ISS ESG

WHITE PAPER SERIES
ESG THEMES & TRENDS 2022

NEW HORIZONS
NAVIGATING ESG IN 2022

Europe, Middle East & Africa

WWW.ISS-ESG.COM

Key Takeaways

- As the mainstreaming of responsible investment continues in Europe, this report examines the drivers consolidating (and fragmenting!) the market for sustainable finance in the coming years, be it through regulation and market penetration (Topic 1), regional disparities (Topic 2), or thematic advancements (Topic 3).
- TOPIC 1 challenges some of the key shibboleths of sustainable finance, looking ahead to when ESG investing becomes the norm – is there a future for ESG-themed products?
- TOPIC 2 gives an update on how sustainable finance actors must navigate EU/UK regulatory disparities post-Brexit. The evidence to date suggests that the divergence between the two markets isn't insurmountable.
- TOPIC 3 prepares the reader for the rising relevance of social issues in responsible investing strategies. While social impacts might be less technical in content, don't expect a European social taxonomy definition to foster a harmony of views – approaches and normative values will trigger a lively debate.

TABLE OF CONTENTS

Key Takeaways 2
Overview 4
Themes 5
Planetary Boundaries 5
Stewardship 5
Inclusion 5
Topic 1: Will the Scale Finally Tip? If Everything is ESG… is Nothing ESG? 6
Not All ESG is Alike – the Question of Motives 7
Regulators have Entered the Arena, But Clarity is Still a Way Away 7
Conclusion 8
Topic 2: UK vs EU Climate Policy 9
Same, Same, but Different 9
Targets 10
Measures 10
Taxonomies 10
Disclosure Requirements 11
Emission Trading Schemes 11
Conclusion 12
Topic 3: From Safeguard to Social Impact – The Rising Relevance of the 'S' in ESG 13
Background 13
Evaluating Social Risks 14
Seeking Impact 16
Conclusion 17

Overview

While the degree of penetration of Environmental, Social and Governance (ESG) factors into investment strategies varies around the world, the EMEA (Europe, the Middle East, and Africa) bloc may be the region with the highest degree of heterogeneity. While the adoption of sustainable finance and clean energy capacity is growing robustly across the region, local markets see differences in the pace of growth.

The European Union (EU) has been an early mover on ESG-related regulatory action, and with various pieces of legislation coming into force in 2022, regional uncertainties will eventually be taken over by standardization as the supranational bloc forges ahead, even if some headwinds persist. As this report will show, the United Kingdom's emerging responsible investment framework has the potential to be compatible with the EU's, and Brexit is not expected to lead to friction for sustainable finance specifically. The rest of the continent is expected to follow as sustainable finance spreads to countries which currently bear few similarities to their Western neighbors on this front.

ESG investment strategies have taken some time to gain recognition in the Middle East and Northern Africa. Several countries including Egypt, Morocco and Jordan lead the region in wind energy production, and some countries are moving to emulate the regulatory action in Europe. The Middle East walks a particularly fine line in the transition from extractives-dominated economies. High energy prices and dropping expenditure on fossil fuel exploration may provide the catalyst for this change.

The European Union (EU) has been an early mover on ESG-related regulatory action, and with various pieces of legislation coming into force in 2022, regional uncertainties will eventually be taken over by standardization as the supranational bloc forges ahead, even if some headwinds persist.

While countries in Sub-Saharan Africa tend to have relatively small environmental footprints, their social challenges are more complex and, for these markets, the topic of access to finance must be addressed before questions of green transition and inclusive growth can be factored in. Nevertheless, green bonds and bank lending are growing throughout the region according to a report by the European Investment Bank, highlighting the increasing relevance of the 'S' in ESG.

Throughout EMEA, ESG considerations have entered a maturing mainstream investment discussion. This paper evaluates three key topics that responsible investors in EMEA will be faced with in 2022 and beyond. We hope that this report helps our clients and key stakeholders to prepare for these emerging ESG challenges.

