# COP26: The future of financial services

**November 16, 2021**

November 3, 2021 was “Finance Day” at the 26th Conference of the Parties (COP26) in Glasgow, Scotland.

## What you need to know

- The Glasgow Financial Alliance for Net Zero (GFANZ) released a progress report, which provides further guidance for members of the Net Zero Banking Alliance (NZBA) and other financial service subsectors;
- All member states of the United Nations Framework Convention on Climate Change (UNFCCC) agreed to the *Glasgow Climate Pact* (the Pact);
- Article V, paragraphs 47 and 55 urge financial institutions (among others) to (i) further scale up investments in climate action, and (ii) accelerate the alignment of their financing activities with the goals of the *Paris Agreement*; and
- These international directives are informing regulatory frameworks and new business practices throughout Canada – voluntary initiatives now may soon be mandatory.

This insight is divided into two parts. Part I summarizes climate finance reports that were delivered in connection with COP26. Part II describes what’s next with respect to climate finance in Canada.

To read more about COP26 and climate finance, please see our previous article.

## Part I: Climate finance reports

Signed on November 14, 2021, the Pact charts a course to formalize new promises made throughout the conference. The parties regrettably acknowledge their failure to mobilize $100 billion (USD) per year by 2020. Further, an international carbon market was notably omitted from the Pact. Nonetheless, pledges were wide-ranging at COP26, and delegates will now return home to integrate these commitments domestically.

### Reports at COP26

*Fourth Biennial Assessment and Overview of Climate Finance Flows (the Biennial Report)*

The parties welcomed the Biennial Report and its conclusions.[1] This report notes that in 2018, private money accounted for 84 per cent of US$322 billion in new renewable energy investments, and mobilized private finance through multilateral, bilateral and regional means were US$14.6 billion. By comparison, the report estimates the following:

| Description of Financial Flow | US$ in Trillions |
|---|---|
| Fixed assets in sectors linked to the fossil fuel system | 32 |
| Stranded assets between 2015-2050 | 20 |
| Real estate assets at risk in 2070 | 35 |
| Green and climate aligned bonds outstanding in 2018 | 1.4 |
| Debt securities outstanding in 2019 | 100 |
| Assets under management in 2019 | 89 |

By some recent estimates, US$32 trillion of investment in decarbonization is needed this decade to put the world on a path towards net-zero.[2]

*GFANZ progress report*

On “Finance Day”, GFANZ produced a progress report and a plan forward for the financial services sector. GFANZ unites the net-zero finance initiatives, which includes the NZBA into one sector-wide strategic alliance. The report allocates work streams in the financial sector (see table below) and discusses some tools for each work stream that are, or will be, available to various financial institutions.

| GFANZ work stream | Vision |
|---|---|
| Financial sector transition plans | Support the development and effective implementation of ambitious, credible net-zero transition plans. |
| Real economy transition plans | Promote upward convergence in the transition plans of corporate clients and investees by providing both companies and financial firms with a view of best practices. |
| Sectoral transition plans | Help financial institutions evaluate sectoral net-zero pathways for heavy emitting industries such steel, aviation, and oil & gas. |
| Portfolio alignment measurement | Further development and effective implementation of portfolio alignment metrics for financial institutions. |

| | |
|---|---|
| Mobilizing capital in emerging markets and developing countries | Facilitate finance in emerging markets and developing countries through capacity building and other initiatives. |
| GFANZ call to action | Advise on specific policies including economy-wide net-zero targets aligned to 1.5 degrees C, reform of financial regulations to support the net-zero transition, phase out of fossil fuel subsidies, pricing carbon emissions, mandatory net-zero transition plans, and climate reporting for public and private enterprise. |

GFANZ wants financial transition plans to be “credible”. Credible transition plans will:

1. Support the real economy;
2. Set targets;
3. Alter business practices; and
4. Disclose key information.

Specific action items and key challenges (such as insufficient coverage of climate considerations in a bank’s products and business lines) are shared within the report. With respect to bank clients, GFANZ will increase the ability of financial institutions to evaluate corporate net-zero transition plans and promote the reallocation of capital to decarbonization efforts.

