27four Investment Managers

COP26
Implications for South Africa

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COP26 (the 26th Conference of the Parties to the United Nations Framework Convention on Climate Change) took place in Glasgow, United Kingdom, in November 2021. Going into the event there were many expectations with a record number of people attending the event, even under strict Covid restrictions. There was pressure to keep the Paris Agreement alive (and keep the temperature increase below 1.5°C) and deepen progress, given the increasingly urgent need to act in reducing emissions and adapting to the already more severe weather being experienced.

The Glasgow Climate Pact and other highlights

The outcome of the negotiations is summarised in the Glasgow Climate Pact. Some positive progress was made, including commitments from Parties to come back with stronger commitments next year.

- For the first time, wording was included to "phase down (though not phase out) coal and fossil fuel subsidies". Notably, China and India intervened to change the wording from the original "phase out" to "phase down" and Saudi Arabia insisted on including "inefficient" in front of the reference to fuel subsidies.
- Progress was made on Article 6, which supports the longer-term carbon market (including offsets) as an important business mechanism and agreements to avoid "double counting".
- Developed countries agreed to double the funding for adaptation by 2025.
- The Adaptation Fund received new pledges of $356 million, approximately three times the mobilisation target for 2022.
- A record $413 million for the Least Developed Countries Fund.

Some outcomes were not as positive:

- General agreement that progress was not enough to limit global warming to 1.5°C, but rather an estimated 2.5°C (but much better than the 3-4°C estimated in Paris), even with deeper commitments made by many countries.
- Concerns about the credibility of some of the commitments and the ability to reach net-zero by 2050.
- Some countries (India) net-zero commitment goal for 2070 rather than 2050 as is the case in most other countries.
- Non-delivery on the $100 billion a year climate finance goal from developed countries, which was delayed another two years.
- Deferral of a proposed loss-and-damage fund.

Many voluntary declarations and commitments were made on the sidelines of the formal negotiations at COP26 including:

- 109 countries signed a Global Methane Pledge to reduce emissions by 30% by 2030.
- Over 140 countries agreed to halt and reverse forest loss and land degradation by 2030.
- 46 countries agreed to phase out domestic coal.
- An H2Zero pledge to accelerate use of decarbonised hydrogen.
- The Beyond Oil and Gas Alliance, pledged to end new licensing for oil and gas exploration and production.
- The Race to Zero campaign aimed at leadership to help achieve net-zero-carbon emissions.
- The Alliance of CEO Climate Leaders, whose approximately 90 CEOs committed to collaborate to accelerate climate action.
- The Glasgow Financial Alliance for Net Zero (GFANZ), comprising financial institutions across the entire financial spectrum and including 450 firms from 45 countries committed over $130 trillion towards the road to net zero.
- Commodity traders committing to work with supply chains to implement climate actions.

Implications for South Africa

Notably, South Africa did not sign the agreement with the 46 countries to phase out domestic coal, citing the risk of stranded assets and the need for a just transition in reference to coal-related jobs. The text referring to phase down rather than “phase out” coal was supported by South Africa during the negotiations and has significant implications for the country. It is in line with the Integrated Resource Plan for electricity and the country targets in the Nationally Determined Contribution (NDC) approved just before COP26. The National Development Plan does, however, have a net zero aspiration by 2050. It remains to be seen whether South Africa will further reduce its targets next year, as requested by the Glasgow Climate Pact.

South Africa can also benefit from extra funding in the Adaptation Fund, which is critical given the fact that South Africa is a climate hot spot. South Africa will thus experience higher temperature increases than other parts of the world, which will exacerbate an already water-stressed situation.

The progress on Article 6 is also significant for South Africa because having a functioning carbon market that includes offsets will contribute to achieving the NDC targets whilst phasing down coal.

The major implication for South Africa at COP26 was the announcement of a pledge from the EU, USA, UK, Germany and France for R131 billion in concessional climate financing and grants to South Africa to “support South Africa’s pathway to low emissions and climate resilient development, to accelerate the just transition and the decarbonisation of the electricity system, and to develop new economic opportunities such as green hydrogen and electric vehicles amongst other interventions to support South Africa’s shift towards a low carbon future.” These funds will be rolled out as needed over the next few years. A task force will be put in place to make sure the rollout addresses alternative jobs, prioritises step change projects not incremental change, leverages additional commercial investment and makes sure that the changes brought about by the additional financing are in line with the NDC and global commitments.

