July 2021

Climate change as a critical issue

Half-Time to COP26: Climate Pressures Accelerate in 2021

This year has seen a number of major new developments on the climate change agenda, as pressure on businesses from financial, political, and societal stakeholders has accelerated.

With climate change firmly established as a critical issue for companies, this note provides an update on the key ways in which climate pressures are being manifested, including:

- **Increased ambition from governments on climate targets and policy**
- **International moves towards new disclosure requirements for companies**
- **Landmark investor activism cases**
- **Significant cases of climate litigation**
- **Increased ambition and action from companies**

Altogether, these developments highlight an increasingly complex set of risks which companies must navigate relating to climate. With further scrutiny and new announcements expected in the run-up to the major international climate summit, COP26 (which will be held in Glasgow, UK, 1st – 12th November), a robust and comprehensive climate strategy is increasingly a requirement for corporates seeking to build trust across political, societal, and financial stakeholders.

Increased ambition from governments on targets and policy

Greater ambition from governments on climate targets, including the United States

This year, several major economies have substantially increased the level of ambition for their climate targets – known as 'Nationally Determined Contributions' or NDCs – in the run-up to COP26. Significantly, this included the United States, which announced a new commitment at President Biden's Climate Summit in April.

A key focus for policy makers was increasing the ambition for short-term targets for 2030, which will need to be implemented through policy and spending decisions shortly.

Important new government commitments to reduce greenhouse gases include:

Country	Commitment
U.S.A.	50-52% reduction in emissions by 2030, below 2005 levels
Japan	46% reduction in emissions by 2030, below 2013 levels
Canada	40-45% reduction in emissions by 2030, below 2005 levels
U.K.	78% reduction in emissions by 2035, below 1990 levels
EU	55% reduction in emissions by 2030, below 1990 levels

Increasingly, the public conversation has shifted to what it will take to deliver on these commitments. To put the United States' proposed emission cuts in context, reaching the new target means accelerating reductions to 5% per year – or roughly half the estimated drop resulting from the pandemic last year, compounded each year for a decade. Achieving this will require significant interventions and changes across the economy.

G20 signals support for a carbon price for the first time

At the Venice International Conference on Climate in July, G20 finance ministers for the first time signaled collective support for carbon pricing, indicating that it should be one of "a wide set of tools" to tackle climate change. This marks a significant shift as the idea of carbon pricing has been contentious, with many commentators having suggested that international political consensus on the issue was unlikely. Some form of carbon pricing already covers 21.7% of global emissions; however, pricing levels vary widely and are not significant enough to curtail emissions in many geographies.

For the moment, this is an expression of political support rather than a detailed policy proposal. But given the rapid cuts in emissions demanded by the climate targets set by many of the G20 governments, policy makers could start to move quickly to assess how to impose a carbon price. Many economists have long argued for such an approach, as it is theoretically the most efficient way to incentivise an economy to reduce emissions – avoiding the need for bespoke regulation to cover many different industries.

EU moves to launch carbon border adjustment tax, expected to raise €9bn

A leaked copy of the legal text still under discussion indicates that the EU scheme will raise an estimated €9bn a year in taxes on carbon-intensive imports once fully operational by 2030. The European Commission intends to introduce the tax gradually starting in 2023 to allow businesses a "transitional" period to adjust and ensure "the least burden possible on trade flows and trade operators."

This will raise the import costs for certain sectors, including initially iron, steel, cement and fertilisers, from high-carbon economies. And as the scheme will only apply to companies in countries without a carbon pricing scheme, it is also expected to act as an incentive for non-EU countries to impose their own schemes, while providing a potential blueprint for other geographies to develop similar measures.

But the world still remains on an unsustainable path

Despite the increased ambition from governments, there still remains a gap in ambition and delivery.

The UN's NDC Synthesis Report, published last December – before some of the updated commitments - concluded that 'the current levels of climate ambition are not on track to meet our Paris Agreement goals'. This conclusion would remain true even after the new commitments in 2021.

Additionally, there is a gap between commitments and action. As bp's Statistical Review of Energy noted in July, "The Paris agreement was met with huge hope and optimism, but that hasn't yet been reflected in a marked improvement in the actual emissions data. ...The COVID-induced fall in carbon emissions last year put emissions closer to the 2-degree pathway, but there is a good chance that much of that dip proves transitory. Hope and ambition need to be translated into tangible, concrete differences."

International moves towards new disclosure requirements for companies

Growing international support for mandatory climate risk reporting for companies

In late 2020, the UK became the first major economy to require businesses to disclose their climate risks through the Task Force for Climate Related Financial Disclosures (TCFD) framework.

This July, the G7 as a whole committed to "moving towards mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants" based off the same TCFD framework. This means that businesses must regularly disclose climate-related information on their organisations, centered around the four thematic areas of governance, strategy, risk management, and metrics/targets. The commitment does not yet have a timeframe but is expected to be developed in the run-up to COP26 in November. Furthermore, Yi Gang, the Governor of the People's Bank of China, has confirmed that China plans to introduce "mandatory disclosure of climate-related information."

These developments will increase pressure on companies to collect, disclose, and account for the physical and transition risks relating to climate. This provides an opportunity for differentiation as investors are increasingly focused on how companies disclose and manage these risks.

Landmark investor activism cases

Two high-profile cases put climate-related shareholder activism firmly on the agenda with significant defeats for established companies in the oil and gas sector.

Exxon Mobil:

In May, small activist hedge fund Engine No. 1 successfully waged a battle to replace three Exxon board members with its own candidates to help drive the oil company towards a lower carbon strategy. Engine No. 1 owned just 0.02% of Exxon stock, but it won the support of major shareholders including BlackRock with a pitch focused on how the existing strategy was not delivering adequate shareholder returns.

