# ESG Now Podcast

# “The Sustainability and Climate Trends to Watch for 2024”

**Transcript, 15 December, 2023**

**Bentley Kaplan**

Hello, and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society, and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, your host for this episode, and this is quite a special episode, as we stand on the cusp of a new year. And that's because we're going to discuss MSCI ESG Research's flagship paper of the year; the Sustainability and Climate Trends to Watch for 2024. Alongside Meggin Eastman, Liz Houston, Jon Ponder, and SK Kim, I was fortunate enough to be on the paper's editorial team curating, shaping, and basking in the collective glow of our research team's most interesting ideas. And what ultimately made its way to publication is only a sample of the great ideas that our collective team developed, many of which had to be left on the cutting room floor, for now at any rate.

On the show, Liz and I are going to take a look at a few of the trends that spoke to us the most. And once you're done listening to us, if you want to read more for yourselves, well the full paper is free to download on MSCI.com. But first up, and before I take too much credit for other people's hard work, here are some of the paper's authors giving you a tasty snippet of the trends that they picked for 2024. Thanks for sticking around for another year. Let's do this.

**Matthias Kemter**

By 2050, if carbon dioxide emissions have risen sharply, the average logistics or warehouse worker in New York City could lose almost 50% more productivity to heat than they did in 2020. This type of analysis opens a new frontier in how we understand the risks that will come with managing the workforce of the future.

**Jon Ponder**

Preliminary findings are striking — across multiple markets, regulators spotted far more audit deficiencies and levied more financial penalties in 2023 than previous years. For investors, this, and other shifts governance data raises some serious questions: Who exactly is minding the shop, and do they have what it takes to do the job well?

**Yoon Young Chung**

High-growth technology industries desperately need new talent. AI may displace human tasks, but it could also enhance human productivity when workforces are trained with the necessary new skills. Which companies will invest in their employees alongside AI, and which will limit their focus to cutting costs?

**Kuldeep Yadav**

Regulations on modern slavery have increased the risk of operational disruption, reputational damage, civil liabilities and financial penalties for companies. And they're also raising the bar on what can be considered for portfolios of quote, unquote sustainable investments.

**Emma Wu**

As ISSB standards roll out, investors will be watching for two things. First, how quickly they will be able to access new disclosures and fresh insights into how companies are performing on climate. And second, how consistent disclosures are across different regions. If there isn't a harmonized approach, it's going to be much harder to draw meaningful conclusions across a global portfolio.

**Raphael Klein**

The upshot of emerging-market companies failing to meet some of these key criteria under the SFDR is that they suddenly become ineligible for many investors' portfolios. And for markets that desperately need transition capital, this would be a big blow.

**Anett Husi**

With its rapid growth in recent years, the private market will have an important role to play in global transition to a low-carbon economy. As we see more data becoming available, investors may be able to put aside some of the myths and misconceptions about the climate risks associated with private assets and instead, move forward with genuine insights.

**Theresa Bodner**

As we go into 2024, the importance of investments in nature will only increase. The landscape of opportunities and risks is complex, however, and investors will need to carefully investigate which projects are indeed credible in maximizing climate and nature returns.

**Bentley Kaplan**

So, there are some pretty intriguing threads to pull on there, and that's what we're looking at every year in this paper, which is now in its 12th annual iteration. And in that time, the world of ESG investing has transformed dramatically. While at the same time, many of the core questions that drive investment decisions have not. And the name of this publication has shifted subtly, but crucially from what was first the ESG Trends to Watch, into the ESG and Climate Trends to Watch, and now in its form of the Sustainability and Climate Trends to Watch. As our Head of ESG Research, Laura Nishikawa notes in her opening letter, "In 2023, much attention has been devoted to the controversy around ESG investing. While reports of ESG's demise have been overstated, it is fair to say that the industry is in a period of transition. Confusing terminology, definitions, and labels have fueled challenges to ESG's credibility from both skeptics and idealists alike. A positive outcome of the current backlash may be that years of inconsistency finally give way to greater clarity around language, goals, and intentions."

So, while we look for greater clarity, we also looked out for how changes in 2024 are going to shape the world of sustainability and climate investing. From the way extreme heat is going to impact how people work and where they choose to live, to how the frothy wonderland of AI is going to bump up against more mature risks like data privacy and the competition for talent, or how companies are going to be under tremendous pressure to map their supply chains in order to address risks linked to forced labor and deforestation, the sudden infusion of nature and biodiversity considerations in reporting and investment decisions, or how private debt may play a role in a climate transition, or how the rollout of global regulations and reporting standards is going to affect what information investors have access to and ultimately how capital might be directed. It really has a little something for everyone.

