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SUSTAINABLE FINANCE MONITOR

The IIF Sustainable Finance Monitor brings together our views on the global sustainable finance agenda, analysis of policy and regulatory initiatives, market trends, and the activities of the IIF Sustainable Finance Working Group (SFWG).

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Quick Read

- ***COP26** – in Glasgow from October 31 to November 12 – will be the most **consequential UNFCCC meeting since Paris**, with hopes for successful outcomes across a broad range of negotiation items.*
- *Amid calls for more ambitious leadership, four key factors will shape the outcome of negotiations: **the unifying goal of Net Zero by 2050, the acceleration of harmful climate impacts, advances in the scientific understanding of climate risks, and**—building on the first three—**much clearer projections of how to decarbonize the global economy.***
- *Achieving a successful outcome at COP will be contingent on three central negotiation points: **the framework for Nationally Determined Contributions (NDCs), Article 6 of the Paris Rulebook, and a post-2025 framework for climate finance**.*
- *Tune in to our **COP Talks** series of virtual webinars, as well as a stream of quick-take 'daily downloads.' We will also be providing summary analysis of the key issues being addressed across the COP agenda.*

Editor's Note

Dear Reader,

Next week, the United Nations Framework Convention on Climate Change (UNFCCC) will host its 26th Conference of the Parties (COP) in Glasgow, under the Presidency of the United Kingdom. Several decades of negotiations have yielded notable milestones, with key victories such as COP21 in Paris in 2015 forging a global agreement to limit global warming to well below 2°c. However, with global greenhouse gas emissions continuing to rise, it is proving challenging to take forward the hard work of implementation and delivery of binding targets that will shape how all sectors of the global economy will transition.

As such, **COP26 is set to be the most consequential UNFCCC meeting since Paris**. The recent Sixth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC) paints a grim picture of the likelihood of future climate impacts associated with warming beyond 2°c. Headlines suggesting that the negotiations represent '**the last chance for humanity**' abound, with warnings of global conflict and chaos – famine, war, the implosion of economies, destruction of huge swaths of the world's cities, and ultimately, collapse of the ecosystems – **if emissions are not drastically cut this coming decade**. In other words, now.

These warnings are well justified. Risks have increased, and the impacts are on our doorstep. We face a definitive moment for global collective action – which will require courage, ambition, and integrity from all negotiation parties. Across the global corporate and financial sectors, the call for stronger action to reduce emissions is growing; the key will be whether governments can deliver the substance needed to translate high-level goals (like Net Zero targets) into actionable plans and strategies.

The IIF will have a small delegation in Glasgow, to bring you an 'on the ground' perspective on key developments at the conference, from insights on negotiations in the 'Blue Zone' to the host of corporate, financial, and civil society stakeholder events alongside the formal proceedings. We will be hosting a series of virtual COP Talks webinars, and a stream of quick-take 'daily downloads' with one-on-one interviews with COP attendees. We will also provide summary analysis of the key issues being addressed across the COP agenda.

This special COP26 issue of the IIF Sustainable Finance Monitor is designed to help IIF members navigate these historic two weeks. To help set the context, we've set out some thoughts on why this COP meeting is so important, drawing on key developments since the delivery of the Paris Agreement in 2015. We cover the key factors shaping a new climate agenda, and three crucial negotiation items to watch as the conference progresses. The final section provides our schedule of virtual activities across the conference.

- Sonja Gibbs, Managing Director and Head of Sustainable Finance, IIF

1. Getting to Glasgow: Four Key Factors Shaping a New Climate Agenda[1]

Despite the long-term time scales that one hears about when discussing climate change – from preindustrial emissions levels to 2100 warming outcomes, the six years since the Paris Agreement was reached have seen massive geopolitical, economic, and climate system changes. Here, we reflect on four key factors since Paris that are coming together to make this years' COP the most important meeting in the history of the UNFCCC.