Click to watch a video covering the key takeaways for investors

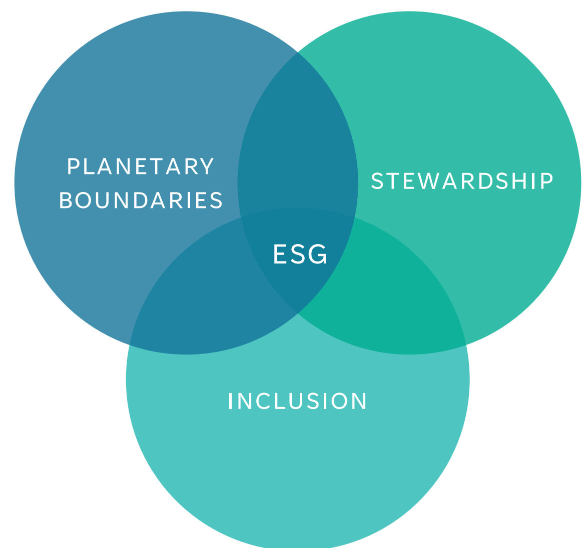
Themes

Planetary Boundaries

Planetary Boundaries refers to the host of risks that result from the degradation of ecological systems including the impacts of climate change, biodiversity loss, ecological collapse, and resource depletion. This theme builds from the traditional "E" in ESG and integrates the considerations of the Nine Planetary Boundaries put forward in 2009 by Johan Rockström (Stockholm Resilience Centre) and Will Steffen (Australian National University).

Stewardship

Extending the traditional "G" in ESG, the theme of Stewardship seeks to encompass the increasingly complex and multi-faceted manifestations of governance risks emerging at the intersection of civil, corporate, digital, and political spheres – risks including data privacy and technological regulation, advocacy and corporate lobbying, corruption, and accountability. Stewardship practices are evolving. Investors seeking to integrate ESG factors into their management processes are using their influence as owners of companies in various ways, including engagement, voting, and portfolio weighting.



Inclusion

The term "Inclusion" aims to frame this theme beyond traditional social issues to better address the host of systemic issues that cause or relate to: wealth and resource disparity; risks to labor and human rights; cultural and racial prejudice; discrimination related to particular demographics and populations, such as gender and age-based discrimination; and issues that impact the democratic participation of individuals and communities in their civil duties and rights.

Topic 1:

Will the Scale Finally Tip? If Everything is ESG... is Nothing ESG?

Lead author: Hendrik Leue, Head of Bespoke Research & Advisory Solutions, ISS ESG
Contributing author: Ronja Wöstheinrich, Associate Vice President, ESG Methodology, ISS ESG

SUMMARY

- As responsible investing enters the financial mainstream, how will stakeholders differentiate between ESG (Environmental, Social and Governance) and non-ESG products in the 2020s?
- Investor attitudes and motives vary widely - and not all financial market actors are equally on board the ESG train.
- Regulation is seeking clarity, but even the most advanced rules can lead to confusion, and this is not helped by a regulatory patchwork across the EMEA region.
- In 2022, investors have an opportunity to get ahead of the game by clearly identifying and communicating their approach to responsible investment, and their underlying motives for adopting that approach.

Sustainable finance has become so ubiquitous over the past decade that an introduction into pop culture would not be unexpected – there is even talk of ESG investing receiving its own TV show! And there is no sign of abatement in the growth of ESG assets. With ESG coming-of-age and clearly emerging from its niche, the inevitable question arises: If everything is ESG, what does it even mean to be ESG?

Trends in regulation and market penetration hint that Europe will be the first global region to answer this question. Indeed, the continent may already be in the middle of the debate. Whistleblowers allege greenwashing over their employer's marketing claims, regulators discuss how to sort the wheat from the chaff, and policymakers enact binding legislation to define 'sustainability'. What is the best approach for investors to take in this environment? Should they feel excited or discouraged at the discussions that are taking place at market level?

Not All ESG is Alike – the Question of Motives

A key debate sustainable finance will have to face is that of its motives. A significant proportion of responsible investors frame their approaches in the context of incorporating ESG only to enhance (short to mid-term) financial performance, and indeed this may be an imperative in markets where there is a narrow definition of fiduciary responsibility. In Europe the concept of double materiality means that there is more scope for portfolios to incorporate values-based propositions, to the extent that they inform good quality decisions about ESG risk exposure and management.

Throwing all these approaches into one 'ESG' basket risks comparing apples to pears, with the result being that the meaning of sustainable investing is diluted. As EU regulators use the Taxonomy to establish clear definitions of what is and isn't a sustainable business activity, the primary concern for consumers of financial products will shift to differentiating between various forms of sustainable investments. A uniform system of how to group different types of ESG approaches is, however, yet to emerge.

