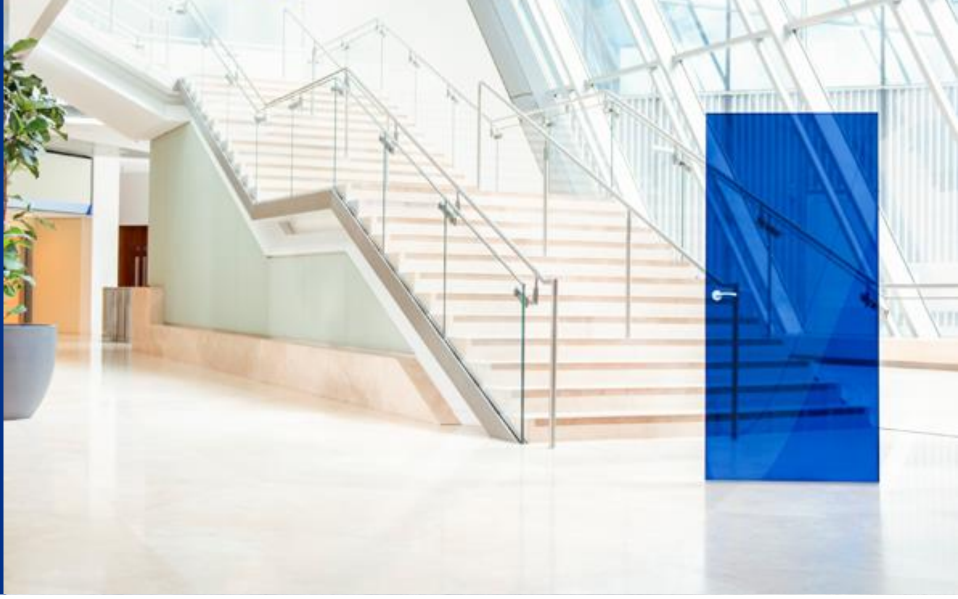
A conversation about COP26

KPMG Board Leadership Centre



As one of the most pressing issues of our age, climate change should be one of the top items on every board agenda. With the UK due to host COP26 in November, the Audit Committee Institute heard from three KPMG climate change and decarbonisation experts on the nature of the road ahead.

It may have taken a back seat during the height of the pandemic, but it never went away. The climate change challenge and what it means for business is an issue set to dominate for decades to come. As nations and individual organisations set Net Zero targets, it is more than just a topic of interest – it must move right to the heart of strategy.

As Sue Bonney, Vice Chair and Head of ESG at KPMG, observed: "There was a brief interlude during COVID-19, but it's right up there again now. There are a number of questions that executives and non-execs should be asking: Is the Board sufficiently literate on this? Are they asking the right questions of the business? Do we have a real understanding of the operational implications of our decarbonisation targets? And, where do we sit compared to our peers?"

What does COP26 hold in store?

The session got underway with an overview from Simon Virley, Vice Chair and Head of Energy & Natural Resources at KPMG, of the much-anticipated COP26 meeting due to be held in Glasgow in the first two weeks of November. Likely to be the most significant COP meeting since COP21 held in Paris in 2015, it will also be one of Britain's first major outings on the global stage post-Brexit. There are some key outcomes to aim for, as Simon reflected:

"With the US signing back up to the Paris Agreement under the Joe Biden presidency, and with China also having pledged to become Net Zero (by 2060), the positive news is that 70% of the world's economy is now committed to Net Zero targets. We can expect the focus at COP26 to be on bringing other remaining key economies on board, such as Australia, India and Brazil. There will also be moves to make good on the $100bn annual climate finance goal affirmed through the Paris Agreement, and to accelerate delivery of the Paris Goals through collaboration between governments, businesses and civil society."

If this all sounds mildly encouraging, it is sobering to reflect that the world is currently not on track at all to meet the Paris Goals. On current trends, the world is set to warm by 4°C by 2050 – double the Paris Agreement target of 2°C. The current pledges and targets that have been made (including, for example, the plan to reduce UK emissions by 68% by 2030) would only bend the line some of the way.

