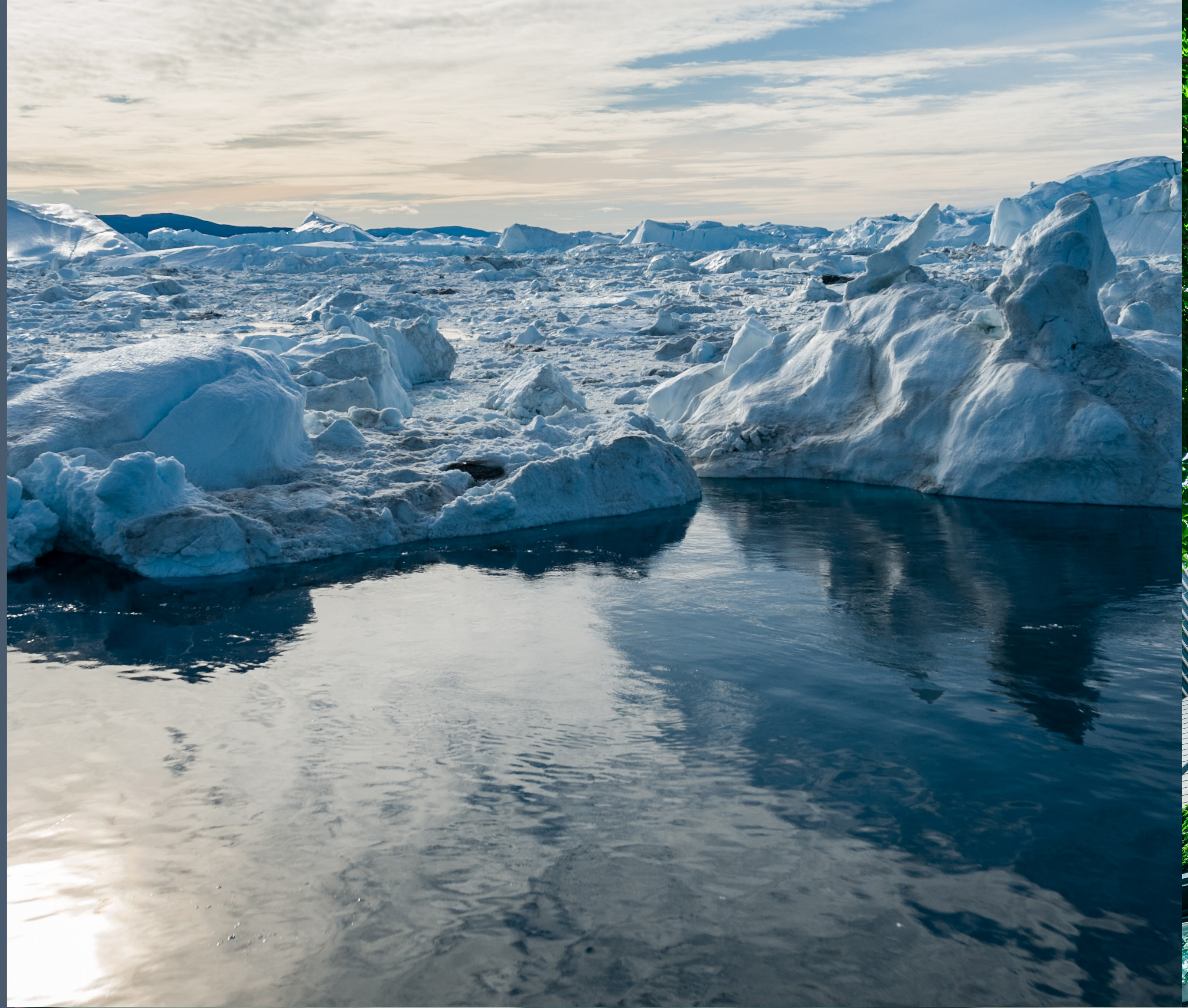
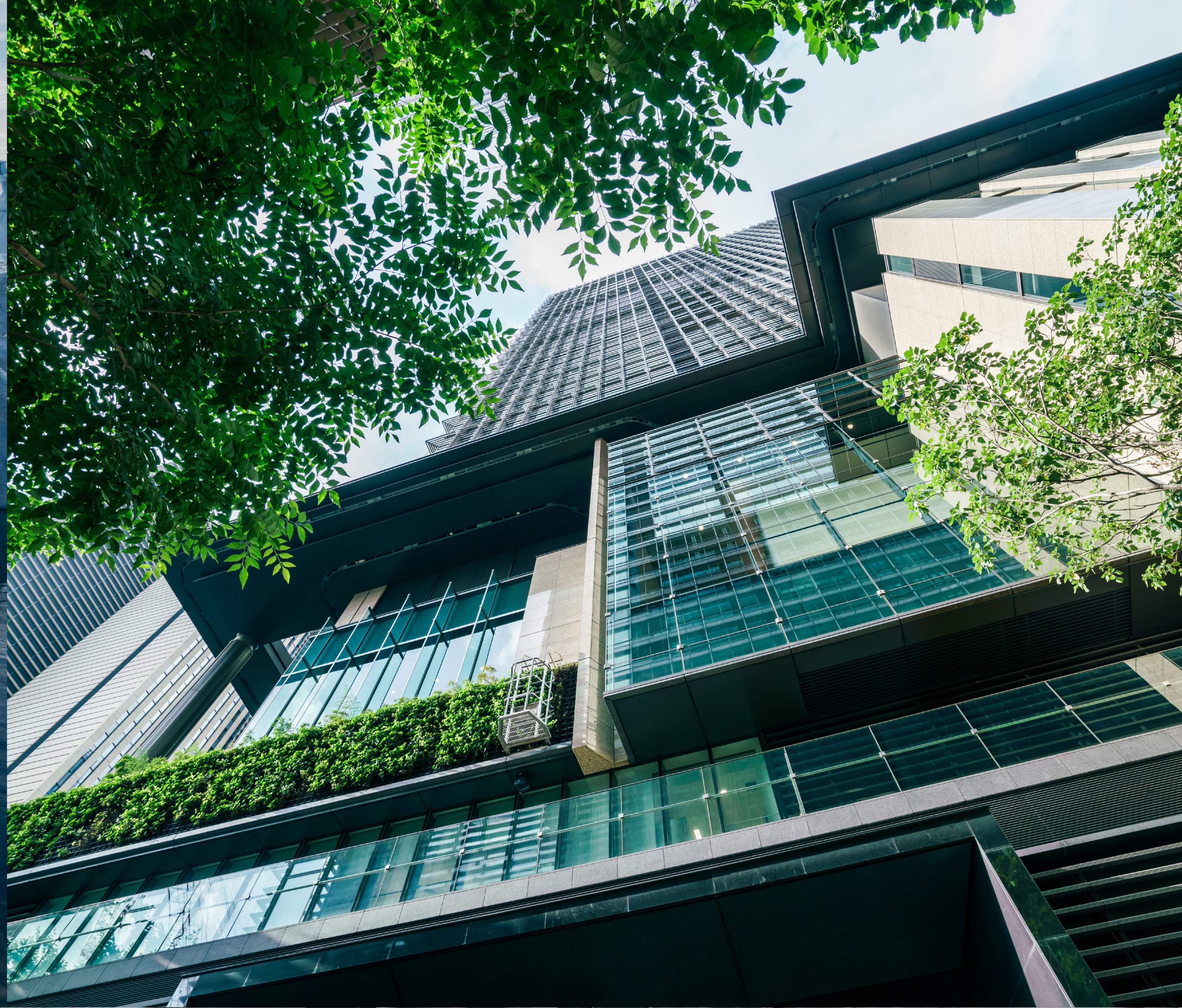
ERM SUSTAINABILITY INSTITUTE

