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COP27: Reflections and key takeaways for financial services

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After two weeks of negotiations and bargaining, the COP27 cover decision has been published.

COP27 has finally drawn to a close, with the negotiating schedule extended from Friday afternoon to the early hours of Sunday morning. As always, the days of technical negotiations and ministerial bargaining resulted in a cover decision – the final text that summarizes the formal outcome of the conference.

This has been one of the biggest climate COPs yet, attracting around 35,000 delegates – including more than ever from the private sector – and around 100 heads of state. COP27 also welcomed a large number of delegates from Africa, developing economies and small island states.

However, COP27 faced a huge task. Moving from the previous era of securing the right commitments – which resulted in the Paris Agreement, built upon by the Glasgow

Climate Pact – into a phase of implementation, all while attempting to tie up longstanding negotiation threads and set against a challenging geopolitical backdrop. Coming into the two weeks of talks, countries were called upon to submit new and updated national climate plans (Nationally Determined Contributions (NDCs)), to begin to measure and track progress – under the Global Stocktake. As well as aiming to establish a mechanism to address Loss and Damage for the first time since it was initially conceptualized at the 1992 Rio Earth Summit three decades prior.

Did the achievements of this "Implementation COP" live up to expectations?

Given the challenging agenda, it was no surprise that the conference's core multilateral negotiations were often slow. Almost every option under the majority of items being negotiated was on the table until the final hour – and despite a key commitment on Loss and Damage, many delegations expressed frustration that the final text failed to address fossil fuels. Without a clear and practical plan to shift the world onto a cleaner energy system globally, there will be little chance of limiting warming to 1.5 degrees.

Key turning points on the COP agenda

- **1.5 degrees:** Concerns of a backslide on the 1.5 degree temperature limit were not fully realized, thanks in part to the G20's Communique which was issued during the second week of COP and reaffirmed the commitment of those countries to keeping 1.5 alive. As well as more frequent and severe storms, heatwaves and crop failures, this half a degree of warming could be the difference between the collapse of major ice sheets and near-entire loss of the coral reef ecosystem.

- **Loss and Damage:** The final text showed more recognition for this item than was expected, with a commitment to set up a financial support structure for countries worst affected by and most vulnerable to the impacts of climate change by COP28 in the United Arab Emirates next year. Delivering on this will rely on resolving the debate as to which countries should be eligible to benefit from this funding – which currently could include countries who contribute significantly to emissions today.

- **Clean energy:** Last year in Glasgow, phasing "down" coal was the first time that a reference to fossil fuels made it into the cover decision. In its 2019 assessment of global emissions, the International Energy Agency (IEA) found that combustion of coal alone was responsible for 0.3 degrees of the 1 degree warming that had been seen to date. This COP, around 80 countries backed a proposal to expand the reference to coal phasedown to cover all fossil fuels, but this did not make it into the final text. As of 2022, scientists believe that we are now at 1.2 degrees of warming globally – and current policies in place put us on track to hit 2.7 degrees, if they are fully implemented.

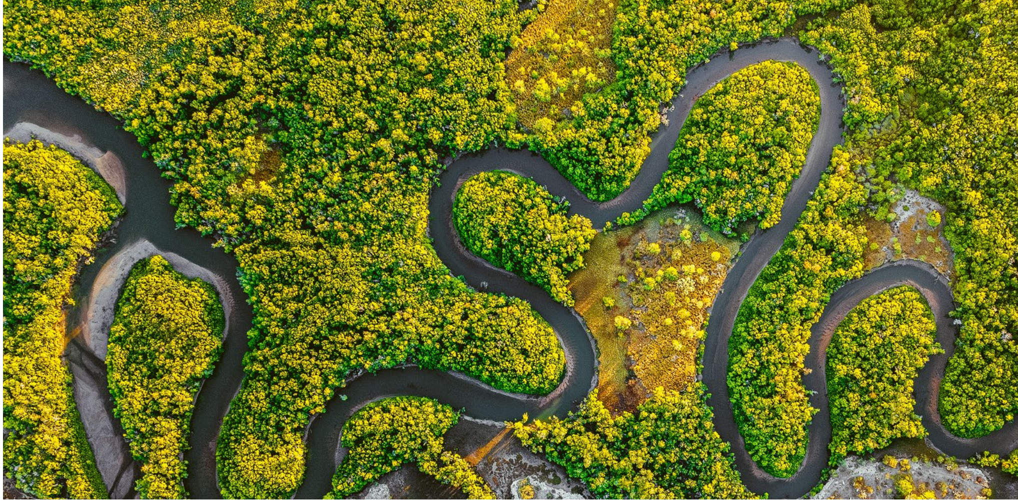
Despite the challenges of the multilateral process at COP27, the tone established on climate change in Bali at the G20, as well as resumed meetings between Presidents Biden and Xi and their respective climate envoys, showed that high-level leadership and ambition on climate change can be an important factor in driving progress toward a more sustainable future. The two global superpowers are not only among the world's largest emitters, but also have a unique ability to collectively rally other countries to action.

