BRAND WATCH
Oliver Balch reports on how 'water-positive' is the new net-zero

ESG WATCH
ESG investors turn up the heat – and feel it themselves, writes Mike Scott

POLICY WATCH
Angeli Mehta reports on John Kerry's failed climate diplomacy mission to China

INTERVIEW
Science Based Targets initiative's Alberto Carrillo Pineda speaks to Oliver Balch

THE SUSTAINABLE BUSINESS

Review

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September 2021

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Hopes for success at COP26 dim despite alarm raised by IPCC

This summer's dire IPCC report, warning of the fast-closing window to avoid planetary catastrophe, came amid rapidly growing evidence that climate change is already having unpredictable and deadly impacts. The flash floods in four north-eastern U.S. states, which killed dozens, is only the latest in a series of extreme weather events of near-biblical proportions this past summer.

With November's COP26 climate conference, where countries will be urged to sign up to rapidly reduce their emissions by 2030, just weeks away, the alarming backdrop must surely mean global leaders will strain every sinew to make the Glasgow summit a success.

But as Angeli Mehta reports in her Policy Watch column this month, Joe Biden's climate envoy, John Kerry, left empty-handed from his trip to China at the beginning of this month to try to persuade the most polluting nation to rein in its coal consumption and set more ambitious emissions reduction targets.

It remains to be seen whether COP26 president Alok Sharma's trip to China three days later, will be any more successful.

It can't help that the U.S. and the UK are both showing reluctance to wean themselves off fossil fuels, with the latter likely to give the go-ahead to a new oil and gas development west of the ›

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MIKE SEGAR/REUTERS

Tropical Storm Ida caused flash flooding in the north-east of the U.S.

Shetland isles. All this flies in the face of the IEA's recent report saying there can be no new fossil fuel development if the world is to keep on a 1.5C pathway by 2050.

In Brand Watch Oliver Balch reports on how recent natural disasters have helped prod brands to target water security as part of their climate response, with Facebook and PepsiCo the latest to commit to becoming "water-positive". And he looks at how the pandemic has exacerbated the pay gap.

In ESG Watch, Mike Scott reports on the response of investors to the IPCC report. Among other developments, a consortium of financial firms backed by the Asian Development Bank is devising plans to speed the closure of Asia's coal-fired power plants. Ceres has launched a new initiative focused on decarbonising six of the highest-emitting sectors in the U.S.

He also reports that asset managers are struggling to get to grips with the EU's new Sustainable Financial Disclosure Regulation, and investigations by regulators in the U.S. and Germany into claims by a former DWS employee that it made misleading claims for its ESG products.

Finally, in our monthly interview slot, Oliver Balch sits down with Alberto Carrillo Pineda, co-founder of the Science Based Targets initiative, to talk about how the SBTi is aiming to boost companies' role in addressing the climate crisis with the planned launch of a new net-carbon standard.

I hope you enjoy this month's issue of The Sustainable Business Review.

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5 Canada Square, Canary Wharf, London, E14 5AQ

Editor-in-chief: Terry Slavin

Sub-editor: Karen Luckhurst

Contributors:
Angeli Mehta
Oliver Balch
Mike Scott

Editorial:
terry.slavin@thomsonreuters.com

Advertising, sales and event opportunities:
Matt Buckingham
matt.buckingham@thomsonreuters.com
+44 (0) 207 536 7242

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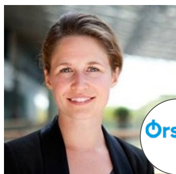
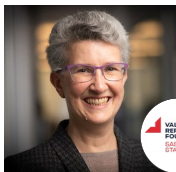


IDA KRABEK
Head of Global Sustainability
Orsted

CLARA BARBY
Project Lead
IFRS Foundation

RICK LACAILLE
EVP & Global Head of ESG
State Street



JANINE GUILLOT
CEO
Value Reporting Foundation

ALAIN DECKERS
Head of Unit, Corp Reporting, Audit and Credit Rating Agencies
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POLICY WATCH

ALY SONG/REUTERS

A TV in a Shanghai restaurant shows footage of U.S. Special Presidential Envoy for Climate John Kerry's visit to Tianjin.

China rebuffs Kerry as IPCC raising stakes for success in Glasgow

Angeli Mehta reports on the backdrop for the latest round of failed U.S. climate diplomacy with China

COP26 is almost upon us. Will August's truly frightening report from climate scientists, alongside ample evidence in a summer of extremes, focus minds enough on the actions needed to save us from ourselves?

The IPCC's latest assessment shows that it's not game over – we still do have a good chance to limit average warming to 1.5 degrees. But only if political leaders take steps to ensure a rapid reduction in emissions by 2030, ahead of net zero in 2050.

Angeli Mehta
Policy correspondent

John Kerry, the climate envoy for the world's second most polluting nation, was in China last week to try to persuade the most polluting nation to rein in its coal consumption and set more ambitious emissions reduction targets.

But the dire political tensions between the two overshadowed his efforts, and he left empty-handed. Whether COP26 president Alok Sharma – who arrived in China ❯

POLICY WATCH

on Kerry's heels – can be any more successful remains to be seen. Observers told Reuters they did not expect China to alter its current trajectory of allowing coal consumption to rise further until after 2025.

And it is not just China that is finding it hard to kick the fossil fuel habit: the U.S. wants increased oil production to lower prices for its consumers.

It seems to be a hard task, too, for the COP26 host. Just as UK businesses are being urged to sign up to net zero ahead of the Glasgow conference, the government looks likely to give the go-ahead to a new oil and gas development west of the Shetland isles. The industry argues that without new drilling, the UK will be even more dependent on oil and gas imports with no control over the emissions associated with their production. The UK sector has a plan to cut its production emissions as well as those of methane. This powerful but relatively short-lived greenhouse gas will be the subject of much discussion at COP26 because rapid cuts are needed to keep alive hopes of limiting warming to 1.5 degrees.

The UK has also delayed making a decision on how it will decarbonise homes and businesses and make them more energy efficient – a mammoth task expected to require £100bn of capital this decade. A strategy is expected this month.

