What does climate leadership mean in the age of net zero commitments?

Deloitte. | investopia

Eight Point Action Plan for Climate Leadership in 2022

Net zero commitments to reduce emissions in order to control climate change represent a global aspiration that we all must play a role in realizing. Based on the best climate scenario models that we have, net zero by 2050 presents us with the most effective way of minimizing the climate risks we face while managing the transition to a low-carbon future.

To get there, climate leadership is vital. It represents a combination of ambition and commitment to not only find a way through the climate crisis, but also to inspire others to seek the same. With the world awash with net zero commitments, what does this mean in the context of climate leadership? While the commitments made signal a long-term vision, what are the leadership actions that will get us there?

2021 - The year the world woke up to the climate crisis?

Emerging evidence of our climate reality: Last year kicked off with President Joe Biden, in the first few hours of becoming president, announcing that the US would be rejoining the Paris Agreement.

However, the year also began with many countries tallying the extensive costs of catastrophic extreme weather events of 2020. The events that followed through the year – from the Intergovernmental Panel on Climate Change concluding that climate change was unequivocally caused by human activities1 through to new data showing the melting of Greenland was surging (the amount of ice vanishing in a single day is enough to cover Florida in 5cm of water2) - showed that much more is needed if we stand a chance of hitting the Paris Agreement goals.

Climate commitments and promises: Against this backdrop, COP263 - the UN climate conference in Glasgow - brought together diplomats, business leaders and civil society with the continued hope of limiting human-caused global warming to 1.5 degree Celsius. While many observers concluded that the conference achieved mixed outcomes, nearly 200 countries unanimously signed the Glasgow Climate Pact4, agreeing to accelerate the fight against the climate crisis and to commit to tougher climate pledges.

In addition to COP26, other climate commitments and promises continue to be made.
More than 130 countries have now set or are considering a target of reducing emissions to net zero by 20505. At the corporate level, over 200 companies have signed the Climate Pledge-6 a commitment to be net zero carbon across their businesses by 2040. Many of these commitments were made in 2021, largely on the back of the IPCC’s ‘code red’ report – for many this is the year that the world got serious about climate.

But awareness and goal setting will not be enough to achieve the Paris Agreement

Moving beyond the net zero narrative: Net zero has become a buzzword and most actors in the public and private sectors have some shape or form of a net zero narrative in place

Ambition versus reality: There is increasing concern that ambition is far ahead of reality. For example, a recent report by New Climate Institute and Carbon Market Watch7 assessed 25 major global corporations' climate claims and found that nearly all of them rely on some form of loophole to significantly exaggerate the ambition of their climate targets and actions. At the same time, the UN has indicated its concern about the credibility of commitments being made. This has led to the establishment of a 'Group of Experts' to analyze private sector claims, with Secretary-General Antonio Guterres, arguing "there is a deficit of credibility and a surplus of confusion over emissions reductions and net-zero targets, with different meanings and different markets".[8]

Moving beyond the net zero narrative: Net zero has become a buzzword and most actors in the public and private sectors have some shape or form of a net zero narrative in place. These run broad and wide including, for example, clearer and bolder corporate plans from heavy emitters, increasingly optimized for the climate transition. In other examples, we also see large scale commitments made through abatement pledges and ESG statements; as well as increased M&A activity to demonstrate positive intent and divestment from assets that contradict that narrative. However, today the major challenge we now face is how to move that narrative around ambitions into credible and transparent decarbonization plans and actions that get us to where we want to be.

Leadership is necessary to prevent the dilution of our climate ambitions and ensure that institutional and societal confidence remains in place

Reframing what climate leadership means for our net zero world – Eight Point Action Plan

To realize our net zero ambitions requires a reframing of what climate leadership means, calling us to move beyond public declarations to tangible and transparent actions. This type of leadership happens at two levels … the level of collective leadership – whereby our collective quests require developing processes and institutions that bring people together to pursue the shared goal of climate action; and individual leadership – whereby we take action as individuals alone and also within organizations to achieve climate goals while also influencing and inspiring others to do the same.

The Eight Priorities Action Plan to drive climate leadership:

1. Governments should put in place the necessary rules and frameworks to oversee

the authenticity of 'net zero' claims National governments are responsible for putting in place sufficient rules and frameworks to ensure that organizations making net zero commitments and carbon neutrality claims are held accountable for their actions. This form of leadership is necessary to prevent the dilution of our climate ambitions and ensure that institutional and societal confidence remains in place.

