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The Acceleration of Climate Action and Sustainability

2020 will surely be remembered as the year of the SARS Covid-19 global pandemic, which has caused extraordinary damage to global economies and society.

However, 2020 will also be remembered as the year that the call for action to mitigate climate change and increase sustainability accelerated on a massive and global scale.

The world has recognized that the actions we take over the next decade will determine whether we achieve the 2015 United Nations Sustainable Development Goals and meet the global commitment to reduce and eventually eliminate greenhouse gas ("GHG") emissions such as carbon dioxide ("CO_2"), in order to limit the global average temperature increase to 1.5°C to 2°C above pre-industrial levels by 2050, as laid out in the 2015 Paris Agreement. Meeting these goals is crucial in order to avoid catastrophic damage to our societies, natural environment and habitats.

Actions to accelerate the shift to a net zero-carbon economy have been announced both regionally and nationally. The European Union, through its new "Green Deal," has set ambitious carbon reduction targets to be achieved by 2030 (going beyond the targets contained in the 2015 Paris Agreement), and a policy framework to do so. China, the world's largest emitter of CO_2, recently set a target to be carbon neutral by 2060, while Japan and Korea both announced net carbon neutral targets by 2050. In the U.S., President-Elect Joe Biden has made the transition to a low-carbon economy a key part of his economic plan and has pledged to move the country to 100% clean energy by 2035.

At the local government and corporate level, commitments to decarbonize have also accelerated globally. By September 2020, the number of entities pursuing net zero-carbon emission targets included 101 regions (a nine-fold increase from 2019) and 823 cities (an eight-fold increase from 2019) representing a carbon footprint larger than the U.S., at 6.5 gigatonnes. The number of companies pursuing net zero-carbon emission targets totaled 1,541 (a three-fold increase from 2019) representing a carbon footprint of 3.5 gigatonnes and combined revenue of $11.4 trillion, or more than half the GDP of the U.S.[1]

The disclosure of the climatic risks of corporations also continues to grow. In the 15 months to October 2020, the number of organizations expressing support for the Task Force on Climate-related Financial Disclosures' climate risk assessments and related financial disclosure recommendations grew more than 85% to over 1,500 organizations globally. This group included over 1,340 companies with a market cap of $12.6 trillion, and financial institutions overseeing assets of $150 trillion.[2]

Importantly, financial regulators and institutional investors have also increasingly recognized that climate change is not just an idiosyncratic characteristic of a specific asset class, a view that was historically widely held as part of Environmental, Social and Governance ("ESG") investing. Rather, financial stakeholders now view the risks (and opportunities) of climate change as a crucial component of fundamental risk/return analysis, both at the individual company level and at the portfolio asset allocation level.

The Network of Central Banks and Supervisors for Greening the Financial System, a group of 83 members and 13 observers comprising the largest institutions (including the U.S. Federal Reserve as of December 2020), argued that climate change is a source of financial risk that falls within central bank mandates. In October 2020, the Bank of England announced that company disclosures on the risks from climate change will become mandatory, and a climate stress test exercise for the financial services sector will be held in June 2021.

Institutional investor groups such as Climate Action 100+, representing investment firms managing over $52 trillion of assets; the Institutional Investor Group on Climate Change, representing approximately €31 trillion of assets; and the One Planet Sovereign Wealth Fund Working Group, representing over $30

[1] NewClimate Institute and Data-Driven EnviroLab.

[2] Task Force on Climate-related Financial Disclosures.

trillion of assets, are similarly focused on identifying, engaging with and investing in companies that are supporting the transition to a lower-carbon future.

Against this backdrop, assets allocated to "sustainable investing" have exploded. As of the end of June 2020, sustainable funds managed a record $1.06 trillion of assets globally, a figure that has more than doubled over the trailing 3 years.[3] In fixed income, the issuance of green bonds is forecast to be $250 billion for 2020. More broadly speaking, sustainable bond issuance reached $288 billion during the first 9 months of 2020, up 24% from the same period in 2019. Total sustainable bond issuance is forecast to reach $425 billion in 2020.[4]

Ocean Industries and Environmental Pollution

The ocean industries are a critical component of the global supply chain, responsible for the production of food and energy, the movement of people and tourism. The global ocean industries' GDP is estimated at over $3 trillion per year, larger than the GDP of the UK or France.[5] Accordingly, the health and sustainability of our oceans are critical, not only to sustain the ocean industries, but also the livelihoods of the approximately 10-12% of the global population which depend upon them. However, environmental pollution and climate change put our oceans at risk; the economic damage inflicted to the oceans and coastlines due to pollution and non-sustainable business practices costs over $83 billion per year.[6]

The importance of the ocean industries is also increasingly being recognized by investors. According to a recent survey by Responsible Investor, 75% of respondents viewed the ocean industries as investable, with 45% of asset managers' clients actively seeking related sustainable investments.