Buildings are the second largest source of emissions (after transport), although the National Housing Federation recently estimated that England's 25m homes emit more CO_2 than are produced by their occupants' cars – underlining the urgency and scale of the task.

Britain's energy regulator, Ofgem, launched a £450m fund for new ideas that can scale to decarbonise heat, power and transport in Britain.

DAVID GRAY/REUTERS

China is under pressure to rein in coal consumption.

The money will come from the network charges that are levied on consumers of gas and electricity – roughly around 25% of an average bill. Ofgem envisages lots of projects will be funded for two months before whittling options down.

The government hasn't ruled out using hydrogen to heat homes. Last month it published a plan that keeps options open on where hydrogen could be deployed – in hard to abate industrial sectors, and in heating – in a bid to build both supply chains and the demand required to bring costs down. It is considering whether to support blending hydrogen in the gas grid, which would create early demand, even if not a substantial solution in the longer term – given that the falling cost of renewables makes electrification a stronger contender. Adding 20% hydrogen to the grid across the UK would cut CO_2 emissions by 6m tonnes a year, say advocates. Trials are under way.

The strategy envisages 5GW low-carbon hydrogen capacity by 2030 in industrial clusters and aims to attract £4bn of investment. Earlier this year a consortium of 60 businesses said they stood ready to invest £3bn in hydrogen projects and urged the government to set a more ambitious target than 5GW.

The Scottish government has already set out its aim for at least 5GW of hydrogen capacity by 2030, capable of producing 27 terrawatt hours (TWh) of energy – the equivalent of almost 30% of the UK's 2019 industrial energy demand.

Westminster is pursuing a "twin track approach" that will support multiple technologies including producing so-called blue hydrogen made from methane, with carbon capture and storage (CCS), or by splitting water molecules using renewable energy (green hydrogen). ›

POLICY WATCH

WILLY BARTON/SHUTTERSTOCK

UK homes are responsible for more emissions than their occupants' cars.

Blue hydrogen is not zero-carbon. The government's climate adviser, the Climate Change Committee (CCC), says in order to qualify for support, blue hydrogen should demonstrate at least the potential 85% life cycle emissions saving it estimates is possible, compared to unabated fossil gas.

The government is consulting on a low-carbon standard that any producer seeking its support would have to meet, as well as working internationally to make sure a global market is based on common standards.

Environmental groups have strongly criticised the inclusion of blue hydrogen, because they fear it will lock in consumption of fossil fuels. Indeed, in its latest economic report the UK's offshore oil and gas industry body, OGUK, argues new investments are needed to help unlock other low carbon energy sources so the "full scale of the government's hydrogen strategy can be embraced".

Similar arguments are being aired in the EU, but the Commission has set its sights on 6GW of electrolyser capacity by 2024. Last month, Germany agreed a deal to invest €40m in green hydrogen production in Namibia. The country is home to abundant wind and solar resources but lacks water, so will have to rely on desalinated seawater – adding to production costs.

Norway-based consultants DNV forecast that green hydrogen will dominate over time. However, even if all electricity is "green" from now on, we still won't achieve net zero by 2050. DNV's analysis suggests hydrogen will scale only in the late 2030s – which is too late for hard to abate sectors such as shipping, and aviation. CCS development needs to happen faster and that requires policy.

In its advice on the UK's sixth carbon budget, the CCC recommended a blue hydrogen bridge, to supplement electrolytic hydrogen. This would reduce emissions more quickly in the short term and develop a role for hydrogen across different sectors. But the CCC wanted the government to set out its vision for the balance between the two – something it failed to do. To meet its net-zero target, the CCC says government will have to reduce the contribution from blue hydrogen by the late 2030s.

In a statement, David Joffe, head of carbon budgets, described the strategy as a "step forward on the path to net zero" but added that "concerns remain around how the UK will go further to reduce emissions from gas-fired powered generation, and we also need clarity on the strategy for decarbonisation of heat for buildings. The next step for the UK government is joining these strategies together to form a comprehensive plan to reach net zero."

THE NUCLEAR OPTION

While many eyes are on hydrogen, nuclear is at a crossroads suggests energy analyst Wood Mackenzie. China is pressing ahead with nuclear – aiming to have 70GW of capacity by 2025, by building plants around the coast.

In Europe opinion is divided, with Belgium intent on closing its nuclear plants by 2025 and replacing them with gas power plants just as the bloc has signed up to a 55% reduction in emissions by 2030. In eastern Europe, nuclear may be a bridge from coal.

The European Commission is being urged by parliamentarians, and energy and nuclear workers' trades unions, to include nuclear in the sustainable finance taxonomy ❯

POLICY WATCH

that is intended to guide investors on the green credentials of economic activities. (See Policy Watch: Biden climate summit long on vision but short on 'how' of getting to net-zero)

In Japan, where the Fukushima disaster of 2011 dented confidence well beyond its shores, some nuclear plants are being switched back on as the country seeks deeper emissions cuts. Its latest energy plan envisages 20-22% of energy will come from nuclear by 2030.

One sticking point around the world is how to deal safely and permanently with nuclear waste. Numerous projects have been stalled because locals don't want the stuff. Feelings are running high in the north of England, where proposals for long term storage are once more being discussed. Sweden has just agreed to expand its interim storage facility after plant operators warned they'd have to shut down reactors as the facility was almost full. Only Finland has begun to develop permanent storage.

Both UK and Welsh governments are interested in deploying small modular reactors on the journey to net zero. Proponents argue that they will be cheaper and safer than conventional reactors and balance the variability of wind and solar. Nuclear could also be used to produce hydrogen, for example on off-peak times. Such a dual strategy is also being examined in the U.S. and Canada, but whether it can be economically viable remains to be seen.

ISSEI KATO/SHUTTERSTOCK

Japan's latest energy plan envisages 20-22% of energy will come from nuclear power by 2030.

PROTECTING BIODIVERSITY

Before COP26, it had been hoped nations would sign off on a global treaty to reverse biodiversity loss by protecting 30% of the planet's land and oceans by 2030. However, the pandemic has forced a delay, so the talks (known as COP15) will be split into two parts – one virtual and the second face-to-face at Kunming in China next April.

