EUROPEAN CENTRAL BANK

EUROSYSTEM

Climate Change Centre

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Key takeaways from COP26 + initial assessment

1. Climate mitigation

1.1 The agreement falls short of achieving the Paris agreement goals but instructs countries to come back in 2022 with strengthened emissions reduction commitments.

- Almost all major countries had already announced their emission reduction commitments (so called 'nationally determined contributions', or NDCs) before COP26. Collectively, the announced NDCs, including the updated pledges made at COP26, would lead to 2.4ºC of warming, according to the estimates by Climate Action Tracker.
- COP26 reached a number of sectoral agreements, which collectively could further reduce the gap between announced NDCs and the 1.5 ºC Paris goal. They need to be accountably implemented, but estimates suggest they could close the emissions gap to a 1.5ºC path by a further 9% compared to the current trend.
- COP26 managed to keep alive the 1.5 ºC Paris Agreement goal and in this context requests that countries improve their emissions reduction commitments by 2022.
- Moreover, COP26 completed the 'Paris rulebook' of detailed rules to implement the Paris Agreement, such as on the transparency of national actions and the fundamental norms for an international carbon market. World leaders agreed on the rules for Article 6 of the Paris Agreement, seeking to establish a framework for a new global carbon market. The new framework comprises two parts: a centralised system open to the public and private sectors, and a separate bilateral system that will allow countries to trade credits to meet their decarbonisation targets.

- **Assessment Climate Change Centre**: *The new framework for carbon markets is a welcome step to help address the currently fragmented and unregulated carbon market, as adequate carbon pricing is considered the most effective policy instrument to incentivise the green transition. However, greater ambition is needed to ensure that the true social and environmental cost of carbon is incorporated into the prices paid by all sectors of the economy, through* ***higher carbon taxes or carbon allowance prices****. As long as environmental externalities are not adequately priced in, green investments can be expected to remain well below their desired level.*

2. Fossil fuels

2.1 For the first time, the COP text mentions fossil fuels, although the language was watered down at the last moment.

- India's late objection changed the call to 'phase out' the use of coal (unless it has carbon capture and storage), to 'phase down' without a date, neither guarantees of action.
- There is no mention of oil and gas, and only a vague call to phase out 'inefficient' fossil fuel subsidies (implying that "efficient" subsidies would be still allowed).
- The text for the first time recognises the need for a 'just transition' for workers and areas affected.

2.2 48 countries committed to shifting away from coal power in the 2030s for major economies and the 2040s for poorer nations.

- Signatories to the agreement also committed to ending all investment in new coal power generation domestically and internationally, and to rapidly scale up deployment of clean power generation. Dozens of organisations also signed up to the pledge, with several major banks agreeing to stop financing the coal industry.
- Major coal-using countries including Poland, Vietnam and Chile were among those to make the commitment. However, the three biggest coal-burners worldwide – China, India, and the USA – among others, did not join the pledge.

2.3 25 countries pledged to end international public financing for unabated fossil fuels by the end of 2022.

- The agreement allows exceptions for 'limited' circumstances but specifies that they must be consistent with a Paris-aligned 1.5C pathway.
- Participating countries include the USA, Italy, Canada, and Germany, together with multilateral development banks. Major fossil fuel-producing countries like Nigeria and Angola, as well as major fossil fuel-financiers such as China, Japan, and South Korea, are absent from the agreement.
- Nevertheless, this comes on top of the recent commitment by G20 leaders to end overseas coal financing, which means that all significant public international financing for coal power specifically has effectively ended.

- **Assessment Climate Change Centre:** *These pledges on fossil fuels and the implementation of corresponding policies could pose considerable transition risks for our economy and should be monitored accordingly. However, and as per our economy-wide stress test, we can be supportive of this: while* ***transition costs may be higher in the short-term, they are much lower in the long run*** *than the catastrophic costs of unrestrained climate change.*

3. Increasing climate finance for developing countries

3.1 The final Glasgow Climate Pact urges developed countries to at least double climate finance for adaptation to developing countries but developed countries have resisted the demands to increase total climate finance.

- The Glasgow agreement met developing countries' request to increase adaptation finance, by requiring rich countries to 'at least double' funds for adaptation (which at presently represents only 25% of climate finance flows).
- In 2009, developed countries pledged to mobilize USD 100bn annually in climate finance by 2020 to support developing countries in reducing their emissions and adapting to climate change. However, developed countries have missed this target, most recently falling USD 20bn short in 2019.
- Developed countries have resisted the demand from developing countries to make up for their failure in 2020 to reach USD 100bn by providing even more funding in 2024 and 2025. Despite announcements to increase funding as of 2026, the COP26 UK Presidency's Climate Finance Delivery Plan states that developed countries will only be able to meet the USD 100bn goal by 2023.
- The Glasgow text sticks at USD 100bn a year – beyond 2025, there will be a new process to define how much they should pay.
- On 'loss and damage' (compensation by the rich countries for the costs their emissions have caused to other countries), developing countries failed to achieve a new financing facility and the text foresees a mere 'dialogue' to discuss 'arrangements'. [redacted]
- The Pact also calls upon multilateral development banks, other financial institutions and the private sector to enhance finance mobilisation to deliver the scale of resources needed to achieve climate plans, particularly with regards to adaptation.