1. Simple Math, Complex Calculus: One guiding number to benchmark climate action.

One of the biggest changes in our global thinking on climate action can be summed by by two small numbers – **1.5** and **Zero** – with the former referencing the level of global warming considered to be the limit of safety by scientists, and the latter being the amount of Net GHG emissions by 2050 needed to stabilize the global climate system. Since the IPCC's special report on 1.5c released in 2019, there has been a renewed focus on the limits of the global carbon budget – the amount of emissions that can be released to meet a given level of warming – as the basis for public and private climate ambition. 63 countries around the world have either officially made or are considering 2050 net-zero climate commitments, and over 3,000 private companies have committed to net zero through the UN Race to Zero initiative. While the concept is comparatively simple, delivering Net Zero across the economy and financial system is proving to be an extraordinarily complex accounting challenge. New analysis by the OECD of countries' net-zero targets highlights the subtle yet critical differences in how governments are formulating and communicating national-level commitments. Within the corporate and financial sectors, institutions have been working at multiple levels to define practices for setting and monitoring progress on Net Zero alignment.

[1] Authors: Jeremy McDaniels, Senior Advisor, Sustainable Finance

COP26 will see a raft of announcements public and private-sector initiatives – we're watching out for **Finance day (Wednesday 3rd)**, where both the Coalition of Ministers for Climate Action and the 4th High-Level Ministerial Dialogue on Long-Term Climate Finance will convene and announcements are expected from coalitions such as the Glasgow Alliance for Financing Net Zero. Critically, action to drive emissions reductions will flow from heavy emitters in the corporate sector; the Science-Based Targets Initiative new Global Net-Zero Standard, launched on October 28th, provides a new benchmark for aligning corporate climate action, focusing on rapid emissions reductions across scopes 1, 2, and 3; near and long-term target setting; and clear guidance on the use of carbon offsets.

2. Continued GHG emissions have now made some climate impacts unstoppable, making adaptation a near term priority.

Global emissions reached a new record last year, according to the latest report from the UN WMO. Despite a minor blip in emissions growth in 2020 due to the COVID-19 pandemic, recent assessments suggest that under current NDCs, emissions are likely to grow 16% by 2030, instead of the sharp 50% decline necessary to achieve a 1.5c pathway. Under this emissions trajectory, the carbon budget left to limit warming will be depleted rapidly, with the WMO estimating that the 1.5c limit may be breached within the next five years. Even at our current level of 1.3c, many critical climate damages are now 'locked-in', and cannot be avoided. In its Sixth Assessment Report, the IPCC confirmed it is "unequivocal" that humans have caused global warming affecting the atmosphere, oceans, and land, resulting in an acceleration of extreme weather events including heatwaves, heavy precipitation, droughts, and tropical cyclones. While countries are required to submit an 'adaptation communication' within NDCs, more work is required to ensure that all countries are adequately factoring the costs of adaptation measures in their own jurisdictions – as well as considering the hard limits to adaptation that some countries, such as low-lying island states, will face as they contend with systemic challenges such as sea-level rise.

3. Small shifts in global averages are influencing major shifts in extremes, with certain physical risk indicators already tracking below long-term worst-case projections.

The events of 2021 have made it clear that no country is safe from the physical impacts of climate change. From massively destructive floods in Western Europe, to fires across the northern hemisphere and extreme rainfall in China, 2021 has been a year of climate extremes – with records of sorts being broken with worrying speed. Critically, many examples of extreme weather observed in recent months and years would have – until very recently – would have been considered virtually impossible in previous years.

Recent improvements in climate attribution analysis have found that a heavy rainfall event in parts of Western Europe is between 1.2 and 9 times more likely and 3-19% more intense than it would be in an environment that is 1.2 °C cooler, demonstrating the tangible effects of human-induced climate change on physical risk. Furthermore, recent research indicates that the record-setting heatwaves in the Pacific Northwest of the United States and Canada in June 2021 are a 1 in 1,000-year event in today's climate and would have been 150 times less likely without anthropogenic climate change. In a future with 2 °C of global warming, however, similar heatwaves are predicted to occur every 5-10 years. The heatwave caused hundreds of deaths and precipitated widespread wildfires, results which will only become more commonplace as temperatures continue to rise.

