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LOOKING AHEAD TO COP28: WHAT CAN WE EXPECT?

– THOUGHT LEADERSHIP

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COP28 – the 28th annual United Nations climate meeting – takes place in Dubai from 30 November, but what can realistically be achieved against a backdrop of increasing geopolitical complexity? In this extract from a recent webinar, moderated by Roger Leese, co-head of Clifford Chance's Global Business and Human Rights practice, we explore some of the major themes that will be covered, including renewable energy, financing and the role of private capital, and carbon markets, and we contextualise what's on the agenda.

The UAE's Presidency

In the run-up to COP28 there was some controversy surrounding COP28 President Designate Dr Sultan Al Jaber's roles as the Chairman of the renewable energy company Masdar and the Group CEO of the oil major, Abu Dhabi National Oil Company (ADNOC), the UAE's largest energy group. However, Daud Khan, a Clifford Chance Partner based in Abu Dhabi, says: "I think it is fair to say that the focus has shifted to the substance of his presidency with support being expressed by senior figures in the US and in the EU and recognition of the significance of this particular COP."

So, what can we expect from COP28 and a UAE presidency? Dr Sultan is seen by many as an advocate for, and bridge to, the Global South, which is suffering from a disproportionate impact of climate change, particularly in Africa. "The Global South is viewed as critical to the climate change agenda and reformation of climate finance and also of international financial institutions. Given Dr Sultan's roles in both the state and the private sector, he is also seen as a voice that can speak to both private as well as public capital – perhaps more so than previous COP presidencies," says Khan. "He has been very vocal about the need for all stakeholders to play their part, including oil and gas companies which may be a useful clarion call for the private energy industry but also sovereign wealth-backed or state-controlled energy groups across the Middle East."

COP28 will not be without challenges. "The Global Stocktake (GS) – which assesses action and progress on climate change – is a sobering reality check. Looming large over this year's conference will be increasing geopolitical tensions in light of the ongoing Israel-Gaza conflict. Perhaps the most significant challenge faced by Dr Sultan is how to compartmentalise the COP28 discussions with their focus on achieving technical commitments from world leaders and distinguishing that from the polarising effect that the regional conflict and broader global conflicts may have on achieving those commitment outcomes," Khan says.

The US perspective

"The Biden Administration has gone all in on programmes that are intended to reduce carbon emissions in the US, sometimes to the point that we make our trading partners unhappy. Tax benefits and the Inflation Reduction Act (IRA) have caused pushback from Europe and some allegations of state aid, but that has not stopped the administration from continuing to roll out programme after programme," says David Evans, a Clifford Chance Senior Counsel, based in Washington D.C.

He adds that the US is continuing to push towards meeting its Paris Agreement requirements. The IRA has nothing to do with inflation but does provide huge tax benefits for all kinds of energy transition projects. Recently, the US Department of Energy announced US$7 billion in grants to fund seven hydrogen hubs as a precursor to creating a hydrogen network across the United States. However, efforts towards meeting Paris Agreement requirements could be hindered by two factors: Israel/Gaza and the US election. "The US is trying to do everything it can to prevent the Israel/Gaza conflict from becoming a wider war in the region – a war would obviously not be good for energy policy or pricing and could distract people from the importance of climate action," says Evans. "Secondly, the Biden Administration has a very ambitious programme, but Biden is an incredibly unpopular president – his approval ratings are in the 37% range. So, whether Joe Biden will be around to complete his efforts is to be seen and, as we know, the likely Republican candidate is not a huge fan of climate action," Evans says.

What are the ambitions for COP28?

The COP28 Presidency's action agenda, which was published in October, includes policy recommendations for government and the private sector calling for the tripling of the renewable power sector, the doubling of energy efficiency between now and 2030 and the promotion of hydrogen.

