Guidance for the financial sector: Scope 3 accounting and reporting of greenhouse gas emissions

Summary of Scoping Workshop

Hosted by JPMorgan Chase, New York, February 25, 2013

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Introduction

Greenhouse Gas Protocol and UNEP Finance Initiative have partnered to investigate the need and potential scope for financial sector guidance to account for greenhouse gas (GHG) emissions associated with lending, iinvestments and advisory services (collectively known as "financed emissions")[1].

As the first step in the scoping phase, interested stakeholders were invited to participate in an online survey to assist in assessing the need and content of new guidance. The survey ran from October to November 2012 and was open to any interested stakeholders. A separate report has been released that summarizes the results of the survey and is available to download from the GHG Protocol website.

As the second part of the scoping phase, two scoping workshops were held. The second of these scoping workshops was held in New York on February 25, 2013. This document provides a summary of the discussions and outcomes of that workshop in New York. The workshop agenda and presentations will also be made available to download from the GHG Protocol website. Another workshop was held in London in December 2012 and a separate summary of that workshop is also available from the GHG Protocol website.

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[1] For more background information visit: http://www.ghgprotocol.org/feature/financial-sector-guidance-corporate-value-chain-scope-3-accounting-and-reporting.

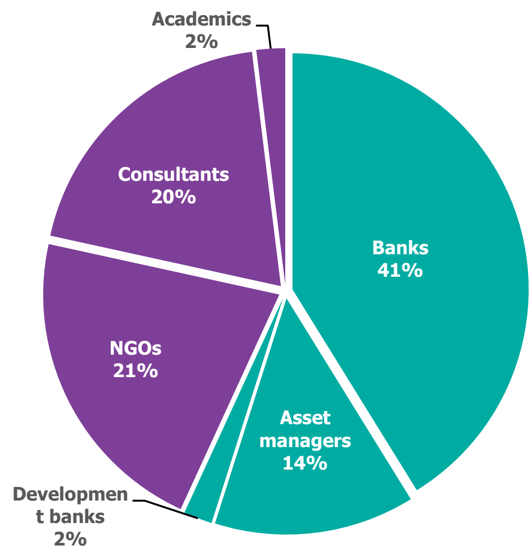
Workshop objectives

The worskhop had three main objectives:

1. Discuss the business case for accounting and reporting financed GHG emissions
2. Gather insights on existing practices and challenges in financed emissions accounting and reporting by financial institutions
3. Gather recommendations for types of financial activity to cover in the guidance and other next steps

The participants

Approximately 50 participants attended the workshop. Just over half of the attendees work directly for financial institutions (the green segments in the chart), and the remainder included NGOs, consultants and academics (the purple segments in the chart).



Summary of workshop outcomes

- **Lending:** There was general agreement that guidance on accounting for GHG emissions associated with lending would be useful and should be pursued by GHG Protocol and UNEP FI, and that project finance and lending to high impact sectors could be prioritized.
- **Investing:** There was general agreement that GHG accounting for investments should be explored further, although no concrete conclusions were reached on the business case for GHG accounting for investments, or the need to develop guidance, or for which asset classes. In order to progress this discussion, more asset owners need to be involved in the process as they are a key group of stakeholders that will drive action in this space.
- **Advisory services:** There was agreement that trading and brokerage services should be excluded from any guidance that is developed. There was some support for the guidance to address underwriting services, possibly as an optional reporting element.

General discussion

Is GHG accounting guidance needed for the financial sector?

The key question for participants related to the business case for GHG accounting for lending, investments and advisory services – how would the data be used by the financial institutions? The business objectives for each of the three groups ('Investing', 'Lending' and 'Advisory Services') are discussed in more detail in the three breakout group sections (beginning on page 4), but some general topics were also discussed during the morning session that are applicable to all three groups:

GHG emissions data could be used for tracking impact

Some participants argued that the ability to measure financed emissions enables banks to track their impact (both positive and negative). One consultant present commented that they are being asked by clients to quantify the GHG emissions of portfolios. They noted that they are dependent on the measurement of GHGs at the company level and that the cost of this should be considered.

