwhile investment," says Sean Colvin, Treasurer for North America at Louis Dreyfus Commodities. "And we are willing to suffer the consequences if we are not living up to the goals that we set."

This approach has had a positive knock-on effect on internal reporting and monitoring at Louis Dreyfus Commodities, which became more streamlined and better integrated into business operations. And the companies we surveyed also experienced these benefits: 73% of those that had issued sustainable finance instruments in the past say the process improved their ability to put robust metrics in place – and this was even more pronounced at companies where the finance team is closely integrated with sustainability initiatives (see Figure 6).

Figure 6. Benefits of issuing sustainable finance instruments

Percentage of companies saying they have experienced benefits from using sustainable finance, broken down based on the level of integration between companies' finance and sustainability teams

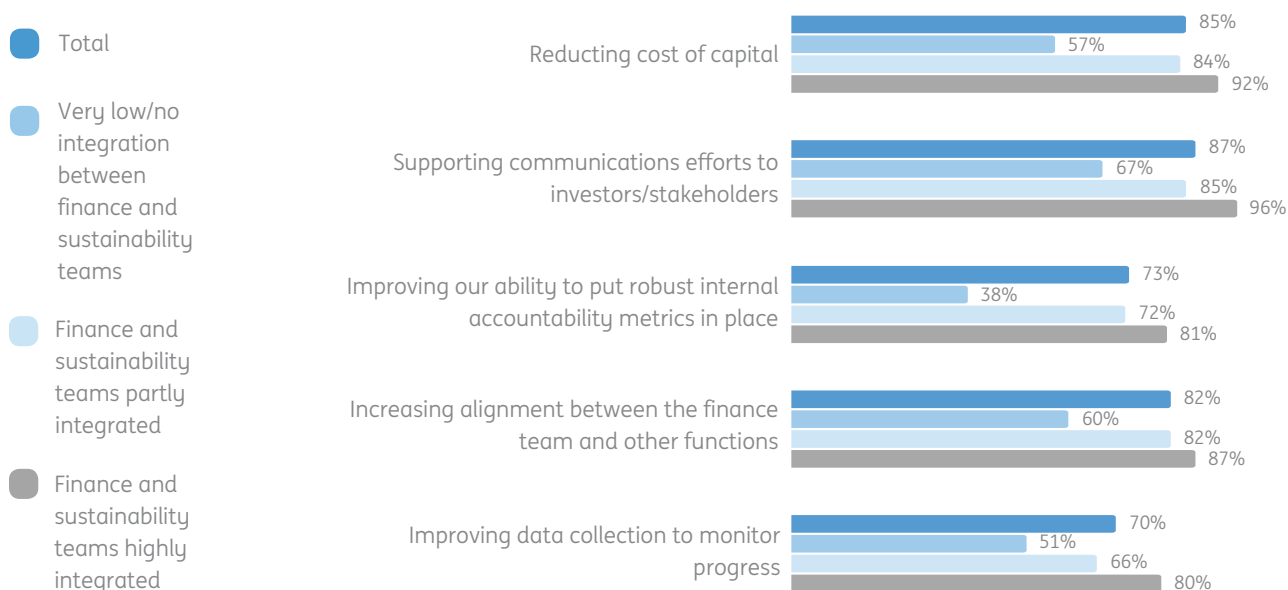
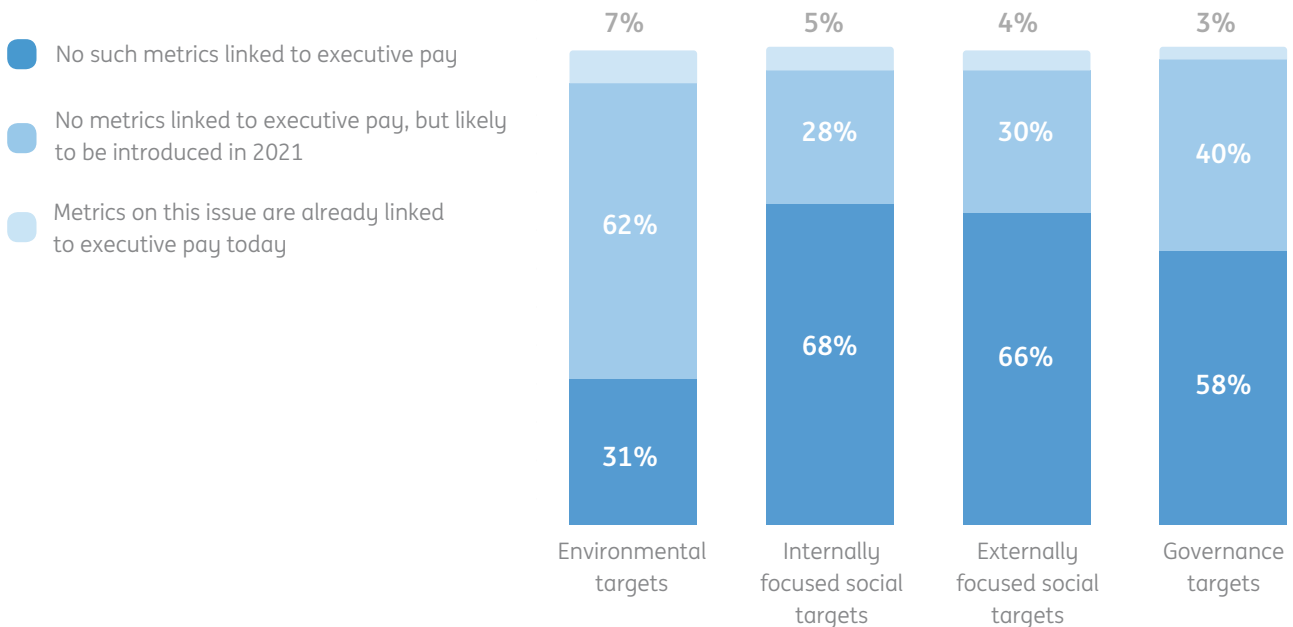


