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Are banks adapting well at each stage of financed emission disclosure?

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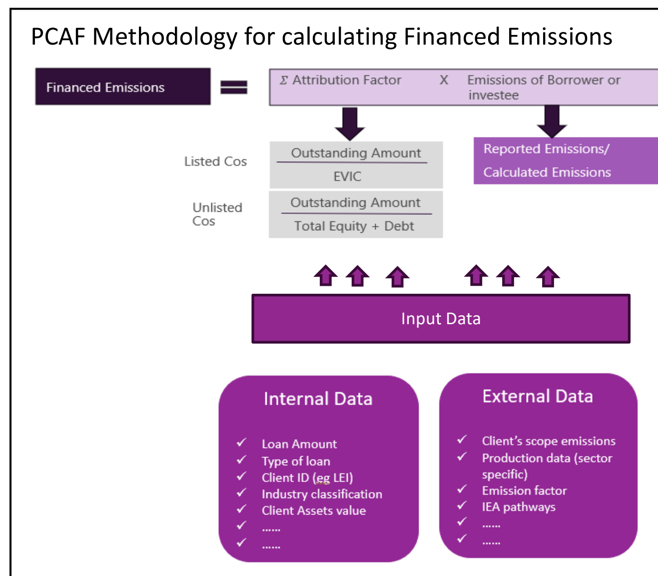
During our early days of learning, we all must have read about the exciting lifecycle of butterflies. When the egg hatches, a caterpillar emerges, which later turns into a pupa and then transforms into a strong-winged, beautiful butterfly. Nonetheless, each stage has its own adaptive requirements, typically known as favorable conditions, like warm weather and specific host plants. And somehow, I feel that a similar lifecycle journey exists with banks globally concerning their financed emissions measurement and disclosures. With emerging regulations and mounting pressure from stakeholders to reduce portfolio-level carbon footprints, many institutions are in different phases of methodology adoption and disclosures. Some financial institutions have just begun evaluating and syncing with the approach, while others are at an advanced stage, breaking away from methodology constraints. However, to flourish, they all need their share of favorable conditions in the form of **timely, reliable, and quality data access**.

Out of the 15 categories of Greenhouse Gas (GHG) scope 3 accounting, the last category is investment emissions, alternatively known as financed emissions. This refers to the carbon emissions that are generated by a bank's clients but are attributed to the bank in proportion to the loans, investments, lending, or finance provided by the bank. The organization Partnership for Carbon Accounting Financials (PCAF) published a methodology in 2020 to measure and disclose the GHG emissions associated with portfolios of loans, investments, provision of insurance, and other financial products and services. For such measurement, banks need a thorough understanding of the PCAF framework for different asset classes and the methodology of emissions calculation for clients and portfolios, which may span multiple industries and geographies when emission data is not provided by the client. Thus, the task of measurement is largely filled with data collection complexities, attribution accuracy, and data quality concerns, and this is where most banks are struggling. **Therefore, it is right to ask whether any banks have favorable conditions to reach their mature butterfly stage** - the stage where no data challenges exist, and banks can thus focus more on meaningful engagements for reducing impact or working towards portfolio alignment.

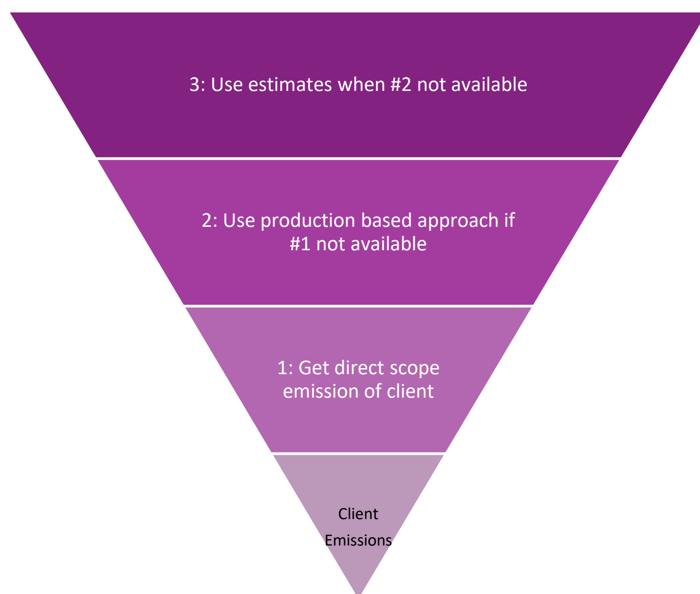


Regions like America and Europe are responsible for the accumulated carbon contribution, and thus regulatory pressure is more stringent on disclosures compared to other regions. Consequently, banks in different regions are at different stages of disclosures, some at the early stage, some at an advanced stage, or in the middle. However, all are facing one challenge or another in measuring their financed emissions.

