Environmental Defence Canada Submission to the UNFCCC's Standing Committee on Finance on Achieving Article 2.1c of the Paris Agreement

June 28, 2023

First workshop under the Sharm el-Sheikh dialogue

Context

Environmental Defence Canada makes this submission on ways to achieve Article 2, paragraph 1(c) of the Paris Agreement (Article 2.1c) based on our organization's expertise and recommendations related to aligning private and public financial flows with the objectives of the Paris Agreement. Article 2.1c commits Parties to "[m]aking finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development". We consider "financial flows" to include both international and domestic public and private flows.

We encourage 2.1c to be a standing item for discussions of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA). Initiatives outside the CMA are not delivering climate finance at the scale, speed, or quality that is required.

Financial flows for reducing emissions and building resilience should be guided by the UNFCCC's principles. Financial flows should be in line with *Common But Differentiated Responsibility and Respective Capabilities (CBDR-RC)*, a gender-responsive approach, with respect for human, Indigenous, and labour rights, and based on science. Formalizing 2.1c as the leading vehicle for discussing climate finance is therefore key.

The upcoming 2.1c dialogues must deliver the ambition required to transform global financial flows systemically and permanently. Aligning financial flows remains a key missing piece to achieve the goals of the Paris Agreement. 2.1c is necessary to meet the other goals of the Paris Agreement: 2.1(a), pursuing efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels, and 2.1(b), increasing the ability to adapt to the adverse impacts of climate change and fostering climate resilience. Finance should work in the best interests of communities and ecosystems. New forms of regulation and reforms to public policy are necessary to achieve the goals of the Paris Agreement and mobilize all financial flows for the public interest.

Key Elements

Private finance

Despite attention on aligning private finance with net-zero, private capital flows disproportionately to climate-damaging investments. Most financial institutions continue to increase their financing for fossil

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fuel investments. The world's largest 60 banks have provided USD $5.5-trillion of funding to the fossil fuel sector since the Paris Agreement was signed.[1]

The goal of 2.1c will not be achieved with voluntary initiatives. Many financial institutions have made voluntary commitments to achieve "net-zero" but do not have commensurate plans to deliver. Voluntary commitments are not held accountable to the core principles of the UNFCCC like CBDR-RC. Under voluntary initiatives, many definitions of "transition" do not align with the leading scientific and economic conclusions from the IPCC and the IEA. External accountability mechanisms through public policy and regulation are needed to ensure credibility.

Climate finance commitments from the financial sector often consider the climate-related risks to portfolios more so than the risks created by their polluting investments. This negatively impacts climate justice and environmental justice. For example, member countries of the Vulnerable 20 (V20) group are already charged more than 117 basis points extra on debt in private markets due to their climate vulnerability.[2] By pricing in the financial risks from climate change without considering the climate implications of investments, private financial institutions do not contribute to positive climate outcomes.[3] Rather, vulnerable communities are financially burdened by an increasing cost of capital for projects in at-risk regions. Financial institutions must be required to go beyond disclosing climate risks and emissions to instead invest in positive climate action, reducing real-world emissions while building resilience.

Regulation from member Parties should ensure financial institutions align with Article 2 of the Paris Agreement. While Parties will take their own approach, the Standing Committee on Finance (SCF) should recommend that Parties:

- Implement mandatory climate transition plans across the economy. All companies and financial institutions should be required to develop, publish, and report publicly on credible climate plans based on standardized metrics. A credible climate plan would include, for example, plans to reduce financed emissions in half by 2030[4]. Requiring credible climate plans in domestic financial regulation would ensure transparency across financial institutions.
- Align any sustainable finance taxonomy (a tool used to categorize investments which advance the goals of the climate transition) with the recommendations of the IEA and the IPCC. A taxonomy should not endorse investments in oil, gas, or coal.

Financial institutions must not merely count and disclose their emissions, but rather proactively align their investments with reducing emissions and building climate resilience (i.e., invest in both mitigation and adaptation). Protecting and reducing negative impacts on biodiversity is also important, in line with Target 15 of the Kunming-Montreal Framework.[5] The SCF should mobilize Parties to set domestic regulation that holds financial institutions accountable.

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[1]https://www.bankingonclimatechaos.org/
[2]http://unepinquiry.org/wp-content/uploads/2018/07/Climate_Change_and_the_Cost_of_Capital_in_Developing_Countries.pdf
[3]https://www.ethicsinfinance.org/wp-content/uploads/Document/2021-Segal.pdf
[4]https://environmentaldefence.ca/report/roadmap-to-a-sustainable-financial-system-in-canada/ (See page 29 of the report, or the bottom of the web page, for the full definition of a *credible climate transition plan*).
[5]https://www.cbd.int/doc/c/e6d3/cd1d/daf663719a03902a9b116c34/cop-15-l-25-en.pdf

Public finance

Governments continue to provide oil and gas companies with significant levels of subsidies, public financing and other forms of government support. Public financial flows are particularly important. Governments control them directly, and they can influence larger private financial flows.

G20 countries have committed to eliminating "inefficient" fossil fuel subsidies by 2025. Further, at the 26th and 27th Conference of the Parties, in Glasgow and Sharm El Sheikh, parties committed to phase out inefficient fossil fuel subsidies while providing targeted support to the poorest and most vulnerable countries. Yet to date very little progress has been made. The IEA estimated that in 2022 fossil fuel subsidies doubled from the previous year to an all-time high of USD $1-trillion.[6] On average, governments have allocated at least USD $643-billion per year for fossil fuel support between 2010 and 2021.[7]

Public spending on clean energy remains a fraction of what is provided by governments to fossil fuel companies. The most recent published analysis from the International Renewable Energy Agency estimated that subsidies for renewables was only USD $167-billion in 2017, much less than public subsidies for fossil fuels.[8] Shifting public support from fossil fuels to clean energy is one way to bridge the gap in financing for clean energy.

