

COP26 summary: a meaningful result



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From 31 October – 13 November world leaders and their delegations from nearly all countries across the globe came together to work on the issue of climate change. We look at what was achieved over the course of the conference:¹

Major takeaways:

- **The ratchet mechanism works:** temperature alignment will continue to be wound down towards 1.5 degrees centigrade over subsequent cycles of negotiations – this is a clear indication of the direction of future policy

- **The private sector has stepped up:** when including all pledges – net-zero targets and other commitments not currently incorporated in policy – they add up to an end result of 1.8 degrees
- **Carbon markets:** rules on international carbon trading have been established. Loopholes remain so caution is needed
- **Civil society is unconvinced:** despite COP26 yielding better results than anyone on the inside expected, protestors and civil society have reacted negatively. Pressure to achieve 1.5 degrees has, if anything, increased. Attention to pledges and especially net-zero commitments will be strong. Companies will face reputational risk if they try to fudge net-zero pledges.

The last-minute games played by the Indian and Chinese delegations got the headlines, but the biggest result to emerge from this COP (Conference of the Parties) was confirmation that the ratchet mechanism designed under Paris 2015 agreement works – this was its first test and it passed. National pledges wound projected temperatures down by 0.3 degrees and, what is more, those pledges will need to be updated by next year's COP, accelerating the ratchet mechanism that would normally run on a five-year cycle.

Going into the summit the goal was to keep the target of 1.5 degrees alive, and this ratchet acceleration has done that. No one expected to be able to get national pledges (known as nationally determined contributions or NDCs) down to 1.5 degrees on a single cycle, so accelerating the next cycle is a meaningful result.

One overarching takeaway is how the focus of these meetings has changed – from 2 degrees and timelines of 2050 to 1.5 degrees and 2030. This aligns the political discussions with the science which shows that a 45% decline in emissions is required, based on 2010 levels, by 2030 in order to limit temperature rise to 1.5 degrees (based on 2019 levels this increases to a 50% decline). Figure 1 shows the alignment of temperatures against various tiers of pledges.

Figure 1: alignment of pledges

Temperature rise (degrees centigrade)	
1.8	If all NDCs, pledges and net-zero targets and corporate pledges agreed at COP26 are achieved (optimistic scenario)
2.1	NDCs plus the US and China net-zero targets
2.4	NDCs submitted at Paris 2015 only
2.7	Current policy (does not include policy proposals)



130 countries promised to collectively halt and reverse forest loss.

The private sector took on more of a role than ever before at this year's COP, with corporate commitments on a number of topics. These are summarised here:

- **Deforestation:** 130 countries promised to collectively halt and reverse forest loss and land degradation by 2030. Countries representing 85% of global forests, including Brazil, Indonesia and the Democratic Republic of Congo (DRC), backed this commitment but scepticism remains around whether it will be delivered. \$12 billion in public funds for forests, and more than \$7 billion in public-private investments have been committed towards this. Thirty financial institutions with more than \$8.7 trillion of global assets committed to eliminate investment in activities linked to deforestation.
- **Methane:** led by the US and the EU, 109 countries committed to reducing methane emissions by 30% before 2030, including Indonesia, Canada, Brazil, UK, Bahrain, Uruguay, Cuba and Malaysia. China has committed to continue the discussion with the US in the first half of 2022 to focus on the specifics of enhancing measurement and mitigation of methane. Russia is a notable absence.
- **Internal Combustion Engines:** a group of companies and countries are working towards 100% electric vehicle sales by 2035 in leading markets and 2040 in developing markets. Members include the UK, Canada, Norway, Chile, India and Kenya, along with Ford, General Motors, Jaguar Land Rover , Mercedes-Benz and Volvo.
- **Innovation:** COP26 saw multiple announcements on innovation in hard-to-abate sectors such as cement, steel and green hydrogen. Some of these are focused on stimulating demand rather than supply, which in turn should encourage existing producers to innovate and increase supply – “if you make it, we will buy it”.
- **Oil and gas:** the attention is broadening beyond coal, and new initiatives are targeting the supply side as well as demand.
- **Coal:** underwhelming agreements outside of South Africa's “just transition” partnership, but the economics are starting to win this battle. For example, even under Donald Trump the US retired the most coal globally and installed the second highest capacity volumes of renewable energy globally

after China. The South African mechanism provides a framework to move other coal dependent nations beyond the fuel.

- **Asset management aiming for net zero:** the Glasgow Financial Alliance for Net Zero announced that firms with a combined \$130 trillion owned or managed have committed to net zero (through the Net Zero Asset Managers commitment, Net Zero Asset Owners and similar pledges covering nearly every corner of the financial services industry). This figure includes a large amount of double-counting and has been widely misinterpreted. Nonetheless, it is a huge share of the world's largest financial institutions committing to net zero – Columbia Threadneedle Investments' AUM is included in this figure as a signatory of the Net Zero Asset Managers Initiative.