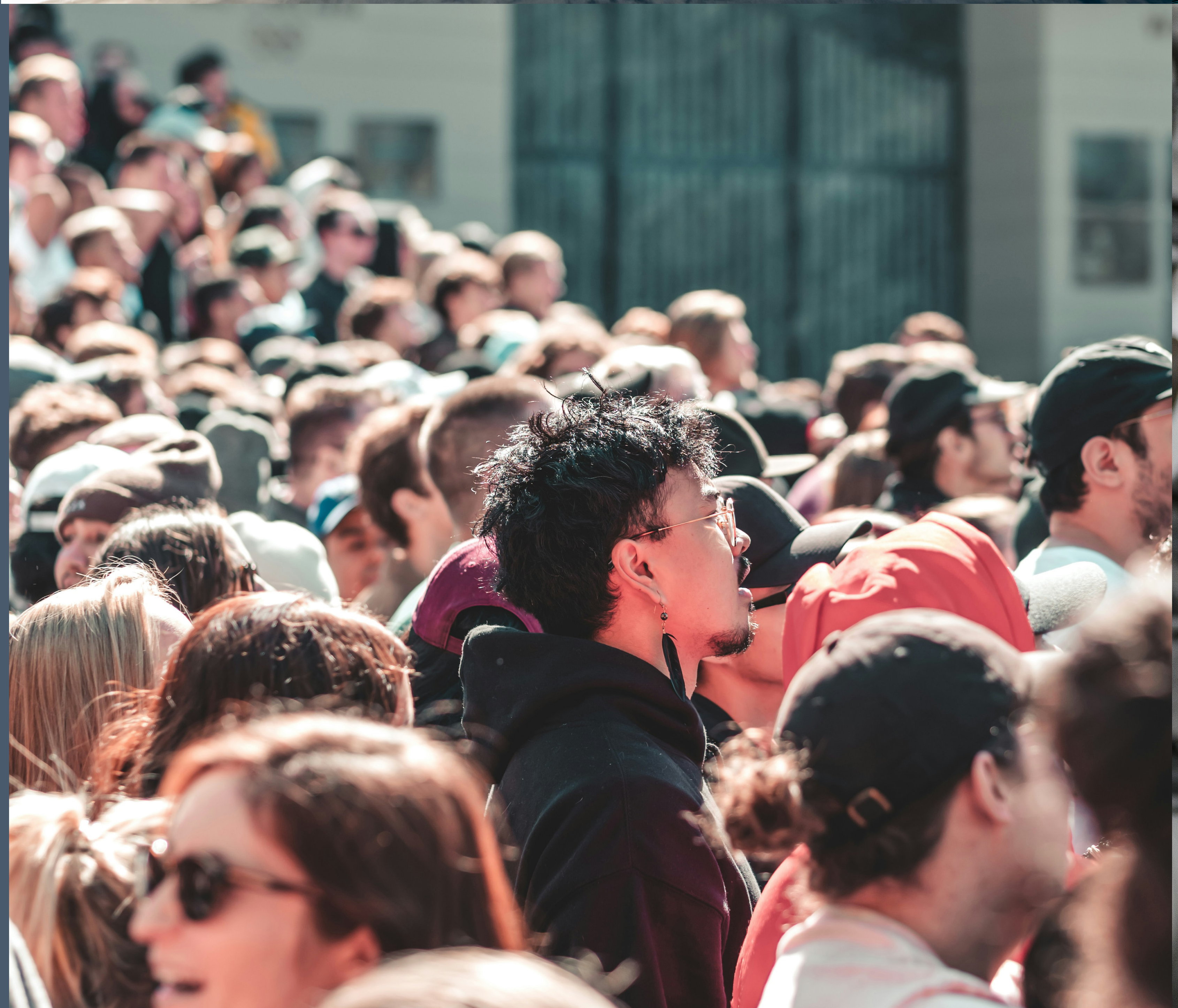
Sustainability Trends

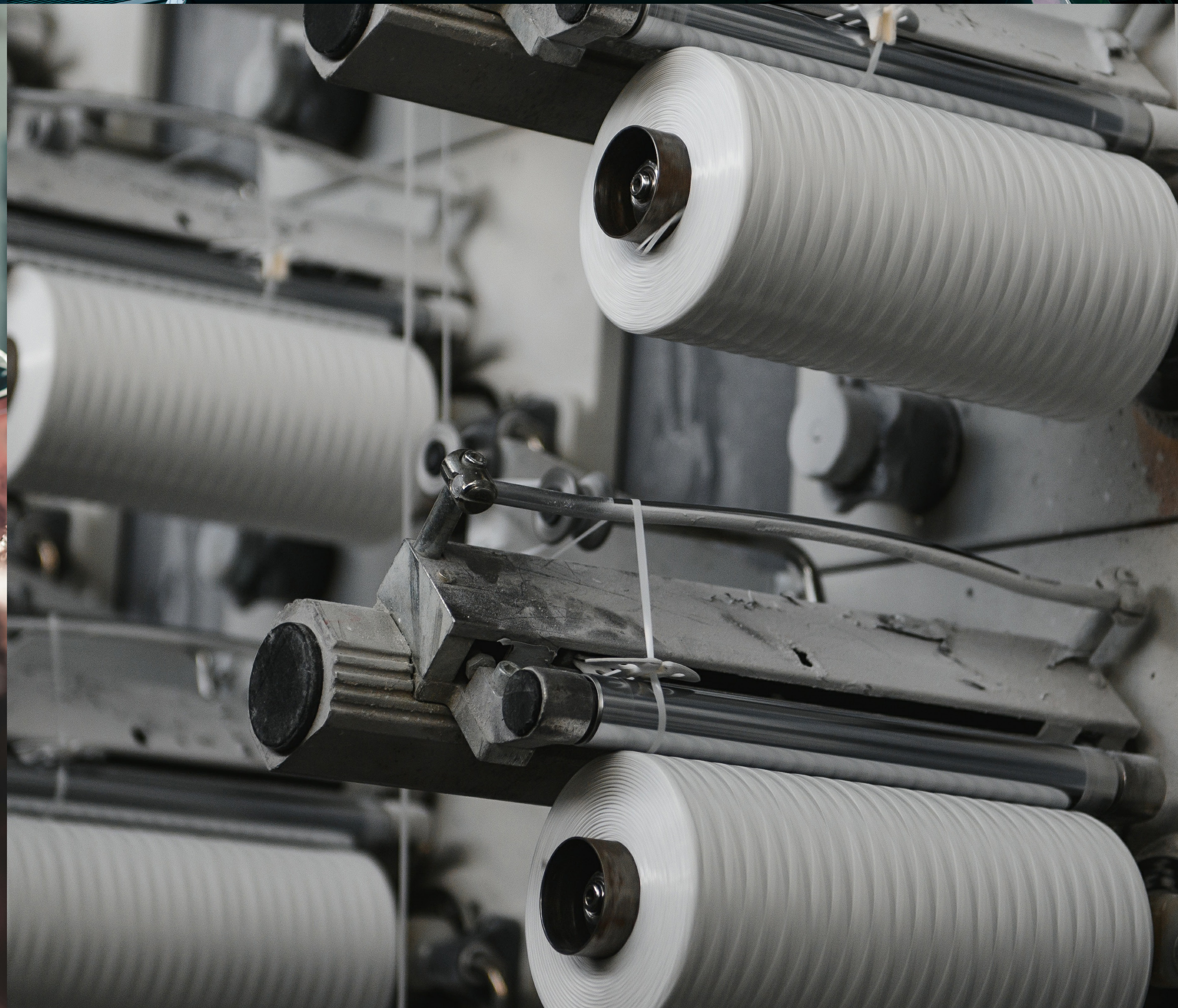
QUARTERLY OUTLOOK

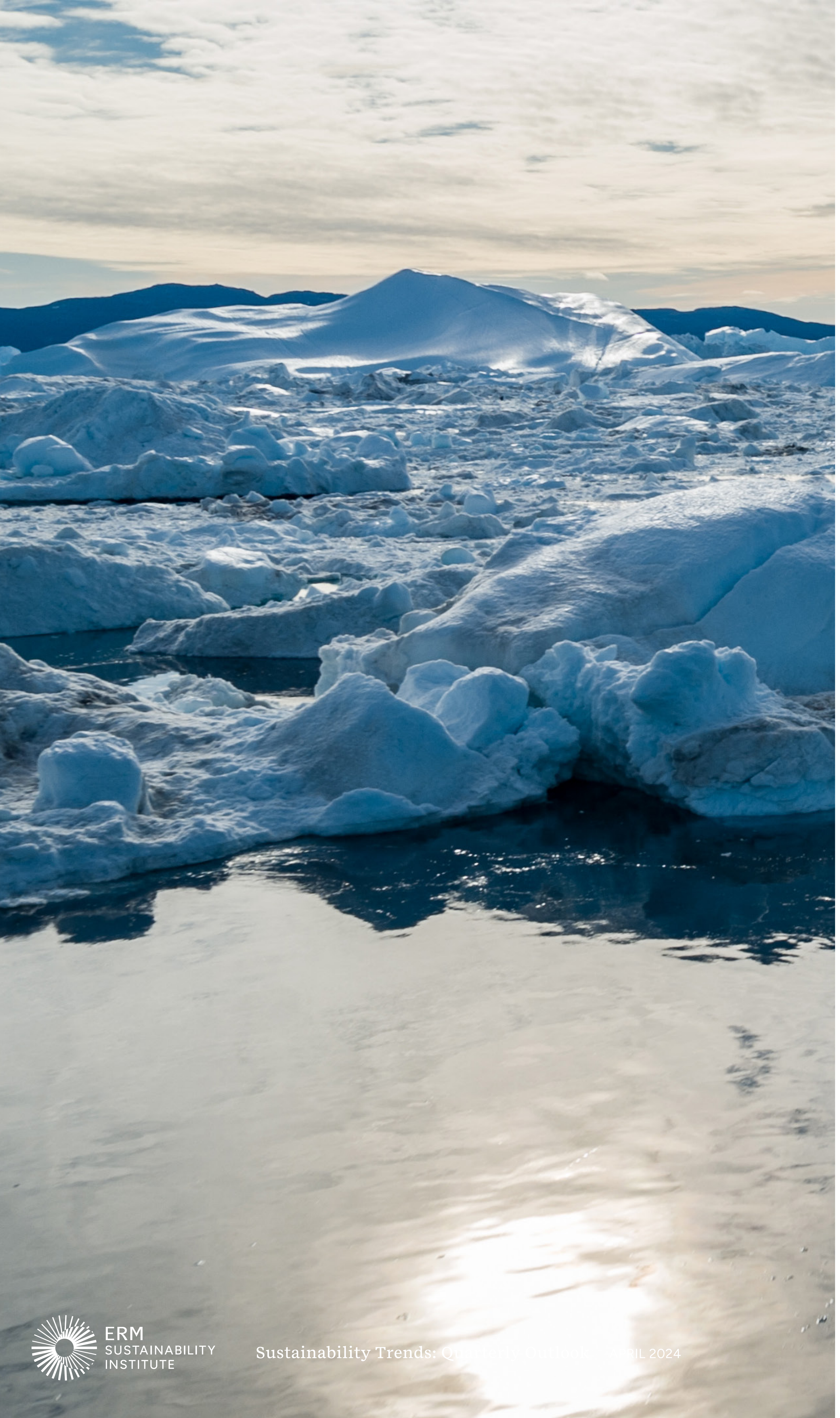
April 2024











One step forward one step back in the fight against climate change