Barriers to fossil fuel subsidy reform include a lack of accountability and reporting requirements. A lack of international definition for 'inefficient' allows countries to avoid fossil fuel subsidy reform by claiming all their subsidies are efficient.

In order to support fossil fuel subsidy reform, the SCF should recommend that Parties:

- Include fossil fuel subsidy reform in their Nationally Determined Contributions (NDCs).
- Establish clear timelines for eliminating subsidies. Countries in the G20 should eliminate all subsidies by 2025, and developing countries should do so as soon as possible.
- Use the World Trade Organization Agreement on Subsidies and Countervailing Measures Article 1.1 definition of subsidies to ensure all relevant measures are captured. This definition includes financial benefits provided to businesses or industries, including direct transfers, foregone revenue, transfer of risk, loan guarantees and provision of goods and services. All forms of public financing should be included.
- Acknowledge that all fossil fuel subsidies are inefficient. If countries won't agree to drop the qualifier 'inefficient' from their commitments, develop a narrow definition that aligns with the goal of the Paris Agreement to limit global temperature rise to 1.5 degrees. Therefore subsidies cannot be found to be efficient if they: a) result in the expansion or continued production of oil and gas (ie. carbon lock-in), b) risk creating stranded assets or dead-ends, c) delay or diminish the transition to renewables, or d) create market distortions which favour oil and gas over renewable energy.

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[6]https://www.iea.org/reports/fossil-fuels-consumption-subsidies-2022
[7]https://www.iisd.org/system/files/2023-03/global-stocktake-shifting-public-financial-flows.pdf
[8]https://www.iisd.org/system/files/2023-03/global-stocktake-shifting-public-financial-flows.pdf

- Immediately adhere to reporting requirements on fossil fuel subsidies under Sustainable Development Goal Indicator 12.c.1.[9]

International finance

Finance must be available and affordable for developing countries to undertake climate action. Transformation is required of the international economic and financial system. High debt costs limit the ability of developing countries to invest in climate action and resilience. Debt restructuring and cancellation are necessary climate solutions. The 2.1c dialogues should examine ways to address the root causes of debt crises in climate vulnerable countries, including unjustly high borrowing costs and insufficient grant-based climate assistance.Developing countries should also be better structurally represented in the governance of international financial institutions and development banks.

Importance of prioritizing grant-based finance

Article 2.1c should be used to mobilize private finance and hold it accountable to principles of equity and justice. But private finance cannot supplant grant-based financing. The Paris Agreement reaffirms that developed countries should take the lead in providing financial assistance, under Article 9.1. Article 2.1c must be not just complementary but additional to Article 9 of the Paris Agreement.

The CMA must deliver grant-based funding to vulnerable and historically less polluting countries, address loss and damage, and transform global financial architecture through debt cancellation and progressive tax mechanisms. Developed countries have a responsibility to provide to developing countries grants and concessional finance, which should be accounted for in grant-equivalent terms.

Article 2.1c is important to build on these keystones of equitable climate finance and ensure that the entire financial system invests in a way that does not undermine climate action. Every private investment has an impact on communities and ecosystems. Article 2.1c should mobilize domestic policy to ensure the impact from every private and public investment is positive and productive, rather than only being financially profitable in the short term. Developing countries should play a key governance role in all conversations about finance, and should not incur high costs for adapting to climate change. Developed countries must deliver on Article 9.1 of the Paris Agreement outside of Article 2.1c, while driving 2.1c forward through regulatory and policy reform as recommended below.

Summary Recommendations

1. Article 2.1c must be delivered in a way that prioritizes justice and equity, including global climate justice and domestic just transitions.
2. Parties should hold private financial institutions accountable for delivering and implementing credible climate transition plans[10]. Parties should regulate private finance to align with the goals of the Paris Agreement, including both reducing emissions (mitigation) and building climate resilience (adaptation).

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[9]https://www.unep.org/explore-topics/sustainable-development-goals/why-do-sustainable-development-goals-matter/goal-12-9

[10]https://environmentaldefence.ca/report/roadmap-to-a-sustainable-financial-system-in-canada/ (See page 29 of the report, or the bottom of the web page, for the full definition of a *credible climate transition plan*).

3. Parties must eliminate fossil fuel subsidies, public financing and other forms of government support to the fossil fuel sector. This can be achieved by establishing clear definitions, timelines and reporting requirements. Parties should also drop the qualifier 'inefficient', or at least develop a narrow definition that aligns with the goal of the Paris Agreement to limit global temperature rise to 1.5 degrees. Therefore subsidies cannot be found to be efficient if they: a) result in the expansion or continued production of oil and gas (ie. carbon lock-in), b) risk creating stranded assets or dead-ends, c) delay or diminish the transition to renewables, or d) create market distortions which favour oil and gas over renewable energy.
4. Reform of international financial institutions is required. Developed countries should prioritize providing grant-based financing to developing countries.

Next steps

Action to align global financial flows with the Paris Agreement is overdue and is now urgent. Throughout 2023, Environmental Defence Canada looks forward to participating in the first workshop under the Sharm-el Sheikh dialogue on Article 2.1c in Bangkok and contributing as the conversation evolves in Dubai at COP28.

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