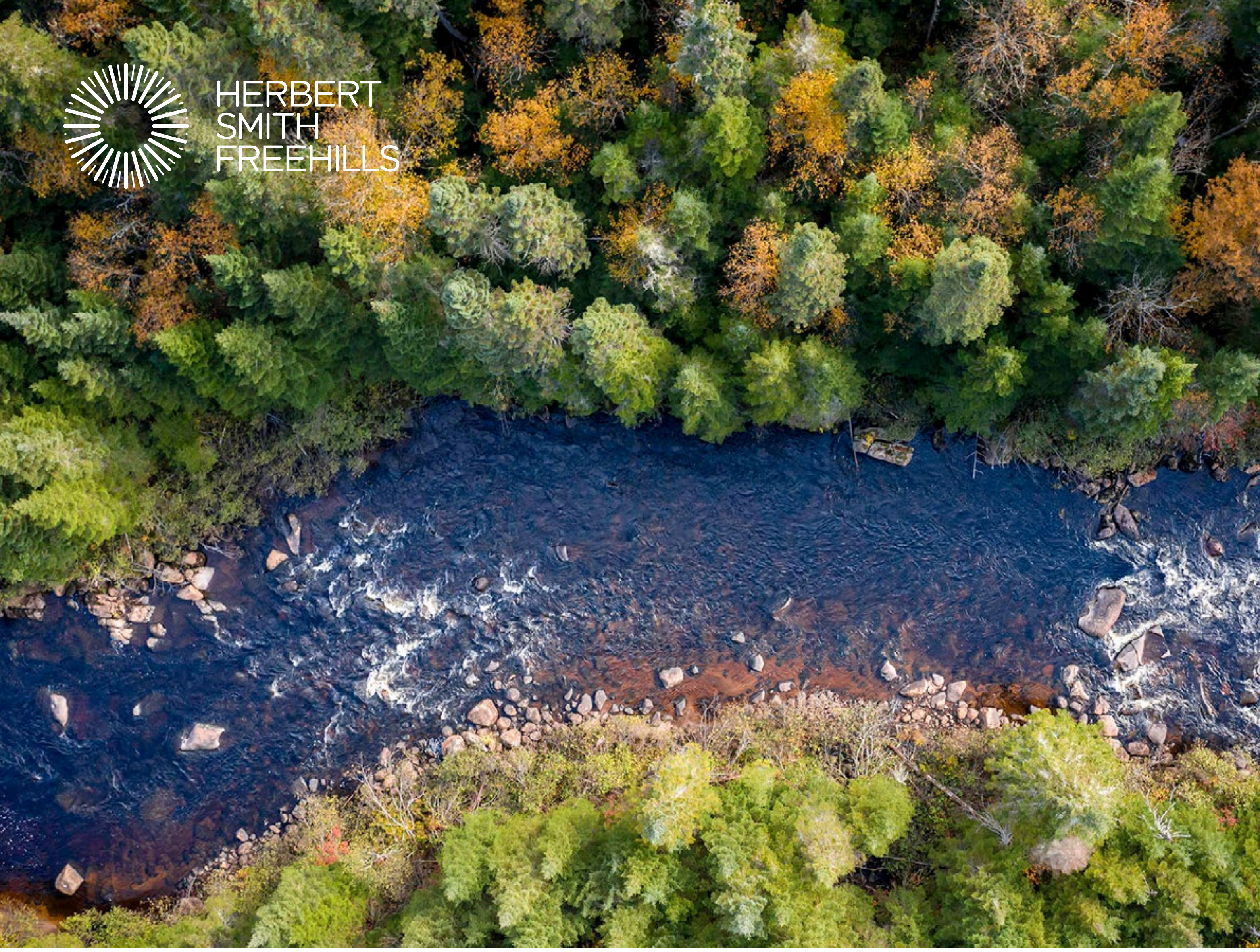

COP26 OUTCOMES

Overview

From 1-14 November 2021, the 26th Conference of the Parties (COP26), the UN-backed forum for tackling climate change, took place in Glasgow. Originally scheduled to take place five years after the Paris Agreement was concluded at COP21, and having been delayed by a year due to the COVID-19 pandemic, the conference was much anticipated. Public expectations on governments to address climate change had reached previously unseen heights. Politicians and the media coined the phrase "humanity's best last chance" to address climate change ahead of COP26.

