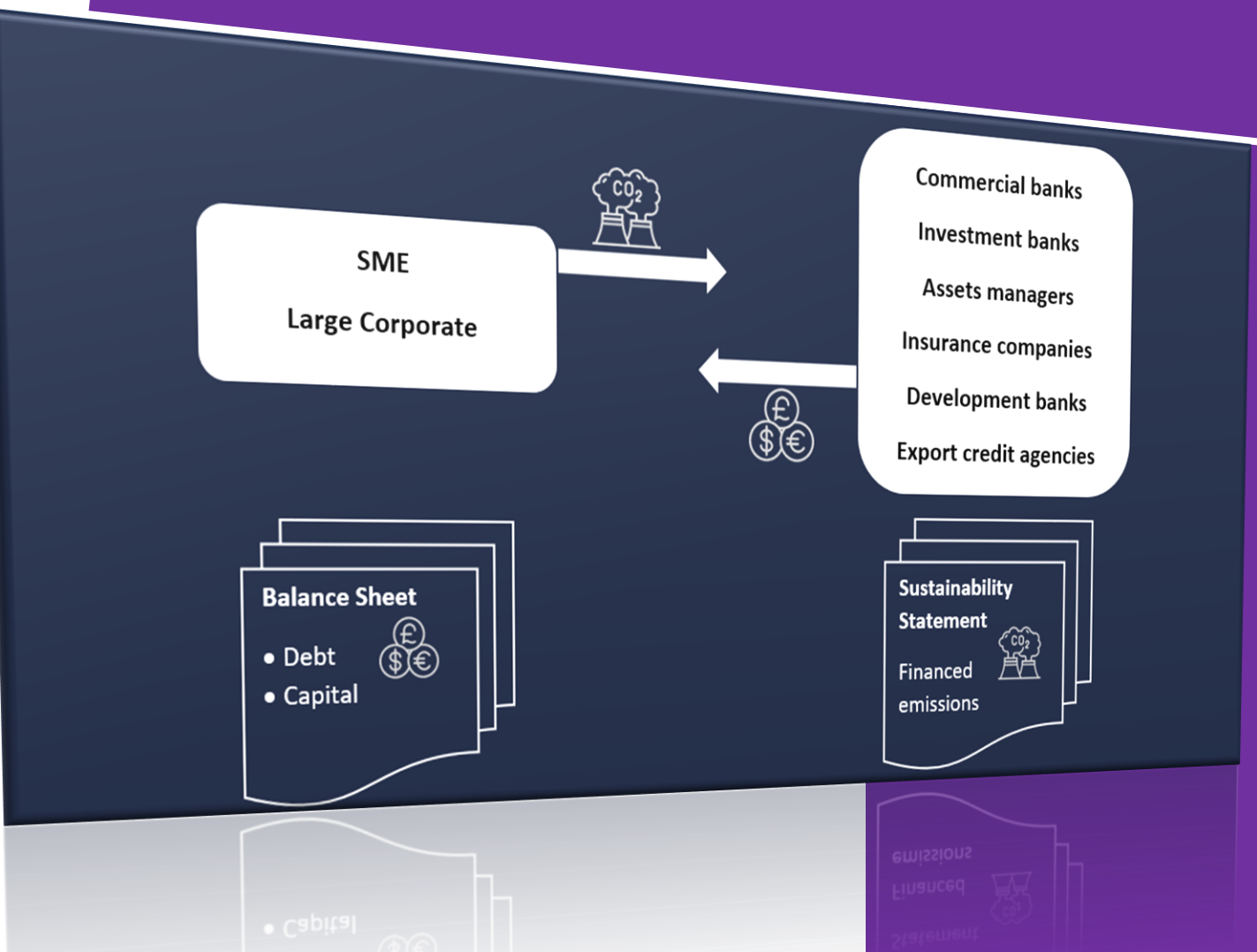
REPORTING ON FINANCED EMISSIONS: The Move Towards the Highest Data Quality and Implications for Organisations Seeking to Attract Funding



ESG Risk Viewer

Summary

Financial institutions across the world, who play a central role in facilitating the transition towards a low-carbon society are increasingly tracking and disclosing the greenhouse gases (GHG) emissions of their loans and investments. The existing methodologies used to calculate financed emissions encourage the use of the highest quality data to estimate the GHG emissions from investees companies.