- **Assessment Climate Change Centre:** *While an increase in climate finance for adaptation is welcome,* [redacted] *still needs to be put into action.* ***More decisive is needed*** *to adapt to our changing climate and make our economies more resilient, such as incorporating physical risks into banks' lending decisions and improving risk-pooling and insurance protection for extreme weather events.*

4. Aligning financial flows with the Paris Agreement

4.1 Over 450 financial institutions with over USD 130tn in assets under management joined the Glasgow Financial Alliance for Net Zero (GFANZ), committing to direct funding towards the green transition.

- Over 90 of the founding GFANZ institutions have already set short-term targets, including 29 asset owners that have committed to reducing portfolio emissions by 25-30% by 2025, as well as 43 asset managers that have published targets for 2030 or sooner.

[redacted]

4.2 Almost two-thirds out of 100 members of the Network for Greening the Financial System (NGFS) published a pledge or strategy on tackling climate change, in addition to the joint "Committed to Action" NGFS declaration.

- Almost all of these pledges and strategies involve actions to strength microprudential and macroprudential climate-related supervision.
- The joint "Committed to Action" NGFS declaration outlines concrete commitments on what its members will deliver in the coming years. It covers all the core activities of its network of central banks and supervisors, aiming to make the financial system more resilient to climate-related risks and encourage the scaling-up of financing flows needed to support the transition towards a greener economy.
- The NGFS pledges to further enhance and enrich its climate scenarios, deepen its analytical work on how climate change might be taken into account in the conduct of monetary policy, and to intensify its work to bridge climate-related data gaps, among others.
- Complementing the joint NGFS declaration, the ECB published its own pledge on climate change action, committing to contribute to the goals of the Paris Agreement within its mandate.

4.3 The International Monetary Fund (IMF) and World Bank's Financial Sector Assessment Program (FSAP) will now examine how climate-related risks impact financial stability and resilience.

- Climate risk stress testing in FSAPs will identify financial system pressure points from physical climate risks and the transition to a low-carbon economy, including assessing climate disclosure and risk management, thereby aiming to reduce the overall likelihood and severity of financial sector crises.

Assessment Climate Change Centre: *Despite this progress, more credible, ambitious, and predictable government climate policies are still needed to foster more green investment, faster decarbonisation, and to improve the resilience of our economy. In addition, banks must incorporate these structural changes in their strategic decision-making and steer the business strategy towards a smooth transition to carbon neutrality.* [redacted] *The European Commission proposal for the revision on the Capital Requirement Directive contains such a proposal on mandatory transition plans.*

5. Developing global and harmonised disclosure standards

5.1 The International Financial Reporting Standards (IFRS) Foundation announced the establishment of the International Sustainability Standards Board (ISSB).

- The ISSB, which will be based in Frankfurt, will develop globally consistent and reliable climate and sustainability standards for financial markets, in order to meet investors' information needs and foster investment in projects that will advance the green transition. This follows support from G7 leaders, among others, to make climate disclosures mandatory.
- The first set of international standards is expected to be formally adopted in 2022. The next step will be for governments to implement these standards in their respective jurisdictions.

- **Assessment Climate Change Centre:** *A set of internationally consistent and reliable disclosure standards will help markets to price more accurately and provide incentives to decarbonise,*

helping to fuel the transition to a greener economy and deter greenwashing. However, ***mandatory disclosures of climate-related risks*** *from a far greater number of companies, as well as disclosures of forward-looking measures to assess the extent to which firms are aligned with net-zero commitments, are still needed.*

6. Pledges to halt deforestation and reduce methane emissions

6.1 110 countries pledged to halt and reverse deforestation by the end of 2030.

- The signatories – including Russia and Brazil, which have the world's highest deforestation rates – collectively cover about 85% of the world's forests.
- The pledge includes almost USD 19.2bn of public and private funds, some of which will be used to restore damaged land, tackle wildfires and support indigenous communities in developing countries.
- Despite its achievements, the pledge has also been met with some scepticism given the lack of monitoring and enforcement tools. Previous plans to end deforestation, such as the 2014 New York Declaration on Forests, have so far fallen very short of their targets. Some of the signatories also prompted cynicism, with Brazil's deforestation at a 12-year high and Indonesian Environment Minister Siti Nurbaya Bakar criticising the deal as 'unfair'.

6.2 More than 30 financial institutions with over USD 8.7tn in assets under management committed to end investment in activities linked to deforestation.

- Focusing on deforestation-intensive agricultural commodities like palm oil, soy, beef, pulp, and paper; the signatories will create plans, milestones, and incentives to meet Paris-aligned timelines.
- Participating institutions agreed to disclose deforestation risk and mitigation activities in their portfolios by the end of 2023, and to publicly report their progress to eliminate commodity-driven deforestation in underlying holdings in investment/lending portfolios by 2025.

6.3 95 countries pledged to reduce their methane emissions by 30% by the end of 2030.

- The signatories collectively represent 70% of the global economy and produce 50% of global methane emissions, which are known to contribute particularly strongly to global warming. However, major methane emitters including India, China and Russia, did not join the pledge.
- A report by the IPCC found that reducing methane emissions using existing technologies could reduce global temperatures by 2100 by up to 0.5C. In many cases, the reduction of methane emissions can be achieved at a relatively low cost, e.g. through repairing and replacing natural gas pipes.

Assessment Climate Change Centre: *The deforestation and the methane pledges and the implementation of corresponding policies could pose considerable transition risks for our economy and should be monitored accordingly. However, and as per our economy-wide stress test, we can be supportive of this: while* ***transition costs may be higher in the short-term, they are much lower in the long run*** *than the catastrophic costs of unrestrained climate change.*