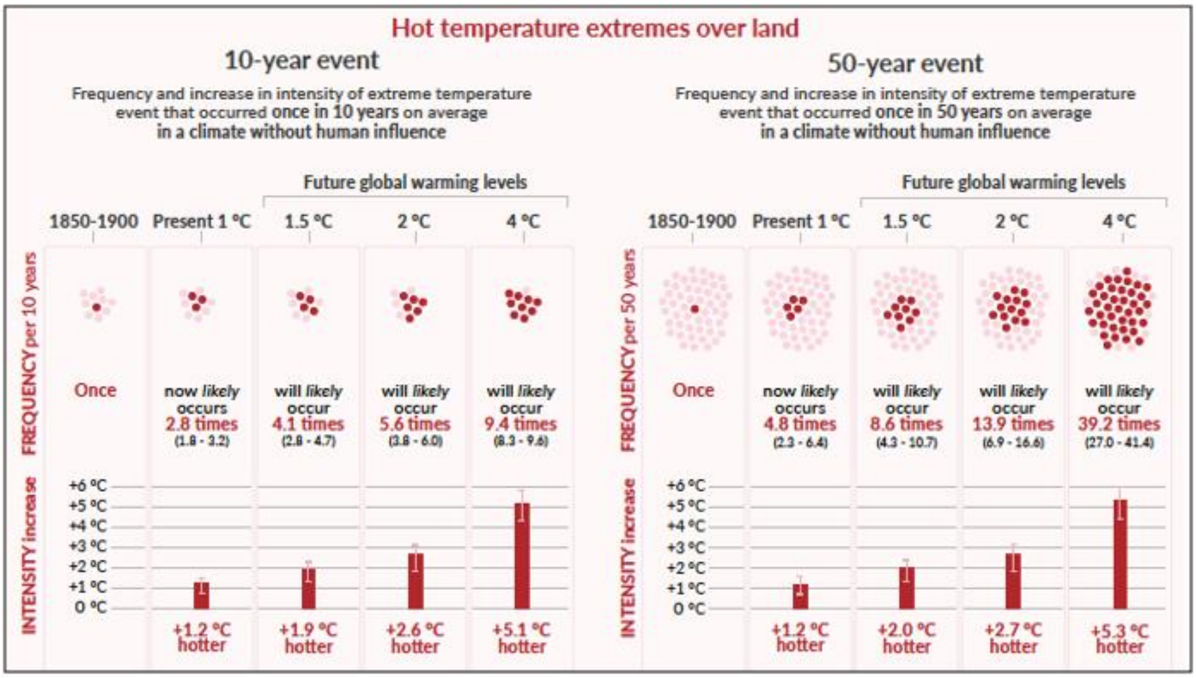
What does a good cop look like?

The COP26 climate conference begins in less than two weeks. What will a successful outcome look like? At Kempen, we believe markets will respond well if global leaders make more detailed commitments to net zero and move towards a minimum price on carbon.

This summer the latest assessment report from the scientists of the IPCC ratcheted up the strength of their language and the urgency of their findings, showing there is no longer any shadow of a doubt connecting human activity with unprecedented global warming.

The analysis examined 5 different potential scenarios around the warming of the planet over the coming years. Every single one of these scenarios suggested that the Earth will reach at least 1.5C of warming in the next 20 years. “With every increment of global warming, changes get larger” concluded the IPCC, compounding the likelihood of extreme weather events such as this summer’s heatwaves and hurricanes in Europe and the US respectively (see image).

Figure: IPCC findings how the frequency of extreme weather may increase with each degree of warming



The alarming IPCC report serves as the underlying scientific basis for next month’s COP26 summit. So, what sort of outcomes should responsible investors be looking for in Glasgow? We suggest three fundamental outcomes are needed:

1) We need more nations to adopt detailed net zero plans by 2050

This is paramount. When the Paris Agreement was first agreed in 2015, countries made emission reduction pledges that were very welcome, but would still see a disastrous 3.2C of global warming by 2050.

This year a majority of countries have committed to carbon neutrality plans (via their Nationally Determined Contributions) but as a UN Climate Change Synthesis Report this month showed these plans are still lacking. Current plans will still lead to an increase of 16% in greenhouse gas emissions by 2030.

So we also need to see shorter, intermediate targets in these national plans. Take for example the introduction of the European Commission's 'Fit for 55' regulation. This legislative package aims to support EU commitments to reduce emissions by at least 55% by 2030 – using instruments such as carbon pricing and energy taxation and higher standards to help accelerate climate action. Just one example is 'Fit for 55's plans for a Carbon Border Adjustment Mechanism (CBAM) which means corporations importing emissions intensive goods such as steel into the EU will have to pay as much tax on their climate impacts as if they were operating within Europe.

Investment markets have signalled that they are ready for this leadership. Investors like Kempen have committed to become a net zero investor by 2050, and we have set a short term target to align all our listed investments with a Paris Pathway by 2025. If countries can respond in-kind then private and public sectors can create a loop of ambition to seriously tackle the climate crisis.