"These are goals shared by all of us who are involved in energy transition projects, but I think what's really needed is to rethink the entire arrangement. Energy transition projects are different from traditional energy projects in my experience and that means all the parties around the table need to think about a risk allocation matrix – that includes the host government, the project developers, multilateral development banks, and development finance institutions," says Evans. "Without this reset, I'm not sure that we can attract the capital that is needed to triple renewable energy production. It's not just about the money – bankers have said there's plenty of money, it's about saying hand on heart to shareholders these are good projects, albeit with a little more risk than in a traditional project."

The finance agenda at COP28

The provision of finance remains critical in addressing the challenges of climate change. It is estimated that to achieve the goals of the Paris Agreement, funds in excess of US$2.4 trillion will be needed in emerging and developing countries by 2030. "The challenge is that the international financial markets do not yet provide adequate financial solutions at the scale that is needed and in a way which is accessible and available to developing economies," says Angela McEwan, a Clifford Chance Partner based in Amsterdam. "What is needed is a very significant transformation in climate finance in order to mobilise the scale needed. How to achieve this is likely to be a significant area of focus at COP28."

Another area of focus is to ensure that longstanding commitments which have already been made in relation to climate finance are being met. "Some progress has been made. For example, the early pledges to the Green Climate Fund (GCF), but this momentum really needs to be maintained. Countries need to double adaptation finance by 2025 for example, which was agreed at COP26. They also need to provide assurances on the delivery of the agreed US$100 billion per annum through to 2025 which was agreed to be provided by developed countries to developing countries. I think honouring all of these commitments will be really an important part of ensuring that there is trust in the overall process," she says.

The role of multilateral development banks

In 2022, multilateral development banks (MDBs) provided record climate finance of US$61 billion for low and middle income economies, and worldwide MDB climate finance reached almost US$100 billion – up from US$82 billion in 2021. However, there is still a huge amount of work that needs to be done. MDBs are being called on to release more capital for climate action in developing countries and to work more closely together with one another. They are being asked to take bold steps to ensure that public money is used in a much more effective way so that it can act as a catalyst to bring about greater flows of private capital. "That is what is really needed and is not quite there at the moment. A lot needs to be done to achieve that and to come up with innovative practical solutions and to build the foundations for an international finance system which can provide the scale of finance which really is needed to tackle climate issues," says McEwan.

She adds that there have been positive developments. For example, COP has joined forces with the International Monetary Fund (IMF), the World Bank and the Glasgow Financial Alliance for Net Zero (GFANZ) to implement specific actions on private capital mobilisations. "In addition, it is acknowledged that better functioning voluntary carbon markets can also really be a very effective way of channelling additional financing to developing countries and supporting local economies."

What part do the World Bank, the IMF and other institutions have to play?

At recent IMF and World Bank meetings in Marrakech, the need to mobilise finance to protect vulnerable nations from climate change was firmly on the agenda. The United Nations' Global Stocktake, which is intended to evaluate progress on climate action, estimates that US$5.9 trillion is required by 2050 for developing countries to achieve their climate goals and at least half of that is required by 2030. "Others estimate the needs to be far greater, but I think what is clear is that climate finance flows are falling short," says London-based Clifford Chance Partner, Deborah Zandstra, who attended the meetings. "The IMF and World Bank do recognise that emerging markets and developing economies will require huge amounts of financing to mitigate climate change, but 80% of that will need to come from the private sector," she adds.

As well as climate challenges, many countries are facing debt distress, with some having reduced or no market access. There are calls for the IMF to reduce barriers to access its own financing, including quicker access with less conditionality to trusts, such as the Resilience and Sustainability Trust and for more funding for this and the Catastrophe Containment and Relief Trust to be made available.

"There are also calls for wealthier countries to rechannel their Special Drawing Rights (SDRs) into these trusts and to other regional development and multilateral banks, and for there to be openness at the IMF to support funding structures that can monetise the value of SDRs and the value they represent as a basket of currency," Zandstra says.