Methane pledge – buying time

Relative to CO₂, methane has 84x as much global warming potential over a 20-year time horizon. Cutting methane rapidly, therefore, gives the world slightly more wiggle room on carbon. This is desperately needed as the latest science outlines that the world has only eight more years of emissions at 2019 levels to go before a 1.5 degree carbon budget is exceeded.

The methane pledge aims for a 30% reduction by 2030; however, the International Energy Agency (IEA) estimates that methane emissions need to fall by 75% to meet net zero.² Canada has committed to this punchy target in the oil and gas sector which, along with agriculture, are responsible for the lion's share of global methane

emissions. More than 50% of methane emissions in the oil and gas sector can be resolved today with current technology, while satellite data is improving the extent to which these emissions can be independently tracked.

Article 6 and carbon trading

The rulebook around carbon trading was finalised at COP26 and part of this is relevant to corporate carbon offsetting. These rules still have a number of loopholes so scrutiny is likely to remain high. We will keep an eye on the type of carbon credits bought by the companies we own – especially those held in responsible investment funds.

Carry over of low-quality credits: while the carry-over of older, less-credible permits from the Kyoto protocol (called CERs) will be allowed, the situation could have been worse. Out of a potential four billion CER credits, only 320 million will be carried forward and these will be clearly labelled and easy to avoid. However, a bigger concern is that governments could authorise projects to continue to issue credits (equivalent to CERs but generated from 2021-2030); but as most of these projects are wind or hydro-related they will at least produce clean energy, and hence avoid emissions and generate credits, whether or not they are eligible under Article 6 and do not provide “additionality”. If all governments authorise all eligible projects to transition into the new system under Article 6, it is estimated 2.8 billion carbon credits of a very low quality would enter the system.

Double counting is (almost) out: Before COP26, Brazil had been arguing for the ability to double-count carbon

credits. What they were suggesting, to use a hypothetical example, was that a carbon credit equivalent to a tonne of carbon dioxide generated by a forestry project in Brazil and sold to the UK would count towards both Brazil's and the UK's NDC, reducing both by one tonne. Brazil stepped away from this position at COP26, enabling a conclusion, and it was agreed that seller countries must account for all units that are transferred to other countries, preventing the possibility of double counting.

However, under the carbon trading mechanism, as opposed to bilateral trading, there is an option for countries to issue non-authorised credits for “other international mitigation purposes”, ie voluntary carbon markets which would not be subject to the carbon accounting adjustments to eliminate double counting. There was heavy debate around how this class of credit should be used and how much it contributes to corporate greenwashing, with countries such as Switzerland calling for stronger rules. Ultimately, companies using authorised credits towards their net-zero targets will be seen as more credible than those using non-authorised credits. It will be interesting to see if carbon credit pricing deviates according to quality once this mechanism is fully established, with a small number of carbon credit rating agencies already in existence.

Voluntary retirement of carbon credits: it was agreed that bilateral carbon trades between countries for use in NDCs will only need to retire credits on a voluntary basis. This is weaker than hoped as cancellation of a portion of emissions would mean more than one tonne of carbon credits would be required to offset one tonne of

actual emissions – meaning an overall net emission reduction. However, the carbon trading mechanism covered in another area of Article 6, and the area most relevant to the private sector, will be subject to a mandatory retirement of 2%. Another rule impacting the trading mechanism, but not bilateral trades, is that 5% of proceeds from trades under the mechanism must be transferred to an Adaptation fund to finance adaptation or resilience projects in the countries already most vulnerable to climate change.

Innovation in hard-to-abate sectors – The Glasgow Breakthrough Agenda

- **Hydrogen:** the World Business Council for Sustainable Development (WBCSD) and the Sustainable Markets Initiative (SMI) announced pledges of 28 companies to drive growth in the demand for, and supply of, hydrogen. This can be in four categories: supply, demand, financial support or technological support. On the demand side pledges add up to 1.6 million tons per annum (mtpa) of low-carbon hydrogen to replace grey hydrogen which is currently used in the chemical industry and refining. On the supply side the pledges

add up to 18 mtpa of low-carbon hydrogen. In emissions terms this would save the equivalent of the annual emissions of Netherlands and Tunisia combined. Also, African and Latin American green hydrogen alliances are aiming to accelerate green hydrogen adoption in those areas. Namibia has already made progress with the Dutch, Belgian and German governments, with Germany committing to provide €40 million.

