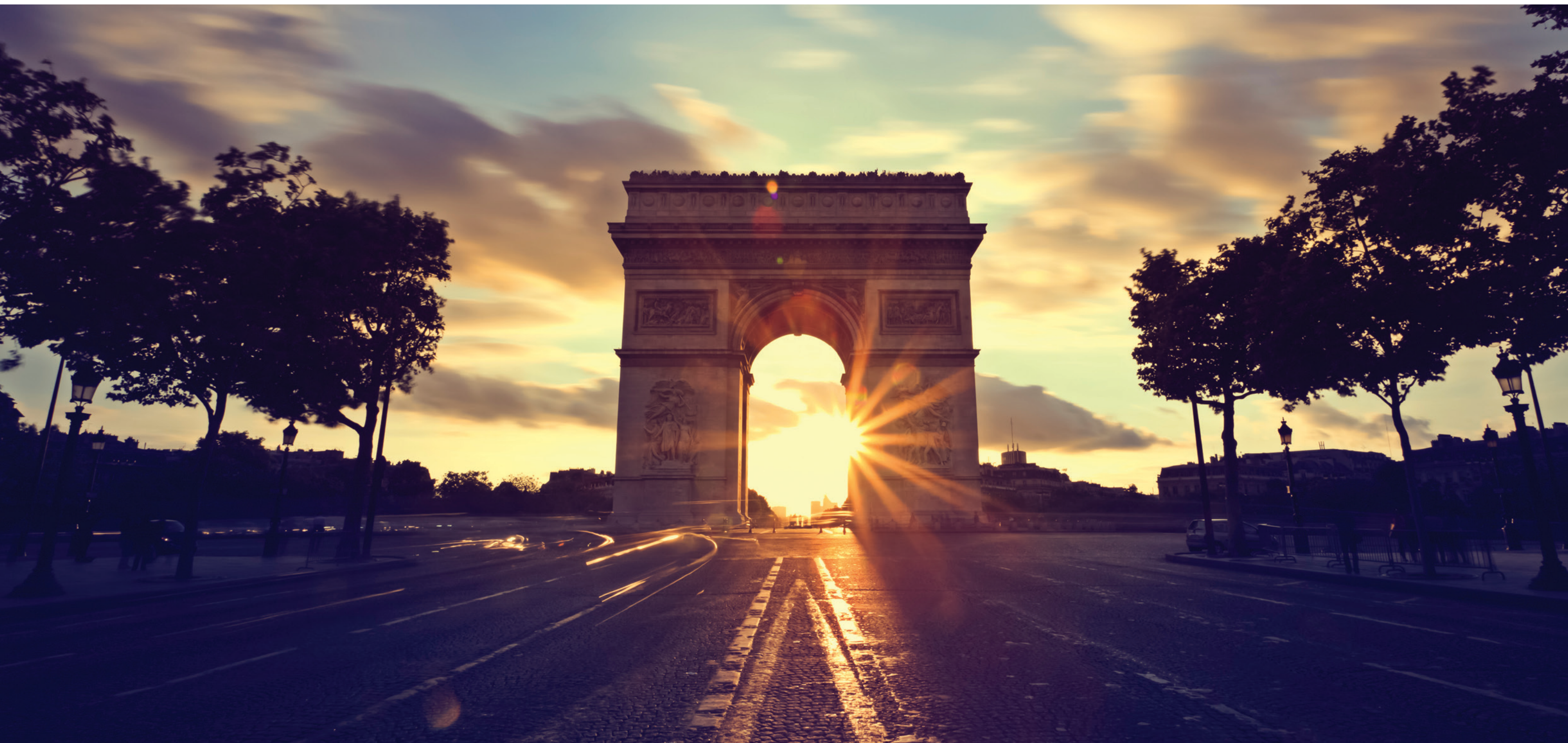
IIGCC
Institutional Investors Group on Climate Change