Chevron:

Dutch campaign group and Chevron shareholder, Follow This, proposed a resolution to encourage the U.S. oil company to reduce all of its emissions. Sixty-one per cent of shareholders voted against the company's board, voting in favour of the activist proposal. The result followed victories for the Dutch activist group earlier in the month at the annual meetings of ConocoPhillips and Phillips 66, where shareholders approved similar resolutions.

Significant cases of climate litigation

Judgements in the Netherlands and Germany marked a new era for climate litigation, with major successes for activists over both company and government action on climate.

Germany: litigation v. the Federal Government

In April, Germany's supreme constitutional court ruled that the government's climate protection measures were insufficient to protect future generations after a complaint brought by environmentalist groups including Fridays for Future and Greenpeace. As a result, the government has until the end of 2022 to improve its Climate Protection Act, passed in 2019, and must meet its 2030 greenhouse gas reduction goals faster. The ruling rested on the argument that it is unconstitutional for emissions-reduction targets to have been postponed for so many years, also arguing that the existing laws did not provide sufficient detail on the government's planned emissions-reduction pathway.

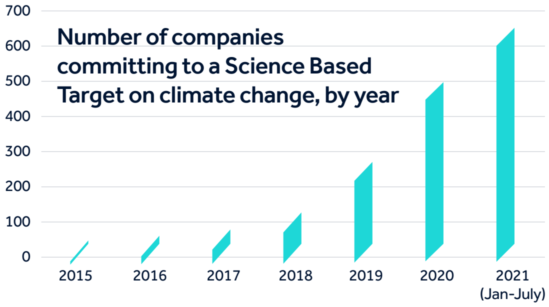
The Netherlands: litigation v. Royal Dutch Shell

In another landmark case, a Dutch court ruled that Royal Dutch Shell was about to breach its human rights obligations to reduce carbon emissions and ordered the company to reduce its emissions in line with the 2015 Paris Agreement (despite not being a party to the agreement), including cutting emissions 45% by 2030 compared to 2019 levels. The court found that Shell's existing carbon mitigation strategy was "not concrete and is full of conditions... that's not enough." Shell had previously said it would reach net zero emissions for itself and from products used by its customers by 2050 and has promised to appeal the judgement.

New ambition and action from companies

Significant increase in corporate net zero commitments

This year has seen a dramatic increase in the number of companies committed to aligning their businesses to net zero, through the Science Based Targets initiative – the leading standard for climate target-setting. There are now more than 1,600 businesses with commitments, with 660 joining in 2021 so far (more than 1.5 times the number which joined in the whole of 2020).



Source: https://sciencebasedtargets.org/

Launch of the Glasgow Financial Alliance for Net Zero

Mark Carney, the former Governor of the Bank of England, launched the Glasgow Financial Alliance for Net Zero (GFANZ) in April, to bring together existing and new net zero finance initiatives into one sector-wide strategic forum. Its goal is to raise the bar on climate action, driving the entire financial sector – asset managers, asset owners, banks, insurers – to set credible net zero targets, while supporting coordination and collaboration across the sector to overcome shared challenges and unlock the trillions in financing needed to fund the net zero transition. GFANZ launched by bringing 43 banks from 23 countries, with assets of $28.5 trillion, into the fold. New commitments from asset managers since means that as of July, $43tn in assets, or almost half of the asset management sector globally in terms of total funds managed, are committed to a net zero emissions target.

What's Next?

The acceleration in momentum on climate change is placing corporate decarbonisation strategies in the crosshairs of investors and civil society. There is particular concern regarding 'greenwashing' given that net zero pledges have, thus far, not stimulated the rapid greenhouse gas reductions required for alignment with the Paris Agreement. According to the Transition Pathway Initiative, only 17% of the world's high-emitting companies are aligned with a pathway to keep temperature rises below 2°C by 2050.

Similarly, new analysis from MSCI of ~9,000 listed companies and their emissions suggests that the world will exceed its 'carbon budget' – the amount of greenhouse gases that can be emitted to keep global warming below 1.5°C - by 2026. This has underlined the current significant gap between ambition and emissions reductions.

Following the greater scrutiny, investors such as BlackRock have issued guidance that companies disclose plans for how their business model is compatible with this a 2°C pathway, with clear interim targets to signpost their journey, and couple action with accurate and transparent annual reporting activities. This is underscored by civil society, such as at an event at London Climate Action Week organised by the UN High Level Climate Champions which brought together a number of senior NGO figures. A key area of concern was the need for greater focus on the delivery of net zero targets – with a shared concern that poor- or low-quality targets are undermining the credibility of the principle of net zero targets. As a result of these forces, we are expecting greater scrutiny of the short-term actions and targets corporates are setting as part of long-term ambitions to reach net zero.

Brunswick's Climate Hub brings together senior expertise from across the connected worlds of finance, policy, and society, to help companies engage meaningfully with the full range of stakeholders on climate change.

Our ambition is to help clients play a successful role in the transition to a resilient, zero-carbon world.

https://www.brunswickgroup.com/climate-hub/

Brian Potskowski
Partner, London
bpotskowski@brunswickgroup.com

Phil Drew
Partner, London
pdrew@brunswickgroup.com

Kathyrn Casson
Director, London
kcasson@brunswickgroup.com

Ruairidh Macintosh
Associate, London
rmacintosh@brunswickgroup.com

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Brunswick Group
16 Lincoln's Inn Fields
London WC2A 3ED
United Kingdom

+44 (0) 20 7404 5959
londonoffice@brunswickgroup.com

BRUNSWICK