COP27: Top 5 Takeaways That Matter

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This report does not constitute a rating action.

Authors

Beth Burks
London
beth.burks@spglobal.com

Bernard De Longevialle
Paris
bernard.delongevialle@spglobal.com

Terry Ellis
London
terry.ellis@spglobal.com

Paul Munday
London
paul.munday@spglobal.com

The Sharm el-Sheikh Climate Change Conference in November 2022 (COP27) did not break new ground, focusing more on impacts than new pledges to reduce emissions. Discussions and initiatives at COP27 focused on the delivery of commitments to deal with climate change and supporting developing economies with related challenges. In this article, we highlight five takeaways from COP27 that we consider most relevant to the world of sustainable finance.

1. Loss and damage, adaptation, and resilience take center stage

After years of talks, COP27 finally saw agreement to set up a loss and damage fund designed to help developing countries following devastating climate events. However, the details about who provides the finance, and how much, as well as how developing countries might access funds remain outstanding. There was also reaffirmation of the agreement to double adaptation finance (reached at COP26 in Glasgow), as well as strengthened adaptation finance commitments by many wealthier countries. Developing countries disproportionately face increasing costs and disruption from the physical impacts of climate change. The Adaptation Agenda--a comprehensive plan centered on 30 actions to deliver resilience to over four billion people--made commitments to mobilize up to $300 billion by 2030 from public and private sources and emboldened 2,000 of the largest companies to integrate physical climate risks and develop actionable plans. Companies, particularly those in more exposed regions, will face growing costs without adaptation and developed countries will be pressed to make good on their commitments.

We believe there is only so much debt that lower- and lower-middle income countries can sustain to finance growing losses and lost revenues from physical climate risks. That's especially true for more vulnerable countries--particularly Small Island Developing States (SIDS) and less ready countries (see our research "Weather Warning: Assessing Countries' Vulnerability To Economic Losses From Physical Climate Risks"). To address that dilemma, beside the need for more grants, concessional loans, and equity, we expect interest to grow in alternative adaptation financing instruments, including debt-for-climate swaps, where debtor countries divert payments into adaptation and resilience projects, and dedicated adaptation and resilience bonds.

2. Transition emphasizes the role of technology

COP27 did not abandon the goal to limit global warming to 1.5°C by 2030, which would require a 43% reduction in GHG emissions by 2030 from 2019 levels. The UN-backed Breakthrough Agenda put forward 25 new measures to accelerate decarbonization in some of the hardest-to-abate sectors like power, transport, and steel production. Backers include the U.S., China, numerous EU states, the U.K., and India, among others--together representing 50% of global GDP. Actions include the development of 50 large net-zero industrial plants, nailing down phase-out dates for internal combustion engine vehicles, and the launch of agricultural R&D initiatives. Some partners will also launch work on a new cement and concrete program in 2023. In addition, a new five-year work program was agreed under the Technology Mechanism of the Paris Agreement, which will support the creation of roadmaps and support technology transfer to developing countries. Elsewhere, announcements included a new commitment from 10 organizations in the shipping sector to decarbonize by 2050, and a new Global Renewables Alliance to accelerate deployment of renewables worldwide.

We think that for hard-to-abate industrial sectors, coordinated efforts on difficult emission sources--such as those in steel and cement manufacture--could resolve technical challenges faster than if companies act alone but progress will depend on the engagement of stakeholders. We see accelerated development of clean technologies as potentially increasing their relative cost competitiveness, presenting opportunities for early adopters and risks for laggards (see our research "Decarbonizing the European Cement Sector"). Both public and private investments could play a key role, with cost of capital a key issue for developing countries and companies.

3. No agreement on a climate finance taxonomy

A clear definition or taxonomy of climate finance has not come out of COP27 and is unlikely to come in the future. A global agreement would better show the current amount of climate finance and gauge its growth and gap, aiding transparency and comparability. Countries cannot agree about what assets can or cannot be financed under the rubric of “climate” and with what instruments, for example, loans or only grants. However, there is acknowledgement that not enough funding is coming from nongovernmental players like investors. Discussions about instrument types will continue. Meanwhile, regulations and countries' nationally determined contributions will likely lay out what activities could be climate financed. For example, some countries could include energy efficiency projects involving fossil fuel-combusting assets, while others might not. On the regulatory front, the International Organization of Securities Commissions (IOSCO) outlined its priorities for sustainability disclosures, mitigating greenwashing and promoting integrity in carbon markets.

We think differences about what may constitute a green project could lead entities, investors, and other stakeholders to take diverging views. For example, activities such as nuclear, mining, desalination, and hazardous waste management are among those that are not common to all taxonomies, according to the Standing Committee on Finance’s report. Without a global taxonomy, entities could continue to issue debt using a green label that varies in type and investors might continue to track various kinds of green use of proceeds. Market players will likely continue to take a number of approaches to determining project eligibility.

4. Closing developing economies' climate finance gap

COP 27 called upon shareholders of multilateral development banks and financial institutions to implement reforms addressing the global climate emergency and mobilize climate finance. UNFCCC estimated that global climate finance in 2019-2020 was less than one-third of the annual investment needed between 2021 and 2025 to maintain a well-below 2°C or 1.5°C pathway. In particular, multilateral development banks (MDB) were pressed to enable access to private capital at scale. One example is blended finance (use of public development finance to mobilize additional commercial capital, primarily from private sources to help achieve sustainability goals). Various initiatives were launched to provide guidance about how to mobilize climate finance, such as development of a Blended Finance Handbook by the NGFS, as well as publication of the Sharm el-Sheikh Guidebook For Just Finance and creation of the Food and Agriculture for Sustainable Transformation initiative by the Egyptian government. Indonesia announced a $20 billion package of international public and private funding to help accelerate its shift to renewables.

We anticipate that MDBs will continue to explore and scale up the use of blended finance and risk-sharing facilities, particularly in low- and middle-income countries. Blended finance may provide a level of confidence to private capital to invest in developing countries--that typically bear higher credit risks and information gaps–and incentivize countries to advance in the energy transition. For example, MDBs can launch more blended investment funds, and depending on their size, they may foster issuance of green, social, sustainable and sustainability-linked debt in developing economies. This could enhance the liquidity and the quality of these instruments, further attracting private capital. See our research "Latin America Green, Social, Sustainability, And Sustainability-Linked Bonds 2022."

5. Climate builds a tighter link with biodiversity

This year's COP featured an inaugural biodiversity day emphasizing the strong links between two global environmental crises: climate change and biodiversity loss. Many countries, looking to restore natural habitats as a solution to both problems, also see biodiversity as an opportunity to rethink economic development, moving away from the destruction to the restoration of nature. The African Forest Landscape Restoration Initiative has pledged to restore over 100 million hectares of land by 2030 (equivalent to the size of France and Germany combined). More announcements may come at the UN biodiversity COP15 starting Dec. 7 in Montreal.

We believe a better understanding of the synergies between climate change and biodiversity may help entities, investors, and other stakeholders better assess both topics, since natural ecosystems can be carbon sinks and also help support more sustainable livelihoods. Therefore, nature-based carbon offsets--such as reforestation projects--could boost investment in projects with both carbon and biodiversity benefits. For example, food and beverage companies whose carbon and biodiversity footprints are important--although mainly lying in the supply chain--would tend to support nature-based carbon offsets. Yet, pressures on biodiversity might persist as demand for natural resources increases, stemming from energy transition projects--such as demand for rare earth metals for electric batteries (see our research "ESG Materiality Map: Metals and Mining").

Writer: Rose Marie Burke. Digital designer: Jack Karonika.