The ocean industries depend upon critical marine vessel infrastructure for:

- Seafood production: fishing vessels and live fish carriers;
- Renewable energy: floating offshore wind generation assets and vessels used to install and maintain the vast offshore wind parks being built;
- Marine transport of people: ferries providing lifeline services, connecting urban and rural communities; and
- Industrial shipping vessels, providing global supply chain services, with the transportation of over 90% of all goods and commodities.[7]

Maritime vessels remain the most carbon-efficient method to transport goods and people.[8] However, due to its massive scale (over 100,000 vessels globally), the ocean industries account for a significant portion of global GHG emissions. In 2018, the shipping industry (international, domestic and fishing) produced approximately 1.1 billion tonnes of GHG emissions, or approximately 3% of global emissions. By 2050, emissions are projected to increase by up to 50% relative to 2018, due to continued growth in transport demand.[9]

Due to oil-based fuels' historically cheap price (as externalities have not been priced-in), high energy density and availability, the vast majority of the ocean industries have traditionally used these high-carbon fuels to power their fleets. In 2019, the ocean industries consumed approximately 221 million tonnes of oil-based fuels, primarily heavy fuel oil and marine diesel oil – or approximately 4 million barrels of crude oil per day, more than a third of the daily oil production of Saudi Arabia.[10]

These oil-based fuels have material environmental impacts: when spilled into the oceans, flora and fauna are destroyed, due to the fuels' high viscosity and ability to form tar lumps that do not dissipate.[11] In addition to CO_2 emissions, other air pollutants such as Sulphur Oxides, Particulate Matter and Nitrous Oxides are also emitted, which have significant environmental and health impacts, particularly to coastal communities and ocean habitats.

In addition to fuel-related emissions and pollution, the ocean industries have other negative impacts on marine environments. A large number of marine

[3] Morningstar.
[4] Moody's.
[5] Credit Suisse.
[6] Cirrus Logistics.
[7] International Chamber of Shipping, World Trade Organization.
[8] World Shipping Council.
[9] International Maritime Organization.
[10] International Energy Agency.
[11] HFO FreeArctic.

species are transferred to non-native environments through water that is used as ballast to stabilize steel-hulled ships. Ballast water is loaded at the source port and pumped out at the destination port. These non-native species may become invasive, out-competing native species and causing enormous (and often irreversible) damage to marine biodiversity. The spread of invasive species is now recognized as one of the greatest threats to the ecological and economic well-being of the planet.[12]

Marine contamination from plastic debris has reached catastrophic levels and is ubiquitous throughout the marine environment, with an estimated 269,000 tonnes afloat at sea.[13] Approximately 20% of the plastic garbage littering the oceans is caused by the shipping industry and offshore oil industry.[14]

Addressing these issues require a mix of regulatory policies (some of which have been enacted or are in progress) and further industry action.

Decarbonizing the Ocean Industries

The ocean industries' importance across energy, food, passenger mobility and global supply chains, and its corresponding significant contribution to global CO_2 emissions, means that decarbonizing is critical to transition the world both to a net zero-carbon future and to ensure the ocean industries' sustainability.

In 2018, the International Maritime Organization ("IMO," a specialized agency of the United Nations responsible for regulating the ocean industries) introduced the *Initial IMO Strategy on Reduction of GHG Emissions from Ships*, which represents the ocean industries' response to the 2015 Paris Agreement's global warming limitation objective. The strategy calls for phasing out GHG emissions from the ocean industries as soon as possible this century, with several specific milestone targets:

- Total annual GHG emissions from vessels to be reduced by at least 50% by 2050 (compared to 2008), while pursuing efforts to phase them out on a pathway of CO_2 emissions reduction consistent with the Paris Agreement temperature goals.
- The carbon intensity (CO_2 emissions per transport work, on average) of the ocean industries to decline by at least 40% by 2030, pursuing efforts towards 70% by 2050 (compared to 2008).