2) We need policy to encourage better climate data

At Kempen, we know better than anyone that markets rely on quality information to make educated decisions. In order to align financial flows with the low carbon transition, companies need to provide good quality data on climate risk and other ESG related issues.

Voluntary reporting via CDP and TCFD (Task Force on Climate-related Financial Disclosures) has seen tens of thousands of companies disclose their climate risks but gaps in quality or in some markets mean that ESG data is still not good enough for investors.

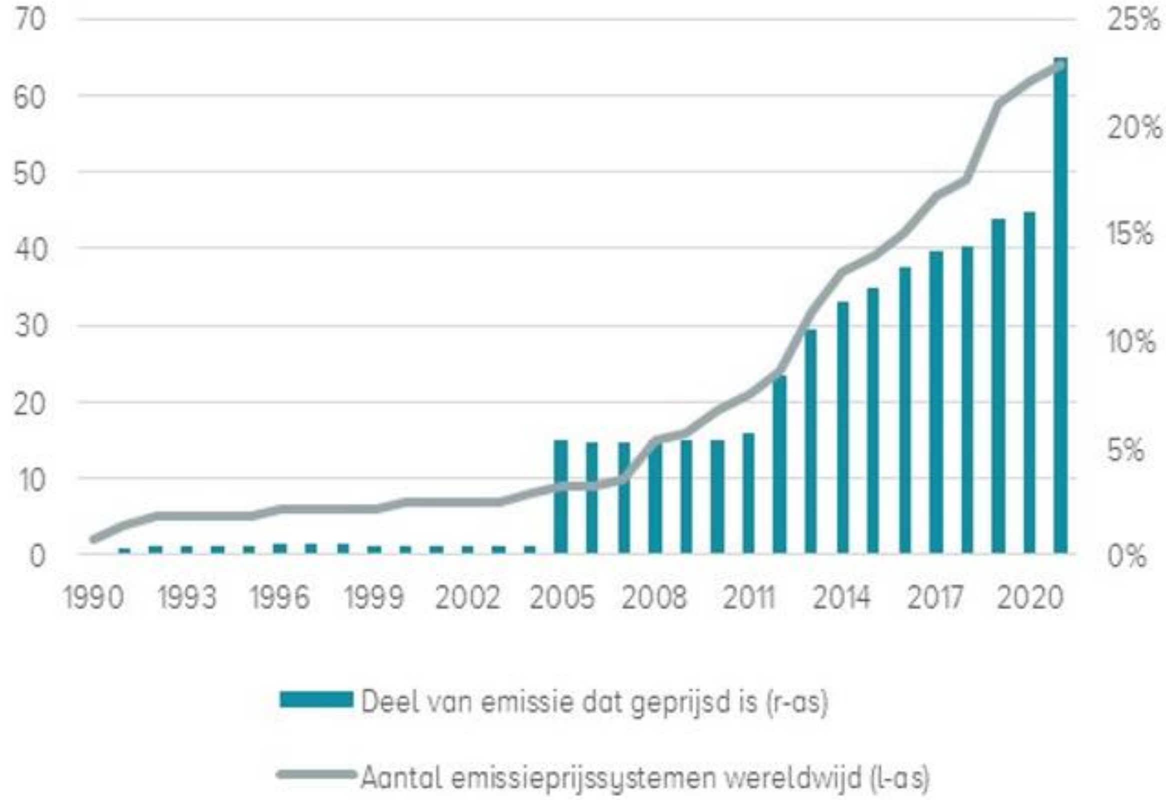
If COP26 can address this issue it would catalyse the alignment of financial flows with a Paris Agreement pathway. The UK and the EU have already made commitments to make climate risk reporting mandatory and we encourage more countries to follow suit.

3) Put a (minimum) price on carbon

One of the challenges with climate risk is that it is an externality which is not yet fully integrated in the economic and financial system. We therefore need to put an adequate price on carbon to make carbon intensive production more expensive and to incentivize sustainable alternatives.

As reported by the IMF however, the global carbon price is currently too low (c. 3 dollar per ton, while 75 dollar per ton or more would be needed to meet the Paris goals) and the World Bank has shown that the global emissions covered by pricing systems are relatively low (see the figure below).

We are seeing regulators and central banks make concrete steps towards integrating climate risks into their risk assessments, with the economy-wide climate stress test by the ECB being a prime example, and this is driving the pricing of carbon forward. But to go further, COP 26 could be an opportunity to set ambitions on a global scale – in line with the recent landmark minimum global tax rate for instance - for a worldwide minimum carbon price.



Forming the ambition loop

From rising water levels to wildfires, the effects of climate change are already upon us and will get worse. We're seeing markets respond – with the exponential growth of the electric car industry, greener infrastructure, and a revolution in building insulation as just some examples – but we need policy makers to inspire investors and companies to push for much more.

The key challenge for COP26 must be to create an ambition loop from business to government and back again in order to support bigger and better climate action.

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