The Executive Board of the IMF recently proposed to the IMF Board of Governors a 50% quota increase to be allocated to members in proportion to their current quotas. This could significantly increase the IMF's resources. There are also calls for a review of the IMF surcharge policies, which are procyclical and result in the costs of borrowing for countries drawing on some of the IMF resources at higher levels than would be expected in the "concessional" space.

"Going forward, I think we can expect policies that encourage both greater debt and climate resilience. For example, the IMF is reviewing its debt sustainability analysis methodologies to incorporate climate action needs," she says.

Clifford Chance has been involved in work over the last two years on climate resilient debt mechanisms in sovereign debt – or pause clauses, as they are sometimes called. G7 countries are starting to offer these mechanisms in their own lending arrangements to other countries and multilaterals such as the Inter American Development Bank and the World Bank are offering these protection mechanisms in some of their own lending to member states. "That's all very positive. It is also worth mentioning that the World Bank is also devising a new approach to track climate outcomes based on impact and is expected to make some quite significant announcements on this at COP28," she says.

Blended finance continues to be a point of focus for how to mobilise private capital in relation to countries that are facing difficulties accessing the capital markets. "The ambition is focused on new products, innovation and sharing of technical capacity. My own view is that adequate credit enhancement products exist already, but some MDBs are more active in providing them than others. There needs to be collaboration between them to share expertise and encourage others, in particular in Africa and Asia, to be more proactive in this space and generally, there needs to be significant scaling up of the offering," says Zandstra.

Some MDBs are worried about the implications of scaling up as it relates to their own balance sheets, but these can also be strengthened through hybrid capital and better use of SDRs.

Debt-for-nature swaps

Clifford Chance has advised on a number of debt-for-nature swaps including those in Ecuador, Barbados and Seychelles. These open another opportunity to raise funding for nature conservation whilst addressing debt challenges and their potential has been recognised by the Global Stocktake Report. "I think for these to really become mainstream, we need to see more collaboration between finance and conservation experts, philanthropy, local communities and international financial institutions to generate a suitable pipeline of projects and conservation activities that have their own funding needs and to generate new financing resources for climate transition. We can expect a number of announcements to facilitate this at COP28," says Zandstra. You can read more in our briefing: **Debt-for-nature swaps: A new generation**.

Carbon markets – what can we expect at COP28?

One of the key points of the COP28 Presidency action agenda is that fixing climate finance and carbon markets mechanisms is crucial. This can mean more regional/national compliance schemes and the need to implement the necessary legislation to operationalise Article 6, the market mechanisms in the Paris Agreement. The Presidency has also highlighted the importance of the voluntary carbon market (VCM) in channelling additional finance, and it calls for standard setters to align on high integrity standards.

"The relationship between the Paris Agreement and the voluntary carbon market has been speculated on at length. Put simply, would the Paris Agreement Article 6 mechanisms lead to a significant reduction in the voluntary carbon market? Yet here we are, the Presidency of COP 28 is recognising its role, and I think that's right," says Clifford Chance Partner Nigel Howorth, who is based in London. "There needs to be a VCM. The Article 6 mechanisms are not operational yet. Article 6.4 is going to be complex and heavy on rules and administration and that means the cost and time it takes to go through that process is not going to be possible for a number of types of projects. The VCM also has a role to pilot methodologies and new types of projects."

However, he adds: "The VCM needs to get itself out of the very difficult corner that it finds itself in and to regain market confidence by establishing a common set of standards to deliver a high integrity market and credits."

On the supply side, there is the Integrity Council for the Voluntary Carbon Market threshold standard for carbon credit quality and, on the demand side (consumers, corporates, buyers), there is the VCMI's Claims Code of Practice which outlines when it is appropriate to make a claim using carbon credits. "What is going to be really interesting about COP28 is to what extent the Article 6.4 Supervisory Body will adopt these same standards. We know that COP28 is working with the VCM on harmonising Article 6 and the VCM integrity efforts, but we don't know yet what that will entail," he says.