It is now estimated that 85% of the world's population has already experienced extreme weather events made worse by human-induced climate change, and that number is only set to grow – especially as we continue to see impacts today that were not anticipated to occur until mid-century.

Looking beyond the near term, even small shifts in global average temperatures can upset the fine balance of ecosystems around the world. The IPCC's most recent report has shown evidence that changes in key tipping points in the climate system, such as Arctic ice sheet collapse, mass death of coral reefs, shifts in vital oceanic currents, and the thawing of the permafrost, are already being observed.

4. We know what is needed to decarbonize the economy, and have a clearer idea of how to finance the transition, but major gaps remain.

The Net Zero by 2050: A Roadmap for the Global Energy Sector report from the IEA sets out the clearest view to date on the trajectory and costs of the transition. More granular analysis is expected in subsequent IPCC working group reports to be released in coming months. These recent projections are aligned with new academic studies illustrating that the costs of investing in the transition are on par with, or less expensive, than continued investments in fossil fuels.

However, recent analysis by the UNEP of countries' plans to continue – and in certain jurisdictions, scale up – extraction of fossil fuels illustrate indicate that the world remains on a high-carbon energy trajectory, which is 'dangerously out of sync' with long-term commitments made under the Paris agreement. Here, the significant attention is being placed on the role of the financial sector as an agent to help drive this transition – but this can only be achieved with clear policies in place that shape the emissions trajectory of energy systems and key real economy sectors. Furthermore, a policy environment that helps to drive capital flows to green infrastructure (for which a financing gap to the tune of $15 trillion from 2021-2040 persists). will be critical, especially in the wake of a sharp slowdown in ESG flows in Q3 2021.

2. UNPACKING THE UNFCCC PROCESS: Key Negotiation Items[2]

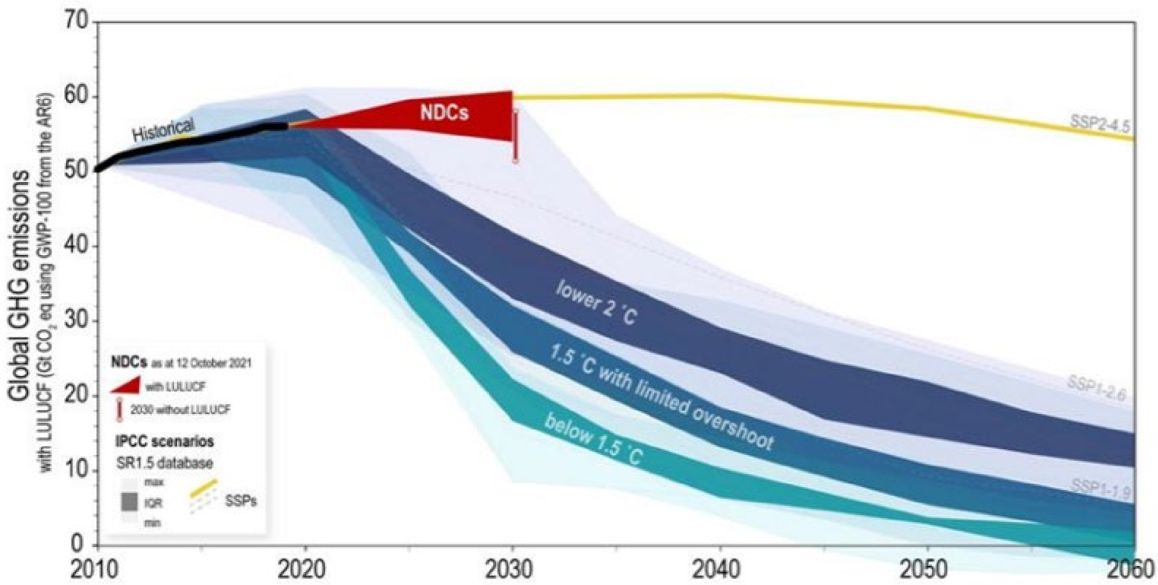
After a 12-month delay due to COVID-19, COP26 will serve as a critical milestone for several elements of the multifaceted UNFCCC process. The primary focus will be on countries own climate action plans, in the form of revised and more ambitious Nationally Determined Contributions (NDCs). In addition, however, negotiators will pick up a significant number of negotiation items that were left unresolved in the last two COP meetings in 2018 and 2019, including on Article 6 of the 'Paris Rulebook' (which significantly blocked progress at COP25), and a host of issues pertaining to climate financing, adaptation, loss and damage, gender, ecosystems, and other issues. Here, we discuss **three make-or-break crux points** in the negotiations, upon which a successful COP outcome will be contingent.