When estimating a counterparty GHG emissions, most financial institutions are shifting from the use of data from *third party sources* to obtaining *verified data directly from the counterparty*. This shift has direct implications for counterparties, and in the case of SMEs operating in carbon-intensive industries, the implications could include

- providing detailed emissions data to capital and financing providers to assist them in meeting their stricter reporting obligations, and
- facing pressure from these capital and financing providers to develop and implement decarbonization strategies that align with their environmental goals.

In terms of access to financing, SMEs with lower emissions profiles may find it easier to access financing as capital and financing providers prioritise sustainable investments.

By understanding and addressing the concerns of capital and financing providers related to financed emissions reporting, not only can SMEs improve stakeholders' relationships, but they can also benefit from enhanced access to capital.

ESG Risk Viewer Carbon-only can be used by

- companies and organisations faced with sustainability data request – effectively relieving them from the burden of responding to numerous ad hoc requests, and
- financial institutions wishing to collect, consolidate and manage sustainability data from their counterparties and value chain actors in one secure place – effectively enabling them to capture data directly from these counterparties and to automate and simplify data flows.

Contents

Introduction

Small and medium enterprises (SMEs) are important drivers of economic growth and employment in many countries, generating around 50% to 60% of value added on average across OECD countries[1]. Although most SMEs focus on niche and local markets, they are also important partners in building resilient and competitive global value chains for larger companies.

SMEs face substantial barriers to accessing capital despite their pivotal role. High interest rates and the absence of collateral, amongst others can hinder access to essential financial resources; and for those SMEs which are successful in raising funds, capital and financing providers mainly focus on *financial metrics,* which are sometimes volatile for SMEs*,* as a basis for their initial and continuing decisions to provide funding.

In this article, we present a new basis that is used by a growing number of capital providers in making financing decisions: the *financed emissions metric*, as an important, yet unexplored route to financing for SMEs.

Starting from capital and financing providers' perspective, we explain financed emissions and how they are calculated and reported for loan portfolios and investments. Next, we highlight the issues with data quality that capital and financing providers face when obtaining data on GHG emissions about their investees companies. We also use some examples of disclosed methodologies on financed emissions to illustrate the desire to shift from obtaining data from *third party sources* to obtaining *verified data directly from their investees companies*.

From the investee companies' perspective, we explain the need to prepare *verifiable data* and to develop transition plans aligned with globally recognised frameworks, thereby contributing to the capital and financing providers' efforts to reduce their financed emissions.

Finally, we present some of the capabilities of ESG Risk Viewer in helping organisations of all sizes around the world prepare verifiable data on GHG emissions, and share this data with their stakeholders.

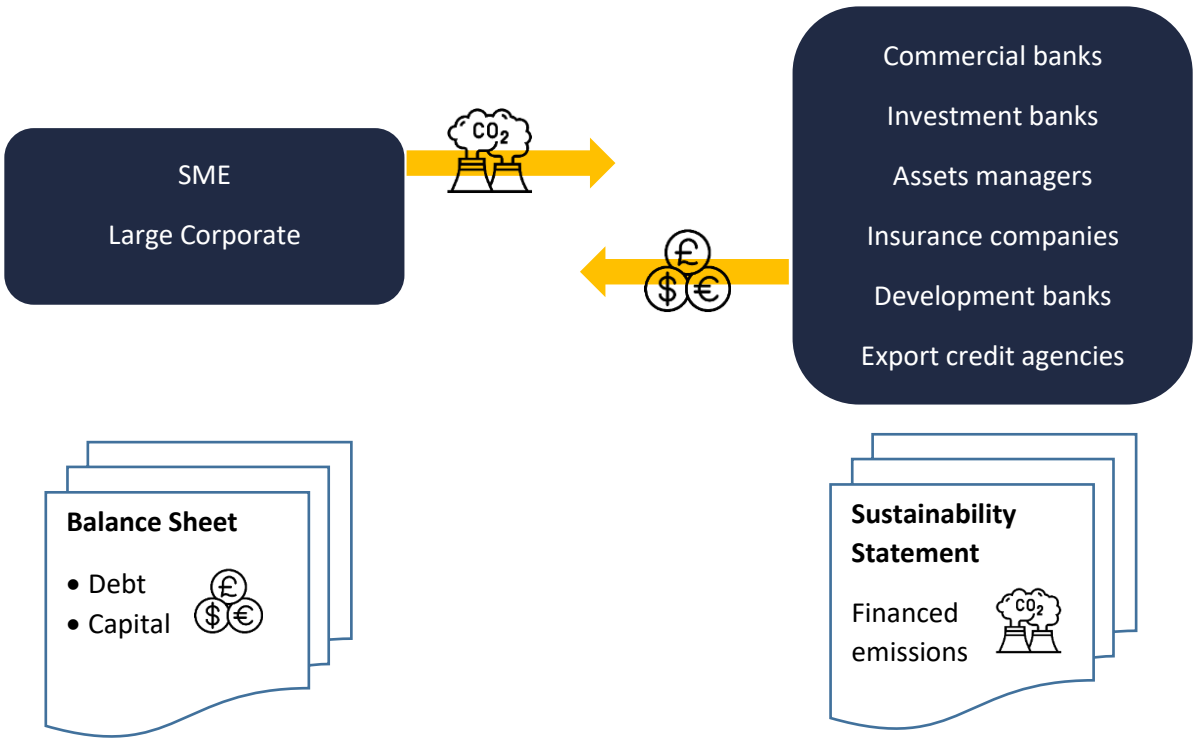
What are "financed emissions"?

