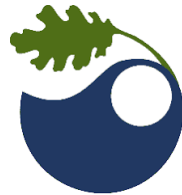


# The Problem(s) with Corporate Climate Commitments

Bren Seminar  
October 25, 2021

Patrick J. Callery



# Investors are paying greater attention to climate change

## Go carbon neutral or get left behind, world's biggest money manager warns companies

CEO Larry Fink lays out importance of environmental priorities in annual letter

Thomson Reuters · Posted: Jan 26, 2021 10:45 AM ET | Last Updated: January 26



**\$5 trillion investor group sets tougher portfolio carbon targets**

Search jobs Sign in Search International edition ▾

# The Guardian

## Investors that manage US\$47tn demand world's biggest polluters back plan for net-zero emissions

Climate Action 100+ group put 161 fossil fuel, mining, transport and other big-emitting companies on notice in latest campaign by shareholders

## BlackRock says the oil companies it invests in should disclose emissions

Published: Feb. 17, 2021 at 6:32 p.m. ET

# Companies are listening



**Net-zero emissions targets adopted by one-fifth of world's largest companies**

**Forbes**

Aug 26, 2019, 04:32pm EDT | 88,938 views

## 101 Companies Committed To Reducing Their Carbon Footprint

 **Blake Morgan** Senior Contributor   
CMO Network  
*I am a Customer Experience Futurist, Author and Keynote Speaker.*

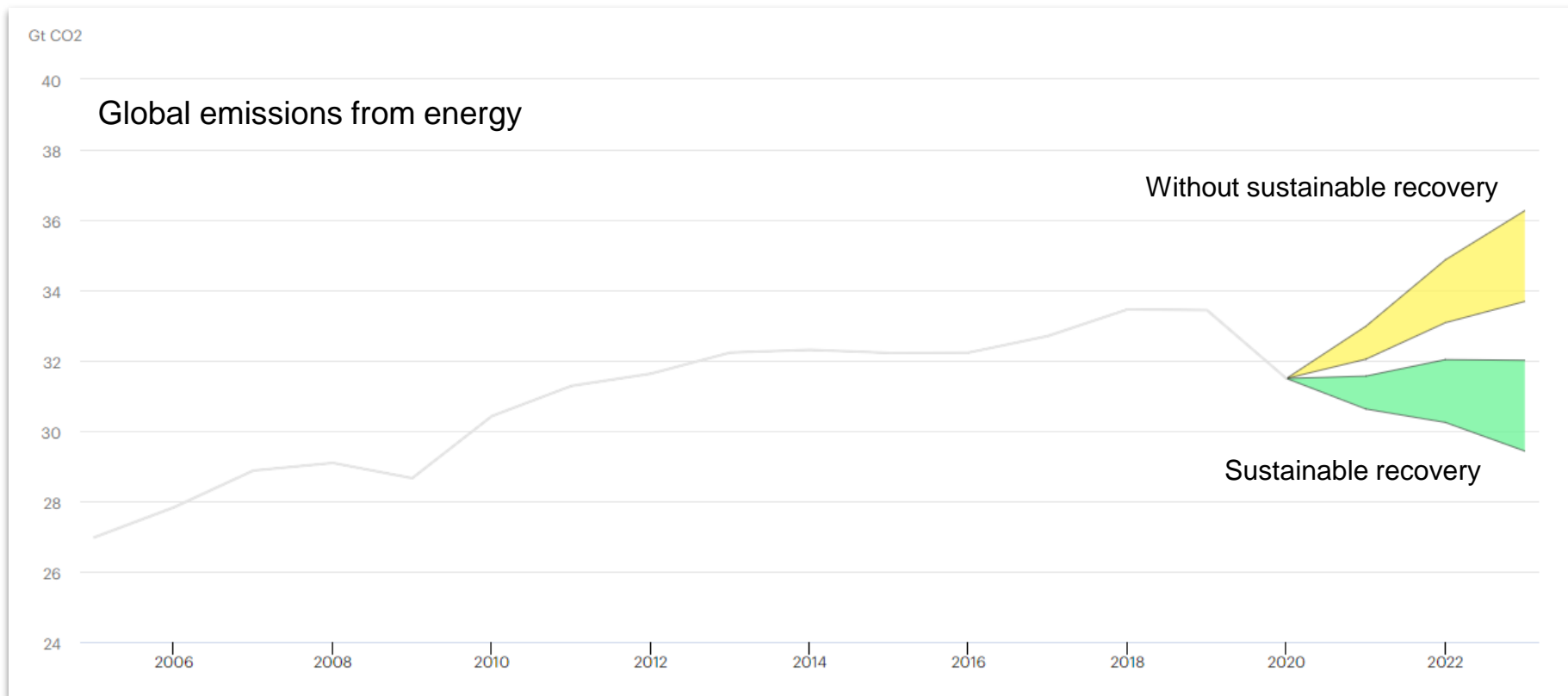
[Follow](#)



UN CLIMATE PRESS RELEASE / 21 SEP, 2020

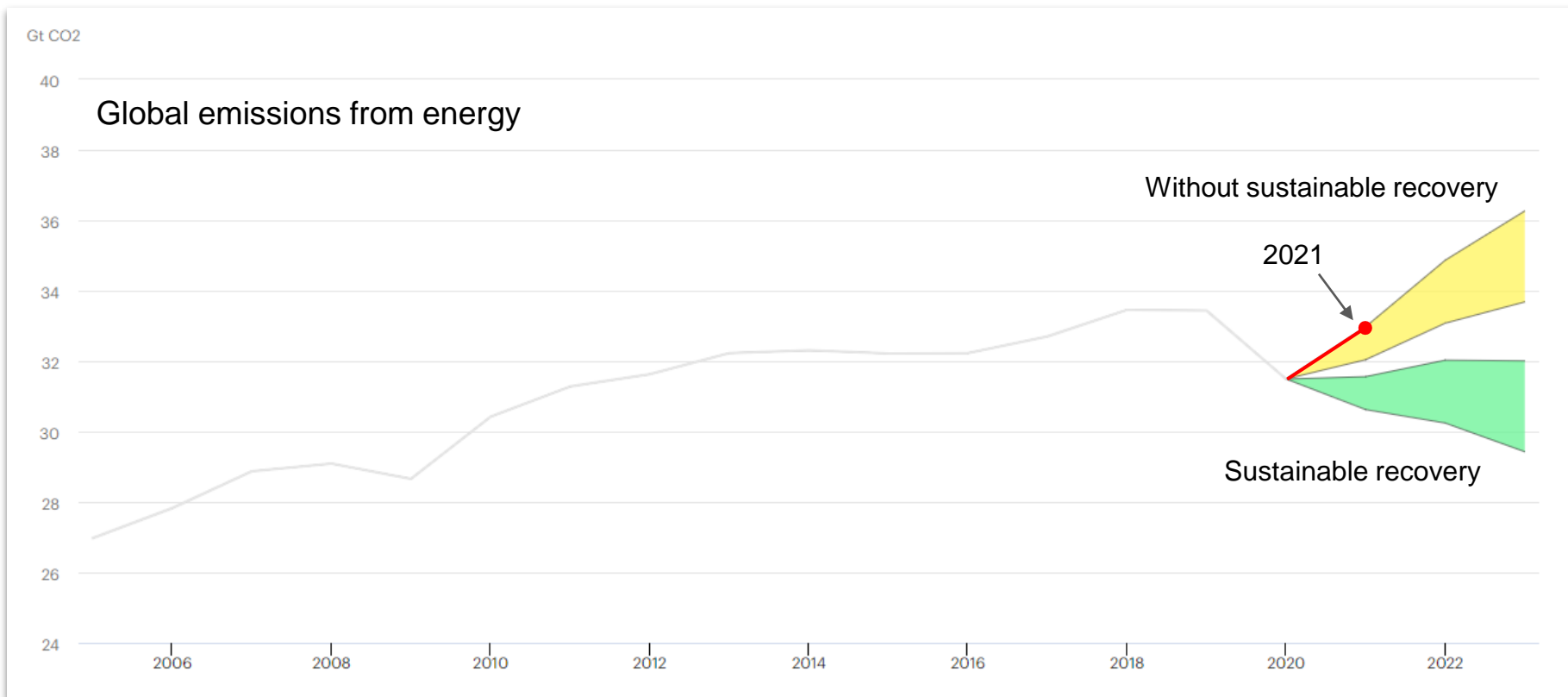
## Commitments to Net Zero Double in Less Than a Year