Regulators have Entered the Arena, But Clarity is Still a Way Away

With more and more financial products claiming to be sustainable investments, a key objective for European regulators is to prevent green- or social-washing. This concern has informed the development and introduction of several classification and labelling systems.

Under the EU's Sustainable Finance Disclosure Regulation (SFDR) asset managers need to disclose what categories a given financial product falls under:

- 'Article 6' funds do not consider any ESG factors;
- 'Article 8' funds integrate sustainability factors, but do not necessarily have them as an objective; and
- the 'Article 9' category is reserved for those funds which have specific sustainability goals as part of their strategy.

A similar system is being developed by the UK's Financial Conduct Authority. In practice, the lines are becoming blurred as SFDR is implemented across different EU regional markets, and fragmentation is a real concern for investors. Moreover, as SFDR focuses on disclosure rather than providing a clear set of expectations around sustainability outcomes, even SFDR Article 9 funds may not deliver the sustainability outperformance for investors seeking value-aligned investment opportunities.

Outside the EU, the broader EMEA region is less uniform in terms of the regulation and mainstreaming of responsible investment. Brexit has taken a significant proportion of European capital outside the scope of EU regulatory frameworks, and looking into the wider EMEA region a patchwork of regulatory initiatives can be observed.

	EGYPT	ISRAEL	MOROCCO	RUSSIA	SWITZERLAND	UAE	UK	UKRAINE
Green Bond guidelines	X		X					X
Climate Risk Management and Disclosure			X		X		X	
Product Disclosures, Labelling of Investment Products					X		X	
ESG Risk Management & Disclosure		X		X		X	X	
Stewardship & Engagement				X			X	
Taxonomies				X			X	

Source: ISS ESG; non-exhaustive list of wider EMEA region's sustainable finance regulation initiatives per area

While differentiation between what is ESG and what is not will be a lasting debate, it should not be forgotten that we are at the start of the responsible investment journey. ESG has not arrived in all asset classes at equal speed. Private markets for instance lag considerably. Moreover, not all investors implement ESG approaches with equivalent conviction, and many remain to be convinced of the merits of the integration of ESG factors into their methodologies.

This uncertainty can be exacerbated by the difference between short-term and longer-term motivations for investors. When Wacker Chemie, a German mid-cap chemical company which is one of the few significant non-Chinese polysilicon manufacturers in the world, announced even tighter sustainability targets in late 2021, this triggered the lowering of an analyst's share price target. One can make the case that short-term cost implications are often given heavier weighting than the longer-term implications of the firm potentially emerging as a key supplier to the solar industry with a low-carbon profile and comparatively little human rights risk.

Conclusion

Not everything is ESG today, and it is unlikely that everything will be ESG tomorrow, even if the lines do appear to blur. The mainstreaming of ESG is still underway in 2022, and as regulators continue to work towards a uniform definition of what is a sustainable investment, investors are likely to continue to contend with a patchwork of regulatory approaches, both within the EU and across the EMEA region more broadly.

Clearer definitions are on the horizon, however, and given market pressure for the integration of sustainability factors into investment processes, it is likely that investors will need to make clear and transparent calls on their approaches in the near future. Given a blanket rejection of ESG integration seems unlikely, investors will need to confirm whether their approaches are primarily driven by the (short-term) financial implications of ESG performance, or whether they are also taking broader issues into account. It is at this point that investment products will seek to differentiate themselves in terms of motives, ambitions, and regional regulations and market demands. Success in negotiating this tightrope walk might just see the ESG TV pilot series extended into multiple seasons!

Topic 2:

UK vs EU Climate Policy

Lead author: Nick Jeans, Head of EMEA Climate Analytics, ISS ESG
Contributing authors: Viola Lutz, Head of ISS ESG Climate Solutions, ISS ESG

SUMMARY

- According to the Climate Action Tracker, both the UK and the EU have work to do to meet their shared objective of achieving Net Zero by 2050, despite being leaders among developed countries on the topic of climate change.
- The uncertainties created by Brexit notwithstanding, the UK and the EU are adopting similar tools to meet their decarbonization targets.
- Divergences in approaches appear, nevertheless, as each refines their strategy to the local market. This is of increasing concern to investors participating in these markets and beyond.
- Multi-lateral efforts are underway with the aim of allaying some of these fears.

