

# 'Netting zero' #2: Priorities for private finance and UN Climate Change Conference of the Parties (COP26)

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The UK will host the 26th UN Climate Change Conference of the Parties ("COP26") in Glasgow on 1 - 12 November 2021. Its overall objectives are to:

1. Limit global temperature increases to below 2°C from pre-industrial levels; and
2. Achieve 100% net zero carbon buildings by 2050.

The objectives require all businesses and organisations to change their business models to commit to achieving the climate goals. These goals require all forms of finance, but the role of private finance is key to expediting the implementation of climate policy, so that capital can be used to (1) manage climate risks as well as (2) build upon climate opportunities as and when they arise. Since retiring as the Governor of the Bank of England, Mark Carney has now specialised in climate finance. As UN Special Envoy on Climate Action and Finance, he has described these sorts of actions as a way of avoiding a climate "Minsky moment", a term used to describe a sudden collapse in confidence which precipitates a financial crash.

Since the Paris Agreement was signed in 2015, it is reported that banks have continued to invest \$2.2 trillion into the fossil fuel industry. Reconstructing a finance system that will work for the long-term is essential to prevent future financial crises. Whilst the carbon offset market is only worth \$300 million a year, both banks and high profile individuals have argued that this figure could be in the hundreds of billions a year in the future.

The objective for the private finance work for COP26 is to "ensure that every professional financial decision takes climate change into account". The COP26 Private Finance Hub will work with the private sector and other stakeholders to develop the following 4 key areas, which span reporting, risk management, returns and mobilisation.

## Reporting

"improving the quantity, quality and comparability of climate related financial disclosures by implementing a common framework built on the Taskforce for Climate-related Financial Disclosures ("TCFD") recommendations."

COP26 Private Finance Hub's goals for reporting are:

1. To encourage the private finance sector to refine TCFD climate related financial disclosure;
2. To agree a way forward to mandatory reporting through both national and international legislation;
3. To establish coalitions of countries who enforce reporting requirements as well as firms committed to full climate related financial disclosures.

In the past few years, the TCFD has developed a framework to help private finance companies, as well as other organisations, more effectively disclose climate-related risks and opportunities through their existing reporting processes. As of last year, more than 370 investors with around \$35 trillion in assets have now committed to engage with the world's largest corporate greenhouse gas emitters to strengthen their climate-related disclosures by implementing the TCFD recommendations.

To achieve the aims, firms must:

- apply the TCFD recommendations outlined in its 2017 report;
- work with financial regulators to adhere to voluntary as well as regulatory reporting guidance;

Mandatory reporting should, in theory, increase the quality and quantity of corporate disclosures, which is essential for managing and mitigating climate risk.

## Risk management

"ensuring that the financial sector can measure and manage climate-related financial risks."

COP26 Private Finance Hub's goals for risk management are:

1. To assess both firms' and the financial sector's resilience to climate risks.
2. To ensure the sector develops tools and products to test strategic resilience;
3. To establish a coalition of both central banks and regulators in order to issue guidance on risk management and to run stress tests.

Climate risks, both physical and transitional, make it challenging for private finance firms to assess climate risks because it relies upon estimates for what a company's future emissions are as well as its current emissions, and the knock-on effects that those might be. A more detailed analysis of insurers' approaches to such risks and the regulatory requirements can be found in our February article.

There has been much improvement on risk management in recent years, with the Network of Central Banks and Supervisors for Greening the Financial System ("NGFS") now comprising 83 members, including the US Federal Reserve System as of December 2020. Together with the 13 observers, these members represent around 75% of global greenhouse emissions and two thirds of global systemically important insurers; this provides hope for a more consistent approach to stress testing in the future.

## Returns

"helping investors identify the opportunities in the transition to net zero and report how their own portfolios are aligned for the transition".

As well as managing risk, it will also be important for investors to understand and evaluate opportunities which could be realised through successful transition.

COP26 Private Finance Hub's goals for returns are:

1. To assess the credibility of transition plans, working with academic and non-governmental organisations to produce guidelines, as well as service providers to analyse firm transition plans.
2. To measure portfolios against the transition to net zero, by encouraging the private finance industry to "develop consumer-friendly metrics" to show how investments align with climate change goals.
3. To commit to net zero, by working with initiatives such as Climate Action 100+ and CDP.

To achieve these aims, firms will need to put in place, inter alia:

- Company disclosures to show how clients' money is being invested; and
- Move towards more sophisticated measuring of portfolio alignment, which, for example, accurately calculate "current and projected emissions in a portfolio and their contribution to global temperature rises".

## Mobilisation

“increasing private financial flows to emerging and developing economies, by connecting available capital with investable projects and encouraging new market structures”

COP26 Private Finance Hub's goals for mobilisation are:

1. To support the development of a pipeline of investment grade projects, which would include assisting the [Climate Finance Leadership Initiative](#) (“CFLI”) in achieving the next steps set out in its report [“Financing the Low Carbon Future”](#). The CFLI was set up by Michael Bloomberg at the request of the UN Secretary-General, and includes members such as Allianz Global Investors, AXA and HSBC. These would include, for example, building on initiatives which address barriers to sustainable infrastructure, such as [Fast Infra](#), which aims to “close the trillion dollar sustainable infrastructure investment gap... by transforming sustainable infrastructure into a mainstream, liquid asset class”.
2. To align the activities of multilateral development banks, new development banks, development finance institutions and with the Paris goals, by aligning investments with climate goals, reporting these in their lending portfolios and providing technical assistance.
3. To encourage the development of new market structures and products by (1) encouraging a “transparent, credible market structure... for scaling liquid, transparent and reliable voluntary carbon markets” as well as (2) creating “new products and markets... to scale up resilient infrastructure spending and insurance coverage to close the insurance protection gap”.

To carry out these goals, firms will need to ensure that they have, inter alia:

- Reliable data to support risk assessment and reporting requirements;
- Strong public policy commitments to low-carbon solutions to help create a favourable investment environment;
- Opportunities to reach economies of scale, using regional integration and coalitions where credit, structural and legal complexities exist;
- Currency stability.

The goals of COP26 are intrinsically linked to private finance's taking responsibility for its role to play in improving our environment.

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