

GHG Protocol / UNEP FI Financed Emissions Initiative

Greenhouse gas accounting guidance and greenhouse gas risk management guidance for financial intermediaries

Advisory Committee Meeting Outcomes

Hosted by Unicredit, May 12-13, 2014
Milan, Italy

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The second meeting of the Advisory Committee took place in Milan, Italy on May 12 and 13, 2014 at Unicredit offices. The objectives of the meeting were to update the Advisory Committee, and get its feedback, on Technical Working Group (TWG) progress related to business goals, scope, boundaries, structure of the accounting guidance and progress on the risk management guidance.

This document provides a summary of key recommendations followed by a condensed summary of the discussion, rather than a comprehensive record of comments.

1. Summary of Key Recommendations

- *Business goals:* There was general agreement with three of the four business goals presented. However, it was suggested that the first business goal—to understand and manage GHG exposure and risk—requires revision.
- *Bank balance sheet to inform scope of accounting guidance for banks:* The scope of financial products covered by the accounting and reporting guidance should include all items on a bank's balance sheet if relevant, since FIs should be responsible for financed emissions related to items in which they have a financial stake.

- *Different reporting boundaries¹ for different FIs:* While no specific decisions were made on accounting boundaries, different boundaries may be needed and suited for different kinds of financial intermediaries, in particular **i)** banks versus **ii)** asset owners / asset managers.
- *Consider underwriting only in risk management guidance rather than in both guidance documents:* There was general agreement on the current approach of including debt and equity underwriting activities in the scope of the risk management guidance but excluding it from the accounting and reporting guidance for several reasons (see below).
- *Non-emissions metrics to contextualize financed emissions:* There was wide agreement on the usefulness of non-emissions metrics for contextualizing and providing additional meaning to the accounting and reporting of financed emissions.
- *'Potential emissions' covered in risk management guidance:* It was agreed that any discussion of future 'potential emissions' associated with assets, such as fossil fuel reserves and resources, should be covered in the risk management guidance rather than the accounting and reporting guidance.
- *Additional AC input needed before road testing:* It was agreed that another AC meeting may be needed prior to the release of the guidance for road testing, which is tentatively scheduled to begin in October 2014. There was agreement to plan for a series of AC webinars to agree on major decisions and issues around July-August 2014 and, if needed, also have an in-person meeting in Geneva in mid-October 2014.

2. Vision and Objectives of the WRI / UNEP FI process

- There was agreement that the vision for the GHG accounting and reporting guidance should include a clarification of what aspects of financed emissions are reasonable and unreasonable for FIs to account and report on, and in what circumstances, and practical calculation guidance for how to perform such accounting and reporting. Although calculation guidance will be created for a large scope of financial products, it was recognized that only a sub-set of transactions is likely to be made subject to a reporting requirement. This and other major decisions are yet to be made (see Boundaries discussion below).
- It was recognized that going forward this vision has to be communicated more clearly and consistently within the Technical Working Groups as well as to external stakeholders so as to manage expectations and strengthen stakeholder buy-in.

3. Business Goals of Scope 3 GHG Emissions Accounting and Reporting by Financial Intermediaries

¹ The 'reporting boundary' refers to which types of assets are required to report for compliance to the standard.

- There was general agreement with three of the four business goals presented. It was decided, however, that the first business goal—to understand and manage GHG exposure and risk—requires revision.
- *Different business goals for different FIs:* It was agreed that business goals related to accounting and reporting need to be articulated across different FI types, particularly asset owners / asset managers vs. banks. The different business goals between asset owners / managers and banks lead to different motivations and different cost-benefit implications for accounting and reporting. Since business goals may vary by FI type, we should consider how the accounting guidance can be tailored to meet these varying needs.
- The AC agrees that TWG discussions and recommendations around business objectives need to consider previously described challenges, including data availability and quality, time and resources required, and client confidentiality.