Prior to COP26, several Canadian banks signed commitment letters to join the NZBA. Membership must publish a report that sets greenhouse gas emission (GHG) targets for 2030 and 2050. Targets will include their clients’ scope 1, scope 2 and scope 3 emissions for certain carbon-intensive sectors. Disclosure is expected to increase between each review period, which occurs every five years. Members will publicly disclose their targets and report progress annually, including an overview of the categories of actions expected to be undertaken to meet the targets and approximate timelines. The related guidelines operate on a comply-or-explain model whereby banks will justify any decision to exclude information about portfolio emissions. These reports will identify progress and areas of improvement for each member.

# Part II: What to watch

Below outlines the developments in Canada’s financial services sector to follow in the interim. Policymakers, central banks and securities regulators are changing the regulatory landscape from the top-down, while the growth of new financial instruments are reshaping economic incentivizes from the bottom-up.

At COP26, the Federal Government reaffirmed existing obligations, such as continuing to lead the Climate Finance Delivery Plan, and delivered new pledges, such as ending new direct public support for the international unabated fossil fuel sector before 2023. Despite these pledges and others at COP26, parties of the UNFCCC are not expected

to achieve their 1.5 Paris target.[3] Now, Canada is expected to deliver, two years early, new nationally determined contributions in advance of COP27 in Egypt.

The Bank of Canada announced on Finance Day that climate risk assessments and the corresponding vulnerabilities would feature in future *Monetary Policy Reports* and annual *Financial System Reviews.* The Financial Stability Oversight Council (FSOC) made similar recommendations to its members to enhance public communication of climate-related efforts, including within annual reports and any relevant risk reports. FSOC will also form two new bodies: the Climate-related Financial Risk Committee and the Climate-related Financial Risk Advisory Committee, which will advise the former. New insights should help Canadian banks with their own transition plans.

In addition, the Bank of Canada announced that it will align its climate risk disclosure with the recommendations of the Task Force on Climate-related Financial Disclosures. Meanwhile, the Canadian Securities Administrators is seeking comments to the *Proposed National Instrument 51-107* until January 17, 2022.[4] See BLG's bulletin of the essentials.

Banks that have signed up to the NZBA will release 2030 and 2050 targets within 18 months of joining. GFANZ wants commercial banks to realign their existing portfolios. Sustainability linked loans (SLLs) are becoming more common in the Canadian debt markets. Canadian banks and their clients are tying pricing to a wide range of climate-focused goals, such as GHG, in alignment with the Science-Based Target initiative, reduction in fresh water usage, green revenues and metrics linked to various Environmental, Social and Governance (ESG) indices. We expect this trend to continue as regulators switch from voluntary policies to mandatory requirements, particularly in the resource sectors.

Financial architecture in the future will align regulatory frameworks with climate reduction efforts. The Sustainable Finance Action Plan, formed from the Expert Panel on Sustainable Finance, is collaborating with Canada's Net-Zero Advisory Board to develop best practices throughout the financial sector. On November 1, 2021, the Minister of Environment and Climate Change and the Minister of Natural Resources sought advice from the Net-Zero Advisory Body with respect to cutting emissions in the oil and gas sector. The advice will inform the Emissions Reduction Plan that the Federal Government plans to table in Parliament over the coming months.

GFANZ is calling on G20 countries to align debt issuances with sustainability goals. Canada is the process of issuing its first sovereign green bond, and if the United Kingdom's recent issuance is any comparison, expect the inaugural bond to be oversubscribed.

BLG will continue to monitor transitions within the financial sector. If you have any questions about regulatory and market developments as opportunities and risks in climate finance continue to grow, please reach out to any of the authors or key contacts below.

[1] Article V, para 42, *Glasgow Climate Pact*.

[2] UN Climate Change Conference UK 2021, Net Zero Financing Road Maps (November 2021).

[3] Climate Action Tracker, Press Release (November 9, 2021).

[4] Canadian Securities Administrators, CSA Staff Notice 51-358, Reporting of Climate Change-related Risk (August 1, 2019).

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Expertise

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