Such frameworks can be designed on a principles-basis – example principles could include:

Net zero strategies must be measured against the urgent pursuit of emission reductions, using evidence-based targets in the process[9]

Clear alignment with broader sustainability objectives such as the Sustainable Development Goals (SDGs)

The use of carbon offsets and carbon removal to be considered only in a cautious manner and with reference to additionality

2. Companies should take the lead on providing the ‘full picture’ on net zero

Corporate leadership in the net zero game is critical and companies should commit to providing the ‘full picture’ on their net zero strategies to their stakeholders, which means covering all of emissions within their value chain. Following the concept introduced by the GHG Protocol[10], emissions should be divided into three categories known as scopes 2 ,1 and 3. Scope 1 covers direct emissions from owned or controlled sources; scope 2 covers emissions from the generation of purchased electricity, heating and cooling of the company; and, scope 3 includes everything else in a company’s value chain – indirect emissions, as a result of activities not owned or controlled by the company. A genuine net zero commitment equires reduction of emissions in each scope – and transparent and full disclosure on the actions being undertaken to achieve this. The full picture should also include expressing emission reductions in both absolute terms and as a share of total emissions. This requires companies to provide details on the reference point used to calculate reductions i.e., the base-year.

A comprehensive corporate net zero strategy will include:

A near-term target that will cover the next 10-5 years and set companies on their °1.5C aligned carbon reduction pathway

A long-term target that will only be met once a company has reduced their absolute emissions by %90 or more

To achieve net-zero with sciencebased targets11, emissions that are not possible to cut - the final %10 or less - have to be neutralized through carbon removals

The full picture should also include expressing emission reductions in both absolute terms and as a share of total emissions

3. Capital markets must redefine the wayin which net zero is reflected in financial decision-making

The capital markets and their actors have been playing an increasingly important climate leadership role. For example, in 2021 former Bank of England Governor and UN Special Envoy on Climate Action and Finance, Mark Carney, launched the Glasgow Finance Alliance for Net Zero (GFANZ) – specifically designed as a forum for leading financial institutions to accelerate the transition to a net zero global economy12.

However, this is just the beginning. For the regulators, the corporates and the financial institutions that play core roles in the global capital markets, climate leadership requires a reconsideration of exactly what can and must be done to achieve net zero. In the first and immediate instance, this should include:

- Building effective capital reallocation and financing structures that drive capital towards companies that are creating solutions to the climate crisis In designing such structures.

This should include an understanding and articulation of impact that:

Reflects intentionality – such that there is specific intent to invest or finance a company, product or assets that helps achieve net zero

Considers materiality – such that a large proportion of the future profits are related to and directly impacting the achievement of net zero

Provides additionality – that any financing solution intervention should contribute in a differentiated way to the achievement of net zero beyond business as usual

Driving financial innovation and fresh thinking so that financial institutions do not solely focus on decarbonizing their portfolio and carbon intensive assets sitting on someone else's balance sheet Rather, financial institutions can play a climate leadership role through developing innovative products and services that ccelerate the speed of the transition – ranging from offering green mortgages to retail clients through to scaling up venture investments into clean and transition technologies

To realize our net zero ambitions requires a reframing of what climate leadership means, calling us to move beyond public declarations to tangible and transparent actions

4. Energy companies should lead the energy transition through speeding up the design and implementation of energy transition strategies

Energy companies with credible energy transition strategies must and will be part of the solution, and therefore move more quickly in terms of putting in place ambitious yet achievable transition strategies for the sector.

This requires a redeployment of cash flows so as to invest in and develop renewable businesses, including associated infrastructure (e.g., electric vehicle charging points on fuel station forecourts). There has been an increase in energy firms committing to achieving net zero by 2050 but more is needed from the energy sector in terms of climate leadership.

For example, energy companies should increase research and development spending to focus on transition solutions.

Net zero invariably means a huge decline in the use of fossil fuels and therefore climate leadership in the energy sector requires significant shifts in thinking. In 2021, the International Energy Agency (IEA) published its flagship report, Net Zero by 2050: A Roadmap for the Global Energy Sector13, outlining a new energy -sector pathway towards net zero and providing a detailed sector-by-sector analysis of the changes needed over the next 30 years. For leading energy companies, the Roadmap presents a powerful plan of how to get there and should be incorporated and reflected in corporate strategies.