But a working group has been listening to arguments and questions from governments and NGOs about how the targets can be practically implemented; how new and existing protected areas can be managed more effectively; where protected areas should be located to deliver biodiversity and ecosystem benefits; and how to ensure indigenous peoples and local communities are "in the driving seat" when it comes to designating and managing them.

Like the climate negotiations, another issue is funds. Working group co-chair Francis Ogwal told journalists: "We need them to be in an amount that is commensurate with the ambition that we'll come up with." Access to funding and the speed of disbursement are also going to be key, he added.

Success next year in Kunming now depends on the climate talks in November.

"If climate change is in excess of 1.5 degrees, it's going to be very difficult to bend the curve on biodiversity loss. So we need a very successful COP26 to deliver on what was agreed in Paris. And then in addition, biodiversity can contribute to that effort," said David Cooper, the Convention on Biological Diversity's deputy executive secretary.

The stakes in Glasgow this November could not be higher.

BRAND WATCH

Facebook and PepsiCo commit to becoming 'water-positive' as climate crisis hits home

Oliver Balch reports on how recent natural disasters have prodded brands to target water security as part of their climate response, and how the pandemic is deepening the pay gap

VIEW ONLINE

PEPSICO

Oliver Balch
Sustainable business correspondent

"Building resilience faster", the tagline for this year's World Water Week, could not have been more apt. Losses from Germany's flash floods a few months ago could hit almost $6bn, for instance, while insurers in the U.S. will be totting up the cost of the recent floodwaters from Hurricane Ida for some time to come. As UN Water warns, progress will need to double – and in some cases quadruple – if the global goal of providing "clean water for all" by 2030 (SDG6) stands a hope of being achieved. According to the agency's latest progress report, one in 10 people lives in (invariably poor) countries experiencing high or critical water stress. Such a scenario "significantly affects" economic activities, agricultural production, and food security, UN Water concludes.

The key word, however, is "building". Water security won't happen of its own accord. So, who is taking action? And what role do brands have to play? As with all UN events, pre-conference announcements proliferated. Facebook (one of 10 core World ›

BRAND WATCH

Water Week sponsors) and PepsiCo both announced intentions to become "water-positive" by 2030. Neither is starting from scratch. In the case of the U.S. social media giant, investing in state-of-the-art cooling and humidifying systems in its data centres has already pushed its water efficiency by 80%.

On the supply side, meanwhile, it is operating watershed regeneration projects in six drought-prone U.S. states where its facilities are based – including its home state of California. For its part, PepsiCo has been working on water stewardship for well over a decade. In 2020 alone, it replenished local water sources to the tune of 2.3bn tonnes of fresh water.

The notion of net water positive draws from business accountancy 101: in short, revenues (in this case, water regenerated) must exceed expenditure (water use) to be viable. It's a similar logic to net zero with carbon, albeit with two significant differences. First, with water, geography matters. One tonne of carbon is the same anywhere in the world; the atmosphere doesn't care. In contrast, the value of water differs hugely from place to place. One litre in the Gobi desert, in other words, is not the same as one litre in the Amazon rainforest. Second, while most carbon targets settle with a neutral balance between carbon emitted and carbon stored (through photosynthesis, typically), water commitments are increasingly expressed as a net positive: more water replenishment than consumption.

Nevertheless, in both carbon and water the emphasis is on reduction before mitigation/replenishment. PepsiCo reports a 15% increase in operational efficiency in water-risk areas since 2015, and a 14% improvement in its agricultural supply chain since the same date.

THILO SCHMUELGEN/REUTERS

Losses from Germany's flash floods in July could hit almost $6bn.

To hit its positive 2030 target will require a 50% reduction in water use, the brand calculates.

And as with carbon strategies, the replenishment piece relies heavily on two factors: hard investment in technology and infrastructure, and the creation of novel partnerships. Neither Facebook nor PepsiCo publishes the totality of their anticipated water-related investments, but as a barometer, PepsiCo has spent £53m over the last 15 years. As for partnerships, these are organised on a watershed-by-watershed basis, although PepsiCo works closely with WaterAid in Africa to meet its commitment to provide 100 million people with safe water by 2030.

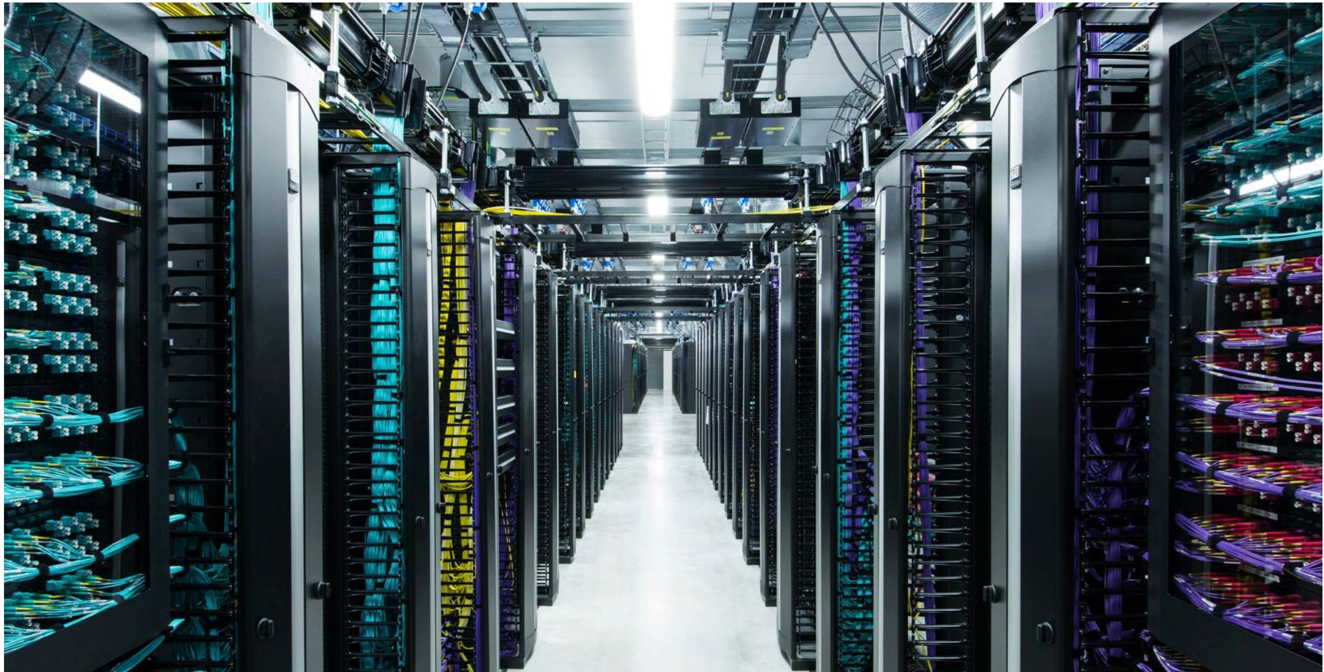
Robustness is another parallel concern. Brands with net-zero commitments are increasingly in the spotlight for using offsets to justify continuing to emit high volumes of emissions. Likewise, question marks hover over corporate water commitments. While "water-positive" targets are not nearly as ubiquitous as net-zero goals (Microsoft and BP are two other notable water positivists) they are increasing amid growing pressure on companies to address the biodiversity crisis as well as climate change.