# Any effect on global emissions?



Source: IEA Global Energy Review 2020 -- CO<sub>2</sub> emissions in 2020 (March 2021)

# Any effect on global emissions?

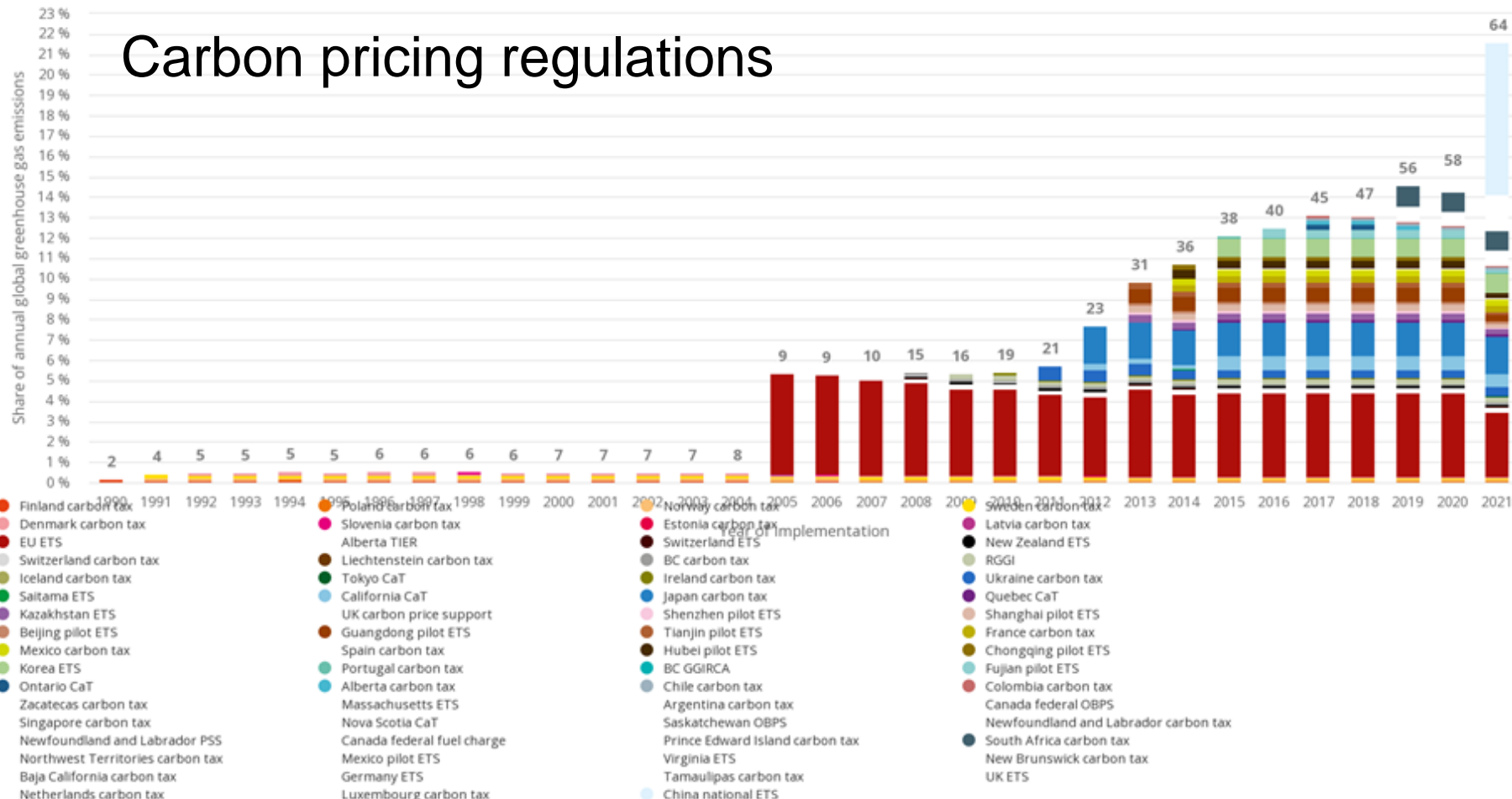


Source: IEA Global Energy Review 2021 (April 2021)

# Potential mechanisms to address industry emissions

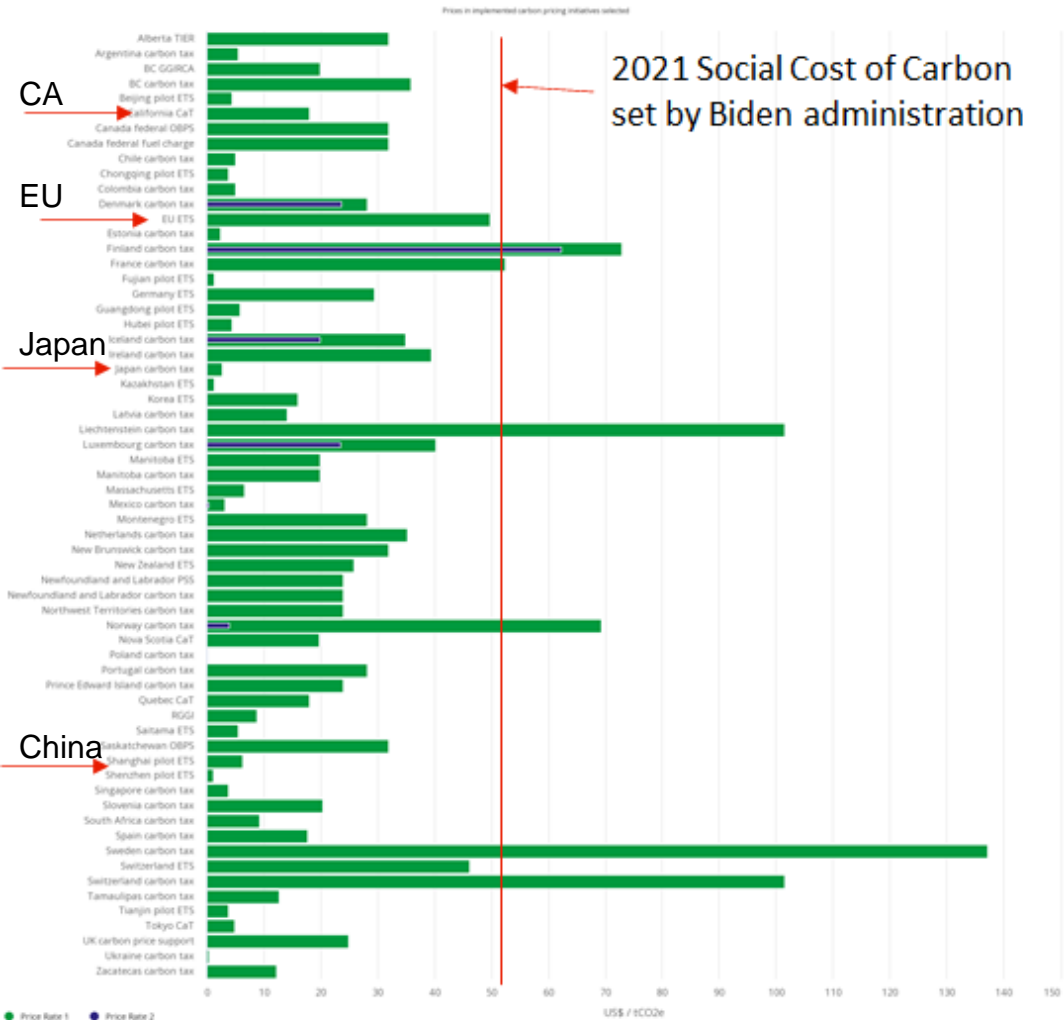
- Carbon pricing
  - Regulatory fees or limits on emissions imposed through market mechanisms
- Mandatory disclosure
  - Regulatory directives imposing transparency over emissions performance
- Voluntary disclosure
  - Leverage institutional pressures for transparency and performance
  - Evolution of corporate climate commitments (i.e., carbon targets)