But for this episode, we're going to have to narrow things down a little by taking a quick peek at four of our eight trends for the upcoming year. To help me do this, I've invited my editorial colleague and trends author Liz Houston out of MSCI's London office. If there was any one trend we were going to start with, it was always going to be the one we picked first in the paper itself titled, “Extreme Heat Hits Home and Work.” And not least because I'm recording this in a sweltering summer office, trying my best to keep the sweat off my keypad.

Now Liz, thanks for joining. You co-authored this trend with Cody Dong and Matthias Kemter and obviously, you're pretty well placed to take us through this. Now, away from the frenzy of writing and editing, what really stood out to you in terms of putting this trend together and thinking about what's happening with extreme heat in 2024?

**Liz Houston**

What really stood out to me here was how climate change has got real in the past few years. This isn't climate change as some theoretical future threat, this is us looking out the window and seeing the smoke from the wildfires or not being able to sleep because it's too hot or it's storms or it's rivers running out of water or something else horrifying. And there are follow-on social impacts of this, and by that, I mean impact on people. So looking into next year, we see some of the social impacts of these extreme weather events increasing. We looked at a couple of angles, as you said, we looked at the impact on homeowners and then the impact on workers. Let's take homeowners first.

I should start by saying that if it feels like these things are happening more often, you are not wrong. And unsurprisingly, insurance companies have been paying very close attention. 2023 saw some of them start to withdraw homeowner insurance from some regions like California or Florida. But even across the US, the cost of homeowner insurance has skyrocketed over 20 years, I mean added to the list of things that have, but certainly compared to household income. We looked at this on a state-by-state basis, at the affordability of homeowners' insurance and how exposed each of those states are to different kinds of climate hazard. What we saw is that some of the states with the worst affordability are also the states facing the highest risks. So the question you have to ask now is, what are the macroeconomic effects going to be? As climate change bites harder, will people still be able to afford their insurance premiums as well as everything else that's gone up in price at the same time? Will it change where they want to live?

**Bentley Kaplan**

Exactly. And sitting here in my home office on the cusp of a southern hemisphere summer, I can feel that bite of climate change getting that little bit harder. And in fact, this question of physical climate risk very much blends with the risks that workers are going to face and how companies are going to have to think about those new kinds of risks.

**Liz Houston**

So yes, the second aspect of this piece was inspired by the stories we've seen in the press over the last couple of summers where warehouse and logistics workers were saying the heat was making their jobs too dangerous. This was interesting because it wasn't just a typical outdoor job like construction where you might expect heat to be an issue. The problem is spreading indoors and it was leading to real problems for workers and companies, becoming a health and safety issue and something workers were prepared to strike over.

Now, workforce relations is something we're very interested in, so we wanted to figure out what was going on here so that we can figure out what might happen next. We looked at how heat and humidity impact jobs in all different kinds of industries, and it turns out it's all about physical activity, so how much physical effort is required to do your job, and air conditioning, because Bentley, I hate to break this to you, but if your job involves sitting at a desk all day writing about sustainability in an air-conditioned office, outside temperatures are less of an issue. Anyway, if you look at it like that, it makes sense that warehousing and logistics workers were struggling the most. So, unless companies start figuring out ways to protect their employees from heat, chances are people just aren't going to be able to carry on at work at the rate they used to.

**Bentley Kaplan**

Indeed. And I do love that dramatic flourish there, Liz. So I best pace myself, even when it comes to making podcasts. Okay, Liz, you've had your turn. Now I'm going to take mine.

So if I was going to pick one of my favorite trends, that would be the one authored by a disproportionate number of colleagues out of our Toronto office, and this is trend number two, which is titled, “Who's Minding the Shop: Spotlight on Corporate Oversight.” And truth be told, I've always had a bit of a soft spot for governance. When I was starting out as an ESG analyst back in the day, I was often advised by senior colleagues and mentors that everything flows from governance, at least in how a company operates. If you understand governance, then you're starting from a good base. And it's probably because of this that every year we write the trends paper, we're always asking, what's going on in governance?

But because governance is this long-running conversation about how a company is or should be run, we don't always have these inflection points where we think the upcoming year is going to be very different from the current one. And that's definitely different in this year's paper, even when it comes to something as era defining as artificial intelligence, which is a topic that we do cover in the paper, but not on this episode, even a massive big shifting trend like that, you're asking questions about the technology or the development itself, but at the same time you're doing that, you also want to know who's behind the wheel, who's overseeing risk management at a company, and steering the ship through these new hazards and towards new opportunities.

**Liz Houston**

Okay. So there's kind of two things going on here. The first is about who's auditing the auditors, and then the second is, you've got this question of how we build better boards.