While COP26 did not manage to deliver on the high expectations the world at large had, some progress was made and the ultimate aim of keeping a 1.5C warming limit alive was arguably kept within reach. One positive development was the global recognition that 1.5C should be the target, rather than merely "well below 2C".

This briefing summarises the key outcomes from COP26, and explains the implications behind the central developments that were achieved.

Key outcomes

- Parties agreed the Glasgow Climate Pact.
- The outstanding elements of the Paris Rulebook were finalised.
- Parties agreed on a "phasedown" of coal and "phase-out" of inefficient fossil fuel subsidies.
- Developed countries have been urged to at least double their 2019 climate finance contributions by 2025.
- A number of pledges, such as the Methane and the Deforestation pledges, were supported by a large group of states.

Shortcomings

- Current emission reduction pledges for 2030 if fully implemented are projected to lead to 2.4C of warming, well above the 1.5°C aim of the Paris Agreement.
- The $100 billion 2020 target for finance supporting developing countries' climate change adaptation and mitigation was missed.
- No notable progress was made on loss and damage, a mechanism designed as the main vehicle under the UNFCCC process to avert, minimize and address loss and damage associated with climate change impacts, including extreme weather events and slow onset events.

Glasgow Climate Pact

Emission reductions – delay to 2022

The Glasgow Climate Pact reflects the final decision of the states parties at COP26. Ultimately, it is a high-level global agreement to accelerate climate action before 2030, but required substantial compromise to garner sufficient support. According to analysis published during the talks current emission reduction pledges for 2030 if fully implemented would lead to a disastrous 2.4C of warming. Therefore, to keep the Paris goal of limiting the global temperature increase to 1.5C alive, the pact aims for states parties to make revised and 1.5C-aligned 2030 emission pledges by the end of 2022.

Coal Phase down

One of the central goals of the UK presidency at COP26 was an agreement to phase-out unabated coal. However, while the negotiations started with the "phase-out" of unabated coal power and inefficient fossil fuel subsidies, the parties ultimately only agreed on a "phasedown" of unabated coal power and a phase-out of inefficient fossil fuel subsidies. This less onerous language was demanded by China and India, and had previously already been featured in the Joint US-China Climate Declaration.

Climate Finance (for adaptation and mitigation)

Having missed the $100bn climate finance target for 2020, developed nations have promised increased financing over the next five years, with the text of the pact suggesting a doubling of 2019 contributions by 2025. However, there remain discussions about the correct and equitable allocation of such funds. To date, the majority of climate funding was deployed in middle income countries where emission reduction measures such as renewable energy projects can make a profit. Less climate finance has reached countries that are most critically in need of adaptation and mitigation measures.

Loss and Damage

No notable progress was made on loss and damage, a mechanism designed as the main vehicle under the UNFCCC process to avert, minimize and address loss and damage associated with climate change impacts, including extreme weather events and slow onset events.

Paris RuleBook

After six years of negotiation, the Paris Rulebook (the "**Rulebook**") was finally completed, allowing now for parties to implement the envisaged mechanisms. Particular focus in these negotiations were being placed on Carbon Markets (Article 6) and Transparency Rules (Article 13).

Article 6 – Carbon Markets

Article 6 of the Paris Agreement relates to the development of an international carbon market to help accelerate the energy transition and lead to an overall reduction in greenhouse gas emissions. Three pieces of guidance were published on Article 6, specifically relating to Article 6(2), Article 6(4) and Article 6(8).

The new framework under Article 6 will comprise (i) a centralised system open to the public and private sectors, and (ii) a separate bilateral system that will allow countries to trade credits that they can use to help meet their decarbonisation targets.

However, there remain points of ambiguity within the Rulebook.

Guidance on cooperative approaches referred to in Article 6(2) (link)

Article 6(2) specifically addresses the international transfer of emission reductions within the bilateral system, in the form of internationally transferred mitigation outcomes ("**ITMOs**"). ITMOs, amongst other things, include emission reductions not claimed for the achievement of a host country's nationally determined contribution ("**NDC**"), as well as emission reductions pursuant to Article 6(4).

