FINANCING THE TRANSITION TO NET ZERO AFTER COP 26

The Covid-19 pandemic engendered a growing public demand for climate action and a global call to align economic recovery with long-term sustainability and climate goals which will require further commitments to finance the transition to net zero by 2050. In that sense, COP26 constituted a unique opportunity to enhance the countries ambitions and reiterate the global commitment to combat climate change with a clear emphasis on a) phasing out fossil fuel use to fend off further impacts b) resilience and adaptation to climate effects, and c) biodiversity hotspots conservation including the accommodation for more reforestation for instance.

The summit came to bolster endeavours towards four crucial outcomes: a) **increased finance for climate action;** b) more ambitious emissions reduction commitments; c) strengthened climate change adaptation efforts, with a focus on loss and damage, through a robust fiscal and policy framework; and d) upgraded international collaboration on energy transition, clean road transport, and protection of nature. While these goals are meaningful, the roadmap towards achieving them will determine how adequately the international community can tip the balance over climate change.

Regardless of the several initiatives, plans, and commitments, **public finance for climate action has shown the least progress** so far, making the climate dialogue on finance during COP26 and its outcome decisive for the achievement of the planned transition to net zero. The latter cannot occur if adequate financing is not properly allocated since after all, where finance goes, emissions go.

State of climate finance: unmet goals and unbalanced funding

Twelve years ago, developed nations made a **significant pledge under the UNFCCC to mobilize US$100 billion for climate finance in developing countries** annually by 2020, to support their adaptation to climate change and thereby mitigate the global rise in temperature. Then, six years later, under the Paris Agreement, countries committed to making finance flows consistent with the achievement of long-term climate goals and to **balance funding between mitigation and adaptation**.

Today, the pledge has clearly fallen short, as OECD estimates show that the total climate finance reached US$79.6 billion in 2019, and the balance is unmet while the impacts continue to grow, affecting particularly the most vulnerable populations. In fact, according to estimations of the Climate Policy Institute (CPI), global mitigation finance reached

US$571 billion in 2019/2020, while adaptation finance totalled US$46 billion with 51% of annual climate finance coming from the public sector (mainly by DFIs) and 49% from the private sector. The dedicated amounts might seem substantial, however, based on scenarios that explore climate finance needs for energy systems, buildings, industry, transport, and other mitigation and adaptation solutions analysed by the CPI, it is estimated that *"annual global climate finance must increase by 588% to USD 4.35 trillion if our climate objectives are to be met by 2030".*

Why such a slow progress?

The inability of developed countries to uphold their funding commitments, and the fact that most of the funds that were actually mobilized were distributed in the form of **loans and not grants**, had exacerbated the mistrust of developing countries. The latter were, and still are, seeking reassurance that finance commitments will be met. While the formal submission of commitments under the Paris Agreement could have played an important role in that sense, the European Union is the only grouping that has submitted its communication on its projected future climate finance provision.

Furthermore, if one considers the **overall investment in high emitting sectors**, climate-positive investments are not significant, and we still largely consume fossil fuel-based electricity. This points out to the fact that while several institutions have started taking action on climate change through emission reduction targets and net zero pledges, action in the real economy dawdles.

Achieving net zero by 2050 will require the mobilization and alignment of all actors of the public and private sectors with the Paris Agreement and when it comes to finance more specifically, every segment of the financial sector needs to build a strong foundation for alignment. But in reality, and based on present experience, public and private sectors do not have a generally accepted definition of climate finance or an actual understanding of what the minimum requirements for financial actors are in that regard.

All in all, we are still awaiting conceivable and cooperative efforts to foster understanding of **each actor's role and prerogatives** as well as transparent net zero commitments supported by coherent transition plans spanning across all sectors.

COP26 paving the way to net zero

Overall, COP26 has further highlighted the necessity of collective global action in addressing the climate crisis, including a clear emphasis on financing the transition, especially considering that most economies are currently recovering and rebuilding after Covid-19. Addressing national concerns first might be an understandable compulsion that governments should not give in to. In fact, the financial sector was extensively represented at Glasgow where Finance Ministers, International Finance Institutions and other actors of the sector met with a view to principally **agree on a new collective finance target** to support the urgent climate action required to reach the net zero commitment.

The targeted topics for funding stated during COP26 for the **public and private sector finance are complementary** in the sense that the former focuses on the development of the infrastructure and the latter on the technology and innovation needed to support the transition. Regarding the public side, the developed countries reiterated their pledge to meet the US$100 billion of climate finance to developing countries. Multilateral Development Banks (MDBs) have restated their commitment and ambition to support the transition and presented an update of their progress on the development and implementation of a framework to align with the Paris Agreement. On the private finance side, around 450 financial firms, members of the Glasgow Financial Alliance for Net Zero (GFANZ) committed to aligning their portfolios to net-zero by 2050 and pledged US$130 trillion of assets until then to support the global effort.

The importance of **climate finance tracking** and the need for a **common reporting framework** in that sense was a big focus of the discussions during COP26**.** Moreover, besides the MDBs, the GFANZ members also committed to an interim target for 2030 and to annually report on their financing activity using the Partnership for Carbon Accounting Financials (PCAF) standards for tracking emissions. In that sense, the disclosure rule will intensify data needs and collection processes that are in scope of the reporting requirement and information will be certainly sought from partners and clients to ensure compliance and alignment.

In general, it is becoming clear that, although it is not yet mandatory, all financial organizations of all sizes and geographical coverages will have **to align their strategies, investment policies, activities, and operating procedures with the Paris Agreement** to remain relevant, competitive and benefit from potential collaborations with MDBs and other major Financing Institutions.

Strong with its **20 years of experience** in the fields of climate change mitigation, adaptation, and resilience, EXERGIA can accompany your organization in its transition journey through the provision of the following services:

- Development, implementation and monitoring of inclusive climate finance strategies and climate action plans.
- Support to the evaluation and/or improvement of green finance strategies and instruments including organizational change, portfolio review, carbon footprint assessment and gap analysis.
- Development and implementation of innovative climate finance tools and solutions including tools facilitating portfolio screening and assessment in climate and biodiversity perspectives.
- Development and implementation of ESG (Environment Social Governance) and E&S management as well as climate risks screening, management, and monitoring systems (FSB-TCFD).
- Design and technical evaluation of multi-sector investment plans, complex bankable projects and project pipelines in sectors such as renewable energy, energy efficiency, waste and water management, agriculture and rural development, agroforestry, sustainable tourism, etc.
- Support in the development of financial products and services to address climate change such as green, blue, and social bonds.