

All About Financed Emissions

INTRODUCTION

Financed emissions refer to the greenhouse gas (GHG) emissions generated by the activities financed by financial institutions. These emissions are linked to lending, investments, and services provided by financial institutions that enable carbon-emitting activities such as manufacturing, energy production, transport, and infrastructure development (StepChange, 2024). These emissions are caused by indirect activities occurring outside the operational boundaries of a financial institution and are classified as **Scope 3 Category 15** emissions under the GHG Protocol's Corporate Value Chains (Scope 3) Standards (GHG Protocol, 2011).

The GHG emissions associated with financial institutions' investing, lending, and underwriting activities (classified under Category 15 of the GHG accounting protocol) amount to an average of more than 700 times their direct operational emissions (CDP Worldwide, 2021). As providers of capital, financial institutions can play a critical role in influencing carbon-intensive projects and businesses. Therefore, measuring financed emissions is important for financial institutions in the following ways:

Emissions Reduction Targets

Measuring financed emissions can provide financial institutions a baseline to set science-based emission reduction targets and develop transition plans to meet the country's Paris Climate Goals. Contextualised with NDC.

Identify Climate-related risks

Accounting for financed emissions of a portfolio aids the financial institution in identifying transition risks from potential regulatory or market changes.

Meet Regulatory Requirements

Measuring financed emissions is becoming an essential part of regulatory compliance as more governments and country financial regulators push for climate-related disclosures. Thought that the country context needs to be incorporated hence added country.



ACCOUNTING METHODOLOGY FOR FINANCED EMISSIONS

Financed emissions are calculated based on guidance and methodology provided under the Partnership for Carbon Accounting Financials (PCAF) standards. To ensure consistency in practice and easier adoption, the PCAF Financed Emission standards are built on the core principles of the GHG Protocol's Corporate Accounting and Reporting Standard and the GHG Protocol Corporate Value Chain (Scope 3) Standard, which are further classified into 15 categories. The PCAF standard (2020) relies on the following unique principles for financial activities:

1. Measurement

Financial institutions shall measure and report their financed emissions for each asset class by "following the money," which means that the money should be followed as far as possible to understand and account for the emissions caused by the financial investments.

2. Attribution

The financial institution's share of emissions shall be proportional to the size of its exposure to the borrower's or investee's total (company or project) value.

The financed emissions calculation equation, which includes an 'attribution factor' and 'emissions of borrower or investee' embeds the application of these principles, which vary based on asset class. The PCAF standard provides detailed guidance on the definition, attribution formulas, and emission data requirements depending on the selected asset class.

Financed emissions

=

$$\sum_i$$

Attribution factor_i

↓

$$\frac{\text{Outstanding amount}_i}{\text{Total equity + debt}_i}$$

X

Emissions_i

(with 1 = borrower or investee)

Additionally, the standard has five levels of data quality. The lower levels of data allow estimates and proxy data for emissions calculation, which aids financial institutions in identifying carbon-intensive hotspots in their portfolios. This ensures that data limitations do not deter financial institutions from taking the first steps toward preparing their inventories.

REFERENCES

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