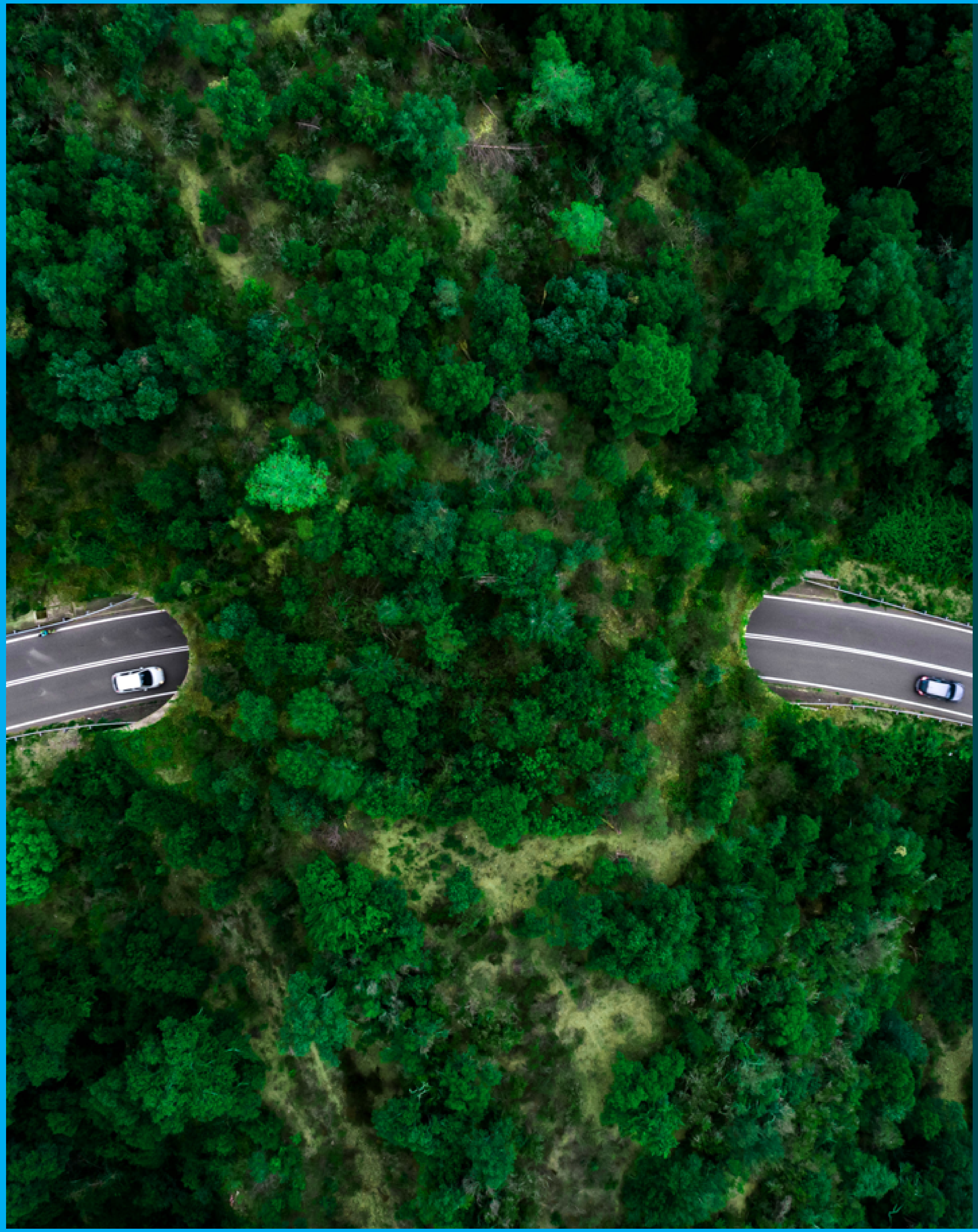

The Transition Mission

10 ESG Themes for 2022

Focus has firmly turned to the transition and 2022 will see companies, sovereigns and investors moving into the implementation phase of their net zero journeys. ESG investing should touch increasing pockets of the market, advancing into macro investing and policy making. In this slideshow, our Research analysts highlight the 10 top ESG themes that are likely to dominate the markets in 2022.