Financed emissions represent the GHG emissions associated with the lending and investment activities of financial institutions such as commercial banks, investment banks, assets managers, insurance companies, development banks and export credit agencies. These are the emissions that occur as a result of the financial support provided to companies, projects, or sectors that generate emissions. For example, when a commercial bank provides a loan to a company to build a power plant, any emissions arising from the operation of that plant are reported as *financed emissions* by the commercial bank.

Financed emissions fall within scope 3 (category 15) downstream emissions under the GHG Protocol. This is because providing capital or financing is a service provided by the financial institution. The tracking and the reporting of their financed emissions can help financial institutions achieve multiple objectives such as creating transparency for stakeholders, managing the financial risks associated with climate policies and regulations, and creating new financial products to further the transition to net zero.

[1]OECD (2024) Structural business statistics by size class and economic activity (ISIC Rev. 4).

Figure 1: Financed emissions



How are financed emissions calculated?

Financed emissions link the financing provided by a financial institution to its customers and their activities in the real economy. Using the Partnership for Carbon Accounting Financials (PCAF)'s Global GHG Accounting & Reporting Standard for example, financial institutions can quantify emissions which are produced by their counterparties, and attribute a proportion of these emissions to the institution responsible for financing them using the following formula:

$$Financed\ emissions = \sum Attribution\ factor\ \times Counterparty\ emissions$$

Attribution factor

The attribution factor is the ratio between the outstanding amount of counterparty finance (numerator) and the economic value of the financed counterparty (denominator), calculated using the following formula:

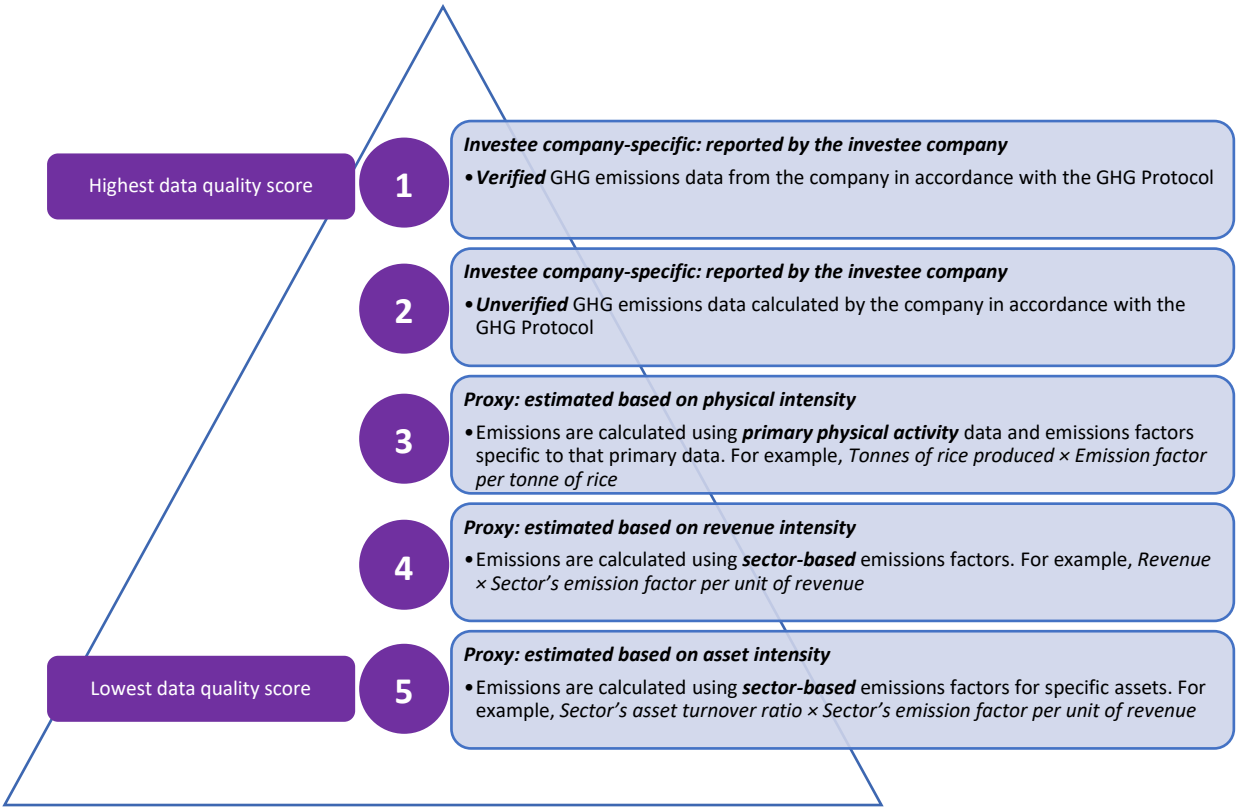
$$Attribution\ factor = \sum \frac{Outstanding\ amount}{Economic\ value\ of\ the\ counterparty}$$