A case in point is cement giant Holcim's announcement this month that it has struck a partnership with the International Union for Conservation of Nature to deliver a net-positive impact on biodiversity by the end of the decade, including a target to achieve water positivity at 75% of its sites, prioritising those facing high levels of water risk.

But talk of "water stewardship" is far from new in business circles. Way back in 2007, for example, the UN Global Compact set up its CEO Water Mandate with a goal of reducing water stress. The business-led initiative currently counts 203 members, including Coca-Cola, Gap, and Heineken. Yet, analysis by the disclosure specialist CDP still finds that over one-third of companies are failing to reduce and possibly even increasing their water withdrawals. That's despite cumulative risks of $301bn identified by those companies that report to it.

Both Facebook and PepsiCo use the World Resources Institute's Aqueduct Water Atlas to assess which of its sites face substantial ›

BRAND WATCH


FACEBOOK

Facebook has invested in cooling systems in its data centres that have pushed water efficiency by 80%.

water risks. (PepsiCo's publicly available submission to CDP reveals 99 such sites, accounting for more than one fifth of its total). PepsiCo is also one of 97 private-sector members of the Alliance for Water Stewardship, which provides a universal standard for designing and implementing good water stewardship projects. The U.S. beverage giant has committed to adopt the standard in all its high-water risk areas by 2025. Facebook, meanwhile, uses an independently verified accounting methodology developed by the World Resources Institute to measure the impact of its water restoration projects.

"What is needed now is to link local actions to robust global targets and disclosure that can accelerate and scale systemic change," says Joe Phelan, who directs the operations of the World Business Council for Sustainable Development in India.

Phelan cites a list of top 10 action areas for business relating to water sustainability (published as part of WBCSD's recent Vision 2050 strategy). These include establishing appropriate water targets, and strengthening corporate disclosure of water-related dependencies and impacts.

During World Water Week, CDP launched a first-of-its-kind tool to help brands assess the potential impact of their portfolios on water resources and water security. The Water Impact Index can also be used by investors to evaluate water-related risks in their portfolios (note: risk levels in the textile, clothing, pharmaceutical, and farming sectors are judged "critical"). PepsiCo will be alert to a research note by UK bank Barclays back in June, which maintained that the global consumer staples sector faces a $200bn impact from water scarcity.

The most obvious overlap between net zero and water-positive commitments is at a practical level. Natural disasters caused by climate change manifest themselves through water nine times out of 10 – be it rising sea levels caused by melting icecaps, floods due to freak storms, or severe drought when aquifers dry up and springs run dry. On the flipside, investment in areas such as wetland conservation or the restoration of coastal seagrasses (so-called seaforestation) can have the dual effect of making water systems more resilient while also curbing climate change. As PepsiCo's chief sustainability officer Jim Andrew succinctly puts it: "Water scarcity is directly linked to the climate crisis."

Drawing on insights from World Water Week, the International Water Management Institute pulls out five key takeaways. The last cites the need to "amplify the discussion" beyond the water community. If ever there was a role for brands, it's that.

PANDEMIC DEEPENING PAY GAP

For years, diversity has been a nice-to-have. Brands make commitments and wax lyrical about the benefits of inclusion (which are multiple), but, as long as no active discrimination is occurring, they are essentially left to their own devices. ❯

BRAND WATCH

GEMPHOTO/SHUTTERSTOCK

FTSE 100 female directors earn 73% less than male colleagues.

The outcomes of such voluntarism are only too clear. The scene in the UK provides a case in point. New research released by the New Street Consulting finds that pay for FTSE 100 female directors is a staggering 73% less than their male counterparts. The pay gap points to an opportunity gap more than straight wage discrimination: nine in 10 (91%) female board members are non-execs rather than execs. The latest annual Green Park Business Leaders Index reveals similar findings, concluding that non-exec roles are "less likely to lead to the C-suite roles". Only around one in eight (12.2%) of the top three executive roles (CFO, CEO, and chair) in FTSE 100 companies are currently occupied by women.

Under-represented groups have been hit disproportionately hard by the pandemic, a reality found to be true in more than half (55%) the companies recently surveyed by workforce solutions specialist KellyOCG. Yet, a small minority are flipping the trend, a group defined by KellyOCG as "vanguards". The survey finds that vanguard companies are nearly twice as likely as laggards (67% v 35%) to be actively executing strategies for diversity, equality and inclusion (DEI). In practice, this translates into ongoing career support for women and individuals from minority groups, DEI training and leader-oriented incentives for leaders, and clear channels for reporting discrimination.

It is not just internal comms that matters. Increasingly, brands are under pressure to inform regulators and investors about their progress on diversity, especially in the U.S. Last November, for example, new rules from the Securities and Exchange Commission (SEC) obliged companies to disclose "material" workforce information. Yet 57% of companies still include no quantitative metrics in their DEI statements, according to a study by Stanford Business School back in May. Democrats in the new Biden Administration are now putting pressure on the SEC to tighten its requirements.