Same, Same, but Different…

The final Trade and Cooperation Agreement, which redefined the UK/EU relationship post-Brexit, ensured continued close collaboration between the parties on climate change by underpinning a shared ambition to achieve economy-wide climate neutrality by 2050.

According to the NGO Climate Action Tracker (CAT), there remains much work to do for both the UK and EU if they are to reach their climate targets. Indeed, the UK and EU rate ‘Almost sufficient’ and ‘Insufficient’ respectively, based on the CAT’s evaluation of government measures to achieve a Paris-aligned temperature limit. ISS ESG’s Country Rating also has the UK performing better than the EU on broad climate related matters:

	UNITED KINGDOM	EUROPEAN UNION
Climate Change and Energy	B	C+
Climate Change	B	B
Climate Performance	B	B-

Source: ISS ESG

With numerous initiatives on their way in the UK, the big question is how climate action policies will interact with those of the EU in the wake of Brexit. This chapter will review those aspects of this discussion most relevant to investors, namely:

- Targets (both medium- and long-term); and
- Measures (including Taxonomies, Disclosure Requirements, and Emission Trading Schemes).

Targets

The UK has been pushing its own climate agenda for some time, even prior to Brexit when it was still part of the EU. The UK's Climate Change Act came into force back in 2008, committing the UK government by law to reducing greenhouse gas emissions by at least 90%, and later 100% (Net Zero), of 1990 levels by 2050, with the aim of transitioning the UK to a low carbon economy.

The UK government has also approved intermediary targets for 2030 of at least a 68% reduction below 1990 levels, alongside a 2035 target of a 78% reduction below 1990 levels. With the adoption of these targets the UK government puts itself on the front foot in terms of limiting a global temperature rise to 1.5° C.

While the EU is also targeting Net Zero by 2050, it has only committed to reducing domestic emissions by 'at least 55%' below 1990 levels by 2030. The EU therefore has the same long-term target but is perhaps slightly more reserved as to their expected progress. This isn't particularly surprising given that 27 states have to be considered as part of the EU's deliberations.

Regardless of the level of ambition, targets require clear actionable plans that are monitored and measured in order to be achieved. So, what are the EU and UK planning to do to meet their targets?

Measures

Similar to corporate decarbonization strategies that provide for credible measures to achieve the company's emission reduction target, sovereigns too are able to deploy a toolbox of measures in their attempt to help reduce emissions and decarbonize their economies. Such tools include:

Taxonomies

A Green Taxonomy is an increasingly common framework that seeks to classify what activities, and thus investments, are environmentally sustainable. They are designed to not only avoid greenwashing, but also to accelerate the transition to Net Zero.

The EU's Taxonomy has become something of a global standard since its creation, and it has also become a blueprint for other jurisdictions looking to implement their own green taxonomies.

In November 2020 the UK announced its own version of such a framework as part of its 10-point plan for a Green Industrial Revolution. Although still in its draft phase, the UK's Green Technical Advisory Group, an advisory body on these initiatives, has already confirmed that

the framework and technical screening criteria will be the same as the EU's, even if some of the metrics and thresholds will be adapted for the UK market. In other words, while the specific criteria may differ, the six objectives, including Climate Change mitigation, remain the same, as do the various steps: substantial contribution criteria; do no significant harm; and minimum social safeguards.

The proliferation of taxonomies across world markets can be alarming for investors with global portfolios trying to keep up, and divergences do exist across other geographies, notably China and Russia. But the International Platform on Sustainable Finance, of which the EU, UK and China are all members, aims to align such initiatives through multilateral policymaker dialogue.

Disclosure Requirements

Disclosure has long been the primary source of discontent within ESG circles, but change is afoot. Improved disclosure is key in monitoring the progress of decarbonization of both investee companies and investment portfolios.

On November 3, 2021, the UK's Financial Conduct Authority (FCA) proposed a series of minimum standards for sustainable and responsible investment products, covering asset managers, asset owners, and corporations.

The UK regulator is proposing disclosure requirements for asset managers and asset owners under the planned Sustainable Disclosure Requirement (SDR) regime with a tiered approach for consumer-facing disclosures and those aimed at institutional investors. It also plans a sustainable investment labelling system. The FCA has also set out a classification system for funds, with minimum criteria for those that market themselves as responsible or sustainable, all in the same vein as the EU's equivalent Sustainable Finance Disclosure Regulation (SFDR).

