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Fund Managers - Estimating the GHG emissions of Loans & Investments (PCAF)
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INTERPRETATION

OF GLOBAL GHG ACCOUNTING AND REPORTING STANDARD FOR THE FINANCIAL INDUSTRY OF PARTNERSHIP FOR CARBON ACCOUNTING FINANCIALS (PCAF)

> **The GHG emissions financed by the loans and investments from financial institutions are called financed emissions or portfolio climate impact.**

The Partnership for Carbon Accounting Financials (PCAF) is an industry-led initiative, which helps financial institutions assess and disclose the greenhouse gas (GHG) emissions from their loans and investments through GHG accounting. Responding to industry demand for a global, standardised GHG accounting approach, PCAF developed the Global GHG Accounting and Reporting Standard for the Financial Industry, serving as a tool guiding banks, asset owners, asset managers and insurers in measuring, disclosing and managing their financed emissions as well as the climate impact of the organisation's lending and investment activities.

GHG accounting is the fundamental part of aligning with the Paris Agreement

The standard recommends five stages that financial institutions can follow to align with the Paris Agreement. Central to the journey is measurement and disclosure of carbon profile, which lays the foundation for setting science-based targets. From GHG accounting to setting SBTs, financial institutions need to measure the absolute GHG emissions of its loan and/or investment, calculate its attributed emissions, generate emission intensity through the application of attribution factor (Σ financed emissions/Σ total attributed activity) and select decarbonisation pathways with emission-based SBT according to SBTi Guidance.

Choosing "control" approach over "equity" approach

While GHG Protocol sets forth three consolidation approaches to define the organisational boundaries of the reporting company, the standard requires that financial institutions measure and report their financed emissions using either the operational control or financial control approach. This is primarily due to the nature of cases when more investments are typically not intended to hold a controlling interest, which leads to a simplified and clear picture by making the financed emissions, under most circumstances, fall under scope 3 emission category 15.

Guidance for selecting the right approach in the calculation of financed emissions

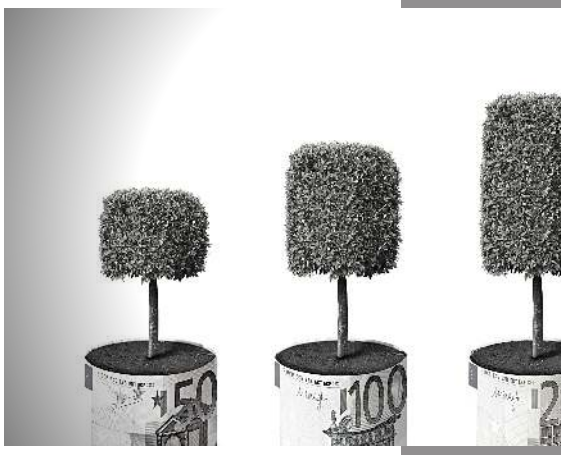
Adhering to the principle of "follow the money", PCAF covers a list of six asset classes of which the accounting methods are given. Financial institutions choose the type and source of financing provided among corporate finance, project finance and consumer finance first, followed by the activities for which the proceeds are used. Based on the choices made, financial institutions end up applying the appropriate asset class method to account for their financed emissions.

Preference for using EVIC (Enterprise Value Including Cash)

In calculating the attribution factor, financial institutions should adopt EVIC of listed companies as the denominator. While emissions tend to be attributed to the total market capitalisation generally, the standard recommends a smooth transition to using EVIC, given its merits including the commonality in the financial sector and avoidance of potentially negative enterprise values.

Three different options for the calculation of financed emissions

As suggested by the standard, three options, namely *Reported Emissions*, *Physical Activity-Based Emissions*, *Economic Activity-Based Emissions*, are distinguished for calculating the financed emissions. Reported Emissions and Physical Activity-based Emissions are normally preferred over Economic Activity-Based Emissions due to their superiority in data quality.



Determination of property value at origination

For asset classes including Commercial Real Estate and Mortgages, the property value at origination may not be easily retrievable considering the varying national and regional policies. As such, by recognising the availability of property value at origination, financial institutions shall use the latest property value available and make it constant for the following years of GHG accounting.

Weighted data quality scores

Data quality is one of the key components highlighted by the standard, in which data quality score tables are provided for each defined asset class ranging from 1 (Highest Data Quality) to 5 (Lowest Data Quality). Financial institutions are encouraged to publish a weighted data quality score by the outstanding amount of the data quality of reported emissions data - Σ Outstanding amount * Data quality score/Σ Outstanding amount.

LISTED EQUITY AND CORPORATE BONDS

For listed companies:

$$\sum_{c} \frac{Outstanding\ amount_c}{EVIC_c} \times Verified\ company\ emissions_c$$

For bonds to private companies:

$$\sum_{c} \frac{Outstanding\ amount_c}{Total\ equity + debt_c} \times Verified\ company\ emissions_c$$

BUSINESS LOANS AND UNLISTED EQUITY

For business loans and equity investments to/in private companies:

$$\sum_{c} \frac{Outstanding\ amount_c}{Total\ equity + debt_c} \times Verified\ company\ emissions_c$$

For business loans to listed companies:

$$\sum_{c} \frac{Outstanding\ amount_c}{EVIC_c} \times Verified\ company\ emissions_c$$

PROJECT FINANCE

$$\sum_{p} \frac{Outstanding\ amount_p}{Total\ equity + debt_p} \times Verified\ project\ emissions_p$$

COMMERCIAL REAL ESTATE

$$\sum_{b,e} \frac{Outstanding\ amount_b}{Property\ value\ at\ origination_b} \times Actual\ energy\ consumption_{b,e} \times Supplier\ specific\ emission\ factor_e$$

MORTGAGES

$$\sum_{b,e} \frac{Outstanding\ amount_b}{Property\ value\ at\ origination_b} x\ Actual\ energy\ consumption_{b,e} \times Supplier\ specific\ emission\ factor_e$$

MOTOR VEHICLE LOANS

$$\sum_{v,f} \frac{Outstanding\ amount_v}{Total\ value\ at\ origination_v} \times Fuel\ consumption_v \times Emission\ factor_f$$

CARBON ACCOUNTING

(An Illustrative Example of Option 1a)

Reference:
(PCAF) The Global GHG Accounting and Reporting Standard for the Financial Industry - https://carbonaccountingfinancials.com/standard

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