This is a major game changer as an investment of this size will not only contribute to the just transition but will also have catalytic impacts on economic growth. It is not yet clear where the money will be allocated other than the broad scope outlined above. Several players, however, have pointed out that much, much more is needed for a full transition away from coal in South Africa. The Department of Environment, Forestry and Fisheries (DEFF) has indicated that $8 billion a year is needed up until 2030 to achieve the NDC targets. So, while this is a very welcome contribution and a wonderful kick start, it is not enough. Much more is needed to make up the gap and ensure the just transition. That is one reason why there is no consensus about coal phase down, let alone coal phase out, within South Africa or even amongst other countries as evidenced by the change in wording in reference to coal.

Reference to hydrogen was also very prolific at COP26 and this is an area that can hold great benefits for South Africa if sufficient renewable energy can be put in place and prices come down. South Africa then has the potential to produce green hydrogen and export it, or other clean molecules. In this way, South Africa can replace many of the anticipated losses in fossil fuel related jobs. Hydrogen related projects and battery storage are likely areas of focus for the funding.

Implications for the financial sector

The importance of the finance and related sectors has been highlighted very clearly at COP26. Asset managers, banks, insurance companies and every other sub-sector have climate change and impact financing firmly on their agendas. A Finance Day was held at COP26 and Oliver Wyman summarised the changing trends in the sector as follows:

- *"The financial sector has mobilised at scale. Now the remaining 60% of the financial services industry needs to consider following suit.*
- *Financial plumbing is being reworked including the announcement of a new International Sustainability Standards Board, and the UK announcing its intent to make net zero transition plans mandatory.*
- *Fossil fuel financing remains the thorniest issue, with NGOs and activists remaining at odds with financial institutions on the way forward.*
- *Capital requirements for climate risk are on the horizon, with one hundred central banks signing a declaration including a commitment to advance supervisory practices.*
- *More needs to be done to mobilise capital in the most impactful areas, especially to help emerging markets and developing countries reach net zero.*
- *Nature and Biodiversity are the next big focus with more than 100 nations pledging to end deforestation and land degradation by 2030, and 33 financial institutions committing to halt financing of agricultural commodity-driven deforestation by 2025."*

Financial institutions have said that there is enough money to fund a net zero future but not enough credible projects. Reaching the net zero targets may require a much deeper understanding of what de-risking projects really means and a relook at risk appetite. There are many calls for regulating the need to integrate climate change into financial company strategies and activities with European Central Bank Executive Board Member Frank Elderson, stating that, in the EU, they should have "a legally binding requirement for banks to have such Paris-compatible transition plans as a capstone to the legislative and private sector initiatives already being put in place." This is aligned with voluntary initiatives such as the Task-force on Climate-Related Financial Disclosure TCFD guidelines.

In National Treasury's Financing a Sustainable Economy paper, they identify that there is an urgent need for enabling sustainable finance and that "Sustainability and making a just transition towards a lower carbon economy need to inform all financial decision-making, as the cost of post impact remedy far outweighs precautionary approach." They put the bill for a just transition at R2 trillion and that "public, private and blended funds through improved capital allocations, enhanced risk identification and management, and the generation of new products" are needed to address the problem". National Treasury has taken steps to develop a Green Finance Taxonomy to help align what is mean by "green" initiatives and it is clear that they expect financial institutions to come to the party.

Climate change is certainly high on the agenda in the finance sector and financial institutions in South Africa. They will be looked at to provide some of the additional finance required for the just energy transition, as well as other climate related projects. Some financial institutions have come under serious pressure from shareholders and faced challenges to be clear on their fossil fuel investment related policies. Many initiatives have been undertaken including, policies on not financing certain categories of new fossil fuel projects, green loans and green bonds, amongst many others.

Increasing pressure on decarbonisation, ESG reporting, transparency and possible long-term regulation means that the finance community in South Africa is in a unique position to help set the pace of the just transition and make a significant impact, not only on the energy economy but also economic growth and social upliftment.

Conclusion

COP26, whilst not achieving everything it set out to, has certainly moved the climate change agenda forward. As with many of these global processes, it is oftentimes what happens outside the formal negotiations rather than inside that helps to move things along. South Africa came away much better off than it went in, and the pledges made for new financing will certainly benefit the economy environmentally and socio-economically. The finance sector will be a major player in facilitating this historic shift.

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