



Introduction

In February 2021, Watson Farley & Williams (“WFW”) published [The Sustainability Imperative](#) report on the impact of environmental, social and governance (“ESG”) considerations on the shipping industry.

Two years on, our new report explores how attitudes have evolved, who is shaping today’s ESG agenda and how sustainability squares with new geopolitical challenges such as the war in Ukraine. It then seeks to chart a path forward, looking at the new technologies available, how they will be funded and potential new regulation in areas like carbon trading.

Built around a global survey of circa 500 industry executives and senior managers, this report’s key findings are:

1. The industry now has a better understanding of how long it will take to meet ESG goals. Respondents estimate that 28% of the maritime industry will meet milestones for emissions within five years.
2. Shipowners have become more collaborative. In 2021, two-thirds said they would like to form partnerships to pursue innovation. Now, 56% already are in ESG-linked tie-ups, of which almost all report tangible progress.
3. Shipowners are more concerned about choosing the right technology than how to pay for it, listing regulatory and technological uncertainty – no longer cost – as the biggest constraint on investment in emissions reduction.
4. LNG and LPG have fallen behind many other alternative fuels in the sustainability planning of shipowners. Perhaps this is because LNG in particular is already viewed as an established transition fuel option although concerns regarding methane slip and fallout from the war in Ukraine are other possible causes.
5. Most of shipping accepts the need for carbon trading and carbon offsets, which will be important for emissions reduction, according to 91% of respondents. Support is weaker in the Americas, though, where 28% believe that clean fuels will almost negate the need for carbon trading and offsets.

Decarbonisation remains the main challenge. Which green technologies will work at scale to help achieve it, how can their adoption be incentivised and who will pay for the transition? Fortunately, shipping now has a greater appreciation of the task ahead.

Industry initiatives such as the Getting to Zero Coalition, the Sea Cargo Charter and the Poseidon Principles have been the main drivers of change on this front to date, though most believe ESG should be driven by regulation rather than voluntary action. Most would like to see this come from the International Maritime Organisation (“IMO”) given its global reach, though that organisation’s reputation for being slow-moving is leading to growing frustration within the industry.

Despite the impact of the war in Ukraine (and related international sanctions regime) on global energy prices, war and political instability are not seen as a particular threat. In order of priority, the following are of greater concern to the maritime sector: new technological developments and requirements; trade tensions; and another black swan event like Covid-19.

Surprisingly, with the exception of the EMEA region where decarbonisation remains the top priority, diversity targets now have the biggest influence on ESG decision making, particularly among listed

companies. Crew welfare issues are also of growing importance to many shipowners, a recognition of the plight of many seafarers during the pandemic.

Financiers in particular can provide compelling incentives for the sector to improve its sustainability metrics, especially across the environment and governance where they are seen to be the main engine of change as the success of the Poseidon Principles shows. Expanding the Principles to cover more than just emissions – recycling for example – is popular with most banks and would significantly raise the bar in promoting sustainability.

Also of interest is why shipowners do or don't invest in achieving emissions reductions. While many already pursue ESG-related due diligence and checks with their suppliers, this is only part of the picture. The big gains come from fleet modernisation, whether it be retrofitting existing ships, ordering conventionally powered ships with emissions reduction equipment, or investing in vessels incorporating alternative propulsion technologies.

This ties in to one of the thorniest challenges to emissions reduction - how to build up the fuelling infrastructure to support any new propulsion technologies developed? A substantial number of ships ordered over the last two years burn alternative fuels, but the number of facilities that can supply these alternative fuels around the world remains limited.

Virtually all shipowners are now considering using alternatives to bunker oil within the next five years. Fewer than in 2021, however, favour LNG or LPG as alternative fuels sources, perhaps due to rocketing gas prices and because these are viewed as transition fuels.

Replacing gas as the top choice among alternatives are biofuels, followed by hydrogen and wind and solar power. Methanol and clean ammonia are also more popular than they were two years ago, while batteries have slumped, possibly because storage technology is not advancing as quickly as expected and shipowners see technology and proven results as important factors in supporting one technology over another.

An even greater driver for opting for a specific fuel source is regulatory guidance, with access to finance being both shipowners' and operators' primary concern. Two years ago, cost was the key issue when choosing a particular technology but this is now the case for only a very small minority, possibly as they expect to pass on or absorb transition costs or due to the challenge of accessing finance mentioned previously.

For some, the biggest obstacle to a sustainable transition is neither finance or technology, but the cost difference between low and zero-emission fuels versus fossil fuels. Demand for clean fuels will only increase if this cost gap is minimised. Opinion varies on how this can be achieved with some looking to government subsidies and investment, while others believe shipowners will have to foot the bill.

Within the wider shipping industry, there is broad acceptance that carbon trading and offsets play an important role in emissions reduction, though opinions differ as to how such systems should apply to shipping. Whatever system is chosen, its effectiveness will depend on the price of carbon. Too low and there is no incentive for change; too high and it will strangle an industry that still has few alternatives to fossil fuels.

Co-operation may be the key to success. Increasing numbers of shipowners, especially larger ones, are now forming tie-ups to pursue sustainability goals, more often with private equity firms and energy players rather than with other shipowners.

Since we published our first report, shipping really has transformed its approach to ESG. Factoring sustainability criteria into decision-making and ESG monitoring of supply chains are now near universal.

Nonetheless, more action is needed if shipping is not to lose out to other sectors in the competition for renewable fuels. This means tougher emissions targets and urgent implementation of a viable shipping market for green fuels. The ball is in the IMO's court, with much expected from its summer MEPC meeting. Voluntary initiatives such as the Getting to Zero Coalition and the Poseidon Principles have been impressively effective, but shipowners and other industry stakeholders are clear that further ESG progress must be driven by regulation.

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