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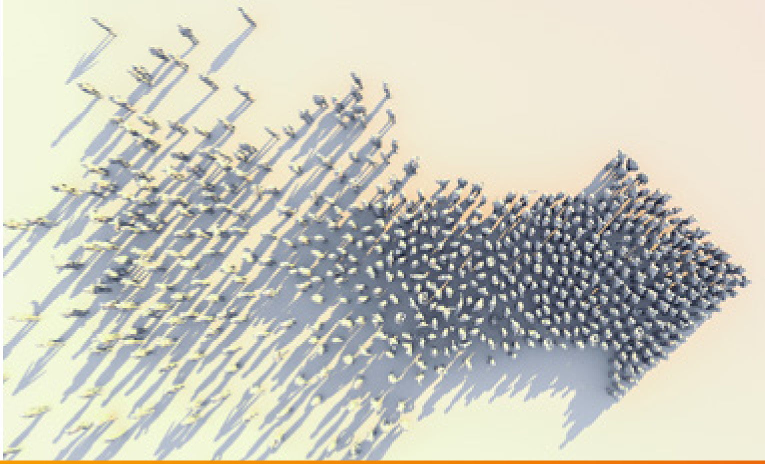

POLICY BRIEF

November 2021

Making finance flows consistent with the Paris Agreement: Opportunities and challenges concerning Article 2.1c

Executive Summary

"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development," also known as Article 2.1c, is of particular importance to the success of the Paris Agreement. It represents one of the three long-term goals of the agreement, while also being a means to achieve the other two long-term goals of mitigation (Article 2.1a) and adaptation (Article 2.1b). Nevertheless, no specific negotiation tracks for Article 2.1c have yet been established. Ambiguities about the interpretation of Article 2.1c and concerns about potential adverse impacts of its implementation are impeding progress on this long-term goal. However, little time is left before the Global Stocktake (GST) in 2023, where a first assessment of the progress towards all three goals will take place. Parties must therefore step up and define a common interpretation of Article 2.1c, assess its relationship with other processes under the Paris Agreement and the United Nations Framework Convention on Climate Change (UNFCCC), and identify a suitable process for tracking progress.

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General recommendations

- **Leadership on interpreting Article 2.1c:** Parties that are eager to advance work on Article 2.1c need to take the lead in suggesting potential fora and elements to come to a joint interpretation, including consideration of the range of relevant actors and activities that play a role. Parties would need to decide whether to request other fora, e.g. the Standing Committee on Finance (SCF), to advance these questions or whether they prefer to negotiate the content as part of a new agenda item.

- **Involving non-Party stakeholders:** Since non-Party stakeholders also play a crucial role in the implementation of Article 2.1c, Parties should decide whether to include these actors in a more structured way (e.g. an open platform) or continue playing a top-down role by guiding non-Party stakeholders only through regulation and incentives. Processes similar to the Talanoa Dialogue or the long-term finance workshops on the USD 100 billion goal could provide examples to build on.

- **Assessing the relationship between Article 9 and Article 2.1c:** Reflecting upon the implications for the implementation of Article 2.1c has shown that its relationship with financial flows referred to as climate finance needs to be defined more clearly.[1] This relates to several processes under the UNFCCC and Paris Agreement, particularly processes on: the provision of climate finance as support for developing countries (Article 9); the potential implications for accessing climate finance (e.g. provided through the Financial Mechanism); and the process defining the new collective quantified post-2025 climate finance goal. The provision of climate finance remains an important building block for a collective approach within the climate crisis, alongside alignment efforts. Climate finance should act as a facilitator of Article 2.1c, for example by supporting countries in creating regulatory frameworks to advance Article 2.1c. At the same time, the general alignment of financial flows should not have negative implications on the volume and channels of direct support for climate actions provided to the most vulnerable countries.

- **Increasing support for the implementation of Article 2.1c**: Article 9 constitutes an obligation for developed countries to provide and mobilize support for mitigation and adaptation. This support, which includes financial flows directed to climate mitigation and adaptation, will benefit the implementation of Article 2.1c. However, such support should be expanded for activities that not only explicitly support mitigation and adaptation, but are more directly linked to Article 2.1c, such as the strengthening of sustainable finance and associated regulatory measures that in turn foster investments in mitigation and adaptation actions. Moreover, to be able to report on progress on Article 2.1c, developing countries will require support to develop the capacities to track national progress. To kickstart the gathering of data and information, even in the absence of an established system to track Article 2.1c, developed countries should provide additional support for national Article 2.1c tracking, e.g. through additional resources outside the regular replenishment circle for the Global Environment Facilities (GEF) Capacity Building Initiative for Transparency (CBIT).

Recommendations for COP26 negotiations

- **Article 2.1c under the SCF agenda item:** The results of the Biennial Assessment and Overview of Climate Finance Flows (BA), including the chapter on mapping information relevant to Article 2.1c, could be considered as a separate sub-item under the Agenda item relating to the report of the SCF, in the event that the current provisional agenda will be adopted.[2] Under this agenda item, Parties could, among other things, reflect upon the initial results of the mapping and on the approach taken by the SCF. Against the background of a lack of guidance on the interpretation of Article 2.1c, which has also become evident in discussing the draft BA within the past SCF meetings, the Parties could consider adding a mandate to the SCF to work on guidance on interpretation of Article 2.1c, or at least launch work on Article 2.1c under the SCF agenda item as part of COP26.

- **Introducing a separate agenda item for Article 2.1c:** Instead of mandating the SCF, Parties could also decide on initiating a separate agenda item on Article 2.1c to enable a

1 Climate finance is defined according to the SCF in their BA as “flows whose expected effect is aimed at reducing emissions or enhancing sinks of GHG, and/or reducing vulnerability of and maintaining and increasing the resilience of human and ecological systems to negative climate change impacts.” Draft Fourth BA, 2021.

2 See UNFCCC (n.d.a.).

broader discussion on surrounding questions (e.g. data, methodology, support for collecting data on Article 2.1c, guidance to actors, involvement of non-UNFCCC actors).[3] While the provisional agenda does not include such an item, Parties could request to add an agenda item on Article 2.1c to the supplemental agenda prior to COP26. If Parties reached consensus, this would allow work on Article 2.1c to already start at COP26. This agenda item could be placed under the CMA, for example under " 8. Matters relating to finance," where the report from the SCF is also placed, but as a separate item instead of being a sub-item to the SCF. Any agenda item would need to advance discussions on how to track progress towards achieving Article 2.1c, since the enhanced transparency framework (ETF) does not require any reporting and, consequently, no system on tracking Article 2.1c has been established.

- **Clarifying the relationship between the post-2025 target and Article 2.1c:** COP26 marks the starting point on negotiations of a post-2025 goal.[4] At the start of this process, the relationship between the provision of climate finance and Article 2.1c should be addressed. Parties should reach a common understanding as soon as possible that obligations under Article 9 prevail and are not touched by Article 2.1c. The subsequent process should determine how Article 2.1c relates to the post-2025 goal and additional requirements beyond the volume of finance provided, such as a requirement that public financial institutions remove any support for activities not consistent with the goals of the Paris Agreement by a certain date.