Business Goal: ‘Understand and Manage GHG Exposure’

- *Limited connection between financed emissions accounting and risk management in banking:* Largely, the AC agrees that for banks there is only a limited connection between financed emissions information / insights and (potential) financial risk. A limited number of AC members see a connection, though financed emissions are only one input to financial risk management. Further, some AC members suggest that FI risk analysis is not intended for the public domain anyway. Several reasons for the limited connection were noted by AC members:
 - Reporting financed emissions for an entire portfolio does not allow an assessment of risk exposure; a more detailed breakdown at the asset level is needed.
 - Once the total annual emissions associated with an asset have been allocated to an FI (i.e. multiplied by the FI’s debt or equity ratio to achieve a measure of responsibility), these allocated emissions become less relevant than the total annual emissions and GHG intensity of the asset and the future ‘potential’ emissions associated with the asset over the period of FI exposure.
 - Non-GHG emissions metrics (i.e. league tables) may be just as valuable as financed emissions for certain use cases.
- There was, on the other hand, AC agreement that the link between financed emissions and (risk) exposure is likely to be much more pronounced in the investor domain (particularly in equity portfolios) than in the banking domain. AP4, LGS, as well as ERAFP were mentioned as organizations using carbon footprinting as a tool in carbon risk management.

Business Goal: ‘Develop GHG-Related Business Opportunities’

- There was broad agreement that portfolio-level Scope 3 GHG emissions information is useful, if not necessary, in the development and marketing of low-carbon financial products, in particular: ‘low-carbon’ portfolios that are actively managed; ‘low-carbon’ indexes for the development of ‘low-carbon’ portfolios that are managed passively; and the development of ‘low-carbon’ bonds, including ‘low-carbon’ asset-backed securities.

Business Goal: 'Value Chain Influence'

- Similar to managing GHG exposure, the asset-level emissions information enabled by financed emissions accounting represents valuable information for client and investee engagement. However, once GHG emissions data is aggregated to portfolio level it loses that potential. It was again noted that the usefulness of financed emissions for investee / client engagement is likely to be more pronounced in the investor domain (particularly in equity portfolios) than in the banking domain.

Business Goal: 'Provide Transparency'

- *Cost-effectiveness of financed emissions disclosure:* It was highlighted that the business goal of 'providing transparency' could be achieved fairly cost-efficiently if it can be achieved using average or modeled, secondary data as opposed to the primary data sourced directly from investees and / or clients. However, it was also discussed that such average emissions factors have both advantages (ease and cost-efficiency) and disadvantages (less ability to distinguish leaders and laggards within a sector / portfolio).
- There was general agreement to use the accounting principles already included in the Scope 3 Standard (relevance, completeness, consistency, accuracy, and transparency). As in other types of GHG accounting, there may be trade-offs between various principles, such as between completeness and accuracy. In such situations, a balanced approach should be strived for that represents a compromise between conflicting principles.

4. Scope and Boundaries

- *Scope of accounting guidance²:* There was some agreement that the scope of financial products covered by the accounting and reporting guidance should include all items on a bank's balance sheet if relevant, since FIs should be responsible for financed emissions related to items in which they have a financial stake. This would include short-term loans such as repurchase agreements and possibly lines of credit if they are part of the total financing of an investee. However, it was also discussed that certain items on the balance sheet are not directly linked to investees, making accounting challenging (e.g. commodities, derivatives). It was agreed that the guidance should include a discussion that reviews all items on bank balance sheets and if necessary discusses why certain items are out of scope.
- *Emissions accounting boundary³:* It was generally agreed that the most relevant scope of financed emissions may be different for different FIs and different sectors. The AC generally

² The 'scope of the accounting guidance' means the list of financial product / vehicle types that are considered and contemplated as part of the guidance development process.

³ The 'emissions accounting boundary for a financed activity / product' relates to the type of GHG emissions information at the asset / investee / client level that FIs should gather and record when developing their own financed emissions inventory. This can be Scope 1, Scope 2, or Scope 3 information.

supports the TWG's early decisions to focus on Scope 1 and 2 emissions associated with investments. However, one AC member also suggested that investments in certain sectors may have material emissions outside these scopes, such as upstream fossil fuel companies, where emissions associated with use of sold products (i.e., burning the produced fuels) during a reporting year may be relevant for certain accounting business goals.