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Theme 1

ESG regulation accelerates globally amid challenges

Regulators are expected to advance and refine their ESG efforts in 2022.

Developments:

The European Union's Sustainable Finance Disclosure Regulation (SFDR) is driving greater disclosures – and it now applies to financial firms, advisers and products.

In the US, the administration intends to make climate change reporting mandatory for companies and is working to provide more detail on the reporting requirements for ESG funds.

In Asia, China has partnered with the EU on taxonomy classifications and Hong Kong regulators have increased their focus on climate reporting standards.

Challenges:

- The expansive global regulatory landscape will remain highly fragmented in 2022.
- There is still no market standard for disclosing sustainability information.
- Portfolio managers may see divesting bad apples as the path of least resistance to align with regulation, in turn leading to best-in-class ESG assets receiving oversized flows, and thereby increasingly impacting future returns.

Theme 2

ESG improvement vs. divesting challenged sectors

Our Research analysts' ongoing conversations with market participants reveal an increasing desire for real-world change by encouraging sustainable business models. Many asset managers have piled into companies with "best-in-class" ESG rankings, resulting in rich valuations. Investments in ESG-challenged sectors are too often divested when instead an approach of engagement to enact positive change could result in more real-world change.

Our analysts believe the market needs:

- Broad recognition that divestment doesn't always bring the desired results and that the market should reward improvement.
- Better forward-looking data to assess the credibility of a company's transition plans.
- Consensus among asset managers on how to engage high-emitting companies and report the outcomes of those engagements to their investors.

Theme 3

Investors put net zero commitments into practice

$84 trillion

Assets under management of signatories to the three largest net zero investment initiatives.[1]

A wave of asset owners and managers made net zero commitments in 2021 and will increasingly put them into action in 2022.

[1]Some double-counting may be shown here where organisations have become signatories of multiple initiatives and where an asset owner that has signed up outsources fund management to an asset manager that has also signed up.

This year, investors will likely expect companies to:

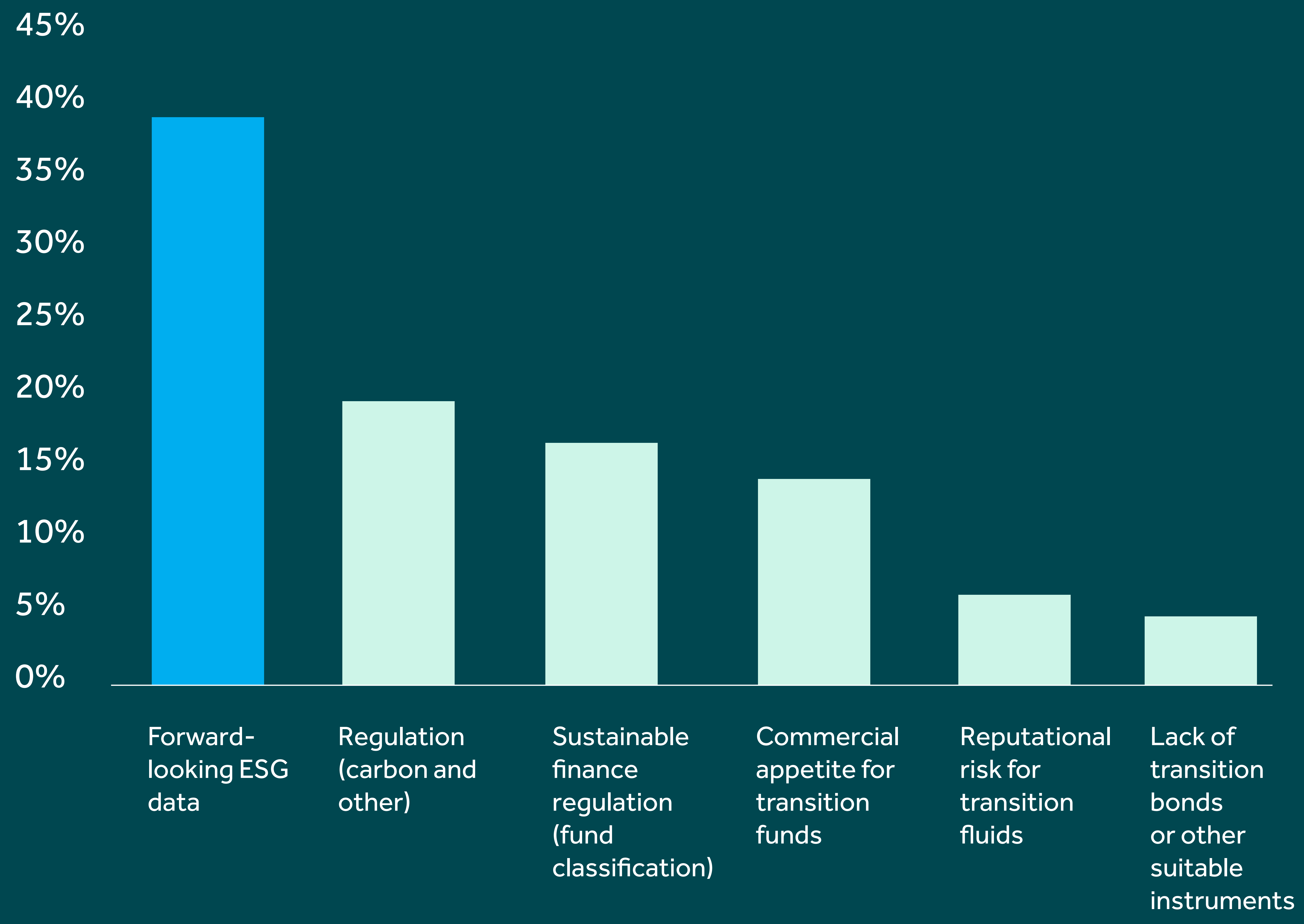
- Make clear and transparent disclosures explaining their goals.
- Demonstrate clear climate strategies to achieve net zero targets.
- Exhibit strong leadership and accountability through executive remuneration and financing tied to targets.
- Engage suppliers on transitioning to lower carbon processes and practices.

Theme 4

Investors clamour for forward-looking data

There has been a heightened focus in developing forward-looking data from both investors and data providers to better understand the future ESG trajectory of companies. Examples of data sets include temperature alignment scores, planned green capex expenditures and the use of natural language processing to assess the credibility of corporate commitments.

2021 Barclays ESG investor survey: What are the biggest challenges for investors to support the transition to a more sustainable economy?



Includes all respondents to our survey (c.250)   Source: Barclays Research 2021 ESG investor survey

