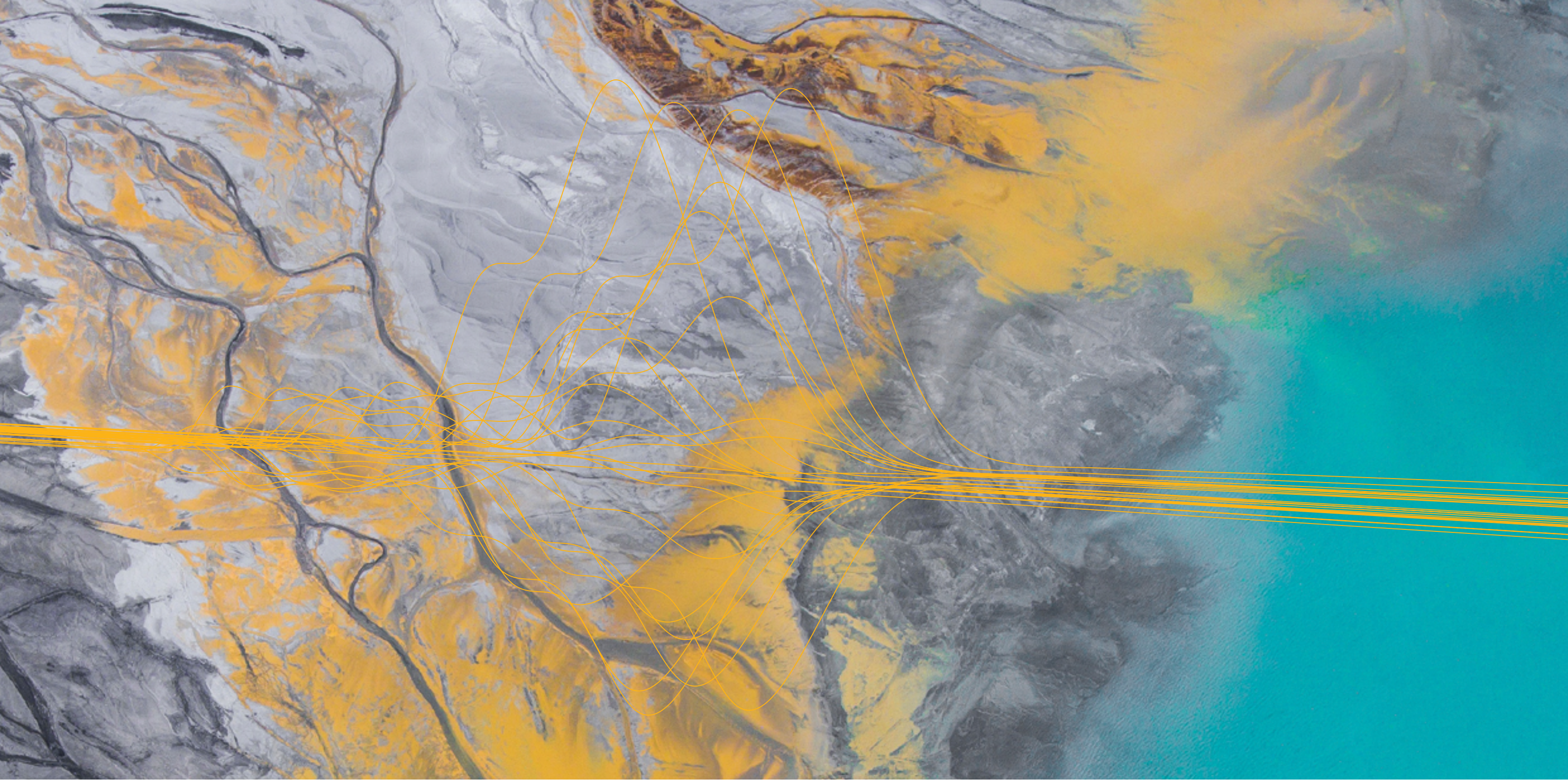

Eight themes on the road from Glasgow

A flurry of announcements over the fortnight

Parallel tracks emerged as COP26 kicked off. During the first week, outside the formal negotiations we saw a raft of pledges from different coalitions on phasing out coal, reducing deforestation, cutting methane emissions, eliminating deforestation from supply chains, all new cars and vans being zero emissions by 2040 or earlier and net-zero pledges from the financial services sector. All of these are welcome. But they aren't enough to close the 1.5°C gap