At the same time, energy industry investors also play a leadership role. The IEA has identified the critical importance of a radical technological transformation of the energy sector14. While renewables and energy efficiency are central pillars, investors must also focus on additional technologies needed – technologies to widely electrify end-use sectors (such as advanced batteries); carbon capture, utilization and storage (CCUS); hydrogen and hydrogen-related fuels; and bioenergy.

Policy makers should also take steps to create the incentive and investment environment through which to drive this climate technology leadership

5. Tech sector should seize the opportunity to advance technologies to support the transition to net zero

The realization of a net zero future is dependent on the technologies that will revolutionize emission reductions and support deployment at scale. This does not stop solely with the energy sector. Technology should be developed and applied to all aspects of our lives, requiring the technology industry to prioritize the development of new technologies that specifically form a critical part of our net zero toolkit.

At the same time, policy makers should also take steps to create the incentive and investment environment through which to drive this climate technology leadership.

One thing we know for sure is that technological development needs to be faster than it currently is, particularly in areas that are not yet explored. A mix of public and private finance needs to be rapidly deployed to push climate technology to maturity.

Key areas in which climate technologies should be developed include, for example, the following:

Digital technologies supporting transition to greener supply chains at both the upstream and downstream ends, such as digitalizing supply chain management to reduce waste and improve efficiency.

Blockchain and the distributed ledger based platforms through which to support the trading of environmental goods and services, based on transparent and efficient trading systems.

AI-infused analytics to drive responsible decision making to be clearly aligned with the Paris Agreement and net zero goals.

Investor leadership demands a coherent and ambitious environmental, social and governance (ESG) strategy is developed and critically, that this includes a path to net zero

6. Investors must commit to portfolio decarbonization

Institutional investors can play a leadership role in driving emission reductions by committing to decarbonizing their investment portfolios. This calls for investors to reduce the carbon intensity of their portfolio by including companies with low emissions or which have made credible commitments to reduce their emissions. However, for maximum impact, emission intensity targets are not enough. Credible net zero strategy should be expressed in absolute emissions also. Investor leadership demands a coherent and ambitious environmental, social and governance (ESG) strategy is developed and, critically, that this includes a path to net zero.

Investors should also play a role in how stranded assets are identified and subsequently managed. Stranded assets are those that at some time prior to the end of their economic life (as assumed at the investment decision point), are no longer able to earn an economic return (i.e., meet the company's internal rate of return), as a result of changes associated with the transition to a low-carbon economy (lower than anticipated demand / prices)[15]. To manage the risks and costs of these stranded assets, investors should leverage our understanding of the carbon budget and price in the risk of asset stranding, as well as pushing capital markets to build in emissions risk into asset prices.

An ESG strategy ensures that the investment approach, as well as the governance and risk management that sits around this, is clearly aligned with net zero goals. It requires the investor to:

- Understand how climate interacts with organizational goals
- Define a net zero commitment including intensity reduction targets
- Build in assumptions for risk and return under different climate scenarios
- Ensure that climate-related constraints are considered in the selection of an optimal portfolio

All eyes are on COP28, to be held in the U.A.E in 2023 - time-critical in setting our direction towards realistically achieving our collective net zero targets.

7. The private sector should pursue widespread use of internal carbon pricing in the absence of a global price on carbon

Much progress has been made on carbon pricing. COP26 ended with a strong result for the carbon markets. After six years of challenging and technical negotiations, an agreement was reached on the Paris Agreement rulebook for international cooperation through carbon markets. This provides the cornerstone for developing the tools needed for a transparent and accountable carbon market. At the same time, significant work has been underway on enhancing the role and robustness of voluntary carbon markets. In 2021, the Taskforce on Scaling Voluntary Carbon Markets (TSVCM) announced the formation of an independent governance body for carbon markets and credits.

Having been set up to take stock of voluntary offsetting schemes and identify key challenges to overcome, the TSVCM has been driving the world towards a global benchmark for carbon credit quality. More is needed and this is where the private sector must play a bigger role.

