COP21 and the Paris Agreement: what it means for UK businesses

Climate policy update

January 2016
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Our view

► The Paris Agreement marks a significant inflection point in global action on climate change.
► Consensus is building for more ambitious carbon mitigation, suggesting that further evolution of the UK’s domestic climate policy is likely.
► The private sector has a critical role to play in the implementation of the Paris Agreement.
► Decarbonisation of economies will create significant opportunities for private sector investment, but also risks for capital exposed to high emissions intensity infrastructure.
► As owners of physical assets, businesses will need to collaborate with Government to engage in adaptation planning and implementation.
► Businesses should consider applying a 2°C stress test to their business models to understand the risks and opportunities within their own boundaries, and broader forces affecting supply chains and customers.

National pledges to cut greenhouse gas emissions

In contrast to previous conferences, COP21 and the Paris Agreement was reached through a global, bottom-up approach that was more palatable to a range of parties. In the lead up to the conference, countries set out their medium-term emissions targets, more than 100 businesses committed to set science-based emissions targets and a multi-billion dollar commitment was made to clean energy financing.

UK businesses also took action ahead of COP21. A number of British companies, including many high street names, wrote to David Cameron calling for stronger action on climate change both domestically and internationally.

COP21 agreed a collective ambition to limit temperature increases to 2°C above pre-industrial levels, with an aspiration for even greater action. While some individual country pledges align with these goals, others do not. However, the Paris Agreement provides a pathway to strengthening these commitments over time.

The role of the private sector

During the two weeks of negotiations, there was unprecedented recognition of the critical role that the private sector needs to play, providing its expertise, capability and resources to support the implementation of the Paris Agreement.

4 themes for business

We see four significant themes for business arising from the Paris Agreement. On the following pages we outline our views on how UK businesses may be impacted by:
► Countries’ commitments and targets
► Carbon markets
► Climate finance
► Adaptation
1. Countries' commitments and targets

One of the key features of COP21 was the Intended Nationally Determined Contributions (INDC) process which saw countries put forward their 2030 greenhouse gas emissions targets ahead of the conference. The flexible nature of INDC target-setting, along with the country-level actions to deliver the targets, led to 187 of the 196 participating countries submitting INDCs. This outcome also formed the basis for a five year review process of country targets and trajectories towards meeting them, to commence in 2023.

Challenges do remain. While the Paris Agreement focuses on limiting temperature rise to 1.5-2°C, the current INDC commitments are not believed to be consistent with this goal: instead, they would likely result in a long-term global temperature rise of 2.7-3.9°C. Despite this, the INDC process could now transform into a mechanism for both tracking action, and driving deeper emissions abatement in future years.

For UK businesses, these outcomes provide a higher degree of certainty about the path ahead for emissions abatement. The UK’s 2008 Climate Change Act, with a long term target of 80 percent emissions reduction by 2050 on a 1990 baseline has a similar design to the Paris Agreement. However, the current trajectory shows the UK missing its targets in mid-2020. This is against a backdrop of a year where support for energy efficiency and clean energy projects such as solar PV in the UK has been rolled back. With David Cameron’s backing of the Paris Agreement, which is striving to limit warming to below 2°C, further evolution of the UK’s domestic climate policy is likely.

2. Carbon markets

The Paris Agreement recognises the central role of market mechanisms in limiting greenhouse gas emissions, and supporting sustainable development. A significant new initiative is the Sustainable Development Mechanism, which focuses on mitigation of greenhouse gas emissions and combines the features of the existing Clean Development Mechanism (CDM) and Joint Implementation initiatives. Similarly to the CDM, the proceeds from activities under the new mechanism will be used to assist developing countries to implement actions to adapt to the physical impacts of climate change. Both developed and developing countries will be able to use the mechanism and be buyers or sellers of carbon units. The carbon units generated by the mechanism are referenced as Internationally Transferred Mitigation Outcomes (ITMOs).

While not forming part of the Paris Agreement, the World Bank Group put forward its vision for the future carbon market landscape, which could include ‘carbon clubs’ and future connected carbon markets, under which (for example) California, China, the EU Emissions Trading Scheme (ETS), Quebec and the US Regional Greenhouse Gas Initiative might be linked.

Within the business community, consensus is building that pricing emissions is inevitable. A recent survey by EY found that 74% of respondents based in countries where carbon pricing mechanisms have not yet been implemented believe they will be in place within the next five years. The wider survey findings also provide evidence that companies are increasingly open to taking independent carbon pricing action, expecting it to lead to overall business performance improvements.

One market moving ahead on carbon pricing is China. China plans to introduce a national emissions trading scheme from 2017, following a number of provincial ‘pilot’ emission trading schemes currently in place. Given the financial implications of a Chinese ETS to UK businesses, there is significant motivation to respond early. Businesses with a greater awareness of their supply chain are likely to make more informed decisions about what suppliers they use and the way they interact with those suppliers.
3. Climate finance

Financing mechanisms extended from developed countries to developing counties for action on climate change were an essential part of the Paris Agreement. The Paris Agreement reiterates the commitment made by developed countries in Copenhagen to mobilise US$100 billion per annum to support action in developing countries by 2020 and agrees to set a new collective goal prior to 2025, with a floor of US$100 billion per annum. Similar to other areas of the Paris Agreement, finance will be subject to regular progress reviews.

Beyond donor and government mobilised finance, the Paris Agreement sets the stage for a scaling-up of private sector finance for climate action given that the level of financing involved in a transition to a low carbon economy will be much greater in magnitude than the proposed commitments. A recent study by The Climate Policy Initiative\(^2\), using available data, estimated that private investment contributed 62% of primary investment flows for renewable energy in 2014, with an increase of 26% on the previous year. Mobilising markets and other private capital will clearly be key, and may provide significant opportunities in coming years as actions increase, for example in low carbon and climate smart technologies. The Paris Agreement should also provide confidence to forward-looking investors and businesses that have started their transition to the low carbon economy.

4. Adaptation

In terms of adaptation, the Paris Agreement establishes a global goal of ‘enhancing adaptive capacity, strengthening resilience and reducing vulnerability to climate change’. As is the case for mitigation efforts, there is a similar process of review and strengthening in place for adaptation.

A significant focus of the Paris Agreement with respect to adaptation is on continuous and enhanced support to those developing countries that are particularly vulnerable to the adverse effects of climate change. The Paris Agreement also provides for all countries to strengthen cooperation on adaptation action, engage in adaptation planning processes, implement actions, and submit and periodically update a communication on adaptation.

As owners of much of the physical assets and infrastructure at risk from the impacts of climate change, businesses will need to collaborate with Government to engage in adaptation planning and implementation. For businesses with operations in developing country nations, opportunities exist to provide innovative adaptation solutions.

Conclusion

While it is easy to say that climate policy continues to evolve, the outcomes of COP21 in Paris are more comprehensive and far-reaching than many anticipated. Change will continue to occur, but there is now a sense that the direction of future change is clearer and more certain than just a few months ago.

Against this background, businesses can prosper. Addressing climate change is in many ways a question of finance and innovation, and the significant investment in low carbon infrastructure that the world needs to embark on represents an opportunity across many sectors. Companies will also need to be agile and insightful by, for example, applying a 2°C stress test to their business models to understand the risks and opportunities within their own boundaries, as well as the broader forces affecting their supply chain and customers. Planning for this future will place businesses in the best position to respond, and grow.

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