Such calls follow the SEC's recent approval of new rules from Nasdaq that oblige companies listed on its exchange to have at least two diverse board members, plus a board-level diversity committee (or to explain why not). In a similar move, New York's Department of Financial Services wrote a 3,800-word letter requesting banks operating in the city "to make the diversity of their leadership a business priority and integrate it into their corporate governance". Citing evidence from consultancy McKinsey on the positive link between diversity and profitability, the city's banking regulator says it "strongly encourages" banks to disclose DEI data.

Pressure to provide consistent, comparable DEI data suggests a growing awareness on the part of investors that diversity rates affect the bottom line. Last year, BlackRock clarified boardroom diversity as one of its key "stewardship" priorities, for instance. Legal & General Investment Management, meanwhile, the largest fund manager in the UK, has given U.S.-based S&P 500 and FTSE 100 companies until January 2022 to have at least one Black, Asian or other ethnic minority on their boards. Failure to do so will see the UK fund manager vote against the re-election of their nomination committee chairs. California-based public corporations are required under law to achieve board diversity targets by 2023.

Brands are often reluctant to go public with their DEI performance for fear of criticism. Yet, admitting shortcomings is not a sign of failure, writes the U.S. writer and activist Simran Jeet Singh in the Harvard Business Review. Instead, he argues, "doing so demonstrates a willingness to reflect and a commitment to move forward with a revised plan of action". Anything else is tokenism. ●

ESG WATCH

Investors put more weight behind ESG, but face mounting scrutiny

In this month's round-up, Mike Scott reports on a new coalition to speed up Asia's exit from coal, Ceres's Ambition 2030 initiative, and greenwash probes into DWS

Mike Scott
ESG Correspondent

FRED GREAVES/REUTERS

As the summer draws to a close, all eyes are turning towards Glasgow in the run-up to the COP26 climate talks. As the summit approaches, investors continue to challenge companies to strengthen their ESG credentials at the same time as they are facing increased scrutiny themselves.

All of this takes places against the background of a summer of extreme temperatures from the west coast of North America to the Arctic and the Middle East, floods from Germany to Nigeria and India – and the publication of the latest report from the Intergovernmental Panel on Climate Change (IPCC), which bleakly sets out what UN Secretary-General António Guterres calls a "code red for humanity".

"The facts are clear: human-induced climate change is indisputable, it affects every region on our planet, and strong, rapid reductions in greenhouse gas emissions are needed to curb warming rates," says Fiona Reynolds, outgoing CEO at the Principles for Responsible Investment.

"The financial services sector has a vital role to play in overcoming these challenges. We encourage investors to review their commitments to tackling climate change and to take action, by setting a net-zero target and supporting initiatives such as Race to Zero and the UN-convened Net-Zero Asset Owner Alliance."

Insurers are already starting to see the impacts on their bottom line, with the Swiss Re Institute reporting that severe weather events drove global insured catastrophe losses of $42bn in the first half of the year, the second highest figure on record.

Analysts at Société Générale suggest that insurers may want to accelerate their exit from coverage of the oil and gas sector, as 23 have for the coal industry. Doing so would increase their shareholder value, Société Générale argues in a new report Insurance ESG Big Picture. However, to date just one, Australia's Suncorp, has said it would not cover new oil and gas production.

Peter Bosshard, global co-ordinator for the Insure Our Future coalition of NGOs, says that insurers "have no excuse for enabling the continued expansion of fossil fuels".

In Australia, the Australasian Centre for Corporate Responsibility (ACCR) has stepped up its efforts to get Australia's fossil fuel producers to address climate change.

It is taking Santos, Australia's ›

ESG WATCH

YMGERMAN/SHUTTERSTOCK

A coal shipment makes its way along China's Yangtze river.

biggest domestic gas supplier, to court to challenge the company's claim that natural gas provides "clean energy" and that it has a "credible and clear plan" to achieve "net-zero" emissions by 2040. "This is the first court case in the world to challenge the veracity of a company's net-zero emissions target, and a world-first test case in relation to the viability of carbon capture and storage (CCS) and the environmental impacts of blue hydrogen," the group says.

The ACCR also attacked a deal in which Woodside Energy will buy oil and gas assets from BHP, which is seeking to to reduce its exposure to fossil fuels, calling it "a disastrous outcome for Woodside shareholders and climate".

On a positive note, Reuters reported last month that financial firms including British insurer Prudential, lenders Citi and HSBC and BlackRock Real Assets, backed by the Asian Development Bank, are devising plans, which they hope to unveil at COP26, to speed the closure of Asia's coal-fired power plants in order to lower the biggest source of carbon emissions.

And sustainable investment group Ceres has launched a new initiative, Ceres Ambition 2030, focused on decarbonising six of the highest-emitting sectors in the U.S.: banking, power, food, oil and gas, steel and transportation. Ceres aims to "set off a cascade of actions that will bring wholesale change in the highest-emitting sectors and stabilise our rapidly warming climate in the next decade".

EVER-EXPANDING ESG

There is growing evidence that the biggest investors are starting to throw their weight behind ESG issues, with BlackRock backing 64% of environmental proposals on shareholder ballots, up from just 11% the previous year.

Companies are coming under pressure, with ESG issues – which were almost never mentioned between 2005 and 2018 – being brought up in almost a fifth of calls (19%) in 2021, according to PIMCO.

DATA DRIVES CLIMATE ACTION

One of the drivers of increased shareholder engagement and activism is the growing amount of data available to help investors to make more informed decisions. New research from Orbitas, for example, shows that if the world meets the requirements of the Paris Agreement, up to 76% of unplanted palm oil concessions and 15% of current plantations could become stranded assets. The study highlights that transition risks are just as important for agricultural ›

ESG WATCH

companies as for those in energy and transport, the group says.

A new project from University College, Dublin, GreenWatch, has developed algorithms that use AI to help investors to detect and quantify greenwashing. "Companies are spinning one story after another," says Andreas Hoepner, a professor in banking and finance at University College, Dublin, who is overseeing the analysis. "If no one checks them, they can say what they want."