COP-21 in Paris – a guide for investors

October 2015



COP-21 could be a turning point in the world's response to climate change – governments have decided that there will be an agreement. How strong this agreement will be is the vexing question for the little time left before the deadline. This guide introduces investors to the UNFCCC process. The Paris process has already made more progress than the Copenhagen process ever did. This guide explains why Paris will be a unique moment. It also introduces the "Paris Alliance", the four pillars of the Paris outcome as we understand them. It previews the main content of Paris alliance, including possible outcomes in terms of the long-term goal, climate finance provisions and national climate plans, and finally gives our take on what this will all mean for investment.

1 A short introduction to the UNFCCC

The United Nations Framework Convention on Climate Change (UNFCCC) is the intergovernmental decision-making body for humanity's response to climate change. The UNFCCC has universal participation with **195 Parties to the Framework Convention**, the main treaty underpinning the intergovernmental climate process. The ultimate objective of the Framework Convention is to avoid dangerous anthropogenic interference with the climate system.

The UNFCCC is supported by the **UNFCCC Secretariat**. The UNFCCC secretariat supports all institutions involved in international climate negotiations, which is by now a complex web. Under the framework convention, the main decision-making body is the Conference of the Parties, which has held 20 sessions so far and has reached a large number of decisions designed to strengthen the collective response to climate change. The 21st session of the COP will be held in Paris from 30 Nov – 11 Dec 2015 (**COP-21**).

In **Cancun** in 2010, world governments agreed to limit global temperature rise to 2 degrees Celsius, which translates the ultimate objective into a concrete temperature goal. In **Durban** in 2011, world governments agreed to develop the universal climate agreement that is to be finalised in Paris.

2 How this became a unique moment

The United Nations do not have the mandate to force countries to take on legally binding emission cuts determined by a global carbon budget. The United Nations – a process that is largely driven by its member states – need to mobilise political will. The Copenhagen climate conference didn't deliver the binding emission cuts that the world expected – most importantly, a large number of countries felt that there was an attempt to force them to accept an infringement on their national sovereignty to deliver a set of polices they were not (yet) ready to deploy. Countries showed their hand very late in the negotiation process, in many instances after the actual Copenhagen Conference.

UN officials and the presidencies of the various COPs since Copenhagen – who have been designing the Paris process – took on board lessons from the Copenhagen process. Countries have been asked to communicate their intended nationally determined contributions well ahead of the Paris conference, so that countries can inspire each other into action and see what others are willing to offer. The UN process will keep score of the collective level of ambition, and ensure countries remain on track to stay within safe bounds through a number of initiatives (see section IV). In the end, the Kyoto Protocol that exemplifies the top-down approach taken in the past, only covered 11% of global emissions – the new agreement will cover more than 80%.

National political leaders have engaged in the Paris process early on as well. The most significant announcement has been the US-China climate pact just ahead of the 2014 G20 summit. The pact is enabled by international trade in environmental goods and services. Similar steps forward were achieved by the German-Brazilian climate communique, the G7 climate conclusions, the UN Secretary General's leader's lunch in New York, and a host of domestic initiatives, such as the EU's 2030 climate-energy framework, the US Clean Power Plan and Chinese action. Some of the world's most powerful political leaders thus have already invested significant political capital into success in Paris, and will be much more willing to compromise than during the culmination of the Copenhagen process. The cost of failure in Paris would be even higher than during the Copenhagen process, because many domestic initiatives are already under development and would face difficulty.

UN countries are generally seen as acting primarily in their national self-interest. However, what constitutes this national interest is subject to intense domestic political debate. There has been a gradual shift in policy-maker mind-sets, as policy-makers are gradually leaning towards the upsides of climate action. In addition, progressive businesses, investors and civil society groups have contributed to what is an unprecedented groundswell of non-state action on climate change.