Counterparty emissions

When estimating the counterparty emissions, most financial institutions adopt the PCAF data quality hierarchy to help provide transparency in their calculation methodologies. Proxies are based on

reported emissions, *physical activity-based emissions*, or *economic activity-based emissions*, and data is prioritised according to its source and its robustness.

Figure 2: Data quality score hierarchy and description



Source: Adapted from *Table 10.1-2. Detailed description of the data quality score table for business loans and unlisted equity*. PCAF (2022). The Global GHG Accounting and Reporting Standard Part A: Financed Emissions. Second Edition.

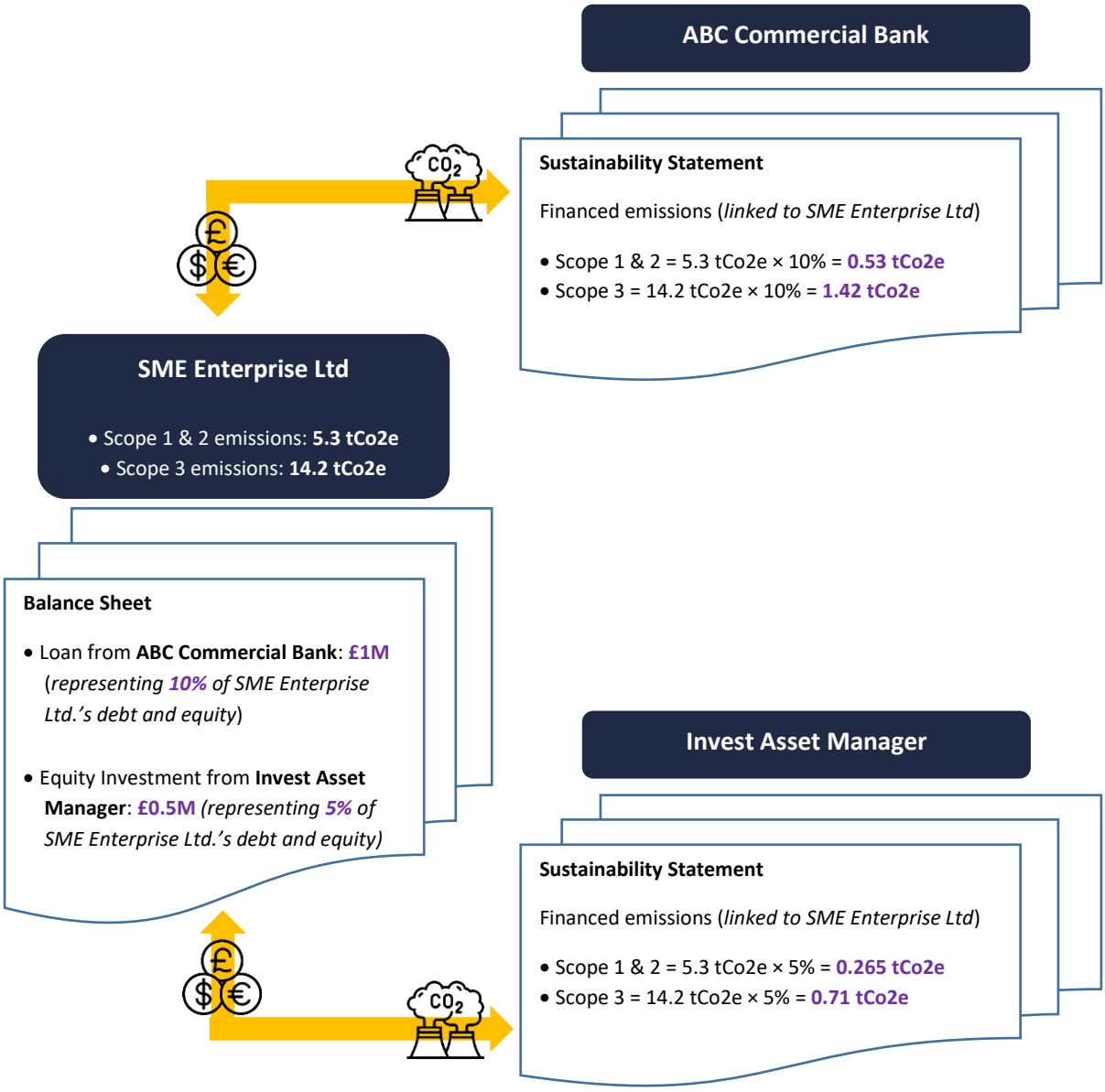
Calculating financed emissions: illustrated example