# Carbon pricing regulations



Note: Only the introduction or removal of an ETS or carbon tax is shown. The coverage of each carbon pricing initiative is presented as a share of annual global GHG emissions for 1990-2015 based on data from the Emission Database for Global Atmospheric Research (EDGAR) version 5.0 including biofuels emissions. The share of global GHG emissions is based on 2015 emissions from Emissions. The GHG emissions coverage for each jurisdiction is based on official government sources and/or estimates. If emissions that are covered by multiple carbon pricing initiatives shown in the graph, these are attributed to the carbon pricing initiative that was implemented first. The information on the China national ETS represents early unofficial estimates based on the announcements, but also corrections following new information from official government sources.

Source: World Bank Carbon Pricing Dashboard



# Realized carbon prices

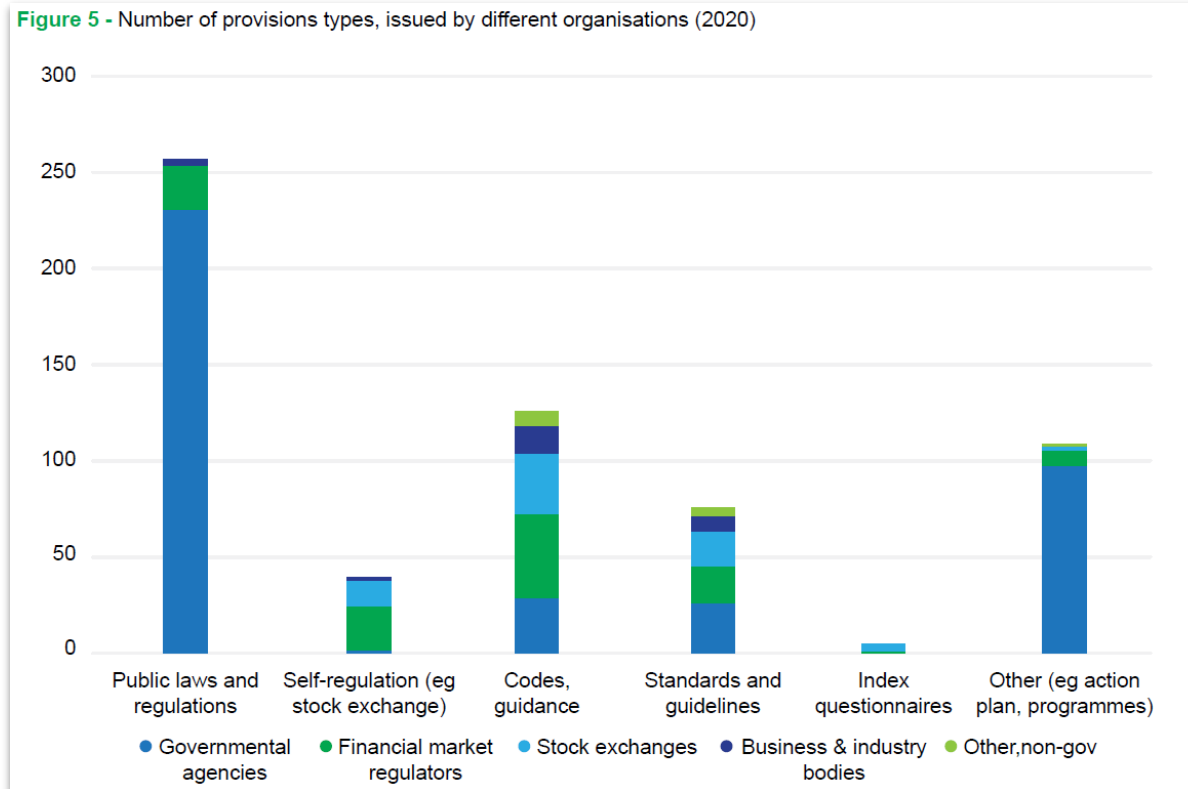
- Carbon tax rates, cap and trade allowance prices
- Largest markets (by CO<sub>2</sub>e) are priced far below SCC
- “Political non-starter” in US



# Mandatory disclosure regulations

- *“Sunlight is the best disinfectant”*
- Transparency directives:
  - US EPA: Toxics Release Inventory (TRI) and 33/50 program
    - Localized pollutants with human/ecological toxicity implications
    - Widely regarded as highly successful
  - US EPA: Greenhouse Gas Reporting Program (GHGRP)
    - Broadly dispersed pollutants with indirect / diffuse effects
    - Limited effect on emissions reductions
- Climate and sustainability reporting instruments increasingly applied globally
  - Specific to regulatory jurisdiction and institutional context

# Lack of alignment across jurisdictions, institutions, directives

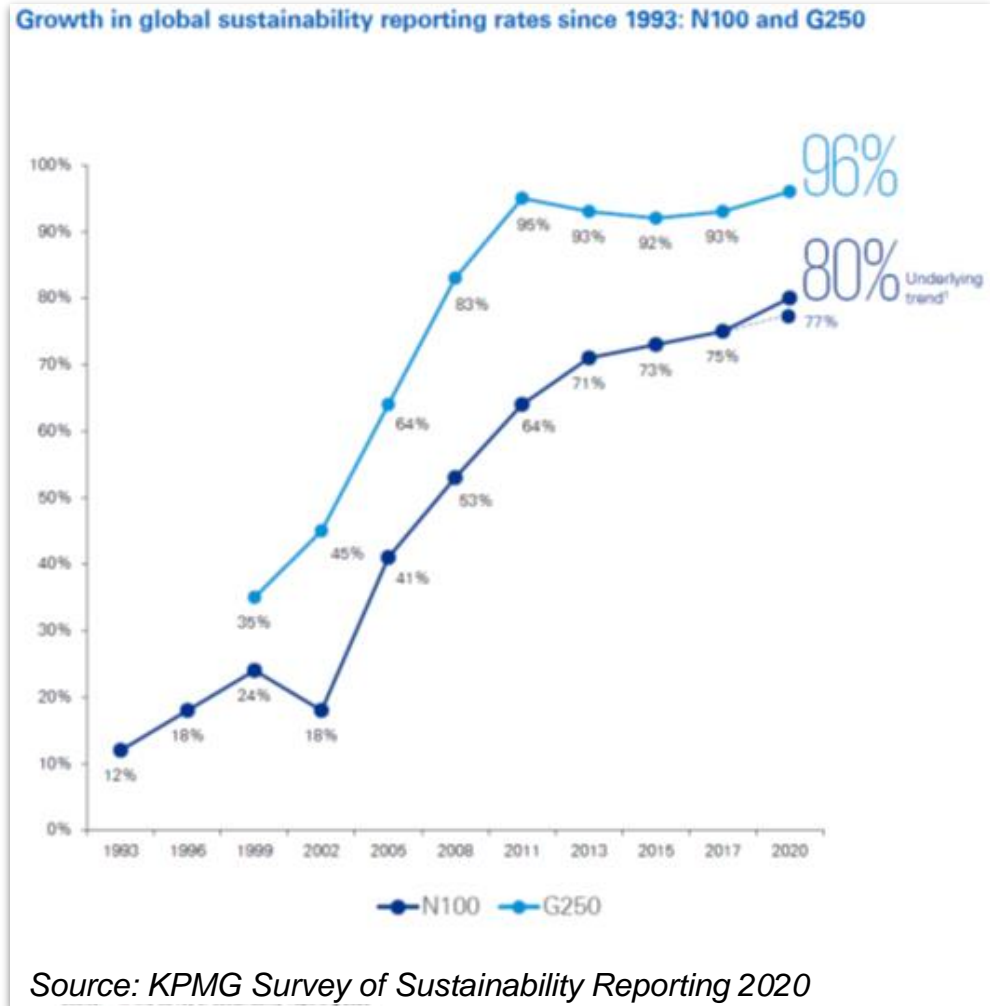


Source: Carrots & Sticks 2020

# Voluntary disclosure

## “Corporate sustainability reports”

- Stakeholder pressures drive adoption
  - Now ubiquitous among global firms
- Inconsistent standards
  - Allows broad discretion in reporting
  - “Selective disclosure”
- Limited accountability
  - Lack of audit oversight
  - Problematic assurance systems
- Greenwash