- **Preparations of the first GST:** The information collection and preparation will commence at the subsidiary bodies (SB) session in November 2021.[5] Apart from the inputs provided through the SCF's BA, a start should be made to collect additional sources of information for assessing Article 2.1c as part of the GST and determine how to address questions such as defining a baseline for measuring progress. The co-facilitators of the technical assessment component of the GST could provide suggestions on the organization of tracking Article 2.1c to steer Parties' attention towards this need.

3 Ibid.
4 See CFAS (2020a).
5 See UNFCCC (2021).

1. Introduction

At the 21st Conference of the Parties (COP21) in Paris, Parties agreed to three long-term goals, one of which highlights the role of finance flows in achieving climate objectives. This is defined in Article 2.1c of the Paris Agreement. By defining consistency of finance flows with climate objectives as a central issue, this goal adds a systematic and long-term perspective that goes beyond "climate finance," which thus far has been the main focus of finance considerations under the United Nations Framework Convention on Climate (UNFCCC).

"This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:

a. *Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;*

b. *Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production; and*

c. *Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."*

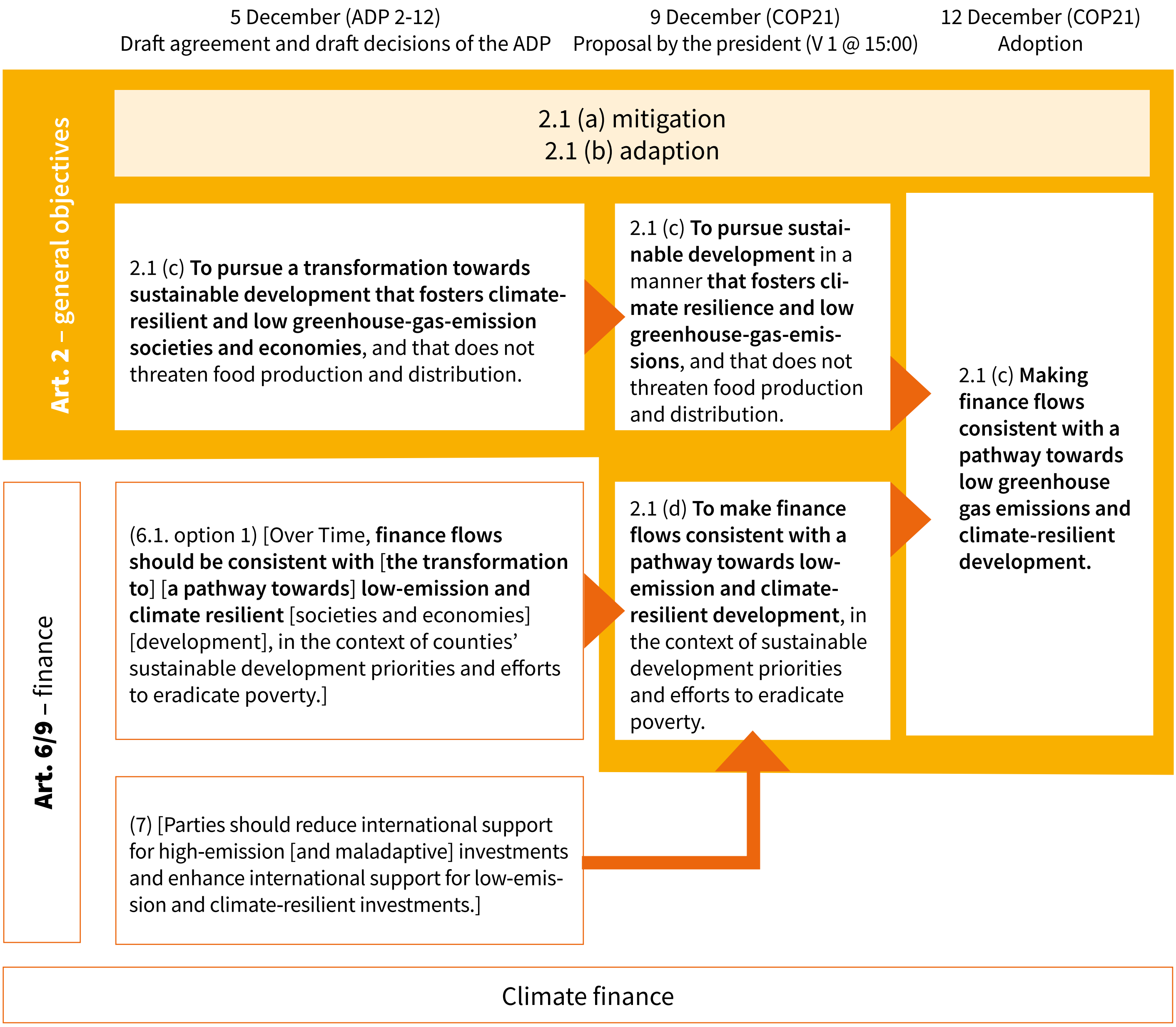
Source: Article 2, paragraph 1 of the Paris Agreement

Since the adoption of the Paris Agreement, different actors have undertaken efforts to operationalize progress toward the goal of Article 2.1c. However, there is still a lack of common understanding about the meaning and the implications of implementing Article 2.1c. This policy brief introduces Article 2.1c and highlights its relevance for different processes under the UNFCCC. In addition, it maps the potential challenges in implementing the article and provides recommendations on how to move forward.

1.1. Article 2.1c and its rationale

Article 2.1c is a complex goal which evolved during the COP21 negotiations to accommodate interests of different negotiation groups (see figure 1).[6] It is one of the three long-term goals of the Paris Agreement, as well as a means for achieving the other two long-term goals of mitigation and adaptation. Under the UNFCCC, references to "finance" so far have focused on finance flows from developed to developing countries with climate objectives, referred to as climate finance.[7] This is a crucial process for realizing mitigation and adaptation goals, however Article 2.1c recognizes the need for a more systematic shift of finance flows. "[M]aking finance flows consistent" with the goals of the Paris Agreement includes, but goes beyond, climate finance. It relates to all public and private financial flows, both national and international, including financial instruments such as bonds, insurances and equity.[8]

Figure 1: The evolution of Article 2.1c during COP21



Source: Based on Zamarioli et al. (2021)