SME Enterprise Ltd's GHG emissions include 5.3 tCo2e for scope 1 & 2 emissions and 14.2 tCo2e for scope 3 emissions; and the company has the following debts and capital included on its balance sheet:

- Loan from ABC Commercial Bank: £1M (representing 10% of SME Enterprise Ltd.'s debt and equity),
- Equity Investment from Invest Asset Manager: £0.5M (representing 5% of SME Enterprise Ltd.'s debt and equity).

For simplicity, we assume that ABC Commercial Bank, Invest Asset Management and SME Enterprise Ltd have the same reporting period.

Figure 3: Calculation of financed emissions



Reporting on financed emissions around the world: methodologies and issues with data quality

Financial institutions, who play a central role in facilitating the transition towards a low-carbon society are increasingly tracking and disclosing the GHG emissions of their loans and investments. Measuring the financed emissions of a portfolio is the foundation enabling these financial institutions to perform scenario analysis, set targets, inform their actions and disclose progress.

In this section, we present some examples of disclosed methodologies on financed emissions by selected financial institutions. In presenting these methodologies, the goal is to highlight their desire to shift from obtaining data from *third party sources* to obtaining *verified data directly from their investees companies*.

Africa

KCB Bank Kenya Limited: HQ - Kenya

"….we engaged Carbon Trust to quantify our portfolio footprint (financed emissions) for the financial year 2023 (FY 2023). The exercise was focused on Scope 3, Category 15: Investments for KCB Group Plc's subsidiary, KCB Bank Kenya.

Data quality is crucial for accurate emissions calculations. The PCAF Standard outlines a data quality hierarchy, scoring data from 1 to 5, with 1 being the most accurate. From the exercise the Bank identified different data quality scores for each asset class and set up a plan to improve data accuracy in future assessments."

Source: KCB Group ESG & Sustainability Report 2023 (p.70)

Asset Class	Data Quality Score
Business Loans	4
Motor Vehicle Loans	4

Asia - Pacific

CIMB Group Holdings Berhad: HQ - Malaysia

"Understanding our financed emissions is a crucial step towards enabling a just climate transition, especially from a perspective of identifying carbon-intensive sectors, asset classes and clients, as well as developing climate targets and effective decarbonisation plans.

In 2022, we began measuring the emissions associated with our on-balance sheet financing for clients across four key operational markets: Malaysia, Indonesia, Singapore and Thailand. As standards, market practices and data availability continue to evolve, we strive to streamline and update our financed emissions calculation methodology and internal processes with a view to improve the completeness and accuracy of our outputs."