On the corporate side, and arguably the most important with regards to reducing emissions, the UK is looking to use the newly formed International Sustainability Standards Board (ISSB) as a basis for their own regulations.

In parallel, the EU has for some time been developing its own guidance on corporate disclosure under the Corporate Sustainability Reporting Directive (CSRD), currently being drafted by the European Financial Reporting Advisory Group (EFRAG). Initial proposals from the EFRAG would require a high level of granularity in corporate disclosure, including Net Zero targets, with information required on 'decarbonization levers' as well as past, current, and future results/plans to facilitate the monitoring of a company's progress.

While final UK requirements remain to be confirmed, it was reassuring that upon the announcement of the ISSB this summer, the EFRAG was quick to confirm that its climate standards are 'fully compatible' with the ISSB's, once again allaying investors' fears of diverging policies across jurisdictions.

Emission Trading Schemes

As part of Brexit, the UK also decided to withdraw from the EU's Emissions Trading System, which according to the EU is a cornerstone of its policy to combat climate change. This announcement alarmed climate groups, given the UK's significant contribution to the continent's emissions. The UK has since launched the UK emissions trading system, with the same ambition to incentivize cost-effective greenhouse gas emission reductions for high impact sectors (for example electric utilities and aviation).

While the UK carbon market may face reduced liquidity given its significantly smaller size, both the UK and EU plan to cooperate on carbon pricing, and the UK is 'open' to the possibility of merging systems once again at some point in the future. Given that there are currently 24 emissions trading schemes in force worldwide, it came as welcome news that COP26 finally put the wheels in motion to ensure greater coherence and transparency across carbon markets.

Conclusion

Net Zero commitments, a green taxonomy, stricter disclosure, and Emissions Trading Systems. There are significant similarities in the approaches being taken to mitigate climate change on both sides of the Channel.

These similarities are largely due to both the UK and the EU remaining tightly entwined and sharing common areas of agreement and common objectives. They remain two leading actors on climate change, pulling in the same direction, each with the freedom and flexibility to apply their own strategies and leverage the work of the other.

Brexit posed a significant potential risk to investors concerned about climate change, with the real prospect that differences in regulatory approaches would create friction and impede action across borders. Investors will need to remain vigilant for potential differences in the approaches taken in the respective markets as they are tweaked and refined – the devil is always in the detail. But at the same time they can be comforted by the multilateral efforts of convergence on the subjects that are likely to have a material smoothing impact. In 2022, investors will have an opportunity to leverage their influence with regulators to ensure that action on climate change is not impeded by the finalizing of Brexit negotiations.

Topic 3:

From Safeguard to Social Impact – The Rising Relevance of the ‘S’ in ESG

Lead author: Hendrik Leue, Head of Bespoke Research & Advisory Solutions, ISS ESG

SUMMARY

- Social issues are gaining prominence, both through regulation in a social taxonomy and via investor initiatives on a ‘just transition’, and European policymakers are playing a key role.
- Investors can take an ex-ante or ex-post approach to measuring social risks.
- Social impact financing can lead to enhanced growth and human development.
- Economic activities will have both horizontal and vertical social impacts, as well as varying normative perspectives, making it more complex to catalogue positive social contributions.

Background

The COVID-19 pandemic has paved the way for greater consideration of ‘S’ topics globally. Given the predominance of welfare states in Europe, it was no surprise to see the region taking decisive action on this topic in 2021. The issuance of the SURE bond, together with its environmental sibling, the NextGenerationEU Green Bond, has made the EU the biggest issuer of sustainability bonds globally.

And in 2022 the continent will likely continue to forge ahead with defining the social dimension in sustainable finance. The EU’s Social Taxonomy Subgroup has issued draft considerations for a Social Taxonomy, which is expected to be finalized in early 2022.

While much of the action in Europe is driven by regulation, investors are also key players. The Principles for Responsible Investment (PRI) has initiated a collective shareholder action on human rights. And some France-based investors are about to bring to life Investors for a just transition as a pooled engagement platform, building on the adoption of the Just Transition Declaration at COP26.

Social issues may also play a larger role in financial risk modelling, with the European Banking Authority choosing to include social risks in its proposed guidelines for future holistic ESG scenario analyses.