6 See Zamarioli et al. (2021).
7 See CFAS (2020b).
8 See Draft of Fourth BA.

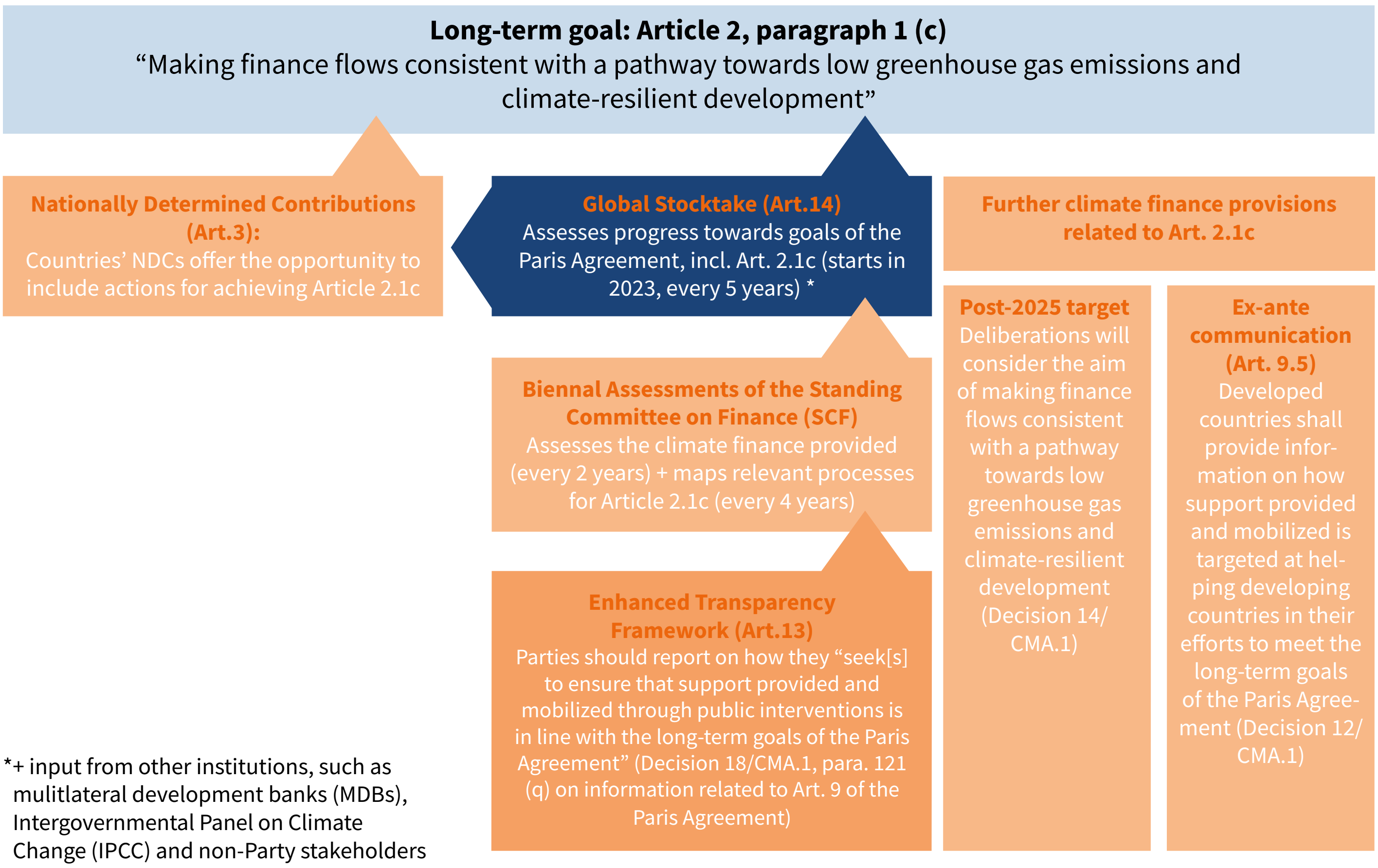
The scope of Article 2.1c offers transformational potential.[9] In 2019, global financial assets amounted to USD 378.9 trillion.[10] In comparison, the Biennial Assessment and Overview of Climate Finance Flows (BA) of the Standing Committee on Finance (SCF) reports that a total of just USD 746 billion in investments had a positive climate relevance in 2018 globally.[11] Climate finance flows provided and mobilized from developed countries reached only USD 79.6 billion in 2019.[12] These numbers indicate the scale of the challenge, as well as the opportunities that could arise if all financial flows, not just climate finance, are made consistent with climate objectives.

To be able to assess the consistency of all finance flows with the Paris Agreement, they need to be categorized as consistent or inconsistent (or neutral). This is a complex task which has to account for the technological and political context, and will need to be updated regularly to represent technological advantages and price changes.[13] Providing this kind of transparency would enable decision-makers to create policies that support the shift away from inconsistent activities and foster investments in activities that contribute to climate objectives. A clear policy environment, in turn, will guide financial decisions of public and private actors. In this way, capital can be allocated to "manage risks and seize opportunities in the transition to net zero."[14]

1.2. Relevance of Article 2.1c for different processes under the UNFCCC and the Paris Agreement

Article 2.1.c relates to multiple processes under the UNFCCC and the Paris Agreement (see figure 2), including the work of the SCF through its BA, Article 14 (the Global Stocktake), Article 9 (provision and mobilization of finance), Article 3 (Nationally Determined Contributions), and Article 13 (the Enhanced Transparency Framework).

Figure 2: Relevance of Article 2.1c to other Paris Agreement and UNFCCC processes



Source: Authors

9 See Zamarioli et al. (2021).
10 See OECD (2020).
11 See Draft Fourth BA. Note: These include public and private finance flows.
12 See OECD (2021a).
13 See OECD (2019a).
14 See Rydge (2020).

BA of the SCF. Currently, the central institution for the COP to provide information on Article 2.1c is the SCF. The first report was published in 2014. In 2018, at COP24, the SCF was mandated to "map, every four years, as part of its biennial assessment and overview of climate finance flows, the available information relevant to Article 2, paragraph 1(c), of the Paris Agreement."[15] A first comprehensive chapter on Article 2.1.c is included in the fourth BA in 2021 (chapter 4). It includes an overview of relevant actors and initiatives, and also identifies gaps and needs to make finance flows consistent with the Paris Agreement. Instead of providing a comprehensive overview, the first edition of the chapter serves as a starting point. Whether the BA of the SCF will continue to be the (only) institution to cover information on Article 2.1c is still to be seen.

Article 14. The results of the BA will also feed into the Global Stocktake (GST, Article 14) taking place in 2023 for the first time.[16] The GST provides an overall assessment process of the progress made towards achieving the Paris Agreement goals, including Article 2.1c. It will take place every five years and rely on a range of inputs. These inputs will likely include information from outside of the UNFCCC process.[17] This would be particularly important for tracking progress towards Article 2.1c, since finance flows involve a range of public and private actors, and many are already developing tools to ensure consistency with the goals of the Paris Agreement. The Global Stocktake in 2023 should, in turn, help Parties to improve their new nationally determined contributions (NDCs) in the next round in 2025.

Article 9. The provision and mobilization of climate finance by developed to developing countries is referenced in Article 9 of the Paris Agreement. To assess the progress on climate finance, Article 9 of the Paris Agreement requests developed countries to:

- Article 9.5: "biennially communicate indicative qualitative and quantitative information" on climate finance *(ex ante finance)*; and

- Article 9.7: "provide transparent and consistent information on support for developing country Parties provided and mobilized through public interventions" *(ex post finance)*.