Source: KPMG Survey of Sustainability Reporting 2020

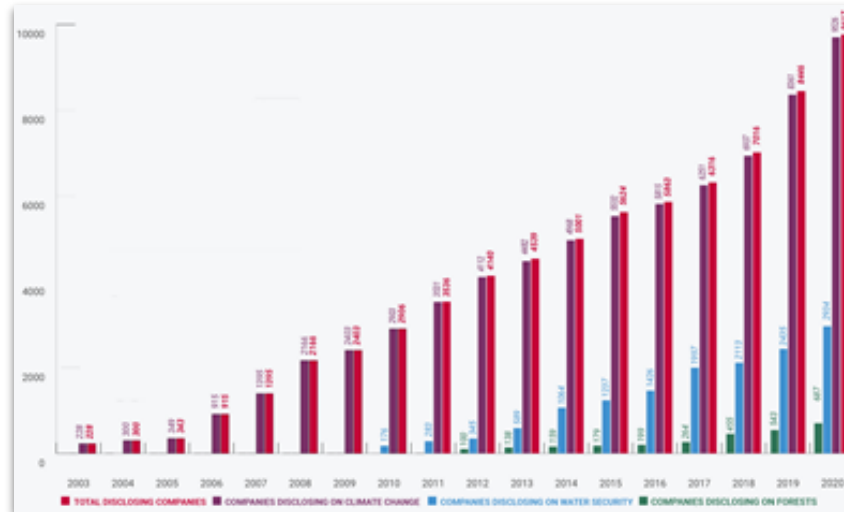
# Voluntary carbon disclosure mechanisms

- Emergence of formal, voluntary mechanisms
  - Fixed, global standards: reduce discretion in firm reporting
  - Enables third-party assurance against public standards
  - Institutional investor pressure drives adoption
  - Allows direct comparison among firms
- Climate disclosure and reporting:
  - Carbon Disclosure Project (CDP)
  - Science-Based Targets Initiative (SBTi)
  - Climate Disclosure Standards Board (CDSB)
  - Task Force on Climate-related Financial Disclosures (TCFD)



# Rapid growth in voluntary climate disclosure

- More than 9500 firms report climate performance to CDP (2020)
  - Endorsed by institutional investors representing over \$100T assets under management
- Nearly 1000 firms report a “science-based target” (2021)
  - Aligned with global / sectoral goals established by Paris Agreement



Source: CDP

# Carbon targets

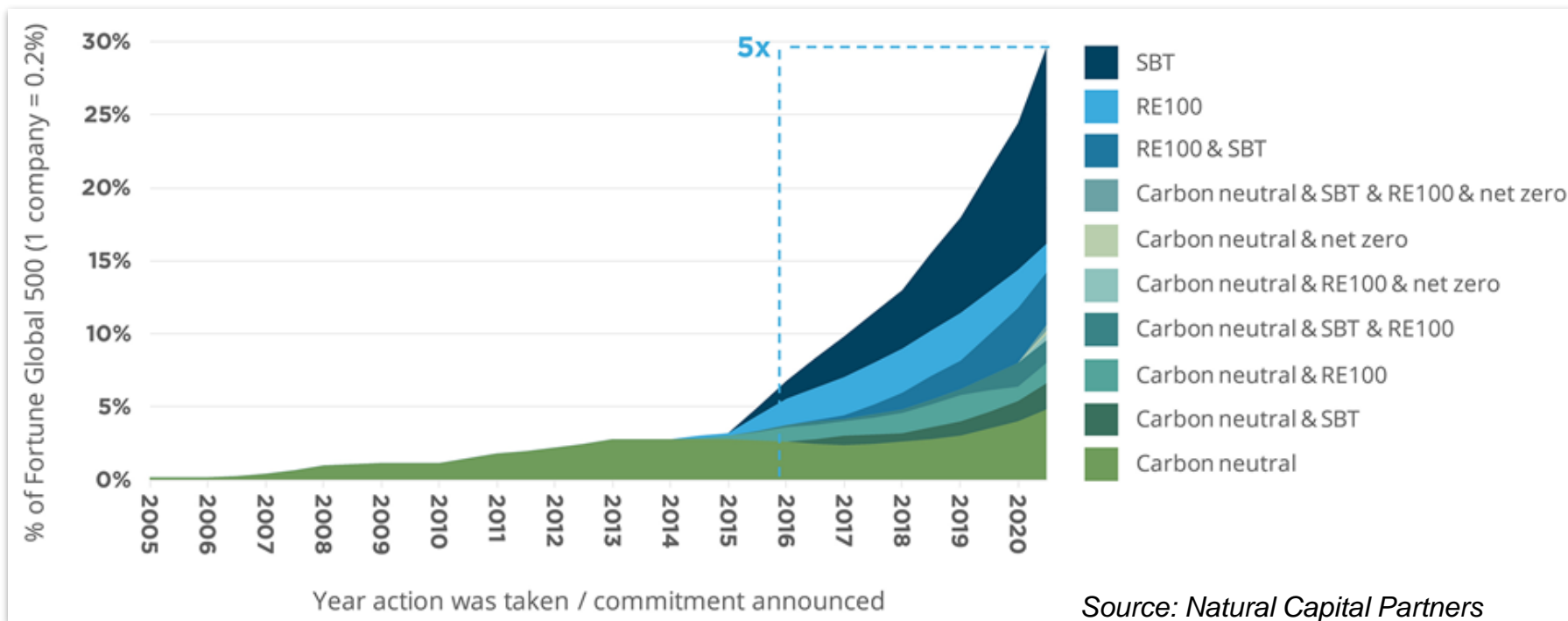
- Rapidly growing practice for communicating corporate climate commitments

Example carbon target:

*Adobe commits to reduce absolute scope 1 and 2 emissions 25% by 2025 from a 2015 base-year.*

# Carbon targets

- Rapid increase in more “ambitious” targets



# Do carbon targets work?

Findings from recent academic research:

- More difficult carbon targets more likely to be attained (*Ioannou et al., 2016*)
- Key aspects of targets associated with lower emissions (*Dahlmann et al., 2019*)
  - Greater target ambition
  - Absolute emissions targets
  - Longer-term orientation
- Science-based targets associated with positive action (*Freiberg et al., 2021*)
  - More ambitious targets
  - Increased investment in emissions reductions
  - Increased reported monetary savings from emissions reduction initiatives



# The problems with corporate climate commitments

Emerging research suggests not all is well:

1. Targets are *not meaningful*
2. Targets are *not being attained*
3. Targets are *getting easier*
4. Ambitious targets generally *rely on offsets*
5. Emissions reports *can be manipulated*