Comparability

Comparability was seen as one of the main objectives of developing standardized GHG accounting guidance for the financial sector. Consistent tracking of GHG emissions and GHG intensity associated with portfolios was seen as a useful application of GHG accounting for the financial sector. Guidance on developing and reporting GHG intensity metrics was seen as an important and useful element of any guidance that will be developed, as was the comparability of portfolio trends over time.

There was also concern that companies would be compared to each other. It was pointed out that comparability of one company's performance over time was a core objective of the GHG Protocol standards, but that comparability of one company to another is more difficult as there are numerous factors that will affect GHG emissions levels. But there is an inevitable interest in comparability and benchmarking even if it is not possible.

It was also mentioned that disclosure of climate-relevant data is important for all types of financial transactions and services, but having standardized guidance and methodologies for each might not necessarily be relevant or useful.

Influence and risk for investors and lenders

Conceptually, the case to account for emissions from equity investments was relatively easy to justify due to the owner relationship, but for some participants, accounting for emissions from lending and advisory services was too abstract. It was suggested by some participants that lending should be regarded as a service provided to the borrower by the bank. This is distinct from investing where the investor assumes partial ownership and, in theory has more accountability. Some participants suggested that ownership (i.e., equity investments) should be split from everything else, and that equity investments should be the only elements that should be accounted for. However, it was also pointed out that equity ownership does not necessarily equate to influence and risk. In fact, it was suggested that often lenders, with their longer time horizons, will be exposed to more risk than equity investors.

Who would use the guidance?

It was argued by some that policymakers should be a primary user of any guidance that is developed for measuring financed emissions because without a price on carbon or a stronger mandate, financial institutions will not make the measurement of financed emissions part of standard business practice, and then GHG accounting just becomes a data collection exercise (of questionable value). However, it was pointed out that there must be value to the financial institutions themselves as they will be the primary users of any guidance developed by GHG Protocol and UNEP FI. It was also noted that GHG Protocol is a policy neutral instrument.

What types of financial activity should be prioritized?

It was suggested that if this is purely a GHG accounting exercise, then all asset classes should be included, but if it is about influence, then that is a different question. The key question is what will the FIs do with this information, other than reporting? It was said that it is too much to ask to develop comprehensive guidance on all financial activities, so what's the right balance? What is achievable and more importantly what is actionable? Prioritization is discussed in more detail in the three breakout group sessions (beginning on page 4).

The issue of double counting
The issue of double counting was raised and it was said that accounting for anything other than equity investments was double (and triple) counting as the emissions have already been accounted for by the investee company. It was pointed out that all indirect emissions accounting is, by definition, double counting, as any company's indirect emissions must be someone else's direct emissions. However, when looking at the full value chain of a financial institution, the emissions enabled by the capital it lends and the advisory services it provides may be significant to the FI's overall impact on climate change.