In the second week at COP, parties worked to reflect some of the pledges in the formal negotiations. On Saturday, 13 November, 2021 consensus was reached on the Glasgow Climate Pact, amid some reservations about a final change to the language on phasing out coal. The decisions adopted in Glasgow delivered on a number of fronts, including finalising sections on transparency and carbon markets provisions in the Paris Rulebook, increasing funding on adaptation for developing countries, recognising the critical role of nature in keeping 1.5°C in reach, and a ten-year Glasgow work programme on Action for Climate Empowerment.

Our thoughts on eight key themes:

1. HALTING DEFORESTATION

A major declaration signed by more than 130 countries promises to collectively halt and reverse forest loss and land degradation by 2030. A commitment on eliminating agricultural commodity-driven deforestation signed by more than 30 financial institutions (including Schroders, AXA, Legal & General Investment Management and Aviva) covering over USD8.7 trillion of global assets under management aims to move away from portfolios that invest in high deforestation-risk agricultural commodity supply chains and towards sustainable production.

All businesses are exposed to sustainability and climate risk in their value chains. Businesses need to prepare and implement adequate due diligence strategies to de-risk their value chain in relation to deforestation and other adverse environmental impacts while ensuring minimum safeguards, eg respect for human rights.

2. ACTION ON FOSSIL FUELS

The Global Methane Pledge requires 105 countries to cut their methane emissions by 30% between 2020 and 2030 and move towards using the best available inventory methodologies to quantify emissions. Coal phase-out secured a 190-strong coalition of countries and organisations, with countries such as Poland, Vietnam, Egypt, Chile and Morocco announcing commitments to phase out coal power. Additionally, 25 countries, including Indonesia, South Korea, Poland and Vietnam, committed not to build or invest in new coal power. 30 nations also signed a statement on international public support for clean energy transition, committing to end new direct public support for the international unabated fossil fuel energy sector by the end of 2022, except in limited and clearly defined circumstances that are consistent with a 1.5°C warming limit and the goals of the Paris Agreement.

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Businesses' exposure to fossil fuels will vary from country to country; however, it is clear that the pressure to phase out fossil fuels will only increase year on year. Most businesses will be exposed to such through their consumption of electricity (ie scope 2 emissions) and other key inputs. Quantification of GHG emissions and a science-based target to reduce emissions will help businesses identify a transition pathway that meets their operational needs and investment requirements in the short and mid-term.

3. ACCELERATING NATIONAL AMBITIONS ON SHOW, BUT MORE IS NEEDED TO ALIGN TO THE PARIS GOAL OF 1.5°C

The Glasgow Climate Pact recognises the need to reduce emissions 45% by 2030 from 2010 levels, which requires accelerated action this decade. Countries now need to scale up mitigation ambition and implementation. The agreement requests governments to strengthen 2030 National Determined Contributions (NDCs) as necessary to align with the Paris Agreement temperature goal by the end of 2022. There will now be an annual ministerial roundtable on pre-2030 ambition starting at COP27 next year to pledge actions and review progress. To galvanise action, the Secretary-General of the United Nations will convene world leaders in 2023 to consider ambitions for 2030.