Meanwhile, CDP's first Water Impact Index highlighted the role of investors in financing the world's most water-intensive and polluting industries (See Brand Watch). According to CDP: "The flow of money from banks, insurers and asset managers into high-impact companies is enabling agribusinesses to pump ever increasing amounts of non-renewable groundwater, it is enabling tailings dams to be constructed at the heads of free-flowing rivers and it is enabling chemical, apparel and pharmaceutical companies to release toxic pollution, much of which is carcinogenic, posing a real and present danger to human health."

QUESTION MARK OVER HYDROGEN

But there is also a huge increase in investment in clean energy, with BloombergNEF reporting that new renewable energy projects attracted $174bn of funding in the first six months of the year, the highest ever first half total. One area that is attracting huge investor enthusiasm is clean hydrogen, where, according to BloombergNEF, "nearly everything has doubled already this year, and we expect the momentum to continue in the months ahead".

But Bloomberg lead hydrogen analyst Martin Tengler warns that "hydrogen's future as a major clean energy source is far from certain.

ANTARA FOTO/WAHDI SEPTIAWAN/REUTERS

If Paris Agreement requirements are met, up to 15% of current palm oil plantations could become stranded assets.

We'll need to see CO_2 prices of at least $100 per ton by 2030 to incentivise hydrogen adoption. No country has such carbon prices today, and we forecast only three markets to reach that level before 2030: Canada, the EU and the UK. It is no surprise then that the vast majority of announced large-scale demand-side clean hydrogen projects come from these regions." (See Policy Watch)

ETFS TARGET NEW NICHES

The breadth and depth of financial products and investments continues to expand and target a growing number of specific niches.

Among them, BNP Paribas Asset Management has launched an ETF that invests in the best-rated ESG performers in the Chinese market, while another new ETF, from Quickro, Tematica Research and HANetf, offers exposure to the growing trend towards "cleaner living" across five sectors – food and dining, health and beauty, buildings and infrastructure, transportation, and energy.

The Cleaner Living ETF highlights that it is Article 8-compliant under the EU's new SFDR (Sustainable Financial Disclosure Regulation), which was introduced to create more transparency around ESG investment and prevent greenwash. Article 8 covers lighter green financial products that "promote environmental or social characteristics", while the objective of Article 9 products is primarily to have an E, S or G impact.

NEW ESG RULES UNDER FIRE

However, it is clear that asset managers are still struggling to get to grips with the new rules and that some are being more diligent about applying the criteria than others. A Reuters study asked 20 of the biggest fund managers for a list of products they market as compliant with Article 8 or 9 of the SFDR. ❯

ESG WATCH

JASON LEE/REUTERS

A new ETF offers exposure to 'cleaner living' across five sectors, including food and dining.

Analysing the funds of the 14 firms that replied revealed that "some Article 8 products have limited claims to sustainability", such as those tracking conventional stock and bond indexes, investing in fossil fuels or buying debt from countries with weak ESG standards such as Saudi Arabia and Nigeria.

Reuters quoted analysis by Morningstar showing that a quarter of Article 8 funds are exposed to companies involved in controversial weapons and one in five to tobacco. A third of Article 8 and 9 funds have more than a 5% exposure to fossil fuel firms. The rules will be tightened up in 2022 and further guidance will be issued, but until then, firms have few limits on what they can dub as sustainable.

Asset managers need to be cautious about trying to paint all their funds with the sustainability brush, not least because of the SEC's launch of a Climate and ESG Enforcement Task Force to crack down on greenwashing. "It has become clear that the SEC views the disclosure of material environmental risks in the investor's best interest," according to Jefferies Equity Research.

The impact of this new approach, and the dangers of making unsubstantiated claims, have quickly become evident. Desiree Fixler, who was sacked from her job as global head of sustainability at DWS earlier this year, alleged that the asset management arm of Deutsche Bank misleadingly claimed that more than half of its $900bn in assets under management were invested using ESG criteria. This allegation is now being investigated by U.S. and German authorities, though DWS denies wrongdoing and stands by its annual report disclosures.

This month, DWS was also one of 125 successful applicants to be accepted as signatories to the UK's influential Stewardship Code after a revamp that set tougher new reporting requirements, including asking asset owners to provide evidence of how they were integrating environmental, social and governance factors into investment decisions.

Schroders, State Street and JPMorgan were among those applicants that failed to pass the review process.

Asked about the probes into DWS, Catherine Howarth, chief executive of ShareAction, the responsible investment charity, told the Financial Times: "I don't think DWS is the worst out there by any means. If DWS has this problem, then a lot of other asset managers have this problem."

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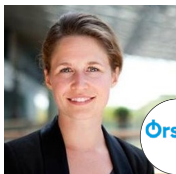

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INTERVIEW

'We have to get from net-zero to near-zero'

Oliver Balch talks to the Science Based Targets initiative's Alberto Carrillo Pineda about how the organisation is aiming to boost companies' role in addressing the climate crisis with the launch of a new net-carbon standard

JETCAT/SHUTTERSTOCK

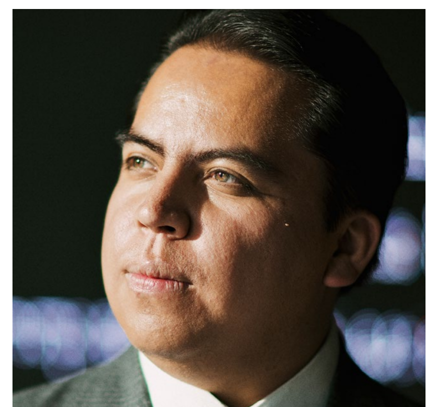
SBTi will publish roadmaps for high-emitting sectors, including aviation.

The world faces a climate crisis. Of that, the science is no longer in doubt. As the latest report from the Intergovernmental Panel on Climate Change made clear, we are left with two options: either we drastically reduce current rates of greenhouse gas emissions by 2050, or we must accept the consequences.