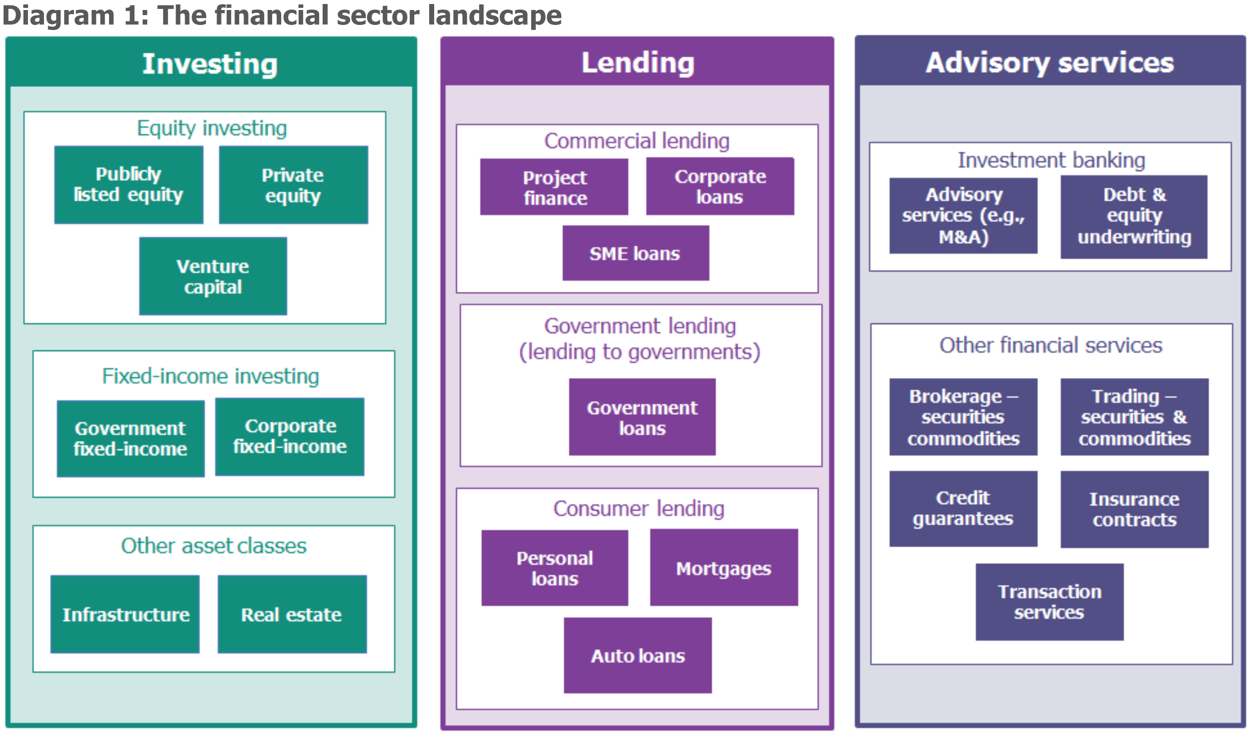
The issue of double counting within a single company's scope 3 category 15 was also raised (e.g., if a bank provided advisory services as well as providing capital, there could be some double counting – depending on the allocation methodology used). This type of double counting may be an issue that could be addressed in the development of the guidance.

Why is Scope 3 category 15 called just "Investments"
In the GHG Protocol Value Chain (Scope 3) Standard, categry 15 is called "Investments". It was pointed out by some participants that it was confusing that scope 3 category 15 is just called "Investments" when it actually also includes lending and in the future may include advisory services as well. It was confirmed that scope 3 category 15 includes investments, lending and advisory services, and it was agreed that the name was perhaps confusing. It was pointed out that the development of Financial Sector Guidance could lead to amendments being made to the Scope 3 Standard, so the name and scope of category 15 could be changed if needed.

Breakout Group discusssions

Participants were divided into 3 groups for breakout groups ('Investing', 'Lending' and 'Advisory Services') to discussion to explore each type of financed emissions in more depth. The diagram below was used as the basis for distinguishing between the different types of financial activities within each group.

Diagram 1: The financial sector landscape



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Lending

Of the three breakout groups, 'Lending' had the clearest consensus that GHG accounting guidance be valuable, and the discussion focused more on the question of what types of lending should be included, rather than on the question of whether lending should be included at all. It was also suggested that the emitting entities (i.e., the companies being financed) should also be involved in the development of the guidance.

Business objectives for measuring GHG emissions from lending

A number of business objectives were discussed for measuring GHG emissions associated with lending:

- *GHG measurement is a necessary first step towards developing a GHG management strategy* – GHG measurement should enable GHG management and it is not possible to effectively manage GHG emissions without first quantifying emissions. Measurement also helps to identify hotspots where the most impact and risk is, and therefore where resources should be invested to minimize those risks. GHG management strategies should also align with and inform broader corporate strategy.
- *Financed emissions is an efficiency metric* – For some participants, measuring the emissions of lending portfolios helps them understand the efficiency of the portfolio – that is the key question being answered by financed emissions data.
- *Transparency* – For some participants, transparency was also seen as a business objective of GHG accounting for lending.
- *Investor interest* – One asset manager present noted that they would want to include the scope 3 emissions from lending of financial institutions in any key performance indicators developed for the banking industry.

