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COP26 and the Role of Private Capital

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On November 13, 2021, the 26th Conference of the Parties to the United Nations Framework Convention on Climate Change — "COP26" — concluded in Glasgow. COP26 sought to progress the goals of the Paris Agreement, which was adopted at COP21 in 2015, to limit global warming to well below 2°C — and preferably to 1.5°C — above pre-industrial levels. Since the Paris Agreement was signed, the Intergovernmental Panel on Climate Change ("IPCC") has determined that limiting warming to 1.5°C will require 'net zero' greenhouse gas emissions by 2050. The Paris Agreement has also mobilized the financial sector, manifested by initiatives such as the Task Force on Climate-related Financial Disclosures ("TCFD").[1] In short, COP26 was held amid unprecedented public and private sector focus on achieving net zero and mitigating and adapting to the physical and transition risks of climate change.

Here, we briefly outline certain key outcomes of COP26 and their possible implications for the role of private capital in efforts to mitigate and adapt to climate change.

COP26 Outcomes

Government Policy — COP26 culminated with 197 countries agreeing to the Glasgow Climate Pact ("GCP"). Though high-level and nonbinding, the GCP calls for action on mitigation, adaptation and finance, including accelerating the energy transition, implementing carbon emissions trading rules pursuant to Article 6 of the Paris Agreement and adaptation funding. But experts say the net zero rhetoric still does not match reality; according to the International Energy Agency, governments' emissions commitments at COP26 remain likely to lead to warming exceeding 1.5°C. The GCP provides that governments will "revisit and strengthen the 2030

[emissions] targets" by the end of 2022. Separately, governments pledged to limit deforestation, shipping emissions and methane emissions,[2] and the U.S. and China issued a joint declaration on climate cooperation.

Role of the Private Sector — At COP26, the Global Financial Alliance for Net Zero ("GFANZ") announced that its participants' $130 trillion of private capital is committed to transforming the economy to net zero. Prior to COP26, GFANZ, which is co-chaired by Mark Carney and Michael Bloomberg, had called on governments to introduce regulation that supports green investment. However, the limited extent of governments' policy commitments at COP26 means that there will now be a renewed focus on market-led initiatives and private capital in helping to drive net zero.

Transparency and Disclosure — The regulatory and financial commitments at COP26 underscore momentum behind climate-related target-setting, transition planning and disclosure. Most notably, the IFRS Foundation announced the launch of the International Sustainability Standards Board ("ISSB"), designed to build upon the work of the TCFD to develop global standards for climate-related disclosures, as well as the work of other standard setters to develop global standards for broader environmental, social and governance disclosures. A key goal of the ISSB is to help combat greenwashing, which is increasingly a focus for financial regulators. The ISSB is expected to issue its first set of standards in the second half of 2022.

Key Potential Private Sector Implications

The Energy Transition: Speed, Pathways and Transparency — The GCP is the first COP final decision to address the transition away from coal and to call for the phase-out of "inefficient fossil fuel subsidies." COP26 coincided with energy security concerns arising out of the first energy crisis of the net zero era, and the GCP commits only to the "phasedown" — rather than the "phase-out" — of coal power. Nevertheless, 39 countries and development banks separately committed to end public investment in fossil fuels by the end of 2022. Moreover, calls for fossil fuel divestment at COP26 were matched by broad investment pledges, notable among them being CIF's launch of a $2.5 billion energy transition fund, multinational commitment to accelerate the deployment of zero-emission vehicles and clean energy, and GFANZ's private capital commitment. U.S. Climate Envoy John Kerry describes the net zero transition as "the greatest economic opportunity

since the Industrial Revolution." There have also been calls for dedicated fossil fuel funds and banks to bridge the financing gap for a global economy that still relies heavily on oil, gas and coal.

International Carbon Markets — Carbon credits generated under market-based incentive programs are expected to play a critical role in achieving net zero goals, including by driving early investment in emissions reduction technologies that may otherwise be difficult to commercialize.[3] However, some stakeholders have thus far hesitated to commit to use of these voluntary carbon markets due to the perception of insufficient standardization or verification. COP26 is significant because rules[4] were finally agreed to implement Article 6 of the Paris Agreement, which governs carbon credit trading between countries of credits generated from UN-certified carbon projects. Such credits can be traded to satisfy each country's nationally determined contributions ("NDCs") under the Paris Agreement. The new Article 6 rules agreed to at COP26 address accounting for credits transferred between countries to avoid double-counting emissions reductions towards NDCs. Although Article 6 does not directly regulate voluntary carbon markets, its crediting mechanism, which requires that the host country make an adjustment to its emissions tally anytime credits are transferred abroad, whether to governments or private actors, may shape the voluntary offset market — and the related work of the Taskforce on Scaling Voluntary Carbon Markets — potentially improving accounting, transparency and standardization.

Physical Risk and Adaptation — Although net zero commitments now cover 88% of global emissions, the policies outlined at COP26 remain unlikely to prevent warming of over 1.5°C. Certain assets are expected to be exposed to the resulting physical risks of climate change, such as wildfires, flooding and other extreme climate events. It is therefore important that owners and managers work with frameworks such as TCFD to assess and mitigate these risks. Recognizing that some physical climate impacts are now unavoidable, COP26 featured new capital commitments to a climate adaptation agenda, which may catalyze a $300 billion per year industry. The GCP commits to "at least double" adaptation funding by 2025, bringing the annual figure to around $40 billion. Such developments underscore the momentum of capital flowing into industries involved in climate adaptation and future investment opportunities.

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1. In our November 10 *Alert*, we detail recent changes to the Task Force on Climate-related Financial Disclosures'

("TCFD") voluntary disclosure framework for companies and financial institutions.↩

2. Kirkland is continuing to monitor regulatory developments pertaining to methane emissions. The Kirkland Energy & Infrastructure blog recently posted a summary of actions directed at methane emissions from the oil and gas sector.↩

3. We explore this topic in our March 5 blog post, "Industry Efforts to Scale Voluntary Carbon Markets Advance."↩

4. *See* "Guidance on cooperative approaches referred to in Article 6, Paragraph 2, of the Paris Agreement" and "Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Paris Agreement."↩

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