Climate urgency and climate action are not always in sync. This quarter brought grim milestones, record damages, and new scientific conundrums, highlighting the compounding issues that come with inaction. At the same time, corporate performance is mixed at best. However, all is not lost as aggressive corporate clean energy purchasing makes clear.

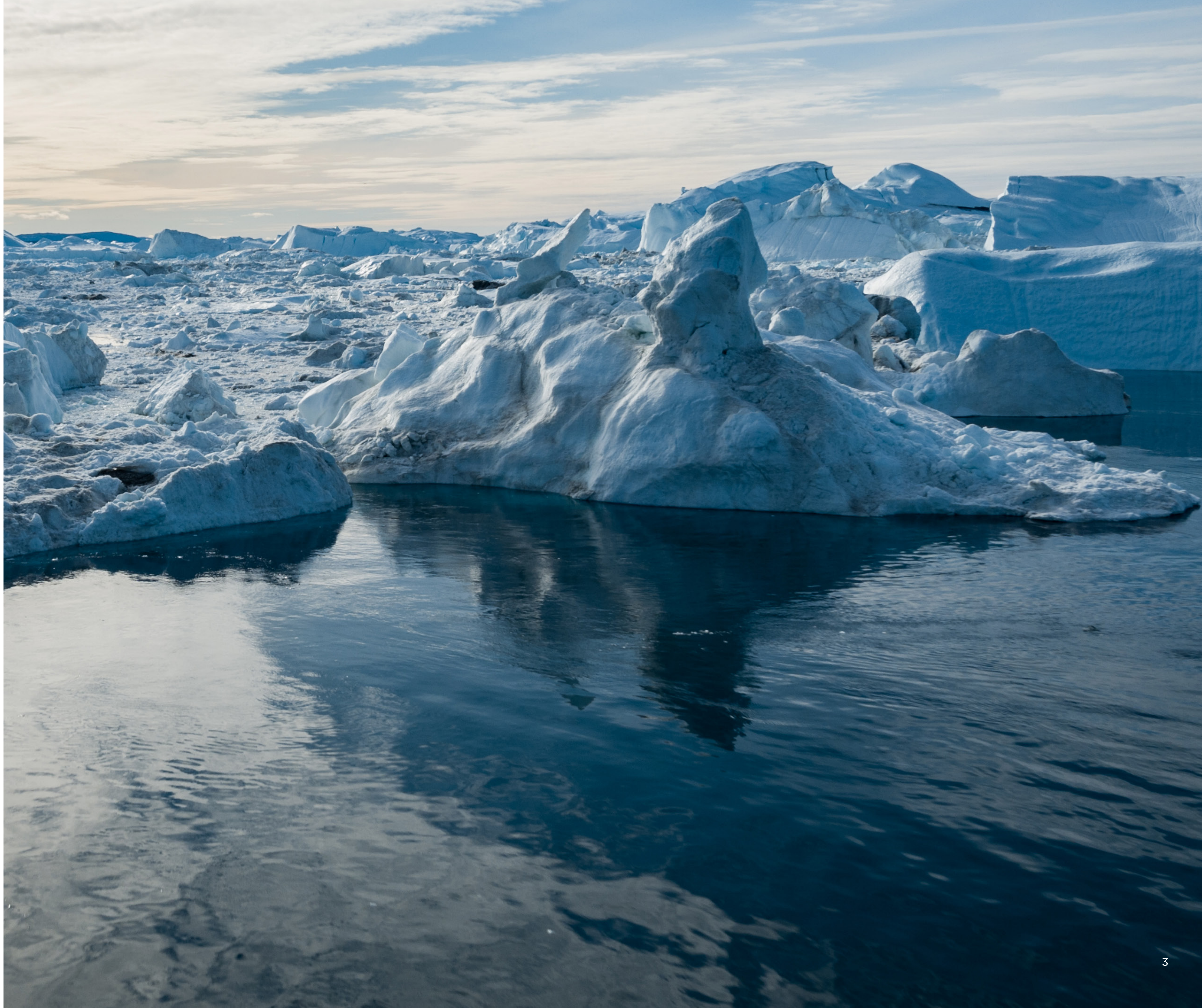
Climate change continues to break records, bringing with it expected and unexpected consequences