The full framework includes various annual and biannual reporting requirements, as well as an Article 6 database as part of, and integrated within, a centralized accounting and reporting platform. Overall, the aim is to ensure transparency, accuracy, completeness, comparability and consistency, and that participation in cooperative approaches under Article 6 does not lead to a net increase in emissions within and between NDC implementation periods.

Rules, modalities and procedures for the mechanism established by Article 6(4) (link)

Article 6(4) addresses the possible use of carbon offsets within both the centralised and bilateral systems. Specifically, so-called A6.4ERs (Article 6(4) emission reductions), of one tonne CO2 equivalence, can be claimed for approved Article 6(4) activities that fulfil certain requirements (for example, the requirement that they are designed to achieve additional emissions mitigation), and are transferable into both systems. Depending on the activity, a crediting period of 5 – 15 years will be available with the possibility of extension. The relevant A6.4ERs are subject to independent verification and certification.

To assist particularly affected developing countries meet the cost of adaptation projects, developers are required to deposit five per cent. of the credits generated by a project (under Article 6(4)) into a fund to help developing countries adapt to climate change, and also make a monetary contribution.

Another two per cent of the credits will automatically be cancelled to facilitate an overall net reduction in emissions, rather than the units simply balancing out emissions as often criticised in carbon offset mechanisms. However, this mandatory cancellation, and the mandatory five per cent levy, will only apply to credits in the centralised open system – the bilateral system will not be affected. In addition to the mandatory cancellation, parties may also choose to voluntarily cancel credits.

The possible issue of double-counting of emission reductions under Article 6(4) under both systems, for example where a state party uses the relevant reductions to meet its own NDC while also making transfers to other countries, has been addressed through the need to make adjustments. This makes it clear that reductions can only be counted once.

One key point of discussion was the treatment of historic emission credits under the Paris Agreement. The 1997 Kyoto Protocol established a system (the Clean Development Mechanism ("**CDM**")) that put into circulation hundreds of millions of carbon credits (certified emission reductions ("**CERs**")) through thousands of projects. The CDM and underlying CERs have been criticised as being of poor quality and for lacking environmental integrity. Critics contend that most of the projects financed under the CDM would have happened anyway without the financial support, saying they do not represent the climate benefits they claim.

Rather than being completely excluded, the states parties agreed that some of these historic credits (likely around 300 million) can still be used under the new Paris Agreement regime. As these transferred CERs can be used to meet countries' first NDCs, this has raised concern for the integrity of the NDC mechanism through this possible dilution and opens the door to greenwashing claims.

Work programme under the framework for non-market approaches referred to in Article 6(8) (link)

The Glasgow Committee on Non-market Approaches ("**NMAs**") was established to provide parties with opportunities for non-market-based cooperation to implement mitigation and adaptation actions in their NDCs. A work programme will be initiated in 2022 for the further exploration of NMAs, with progress and outcomes to be reported back to states parties.

Article 13 – Transparency

States parties adopted guidance to implement the enhanced transparency framework ("**ETF**") established under Article 13 of the Paris Agreement. The ETF aims to ensure that states parties report on how they are addressing climate change in an accurate and clear manner. The adopted guidance includes templates setting out the information which states parties are expected to provide in their regular reporting, as well as the format which they should use. Where capacity constraints prevent developing states parties from providing the full suite of information, they are permitted a degree of flexibility in the content of their reporting.

States parties which use Article 6 carbon trading measures to meet their NDCs are asked to provide information on the integrity of such measures in the relevant template. The guidance also sets out processes to train the experts who will review submitted reports, to assist states parties needing to build reporting capacity, and to finalise the review procedure for climate change adaptation and impacts reporting.

Why is this important?

While COP26 has not delivered on the high expectations placed on it, the outcomes of the conference will nevertheless have a noticeable impact on businesses.

Whilst many countries increased their NDCs (the vehicle through which the UN counts countries' efforts against climate change), these NDCs will, in many cases, still need to be translated into regulatory action. It is this regulatory action which will impact the way companies can do business in various jurisdictions around the world. At the same time, it is clear that more ambitious emission reduction targets are needed to achieve the objective of the Paris Agreement.