Other countries are encouraged to do the same. At COP24 in Katowice, Parties negotiated what kind of information should be reported and agreed to "provide information on how support provided and mobilized is targeted at helping developing countries in their efforts to meet the long-term goals of the Paris Agreement, including by assisting them in efforts to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."[18]

At COP15 in Copenhagen, developed countries committed to mobilize USD 100 billion a year by 2020.[19] OECD data suggests that in 2019 more than USD 20 billion was still missing to achieve the target.[20] Negotiations on the new collective quantified post-2025 goal are to be initiated at the third meeting of the Parties to the Paris Agreement at COP26 in Glasgow (CMA3). The Katowice decision on the new goal[21] explicitly stated that the deliberations should consider "the aim to strengthen the global response to the threat of climate change in the context of sustainable development and efforts to eradicate poverty, including by making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."[22]

Thus, climate finance from developed countries is one crucial aspect for achieving consistency of finance flows with climate objectives. In addition to direct project support, capacity building and creating a supportive policy environment for structural reforms towards Article 2.1c can contribute to necessary shifts.[23]

Article 3: Article 3 of the Paris Agreement notes the relevance of Parties' NDCs for Article 2.1c. Parties "are to undertake and communicate ambitious efforts [...] to achieving the purpose of this Agreement as set out in Article 2." Therefore, NDCs, which are supposed to be submitted every five years, offer an opportunity to include measures and policies that support financial flows consistent with climate objectives.

15 See UNFCCC Decision 4/CP.24, para.10.
16 See UNFCCC Decision 19/CMA.1, para 36.
17 See Whitley et al. (2018).
18 See UNFCCC Decision 12/CMA.1, Annex (m).
19 See UNFCCC Decision 2/CP.15.
20 See OECD (2021a).
21 See UNFCCC Decision 14/CMA.1.
22 See CFAS (2020a).
23 Ibid.

Example: Antigua and Barbuda's NDC

In their updated NDC from 2021, Antigua and Barbuda included a conditional finance target, specifically referring to Article 2.1c of the Paris Agreement:

» A legal and technical framework via regulations is agreed as an enabling environment to support the national alignment of all finance flows with a low greenhouse gas emissions, climate resilient development pathway (i.e. achieving Article 2(1)(c) of the Paris Agreement).

Article 13. The enhanced transparency framework (ETF) under the UNFCCC (Article 13) lays out key sources of information provided by Parties to assess the progress of NDCs. In the Katowice climate package[24], Parties agreed to a framework of modalities, procedures and guidelines (MPGs) that apply to all Parties, but also leaves flexibility to developing countries.[25] Paragraph 121(q) of the MPGs refers to the long-term goals of the Paris Agreement, including Article 2.1c ("How it seeks to ensure that support provided and mobilized through public interventions is in line with the long-term goals of the Paris Agreement").[26] From 2024 onwards, countries will have to submit Biennial Transparency Reports (BTR) which will include, among other things, information on finance and support provided by developed countries and finance needs of developing countries. The ETF will also be an important source to inform the Global Stocktake.

2. Interpretations of Article 2.1c

Apart from its phrasing in the Paris Agreement ("[m]aking finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"[27]), there is currently no official definition nor more detailed description of Article 2.1c. Moreover, there is no dedicated work stream within international climate change negotiations to arrive at a definition nor an approach to assessment of Article 2.1c. However, the need for guidance on Article 2.1c is becoming increasingly evident given the task of measuring progress towards the objective (e.g. as part of the first GST in 2023) and the need to hold Parties (or related actors) accountable for their supportive and non-supportive actions.

Mapping of relevant information by the SCF

Looking at existing processes and bodies under the UNFCCC and the Paris Agreement that are relevant to 2.1c (see figure 2), the strongest input on its interpretation is currently coming from the SCF. Although the SCF has been tasked with mapping potentially relevant information, it has been repeatedly emphasized in SCF meetings that its mandate refers to an open, non-exclusive mapping exercise and that the exercise is not a process leading towards a common, official definition of Article 2.1c.[28]

In relation to climate finance, the SCF has been given the role of guiding institution in defining the term in relation to tracking climate-related financial sources under the UNFCCC, the main task of the BA. To date, this process has not led to an official definition of climate finance, but rather a working definition and an ongoing process on how to improve the term's assessment. The work on Article 2.1c could build upon these experiences. However, the scope of Article 2.1c goes beyond that of climate finance (see table 1) and involves other financial flows that would have to be assessed against their supportive or non-supportive role toward the goals of the Paris Agreement.

Preparation of the first GST

While the SCF is going ahead with its mapping exercise, the GST represents the forum in which progress on Article 2.1c, as well as other objectives, will be discussed.[29] Since the GST is a new format, with the first edition to take place in 2023, its implementation is currently still in preparation. In September 2021, a revised non-paper was published by the Chairs of the SBSTA and the SBI to assist Parties and other stakeholders in their preparation for the first GST.[30] The non-paper includes organizational information as well as guiding questions for all components of the GST. Related to Article 2.1c, it includes the questions of what evidence and methodologies exist for

24 See UNFCCC, Decision 18/CMA.1, Annex.
25 See UNFCCC (n.d.b.).
26 See UNFCCC Decision 18/CMA.1., Annex, para.121(q).
27 See UN (2015), p. 3.
28 See UN Climate Change n.d., Note: Recordings of the past SCF meetings are available on the YouTube Channel of the UNFCCC Secretariat.
29 See UNFCCC (n.d.c).
30 See UNFCCC (2021).

Table 1: Respective scopes of Article 2.1c-related and climate finance tracking

Scope of climate finance tracking	Finance to activities aimed to contribute to climate objectives	Scope of Article 2.1c-related finance tracking
	Finance to activities with climate-related co-benefits	
	Finance to activities with no particular climate-related impact	
	Finance to activities that undermine climate objectives	

Source: Based on OECD 2019

taking stock of its implementation and what data is available based on this. It does not provide a framework or an exemplary list of relevant sources to be considered. It calls upon the co-facilitators of the GST to provide a clearer narrative for each of the GST's elements.[31]

The current efforts by the SCF to map relevant information and the early preparatory stage of the GST shows that there is still a lot of room for interpretation in relation to Article 2.1c. On the one hand, this is an acknowledgement of its complexity. On the other hand, it raises the question as to how its implementation and the related assessment can be undertaken in a thorough manner. To get a better idea of the underlying challenges in interpreting Article 2.1c, the following sub-chapters will address two relevant elements, namely actors and activities.

2.1. Actors

While Parties, meaning country governments, are signatories to the Paris Agreement, the phrasing of Article 2.1c involves the general term "financial flows,"[32] implying that this involves all actors, public and non-public, with a role in managing and distributing financial resources.[33] This means governments would be primarily responsible for ensuring the implementation of Article 2.1c, while a much wider group of stakeholders will actually create the "real-world impacts."[34] Public institutions could take leadership in implementing the goal by: aligning their own financial activities (e.g. government budgets); creating an enabling environment (e.g. through financial policies and regulation); and aligning financial activities within their sphere of influence (e.g. public finance institutions such as Development Finance Institutions [DFI]).[35] In the case of DFIs, according to available data, this has already started to happen. For example, the 2018 BA states that DFIs "adopted several tools and criteria for making finance consistent with mitigation and adaptation objectives" (e.g. positive lists with investment priorities, negative lists with sectors excluded from financing, and quantitative conditions such as emissions intensity of investments in the power sector).[36] Information compiled by the Climate Policy Initiative (CPI) also confirms that public finance institutions have started to take a proactive role.[37] While progress is being made, the 2018 BA also found that public finance institutions, including DFIs, still finance activities related to fossil fuels.[38] Multilateral development banks (MDBs) alone provided USD 3 billion in support for fossil fuels in 2020.[39]