Nascent Stage: Currently, there are regions where regulations are still evolving, and a limited number of companies and banks are reporting emissions or publishing their activity data. The trend suggests that many banks in such regions are becoming signatories to PCAF and claiming to be avant-garde in their region. For instance, , Banco Pichincha is the first Ecuadorian signatory to publish a disclosure with PCAF in 2024, while DenizBank is PCAF's first Turkish signatory, ArmswissBank is the first Armenian signatory, and Banco Popular Dominicano is the first Caribbean financial institution to join the race in the recent past. It is indeed a good start and an initiative from banks to be a part of like-minded institutions. However, **access to data** remains a big challenge in such regions, where banks are bound to choose either reporting estimated emissions or spending on acquiring data from a third party. BRAC Bank in Bangladesh and NMB Bank in Nepal, while reporting estimated financed emissions in their latest reports, mentioned that their region-specific data was unavailable in the PCAF database for emission factors.

Growth Stage: Banks in this stage have reported emissions at a granular level either for the first time to date or are preparing to disclose soon, such as US Bancorp, PNC Bank, Fifth Third Bancorp and M&T Bank. These banks are in the process of calculating their financed emissions, setting their net-zero targets aligned with industry standards, and will be disclosing the results in the coming year. However, the majority of banks in this stage are required to **allocate resources** for data, technology, analytics, and modeling. They need to fill unavailable **data gaps and rectify entries** internally, collect reported emissions data from **different sources** like clients or third-party data providers, and procure licenses or subscriptions for various sector-specific client data inputs from **multiple data providers**. This process is not only lengthy but may also cost a significant amount.

Since banks depend on external sources for their disclosures and reports, they have limited control over the **timely availability of required data** or the availability of data for emerging technologies like hydrogen capacity, biofuel, and CCUS. The **quality and reliability** of sourced data could also be questionable when no standard approach is followed by the bank's clients. JP Morgan, in its report, mentioned that the lack of reliable and standardized techniques for measuring methane emissions may lead to less accurate reporting. Thus, any inaccuracies in the data undermine the bank's targets and could have a significant impact on their ability to meet them.



Advanced Stage: Banks in this stage have reported emissions for priority sectors in the first wave and are moving to or have completed wave 2 disclosures for the next set of hard-to-abate sectors. The approach and challenges remain similar to what growth stage banks contend with. Additionally, they have been facing additional concerns during year-over-year reporting, which may distort the bank's progress against the interim target. These concerns include equity market volatility leading to changes in EVIC,

transitory spikes or falls in year-end outstanding balances, transitioning from estimated to reported actual data by clients, and any inconsistencies in clients' own reporting, among others. All these factors impact on the financed emissions without any changes in actual sectoral emissions performance or changes in the bank's financing activities.

Citi Bank mentioned that the year-over-year reduction in financed emissions in its Energy portfolio was primarily due to the general increase in market valuation and EVIC for the portfolio, as well as fluctuations in year-end exposure. PCAF is working to address these shortcomings in the methodology; however, banks like JP Morgan have already carved out possible solutions for a few of them. The bank has been using its own defined approach of a 3-year average EVIC to deal with equity market fluctuations and a 12-month average committed financing against end-of-period EVIC and year-end outstanding balance, respectively, as suggested in the PCAF methodology.

Conclusion

The PCAF Standard is still evolving, aiming to provide a robust and transparent framework for financial institutions to assess and report their financed emissions, ultimately contributing to a more sustainable financial system. Recently, it partnered with S&P sustainability1 to address challenges related to the scarcity of high-quality data and the lack of standardization across existing reporting processes. Additionally, the government of each local region should mandate corporates to report emissions, similar to the move taken by the Governor of California in October 2023, when he signed a new law requiring big companies in the region to disclose emissions. Finally, simplifying this intricate process of calculating financed emissions is essential for accurate measurement, which would lead to target setting, effective mitigation strategies, and ultimately combating the impacts of climate change.

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