It was suggested by some participants that understanding what the results will be used for was an important first question that would drive the methodology used. It was pointed out that GHG Protocol frameworks generally allow sufficient flexibility in data types to accommodate various different use cases.

Objectives of GHG accounting guidance

As well as discussing the business objectives for accounting for emissions from lending, the participants also discussed the value in having a standardized framework developed by GHG Protocol and UNEP FI. The key objective for standardized guidance was to enable consistency among peers. Guidance could also help financial institutions identify material risks.

Which types of lending should be included in the guidance?

Priorities will vary between banks

From the discussions it was clear that priorities will be different for different financial institutions, depending on their activities – no one size fits all. Lending types that account for a large proportion of revenues and a large proportion of emissions should be prioritized.

Staged approach, starting with project finance and corporate loans to high impact sectors

It was generally agreed that project finance is where the business case for measuring financed emissions is most clear. But it was also noted that project finance only accounts for a small portion of lending activity. It was suggested that top priorities could be project finance and general purpose corporate loans to high impact sectors such as utilities, oil and gas, agriculture, extractives, energy intensive industry (cement, steel, etc.) and real estate. There was also some interest amongst participants in residential real estate lending. This approach applies the "80-20" rule (i.e., 20% of a bank's lending volume will likely account for 80% of its financed emissions). These lending types could be addressed first, and then others could be added in later stages as needed. It was noted that the multilateral development banks were in the process of consolidating their carbon accounting methodologies for project finance and that the GHGP guideline should refer to and build on it.

Involve industry in the guidance development process
It was suggested that there needed to be more interaction between the emitting entities (i.e., industry) and the financing entities (the financial institutions) when developing guidance. Industry should play a key role in the guidance development process as they are the entities that are actually emitting the GHGs, and therefore there will be implications for them in terms of data reporting requests, etc.

Technical issues and challenges
Various technical issues were identified that would need to be addressed during the development of the sector guidance. These included:

- Boundary setting – what scopes of the borrower's emissions should be included, just scope 1 and 2 emissions, or should scope 3 also be included? (It was suggested at the workshop that scope 3 emissions of the borrower could be reported for sectors where scope 3 is significant, but that scope 3 could be reported separately from scope 1 and scope 2, in order to maintain transparency.)
- Top down or bottom up approach
- Data quality and availability – lenders can only collect what the clients will provide. Data collection is particularly challenging when assessing the lifetime emissions of projects. Data availability was identified as an issue for SME loans, loans to privately held companies and loans to governments.
- Syndication – how to allocate emissions across the members. Role of institution in transaction is important, book-runner has a lot more influence than other lenders
- How to allocate emissions when refinancing of a similar loan
- How could this data be assured?

Investing
There was broad agreement that GHG accounting for investments should be explored further, although no concrete conclusions were reached on the business case for GHG accounting for investments, or the need to develop guidance, or for which asset classes.

The Investing breakout group focused mainly on discussing the business objectives of GHG accounting for investors. The primary users of any guidance need to be the asset owners and/or the asset managers. Other groups, like NGOs or policymakers can use the guidance also, but they are not the primary audience. It was pointed our that if there is not value to the asset owners and/or asset managers in developing GHG accounting guidance, then GHG Protocol is not achieving its mission [which is to *"provide the foundation for sustainable climate strategies and more efficient, resilient and profitable organizations."*]

Other stakeholders need to be including in the discussions
A key outcome from the investing discussions was that asset owners need to be a key group of stakeholders driving action in this space and that more asset owners need to be involved in guidance developed on accounting for emissions from investment portfolios. Asset owners and asset managers are inextricably linked – you cannot develop guidance for one without the other. It was also pointed out that insurance companies are large asset owners, so they should be involved in these discussions, as well as other asset owners (e.g., pension funds). It was suggested that any project that addresses investors should be in conjunction with other investor initiatives such as the Principles for Responsible Investment.

It was also argued by some that retail investment products should be included, so that the general public – as asset owners – could make better informed decisions about the climate change impact of their Investments, but the main focus of the discussion was on institutional investors.