Momentum for financial services

The final days of COP27 generated some important developments for financial services. Whether inside COP or on the sidelines, there were moments of real momentum in areas of direct interest to the financial services industry. Announcements aimed at or affecting private sector finance providers came from a combination of multilateral, bilateral and fringe activities.

Key announcements linked to COP27 include:

- **The Bali Leader's Declaration.** The G20 in Bali reaffirmed leading nations' political commitment to full implementation of the Paris Agreement and the Glasgow Climate Pact – something that had been called into question earlier in the two weeks of COP27. As the Declaration put it: "Noting the IPCC assessments that the impact of climate change will be much lower at a temperature increase of 1.5°C compared with 2°C, we resolve to pursue efforts to limit the temperature increase to 1.5°C."
    - Implications for financial services: Political resolve to keep working toward the goal of limiting climate change to 1.5°C – despite the disruption caused by COVID-19 and the war in Ukraine – gives confidence that major economies intend to continue to progress toward more 1.5 degree compatible policies and regulations. While more is needed in terms of clear, directional climate policy, this should give a level of much-needed confidence to financial institutions in these economies as to the future operating environment within which they will exist.
- **The High-Level Expert Group (HLEG).** The UN HLEG's report on Net Zero Emissions Commitments set out clear standards for net-zero.
    - Implications for financial services: Clearer guidance on what constitutes a credible net-zero commitment will help financial institutions to not only give their stakeholders confidence in their own commitments, but also to better assess those of their counterparties, making it easier to track progress on decarbonizing financed emissions and to establish credibility.
- **Just Energy Transition Partnerships (JET-Ps).** The announcement of a JET-P between the US, Japan and Indonesia was another milestone for this concept. Given the context of developed nations'



failure to meet their annual $100bn adaptation finance commitment, there is some optimism that JET-Ps could represent an alternative, efficient way to channel mitigation finance to emerging economies.

- Implications for financial services: Approximately half of the finance offered through this JET-P is reported to be provided by the private sector. While this is just one deal, it could become an illustration of how blended finance can help to drive the energy transition in emerging economies and unlock the trillions on the table under the Glasgow Financial Alliance for Net Zero (GFANZ). Private financial institutions should be closely watching as the finer details of this deal are worked out.

- **The Bridgetown Initiative.** This plan for systemic reform was put forward by Mia Mottley, Prime Minister of Barbados. Among other things, it makes proposals that would increase the efficiency and financial impact of the World Bank and other multilateral development banks (MDBs).
  - Implications for financial services: If successful, multilateral development bank (MBD) reform could improve early-stage support for climate finance investments, de-risking projects for subsequent investors and making it easier for private finance to invest in the transition in emerging and developing economies.

- **Carbon markets.** The negotiations around this technical and sensitive topic have been particularly complex and raise important questions about the future of carbon markets. Multiple instances of allowing double and triple counting of carbon credits, poor quality offsets and even potentially reclaim ownership ("authorization") of carbon credits once they have been already issued into the market.
  - Implications for financial services: It remains unclear which of the proposals currently under discussion will be adopted. However, they have the potential to significantly limit the future availability and quality of carbon offsets and

the authorization debate presents a critical challenge to companies looking to purchase carbon credits to offset emissions. This could have material implications for financial institutions' decarbonization strategies, particularly in terms of restricting the ability to balance out any remaining residual emissions of their counterparties. Financial organizations should be taking steps now to understand the supply available on the market, the impact that Article 6 could have on this, and the steps they can take to mitigate against future carbon credit supply and integrity risk with respect to meeting their net-zero targets.

Entering the "implementation" decade

The success of bilateral and private sector activity in Sharm El-Sheikh gives us an indication of how future climate COPs during the crucial "implementation decade" of the 2020s might look. Experience already suggests that smaller partnerships could represent an efficient way to mobilize climate action and climate finance. Focused groups of governments, development banks and commercial finance providers can move much faster than initiatives that require global agreement and organization.

This implies that, even if multilateral progress is slow, the concentrations of political energy that COPs provide will continue to create a slipstream of momentum upon which private sector actors can build their own activity – mobilizing a new ecosystem of alliances for delivering climate finance and sustainable returns at scale.

The next focus: COP15 and COP28

The focus now shifts toward COP28 next year in the UAE, and also to Montreal where the biodiversity-focused COP15 is taking place next month. The cover decision of COP27 recognizes that fighting climate change and protecting biodiversity are two sides of the same coin. If a significant agreement can be reached in Montreal, that will provide a critical backstop for momentum on global climate action.

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