Portfolio Carbon Initiative

Acting as market makers, capital providers, and advisers, financial institutions (FIs) are important actors in the shift to a low-carbon economy. As providers of debt and equity, capital financial institutions can be considered potential financiers, and hence key enablers, of the transition to the low-carbon economy. Additionally, the transition to a low-carbon economy will make GHG emissions increasingly costly and thus carbon-intensive assets increasingly risky—this will expose financial institutions to such risks within their lending and investment portfolios.

Against this background, it is clear that financial institutions (including institutional investors) and their stakeholders (including depositors, beneficiaries, regulators, and the general public) have an interest in understanding both the carbon risk exposure of financial institutions as well as their alignment with the low-carbon economy.

At present, however, many financial actors only calculate and report GHG emissions from their direct operations such as fuel and electricity use (Scope 1 and 2) and very limited additional information on the climate-related implications of their investments and investment portfolios. For more than ten years, companies in many sectors have relied on the GHG Protocol Corporate Standard for guidance on accounting and reporting of GHG emissions, and over 70% of survey respondents from the finance sector used GHG Protocol to report their scope 1 and 2 emissions to the Carbon Disclosure Project (CDP) in 2014. Yet this reporting says little about FIs’ full climate change impacts, the financial risks that result from them, and whether their practices are aligned with the low-carbon economy.

To address this concern, several banks, asset managers and NGOs have started to develop and test accounting methodologies for ‘financed GHG emissions’ (emissions related to financial assets held). In late 2011, the GHG Protocol released the Corporate Value Chain Accounting and Reporting Standard (the Scope 3 Standard). This standard provides a framework to account for emissions from an organization’s entire value chain, including the emissions from its investments. However, feedback from stakeholders suggested that more detailed guidance was needed to cater to the realities and needs of the finance sector and to harmonize the various existing approaches. During a year-long scoping phase, and with input from an Advisory Committee, it was determined that the financial sector needed guidance on two distinct but interlinked challenges:

- In order to provide harmonized and meaningful emissions disclosure, financial institutions need accounting guidance on how to measure and report emissions from their financial assets.

- Financial institutions need guidance on how to identify, assess, and manage ‘carbon asset risks’ in their lending and investing portfolios.

In response to these challenges, the United Nations Environment Programme Finance Initiative (UNEP FI) and the Greenhouse Gas Protocol (GHG Protocol) initiated the Financed Emissions Initiative project in early 2014, an international, multi-stakeholder process to enable practical, meaningful and actionable disclosure of financial institutions’ Scope 3 GHG emissions from lending and investing activities. The first six months of this process revealed several challenges, notably a lack of sufficient understanding and

1 CDP survey data, 2014
consensus as to which climate metrics are most meaningful, practical, and actionable for different purposes. The discussions also suggested that business goals related to accounting and reporting climate-related data can be very different from one type of financial institution to another (institutional investors as ‘universal owners’, development banks with an internal climate policy, asset managers facing marketing constraints and opportunities, commercial banks facing reputational challenges, etc.). Thus, a need emerged to tailor the guidance to different segments, or actors, of the financial system in order to develop a credible and consensus-driven global standard.

The rationale for tailored guidance

Since the launch of the UNEP FI/GHG Protocol process, a growing appetite has emerged for a robust and global standard for carbon footprinting by asset owners. The recent launch of the PRI Montreal Pledge and the Portfolio Decarbonization Coalition are cases in point. Despite this growing appetite to develop carbon footprinting guidance for institutional investors, the first six months of the process have shown that stakeholders in the process are divided over the practicality and meaningfulness of using the Scope 3 emissions concept to deliver transparency and disclosure to external stakeholders and shareholders.

In response to these divergent opinions and needs, GHG Protocol and UNEP FI will now facilitate 3 separate work streams: two focused on developing climate performance metrics\(^2\) for asset owners and banks, and a third continuing to develop guidance on assessing and managing carbon asset risks\(^3\).

These three work-streams will collectively develop 4 products through a multi-stakeholder process with balanced representation from financial sector companies, governments, environmental groups, academics and consultants across the globe. GHG Protocol and UNEP FI will team up with the 2\(^{o}\) Investing Initiative (2\(^{o}i\)) to develop 2 of these products and benefit from its research. Due to the expanded focus on a broad range of performance metrics, the process is being renamed the Portfolio Carbon Initiative.

The existing Advisory Committee and Technical Working Groups will be engaged in the development of all products.

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2 The concept of ‘climate performance’ relates to the contribution of a financial institution to financing the transition to a low-carbon economy.

3 The concept of ‘Carbon Asset Risk’ refers to the exposure of an investor or lender to the financial risks associated with the carbon emissions of the investee (e.g. exposure to potential new carbon or energy-related taxes).
Workstream 1: Asset Owner Climate Performance

Workstream 1 will build off the learnings of the process to date and deliver an evaluation of climate performance metrics, including recommendations for disclosure and target setting by institutional investors. This initial step will in turn inform an Asset Owners accounting guidance to standardize the accounting and reporting of climate performance by Asset Owners. It is intended that this assessment and guidance will directly inform current initiatives such as the Montreal Pledge and the PDC.

Figure 2: Workstream 1 timeline
Workstream 1 includes 2 key phases:

**Phase 1 – Comparative Analysis Report:** in partnership with 2° Investing Initiative, a report to investors will be delivered by Summer 2015 with a draft available by March 2015. The report will include an evaluation of currently available metrics by asset class, provide best-practices based on available data, and recommend the next steps to reach a science-based target setting and accounting framework. A primary goal of this phase one is to support interested investors in setting mitigation targets and responding to efforts such as the Montreal Pledge and the PDC. Metrics will be assessed using criteria such as practicality and meaningfulness. While the process will seek to establish as much agreement as is currently possible, where consensus is not possible the document will include an overview of divergent stakeholder opinions.