There are well established international frameworks that set up measurable baselines on social issues. The International Labour Organization's set of core conventions dates back to the mid-20th century. The Forced Labour Convention will celebrate its centenary just eight years from now in 2030, and 'modern slavery' is a major business and supply chain risk today. The broader United Nations Guiding Principles on Business and Human Rights were formulated in 2011, four years before the Paris Agreement was adopted.

Outside the realm of project finance, however, social issues have not received the investor interest that environmental topics have enjoyed. The European Union's ambition to establish a social taxonomy, as well as wider business regulations such as supply chain due diligence, are aimed at bringing the consideration of social issues into parity with the climate and other environmental-related objectives. The topic is not without challenges for investors, however, particularly in terms of the selection of relevant quantitative metrics. The two most common approaches taken to evaluating the social dimension of ESG investment involve:

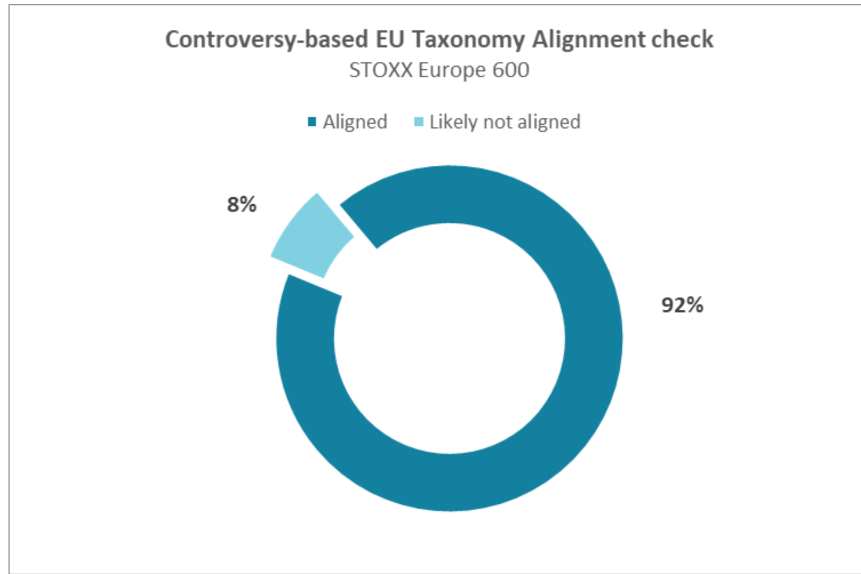
- determining an investor's exposure to social risks; and
- evaluating the potential social benefits and positive impacts of an investment or portfolio.

Evaluating Social Risks

While the EU Taxonomy currently encompasses only environmental objectives, it also comprises so-called 'Minimum Social Safeguards' with which an eligible contributing business activity has to comply in order to qualify as aligned with the Taxonomy. The frameworks which are referenced as benchmarks to assess companies against in this context include the OECD Guidelines on Multinational Enterprises as well as the aforementioned UN Guiding Principles, which in turn reference the ILO conventions. Even in its current state, the EU Taxonomy thus provides useful guidance on where to look when evaluating social risks. In practice, however, the application is still complex, with the main issue being whether an ex-ante or ex-post view is most appropriate in terms of the fulfillment of social safeguards criteria.

The following graphic sets out the proportion of companies within the Stoxx Europe 600 Index judged to be aligned with Minimum Social Safeguards according to ISS ESG's EU Taxonomy Alignment Solution. In this case an ex-post test is being applied, checking if companies are exposed to relevant Norm-based controversies. Companies which are deemed likely not aligned may have been found to be violating internationally acknowledged human rights, labor rights, or anti-bribery norms.