Despite all this progress, some caveats are warranted. The Paris conference will not be the single defining moment in which humanity finalises its entire, comprehensive framework for addressing climate change. Complex action is required at all levels of government, and as technologies and knowledge of successful policy approaches improves, there will be a need to reconfigure and renegotiate the global response to climate change. Much of what will be agreed in Paris will need to be operationalised later on, and will require updating every five years. However, Paris can be the moment in which the world's response to climate change was brought further in line with science, and key actors first and foremost from governments, but also from business, cities and the investment community came together to unite under the Paris alliance.

3 Four pillars of the Paris agreement ("The Paris Alliance")

1 Agreement & Decision	2 Finance package	3 NDCs	4 Action agenda
Main principles guiding international climate policy in the agreement (legally binding without requiring domestic ratification) Implementing provisions in the decision (politically binding)	Pathway for scaling up climate finance flows to developing countries to USD 100bn annually by 2020 and agreement on how to proceed with climate finance post-2020	National climate mitigation efforts	Capturing new and existing commitments by investors, companies, subnational actors (cities, federal states) through the Paris pledge, the Lima Paris Action Agenda and the Non-State Actors Zone for Climate Action

Central to the Paris alliance will be the **agreement and decision** (Pillar 1), which will determine the government framework for action against climate change. This will involve shared objectives, principles and institutions enabling the implementation of the nationally determined contributions (NDCs) and adaptation efforts. The agreement will be legally binding. However, it will most likely not contain any elements that require transposition into national legislation under most legal systems.

In the Copenhagen process, legal form was highly controversial. Some saw it as indispensable in order to galvanise political will – but sovereign countries cannot be forced to accept restrictions on their national sovereignty unless they have the political will to do so. Investors should pay less attention to the legal form of the Paris agreement and decision than to its content. Many countries have a good track-record of following through on political commitments even after a change in government, as long as countries understand the rationale and urgency of their action.

The ambition is that the political commitments reached in Paris will be translated into binding national legislation and support schemes that will be designed to attract investment – while the content of the agreement will not send a strong investment signal of itself, investors should take a comprehensive view of the Paris agreement, the underpinning pledges by national governments, and the policies they adopt to implement these pledges. Taken together, the impact on infrastructure investment will be significant.

The proposal by the negotiation chairs for making the agreement legally binding is as follows: The agreement will be formally adopted in Paris through a COP decision and then signed during an event organised by the United Nations Secretary General in New York in early 2016. The agreement will be open for signature until March 2017, with the corresponding process of ratification, acceptance or approval, or instrument of accession, following the official signature. It is possible that the submission of a nationally determined contribution will be a precondition for joining the agreement, but the relevant paragraph of the agreement has not been fleshed out yet.

The first part of the **climate finance package** (Pillar 2) is a set of contributions from donor governments to deliver the goal of mobilising USD 100bn from public, private and innovative sources by 2020. The second part is the climate finance landscape post-2020.

The **nationally determined contributions** (Pillar 3) will be captured in the Paris alliance. It remains controversial if the NDCs should be made legally binding. Again, investors should require a high ambition level, with secondary attention given to legal form. Binding national legislation does not require binding commitments under international law.

The **non-state actors** part of the Paris alliance (Pillar 4) will capture contributions from investors, companies, sub-national actors (such as cities and federal states) and civil society.

4 Elements of the Paris agreement

Objectives / long-term goals

Quantitative mitigation goal: Key issues are the **peaking year for global emissions** (which UN climate scientists prescribe for 2020), the **2050 emission reductions goal** and the **long-term goal** (the G7 recently committed to the full decarbonisation of the global economy over the course of this century). Of these three goals, a qualitative long-term goal seems the most likely to be adopted in Paris. The EU position during the Copenhagen process required a quantified global 2050 emission reduction target, which was never agreed by the UN. Global appetite for such a 2050 goal has not improved significantly. Individual countries might submit national deep decarbonisation plans with a 2050 goal (see mitigation section), but a global 2050 goal will face resistance particularly from some fossil-fuel producing countries. However, important consequences for future targets would be derived from an agreement on a qualitative long-term goal (a goal such as near-zero emissions over the course of the century).