Figure 7. The number of companies that have tied executive remuneration to four types of ESG metrics



Another way in which companies are putting money on the table to strengthen accountability is by linking executive remuneration to ESG targets.

Multinationals including Apple, BP, Shell, BMW and Volkswagen have all gone down this route, but they are in the minority: less than one in 10 companies in our survey having done this to date. However, there could be a flurry of activity in this area over the next 12 months – particularly when it comes to environmental metrics (see Figure 7).

For this approach to create credible accountability, there must, again, be full transparency. What KPIs are being measured? And exactly how are they integrated into remuneration structures?

This may not be possible across the whole range of ESG issues just yet, however. “A third of our executives’ long-term incentive is linked to ESG targets, but for

now that is limited to climate, water and waste,” says LafargeHolcim’s Magali Anderson. “And it does not include any social targets – purely because we do not have a robust enough KPI yet.”

And CalSTRS’ Aisha Mastagni says that this is an area where investors need to tread carefully. “I do not think we have enough basic disclosure around many companies’ material ESG risks to even start evaluating compensation that is linked to sustainability KPIs,” she says. “And in the US, there is a host of other problems around remuneration and a lack of alignment with shareholder value.”

“We can only evaluate the outcomes of the decisions that the board makes and make a judgment on them,” she adds. “But at the end of the day, we should be taking action against those board members if there are serious problems – not trying to micromanage the compensation plan.”

A close-up photograph of a butterfly with orange and black wings perched on a person's hand. The butterfly's wings are spread, showing intricate patterns of orange, black, and white. The person's hand is visible, with a purple nail polish on the thumb. The background is blurred, showing green foliage and a person wearing a blue and white striped shirt.

Section 3

An inclusive transition:

The evolving role of capital markets



“We generally do not believe in throwing out a whole industry. We are trying to show that engagement does work and recognising that a company may have a number of issues, but we need them to be part of the solution.”

Aeisha Mastagni
Portfolio Manager
Sustainable Investment and Stewardship Strategies,
CalSTRS

A balance of carrot and stick

Many of today's institutional investors are taking a multi-pronged approach to applying ESG principles to their portfolios. This includes active ownership practices and various methods of integrating ESG issues into their investment analysis. In practice, this brings both carrot and stick into the equation.

The investors in our survey indicate that systematic ESG integration – where ESG data is part of the security-analysis process – exercising voting rights and active engagement are all more effective than exclusion practices in driving companies to change their behaviour (see Figure 8).