For their part, private sector actors are also moving ahead with initiatives, such as the International Investors Group on Climate Change (IIGCC) and its Paris Aligned Investment Initiative (PAII), which represents investors managing USD 33 trillion in assets. The IIGCC provides its members with a platform for discussing capital allocation decisions in light of climate change and for reaching out collectively to other stakeholders, such as policymakers.[40]

31 Parties were encouraged to nominate co-facilitators until August 2021. Till September 2021, developed country Parties nominated Mr. Farhan Akhtar from the United States, while there was not yet a nominee for developing countries at that point in time (UNFCCC 2021).
32 See UN (2015), p. 3.
33 See SCF (2019), p. 45ff.
34 See Bodle/Noens (2018), p. 253.
35 See Whitley et. al. (2018), p. 12.
36 See SCF (2019), p. 48.
37 See CPI (2019), p. 28f, Note: CPI says that DFI could go even further by, for example, also examining their partnerships with the private sector.
38 See SCF (2019), p. 105.
39 See IISD (2021).
40 See IIGCC (n.d.).

Governments are also playing a role in providing guidance and contributing to the harmonization of approaches taken by actors. One example is the Coalition of Finance Ministers for Climate Action, which brings together fiscal and economic policymakers from 65 countries. The Coalition has identified a range of activities for finance ministries to support the alignment of finance flows with the Paris Agreement, including awareness-raising within the financial sector about tools and methodologies; encouraging system-wide sustainability and climate initiatives; and setting up monitoring mechanisms.[41]

2.2. Activities

To become active on Art 2.1c, it is necessary for both public and private sector actors to understand what activities could be relevant. Does it mean climate-proofing all financing related activities and, if so, how? Does it mean completely divesting from activities that are not consistent with climate objectives, including fossil fuel subsidies? Does it mean proactively influencing financing towards climate action (e.g. increasing the overall financing volume for such projects compared to projects targeting other impacts)? So far, the range of activities and the minimum requirements they must fulfil has yet to be clarified by UNFCCC Parties, who agreed upon this long-term goal. While this flexibility reflects the long-term vision of Article 2.1c (i.e. relevant activities could change over time) and the need to take into consideration different circumstances and pathways of countries or actors, a lack of guidance on which activities to prioritize or which requirements to set, can also lead to a choice for less ambitious actions.

Based on the phrasing of Article 2.1c, "financial flows" are the subject matter and the goal of the activities should be to ensure "consisten[cy] with a pathway towards low greenhouse gas emissions and climate-resilient development."[42] The word pathway implies that there are multiple ways of achieving the goal, without including or excluding specific activities, and that there is a wider spectrum of ambition connected to these activities. This refers to potential conflicts between climate and development goals that are currently being addressed through transition strategies, e.g. the reliance on fossil fuels of some countries makes it more difficult for them to enable the shift to renewable sources due to economic and social implications. This has already led to debates outside the UNFCCC context, for example, among financial sector actors (i.e. banks, institutional investors) about what Paris Agreement alignment (or misalignment) means[43] and whether "transition finance" could also be counted towards the objective.[44] Meanwhile, some government efforts have been directed toward development of classification systems, with the EU taxonomy for sustainable activities being the most prominent example.[45]

Within the UNFCCC context, the SCF provided an initial overview of "emerging practices and metrics" that could be of relevance for Article 2.1c in its 2018 BA report.[46] This overview focused on financial sector actors' and their instruments (i.e. bank lending, bond markets, listed equity, private equity, insurance and reinsurance, assets under management, financial services). It included data on financial flows and stocks consistent with low greenhouse gas emissions and climate resilient pathways, as well as information on the integration of climate considerations in decision-making. The comprehensive chapter on Article 2.1c in the 2020 BA report broadens its scope, also taking into account, for example, actions by public sector actors and initiatives involving cooperation between public and private sector actors.[47]

3. Potential implications of implementing Article 2.1c

Against the background of uncertainty about the interpretation of Article 2.1c, this chapter sheds light on the potential implications of implementing Article 2.1c. The identified topics have been derived from a roundtable discussion which was organized as input into this policy brief (held virtually and using Chatham House Rules). The roundtable involved negotiators from both developed and developing country constituencies. The goal of this chapter is to provide an overview of the most pressing issues to be addressed in further discussions on the implementation of Article 2.1c.

41 See The Coalition of Finance Ministers for Climate Action (2021a), p 10.
42 See UN (2015), p. 3.
43 See The Coalition of Finance Ministers for Climate Action (2021b).
44 See Tandon (2021).
45 See European Commission (2021).
46 See SCF (2019), p 45ff.
47 See UN Climate Change (n.d.), Note: On 2 September, a virtual stakeholder dialogue on the latest status of reports to be developed by the SCF, including the BA, took place.

3.1. Defining Article 2.1c

It has already been noted that the absence of a clear definition of Article 2.1c is a challenge for actors aiming to implement, or work towards implementation, of the article. But the process of deriving a common definition of Article 2.1c is a challenge in and of itself. Lessons learned in this regard could be drawn from the issue of finding a common definition for climate finance among Parties to the UNFCCC, which to date has not happened. The definition of climate finance applied by the SCF is a so-called working or operational definition. For each new BA, the SCF provides an overview of the definitions applied by different actors.[48] This raises the question as to whether the different views of Parties could be aligned for a more detailed definition of Article 2.1c.

The variety of views on the meaning and implications of Article 2.1c relates to the fact that Parties find themselves in different circumstances, economically and socially. The different perspectives revolve around the question of suitable activities (e.g. whether fossil fuel activities by financial actors should cease immediately or continue for a while for development purposes). While certain economies may easily shift or are already on a low-carbon pathway, others struggle with transitional challenges related to development aspects, such as securing employment opportunities ("just transition") or counting on royalties from extracting fossil fuels for state budgets. Looking at the process of developing the EU taxonomy shows that finding an agreement on relevant activities even among actors in a relatively comparable economic situation can be a big challenge (e.g. reflected in the intense debate around including natural gas).[49]

Lastly, aligning all financial flows requires private sector actors to take a more active role in steering their financial resources, beyond just the private sector activities that are mobilized through public climate finance. Within the process of finding a definition of Article 2.1c, whether and how non-UNFCCC actors could or should be considered would have to be discussed.

If Parties decided to refrain from developing a common definition for Article 2.1c, a way to provide guidance towards its implementation and related measurement could be starting an open collection of relevant activities with the option to discuss a potential prioritization of actions for a specific timeframe. However, to launch any discussion on such a process would depend on the availability of the respective forum or workstream to deal with such questions. It could be part of the negotiations or addressed by a process on the sidelines, such as the Talanoa Dialogue, and could enable strong engagement by non-Party stakeholders.[50] At the moment, Article 2.1c is mainly integrated into other processes (e.g. under the SCF mandate or the GST). Parties to the UNFCCC would need to decide whether this topic should receive a higher level of attention.