Source: CIMB Group Holdings (2023) Moving Forward with You: Sustainability Report 2023 (p.46)

Asset Class	Weighted Data Quality Score for Scope 1 & 2	Weighted Data Quality Score for Scope 3
Business Loans & Unlisted Equity	4.16	4.24

Europe

ABN AMRO: HQ - Netherlands

"While we are making steps to improve the quality of the data sources used for financed scope 1 and 2 emission, as evidenced by the improved data quality score, estimates of our clients' scope 3 emissions depend almost entirely on the environmentally extended input-output (EEIO) emission factors of carbon intensities by industry, as supplied by the PCAF. These emission factors have the lowest score for data quality and are currently limited to upstream scope 3 GHG emissions only. We

aim to gradually improve the coverage of clients' scope 3 emissions by using more client-specific data."

Source: ABN AMRO Integrated Annual Report 2023: Sustainability Statements, p. 252)

Asset Class	**PCAF average data quality score**
Corporate loans at amortised cost	4.4
Corporate loans at fair value through P&L	5.0

HSBC Holdings: HQ - United Kingdom

"The majority of our clients do not yet report the full scope of greenhouse gas emissions included in our analysis, in particular scope 3 emissions. In the absence of client-reported emissions, we estimated emissions using proxies based on company production and revenue figures. Although we sought to minimise the use of non-company-specific data, we applied industry averages in our analysis where company-specific data was unavailable through our vendor datasets. As data improves, estimates will be replaced with reported figures.

Third-party datasets that feed into our analysis may have up to a two-year lag in reported emissions figures, and we are working with data providers to help reduce this. Mapping external datasets to our internal client entities is challenging due to complex company ownership structures."

Source: HSBC Holdings plc (2024) Annual Report and Accounts 2024. (p.55)

Sector	**PCAF data quality score for Scope 1 & 2**	**PCAF data quality score for Scope 3**
Power and utilities	3.3	N/A
Iron, steel and aluminium	3.0	N/A
Aviation	3.3	2.4
Automotive	2.7	2.9

Groupe BPCE: HQ - France

"The continuous improvement of methodologies, tools and the enhanced quality and comprehensiveness of reported data will enable Groupe BPCE to better assess the level of emissions and the commitments of its clients during their transformation."

Source: Groupe BPCE (2024) TCFD, The climate report of Groupe BPCE, 2023 Edition (p.51)

Sector	**PCAF data quality score for Scope 1 & 2**	**PCAF data quality score for Scope 3**
Oil & Gas	Not available	3.7
Power generation	2.3	Not available
Automotive (Natixis CIB only)	Not available	3
Steel (Natixis CIB only)	3	Not available
Cement (Natixis CIB only)	3	Not available

Latin America

Banco Bradesco S.A.: HQ – Brazil

"The calculation of financed emissions is a constantly evolving process at Bradesco. Since implementing the PCAF methodology in 2020, we have sought to improve it in each cycle, combining technology with our analytical capacity in mapping, capturing and processing data to apply equations that enable the best possible quality for measuring the climate impact of our businesses.

When calculating our financed emissions, we cover GHG emissions generated by the granting of corporate loans from all legal entity segments in the expanded credit portfolio of Bradesco bank and investments managed by Bradesco Asset.

We always seek to use GHG emissions and financial data disclosed by companies in our analysis…. The availability of inventory data is still quite limited, as per demonstrated by the PCAF scores. In the absence of client data, we use the sectoral emission factors…"

Source: Banco Bradesco S.A. (2024) Climate Report Structured based on the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations (p. 36)

Corporate Credit Portfolio - Sectors	**PCAF data quality score for Scope 1 & 2**
Agriculture	4.80
Aluminium	2.99
Coal	5.00
Cement	4.32
Iron and Steel	2.97

Middle East and North Africa

First Abu Dhabi Bank (FAB) PJSC: HQ - United Arab Emirates

"As part of our first wave of disclosures, we have prioritised the O&G, power generation and aviation sectors. We chose these sectors as they contribute around 80%3 of our global greenhouse gas emissions. In line with NZBA requirements, we are focusing our efforts on priority sectors where we can have the most significant impact, i.e. the most GHG-intensive sectors within our portfolios.

Our outstanding exposure was measured, following PCAF standard recommendations, by considering loans and advances and long-term investments held for financing as of year-end 2021. Although we applied the methodology using the best data available, it is still subject to limitations:

• Our measurement depends on data availability at the client level.