It no longer takes a climate scientist or meteorologist to set out the ramifications of option two. Just turn on the TV news. "Once-in-a-generation" weather events are fast becoming habitual.

Science is doing an increasingly compelling job of telling us where we currently stand, as well as where we need to end up (at no more than 1.5C above pre-industrial levels by mid-century). But how to get there remains highly contested.

Providing clarity is the task that Alberto Carrillo Pineda and his 40 or so colleagues at the Science Based Targets initiative (SBTi) have set for themselves. ›



SBTi's Alberto Carrillo Pineda.

INTERVIEW

NAILIA SCHWARZ/SHUTTERSTOCK

Pineda warns climate security cannot be achieved by business-as-usual and an over-reliance on offsetting.

Pineda, a Mexican-born former carbon market consultant, is adamant about the driving purpose of the organisation that he helped found back in 2015.

"From the beginning, SBTi has had the priority of making sure that [climate] targets lead to an absolute reduction of emissions," he says.

In other words, forget the notion that climate security can be achieved by making a tweak here and there to business-as-usual, and then offsetting everything else. Such a strategy is an invitation to irreversible climate change, he argues.

Pineda concedes that 5% to 10% of emissions may prove technologically impossible or economically unfeasible to remove (think: eliminating methane from livestock or living without cement).

In the absence of a breakthrough solution, offsetting these residual emissions appears to be the only viable option – at least for now.

Likewise, SBTi doesn't rule out offsetting as an interim measure as companies decarbonise. The emphasis is on the word "interim", however. Ultimately, everything that can be reduced must be reduced, without undue delay.

Such a "near zero" goal means, among other changes, "no room for new fossil fuel development". It also implies a reversal in almost all climate plans by business, which, in his qualified opinion, are "not consistent with the transformation that needs to happen at a global level".

SBTi's role is not about pointing the finger, however. Instead, the Berlin-based voluntary organisation endeavours to work alongside companies and others to establish scientifically robust and empirically verifiable climate reduction strategies.

To that end, it has developed a detailed methodology and set of criteria for setting short and long-term targets, drawing on guidance from a swathe of both technical and scientific experts.

Building on this work, it is preparing to launch a new net-zero standard at the upcoming UN climate summit in November. The tool, which Pineda says is designed as a "transparent mechanism for validating net-zero targets", is currently being road-tested by 79 companies.

According to a draft of the standard, the validation criteria are in addition to SBTi's existing criteria for determining whether a company complies with its new goal of a 1.5-degrees trajectory.

In their net-zero plans, which ›

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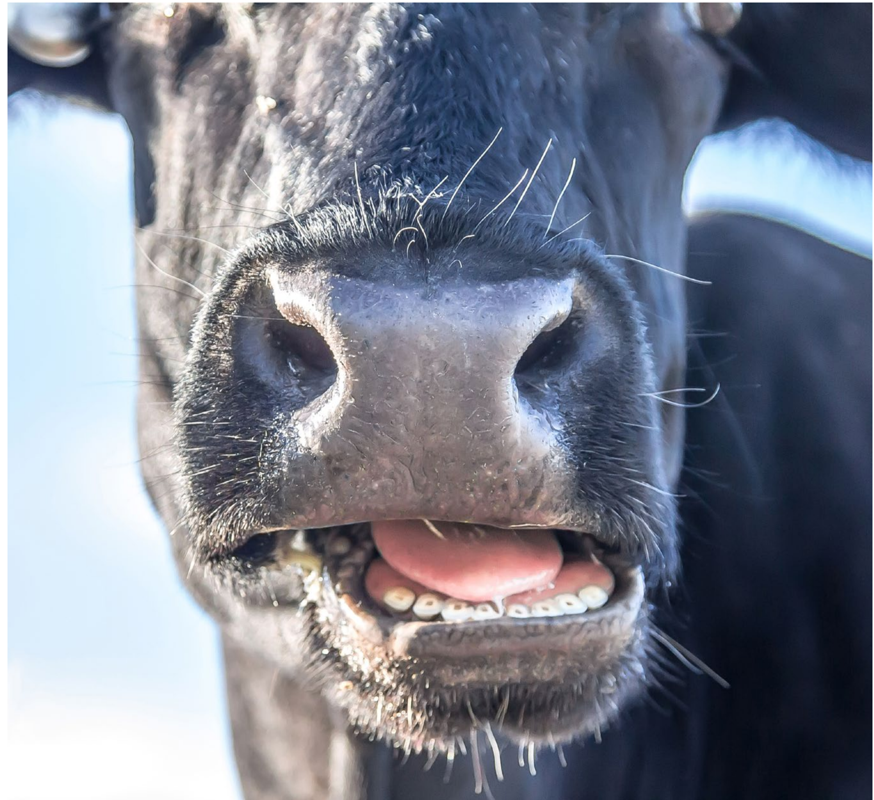
must be communicated publicly in full, companies will be required to clearly indicate the magnitude of emissions reductions that will be achieved through their plan, and provide interim targets.

The draft offers the following hypothetical example: "Company A commits to reach net-zero greenhouse emissions across scopes 1, 2, and 3 by 2040 from a 2020 base year. As part of this commitment, the company commits to reduce absolute emissions 50% by 2030 and 90% by 2040."

SBTi intends to use the GHG Protocol Land Sector and Removals Initiative to accurately account for carbon removals, although it concedes that criteria may face "further refinement" as the standard develops.

"Hopefully it will address some of the noise we're seeing today with net-zero target setting," Pineda adds.



VLADIMIR KONSTANTINOV/SHUTTERSTOCK

Eliminating methane emissions from livestock is not feasilble.

CASCADE EFFECT

In other new developments, SBTi is preparing to unveil a series of sector-based roadmaps for high-emitting industries.

First out of the blocks will be guidelines for the oil and gas industry, as well as shipping, aviation, forestry and agriculture, all of which are expected in the coming months. Similar guidance for the cement, steel, construction and chemical sectors is scheduled to follow over the next year or so.

SBTi's sector focus ties into a long-standing theory of change that prioritises persuading the 2,000 companies with the largest carbon footprint to commit to robust reduction targets.