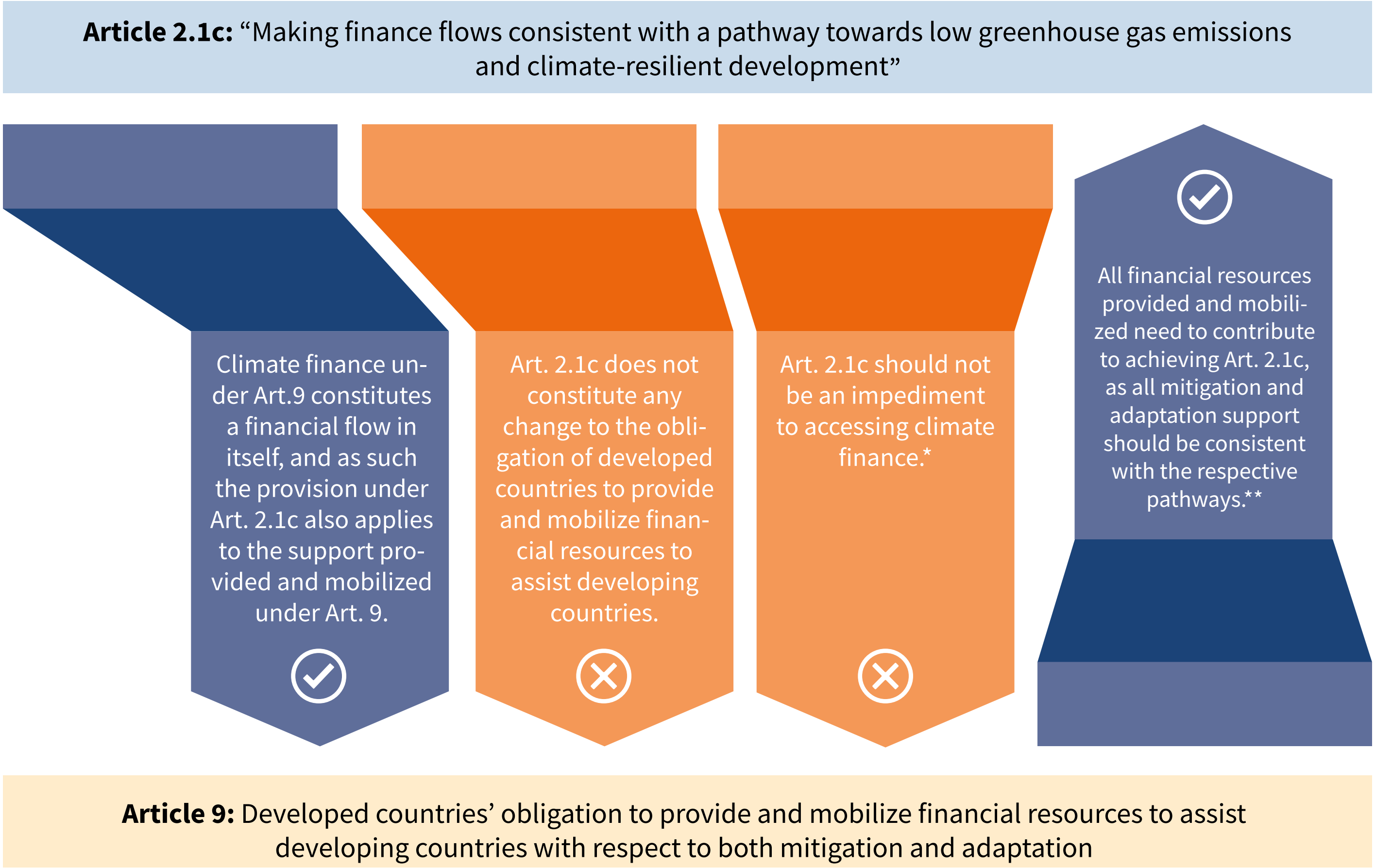
3.2. Impacts on international (climate) finance flows

The link between Article 2.1c and Article 9 is one of the most debated issues and is rooted in the evolution of Article 2.1c. As figure 1 shows, the reference to consistent finance flows was moved from the finance section (Article 6/9) to a general goal (Article 2) during the negotiations. Therefore, interpretations of negotiators on how these two articles relate to each other range from Article 9 having no relation to Article 2.1c to Article 9 as inherently part of Article 2.1c, since it also concerns financial flows. As mentioned above, Article 2.1c refers to *all* finance flows, not only the ones from developed to developing countries in accordance with Article 9. Although the two articles have to be differentiated in terms of their scope, aim and responsibilities, there are links that have to be considered to increase synergies and reduce potentially negative effects in the implementation of both articles (see figure 3).

Most importantly, developing countries are concerned that increasing attention on Article 2.1c could lead developed countries to neglect their obligations under Article 9. This stems from the different views on the extent to which Article 9 is part of Article 2.1c. Clarifying the differences in obligations and assessing the relationship between Article 9 and Article 2.1c more thoroughly could help to reduce these concerns. It should be communicated very clearly that developed countries obligations under Article 9 to provide and mobilize climate finance to developing countries will in no way be reduced with the implementation of Article 2.1c. As climate finance flows are finance flows to be considered under Article 2.1c, these flows also need to be consistent with the goals of

48 See SCF (2019) for the latest overview.
49 See European Commission (2021), Euractiv (2021).
50 See UNFCCC (n.d.d.).

Figure 3: Potential links between Article 2.1c and Article 9



* As long as the entity displays a plan to make its portfolio progressively consistent with low GHG emissions and climate-resilient development pathway.

** This also entails resources that indirectly contribute to achieving Article 2.1c, by e.g. supporting the greening of the financial sector.

Source: Authors

the Paris Agreement. With the post-2025 target negotiations yet to start, these concerns should be addressed at the outset of the talks to avoid confusion and corresponding tensions in the negotiations.

Another potential implication of the implementation of Article 2.1c concerns access to finance for developing countries. If the consistency of activities with climate objectives becomes a prerequisite to access finance from multilateral climate funds (as has been suggested in the GCF re-accreditation processes of the Development Bank of Southern Africa[51]), this would pose a challenge for many countries. Funds for climate action are already contested, while access to climate finance for developing countries is crucial for building resilience and meeting mitigation targets.[52] Thus, rejecting access to finance for these countries based on Article 2.1c risks inhibiting their transformation to low-carbon and climate-resilient development, which needs to be avoided. These funds should be used to support countries’ activities towards achieving Article 2.1c, as well as to support institutions channeling the funds to accelerate their portfolio transition.

Similarly, transparency on climate risks could inhibit international investments from already financially strapped and particularly vulnerable countries.[53] The risks of investing in climate vulnerable countries might become too high for many investors as they increasingly factor in climate risks, resulting in an increased cost of financing.[54] This would make

51 See Climate Home News (2021).
52 See CFAS (2021b).
53 See Zamarioli et al. (2021).
54 See Volz et al. (2020).

international financial support by public institutions critical for reducing the additional financial burden (associated with climate-induced increases in capital costs) that could face the most climate vulnerable countries.