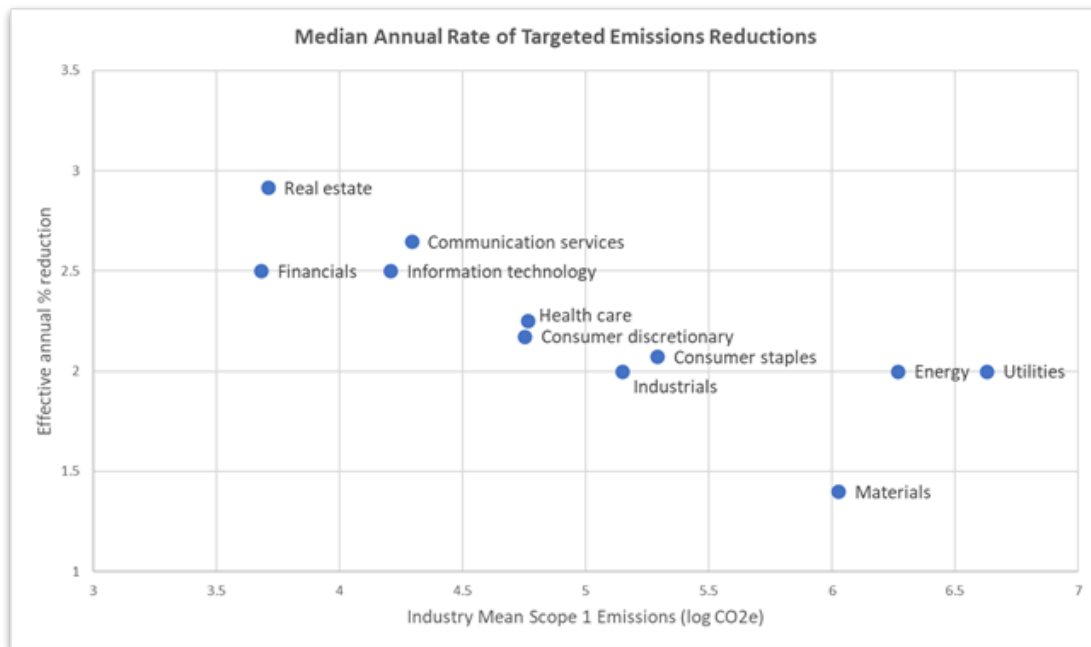
# 1. Carbon targets are not meaningful

## Insufficiently aggressive

- Annual emissions reductions of 4.2% required for 1.5°C warming (SBTi)
- Median carbon target = 2.1% per year

## Wrong sectors

- Emissions-intensive industries report smaller targets



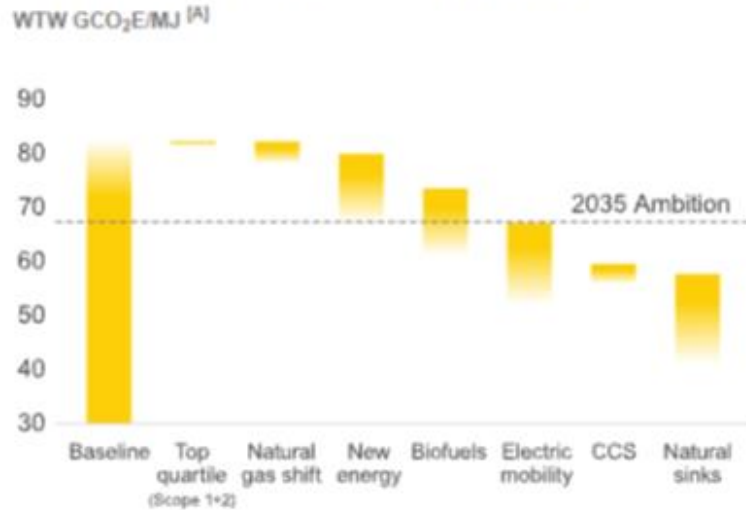
Source: Analysis of CDP data from Callery & Kim (2021)



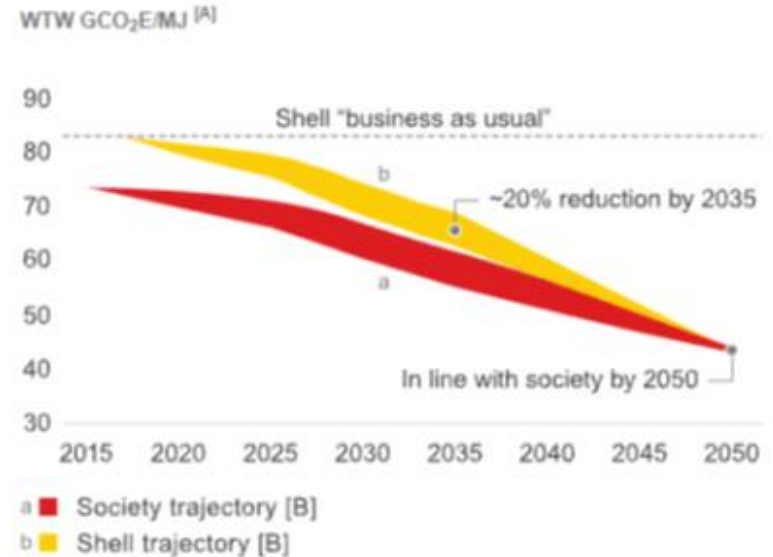
# Example: high Scope 1 emissions sector (oil & gas)



## Potential tools to achieve our 2035 net carbon footprint [A] ambition

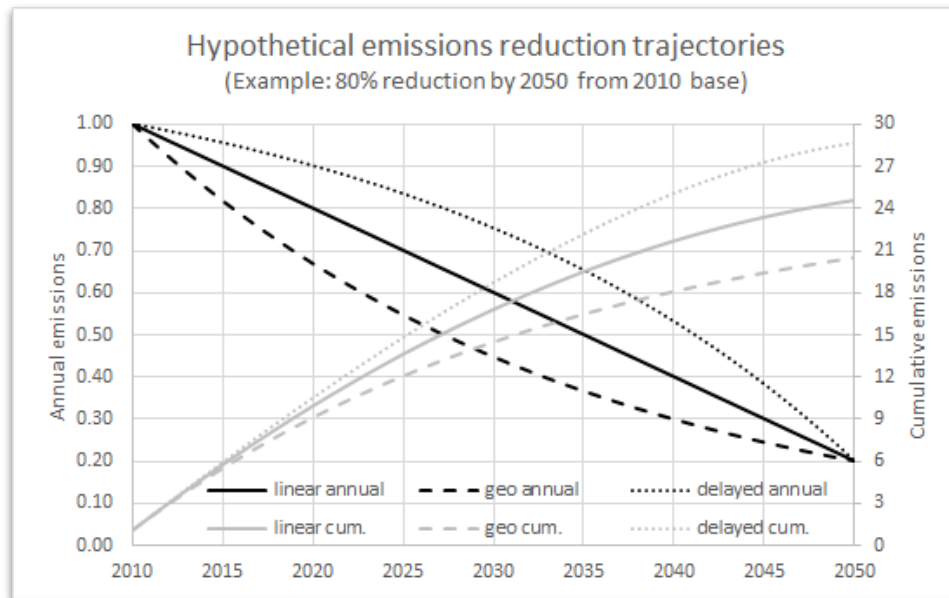


## Ambition for net carbon footprint [A]



## 2. Existing carbon targets are not being attained

- Attainment falling short
  - Fewer than 40% of expired targets attained
- Progress lacking
  - Fewer than 50% of ongoing targets are on track (linear reduction trajectory)
- Emissions trajectory matters!
  - Front-loaded reductions result in lower cumulative emissions
  - SBTi recommends linear pathway
  - Sectoral decarbonization approach (SDA) allows for delayed trajectory in certain sectors, in line with formal pathways
  - SDA indicates geometric pathway for electricity sector (i.e., Scope 2)