Nationally Determined Contributions: Lacking in detail, ambition, and speed

The latest NDC synthesis report from the UNFCCC (released on October 25th) indicates that while an increasing number of countries are indeed coming forth with updated plans (with 116 new or updated NDCs communicated by 143 Parties as on 12 October 2021), the content of the plans are still lacking when stacked up against the emissions trajectory required to meet a 1.5 or even 2c pathway. As indicated in the figure below, current NDCs will place the world on a track for a 16 per cent in global GHG emission in 2030 compared to 2019, leading to a global temperature rise of around 2.7c by the end of the century. According to UNFCCC Executive Secretary Patricia Espinosa, "overshooting the temperature goals will lead to a destabilised world and endless suffering, especially among those who have contributed the least to the GHG emissions in the atmosphere."

[2] Authors: Jeremy McDaniels, Senior Advisor, Sustainable Finance

Comparison of global emissions under scenarios assessed in the Intergovernmental Panel on Climate Change Special Report on Global Warming of 1.5 °C with total global emissions according to nationally determined contributions



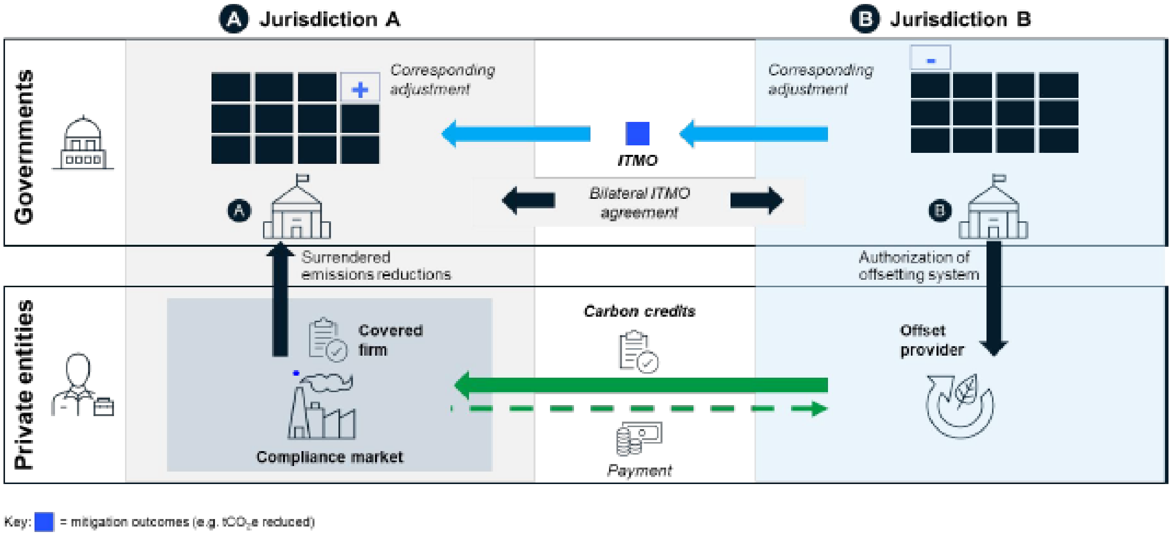
Source: UNFCCC

The issue of common time frames for NDCs remain unresolved since COP24, where countries agreed that NDCs implemented from 2031 onwards should use common time frames. However, they were unable to decide the period from which and duration for which common time frames should apply. Options for durations currently on the table include, 5, 10, 5+5, or 10 years with a 5-year "indicative waypoint", with a variety of starting points being considered. At the end of these time frames, NDCs will be reviewed and resubmitted with increasing ambition, acting as a "ratchet mechanism" of sorts to scale climate action and commitments. Without comparable, common timeframes, aggregate analysis of NDCs and their alignment is challenging. COP26 will be the venue to work this through, and the decision on NDC common time frames will serve as the foundation for other important areas, including the methodology (such as common formats for disclosure) for disclosure of progress on NDCs.

Article 6: deciding the future of a global carbon market infrastructure

The costs of emissions reductions can vary substantially across economic sectors and countries. Recognizing this, the Paris Agreement provides a framework for international cooperation which includes enabling cooperation through carbon markets. Article 6.2 establishes a mechanism by which countries can cooperate using "internationally transferred mitigation outcomes" (ITMOs). This means that a country can sell progression towards its own NDC target to a buyer country wishing to further progress towards its NDC target. Underlying this mechanism is the requirement that emissions reductions are not counted twice.