- Climate change crossed a grim milestone in 2023, with the European Union's Copernicus Climate Change Service reporting that global temperatures exceeded 1.5°C (the Paris Agreement's goal) over a 12-month period (February 2023-January 2024) for the first time ever. Rising temperatures have not let up in the time since. March 2024 was the tenth month in a row with the hottest average temperature on record. Europe has the questionable honor of being the fastest-warming continent in the world: a global 1.5°C rise in temperature will translate into a 3°C rise there.
- These records have consequences. In 2023, natural disasters caused \$280 billion (about \$860 per person in the US) in economic losses thanks to a record number of insured-loss events (disasters that cause losses beyond a certain insured threshold). Overall, insured-loss events doubled over the last 30 years and could double again in the next decade. Multiplying natural disasters are an unfortunate yet expected result of climate change, as are rising ocean temperatures. However, the sky-high ocean temperatures recorded over 2023 and so far in 2024 are perplexing scientists. While the ongoing El Niño and the 2022 eruption of the Hunga Tonga-Hunga Ha'apai volcano in New Zealand are clear drivers, they only partially explain the warming observed. As climate change progresses, more surprises like this are likely in store.

Corporate and investor climate action has an up-and-down first quarter

- Corporate and investor progress on climate action was mixed in 2024's first quarter. The Science Based Targets initiative (SBTi) removed the commitments of over 200 companies in March after they failed to share net zero targets for validation with the SBTi within two years of making a commitment to do so. This move was preceded by the February exit of prominent investors from Climate Action 100+ (an investor initiative to push companies to decarbonize) who cited concerns that their participation could be interpreted as violating anti-trust laws. SBTi also announced it is considering updating its Corporate Net-Zero Standard to allow companies to use environmental attribute certificates (i.e., carbon credits sourced from voluntary carbon markets) to count towards Scope 3 emissions abatement, a step many companies and some experts have been advocating for. However, the potential use of credits for Scope 3 would be controversial, given the ongoing debate over whether environmental attribute certificates represent actual emissions reductions.

- Another headline in the context of historical CO_2 emissions was an April study that traced 80 percent of global fossil fuel and cement CO_2 emissions since 2015's Paris Agreement to just 57 companies and state-related firms. While eye-opening, this finding also inspires hope that targeted action by these entities could dramatically reduce global emissions.
- Despite the mixed corporate record, there are also signs of progress. Research released in February found that corporate clean energy purchases surged to a record 46 GW in 2023, a 12 percent gain over 2022. Corporates are also increasingly disclosing their greenhouse gas emissions: an April report found that approximately 60 percent of public companies globally now disclose Scope 1 and 2 emissions, compared to approximately 44 percent two years ago. Scope 3 emissions disclosures made an even larger jump, with approximately 42 percent of public companies disclosing a portion of these emissions, compared to 25 percent two years ago.



Anti-greenwashing momentum continues, and disclosure standards emerge globally

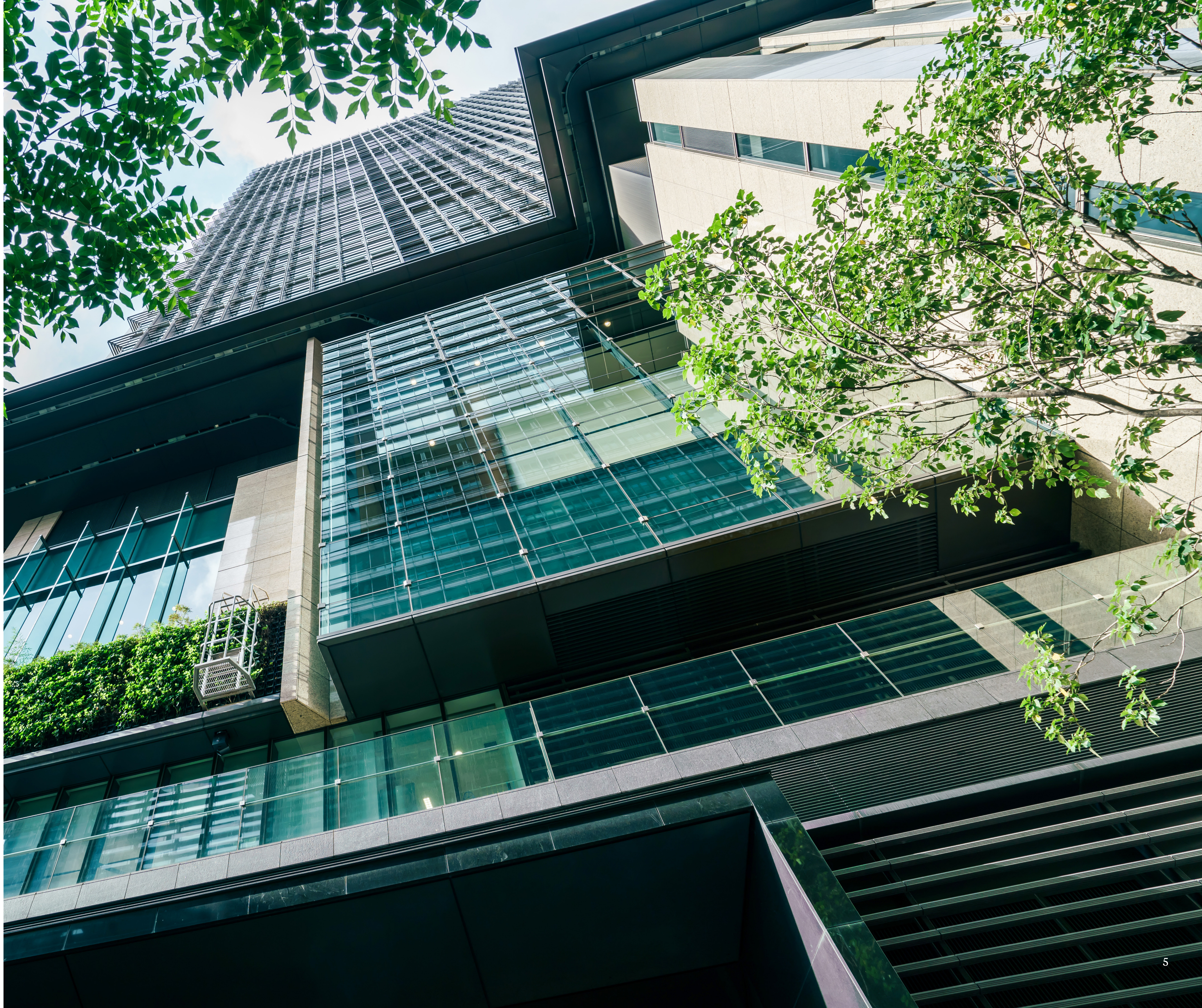
A transformation in sustainability communications is underway. The time when companies could overstate the impacts of their sustainability efforts has passed as governments worldwide increasingly crack down on greenwashing. The former free-for-all of unsubstantiated sustainability claims is being replaced by a standardized disclosure ecosystem that promises to bring order to the space.