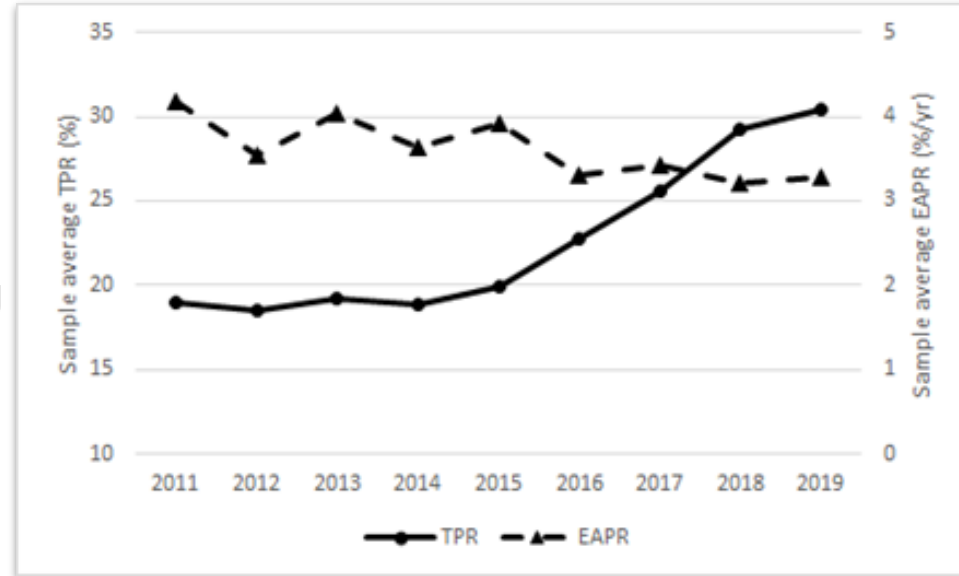


Source: [Callery & Kim \(2020\)](#)

### 3. New carbon targets are getting easier

- Nominal size increasing
  - Total percentage reduction
- Target horizons lengthening
  - “Long-term orientation”
- Effective annual reduction decreasing
  - Lower percentage reduction per year

Nominal target size increasing, rate of reductions decreasing



Source: [Callery & Kim \(2020\)](#)

### 3. *Existing* carbon targets are getting easier

- More than 50% of all disclosed targets change from year-to-year
- Analogy: corporate financial targets
  - Companies held to account for relaxed / unattained financial targets
- Carbon targets: investors do not attend to target consistency
- Methods of surreptitiously relaxing targets
  - Increasing nominal size while reducing effective rate of reduction
  - Backdating the “baseline year”
  - Allocating more aggressive targets to smaller operations
  - Allocating more aggressive targets to supply chain emissions (Scope 2, 3)

## 4. Ambitious carbon targets rely on offsets

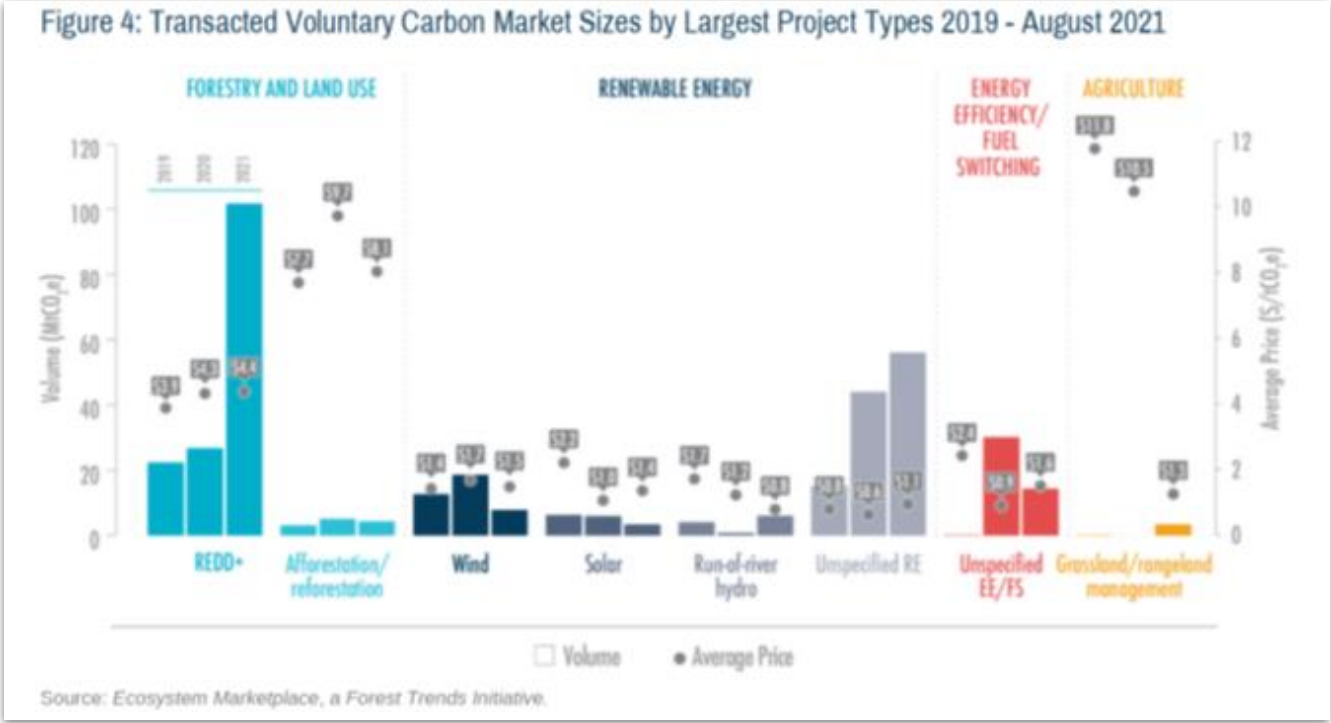
- How are carbon targets to be achieved?
  - Emissions reductions, carbon removals, carbon offsets
- How much of net zero commitments are emissions reductions vs offsets?
  - Offsets must be “real, measurable, and additional”
  - SBTi guidelines don’t allow offsets, only removals
- Problems with offsets
  - Most offsets not plausibly additional (EU ETS: [CDM](#), [JI](#))
  - [Forest offset programs](#) may do more harm than good ([REDD](#))
  - Perverse incentives ([HFC destruction credits](#))
  - Voluntary market largely unregulated