This may result in more regular revisions and increases of national emission reduction targets coupled with follow-on legislative and regulatory changes. It will therefore be essential for businesses to maintain an awareness of wider legislative, regulatory and market developments to ensure they do not fall behind. In light of the US lead methane pledge, immediate regulatory consequences are expected in relation to methane emissions.

Related to regulatory developments, we anticipate a continuous increase in climate and wider ESG-related disclosure obligations to aid the effective deployment of capital.

With the Article 6 rulebook in place, carbon markets are likely to play a central role over the coming years and decades in supporting the energy transition and emission reduction targets.

What has been clear from COP26 is the now undeniable level of investor expectation in relation to climate change and the related reputational risk in case of inaction. As stressed by various world leaders throughout COP, the private sector will play a central role in the world's transition to net-zero. While this brings challenges, there will be considerable opportunities for businesses which lead on this journey.

Key COP26 pledges

Traditionally the COP process led by the UN requires unanimous agreement between states parties. One successful approach of the UK presidency was the use of smaller country-alliances on various topics to reach pledges that, while strictly speaking were independent from COP26, nevertheless contributed to the perceived outcome of the conference and allowed for progress on some issues where no full consensus could be reached. Some of the key pledges announced during COP26 were the:

- **Beyond Oil and Gas Alliance Declaration:** the Beyond Oil and Gas Alliance was launched by Costa Rica and Denmark. Both states and other Alliance members committed to work towards setting an end-date on their oil and gas production.
- **Clydebank Declaration for Green Shipping Corridors:** More than 20 states pledged to support the establishment of zero emission maritime routes between ports.
- **Congo Basin Joint Donor Statement:** ten states, the European Union, and the Bezos Earth Fund announced $1.5 billion of financing for the conservation of natural carbon stores in the Congo Basin from 2021-2025.
- **Declaration on Accelerating the Transition to 100% Zero Emission Cars and Vans:** Over 70 states and territories, as well as numerous organisations pledged to 'work towards all sales of new cars and vans being zero emission globally by 2040'.
- **Glasgow Leaders' Declaration on Forests and Land Use:** More than 140 states, accounting for over 90% of forests worldwide, pledged to work collectively to 'halt and reverse forest loss and land degradation by 2030'.
- **Global Coal to Clean Power Transition Statement:** Around 190 states, territories and organisations committed to 'end new direct government support for unabated international coal-fired power generation'.
- **Global Forest Finance Pledge:** 11 states and the European Union pledged $12 billion in climate finance for forest conservation between 2021-2025.
- **Global Methane Pledge:** More than 100 states committed to cooperate 'to collectively reduce global anthropogenic methane emissions across all sectors by at least 30 percent below 2020 levels by 2030'.
- **Multilateral Development Banks Joint Nature Statement:** Multilateral Development Banks including the World Bank Group and the European Investment Bank issued a joint statement pledging to support 'nature positive' investments.
- **International Aviation Climate Ambition Coalition:** More than 20 states pledged to support the adoption by the International Civil Aviation Organisation of an emissions goal consistent with a 1.5°C warming limit.
- **International Just Energy Transition Partnership:** France, Germany, the UK, the USA and the European Union set out a provisional arrangement which would see South Africa engage in accelerated decarbonisation in exchange for an initial $8.5 billion financing commitment.
- **Statement on International Public Support for the Clean Energy Transition:** More than 35 states and financial institutions committed to 'end new direct public support for the international unabated fossil fuel energy sector by the end of 2022', except in limited circumstances consistent with a 1.5°C warming limit.
- **Zero Emission Vehicles Transition Council 2022 Action Plan:** The Council, which includes governmental representatives from major automobile markets worldwide, set out priorities including the promotion of vehicle charging infrastructure and effective fuel efficiency standards.

Key contacts

Silke Goldberg
Partner
T +44 20 7466 2612
silke.goldberg@hsf.com

Jannis Bille
Associate
T +44 20 7466 6314
jannis.bille@hsf.com