In addition, the Sustainable Ocean Principles outlines a framework to achieve the United Nation's Sustainable Development Goal 14 – 'Life below water.' This framework addresses not only climate change, but also a broader range of environmental and social impact guidelines to which businesses active in the ocean industries are expected to adhere.

As discussed above, large corporations are already moving to decarbonize their businesses and supply chains by setting net-zero carbon targets, several of which are to be achieved by the early 2030s. In the case of the ocean industries, sectors like industrial shipping are part of these larger corporations' Scope 3 carbon emissions, representing indirect emissions related to the transportation of goods and people. Accordingly, corporations are increasingly focused on reducing these emissions by working with lower-carbon transportation providers.

Financial institutions are also adapting; since 2019, 20 banks representing approximately $150 billion in shipping finance have signed the Poseidon Principles, a voluntary set of standards requiring banks to disclose the carbon intensity of their vessel financing businesses. These banks have pledged to reduce the emissions from their vessel portfolios in line with the Paris Agreement. The consequences are clear: banks will increasingly allocate debt capital to low-carbon businesses in the ocean industries.

Decarbonization Pathways

Battery technology is a viable pathway for the primary propulsion of short-sea ships (e.g., ferries, barges, harbor equipment and coastal shipping), given the short distances travelled and the ability to spend time in port each day, where vessels can re-charge onboard batteries by plugging into onshore charging stations.

For other parts of the ocean industries – industrial shipping, renewable energy and seafood, where energy use is much higher and the required energy

[12] International Maritime Organization.
[13] Eriksen M, Lebreton LCM, Carson HS, Thiel M, Moore CJ, et al. (2014).
[14] Lane Powel (2019).

storage is substantial – current zero-emission solutions are unworkable.

For these "hard-to-abate" sectors, low-carbon fuels such as liquefied natural gas, liquefied petroleum gas and biofuels are being increasingly utilized until ultra-low carbon and zero-emission fuels/technologies (e.g. electro-fuels such as green ammonia, hydrogen, methanol and methane) are available and successfully commercialized.

Given the economic life of a vessel is generally 25-30 years (therefore vessels built today may still be in service in the 2040s), capital budgeting decisions regarding which vessels to acquire and their respective primary and auxiliary propulsion systems is incredibly important. Accordingly, investing in vessels with the ability to switch to increasingly low-carbon fuels at the lowest possible cost is key.

The relative price of these ultra-low carbon and zero-emission fuels will dictate their long-term uptake. The relative price and commercial availability of these fuels will depend on the buildout and relative cost of their production, distribution and storage infrastructure, which is in turn dependent on regional industrial energy policies, carbon/environmental regulations, large ocean industry companies' corporate strategies, and the capital expenditure financing available.

In addition to next-generation primary propulsion and auxiliary power systems, improving the energy management and emissions efficiency of vessels over their economic lives will be further enhanced through digitalization and other operational improvements.

Such measures are a key part of the overall strategy of vessel owners, operators and end-user corporations to improve energy and cost efficiencies. For example, energy-saving devices such as kites and sails can be installed cost-effectively on many vessels today, while the wide use of sensors on board allows data to be collected and analyzed to improve engine system efficiency and enhance hull designs to be better suited to the operational profile of the vessel.

No Silver Bullet – the Need to Act Now

Due to the vast size of the ocean industries and the diverse use of maritime vessels and equipment, no silver bullet solution exists to decarbonize and reduce the environmental impacts of the entire ocean industry. Rather, different fuel technologies, as well as digital and operational solutions, will need to be deployed for various vessel types and sectors.

Importantly, progress on reducing emissions needs to begin now, aligning with customer/corporate demands for sustainable supply chains, while developing the technologies and infrastructure needed for a full decarbonization of the ocean industries in the future.

National and local governments, as well as corporations, are recognizing that there is no time to wait, and that the global carbon budget (the amount of GHG we can emit into the atmosphere) to stay within a 1.5°C to 2°C warmer world will likely be breached in the next decade or so,[15] unless significant action is taken now.

The progress made by the ocean industries today and over the next decade to reduce its carbon emissions and environmental impact will be critical to accelerate the transition to a net zero-carbon and sustainable future to meet the objectives of the Paris Agreement and Sustainable Development Goals.

[15] Carbon Tracker Initiative.

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