**Bentley Kaplan**

Exactly. I think the actual data that we have here is what tells such a compelling story. It's no secret that today's boards are under a lot of pressure to oversee big and sudden changes to operating environments. And we see this response from nomination committees in the expertise of new directors that have been appointed in 2022 and in 2023, technology and cybersecurity skills and experience were in the top three of these new directors, but at the same time, we're seeing these new skills, you also have some areas in key director skills tailing off where we see a net negative change in the total board members with financial industry or risk management expertise, the more classical director attributes. And seeing these two things happen simultaneously, as the authors of the trend say, 2024 is going to be all about nomination committees needing to add new skills to address emerging risks while still maintaining boardroom basics.

And while boards are trying to find themselves, so too are auditors. You've got this critical piece of the financial system auditing and as a temptation to kind of take it for granted, to sort of assume that auditors validate financial reports and that this assurance is rock solid. But then you have these occasional company collapses, like at Carillion or Wirecard or Silicon Valley Bank, and then that raises a bit of a storm and some finger pointing.

**Liz Houston**

Or, sorry to interrupt, if you are old like me, you might point to a few more of these going back, like Enron, AIG, or WorldCom, full disclosure, I briefly worked for WorldCom just before they collapsed. Those two events are unrelated, I promise. So, okay, how are things different now?

**Bentley Kaplan**

Right. Okay. So let's leave aside your stint at WorldCom. You can't make this stuff up. We always do have these anecdotes or anomalies, these singular big cases, which can feel sort of like once offs and maybe sort of uneasily dismissed and we all carry on. But what has shifted and where we think 2024 is going to be different is through the way that audit regulators, the people that are overseeing auditors, have really started poking around with much more intensity. 2023 was a very different year in that way. We saw financial penalties across the US and the UK and India. They spiked 300% compared to 2022, and US regulators found 200% more deficiencies in their audit engagements. And that's massive, especially when so many investors rely on audit statements to gauge financial risks as the sort of baseline indicator.

So the year ahead might be a really key one for investors, not only in terms of assessing the suitability of auditors, but also in terms of voting their proxies. And in brief, and without wanting to take over too much time on this, I think that gives a pretty decent taste of our trend on corporate governance. So let me flip things back to you, Liz. You know, this work on trends goes back a few months. And at the beginning, we had a broad field of ideas, that we winnowed down and reshaped into these final eight.

But right at the outset, it was clear that you had a bee in your bonnet –- in a good way – about supply chains. So why don't you take us through trend number four, which we've titled "Supply-chain due diligence becomes the law as regulators target action alongside disclosure."

**Liz Houston**

Thanks. So, yes, I'm returning to one of my favorite subjects now; supply chains. I find them endlessly fascinating because they play such an important role in the global economy, but they can be so opaque. So, so many players at each stage in the production process and so little visibility on who is trading with who. But for a lot of industries, particularly mine, the consumer industries, the supply chain is where they have the biggest impact. If you take the consumer sectors, for example, it's true for climate and it's true for other environmental and social impacts, like deforestation or modern slavery.

Now, maybe once upon a time, this was all a bit out of sight out of mind for companies, but what we're seeing now is new rules to make companies take more responsibility for what happens in their supply chains. So now something that happens at a supplier to a supplier to a supplier isn't just potentially embarrassing, it might be a potential lawsuit or financial penalty. And what this means is that there are more reasons than ever for companies to try and figure out who exactly all those suppliers to suppliers to suppliers actually are.

**Bentley Kaplan**

Right. And, of course, supply chains are these infinitely complex things, the bigger the company, the more complex it gets. I think what really spoke to me about this trend, and I think we bring it out well in the paper, is how these supply chain risks are not only about something very specific, they extend into both environmental and social risks for different companies and sometimes, in some cases, both risks at the same time. So maybe you could just take us through the environmental and the social side of these supply chain risks.

**Liz Houston**

Okay, so I'll start with the anti-deforestation law, and it's December, so I'm going to illustrate this by talking about chocolate, but there are lots of other foodstuffs and commodities this could apply to. So, this new law means that companies selling chocolate in the EU will have to prove it didn't come from deforested land, really prove it as well. Not just like, "Well, my supplier pinky promised me and I have a receipt." No. We're talking more like, "Here's some satellite imagery showing the precise geolocation where my cocoa beans were grown."

Anyway, the point is most companies are miles away from being able to do this right now. When we checked, less than one in 10 were tracing their cocoa. So there's a big business opportunity for anyone who can come in with the technology to solve this problem in the coming year. Something to think about while you're eating your body weight in chocolate coins.