"The world is continuing to use fossil fuels at an unsustainable rate," Simon remarked. "Last year, for the first time, global emissions did in fact fall a little because of COVID and its downward impact on travel and industry. But, to put the size of the challenge in perspective, we need to see a similar fall every single year for the next 30 years consecutively if we're to meet targets."

UK leading the way?

The UK is in fact a leader on the global stage, having reduced emissions by 50% since 1990. This has taken us halfway to our Net Zero target. Nevertheless, Simon was quick to point out that the second half of the journey will be much harder than the first. "The first half has been all about the decarbonisation of the power sector. But in the second half, we'll need to tackle some much harder industries, like agriculture, and it will begin to affect businesses and consumers in very real and tangible ways. Extraordinary levels of behavioural change will be needed."

It's also true, as one attendee observed, that the UK's success to date has in part been achieved by relying on other countries to use their energy to provide all the energy intensive manufactured materials we import. This is an interesting argument as one could argue that the UK has perhaps unwittingly increased global emissions by exporting industrial production to coal fired manufacturing in China. It's a sign of just how difficult and complex the issue of carbon reduction is.

Geopolitics and cross-border taxes

With carbon border adjustment taxes set to be introduced in the coming years – to be levied on goods from countries that have not yet signed up to Net Zero targets – challenging geopolitical arguments lie ahead.

The EU is due to publish its proposals for this in June, with taxes set to come into effect in 2023. The UK is also working on its own separate proposals. "The geopolitics of this are about to get extremely difficult," Simon warned. "The old battles around oil in the Middle East are going to shift to taxation battles over the metals and cobalt needed from places like the Democratic Republic of Congo for our electric vehicle batteries."

The business challenge: responsibility and resilience

So, what does all of this mean for business? Bridget Beals, co-lead of KPMG's Climate Risk and Decarbonisation practice, said that the two principal lenses business leaders should be looking through are Responsibility and Resilience. Climate responsibility is about thinking through – including measuring and setting targets for – the organisation's business impact on the environment in terms of such areas as fossil fuel usage, emissions, water, waste & recycling, and biodiversity impacts. This is an area that most businesses – certainly bigger publicly listed ones – have a reasonable handle on. More than 1200 organisations, for example, have signed up to the Science Based Targets Initiative (SBTi) on Paris Aligned targets to limit temperature rises to 1.5°C by 2050.

Resilience, however, is a newer phenomenon and one that is being brought ever more sharply into focus as climate events – wildfires, droughts, floods, polar vortexes and more – cause physical impacts that test businesses' operations.

Resilience is by no means confined to physical events. As nationalism linked to the green agenda heightens, we can expect impacts to affect supply chains, margins and business models.

The COVID-19 pandemic has also thrown this into sharp relief. Many organisations realised that they had an insufficient understanding of the end-to-end supply chains on which they rely – not just tier one suppliers, but deeper into tier two and three. There are systemic risks and threats to resilience that businesses have got to develop their understanding of and response to."

Alongside these challenges, new regulations to drive both decarbonisation itself and to increase the transparency and comparability of reporting (such as the Taskforce on Climate-Related Financial Disclosures) are also raising the bar.

Modelling the scenarios

With so much at stake, scenario analysis and planning play an important role in helping organisations navigate their way. Crucially, scenario planning (based around different levels of warming over the coming years) should consider not only first order impacts on a business, but second and third order ones too.

"Scenario planning helps businesses think strategically about climate change, rather than as a simple disclosure issue," Bridget observed. "It's about identifying what is material for the business, how the risks and opportunities could manifest themselves through bottom-up analysis, and also developing a clear narrative that links strategy to reporting."

All in it together

A theme that came through in the discussions with attendees was the need for strong governmental policymaking and very clear communications and messaging to bring consumers on the journey. The 'ordinary man narrative' must be compelling and show the benefits of change.

Collectively, there is a huge task ahead. Business must play a full role and help lead the way – including driving up collaboration with each other across sectors to find new solutions that help deliver on the low carbon future the planet so urgently needs.

The KPMG Board Leadership Centre

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