- **Steel and cement:** The UK and India led the Industrial Deep Decarbonisation Initiative (IDDI), alongside Canada and Germany, which aims to drive demand for “green” steel and green cement which will in turn accelerate supply. Currently, cement and steel each account for around 7% of energy-related emissions globally but do not have easy decarbonisation options. This is because the high temperatures required are harder (but not impossible) to achieve via electricity rather than fossil fuel energy. The most common process of steelmaking also uses coal as a reagent, although it is possible to use hydrogen. The initiative will work to set criteria for green cement and steel, encourage greater transparency and traceability and look to set a

globally recognised target for public procurement of green steel and cement. Member governments also committed to the disclosure of embodied carbon of major public construction by no later than 2025.³

- **Steel, trucking, shipping, aviation, cement, aluminium, chemicals and direct air capture:** The first movers coalition is a US-led coalition of corporates to stimulate clean tech demand for hard-to-decarbonise areas which will in turn incentivise supply. Its statement said: “Members will use their global purchasing power to create new markets for these emerging technologies. These new demand signals empower suppliers to develop and scale their innovations between now and 2030 – helping us to reach our global emission targets.”⁴
- **Shipping:** there were three announcements/initiatives of note. More than 200 businesses have committed to scale and commercialise zero-emissions shipping vessels and fuels by 2030. In turn, nine blue chip companies have committed to shift 100% of their ocean freight to zero carbon options by 2040, including Amazon, Ikea, Michelin and Unilever. Finally, 19 countries have



The methane pledge aims for a 30% reduction by 2030.

signed the Clydebank declaration to support the establishment of six zero-emission shipping routes by the middle of this decade with more by 2030. With the International Maritime Organisation meeting in less than two weeks to negotiate emissions standards, this is a positive move that should pave the way for productive talks.

The focus moves beyond coal

Outside of corporate pledges, the final text of the Glasgow Climate Pact references the phase-down of inefficient fossil fuel subsidies. This had already been announced by the G20, but giving the commitment a global stage adds emphasis and scope for further debate. However, the term “inefficient” provides a lot of flexibility for nations, including the UK, which are not ready to phase these subsidies out yet. Currently, fossil fuel subsidies amount to around half a trillion dollars per year – far outstripping subsidies for renewables.

A “Beyond Oil and Gas Alliance” also emerged, with Denmark, Wales, Costa Rica, California, France, Sweden, Greenland, New Zealand, Portugal and

Quebec signing up. The commitment involves ending new exploration permits for oil and gas. None of these nations are major producers, so this will not drive any significant impact, but it shows the pressure that governments are under to address the supply side instead of focusing purely on demand reduction. This is obviously not the optimum tactic when considering recent energy price volatility but, as we have previously written, we are in for a bumpy ride to net zero.

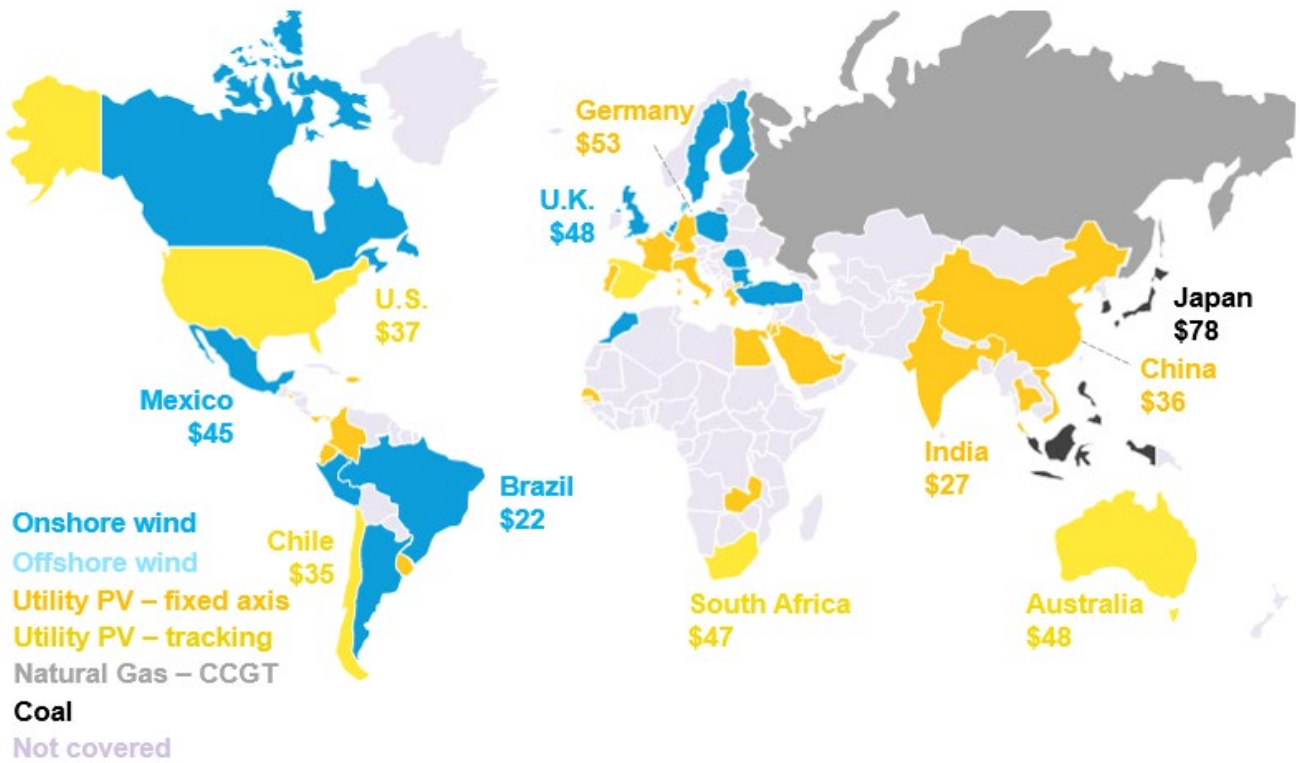
Finally, more than 30 countries and financial institutions signed a statement committing to halting all direct public financing for fossil fuel development overseas by the end of 2022 and diverting the spending to green energy. This comes hot on the heels of a similar announcement ending public financing for coal. Canada signed up, which is significant as the largest funder of fossil fuels in the G20, as did the US, the UK and Germany. The commitment has the potential to shift \$23.6 billion of fossil fuel investment to clean energy.⁵ However, Japan, Korea and China are the biggest providers of this finance globally and have not yet signed the wider fossil fuel agreement. A report