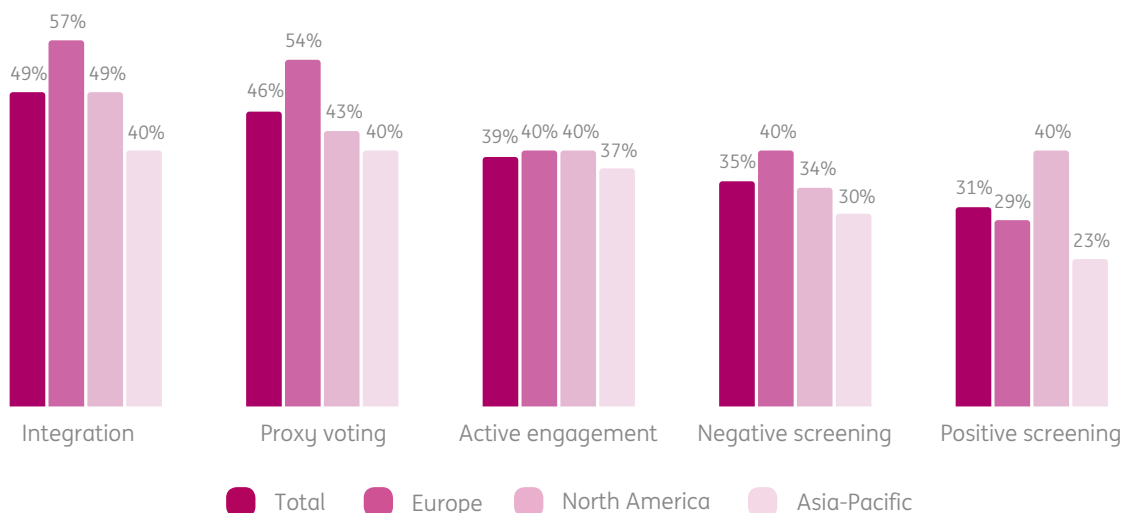
CalSTRS' Aisha Mastagni says the pension fund has a strong view about divestment. "We do not want to throw out the good with the bad by excluding an entire industry, so it would only be a last resort," she says. "We have a range of tools, from proxy voting to shareholder proposals to collaborative engagements, before we get to that stage. And if those fail, we look at activist stewardship, which might mean working to

change the make-up of the board – something we are supporting Engine No. 1 to do at ExxonMobil."

And at Nuveen, the strategies he manages utilise a best-in-class ESG methodology that does not exclude companies from its investable universe but does seek to identify and hold only 'ESG leaders,' Stephen Liberatore says they engage closely with those companies currently deemed as 'non-leaders' to help them improve.

"It is important that those companies that are not considered ESG leaders at the moment are not dealing with a structure where they think, 'Well, my entire sector is excluded, so there is really nothing I can do to be included,'" he says. "Our intra-sector analysis allows us to say, 'Well, your competitor is doing X, Y, and Z, which means you clearly can too.' And then, it is a matter of whether they want to, so it is about providing carrot and stick – you lose a lot of influence when it is just a one-way street."

Figure 8. Proportions of investors who rate five ESG integration approaches as 'highly effective' in changing company behaviours



Power progress with sustainable finance

There were many firsts in 2020 that companies and investors will be happy to forget, but it was also a year of more welcome firsts in the sustainable finance market.

The EU committed to its first ever green bond issuance, setting out plans to fund nearly a third of its €750 billion pandemic recovery fund with sustainable debt. The first Sustainability-Linked Bond Principles (SLBP) were published by the International Capital Market Association (ICMA) in June. And social bond issuance jumped sevenfold to \$147.7 billion in 2020, largely driven by pandemic relief efforts.

These developments are hugely significant for companies and investors for three reasons:

1. Sustainable finance will soar to new heights

Uptake of sustainable debt by institutional investors is likely to be turbo-charged by the large sovereign issuances of green and social bonds in particular.

“It provides liquidity and benchmark pricing for the market as well as volume,” says the Climate Bonds Initiative’s Sean Kidney. “We are having conversations about green bonds, social bonds and sustainable bonds in every part of the world. The real story is that capital with purpose is here to stay, and the market is looking for ways to extend the concept that has been proven with green bonds.”

As the market grows, investors are likely to push issuers to extend the ambition of their targets, and focus on areas where they can have the biggest impact.