3.3. Pathways

The reference of "[...] *pathway* towards low greenhouse gas emissions and climate-resilient development" in Article 2.1c is another formulation that leaves room for debate. There is no one clear pathway, but rather many different pathways that can be used to assess consistency of activities with the goals of the Paris Agreement. National or sectoral pathways, for example, can be used to derive benchmarks and compliance and exclusion lists that help categorize activities.[55] The taxonomy of the EU presents one example for such an exercise.[56]

The wording was also chosen to reflect different country contexts. Many countries fear that a fast transition towards low-emissions will hold back their economic and social development. Particularly countries with high shares of fossil fuels in their energy mix are concerned by this and highlight the "principle of common but differentiated responsibilities and respective capabilities, in light of different national circumstances," which was reiterated in Article 2.2 of the Paris Agreement. Countries' dependence on fossil fuels poses challenges that have to be managed carefully. For example, countries are generating important tax revenues from fossil fuel industries, which are difficult to replace. However, fossil fuels are also strongly subsidized by governments across the world. The G20 alone provided over USD 584 billion in support (e.g. price support, direct budget transfers and tax expenditures) of fossil fuels (annual average between 2017-2019).[57] This skews the real costs of fossil fuels. These financial flows would need to be redirected to implement Article 2.1c, which could in turn help to buffer declining tax revenues from fossil fuels. Next to financial concerns, social issues, particularly potential job losses within fossil fuel industries, inhibit policymakers from taking stronger action. Discussions around the implementation of Article 2.1c should therefore consider how to make the transition pathway as just and equitable as possible for all parts of the population.

Given the variety of pathways, more guidance is needed on which pathways are suitable to be considered consistent with the Paris Agreement. It should be clarified that pathways have to be compatible with the 1.5°C temperature goal and should be country-specific. For example, the World Energy Outlook of 2021 (WEO) by the International Energy Agency (IEA) outlines a pathway to achieve an energy transition compatible with a 1.5°C warming.[58] The WEO21 points out that policy and regulatory reforms in combination with climate finance commitments by developed countries and public financial institutions will be necessary to push the transition forward.

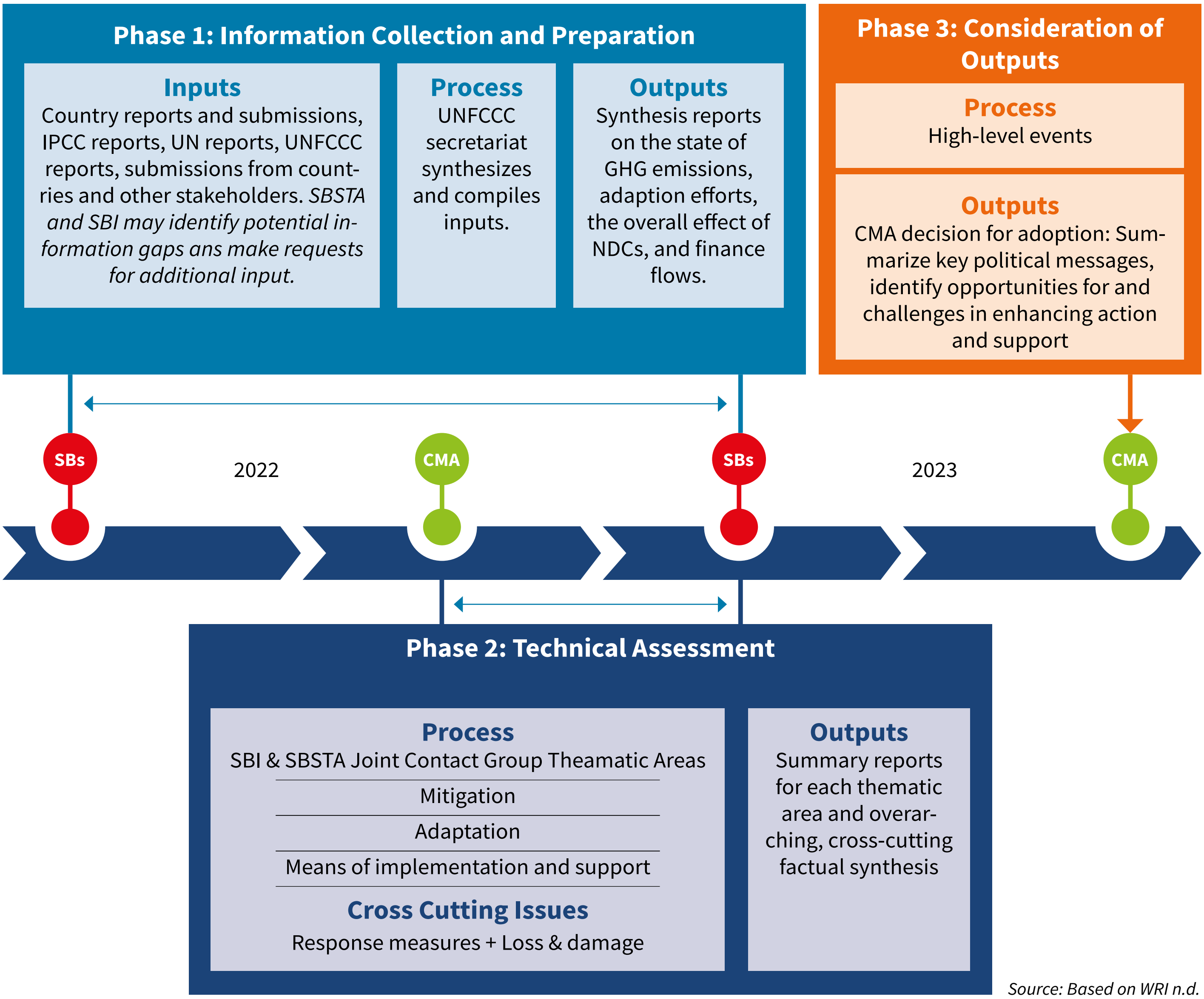
3.4. Tracking progress towards 2.1c

Progress on implementing Article 2.1c, among other objectives of the Paris Agreement, will be presented and discussed at the first GST in 2023 (see figure 4). Although the UNFCCC has much experience in providing guidance on different reporting formats, reporting in relation to Article 2.1c has yet to be defined. According to the latest guidance on the GST, the non-paper by the SBSTA and SBI chairs, the process of collecting methodologies and relevant data has yet to start. The relative openness to interpreting Article 2.1c implies that reporting on Article 2.1c could be similarly open. It could entail assembling a wide variety of quantitative and qualitative sources. Guidance would therefore be needed on how to define and measure progress, including the question of what constitutes a baseline.

It is not currently clear what types of sources will be considered for gathering relevant information. Generally, the Enhanced Transparency Framework (ETF) will provide for a breadth of information; yet, the ETF does not foresee Parties to report their progress towards achieving Article 2.1c.[59] Moreover, the GST is meant to focus on a global assessment, and not on country-specific information[60]. Currently, the SCF has been put in the position of delivering an initial mapping of relevant information on Article 2.1c as a chapter in its upcoming BA. The decision on the GST mentioned the SCF's BA as a necessary source to be considered.[61] However, it is open to discussion if this is to be seen as the only starting point for the framework of tracking Article 2.1c. The discussions in the SCF on the draft BA revealed that there are still diverging views on Article 2.1c, including on what data is to be collected and how to interpret or present it.[62] ***(Figure 4)***

55 The Fourth BA (2021) names various examples of what could be used as a pathway. The OECD (2021b) maps several initiatives (taxonomies, guidances and principles) of public and private actors for transition finance.
56 See European Commission (2021).
57 See IISD (2020).
58 See IEA WEO (2021).
59 See UNFCCC (2020).
60 See UNFCCC Decision 19/CMA.1.
61 See UNFCCC Decision 19/CMA.1, p. 57.
62 See recordings of 2021 SCF meetings on UN Climate Change n.d. or summaries of past SCF meetings at CFAS (2021a).