Asset managers integrate GHG data in other ways
The business case for GHG accounting for investment portfolios was not clear to many participants. It was stated that it was important to understand the reality of influence of investors in this context. It was established that some asset managers have ESG policies that integrate GHG emissions information into investment decisions. Few, if any, asset managers assess the GHG inventory of investment portfolios, although one of the asset managers present was doing some work on aggregation of GHG data at a portfolio level, but this was at an early stage.

Asset owners can mandate certain things, for example, CalSTRS discloses 20 risk factors and asks asset owners to report on them. One aim of "sustainable" investing is to educate asset owners on issues such as climate change, but any drive to measure and report GHG emissions from investment portfolios needs to come from the asset owners, not the asset managers.
Although the topic of the workshop was on a carbon accounting standard, not a carbon management tool, much of the discussion on the business case concentrated on its usefulness for risk management. This point may require further clarification and discussion.

Advisory services

In general, there was an interest from many but not a strong voice for including advisory services in GHG accounting guidance for the financial sector, as there is a weaker link between the activity causing emissions and the bank providing the services that in part enable those activities. Advisory services are off-balance sheet activities, and are therefore less obviously associated with the GHG inventory of a bank. Advisory services were regarded by some attendees as being too nebulous to include in GHG accounting guidance, but it was also pointed out that lending is only a small part of revenues, so excluding advisory services may, depending on the financial institution (eg. investment banking, insurance) exclude a signficant portion of their revenue.

Including advisory services was regarded as potentially very complex, so it was suggested that perhaps a staged approach was needed, to go from less ambitious activities to more ambitious.

Trading and brokerage
The group consensus was that trading and brokerage should not be included in GHG accounting for the financial sector. This was due to the low influence that GHG accounting could have on trading and brokerage, as well as the complexity of GHG accounting for trading and brokerage. Securities are traded constantly, so determining a relevant time boundary for emissions associated with trading is too hard.

Insurance and credit guarantees
The group did not have sufficient insurance expertise to come to an informed decision about including insurance contracts. Credit guarantees were also not discussed at length, but it was suggested that, given their importance in enabling business activities they could be included as an optional reporting element.

Underwriting
There was interest from the group to explore the inclusion of underwriting services but no recommendation on inclusion or exclusion.There were also uncertainties about whether or not it should be prioritized given limited resources from banks for participation in the guidance development process.

Arguments for including underwriting:

- Underwriting is the point of maximum information in the market, and therefore potentially the point of most influence.
- It was also noted that currently there is not a lot of transparency in this area, so any increased visibility would be beneficial.

Arguments against including underwriting:

- Practicality was raised as a key concern – this is very complicated.
- It was noted that the relationship between an underwriting and an issuing company is very different to the relationship between an investor and an investee company. It was argued that the case for including underwriting was less clear than for investing or lending, as the responsibility of the underwriter for the emissions of the issuing company is less clear than the responsibility of an investor for the GHG emissions of an investee company.
- Any potential risk associated with the GHG emissions of an issuing company is risk for the potential investors, not for the investment bank itself. So it may be useful for the investment bank to provide this information to potential investors, but it may not be appropriate for the bank to be accounting for those GHG emissions in its inventory.

If underwriting were to be included, it was noted that the banks would want guidance that is realistic and practical. There was a fear that gathering this information could be hugely time-consuming exercise, that may not be helpful in all cases. Some suggestions were made for how to reduce the resource requirements, which included guidance on setting significance thresholds; providing default emissions factors; and one other suggestion was to initially focus on publicly-available data.

Technical issues specific to advisory services

A number of technical issues were also identified in the group. These included:

- How to account for emissions when there are multiple transactions over a year
- Secondary offering within year – new capital (one suggested solution was to focus on new capital raises rather than secondary capital raises)
- Allocation across different parties – is double counting an issue (and how to contextualize if we are double counting)
- Would follow-on offering or refinancing count again for the financial institution?
- Role of institutions within syndicates

Next steps

The scoping phase of the project is near completion and discussions with stakeholders are ongoing. Based on the information gathered in the scoping, the structure of the guidance development process will be finalized and launched in mid-2013. Information will be released shortly about how interested stakeholders can participate.