Theme 5

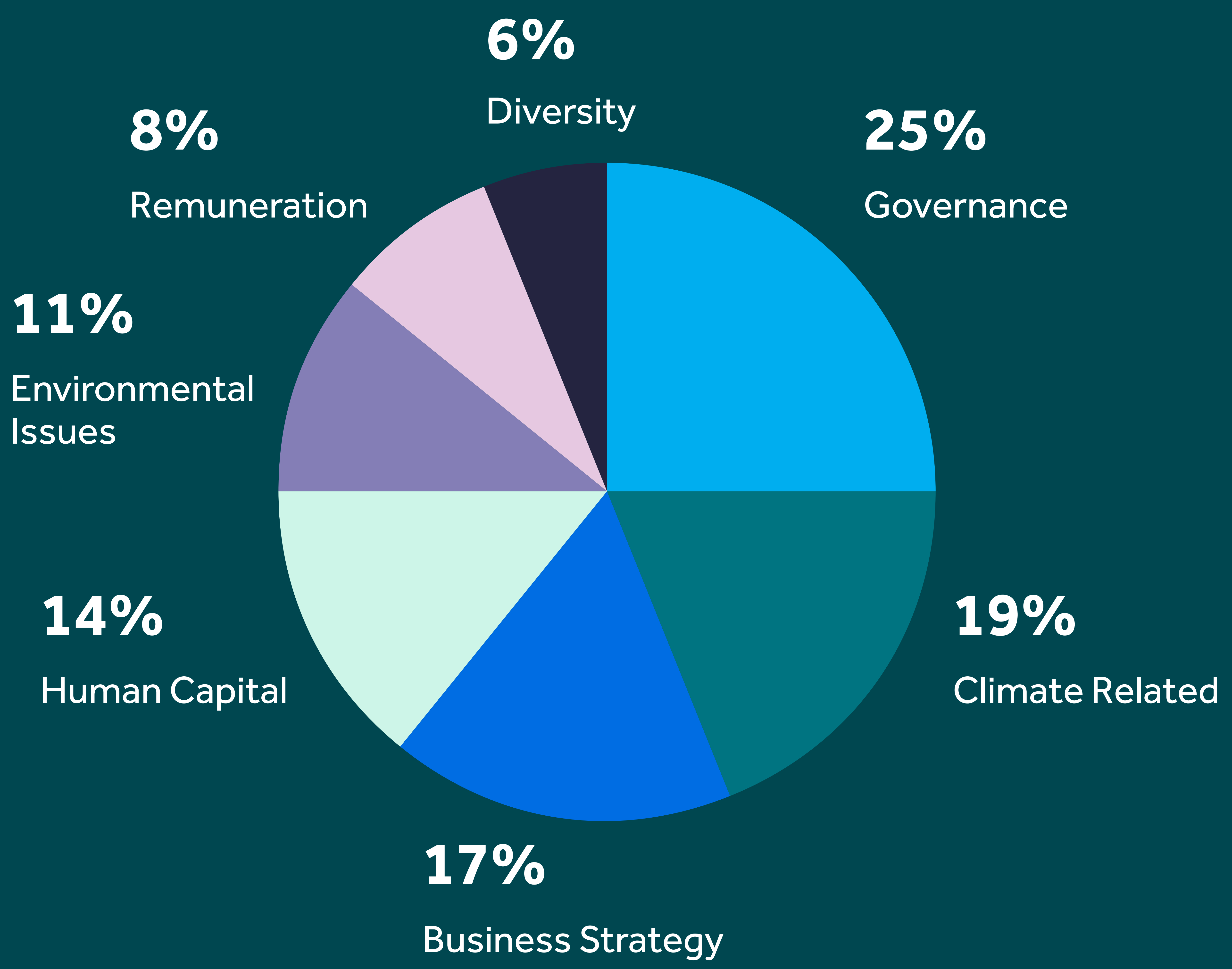
Impact of investor engagement comes into focus

Our analysts expect to see more asset managers working to report on engagement outcomes quantitatively rather than only providing case studies in their ESG and Stewardship reports.

Credit investors could join up with equity investors in supporting the transition. The sustainability-linked bond (SLB) market is a prime candidate for better dialogue between investors and issuers.

As engagement efforts move forward, our analysts see linking executive compensation to decarbonisation targets as a logical next step.

Topics of engagement for asset managers in 2022



Based on data from 10 asset managers

Source: Investor ESG and Stewardship reporting

Theme 6

Greenwashing accusations to also hit investors

Our analysts see complex regulation and difficulty in integrating ESG strategies creating room for interpretation. This could draw greenwashing claims to be directed at institutional investors in 2022, not just issuers. Mandatory disclosure requirements and new rules on ESG labels will not only make scrutiny easier for regulators, but investment fund clients as well.