To avoid this, the seller nation must make a "corresponding adjustment" by adjusting its own greenhouse gas inventory to reflect the sale of the ITMO. The sold ITMO does not count towards the seller country's climate targets. Article 6.4 supplements this by creating a new, UN-governed crediting mechanism, that will enable the generation of carbon credits recognized under the Paris Agreement and their trade by both the public and private sectors. This Article 6.4 mechanism would replace the Kyoto Protocol-era CDM.



Source: IIF, Vivid Economics

For more information, please see the recently-released IIF report [Getting to Net-Zero: The Vital Role of Global Carbon Markets.]

Climate Finance for Developing Countries: Billions lacking, yet Trillions needed

Undergirding all of the negotiations on emissions reductions is the critical question of how it will be paid for, and by whom. The challenge of climate finance is especially acute in emerging markets, where estimates of the costs of financing the transition range into the trillions per year. At COP15 in Copenhagen, developed countries pledged to deliver 100bn of climate finance to developed countries by 2020; this was formalized in Article 9 of the Paris Agreement stipulates that developed countries shall provide financial resources to assist developing country Parties with respect to both mitigation and adaptation. Recent analysis from the UN, however, suggests that this goal is far from being achieved. At COP26, a new framework will be negotiated to deliver increased flows of finance from 2025 onwards. Successful delivery of this new framework will be contingent on multiple factors, including evidence of progress and clear plans. A formal status update from developed countries on provision of climate finance (summarizing 'biennial finance communications') is due at the conference, detailing the volume of finance flows to be contributed by each party, and critically, how it is contributed. Other key issues include underlying definitions for climate finance, the balance of flows of finance to mitigation and adaptation, and the 'additionality' of such finance – including the distinction of these flows from broader development finance.

3. IIF @ COP26

- A Practitioner's Guide: Considerations for Banks Setting a Net Zero Strategy – October 29
- Advancing Global Coordination on Sustainable Finance Policy – November 1
- Emerging Markets Investing through an ESG Lens – November 2
- The Future of ESG Disclosure – November 3
- The World is Waiting: Advancing Net Zero Commitments in Financial Services – November 8
- Financing the Transition—Unlocking Funding for Clean Technology – November 8
- Natural Capital and Biodiversity – November 9