This represents a significant shift from a five-year cycle agreed in Paris to a yearly one. If governments do not collectively reduce emissions 45% by 2030 from 2010 levels, the 1.5°C target will truly be out of reach and will result in more severe physical climate impacts. Businesses will need to consider such accelerated pressure to mitigate GHG emissions (ie transitional risk, enhanced policy and regulation, technology risk, market risk and legal risks) as part of their climate-related financial reporting and disclosure. If done adequately, this will enable businesses to manage climate risk and seize business opportunities.

4. THE PARIS AGREEMENT CARBON MARKET

Countries also reached agreement on the pending issues of the Paris Rulebook. One of the outstanding elements agreed in Glasgow relates to voluntary cooperation mechanisms under Article 6 of the Paris Agreement, which covers mechanisms based on carbon markets and a third based on non-market approaches. The latter takes forward the development of climate cooperation under Article 6.8, with the formation of a Glasgow Committee on Non-market Approaches, which is due to meet twice a year until at least 2027.

For the bilateral mechanism established under Article 6.2, the rules ensure authorisation for the use of Internationally Transferred Mitigation Outcomes (ITMOs), tracking of ITMOs and the requirement to carry out corresponding adjustments so they are reflected in each country's NDCs.

For the mechanism under Article 6.4, the rules agreed pave the way for host governments to provide authorisation for emission reductions issued for use towards achievement of NDCs and/or for other international mitigation purposes. Corresponding adjustments will apply to all authorised 6.4 certified emission reductions to prevent the risk of double counting. It's not yet clear what will fall under "other international mitigation purposes," but this paves the way for emission reduction purchased by corporates that are authorised by host governments to be accounted for via corresponding adjustments, which importantly reduces the risk of double counting or double claiming in the voluntary carbon market.

Article 6 rules may encourage countries to consider linking their emissions trading systems, or to purchase emission reductions they can use towards their national climate goals. The rules also provide for environmental integrity through authorisations and corresponding adjustments. However, more detailed rules will be required to provide guidance on international mitigation purposes and the use of unauthorised issued certificates by public and private entities.

5. FINANCIAL SECTOR SEEKS TO ACCELERATE THE TRANSITION

COP saw a broader conversion from the finance sector under the banner of the Glasgow Financial Alliance for Net Zero (GFANZ), chaired by Mark Carney, UN Special Envoy on Climate Action and Finance. GFANZ brings together existing and new net-zero finance initiatives in one sector-wide coalition, providing a forum for financial institutions to accelerate the transition to a net-zero global economy.

GFANZ's membership currently includes over 450 financial firms across 45 countries responsible for assets of over USD130 trillion. This constitutes the largest private financial sector initiative thus far and their presence was notable as the first time the mainstream financial sector has attended a COP. Both governments and the financial services sector have much to do to define and implement the incentives and frameworks to deploy resources at speed and scale towards climate positive and carbon negative commercial opportunities to achieve Mr Carney's view of the financial sector transitioning from being a "fault-line into a pipe-line" in net-zero terms.

The financial services sector will need to enhance the depth of its climate-related financial disclosures, including its strategy stress test analysis and data on financed emissions. The expectation for the finance sector is to develop adequate net-zero plans to align portfolios to the Paris Agreement goal, which will be under enhanced scrutiny by a wide range of stakeholders.

6. SCRUTINY OF CORPORATE NET-ZERO TARGETS SET TO ESCALATE

With such momentum towards net-zero pledges, all eyes are now on implementation, transparency and accountability. In the words of Antonio Guterres, Secretary-General of the United Nations, "we need pledges to be implemented. We need commitments to turn concrete. We need actions to be verified. We need to bridge the deep and real credibility gap."

Because of this – and beyond the mechanisms already set out in the Paris Agreement – the Secretary-General has decided to establish a High-Level Expert Group to propose clear standards to measure and analyse net-zero commitments from non-state actors. This group will build on existing work and submit a series of recommendations to the Secretary-General during the course of 2022.