Implementation will not be perfect, so credibility is at risk for investors with ESG policies and strategies if greenwashing allegations grow more prevalent.

To avoid such scrutiny, as well as regulatory interventions, ESG funds should:

- Differentiate themselves meaningfully from their non-ESG counterparts.
- Adopt robust processes substantiating the narratives in their marketing materials.
- Focus on real, shorter-term targets that are easily observable.
- Evaluate the objectives of investee companies, especially when disclosures are lacking.

Theme 7

ESG in macro goes mainstream

As ESG in macro becomes one of the hottest topics in the market, the discussion raises several questions for 2022:

- How will ESG agendas impact inflation, GDP, trade, central bank mandates and other macroeconomic issues?
- Will climate change risks be incorporated in stress testing requirements for financial institutions?
- How will climate change and transition policies affect interest rates?
- How can macro funds develop an ESG framework for sovereigns, which can be less open to engagement than corporates.

Climate change events and policies will inevitably affect prices and valuations, creating new macroeconomic and financial risks. Central banks will potentially adjust their policies to not only manage these risks but also to facilitate the transition toward a low-carbon world.

Theme 8

Progress towards carbon pricing

$75

The minimum global price per tonne of carbon dioxide equivalents needed by 2030, according to the International Monetary Fund.

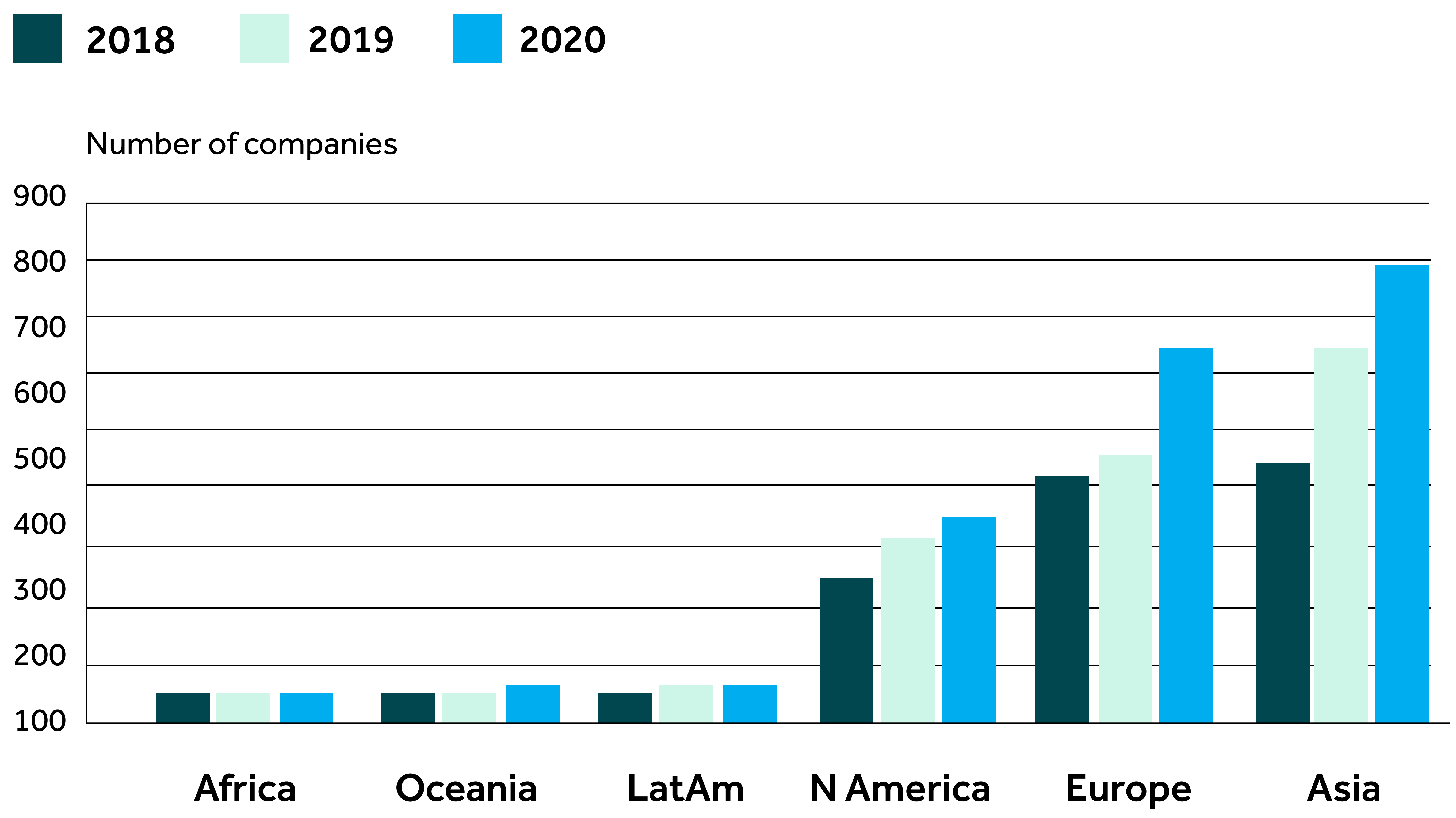
$3

The average price per tonne* covering just 21.5% of global emissions today.

*Estimated global average carbon price as of 2020-21.
Source: IMF, OECD, IEA, Ember Climate, the White House.

There were no conclusive decisions on a uniform carbon pricing mechanism at COP26, but the EU, US, UK, Canada and others support pricing carbon emissions. Additionally, more than 2,000 companies representing $27 trillion in market capitalisation are using or planning to use internal carbon pricing within the next two years. This includes 57% of the world's largest corporations.

Companies pricing or planning to price carbon - by region



Source: CDP

Theme 9

Carbon offsets rise in importance but come under greater scrutiny

$1.5 trillion

Potential size of carbon offset market by 2050

Source: Barclays Research

