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

Summary of Scoping Workshop

Hosted by Bank of America Merrill Lynch, December 19 2012, London

---

Table of Contents

GREENHOUSE GAS PROTOCOL

UNEP Finance Initiative
Innovative financing for sustainability

Introduction

Greenhouse Gas Protocol and UNEP Finance Initiative have partnered to investigate whether to develop guidance for the financial sector to account for greenhouse gas (GHG) emissions associated with lending and investments ("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 was open to any interested parties. The survey ran from October to November 2012. A separate report has been released that summarizes the results of the survey and is available to download from the GHG Protocol website: http://www.ghgprotocol.org/feature/financial-sector-guidance-corporate-value-chain-scope-3-accounting-and-reporting.

As the second part of the scoping phase, two scoping workshops are being held. The first of these scoping workshops was held in London on December 19, 2012. This document provides a summary of the discussions and outcomes of this workshop. The workshop agenda and presentations can be downloaded from the GHG Protocol website: http://www.ghgprotocol.org/feature/financial-sector-guidance-corporate-value-chain-scope-3-accounting-and-reporting.

Another workshop is planned for New York in late February 2013. A summary of this workshop will be published separately afterwards.

Workshop objectives

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

The participants and their expectations

Approximately 30 participants attended the workshop. At the beginning of the day participants were asked to say what their expectations were for the workshop:

- Explore current reporting landscape and share experiences – 38%
- Assess risk exposure and due diligence – 13%
- Drive low carbon economy – 13%
- Help develop common standard – 13%
- Contribute lessons from their own experiences and methodologies – 13%
- Ensure the right kind of disclosure – 4%
- Understand the business sense of GHG information – 4%
- Measuring impact of specific financial product(s) – 4%

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

Summary of workshop outcomes

It was generally agreed that:

1. There is a broad need to develop standardized guidance for lending and investments.
2. The guidance should focus on developing the accounting framework for financed emissions, rather than on risk analysis (this accounting framework can provide the necessary foundation for subsequent use of the data in a number of different ways, including risk analysis).
3. There are three groups of financed emissions, each of which should be discussed separately: investments (equities, bonds, etc.); lending (corporate loans, project finance, mortgages, etc.) and financial services (underwriting, advisory services, etc.).
4. Lending and investing should be included in the guidance, but there was no consensus on whether financial services (underwriting, advisory services, etc.) should be included.
5. The guidance should not focus on avoided emissions as GHG Protocol has already developed a separate guidance (the Project Protocol) that financial institutions can use to account for avoided emissions from individual projects that they finance.
6. It was also widely agreed that practicality of implementation should be a core consideration when developing the guidance.

What is the aim of the guidance – understanding responsibility or risk?

It became clear from the discussions that there were two broad objectives for measuring financed emissions. The first objective is to understand the 'responsibility' of financial institutions for the emissions they enable through investing and financing vis-à-vis external stakeholders (including financing the transition to a low carbon economy). The second objective is to understand the risks to the FI associated with GHG emissions.

It was clarified that the goal of the GHG Protocol is to provide an accounting framework for measuring and reporting upon which all other elements can develop. Therefore, the guidance should not focus on one single use (i.e., risk management) but instead the driving force should be to provide an accounting framework that will serve the majority of possible users. It was explained that accounting of financed emissions enables financial institutions to perform risk management as a next and separate step. Most financed emissions data collected for GHG accounting and reporting purposes are unlikely to serve as risk management information directly but can instead provide the data to perform such assessments subsequently.

Different forms of financial intermediation (financial services, products) are associated with different risks. For example equity earnings are higher than debt earnings, so if risk analysis was the objective of the guidance, then the suggestion was that the emissions should be weighted according to value (i.e., yield) in order to understand the different risks associated with different sources of emissions (e.g., equity vs debt). However it was broadly agreed that it is not for GHG Protocol to determine any weighting between equity and debt but simply to provide a framework for reporting the actual emissions quantities. Some participants thought it would be useful for GHG Protocol to provide guidance on weighting (i.e., aspects to consider when deciding whether to apply weightings) that financial institutions may use to design their own weightings to different types of financed emissions (e.g., equity and debt) as part of a risk management exercise.

Break-out Group discusssions

Participants were divided into 2 groups for break-out groups discussions to discuss specific accounting challenges and approaches related to Banking and Investing.