by Climate Analytics was released to coincide with COP, which outlines that by 2030 gas will be responsible for 70% of the projected increase in fossil CO₂ emissions and 60% of the methane. Expect attention to intensify on this transition fuel.

An innovative “just transition” coal phase-out partnership with South Africa was announced,⁶ which will provide \$8.5 billion to support South Africa in moving to clean energy while aiming to avoid the negative social implications of shutting down a major industry. The country has one of the most coal-intensive grids globally and an economy heavily dependent on the fossil fuel. This could work as a template for other regions and discussions have already begun with countries like Indonesia.

Leading technologies for new bulk electricity generation are shown in Figure 2 by geography, with renewables leading the way in countries representing more than two-thirds of the world population and 91% of electricity generation. Similar mechanisms to South Africa’s will be needed to support a just transition away from coal.

Figure 2: Cheapest source of bulk generation, H1 2021.



Source: BloombergNEF. Note: The map shows the technology with the lowest levelised cost of energy (LCOE) for new-build plants in each country where BNEF has data. The dollar numbers denote the per-MWh benchmark levelised-cost of the cheapest technology. All LCOEs are in nominal terms. Calculations exclude subsidies, tax credit or grid connection costs. CCGT = combined-cycle gas turbine.

Net-zero pledges

Scrutiny of dodgy net-zero targets is increasing, and will continue to do so. “More than 80% of global GDP – and 77% of global greenhouse gases – are now covered by a national net-zero target, up from 68% and 61% last year”, according to a new tracker co-led by the University of Oxford.⁷ “That number shrinks to 10% of global GDP and 5% of global emissions if only strong commitments and clear plans are included.”⁸

The US published its plan during COP26 to achieve net zero,⁹ with the UK doing likewise in the run up to COP.¹⁰ These add credibility and pave the way for other nations and corporations to follow suit. As this happens, expect to see the University of Oxford’s 10% GDP and 5% emissions of credible targets start to close the gap to the 80%/77% announced. The UN has also announced an oversight body for net-zero targets.¹¹

Source:

- 1 Note: source of all data, unless otherwise stated, is <https://ukcop26.org/>
- 2 <https://www.iea.org/reports/curtailing-methane-emissions-from-fossil-fuel-operations>
- 3 <https://www.unido.org/IDD1>
- 4 <https://www.weforum.org/first-movers-coalition>
- 5 <https://www.e3g.org/news/coal-cop26-ending-international-public-fossil-finance-coal-done-oil-and-gas-began/>
- 6 <https://www.gov.uk/government/news/joint-statement-international-just-energy-transition-partnership>
- 7 <https://zerotracker.net/>
- 8 <https://www.ox.ac.uk/news/2021-11-01-80-world-economy-now-aiming-net-zero-not-all-pledges-are-equal>
- 9 <https://www.whitehouse.gov/wp-content/uploads/2021/10/US-Long-Term-Strategy.pdf>
- 10 <https://www.gov.uk/government/publications/net-zero-strategy>
- 11 <https://www.un.org/en/climatechange/net-zero-coalition>

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