- *No clear choice for reporting boundary:* Four potential accounting boundaries were discussed⁴ and there was productive discussion regarding the strengths and weaknesses of each. Each proposed boundary found some support among AC members, showing that each one has both strengths and weaknesses and may be preferred by different FIs.
- *Different reporting boundaries⁵ for different FIs:* The point was raised that different reporting boundaries may be needed and suited for different kinds of financial intermediaries, in particular **i)** banks versus **ii)** asset owners / asset managers.
 - i. For banks - Use of average data to improve emissions accounting coverage:* In a banking context, there was some support for taking a broad and inclusive boundary similar to the Scope 3 Standard (allowing for justified exclusions) and requiring reporting for the whole balance sheet (assuming that this can be done cost-effectively using average data as opposed to primary data), with more advanced calculation methods and data used for particularly GHG-intensive sectors ('GHG emissions hotspots') as well as large transactions with known use of proceeds (variation of boundary option 1). Roughly half of the AC members favored a more limited reporting boundary focused on known use of proceeds and GHG-intensive sectors only (also a variation on boundary option 1).
 - ii. For asset owners / managers –* For investors, there was also support for taking a broad and inclusive boundary similar to the Scope 3 Standard (allowing for justified exclusions) and requiring reporting for most, if not all, assets under management based on a prescribed significance threshold (option 3).

⁴ The four discussed boundaries included ("Shall" representing requirements, "Should" representing optional elements):

- a) Shall account for all emissions from products / advisory services with known use of proceeds AND Should account for all emissions from products / advisory services from unknown use of proceeds that are: Relevant to your business goal; or Included in the following GHG intensive sectors (Sectors TBD); or meet a significance threshold of x%, as defined by the FI
- b) Should account for emissions using the recommended boundary approach consistent with the FIs primary business goal
- c) Shall account for all category 15 emissions above significance threshold of x% \$ invested / lent
- d) Shall account for all emissions from lending / investing / advisory services in the top x number of GHG intensive sectors. Should account for emissions from other sectors relevant to your business goals.

⁵ The 'reporting boundary' refers to which types of assets are required to report for compliance to the standard.

- iii.* There was little support for boundary option 2, which recommends that a FI choose a boundary based on their business goal. AC members prefer a more prescriptive approach that creates further consistency across FIs.

5. Calculation Guidance

- *Review use of enterprise value for emissions allocation:* There was feedback from some AC members to review the proposal to use enterprise value as the denominator of the allocation factor for financed emissions associated with companies and to consider the use of book value. Concern was expressed about both the complexity of the concept as well as availability of data for unlisted companies.
- *Review debt and equity equivalence:* There was some agreement to review the concept of “a dollar is a dollar” for accounting for financed emissions between debt and equity. A few AC members expressed concern with this accounting concept, since risk profiles are very different for debt and equity investments.
- *Consider underwriting only in risk management guidance rather than in both guidance documents:* There was general agreement on the current approach of including debt and equity underwriting activities in the scope of the risk management guidance but excluding it from the accounting and reporting guidance. There were several important points discussed related to this proposal:
 - There is no logical way to allocate emissions associated with underwriting or to sum such emissions together with financed emissions associated with debt and equity.
 - As discussed above, there was some support for setting the scope of the accounting and reporting guidance on the bank’s balance sheet, which generally does not include services such as underwriting and M&A advisory. Emissions associated with an underwritten company or asset will become part of a FI’s financed emissions if the FI is unable to sell the security and it moves to the FI balance sheet.
 - Fees for underwriting are sensitive business information and would not always be available for allocating emissions.
 - Financed emissions should be accounted for by asset owners rather than underwriters.
 - It was also mentioned that many NGOs and other external stakeholders are interested in banks reporting emissions associated with underwriting and may be unsatisfied with its lack of inclusion in the accounting guidance.
- *No agreement on business case for government and consumer emissions accounting:* Some AC members questioned the business goals associated with emissions accounting guidance for government finance (e.g. sovereign and municipal bonds) and consumer finance (e.g. mortgages, auto loans). There was also little agreement on how to allocate financed emissions for government and consumer financial products, since there is limited data availability for **i)** the equivalents of enterprise / book value for consumers and governments and **ii)** these entities’ Scope 1 and 2 emissions. AC members suggested that TWGs examine existing methodologies from current financed emissions data providers to gauge how such accounting has been done previously.

- *Non-emissions metrics to contextualize financed emissions:* There was wide agreement on the usefulness of non-emissions metrics for contextualizing and providing additional meaning to the accounting and reporting of financed emissions. There was no specific agreement on the types of metrics that would be most useful (risk management and ESG strategies, sector investment ratios, GHG intensity compared to benchmarks, GHG intensity targets and progress) but AC members agreed these metrics should be designed for complementarity to the financed emissions inventory. The issue will be further addressed by a TWG 4 subgroup focused on performance metrics.
- *Guidance on interpretation of an FI's GHG inventory is critical to financed emissions reporting:* It was agreed that the planned chapter on interpretation of financed emissions is critically important to the success of the guidance, and it was suggested that this section should include specific guidance on both what to do and what not to do during the interpretation of financed emissions inventories by both internal and external stakeholders.