• Methodology to calculate emissions might differ from one client to another.

• Client emissions data is generally not audited."

Source: First Abu Dhabi Bank (FAB) (2023) FAB'S Pathway to Net Zero (p.20 - 21)

North America

Fifth Third Bank: HQ - United States

"Availability and quality of data continue to be major limiting factors in the reporting of financed emissions. As PCAF points out, estimation methodologies currently in use for financed emissions have low data-quality scores and thus may not align with the actual emissions performance of the borrowers in scope. High-quality data, particularly emissions information direct from borrowers, in many cases is not available…

Because we have not performed an analysis of proxy data and we rely on emissions data that is estimated, actual emissions are likely to differ from those disclosed … Fifth Third is working toward higher data-quality scores for future emissions disclosures and will seek to leverage the highest quality data available to improve the decision usefulness and comparability of disclosed data over time…

At present, the Bank does not include any client reported emissions data as part of the calculation in this disclosure. Many clients are not yet disclosing emissions and those that do are not all disclosing in a uniform manner."

Source: Fifth Third Bank (2024) Financed Emissions Disclosure: Addendum to the 2022 Task Force on Climate-Related Financial Disclosures Report (p. 5)

Oaktree Capital Management, L.P.: HQ - United States

"Measuring and managing emissions is a key part of our long-term climate strategy. We aim to improve the quality of our GHG emissions data and work with our portfolio companies to improve disclosure. We follow PCAF guidance when calculating financed emissions but are constrained by data availability issues in certain asset classes and strategies.

We currently include Scope 1 and Scope 2 emissions when calculating portfolio company emissions. We currently do not include Scope 3 emissions because of the lack of quality data. We continue to evaluate how we might include Scope 3 emissions data in our financed emissions calculations in the future, in line with PCAF guidance."

Source: Oaktree Capital Management (2024) Oaktree Responsibility Report 2023 (p. 72)

TD Bank Group: HQ – Canada

"We estimate our financed emissions footprint in accordance with the guidance published by PCAF. By publishing our footprint, we aim to provide an overview of TD's attributed absolute financed emissions profile across sectors and asset classes, along with information on the quality of data underpinning our financed emissions calculations.

For business loans and investments, we generally observe that data quality is better for Scope 1 and 2 emissions compared to Scope 3. We also observe that data quality is stronger for larger public companies compared to smaller private companies; that is why, under the committed lending approach (which skews toward larger public companies), we see slightly better data quality scores. We intend to continue to update our financed emissions disclosures, including our data quality scores, over time as data quality and data coverage improve."

Source: TD Bank Group (2023) 2022 TD's Climate Action Plan: Report on Progress and Update on TCFD (p. 42 and p. 44)

Sector (for business loans and investments combined (drawn lending basis for business loans)	**PCAF data quality score for Scope 1 & 2**	**PCAF data quality score for Scope 3**
Energy	3.6	4.1
Power & utilities	3.7	-
Automotive	4.3	3.0
Shipping	4.6	-
Aviation	4.6	-
Agriculture	4.9	-
Industrials	4.8	4.8

Implications for investees companies

As we have explained so far, capital and financing providers such as commercial banks and assets managers are increasingly being held accountable for the emissions associated with their lending and investment portfolios. This practice has significant implications for investee companies, especially those operating in carbon-intensive industries.

Investee companies may be required to provide detailed emissions data to capital and financing providers to assist them in meeting their stricter reporting obligations. They may also face pressure from these capital and financing providers to develop and implement decarbonization strategies to align with their environmental goals. In terms of access to financing, companies with lower emissions profiles may find it easier to access financing as capital and financing providers prioritise sustainable investments.

By understanding and addressing the concerns of capital and financing providers related to financed emissions reporting, not only can investee companies improve stakeholders' relationships, but they can also benefit from enhanced access to capital.