Banking

Lending

A key question raised during discussions was the extent to which debt and equity transactions should be treated differently when it comes to GHG accounting. This relates to the question of how accountable financial institutions are for the GHG emissions associated with their lending and investing activities. In the case of equity investments, there was general agreement that ownership has a connection to accountability. In the case of debt (e.g., commercial loans), which merely represents a service, the source for accountability is not as strong. Nevertheless, workshop participants considered a debt-based relationship between a lender and borrower to be a source of GHG emissions accountability for the lender. It was also noted that risk exposure for loans can be higher than for certain shorter-term equity investments, so including lending could be important from a risk management perspective.

Corporate lending was regarded as the "lowest hanging fruit" and could be the priority for a banking work group. However, it was also pointed out that the most important categories of lending will vary significantly from bank to bank and from country to country. It was therefore suggested by some that all types of lending should be included in the guidance and FIs could then account for the emissions from their most significant lending activities (significant in terms of financial value and quantities of emissions).

Types of lending that might be addressed in the guidance include: project finance, corporate loans (with and without known use of proceeds), SME loans, government loans, mortgages, and consumer loans. No conclusive decision was reached on whether consumer loans should be included in the guidance. It was pointed out by some that separate methodologies may be needed for different types of lending due to the different considerations around setting the boundary for each type of borrower (e.g., guidance on including the borrowing company's scope 3 emissions when accounting for corporate loans).

Financial services

As stated above, it was broadly agreed that FIs should account for emissions associated with investment and lending activities. One question raised was whether Scope 3 emissions of FIs should be limited to emissions associated with investing and lending, or whether other services that FIs provided should also be included (for example underwriting and advisory services). Participants gave various arguments for and against accounting for emissions from financial services:

Reasons given for why services <u>should</u> be included

1. Services such as underwriting are essential to company activities so they "enable" the company's emissions
2. Financial services can represent a large portion of a FI's revenue stream, and where you are earning money you are responsible
3. To change behavior in your organization you need to look at the P&L valuation
4. The guidance should be as comprehensive as possible – all of a FI's activities should be covered

Reasons given for why services <u>should not</u> be included

1. They are off-balance sheet activities, so they should be accounted for by the holders of the assets instead (i.e., all emissions will be on someone's balance sheet)
2. The link to responsibility is less clear as there is not a financial stake in the company's activity (i.e., there is no clear way to allocate a proportion of the company's emissions to the financial service provider)

3. If service providers have to account for the emissions from the companies to which they provide the service, then this logic should also be applied to other service providers that are equally essential to the transaction, e.g., lawyers, consultants, etc.

It was decided that the key question was whether GHG accounting should align with a FI's balance sheet or its income statement. It was agreed that on-balance sheet activities should be the priority for banks, but it was argued by some that off-balance sheet activities must also be included in order to be complete and transparent because some off-balance sheet activities can represent significant portions of a FI's income. It was clarified that corporate accounting generally aligns with a company's income generating activities in the reporting year, rather than its balance sheet. A suggested approach was to use a hybrid method that includes emissions associated with all on-balance sheet activities but also provides flexibility to include any significant sources of emissions associated with income that is not captured on the balance sheet.

Investing

The discussion of investing focused mostly on the business case for accounting for GHGs of investment portfolios. It was argued that the carbon intensity figure of financial investments of one company is not necessarily comparable to that of another company, however, this is also true for financial data and some investors at the workshop did think that using GHG emissions data at the investee level (company-by-company, transaction-by-transaction) is useful and necessary in order to understand and assess GHG risk exposure. However, once data at the investee-level is aggregated into data at the portfolio level it loses its ability to inform risk assessment. This is because carbon risk is a function of both carbon emissions (or carbon emissions intensity) and carbon regulation (carbon price, etc.) in the places where the emissions occur. As portfolios will most often be associated with GHG emissions from a variety of potentially very different countries, jurisdictions and regulatory frameworks, carbon data (absolute and intensity figures) at portfolio level will often not enable carbon risk assessment. It was noted, however, that even though the average carbon intensity of a portfolio may not directly contribute to moving towards a low carbon economy, the goal could be to identify how subsets of the portfolio are progressing. In addition, comparing portfolios in the same sector in the same region can be meaningful to see the difference in risk exposure and to measure performance.

It was noted that while the guidance will not directly address these applications of GHG data, the data gathered for a portfolio inventory could be used as the foundation for approaches to benchmarking, performance measurement and risk assessment.