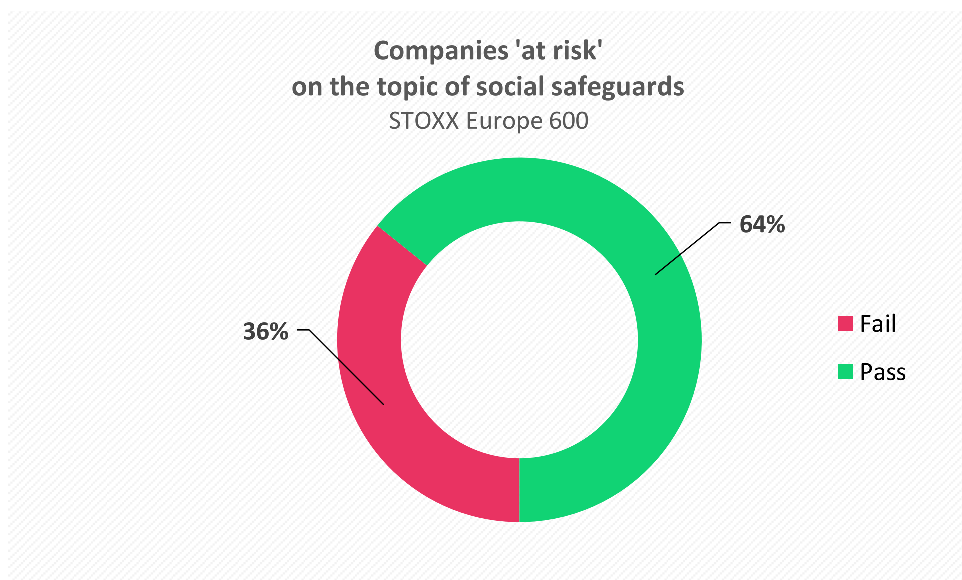
Figure 1: Ex-post Controversy-based alignment check



Source: ISS ESG

History is of course not always the best predictor of future risks. Bearing this in mind, investors may opt for an ex-ante approach, conducting due diligence on the preemptive minimum safeguards reported by an investee company. ISS ESG's Corporate Rating evaluates not only a company's past track record, but also its preparedness to manage emerging social risks.

Figure 2: Ex-ante approach - Companies flagged for being "at risk" on the topic of social safeguards



Source: ISS ESG

As can be seen from the charts above, the selection of an ex-post or an ex-ante approach can have a significant impact on the number of companies impacted. While controversies (based on ISS ESG's Norm-based Research) relating to human rights, labor rights, and anti-bribery, are rare across the analyzed index, there are a far greater number of companies that aren't

able to demonstrate the presence of adequate measures to address social risks, as measured in the ISS ESG Corporate Ratings.

As touched on in a joint investor study conducted by ISS ESG and adelphi, uncertainty around the level of due diligence required to meet the Do No Significant Harm and Minimum Social Safeguards standards is likely to inform investor choices about the best ESG methodology to apply. Given the significant number of companies not meeting the ex-ante threshold in terms of managing social risks, this topic is likely to be more productive as a source of engagement in 2022, rather than merely applying a screening tool.

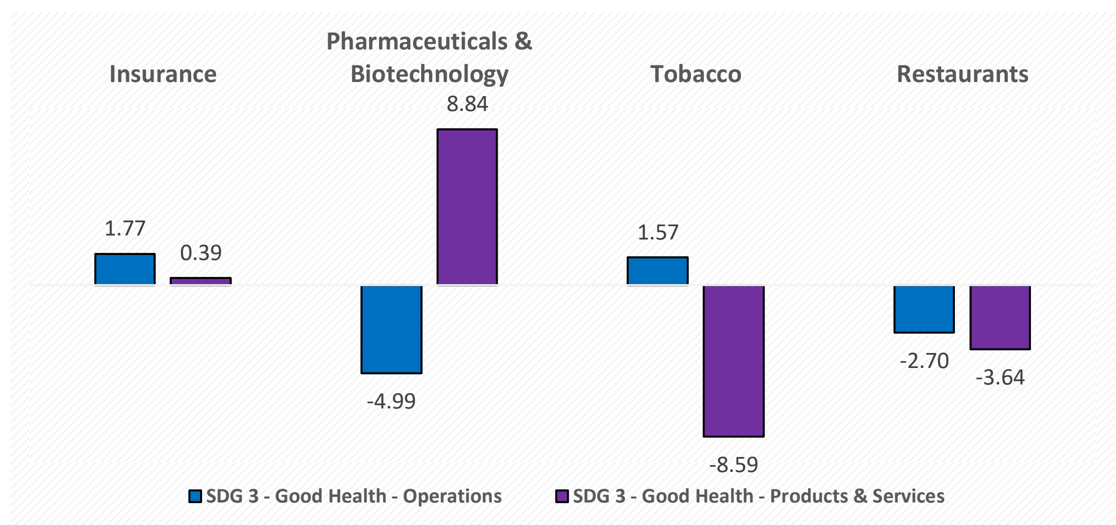
Seeking Impact

In addition to managing social risks in an investment portfolio, there is also plenty of opportunity for financing positive social impacts. Once again, however, the story becomes more complex for social aspects than for environmental objectives such as climate change mitigation.