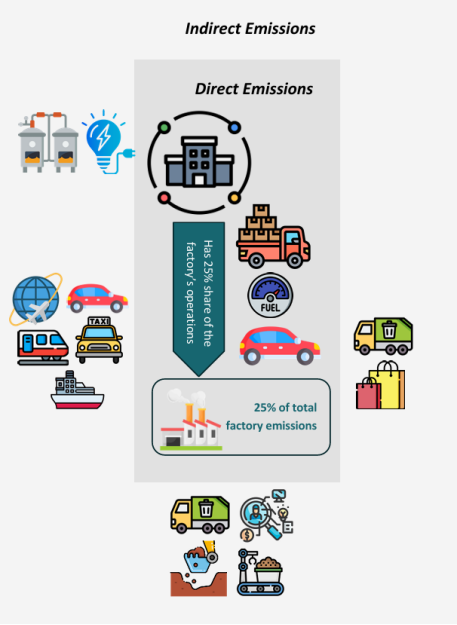
About ESG Risk Viewer – Carbon Solution

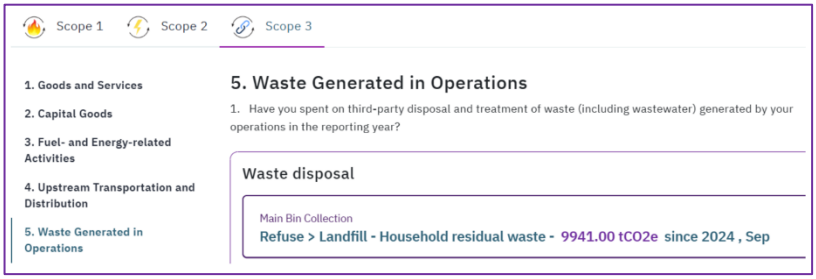
In this section, we present some of the capabilities of ESG Risk Viewer in helping companies of all sizes around the world, both providers of capital and investee companies to address the data quality concerns highlighted above.

From the setting of operational boundaries…

Your organisation's operational boundaries consist of all activities causing GHG emissions linked to the organisation's operations, broken down by categories: direct emissions and indirect emissions.

ESG Risk Viewer guides you in defining your operational boundaries with an intuitive and simple to complete questionnaire, covering scope 1, 2 and 3 emissions.





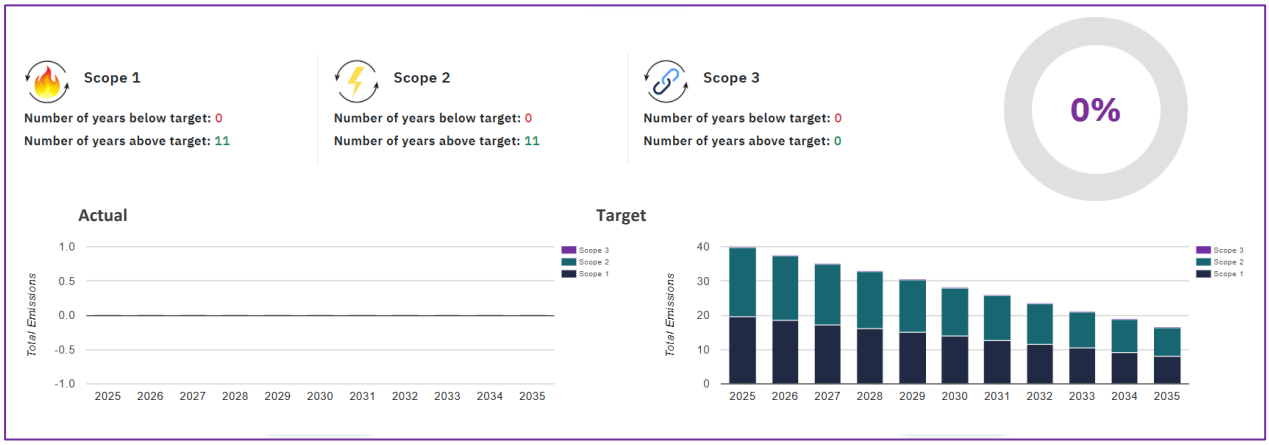
Even if your organisation has an existing tool to track and manage its GHG emissions, the existing information can easily be transferred into our platform.

…To the monitoring of actions and progress via an intuitive dashboard

Designed for businesses of all sizes, industries, all across the globe, ESG Risk Viewer empowers you to measure your carbon footprint and make informed decisions on how to reduce it, saving you time and money.

Everything is there to make it easier to

- *measure, track and benchmark your emissions,*
- *identify emissions hotspots, and*
- *obtain comprehensive reports on a click.*



The benefits are varied:

- *Focus on day-to-day activities,*
- *Speed your organisation's reply to information requests,*
- *Gain new business and access to sustainability-linked financing, and*
- *Comply with regulations.*

www.esgriskviewer.com

For further information about any of the contents of this article, please contact us at info@esgriskviewer.com

ESG Risk Viewer