# Voluntary offset market surging to meet corporate demand

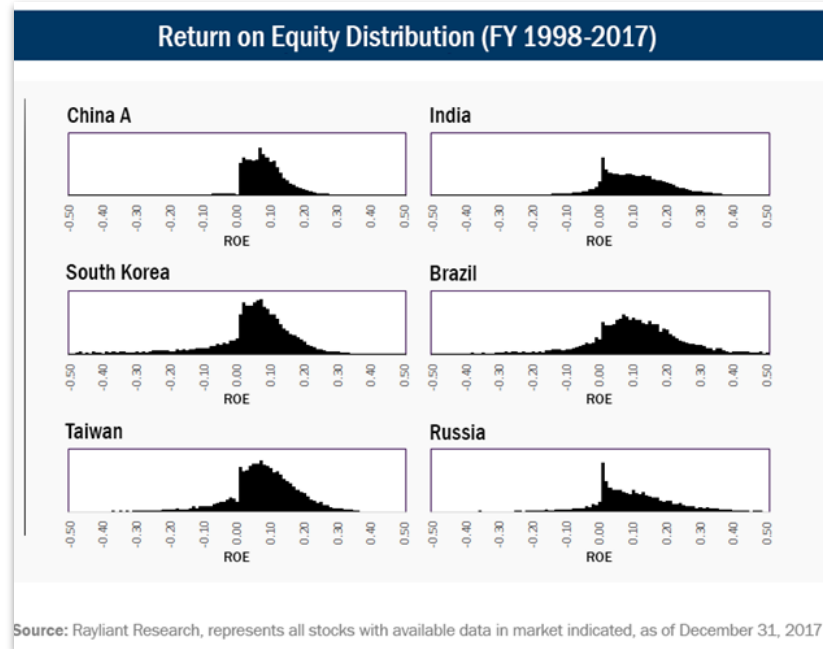


# Voluntary offset prices continue to fall



## 5. Emissions reports can be manipulated

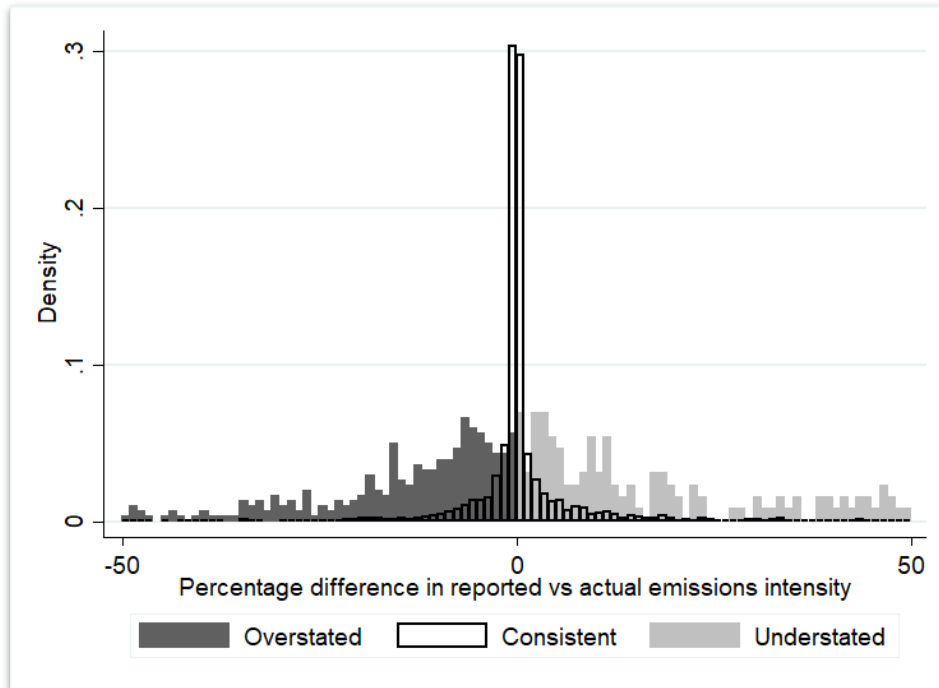
- Analogy: financial reporting
  - Loopholes in GAAP
  - “Earnings management”
- Carbon reporting tricks:
  - Multiple emissions inventory standards
  - Changing reporting boundaries
  - Divestment of facilities
  - Complex accounting rules for scope 2 and 3
  - Restatement



# Emissions disclosure manipulation

- Lack of audit oversight
  - “Limited assurance”
- Low probability of detection
  - Limited investor attention
- Incentives to misrepresent emissions
  - Data embedded into investor algorithms
  - Emissions disclosures unreliable

**Misstatement in Emissions Intensity Percentage Reduction**



Source: [Callery & Perkins \(2021\)](#)

# The problem with corporate climate commitments

- *“A business that pursues ‘sustainability’ as conventionally understood becomes, in the media’s eye and in customer perception, a ‘green’ company, absolved of doing anything else. Such firms don’t have to undertake the hard work of political activism that might actually drive down global emissions... they don’t even need to cut their emissions to be labeled a leader. They just need to aspire to it.”*
- *“The approach has been evil because it represents complicity. Complicity with the fossil fuel industry and the structure it created—its capture of government; its ownership of the economy; its buried but enduring subsidies; its support, by political proxy, for anti-democratic practices that would restrict regulation; its construction of a world in which citizens exist in a fossil economy, not of their creation but nonetheless blame themselves for it.”*

Excerpt from:

Auden Schendler (2021), [“The Complicity of Corporate Sustainability”](#), *Stanford Social Innovation Review*

# The complicity of corporate sustainability

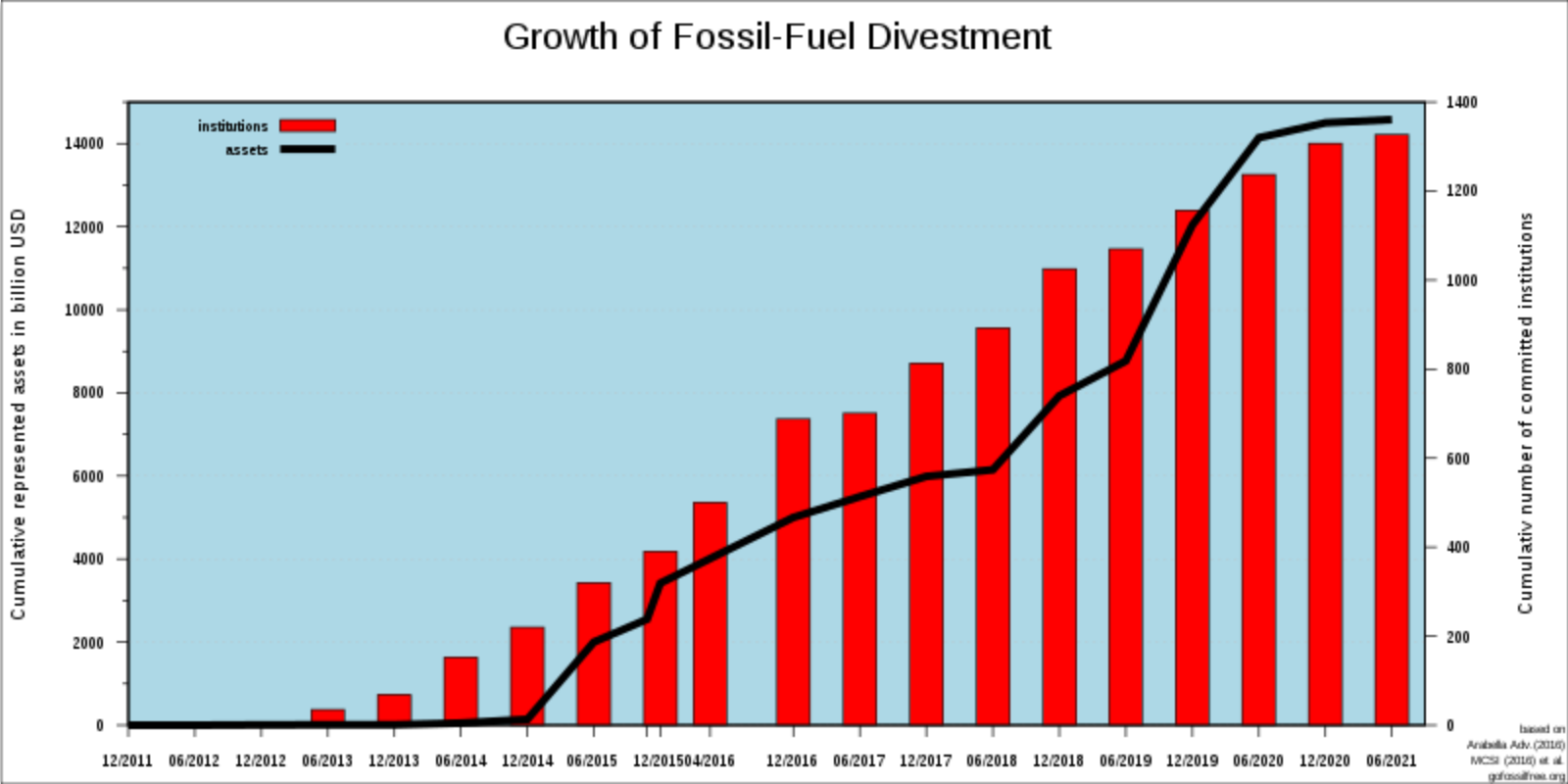
Entrenched interests protect the status quo:

- **Distraction**
  - “Sustainable business practices” displace meaningful action
  - Long-term carbon targets allow deferred action until technology becomes available
- **Duplicity**
  - Claiming [support for climate policy in public](#) while [lobbying against it in private](#)
  - Promoting a [“doomed policy”](#) under false pretense
- **Complicity**
  - Focusing on [individual choice](#) rather than [systemic change](#)

# What can investors do?

- Institutional investors: manage investments on behalf of clients
  - Pension funds; endowments; mutual funds; hedge funds
  - Often hold large blocks of equity shares
- Sensitive to capital at risk
- Multiple methods to engage corporations in risk management
  - Divestment
  - ESG investing
  - Active engagement

# Fossil fuel divestment movement



Source: *Wikimedia Commons*

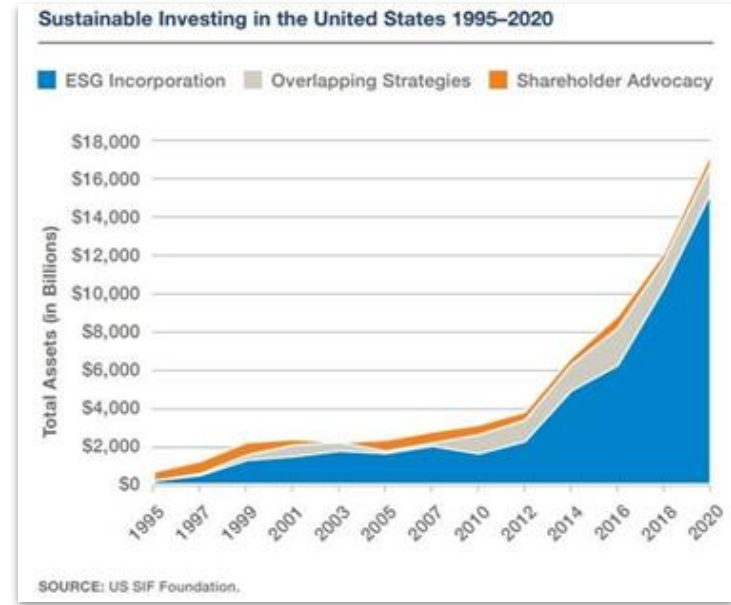


# Does divestment work?

- Evidence from South Africa (anti-apartheid divestment movement, 1980s)
  - [Little impact on stock prices](#)... ultimately relied on economic impacts of direct capital flight
- Divestment occurs largely in secondary market
  - [Limited impact on stock prices](#) or access to capital
  - State-owned firms largely inaccessible
- [Indirect effects](#) may be more powerful than tangible limits on access to capital
  - Raising awareness; changing public discourse on industry legitimacy
- [Divestment movement](#) focus [shifting toward financiers](#)

# ESG investing

- Environmental, Social, and Governance
- Rapidly growing trend -- 1/3 of AUM in US
  - Exclusionary screening (a gentler form of divestment)
  - Sectoral / thematic (targeting emerging sectors)
  - ESG integration (integrated into fundamental analysis)
- What makes a company “ESG”?
  - Multiple investment advisories develop scores based on company disclosures and media reports
- Complaints
  - ESG ratings are [subjective](#) and [diverge between data providers](#)
  - Just drives greater demand for “FANG” stocks
  - Secondary market -- doesn’t affect access to capital
  - Perverse incentives for [institutional asset managers](#) and [corporate executives](#)



# ESG investing and climate change

OPINION

## **BlackRock hired me to make sustainable investing mainstream. Now I realize it's a deadly distraction from the climate-change threat**

**TARIQ FANCY**

CONTRIBUTED TO THE GLOBE AND MAIL

PUBLISHED MARCH 25, 2021

UPDATED MARCH 30, 2021



# A deadly distraction

- *“The financial services industry is duping the American public with its pro-environment, sustainable investing practices. This multi-trillion dollar arena of socially conscious investing is being presented as something it's not. In essence, Wall Street is greenwashing the economic system and, in the process, creating a deadly distraction. I should know; I was at the heart of it.”*
- *“Imagine the planet is a cancer patient, and climate change is the cancer. Wall Street is prescribing wheatgrass: A well-marketed, profitable idea that has no chance of curing or even slowing down the cancer. In this scenario, wheatgrass is the deadly distraction, misleading the public and delaying lifesaving measures like chemotherapy. But like giving false hope to unproven cures in the midst of a pandemic, the consequences of such irresponsibility are all too obvious. And motivation for why the industry continues to greenwash is all too obvious.”*

Excerpt from:

Tariq Fancy (March 16, 2021), “Financial world greenwashing the public with deadly distraction in sustainable investing practices”, *USA Today*.

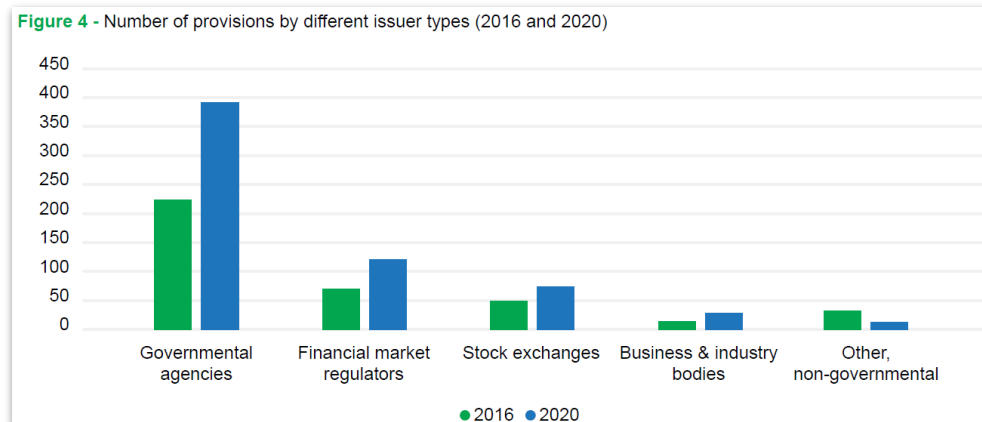
# Active engagement

- Shareholder resolutions
  - Bring governance proposals to a vote at annual meeting of stockholders
  - Increasingly filed on climate-related issues
  - Require only very small minority holding to engage
- Shareholder activism
  - Investors leverage large stock holdings to [engage firms from within](#)
  - Example: [Climate Action 100+](#)
- Activist shareholders
  - “Proxy battles”
  - Example: [Exxon-Mobil and Engine No.1](#)



# What can regulators do?

- Regulators are taking notice
  - Effective regulation of climate disclosure can be realized outside of legislative process
  - SEC [weighing enforcement action on climate disclosure](#)
  - Organizations call on EU to [enact unified sustainability disclosure standards](#)
- Disclosure regulation must:
  - Measure outcomes, not policies
  - Enforce strict accountability



Source: Carrots & Sticks

# Outcomes, not policies

- Long-term carbon targets are meaningless
- Measure firms on **results**
  - Manage emissions as with financial performance
  - Track annual goals in support of long-term target
  - Trajectory in line with formal pathway scenarios (e.g., IPCC 1.5°C)
  - Prioritize Scope 1 emissions

# Strict accountability

- How do you hold firms accountable for voluntary targets?
  - The market already does this: with financial performance targets
  - Investors recognizing emissions and carbon risk are “material”
- Securities regulation agencies can enforce discipline in reporting
  - Strict guidelines on emissions accounting and voluntary reporting
  - Require third-party auditing; penalties for fraud
- Investors will follow
  - Activist shareholders will demand conformance
- Corporate governance will follow
  - Board oversight of reporting practices
  - Align managerial incentives with emissions performance