The logic here relies as much in the cascade effect that such commitments will have through their value chains as it does on these big hitters reducing their own direct emissions. Sign up 2,000 companies, Pineda says, and you reach 45,000 more.

SBTi has to date validated the targets of 863 companies, with about the same number again waiting in the wings for SBTi's official tick. The majority, moreover, tend to be large-scale multinationals operating in the pivotal sectors identified.

A key challenge for the voluntary standard-setter going forward is to widen its net. Most of SBTi's verified companies are predominantly clustered in the U.S., UK, western Europe and Japan.

Notable absentees from the global north are Australia and Canada, while some "initial momentum" is being seen in the large economies of the global south, such as China, Mexico, Brazil and Indonesia.

State-led companies are also absent, a problem that Pineda puts down to government policy not being "where it should be" with respect to climate.

"In countries like China and South Korea, the main driver [of climate action] is policy... ultimately, governments need to create the conditions to transition to a net-zero economy," he states.

In this regard, he'd welcome legislators the world over to establish their own mandated target-setting rules. It would do SBTi out of a job, but, in his view, that would be all to the good.

For now, however, the patchwork nature of national regulatory approaches means SBTi is very much still in business. It also means that the systems-wide changes required for SBTi-verified companies to hit their individual targets are yet to happen.

The disconnect between action and ambition creates a tension that Pineda welcomes. Alone, ›

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companies can only go so far in decarbonising, he reasons.

"Setting targets create a tension with what companies can do by themselves [and] that tension is exactly what is needed to create alignment between business, the financial sector and governments to actually go through the transition we need."

Another tension is where to set the bar with regards to carbon reductions. Remarkable as the 2015 Paris Agreement was, it left this question hanging. Was it "well below" 2 degrees, or "preferably" no more than 1.5 degrees, as also stated?

SBTi's historic policy has been to give companies the choice. Little wonder that most opted for the more lenient of the two benchmarks.

When the IPCC published a landmark report in 2018 strongly laying out the case for the stricter 1.5C target, it forced SBTi into a rethink.

Changing tack immediately wasn't feasible, Pineda insists. Most carbon reduction plans it had verified were pinned to a "below 2-degrees" threshold. Second, despite the IPCC's confidence, it was still far from clear what a 1.5 pathway looked like for an individual business.

"We only got a 1.5C-aligned scenario from the IEA [International Energy Agency] in May. So before then, it was actually very difficult to be able to model sector-specific 1.5-degree aligned targets," he explains.

Back in May 2019, SBTi launched a high-profile campaign to persuade businesses to increase their ambition. From an initial group of 28, the number of companies committed to a 1.5C target stands at 732 (with a collective market capitalisation of over $13tn).

As of July this year, all companies submitting new carbon reduction plans to SBTi for verification have no option but to commit to the 1.5C milestone.

SBTi will produce net-zero carbon guidelines for the oil and gas industry.

Those companies with existing plans verified at below 2C will be encouraged to update their commitments. Some already have. Those yet to do so will not have their verification status withdrawn, Pineda confirms, but their ongoing involvement in SBTi is conditional on them updating to 1.5C when their plans are next up for revision (in effect, by 2023 or before).

"We have just two or three years to get most of the companies on this new trajectory. Otherwise, we are going to miss the opportunity of limiting warming to 1.5 degrees."

Fortunately, enough policymakers now seem to agree to make the 1.5C target "almost unavoidable" for companies, he adds, citing ambitious 2030 climate goals in the UK and European Union by way of examples.

Should legislators begin to mandate the reporting requirements laid out by the Taskforce on Climate-related Financial Disclosures (as Pineda hopes they will), then the pressure to set clear and ambitious climate targets will build.

The two organisations are ›

INTERVIEW

BUZAS BOTOND/SHUTTERSTOCK

SBTi operates separately from the Science Based Targets Network, a similar initiative for nature.

currently working on a joint project funded by the Bloomberg Foundation to assess the convergences between their respective methodologies and requirements. The result will be published in a forthcoming report.

SCALING UP

Such cooperation is welcome. Influential as SBTi has become over recent years, it is not the only target-setting initiative in town. Pineda points to a surge in attempts at assessing and benchmarking corporate climate strategies, particularly by financial institutions. The risk of fragmentation is obvious.

Another fast-moving trend is transfer of science-based target setting into other environmental fields, such as nature, water and waste.

SBTi's four founder partners – the World Resources Institute, the UN Global Compact, CDP and WWF – recently teamed up with around 40 other charitable, academic and business institutions to launch a similar initiative for nature.

Despite sharing the same essential goals, SBTi and the similar sounding Science Based Targets Network operate as separate entities. The logic here, according to Pineda, is that the two fields find themselves at different points of development; for climate targets, it is all about scaling an established methodology and set of protocols; while for nature, the emphasis is still on putting this basic architecture in place.

Complicating matters further, the impacts and metrics for measuring and managing climate impacts are global and uniform, while for nature they tend to be local and heterogenous.

Even so, Pineda concedes that today's climate and nature crises are interlinked and a more coordinated response from business would be welcome.

Ultimately, whatever issue happens to be subject to science-based target setting, the end point is the same: learning to live within the "boundaries of the planet".

In that regard, SBTi's managing director judges today's current economic model to be "untenable". The implication? "If we take planetary sciences, then a major transition across multiple environmental dimensions is what is needed."

Setting climate targets used to be a veritable Wild West. Over the last half-a-dozen years, SBTi has done a huge amount to draw some lines in the sand. The current splurge of offset-dependent net-zero commitments indicates that there is still some way to go.

That said, if science teaches anything, it's that there is a solution out there just waiting to be found. What's hard, as SBTi's impressive example demonstrates, is to keep pushing until you find it.

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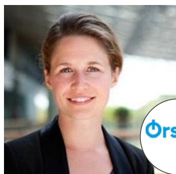

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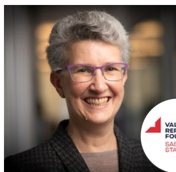

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CEO
Value Reporting Foundation

ALAIN DECKERS
Head of Unit, Corp Reporting, Audit and Credit Rating Agencies
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