Increasingly, disclosure of GHG emissions of investments is part of asset owners' RFPs (Requests for Proposals) to asset managers and may become legal requirements. It was generally agreed that the GHG Protocol guidance would help to standardize the reporting framework so that regulators can align with an existing standard. It was suggested that if the guidance is developed together with the financial industry, all stakeholders will benefit. It was noted that this logic implies that the guidance should be developed as broadly as possible (i.e., it should cover as many asset classes as possible). It was also agreed that the time and cost burden of collecting data (on potentially tens of thousands of holdings) should be taken into account when developing the guidance.

Methodological questions and suggestions from participants

Data quality

One of the biggest challenges is data quality and availability. Guidance on data collection, assessing data quality and using secondary data should be included in the guidance.

Using thresholds

One presentation showed that the 80-20 rule – that roughly 80% of the effects (emissions) come from 20% of the causes (activities) – also applies to financed emissions and that average sectoral data is a fairly reliable substitute to cover the last 20% of emissions. It was suggested therefore that a significance threshold value in terms of GHG emissions could be used to help focus data collection.

Time horizons

Two questions raised during the workshop relate to time horizons:

1. In the case of a loan provided to build a power plant: if a power plant has a lifetime of 40 years, its construction time spans 4 years and the loan is repaid within 6 years, which GHG emissions, for what time spans, should be accounted for by the lender?
2. What happens in cases where investors rather than 'investing' in companies 'trade' with them which results in individual securities being held in portfolios for only short lapses of time (at times as short as a few milliseconds)?

Including projections of future emissions

It was noted that developments are underway at the International Integrated Reporting Committee and other initiatives to develop ways to report on forward looking information. On the other hand, in line with current financial reporting practices, GHG Protocol's corporate reporting framework (scope 1, scope 2 and scope 3 emissions) assesses emissions associated with a company's business activities in the reporting year. Scope 1 and scope 2 reporting therefore shows actual emissions that occured in the reporting year. But some scope 3 emissions may occur in the future (e.g., from the use of a sold product). Therefore it was noted that scope 3 GHG accounting has already set a precedent that enables the reporting of future emissions associated with a company's activities in the reporting year. This framework will be relevant to some financed emissions where the FI's activity in the current year will result in emissions occuring in future years (such as project finance). It was suggested that information on reporting future emissions be included in the guidance.

Conclusions

Participants showed broad interest in developing financial sector guidance. Many of the issues discussed during the workshop could be addressed during the guidance development process, and the in depth discussions demonstrated a need for a harmonized approach to accounting for financed emissions. It also became apparent that there were three distinct groups of financed emissions that were being discussed: investments (equities, bonds, etc.); lending (corporate loans, project finance, mortgages, etc.) and financial services (underwriting, advisory services, etc.).

It was generally agreed that lending and investing should be included in the guidance, but it was undecided exactly what asset classes and types of lending should be included. Some participants stated that the guidance should be as broad as possible (i.e., it should cover all the different asset classes and types of lending) and others said that the focus should be on the major asset classes and lending types. It was also undecided whether financial services (underwriting, advisory services, etc.) should be included.

Next steps

A similar scoping workshop will be held in New York on February 25th 2013, hosted by JP Morgan Chase. If the conclusion of the scoping phase is to proceed with the development of guidance, the subsequent steps in the guidance development process are shown in the table below.

Scoping Phase	**Stakeholder Survey**	Online survey to assess interest in project, gain initial understanding of potential scope, identify funders, advisory committee, and other key stakeholders	*Complete*
	Scoping Workshop	Roundtable discussions in London and New York focused on clarifying scope of guidance	*Winter 2013*
Development Phase	**Planning & Finalize Scope**	Develop governance plan and launch guidance development process	*Winter – Spring 2013*
	Technical Working Groups	Groups of experts draft guidance for each investment category	*Spring – Fall 2013*
	Road Testing	Based on draft guidance, a number of institutions conduct emissions inventories	*Winter 2013-14*
	Public Comment	Wider stakeholder opportunity to review draft and comment (includes webinars to present the proposed guidance). Conducted concurrently with road testing	*Winter 2013-14*
	Revise Guidance	Revise guidance based on stakeholder feedback and road test feedback	*Spring / Summer 2014*
	Publication	Release final version of GHG Protocol Financial Sector Guidance as supplement to the GHG Protocol Scope 3 Standard	*Fall 2014*
Implementation Phase	**Outreach**	Outreach through training workshops and conferences	*Fall 2014 onwards*