Companies' sustainability communications under the microscope

- Several companies confronted greenwashing headaches of their own making in the first quarter. In March, a Dutch court found that KLM misled customers with an advertising campaign promoting the airline as a way to fly sustainably since it used sustainable aviation fuel and carbon credits to mitigate greenhouse gas emissions. Later in the month, the fashion brands ASOS, Boohoo, and George at Asda signed agreements with the UK's Competition and Markets Authority (CMA) to change how they promote the sustainability credentials of their products, after a CMA review found the brands made sustainability claims without disclosing verifiable supporting information. Also, in March, an Australian court determined that Vanguard Investments Australia misled customers by stating that one of its ESG funds did not invest in fossil fuels when it, in fact, did invest in fossil fuel-related activities.
- In March, the European Union moved to limit future greenwashing incidents in the bloc when the European Parliament approved the Directive on Green Claims. This directive would establish criteria for companies to prove their environmental claims and labels and outlines verification processes for them.
- With fears of legal action rising, companies in the U.S. seem to be scaling back their sustainability communications. A study released in March found that the 50 largest U.S. public companies decreased their environmental-related communications by 24 percent over the past three years and reduced the visibility of their broader ESG communications to the general public.

Disclosure standards here, there, and everywhere

- The first quarter saw sustainability disclosure standards emerge across almost all corners of the globe. In February, China's three primary stock exchanges released disclosure rules, which will require listed companies to report on their sustainability initiatives starting in 2026. To the east, in April, Japan released feedback drafts of its mandatory sustainability disclosure standards based on the International Sustainability Standards Board's (ISSB) IFRS standards, with the aim to publish finalized versions by March 2025. Other countries considered or proposed ISSB-aligned standards during the first quarter as well, including Malaysia, Canada, and Nigeria.
- The United States bucked the disclosure trend, somewhat. In early March, the U.S. Securities and Exchange Commission (SEC) adopted its long-awaited Rules to Enhance and Standardize Climate-Related Disclosures for Investors, which outline a set of climate-related disclosure requirements for public companies in the U.S. However, soon after adoption, the rules were halted by a federal court after two oil and gas companies sued to stop them. Because of this suit, the SEC in April decided to stay the rules as they undergo judicial review to limit regulatory uncertainty for companies subject to them.



Mixed results for social initiatives as U.S. companies scale back DEI efforts, but human rights pressure on companies builds globally

Political pressure and legal attacks in the U.S. lead to backtracking on DEI at U.S. companies. In parallel, human rights due diligence initiatives are to expand after the European Union finalizes the CSDDD and other initiatives to secure human rights emerge.

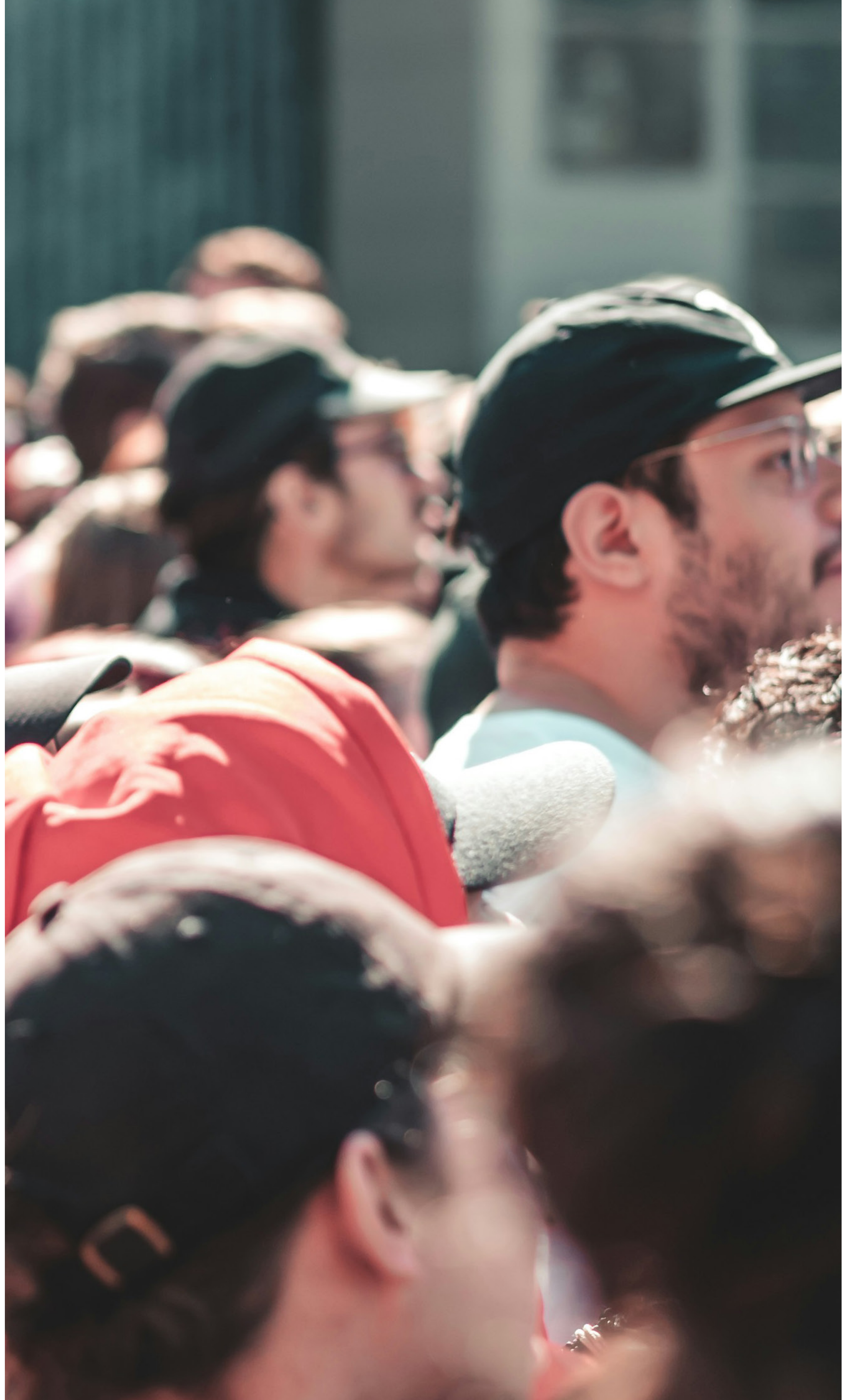
Long-simmering U.S. DEI backlash begins to boil