Evaluation of potential positive outcomes arising from a company's social performance can be conducted under two broad headings: horizontal and vertical contributions. The former encapsulates those positive outcomes enjoyed by communities, consumers, and workers, through the general conduct of a corporation's business, for example by providing employment in a given community. The latter refers to products and services which in themselves contribute to social objectives.

These measures can be explored using ISS ESG's SDG Impact Rating, a data set that analyses a company's impact in terms of the United Nations Sustainable Development Goals (SDGs). The data is presented in the form of three pillars: 'how' a company operates (the horizontal impact, blue in the chart below); a company's Products and Services, i.e., 'what' it does (the vertical impact, purple in the chart below); and the respective past controversy exposure to a given SDG. Each company's operations are evaluated in the light of a given SDG, according to the first two pillars - 'what' a company does vs 'how' a company does it.

Figure 3: SDG Impact Rating Scores for Pillars 'Operations' and 'Products & Services'; SDG 3 – Good Health; Selected industry averages



Source: ISS ESG

The above graphic provides a practical example of how the vertical and the horizontal dimensions of impact can vary across different industries:

- While insurance companies usually have good working standards in place in their operational units as well as low supplier risks (horizontal impacts), they also offer services which provide health benefits such as health and accident insurance schemes (vertical impacts).
- Unsurprisingly, pharmaceutical companies have on average the highest positive impact on SDG element 3 through their products and services (vertical impacts). However, the sector tends to underperform on consumer-related indicators, and there are questions relating to access to medicines for underserved communities, as well as health-related environmental externalities like the discharge of contaminated wastewater (horizontal impacts).
- Tobacco products are clearly negative in terms of their vertical impact, but operational (horizontal) impacts are on average acceptable if supply chain risks are not factored in.
- The restaurant sub-industry yields both negatives in terms of unhealthy food products and fast food chains (vertical impacts), and negative operations (horizontal impacts), based largely on comparatively poor working conditions.

Both of these dimensions are also included in the EU's Social Taxonomy draft proposal from July 2021. How the Platform on Sustainable Finance's Subgroup on social taxonomy approaches this classification scheme is likely to have a defining influence on the general attitude towards social aspects in sustainable finance. Social impact financing has the potential to not only avert negative social impacts, it also opens up a business case for enhanced human development, improved economic inclusion, and thus more robust and equitable growth.

Conclusion

Social preferences and norms vary more than science-based climate targets, and therefore the European social taxonomy may yield less specific global standard-setting than its environmental counterpart. Don't expect more harmony than with the current kerfuffle around the greenery of nuclear and natural gas, however – the European defense industry is already anxious about a drought of funding, instead calling for their activities to be included as positive for social outcomes due to their contribution to global peace and freedom. In 2022, investors should prepare for discussions around values and value as the EU's social taxonomy is set to move off the drawing board and further fuel the ever more prominent debate around the 'S'.

We empower investors and companies to build for long-term and sustainable growth by providing high-quality data, analytics, and insight.

SUCCEED WITH ISS ESG SOLUTIONS

Email sales@iss-esg.com or visit www.iss-esg.com for more information.

ABOUT ISS ESG

ISS ESG is the responsible investment arm of Institutional Shareholder Services Inc., the world's leading provider of environmental, social, and governance solutions for asset owners, asset managers, hedge funds, and asset servicing providers. With more than 30 years of corporate governance expertise and 25 years of providing in-depth responsible investment research and analytics, ISS ESG has the unique understanding of the requirements of institutional investors. With its comprehensive offering of solutions, ISS ESG enables investors to develop and integrate responsible investing policies and practices, engage on responsible investment issues, and monitor portfolio company practices through screening solutions. It also provides climate data, analytics, and advisory services to help financial market participants understand, measure, and act on climate-related risks across all asset classes. In addition, ISS ESG delivers corporate and country ESG research and ratings enabling its clients to identify material social and environmental risks and opportunities.

This document and all of the information contained in it is the property of Institutional Shareholder Services Inc. ("ISS") or its subsidiaries. The Information may not be reproduced or redisseminated in whole or in part without prior written permission of ISS. ISS makes no express or implied warranties or representations with respect to the information.

© 2022 | Institutional Shareholder Services and/or its affiliates