The process to develop the report will involve several steps, including desk research, targeted outreach with metrics and index providers, stakeholder workshops, and online surveys. The Technical Working Groups and Advisory Committee members will have several opportunities to provide input to the process, including reviewing outlines, attending workshops, and reviewing drafts of the report. The process will be coordinated with UN Principles for Responsible Investment (PRI), who will engage with current and potential signatories of the Montreal Pledge to get feedback on the analysis.

**Phase 2: Guidance:** Using the results from the report as a key input, guidance on standardized accounting and reporting of climate performance, including portfolio-carbon footprints, will be developed and delivered using the GHG Protocol inclusive, consensus-based process. The format of the deliverables and the schedule for this phase 2 will be defined based on the conclusions of phase 1, in coordination with the Advisory Committee.

**Workstream 2: Bank Climate Performance Metrics**

Similar to the asset owner report in Workstream 1, in Workstream 2 the initiative will produce a comparative analysis of climate performance metrics, building off the learnings of the 2014 TWG process and taking into account the specificities of the banking sector, notably in terms of availability of data and primary business goals of transparency and disclosure. This evaluation will also be developed in partnership with 2° Investing Initiative. The evaluation will primarily be based on a review of existing practices. Technical Working Group and Advisory Committee members will have several opportunities to provide input to the report development, including reviewing outlines, attending workshops, and reviewing drafts of the document. This report will build on the significant discussions to date in the UNEP FI/GHG Protocol process to provide a comparative assessment of the advantages and disadvantages of different climate performance metrics. It will be delivered by Fall 2015.

The potential development of guidance on reporting climate performance from banking activities will be considered after the drafting of the comparative assessment has been completed. Development of guidance will be subject to stakeholder interest and available resources.
Workstream 3: Carbon Asset Risk

Continuing on from the first phase of the UNEP FI/GHG Protocol process, Workstream 3 will develop carbon asset risk (CAR) management guidance that will address the questions of why and when GHG emissions associated with carbon-intensive assets lead to financial risks, as well as how these risks can be assessed and mitigated.

The carbon asset risk management guidance will create a practical framework to assess CAR and will help inform financial actors on their options in managing it. The CAR guidance will discuss several hotly debated questions such as: What types of risks are associated with carbon-intensive financial assets? Where are these risks located in lending and investment portfolios? What types of information need to be collected and analyzed to help determine the importance of such risks? What tools are available? What are effective and appropriate strategies to manage these risks?

Given that significant progress has already been made in discussing and writing the CAR guidance (a first draft was reviewed by technical working group members in September 2014), final guidance will be delivered by May 2015.

Governance
The governance structure associated with the UNEP FI/GHG Protocol financed emissions process consisted of an Advisory Committee and a series of Technical Working Groups delineated by investee classes (companies, governments, and consumers). Due to the recent emergence of the need to further tailor guidance to different financial actors, UNEP FI and GHG Protocol (in coordination with 2° Investing
In partnership with

GHG Protocol, UNEP-FI, PRI, banks, investors, governments, service providers, and NGOs.

GHG Protocol, UNEP-FI, 2°ii, PRI, banks, investors, governments, service providers, and NGOs.

GHG Protocol and UNEP FI will re-invite all participants to the Advisory Committee and TWGs, aiming for balanced representation by geographic location and organization type. The balanced representation of stakeholders, led by participation of financial actors, will ensure that the products developed will be practical, meaningful and actionable across all stakeholders, as well as accepted world-wide among financial practitioners.

**Project partners**

**Greenhouse Gas (GHG) Protocol**
GHG Protocol is the most widely used international accounting tool for government and business leaders to understand, quantify, and manage GHG emissions. It provides the accounting framework for nearly every GHG standard and program in the world – from ISO 14064 to CDP – as well as hundreds of GHG inventories prepared by individual companies world-wide. GHG Protocol has more than a decade of experience developing GHG accounting standards and guidance. GHG Protocol’s highly successful multi-stakeholder standard development process, combined with the GHG Protocol’s team of technical experts ensures high-quality publications and wide adoption.

**UNEP Finance Initiative (UNEP FI)**
UNEP FI is a unique public-private partnership between the United Nations Environment Programme and more than 200 financial institutions – insurers, investors, lenders – working to better align the operations of financial markets with sustainable development. Within a wide range of activities that span normative frameworks, policy dialogue, training, and research, UNEP FI develops practitioner guidance on the
integration of sustainability considerations into decision-making, including in the area of accounting and reporting. From 2003 to 2008, UNEP FI co-convened the process that developed the Reporting Guidelines and Financial Sector Supplement of the Global Reporting Initiative (GRI).

**2 degrees Investing Initiative (2DII)**

2°ii is a think tank working to align the financial sector with 2°C climate goals, via three work streams:

- Develop the metrics and tools to measure the climate performance of financial institutions;
- Study the barriers and potential drivers related to investment processes;
- Mobilize financial regulation and policy incentives to shift capital to energy transition financing.

2°ii was founded in 2012, is based in Paris and New York and has projects in Europe, China, and the United States. It is a non-profit company with 100 members in 12 countries, including financial institutions, governmental organizations, research organizations, NGOs and finance sector professionals.

**UN Principles for Responsible Investment (UN PRI)**

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system. The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.