6. Emissions Accounting Guidance Document Structure

- *Guidance organized by asset class rather than consumer class:* There was general support to restructure the accounting and reporting guidance to be organized around asset classes (debt, equity) rather than consumer groups (companies, projects, governments, consumers) in order to avoid repetition, if the TWGs are supportive of this new structure. It was agreed that an important first step will be developing an outline that provides clarity on what is expected of each TWG within the context of a new structure
- There was no support for restructuring the TWGs to match this new document structure given the amount of work already done to date.

7. Risk Management Guidance

- There was general agreement on the proposed vision of the risk management guidance—guidance for the internal management of financial risk associated with recouping an expected return over an expected period. It was generally agreed that the role of the guidance is not to provide a general estimate of the likelihood of 'stranded assets' but to enable each FI to make such a determination itself.
- *Types of risk included:* There was productive discussion on the scope of the risks covered in the guidance:
 - There were mixed opinions on the potential inclusion of non-fossil-fuel but GHG-intensive sectors, particularly agriculture and forestry. The potential was discussed for a more detailed phase 2 related to these sectors. This potential option will be discussed in more detail by the TWG members at the in-person meeting in June.
 - There was agreement on the exclusion of the risk associated with physical impacts that may be worsened by climate change, such as risk related to an increase in severe weather events. However, the risk that such worsening physical damage could drive policy or regulatory changes should be considered within scope. There was a limited

discussion on the potential inclusion of risks associated with water availability, but no decision was made on whether this risk should be included.

- *'Potential emissions' covered in risk management guidance:* It was generally agreed that since the accounting and reporting guidance will generally focus on annual emissions, any discussion of future 'potential emissions' associated with assets, such as fossil fuel reserves and resources, should be covered in the risk management guidance rather than the accounting and reporting guidance. It was generally agreed that accounting for such emissions can be useful for risk management—when analyzed in context with other factors such as production cost and reserve location—but that reporting these emissions to the public should be the responsibility of fossil fuel companies rather than FIs.

8. Engagement Strategy and Next Steps

- A number of groups were identified as important stakeholders to further engage throughout the development, road testing, and launch of both guidance. It was determined that the group should work to increase participation from: institutional investors (e.g. pension funds); financial sector trade associations; data providers; and advocacy groups. A number of events were also discussed as potential places to promote the guidance development and launch.
- It was agreed that another AC meeting may be needed prior to the release of the guidance for road testing, which is tentatively scheduled to begin in October 2014. There was agreement to plan for a series of AC webinars on major decisions and issues around July-August 2014 and, if needed, also have an in-person meeting in Geneva in mid-October 2014.

9. List of Attendees

Advisory Committee Members

- Christopher Bray, Barclays
- Mark Campanale, Carbon Tracker Initiative
- Giorgio Capurri, UniCredit
- Stanislas Dupre, 2° Investing Initiative
- Tim Hassett, WWF US
- James Hulse, CDP
- Kaj Jensen, Bank of America
- Nathan Fabian, Investor Group on Climate Change (IGCC)
- Karsten Loeffler, Allianz Group
- Richard Pearl, State Street

Technical Working Group Chairs

- Yann Kermode, UBS
- Magnus Borelius, City of Gothenburg
- Marisa Buchanan, JPMorgan Chase & Co.

Secretariat

- Barruch Ben Zekry, WRI
- Cynthia Cummis, WRI
- Christopher Weber, WRI
- Remco Fischer, UNEP FI
- Magdalena Paszkiewicz, UNEP FI

Advisory Committee Members Unable to Attend

- Chris Walker, EY
- Christopher Rowe, Prudential Investment Management
- Cory Weiss, PwC
- Tom Kerr, IFC
- Robyn Luhning, Wells Fargo
- Julie Fox-Gorte, Pax World
- Bill Harnett, Local Government Super
- Sefton Laing, RBS
- Daniel Marroquin, Banamex
- Julian Poulter, Asset Owners Disclosure Project
- Steve Priddy, London School of Business and Finance
- Elisa Tonda, UNEP Business and Industry Unit (observer only)
- Namita Vikas, YES Bank