“Some KPI structures that were accepted before, such as issuers addressing their own carbon footprint, are starting to be challenged by investors as the market evolves,” says Ana Carolina Oliveira, Head of Sustainable Finance – Americas, at ING. “They are increasingly saying, ‘Well, those are the basics that you really need to do anyway, so we want you to go a step further and look at your suppliers too.’”

2. The market has become more inclusive across sectors

In our survey, 66% of companies say that the expansion of the sustainable finance market beyond green bonds makes it more relevant and accessible for them.

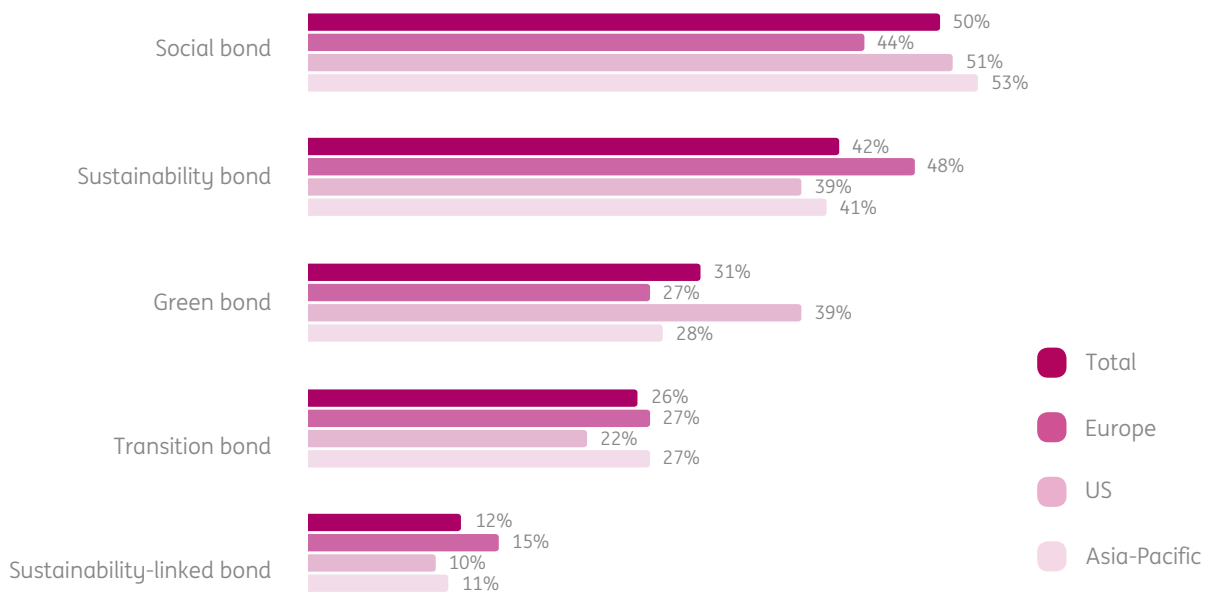
“Debt instruments with a sustainability-linked component and tools like the climate transition finance guidelines are a complement to the existing market and they allow more industries and issuer types to participate,” says ING’s Ana Carolina Oliveira. “Corporates interested into tapping the sustainable debt market but that would not have had the balance sheet to build a large enough pool of eligible green and sustainable projects now have the opportunity to issue sustainable debt and benefit from the advantages it brings – as long as they select material issues, with realistic yet ambitious improvement targets.”

3. Increased rigor will be applied to social progress

The strong momentum behind social bond issuance and subscription rates is set to continue over the next 12 months. The companies and investors in our survey both say they have stronger appetite for social bonds than green bonds, at least in the short term, with the pandemic recovery a strong driver for this (see Figures 9a and 9b).

Figure 9a. The sustainable finance instruments that companies are most likely to issue over the next 12 months

Percentage of companies saying they are likely to issue each instrument over the next 12 months

