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Recent developments in measurement of financed emissions

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NOTE

1) In the case of an equity portfolio, for example, financed emissions are calculated by summing each investee's scope1-2 emissions multiplied by the financial institution's equity ownership percentage. Under the GHG Protocol, financed emissions are counted included in category 15 of the financial institution's scope 3 emissions (indirect emissions other than scope 2 emissions).

2) CDP Financial Services Disclosure Report 2020

3) The Net-Zero Asset Owner Alliance, Net Zero Asset Managers initiative and NZBA were established by the UN Environment Programme Finance Initiative in September 2019, December 2020 and April 2021, respectively.

4) The NZBA has 45 financial institution signatories (per its website as of July 2021). MUFG announced it had become a signatory in May 2021.

5) The Network for Greening the Financial System is playing a lead role in developing financial regulatory policy responses to climate change risks.

Executive Summary

Amid growing interest in measurement and disclosure of financed emissions, financial institutions are starting to assemble the requisite datasets and develop uniform calculation standards. Such initiatives may push financial institutions' borrowers and investees to decarbonize faster.

Growing importance of measuring financed emissions

Financial institutions are becoming increasingly committed to measuring and disclosing financed emissions (i.e., their pro-rata share of their investees and corporate borrowers' CO₂ emissions). Financed emissions are calculated by multiplying the investees and borrowers' total emissions by an attribution factor that represents the financial institution's pro-rata share¹⁾. Financed emissions are classified as indirect CO₂ emissions of the financial institution.

Financial institutions that measure and disclose their financed emissions are still in the minority. The Carbon Disclosure Project (CDP), an international NGO, reported in May 2021 that only 25% of the financial institutions it surveyed were disclosing their financed emissions as of 2020²⁾. In April 2021, however, the UN spearheaded the formation of a Net-Zero Banking Alliance (NZBA) modeled after similar initiatives for asset owners and asset managers launched in 2019 and 2020, respectively³⁾. The NZBA aims to reduce banks' financed emissions to net zero by 2050. Its signatories include Japan's Mitsubishi UFJ Financial Group in addition to Western financial institutions such as Barclays, BNP Paribas and Morgan Stanley⁴⁾.

The growing focus on financed emissions reflects multiple factors. First, the companies represented in financial institutions' equity portfolios and loan books account for a large share of global CO₂ emissions. Second, financial institutions are expected to nudge their corporate customers to reduce CO₂ emissions through their lending and investment decisions. Even some regulations require financial institutions to set targets or make commitments to reduce CO₂ emissions. Third, from a risk-management standpoint, central banks and regulatory authorities⁵⁾ are pressuring financial institutions to quantify their portfolios' impact on climate change.

However, measuring and disclosing financed emissions poses several challenges. The first is that a detailed calculation methodology needs to be established for each of the diverse financial assets that financial institutions own, including equities, bonds, business loans and real estate investments. Although the GHG Protocol, a CO₂ emissions measurement standard, defines a calculation method for financed CO₂ emissions, its applicability is limited largely to debt borrowed for a predetermined purpose. A second challenge is lack of availability of data required to measure emissions. While more and more publicly traded companies have recently been disclosing their CO₂ emissions in sustainability reports and elsewhere in response to public pressure to mitigate global warming, data on SMEs and other privately held companies' emissions remain scarce⁶⁾. Even when data are available, they are often lacking in terms of reliability and/or comparability⁷⁾.

6) Even in Japan, data on GHG emissions and their measurement, reporting and disclosure pursuant to the Act on Promotion of Global Warming Countermeasures are available, but measurement standards currently differ somewhat from GHG Protocol-compliant emissions data. Other issues in Japan include lengthy time lags between reporting and disclosure.

7) NGFS Progress Report On Bridging Data Gaps in May 2021.

8) Japan's Mizuho Financial Group announced it had joined the PCAF in July 2021.

9) The quality of data on companies' CO₂ emissions is scored as follows. Score 1: emissions reported by the company; Score 2: estimates based on the company's energy consumption; Score 3: estimates based on the company's production volume; Score 4: estimates based on estimated sector-wide emissions per unit of revenue; Score 5: estimates based on estimated sector-wide emissions per unit of asset

Measurement/disclosure initiatives led by financial institutions

Amid such challenges, financial institutions are starting to launch initiatives to measure and disclose financed emissions and expedite progress toward carbon neutrality while developing uniform standards for measurement methods and data inputs. A case in point is the Partnership for Carbon Accounting Financials (PCAF), most of the founding members of which are Dutch financial institutions⁸⁾. In November 2020, it published the Global GHG Accounting & Reporting Standard for the Financial Industry, an international standard for measurement and disclosure of financed emissions by banks, asset managers and asset owners.

While conforming with the GHG Protocol, the PCAF standard is more detailed. It provides measurement and disclosure standards for six asset classes, including business loans, commercial real estate and mortgages in addition to listed equities and corporate bonds. One hallmark of the PCAF standard is that it provides explicit guidance on data sources that should be used when CO₂ emissions data are not available directly from the individual borrower/investee. It also mandates disclosure of data quality scorecards, with data scored on a scale of 1 (highest quality) to 5 (lowest quality). Verified data are assigned a score of 1 while estimates based on sector-wide emissions per unit of revenue or per unit of asset are assigned a score of 4 or 5 because they are subject to a margin of error⁹⁾. In addition to providing alternative methods of measuring and disclosing financed emissions using estimates when data constraints exist, the PFAC standard should increase the transparency and comparability of financed emissions data disclosed

by financial institutions.

Aside from standards, another high-profile initiative is BlueTrack, a financed emissions measurement and management tool publicly released by Barclays in December 2020. In March 2020, Barclays became the first UK bank to pledge to reduce its financed emissions to net zero, having already achieved net-zero direct CO₂ emissions. With BlueTrack, Barclays sets benchmarks for reducing financed CO₂ emissions on a portfolio-wide basis and assesses every loan and investment based on the borrower/investee's CO₂ emissions. BlueTrack users can track CO₂ emissions on both a company-by-company and portfolio-wide basis, monitor them against their benchmarks and utilize the data in their disclosures. BlueTrack incorporates estimates used in its calculations and external scenarios from international organizations like the IEA. Barclays discloses the scenarios and data used by BlueTrack, as well as future upgrade plans, in detail¹⁰⁾. At present, BlueTrack covers only two sectors, energy and electric power, but Barclays plans to expand its coverage to more sectors, including cement. It is reportedly also exploring use of actual measurements as data inputs.

¹⁰⁾ See <https://home.barclays/society/our-position-on-climate-change/bluetrack/>.

Such initiatives could spur broader efforts by financial institutions to measure and disclose financed emissions and upgrade their internal management utilizing emissions data. From a data standpoint, tracking progress against a benchmark requires knowledge of individual companies' emissions reduction targets and performance. To gain such knowledge, financial institutions will have to improve data quality and increase the granularity of their scenario analyses. In fact, Barclays' internal management reportedly involves analysis of company-disclosed information in addition to output from BlueTrack.

If in addition to measuring and disclosing financed emissions, financial institutions are able to compile datasets and access high-quality data, they should be able to more effectively influence companies through their lending/investment decisions and monitor borrowers/investees' decarbonization.

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