Net zero commitments will result in surging demand for carbon offsets. Our Research analysts expect more scrutiny on how businesses plan to use them: In place of decarbonising? Or as a short-term solution while decarbonising?

Not all carbon credits are created equally, and the voluntary carbon credit market remains unregulated. Society, governments and business must prioritise genuine reductions in greenhouse gases.

Our analysts' modelling shows nature-based solutions (NBS), including forestry, carbon farming and blue carbon, could provide 25-35% of the greenhouse gas emission reductions needed to meet the Paris Accord. NBS should be seen as an interim solution and carbon credits should support long-term sustainable land use.

Theme 10

Targeting deforestation and measuring biodiversity

120

More than 120 countries signed on to the Glasgow Leaders' Declaration on Forest & Land Use at COP26, marking a commitment to halt and reverse forest loss and land degradation by 2030.

In 2022, investors should pay close attention to the EU's work on minimising deforestation risks linked to products sold in EU markets. Third-party certification and satellite technology will increasingly provide independent verification of sustainable production practices.

Governments, companies and financial institutions will be pushed further to measure and report their dependency and impact on biodiversity.

Currently, there is no standardised framework to do this, though there are two key opportunities ahead: the conclusion of COP15 on Biodiversity and publication of a beta framework by the Taskforce on Nature-related Financial Disclosures (TNFD).

Our Research analysts' view

Investment managers face myriad challenges in 2022, including the potential for scrutiny from the wider public. Managers will need to find better forward-looking data to assess the credibility of companies' transition strategies, and they must develop more quantitative measures to demonstrate the outcomes of their engagements.

As ESG momentum builds, investment managers will likely feel increasing tension between their clients' desires, a raft of incoming regulation and what they feel is the right thing to do in support of the transition – all while trying to maximise returns.

In this fluid environment, it's critical to track the key themes identified. Neither investors nor issuers want to be left behind.

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