There will now be an increased focus on greenwashing, particularly in light of the raft of pledges aligned to the Paris Agreement, with litigators predicting a wave of greenwashing claims coming down the line. The emerging trend in climate action is towards stakeholder accountability: governments, non-state actors, private sector and civil society. In line with this, the UK government announced at the start of COP that it will move towards making the publication of transition plans mandatory.

To achieve this, the UK will set up a high-level Transition Plan Taskforce to develop a "gold standard" for transition plans and associated cutting-edge metrics, coordinating with international efforts under GFANZ and others, and reporting by the end of 2022.

Any business wanting to retain market share, and remain competitive and relevant must now:

- develop credible near- and mid-term climate action plans or review and revise them if already prepared;
- implement plans with urgency and conviction; and
- create transparency and accountability frameworks to track progress and results.

Such plans cannot be developed or implemented in a vacuum. They will need to align with broader sustainability factors on both sides of the equation – environment and social factors. Speed, fairness and transparency and governance need to be at the centre of any climate action.

7. INTERNATIONAL ACCOUNTING STANDARDS CONVERGE UNDER THE GOVERNANCE OF THE IFRS FOUNDATION.

In the next 12 to 18 months we'll see enhanced regulatory attention of climate-related plans and corporate sustainability reporting. On 3 November 2021, the IFRS Foundation Trustees announced the creation of the International Sustainability Standards Board (ISSB) to help meet the demand for high quality, reliable harmonisation of corporate reporting.

As part of the momentum, post-COP26 we'll see such responses coming from a multitude of jurisdictions, along with increasing pressure from stakeholders to prevent greenwashing on both climate and sustainability-related claims. Business needs to assess which Environmental, Social and Governance (ESG) factors are financially material to their business model and broader material environmental and social impacts: the so-called concept of "double materiality". With the formation of the ISSB, the market will be able to move towards a harmonised corporate sustainability reporting framework.

8. ADAPTATION FINALLY ON THE AGENDA

The Glasgow outcome also acknowledges that impacts at 1.5°C are significantly lower than at 2°C global warming and calls for developed nations to at least double their collective provision of climate finance for adaptation from 2019 levels by 2025. This financing commitment will also increase the attention of stakeholders on resilience to the physical impacts of climate change and resilient business models.

Businesses are not only exposed to the physical impacts of climate change due to their geographic location and key dependencies on natural resources, but also through their entire value chains. In-depth understanding of how business models can build resilience will be key a differentiator of successful and long-term business models as we experience more frequent acute events and chronic climate-related impacts.

Final thoughts

Important progress was made in Glasgow at COP26, but more work is needed to raise ambition and implement current pledges.

The Glasgow Climate Pact is a consensus agreement that left many dissatisfied. Nevertheless, in parallel to the formal climate negotiations, the UK COP Presidency managed to coalesce various groups of countries and stakeholders into important announcements. During COP26 at the world leaders' summit, the UK Prime Minister launched a "Breakthrough Agenda" which reflects a commitment to work together internationally this decade to accelerate the development and deployment of the clean technologies and sustainable solutions needed to meet our Paris Agreement goals, ensuring they are affordable and accessible for all. Endorsed by more than 40 countries, the Agenda has five "Glasgow breakthrough" areas of focus: clean power, zero-emission vehicles, near-zero emissions steel, hydrogen and agriculture.

The ultimate test of Glasgow will be in how different stakeholders deliver on their pledges with real, short-term, accelerated actions. Civil society and citizens at large were underwhelmed by the shortcomings regarding the ambition and climate justice, with some calling COP26 a failure, and Greta Thunberg describing it as "a global north greenwash festival." Transparency and accountability will play a central role in demonstrating clear progress towards limiting global warming to the 1.5°C goal. COP27 can't come soon enough to keep the pressure on governments and all relevant stakeholders to make further and tangible progress towards 1.5°C and ultimately a just transition to net-zero. We all, including lawyers, have an important role to play in this journey and we look forward to continuing to do so.

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