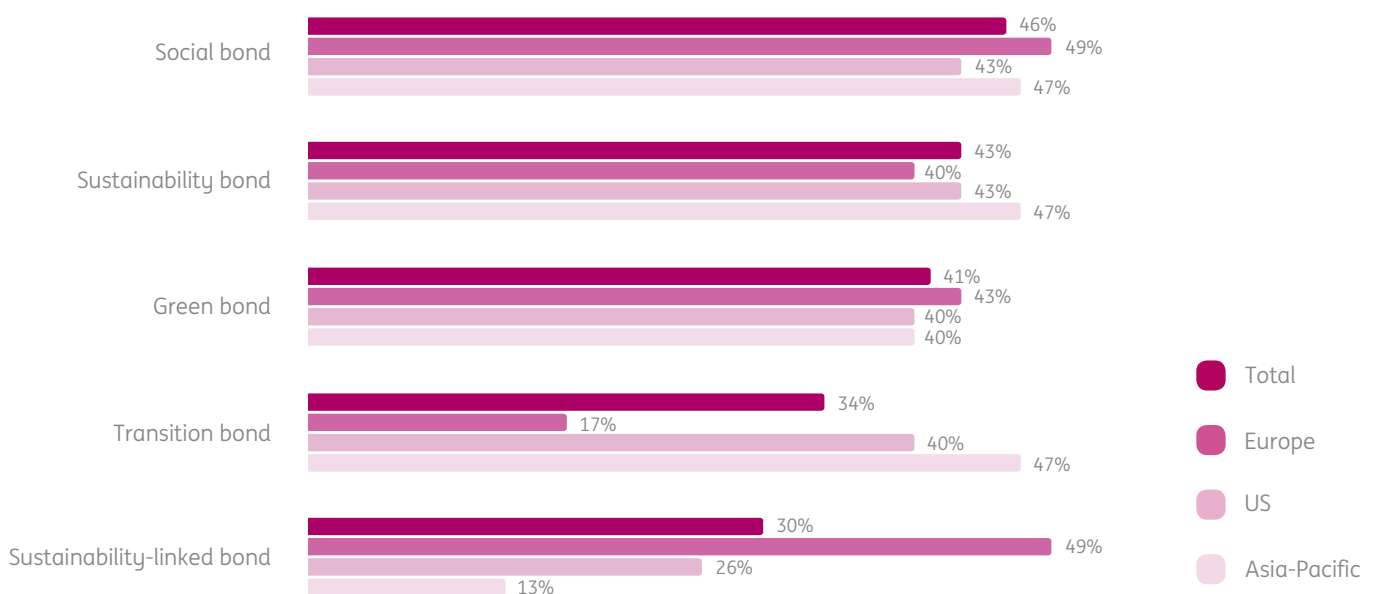


One consequence of this is that investors will identify a broader set of targeted outcomes for their social impact investments. Stephen Liberatore says that the surge in issuance has led to Nuveen winning its first purely social bond mandate for an institutional investor. “They had a separately managed green bond account with us, but now we are able to build out a broader more diversified social bond portfolio,” he says. “We are able to look at Covid relief and the different responses and target different outcomes.”

The exponential growth in allocations to social bonds is also triggering a race to put in place appropriate standards and taxonomies to measure and report on outcomes. “We and others are hurriedly looking at how we can add some rigor to this market, so that means it is a next-12-month job – not a next-36-month job,” says the Climate Bonds Initiative’s Sean Kidney. “The reporting and transparency is key for investors, because it gives them clarity that capital is being used in the right way – and it is also a vital tool for predicting risk.”

Figure 9b. The sustainable finance instruments that investors have the strongest appetite for over the next 12 months

Percentage of investors ranking each instrument in their top two, based on appetite to invest over the next 12 months







Conclusion: We need to raise the bar together

Among the many lessons of the pandemic, the evidence that governments, companies and citizens can make radical changes to the way they operate and live – and can do so at great speed – is an especially powerful one.

Governments have partnered with the private sector to develop and roll-out Covid-19 vaccines at an unprecedented pace. While companies have demonstrated extraordinary agility in adapting operations and mobilising supply chains to meet the changing needs of their customers.

And, rather than take a back seat, early signs suggest that sustainability is becoming more embedded in government policy and company strategy than ever before as the recovery gets underway. Sustainable finance has been baked into stimulus packages, notably in the EU and the UK. And, as our research shows, companies and investors are setting targets to move faster and further on improving their environmental and social impact.

It is encouraging to see a growing alignment between public and private stakeholders, as we know it is only through coordinated action that we can achieve the necessary scale and pace of change to mitigate the systemic global risks that lie ahead.

But ambition alone will not be enough. It must be accompanied by greater transparency into the progress being made, with stronger accountability to ensure commitments are met. As we have outlined in this report, the role of capital markets will be pivotal in bringing this to fruition over the next few years.

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Survey

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