Then the social side. So the target here for a lot of regulators is modern slavery. And this isn't just the EU this time, this is happening in lots of different places. Now, laws against modern slavery aren't a new thing, but what is new is what's being asked of companies. So not carrying out proper due diligence could mean goods being stopped at the border or it could mean a major lawsuit. And again, it comes back to that question of traceability.

**Bentley Kaplan**

Yes, traceability. It's been a nagging challenge, but it's quickly moving from the "nice to have" column, into the "have to have" column, as we see this sort of regulatory ratcheting. And we see this drift across a few different macro themes – not only supply chain traceability – where things that were previously just about more values-based investing, are becoming either mandatory, or rolled up into financial relevance. Biodiversity is another example of that, and it makes a great end in the Trends paper, as trend number eight, which we call "Investing in Nature".

And maybe not as controversial a confession as your brief stint at WorldCom, Liz, but in my life before ESG and sustainability, I was quite attached to the world of conservation. And when I made a move into the financial sector, it really felt like this massive sideways leap, back then, heading kind of into this totally different landscape. But now you have the situation where you have these two very different worlds sort of carefully looking to connect as investors are looking for ways to measure, not only the impacts of companies on nature, but the risks that they face from nature impacts. And these early steps are tricky, for sure. In September, the Task Force on Nature-Related Financial Disclosures, or the TNFD, released its final recommendations and a framework for how companies can assess and disclose and then manage nature-related risks and impacts.

But it's a well-worn phrase that you can only manage what you can measure. And when it comes to nature and biodiversity, it's this measurement that can be really, really tricky because, unlike for climate change, there isn't really a carbon emissions type equivalent for nature that can draw such a bold line between companies and their impacts. And this is something we looked at for this trend, and you're not going to remember this one in a hurry, but the metric we're talking about is the potentially disappeared fraction of species, or PDF, and it's basically a way of rolling up land use and water consumption and greenhouse gas emissions into a single metric. And that metric is there to tell you how much species extinction a company is responsible for. And looking across different sectors, what we saw was big disparities, these very big differences with something like utilities having a much higher PDF value than something like, say, real estate. So more of a potential contribution to species extinction.

**Liz Houston**

Okay. So I hear you that it's complicated, but let's say for the sake of argument that we do have a new metric, like a biodiversity equivalent of carbon emissions. What does that give us or what does that give investors rather?

**Bentley Kaplan**

Yeah, you can only manage what you can measure, and once you figure out the measurement, then the work really starts. And that's very true for biodiversity. And the same questions would hold for this as would for climate investing. Are you looking to limit a company or portfolio externalities? Are you looking to limit exposure to risks from biodiversity loss? Are you trying to identify potential engagement opportunities?

And we look at two different avenues that some investors are looking at to target in terms of their investments in biodiversity and nature. One of them is debt for nature swaps, these are quite interesting. These are deals that see debt discounts or relief being exchanged for commitments to finance land and marine conservation measures. And then the other part we look at is coming from investments into the voluntary carbon market through nature-based projects. And a shout out to MSCI Carbon Markets for this one, known until pretty recently as Trove Research, and the team there has been collecting some very interesting data on investments in nature-based projects and carbon credits.

And this includes assessments of the integrity of thousands of different projects in terms of their positive impacts on both nature and climate and investments here are being made by asset owners, institutional investors, corporate investors, and fund managers. So it really is quite a broad collection that are taking an interest in these types of investments. And to be honest, a lot of the space is super new. So it's going to be very interesting to see, in 2024, how this rolls out, especially given the volume of companies that have included some type of offset in their net zero strategies.

And to be honest, I could keep going and would really love to waffle through another three or four trends, but really I think I'd fall short of the trends paper itself. So, I think this might be a good place to end off with a hastily tied bow and hopefully we've given everyone a taste of what's ahead in 2024. So, without further ado, Liz, thanks for joining today and for sharing, especially given how newly minted the paper is and how badly we both need a holiday.

**Liz Houston**

Thank you very much for having me, Bentley. It was a pleasure.

**Bentley Kaplan**

And that is it for the week, and almost it for the year. A massive thanks to Liz for joining me on this episode. There are too many authors to thank for their hard work on this year's trends paper, but if you want to find out who's behind all this research, download the paper for free from MSCI.com and see how we think the year ahead is going to unfold with an ESG twist.

Thank you very much for tuning in. This is going to be my last episode of 2023, and it has been a wild, exciting, and challenging year. We should be able to sneak in one more episode next week before the ESG Now team officially calls it quits and starts prepping for the year-end parties. And in the meantime, wishing every listener a great end to your year and an even better one to come.

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