Figure 4: Timeline for the first GST in 2023



Source: Based on WRI n.d.

4. Recommendations

While the phrasing of Article 2.1c appears to be relatively simple, its implications could be far reaching – perhaps even leading towards a climate-friendly transformation of global finance.[63] However, a closer look at uncertainties around its interpretation, as well as different concerns and opinions about its implementation, reveals that some open questions may need to be resolved to realize the full potential of Article 2.1c. One driver for dedicating more attention to these questions is the integration of Article 2.1c within the reporting framework under the Paris Agreement, namely the upcoming GST in 2023. This process makes it necessary to engage more deeply with the question on how to assess progress towards Article 2.1c, indirectly touching upon the topics of its interpretation and implementation. Against this background, Parties are urged to identify a suitable process in which these questions could be addressed effectively, while at the same time accommodating varying opinions. The following section includes general recommendations on a way forward on Article 2.1c as well as suggestions on how to act on the topic within upcoming COP26 negotiations.

63 Zamarioli et. al. (2021).

4.1 General recommendations

Leadership on interpreting Article 2.1c: Parties that are eager to advance work on Article 2.1c need to take the lead in suggesting potential fora and elements to come to a joint interpretation, including consideration of the range of relevant actors and activities that play a role. Parties would need to decide whether to request other fora, e.g. the Standing Committee on Finance (SCF), to advance these questions or whether they prefer to negotiate the content as part of a new agenda item.

Involving non-Party stakeholders: Since non-Party stakeholders also play a crucial role in the implementation of Article 2.1c, Parties should decide whether to include these actors in a more structured way (e.g. an open platform) or continue playing a top-down role by guiding non-Party stakeholders only through regulation and incentives. Processes similar to the Talanoa Dialogue or the long-term finance workshops on the USD 100 billion goal could provide examples to build on.

Assessing the relationship between Article 9 and Article 2.1c: Reflecting upon the implications for the implementation of Article 2.1c has shown that its relationship with financial flows referred to as climate finance needs to be defined more clearly.[64] This relates to several processes under the UNFCCC and Paris Agreement, particularly processes on: the provision of climate finance as support for developing countries (Article 9); the potential implications for accessing climate finance (e.g. provided through the Financial Mechanism); and the process defining the new collective quantified post-2025 climate finance goal. The provision of climate finance remains an important building block for a collective approach within the climate crisis, alongside alignment efforts. Climate finance should act as a facilitator of Article 2.1c, for example by supporting countries in creating regulatory frameworks to advance Article 2.1c. At the same time, the general alignment of financial flows should not have negative implications on the volume and channels of direct support for climate actions provided to the most vulnerable countries.

Increasing support for the implementation of Article 2.1c: Article 9 constitutes an obligation for developed countries to provide and mobilize support for mitigation and adaptation. This support, which includes financial flows directed to climate mitigation and adaptation, will benefit the implementation of Article 2.1c. However, such support should be expanded for activities that not only explicitly support mitigation and adaptation, but are more directly linked to Article 2.1c, such as the strengthening of sustainable finance and associated regulatory measures that in turn foster investments in mitigation and adaptation actions. Moreover, to be able to report on progress on Article 2.1c, developing countries will require support to develop the capacities to track national progress. To kickstart the gathering of data and information, even in the absence of an established system to track Article 2.1c, developed countries should provide additional support for national Article 2.1c tracking, e.g. through additional resources outside the regular replenishment circle for the Global Environment Facilities (GEF) Capacity Building Initiative for Transparency (CBIT).

4.2 Recommendations for COP26 negotiations

Article 2.1c under the SCF agenda item: The results of the Biennial Assessment and Overview of Climate Finance Flows (BA), including the chapter on mapping information relevant to Article 2.1c, could be considered as a separate sub-item under the Agenda item relating to the report of the SCF, in the event that the current provisional agenda will be adopted.[65] Under this agenda item, Parties could, among other things, reflect upon the initial results of the mapping and on the approach taken by the SCF. Against the background of a lack of guidance on the interpretation of Article 2.1c, which has also become evident in discussing the draft BA within the past SCF meetings, the Parties could consider adding a mandate to the SCF to work on guidance on interpretation of Article 2.1c, or at least launch work on Article 2.1c under the SCF agenda item as part of COP26.

Introducing a separate agenda item for Article 2.1c: Instead of mandating the SCF, Parties could also decide on initiating a separate agenda item on Article 2.1c to enable a broader discussion on surrounding questions (e.g. data, methodology, support for collecting data on Article 2.1c, guidance to actors, involvement of non-UNFCCC actors).[66] While the provisional agenda does not include such an item, Parties could request to add an agenda item on Article 2.1c to

64 Climate finance is defined according to the SCF in their BA as “flows whose expected effect is aimed at reducing emissions or enhancing sinks of GHG, and/ or reducing vulnerability of and maintaining and increasing the resilience of human and ecological systems to negative climate change impacts.” Draft Fourth BA, 2021.

65 See UNFCCC (n.d.a.).

66 Ibid.

67 See CFAS (2020a).

the supplemental agenda prior to COP26. If Parties reached consensus, this would allow work on Article 2.1c to already start at COP26. This agenda item could be placed under the CMA, for example under “8. Matters relating to finance”, where the report from the SCF is also placed, but as a separate item instead of being a sub-item to the SCF. Any agenda item would need to advance discussions on how to track progress towards achieving Article 2.1c, since the enhanced transparency framework (ETF) does not require any reporting and, consequently, no system on tracking Article 2.1c has been established.

Clarifying the relationship between the post-2025 target and Article 2.1c: COP26 marks the starting point on negotiations of a post-2025 goal.[67] At the start of this process, the relationship between the provision of climate finance and Article 2.1c should be addressed. Parties should reach a common understanding as soon as possible that obligations under Article 9 prevail and are not touched by Article 2.1c. The subsequent process should determine how Article 2.1c relates to the post-2025 goal and additional requirements beyond the volume of finance provided, such as a requirement that public financial institutions remove any support for activities not consistent with the goals of the Paris Agreement by a certain date.

Preparations of the first GST: The information collection and preparation will commence at the subsidiary bodies (SB) session in November 2021.[68] Apart from the inputs provided through the SCF’s BA, a start should be made to collect additional sources of information for assessing Article 2.1c as part of the GST and determine how to address questions such as defining a baseline for measuring progress. The co-facilitators of the technical assessment component of the GST could provide suggestions on the organization of tracking Article 2.1c to steer Parties’ attention towards this need.

68 See UNFCCC (2021).

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