Qualitative adaptation goal: A global commitment to enhance adaptation.

Mitigation

Nationally Determined Contributions (NDCs): More than 80% of global emissions are expected to be covered by the NDCs, which will lead to a significant deviation from business as usual emissions that will set the world on track to stay within 2.5-3 degrees Celsius of global average temperature rise. This is a significant achievement given past predictions of up to 5 degrees Celsius of average temperature rise. However, to keep the 2 degrees objective within reach, governments are discussing a number of measures:

- The NDCs will most likely cover the **contribution period until 2025** rather than 2030, although some NDCs will be derived from longer-term 2030 targets (the EU for example has committed to 2030 targets). The reason: shorter contribution periods avoid lock-in of low ambition levels, and allow more ambitious contributions once technologies have even further matured.
- There will most likely be an **ambition mechanism** which will ensure that each subsequent NDC represents a progression from previous commitments, and that ambition will only be tightened.
- Furthermore, there have been some advocates of **deep decarbonisation plans** to complement the INDCs. The DDPs would outline mitigation ambition out to 2050 and flow from the long-term goals.

Adaptation & loss and damage

Key issues are **national adaptation efforts** which will be a universal obligation of countries and listed in the Paris agreement. These efforts essentially complement the NDCs. National adaptation efforts will also be periodically updated (every five years). Existing institutional arrangements to address loss and damage will likely also form part of the Paris agreement.

Finance & support

Early progress is expected on climate finance for pre-2020. Donor countries are expected to outline a pathway to scaling up climate finance to **USD 100bn of public, private and innovative sources of financing** by 2020 ahead of the World Bank Annual Meeting in Lima in early October. Donor countries include developed and some emerging markets, such as China. Further work is centred on aligning **wider investment trends** with a 2 degrees compatible pathway ("shifting the trillions"). This currently primarily refers to finance channelled and leveraged through the multilateral development banks and national development finance institutions.

Post-2020 climate finance will be a major stumbling block for the Paris agreement. Donor governments are reluctant to commit budgetary resources this far in advance. The reason is that this would infringe on parliamentary control of public spending which usually operates in one-year cycles. Donor governments are extremely reluctant to show their hand – a deal will likely only be reached in the final hours of the Paris conference.

Transparency on climate finance flows and planned future support will be crucial. Analogous to mitigation and adaptation provisions, finance and other support packages shall also be **reviewed** every five years. Donor governments have recently agreed on a common methodology for measuring climate finance flows. This primarily relates to a common definition on the treatment of concessionary finance such as lower-cost loans and the treatment of private capital leveraged through public resources.

Transparency

Monitoring, reporting and verification (MRV) of the aforementioned commitments will ensure that from 2020, full, transparent and verifiable information is provided by all Parties on all elements. For mitigation, this will require more comprehensive accounting of greenhouse gas sources. This accounting will strengthen the ability of governments to take targeted measures, and puts in place the infrastructure for the introduction of an emissions trading scheme in a wider range of countries.

5 Investor implications

Firstly, the NDCs will provide increased certainty on government intentions and will be translated into investable policies, such as national infrastructure investment support schemes. The NDCs will entail a substantial deviation from business as usual greenhouse gas emissions and will guide infrastructure planning across the globe. Some of the NDCs are transformative, while others work around the fringes.

Secondly, the potential inclusion of the long-term goal would put a clear end-date to unabated fossil fuel usage. It will send a clear signal that world governments are committed to ending fossil fuel usage before all reserves are used up, and to provide corresponding support to enable the deployment of low-carbon technologies. While this is a long-term objective, it will signify a clear direction of travel for governments and their intervention in infrastructure markets.