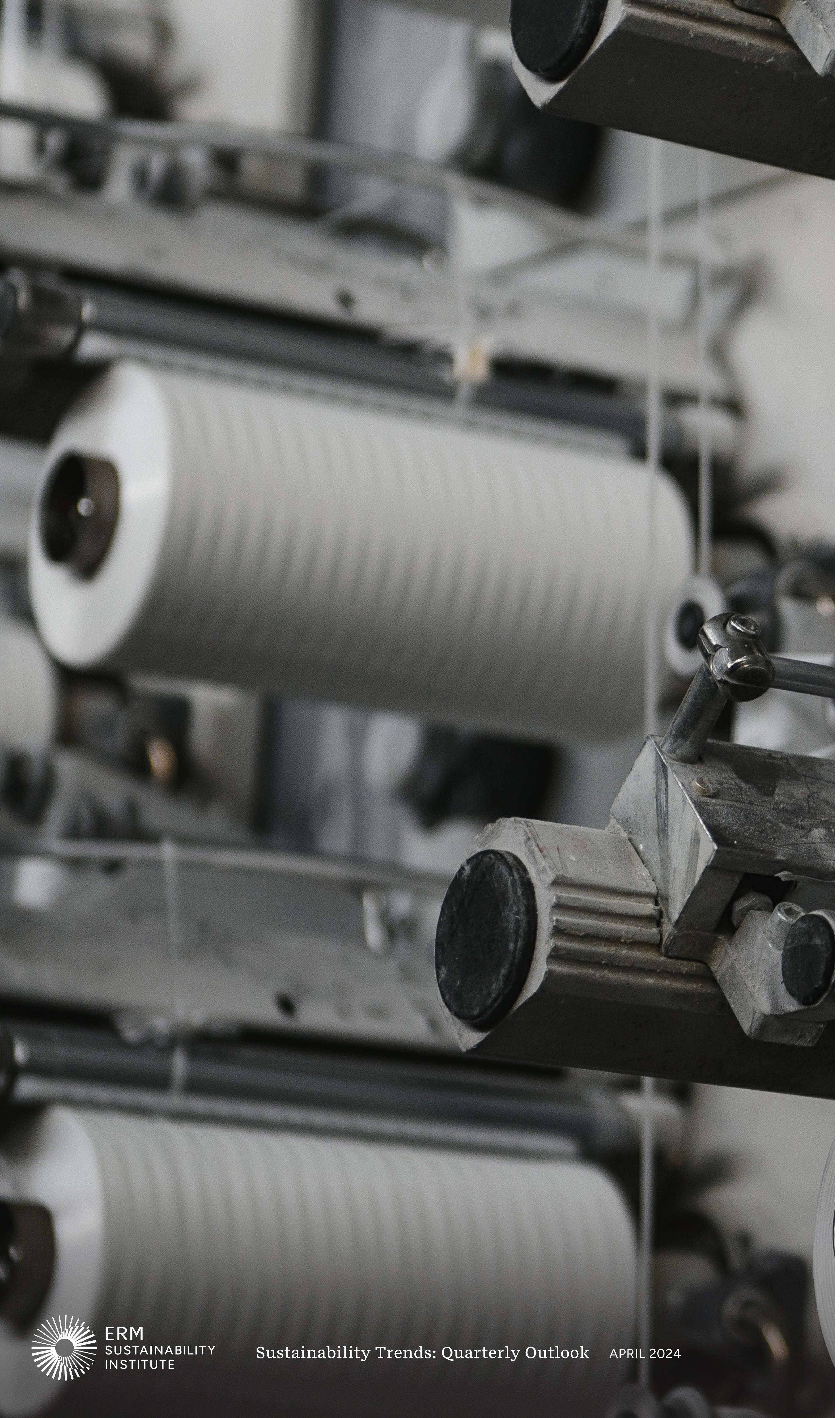
- Corporate diversity, equity, and inclusion (DEI) initiatives expanded dramatically in the U.S. after George Floyd's murder in 2020. Almost four years later, companies are retreating from these initiatives as criticism and economics catch up with them. Tech companies have often led the way on DEI. That is changing. Both Google and Meta made significant cuts to DEI programs in 2023 because of growing economic headwinds facing the industry. Zoom took things a step further when, in February, it fired most of its DEI team because of both stakeholder and economic pressures.
- Beyond the tech space, PricewaterhouseCoopers in January dropped diversity targets in the U.S. after the legality of some of its internships and scholarships were questioned by activists following the Supreme Court's 2023 overturning of affirmative action in college admissions. Financial firms are also scaling back. For example, Bank of America opened internal programs for women and minorities to all employees in the face of pressure, and BNY Mellon is reevaluating its move to link executive compensation to diversity targets.
- Legal pushback is also growing. In February, the 5th Circuit U.S. Court of Appeals agreed to rehear two conservative group's challenge to a Nasdaq rule that requires listed companies to disclose a board diversity matrix and have at least two diverse (i.e., are either a women, minority, or LGBTQ+) board directors.

