Analysis The UN climate summit and corporate transition plans

- *Decarbonisation strategies in the public and private sectors are interdependent.*
- *Corporate transition plans are now subject to more rigorous standards.*
- *An ambitious climate scenario of 1.5°C warming often defines these plans.*
- *Investors and financial supervisors scrutinise these plans to stem 'greenwashing'.*
- *The shrinking global carbon budget will soon need to be reflected.*

Emission reductions: still off-track

A series of reports ahead of this week's UN climate summit again underlined how much further carbon emissions must fall if dangerous climate collapse is to be avoided. Carbon emissions may peak this decade, but the target of a 1.5°C warming looks increasingly ambitious: on current 'business as usual' scenarios, the world is in fact on track for 2.5°C to 2.9°C warming.[1]

Corporate transition plans: more scrutiny

Climate transition plans are now essential …

Over half of the world's 2,000 largest companies have a net-zero target, though few flesh out a full strategy for how they will get there.[2] Investors have long argued that corporate commitments are worth little if targets are distant, do not cover the full scope of emissions, rely on untested technologies, or are not backed up by internal governance and incentives.

Private sector climate strategies will now come under the spotlight just as much as those of governments. In fact, governments hold companies to account, as for instance, stated in the latest G7 communiqué:

> *"We highlight the need for companies to implement their net-zero transition in line with the temperature goal of the Paris Agreement based on credible corporate climate transition plans"*.[3]

These more comprehensive (climate) transition plans have become the norm and an essential tool for defining a private sector climate strategy. They set the near-term targets, actions, and accountability mechanisms that allow a firm to transform its business towards a low-emission, climate-resilient pathway.

In the so-called hard-to-abate sectors, such as steel and cement, construction, and shipping, few purely green technologies are available in the short term. Companies' plans to converge to a net-zero world are therefore crucial, including in investor interactions.

But to comply with regulation and target setting in the investment industry, corporate transition plans will need to set out ambitious emission reduction paths, in line with the Paris Agreement goal of limiting warming below 2°C:

… which requires an accepted global warming scenario

- Under the EU Corporate Sustainability Reporting Directive (CSRD), 50,000 companies, including many outside the EU, will need to report on climate plans where they exist and set out how these plans will deliver a 1.5°C scenario.[4] This requirement may be sharpened further in upcoming legislation on corporate due diligence, and may be replicated in the EU's capital markets law (MiFID II), and bank prudential regulation (CRD/CRR). Similar requirements are set out by the international accounting body IFRS (ISSB), whose standards will serve as a global baseline for sustainability disclosures. A new UK framework was released in October and will soon become Financial Conduct Authority (FCA) regulation.

- Capital market standards published by industry body ICMA also call for a 1.5°C trajectory and see a 2°C trajectory as the minimum.[5] This will have important implications for the increasingly popular segment of transition finance and sustainability-linked bonds.
- Various investor alliances have developed tools and standards for assessing corporate transition plans. Importantly, the Glasgow Financial Alliance for Net Zero (GFANZ) adheres to the 1.5°C target.[6]

Comprehensive transition planning is important for resilience

Companies that adopt comprehensive transition plans are likely more resilient to fresh climate regulation and changing consumer tastes and will be able to access more efficient, low-carbon technologies.

Conversely, poorly designed plans will expose firms to allegations of 'greenwashing', stranded and devalued assets, and possibly to litigation.

Companies, investment funds, and financial institutions that claim to be aligned with the Paris Agreement will be held to account based on the now more rigorous transition plan standards.

Supervisors have announced they will monitor compliance and will take action when they spot shallow or misleading transition plans.

Because there are over two dozen standards for how transition plans are done, greenwashing investigations will likely be initiated where supervisors suspect a willful intent to deceive.[7]

US and UK capital market supervisors have already beefed up their resources in ESG enforcement to that end.

Reflecting climate scenarios in corporate plans

The carbon budget is a moving target

One potential weakness of existing transition plans is a lack of ambition in emission reduction paths, and confusion about how they should be defined.

There is a near-linear relationship between cumulative carbon dioxide emissions in the atmosphere and global temperatures. The 1.5°C warming target therefore implies a specific maximum CO_2 concentration, and hence the remaining carbon budget before that limit is breached. Based on the most recent studies, a 50% likelihood of sticking to the 1.5°C target allows only an additional 250 gigatonnes of CO_2, equivalent to roughly six years of emissions at present rates.[8]

There is as yet no straightforward way to translate this global carbon budget into the emission reduction paths for individual industrial sectors and companies, and regulators have not yet prescribed these paths.[9]

But it is clear that the emission 'glide-paths' for individual sectors will need to become steeper than previously thought.

Investors are starting to compare the various methods used by commercial verifiers and other academic entities in judging transition paths.[10] In defining their climate plans companies will need to stay alert to the shifting consensus in climate science.

Watch for

- UN climate summit: country commitments on emission cuts and the role of the private sector.
- New regulation in the EU, which may make transition plans mandatory.
- Regulators defining decarbonisation paths for individual industries.
- FCA enforcement action against inadequate net zero targets and transition plans.
- Tipping points that may further shrink the global carbon budget.

Endnotes

[1] At COP21 in 2015, global leaders agreed that in 2023 they would take stock of their collective efforts to meet the goals of the Paris Agreement in 2023, one outcome is the 'Emissions Gap Report' (https://www.unep.org/resources/emissions-gap-report-2023). The parallel Corporate Climate Stocktake (CCST) was led by the *We Mean Business Coalition* and supported by the UN Climate Champions team and Bain & Company, available at: https://www.wemeanbusinesscoalition.org/wp-content/uploads/2023/11/WMBC_Corporate_Climate_Stocktake_2023_v6.pdf

[2] https://zerotracker.net, for a stocktake of net-zero plans see also the assessment by CDP: https://www.cdp.net/en/articles/climate/new-cdp-data-shows-companies-are-recognizing-the-need-for-climate-transition-plans-but-are-not-moving-fast-enough-amidst-incoming-mandatory-disclosure

[3] https://www.g7hiroshima.go.jp/en/documents/

[4] See Appendix B in the new EU disclosure requirement: https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2F08%2520Draft%2520ESRS%2520E1%2520Climate%2520Change%2520November%25202022.pdf

[5] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/

[6] https://www.unepfi.org/industries/target-setting-protocol-third-edition/

[7] A proposal how to identify common ground among the methodologies was published here: https://wwfint.awsassets.panda.org/downloads/red-flag-indicators-for-transition-plan-inconsistencies-and-greenwashing-26-sept.pdf.

[8] https://climatechangetracker.org/igcc/current-remaining-carbon-budget-and-trajectory-till-exhaustion. Even though the global carbon budget is the key parameter for both public and private sector climate strategies it is by no means static**.** It could well go down, once climate tipping points are crossed. Methane releases from the permafrost or a rapid unravelling of carbon sinks such as the Amazon forest are just two such tipping points: https://www.science.org/doi/10.1126/science.abn7950.

[9] The prevailing model of sectoral decarbonisation paths will have all companies within a certain sector converge along the same path of carbon intensities, though there are many other methodologies: https://iopscience.iop.org/article/10.1088/1748-9326/abe57b.

[10] Industry body ICMA compiles some 30 sources here: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/

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