Article 6 of the Paris Agreement – providing a structure for a carbon credit market

It appears that the majority of discussions and decisions taken at COP28 will be about operationalising Article 6.4 under which greenhouse gas emission mitigation outcomes may be transferred internationally. "The majority of the work is going to be around the Article 6.4 mechanism and filling in the gaps that were left over from COP27," says Howorth. In the last year, the Supervisory Board has been hard at work and has come up with recommendations, standards, procedures, guidance and a sustainability tool. These contain lots of details around how projects can register and get credits issued, the sort of standards they have to meet in their design and implementation and how they are validated and verified. "There are two really interesting things that have arisen, and they are currently out for consultation before the COP. The first is a sustainable development tool that is designed so that projects are assessed and report on their negative and positive impacts and how they're going to implement mitigation strategies. The second is an appeals and grievance procedure, which is unique, certainly in carbon markets. The proposal is to bring in a procedure by which individuals, communities and organisations can challenge the decisions of the Supervisory Board, such as to register a project or to issue credits," Howorth explains.

"It's going to be very interesting to see how that plays out. There is remaining uncertainty around the methodologies that projects have to follow without those being agreed and adopted – it could be another year yet before this mechanism is up and running. And carbon emissions removals guidance remains controversial – a recommendation was put forward at COP27 but was rejected."

Biodiversity

COP28 is dedicating a day to nature, land use and oceans following the landmark Global Biodiversity Framework agreed at the end of 2022 and now signed by 188 governments. "A critical part of COP28 is how to finance these measures to deliver not only the Paris Agreement, but also the Global Biodiversity Framework," says Howorth. There is a specific session at COP28 on the integration of nature-positive criteria into economic and financial systems and markets; mechanisms to unlock sovereign finance for nature; the mobilisation of private capital to support nature-based solutions; and the establishment of new markets/ revenue streams to support conservation. "One of the most interesting things is around talk of a road map to get global compliance and voluntary markets for nature, forests and biodiversity credits. I think we are going to see pledges on mangroves and oceans, and I think there will be a lot of discussion around nature financing," he says. For more information, see our briefing: **Taskforce on nature-related financial disclosures (TNFD) recommendations published**

However, it is likely to be complex. "While a ton of CO_2 is the same in one jurisdiction as another, a tiger is not the same as a lion and is not the same as a frog, so biodiversity is much more difficult to put a price to and to come up with a single credit that could be as easily traded as perhaps carbon is," says Howorth.

Is the UAE leading by example?

COP host states have traditionally tried to lead by example and set the tone for the event. The UAE has committed to investing 600 billion Dirham (US$150 billion) in clean and renewable energies over the next three decades and aims to plant more than 100 million mangroves by 2030 to align with the UN Convention on Biodiversity. In addition, Masdar, one of the leading renewable energy businesses in the UAE, is investing in green hydrogen projects in the tens of gigawatts. "There is a commitment in terms of deployment of capital and, more generally, ambition. That is supported by the speed of regulatory change that we're seeing in the UAE. In the last two years, we've seen more than fifteen pieces of legislative guidance passed or issued by UAE authorities focused on sustainability disclosure, green finance and green bonds. We're seeing the desire to place the capital to support that ambition backed by some regulatory safeguards to ensure that it's done in a consistent and appropriate way," says Daud Khan.

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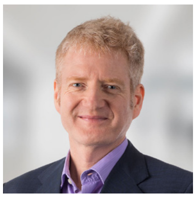

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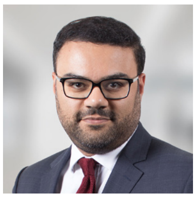

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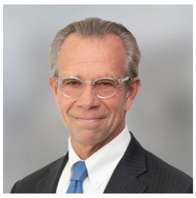

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