Carbon pricing is an essential part of the solution – an internal price that places a monetary value on emissions which can then be used to factor into investment decisions and business operations. The private sector should seek innovative ways to use carbon pricing in order to identify greater opportunities for greenhouse gas mitigation and reduce climate-related risks.

For example:

- For corporates – using internal carbon pricing in investment appraisal and decision-making to evaluate risks from mandatory carbon pricing.
- For banking institutions – using carbon pricing approaches to understand and assess their own portfolios, as well as in reviewing credit applications.
- For investors – applying internal carbon pricing in investment decisions to better manage climate-related risks and opportunities.

The more that companies around the world
start instituting their own internal price on carbon, the better prepared they are for a transition to a low-carbon economy and aligned with our net zero ambitions.

Governments, regulators, the private sector and civil society in the region are engaging on net zero priorities to ensure a truly successful COP28

8. Setting our leadership ambition now for COP28 - climate leadership driven from the Middle East

All eyes are on COP28, to be held in the U.A.E in 2023 - time-critical in setting our direction towards realistically achieving our collective net zero targets. Climate leadership will be required more than ever before. The region is already stepping up to this leadership role – in particular, with Saudi Arabia, the U.A.E and Bahrain taking the significant step forward in setting net zero targets at the national level.

As we look forward to COP28, key actors in the Middle East are proactively seeking climate solutions that deliver real impact on the region's emissions trajectory as well as defining their climate leadership roles. Governments, regulators, the private sector and civil society in the region are engaging on net zero priorities to ensure a truly successful COP28.

In particular, to deliver success, COP28 should aim to:

Identify solutions to scale the sustainable finance market such that it can deliver on the financing and investment needs to support the net zero transition

Incubate and accelerate critical climate technologies for urgent deployment across the world, as well as converge negotiations on finance and technology for climate action

Progress on international negotiations to set a global price on carbon, as well as promulgating the development of efficient carbon markets

Provide an urgent response to the decarbonization of agriculture and food systems as well as addressing the needs of farmers across the globe

Endnotes

1 Climate change widespread, rapid, and intensifying – IPCC — IPCC

2 World Meteorological Organization 2021

3 HOME - UN Climate Change Conference (COP26) at the SEC – Glasgow 2021 (ukcop26.org)

4 Glasgow Climate Pact | UNFCCC

5 Net Zero Coalition | United Nations

6 The Climate Pledge | Net Zero Carbon by 2040

7 Top corporations use misleading climate pledges to greenwash image, new report - Carbon Market Watch

8 Secretary-General›s remarks to the World Leaders Summit - COP 26 | United Nations Secretary-General

9 Ambitious corporate climate action - Science Based Targets

10 Greenhouse Gas Protocol | (ghgprotocol.org)

11 The Science Based Targets Initiative (SBTi) have launched a Net-Zero Standard, providing an independent assessment of corporate net zero target setting.

12 Glasgow Financial Alliance for Net Zero (gfanzero.com)

13 Net Zero by 2050 – Analysis - IEA

14 Technology needs for net-zero emissions –Energy Technology Perspectives 2020 – Analysis - IEA

15 Stranded Assets - Carbon Tracker Initiative

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication.

Deloitte & Touche (M.E.) LLP (“DME”) is the affiliate for the territories of the Middle East and Cyprus of Deloitte NSE LLP (“NSE”), a UK limited liability partnership and member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”).

Deloitte refers to one or more of DTTL, its global network of member firms, and their related entities. DTTL (also referred to as “Deloitte Global”) and each of its member firms are legally separate and independent entities. DTTL, NSE and DME do not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories, serves four out of five Fortune Global 500® companies. Learn how Deloitte’s approximately 300,000 people make an impact that matters at www.deloitte.com.

DME would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. DME accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

DME is a leading professional services firm established in the Middle East region with uninterrupted presence since 1926. DME’s presence in the Middle East region is established through its affiliated independent legal entities, which are licensed to operate and to provide services under the applicable laws and regulations of the relevant country. DME’s affiliates and related entities cannot oblige each other and/or DME, and when providing services, each affiliate and related entity engages directly and independently with its own clients and shall only be liable for its own acts or omissions and not those of any other affiliate.

DME provides audit and assurance, consulting, financial advisory, risk advisory and tax, services through 27 offices in 15 countries with more than 5,000 partners, directors and staff.

Deloitte. | investopia