Human rights developments show change is on the way

- After concerns that it would overburden companies with red tape briefly clouded its future, the European Parliament adopted the Corporate Sustainability Due Diligence Directive (CSDDD) in April. The Directive requires companies to identify, prevent, and, where necessary, mitigate and cease the adverse impacts of business activities on human rights and the environment. Although the final version's scope was reduced (companies with more than 1,000 employees and over €450 million in revenue must comply compared to 500 employees and over €150 million in revenue as originally proposed), the law will usher in a new era for corporate human rights initiatives as it well help them protect against risks and address issues before they escalate.

- In the U.S., the Biden Administration released its second National Action Plan (NAP) on Responsible Business Conduct, outlining its expectations that businesses conduct human rights due diligence in their value chains. Additionally, the voluntary NAP established a Federal Advisory Committee on Responsible Business Conduct to boost collaboration between the private sector, communities, unions, civil society, and other stakeholders on responsible business conduct issues.
- There was also bilateral human rights action. In February, Japan and the U.S. held the first meetings of the U.S.-Japan Task Force on the Promotion of Human Rights and International Labor Standards in Supply Chains. Launched last year, the meetings discussed actions to stop the use of forced labor in supply chains through mandatory and voluntary mechanisms like the United States-Mexico-Canada Agreement and Japan's human rights due diligence guidelines, respectively.
- Some other notable wins for human rights occurred outside policy. In April, the European Court of Human Rights ruled that Switzerland violated the human rights of over 2,000 Swiss women by failing to address "critical gaps" in the country's climate policies and meet past climate targets. The ruling, which is applicable to all 46 countries party to the court, could open the door for similar lawsuits in the future.
- Lastly, the World Business Council for Sustainable Development (WBCSD) launched the second iteration of its Business Commission to Tackle Inequality (BCTI) in April. BCTI 2.0 extends the initiative to create inclusive, equitable markets and ensure a just transition by two years and sees three UN agencies (UN Global Compact, UNICEF, and UNHCR) and over 80 CEOs of leading multinationals and civil society organizations join.





Corporate sustainability ambitions push innovation into new territories

As corporate sustainability ambitions grow, companies are turning to novel solutions to some of their most pressing challenges. From material alternatives and reuse to sustainable fuels and feedstocks, the scale and scope of company action are pushing new boundaries.

Product sustainability advances bring circularity and reuse to the forefront

- In February, lululemon announced it developed the world's first enzymatically recycled nylon-based product. Created in partnership with startup Samsara Eco, the activewear company hopes the technology behind the long-sleeve top will help it scale its use of recycled nylon, a material currently only available in limited quantities when produced using post-industrial material waste. In March, H&M Group, and venture capital firm Vargas launched Syre to scale textile-to-textile polyester recycling. Compared to traditional polyester recycling, which converts plastic bottles, textile-to-textile recycling will help H&M Group close its polyester recycling loop and move it closer to a circular business model.
- Innovation was not limited to the clothing sector. In January, Jewelry company Pandora announced that it now uses 100 percent recycled gold and silver in its products, a year ahead of its 2025 target. Achieving 100 percent recycled silver was much more difficult than gold due to supply constraints. To ensure supply, Pandora worked with its suppliers to establish dedicated recycled silver supply chains that source silver from silverware and industrial byproducts from the chemicals and petrochemical industries.
- Circular initiatives are also increasing in size. Developers in London's Canary Wharf are recycling concrete from buildings they are demolishing and reusing it in buildings under construction nearby to reduce emissions associated with virgin concrete production.

New energy transition solutions light up the room

- Companies in 2024's first quarter were busy pursuing new energy solutions. To start the year, Plug Power finished installing the first hydrogen electrolyzer at an Amazon fulfillment center in Colorado. Now operating, the electrolyzer can produce enough hydrogen to fuel up to 400 fuel cell-powered forklifts, although only 225 currently operate on the site. In another example of a solutions-focused partnership, Microsoft signed an agreement with carbon removal provider Neustark to source over 27,000 tons of carbon removal credits. Neustark generates these credits by capturing biogenic CO_2 from biogas plants and permanently binding it to demolished concrete granules, which can then be used in recycled concrete or other construction applications.

- Companies are also reimagining old energy processes and outputs. In April, a Phillips 66 refinery in California began processing only renewable feedstocks. The refinery uses waste oils, fats, greases, and vegetable oils to produce approximately 30,000 barrels of renewable diesel a day. It aims to produce 50,000 barrels per day and begin renewable jet fuel production by the end of 2024's second quarter.
- Sustainable aviation fuel (SAF) is making a promising start in 2024. Airbus and TotalEnergies launched a new partnership under which TotalEnergies will eventually supply Airbus with enough SAF to meet over half of Airbus' European fuel needs. International Airlines Group also grabbed attention after purchasing almost 1 billion liters of SAF from the producer Twelve, the largest SAF purchase to date, with first deliveries slated for 2025. Governments are acting too. In February, Singapore announced that at least 1 percent of all departing flights' fuel must be SAF, a number that will rise to between 3 and 5 percent by 2030.