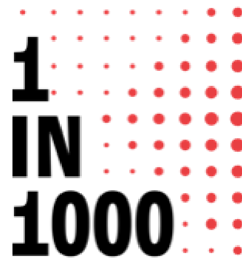
1 IN 1000

0% OF PCAF SIGNATORIES COMPLY WITH PCAF REPORTING REQUIREMENTS

A review of 70 disclosures by PCAF signatories as to their compliance with the PCAF standard

About 1in1000

1in1000 is a research program by the 2° Investing Initiative that brings together new & existing research projects on long-termism, climate change, and adjacent future risks for financial markets, the economy, and society. Its objective is to develop evidence, design tools, and build capacity to help financial institutions and supervisors to mitigate and adapt to future risks and challenges. The programme focuses on climate change (inter-) connected risks and challenges, notably risks stemming from ecosystem services and biodiversity loss, as well as risks from social cohesion and resilience. To achieve this objective, 1in1000 operates with three main areas: i) Long-term metrics; (ii) Risk (management) tools and frameworks; and (iii) Policies & incentives.



Author: Jakob Thomä

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To avoid naming and shaming, no individual financial institutions are mentioned in this report. Any financial institution that would like to see their assessment, can contact jakob@2degrees-investing.org and we will share it on a confidential basis. We commit to publicly disclosing any errors or omissions should this review process identify any.

The report was shared with the PCAF Secretariat prior to publication in order to identify any misstatements, errors, or omissions. Any public statements will be added as an annex to this report.

I. Introduction

The PCAF methodology standard (2020) lays out a set of "reporting requirements" that all PCAF signatories must comply with. This report seeks to identify the extent to which PCAF signatories comply with certain components of these requirements in their PCAF disclosure. In particular, the analysis focuses on the following two requirements

- ***Recalculation and significance threshold**: "Financial institutions shall, in line with the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard requirement (pg. 104162), establish a baseline recalculation policy to define under which circumstances a recalculating of (base year) financed emissions is necessary to ensure the consistency, comparability, and relevance of the reported GHG emissions data over time. As part of this base year emissions recalculation policy, financial institutions shall establish and disclose the significance threshold that triggers base year emissions recalculations."*

- ***Coverage. "**Financial institutions shall disclose the percentage of their total loans and investments covered in their financed emissions inventories for the six asset classes covered in Chapter 5 (e.g., a financial institution's total outstanding loans and investments by asset class noting any limitations and exclusions)."*

The review also seeks to identify the extent to which sector-specific results are disclosed, an important feature of climate-related disclosures identified across a range of frameworks, notably the TCFD. There is some ambiguity in the PCAF standard wording as to whether disaggregated data at sector level is mandatory or not. As a result, this component is not clearly identified in this report as a requirement but reviewed given the understanding that such transparency at minimum constitutes best practice and may be considered required under a narrow reading of the standard.

Finally, the report looks to identify the share of PCAF disclosures where more than 50% of the underlying data used to inform the disclosures meets the PCAF data quality score 3 or higher, effectively involving client specific estimates or better data beyond the clients' sector and regional split. It is important to flag here that neither disclosure of data quality nor specific thresholds are required under the PCAF standard.

The objective of this review is not to name and shame any individual PCAF signatory. It is for this reason that the actual results for individual institutions are not publicly provided, although they may be reviewed by the individual financial institutions upon request, and we are ready to correct any omissions or errors that this process may reveal. Rather, our goal is to raise the overall standard of disclosures and ensure compliance with guidelines to avoid potential greenwashing risks associated with pledging frameworks. Finally, the ambition demonstrated by the PCAF standard to require rebaselining policies is an important step in the direction of accounting impact and avoiding disclosures of "paper emissions" versus real-world emissions reductions and thus standard compliance can shift the market more broadly towards impact.

Section II outlines the approach and Section III summarizes the results. Section IV provides some concluding remarks and recommendations on next steps.

II. Approach

According to the PCAF website, 279 financial institutions are PCAF signatories. The disclosures of 82 of the 279 signatories both reference the status as PCAF signatory and have their disclosures featured on the PCAF website. Of the 82 disclosures available on the PCAF website, this report reviewed 70, with 12 discarded due to language barriers in processing the report information. The review process involved a manual review of the documents to identify references to the elements described above. This review involved a combination of section reviews, searching relevant terms, and where necessary, a review of the financial institutions' website and linked material for complementary analysis.

Following caveats need to be considered:

- **Timestamp.** A manual review of financial institutions' websites suggests that the PCAF website may not always host the most recent financed emissions disclosures. The results may thus not reflect the most up to date disclosures of PCAF signatories.

- **Other information.** The analysis focused on the disclosures of PCAF signatories highlighted on the PCAF website. While the PCAF standard suggests that the disclosure should be in one place, it may be that further information not tracked in the PCAF report exists through other channels.

- **Human error.** The processing of 70 PCAF reports involved a significant amount of manual labour. It is thus not impossible that any individual analysis may not be accurate. The process did involve however spot checks to ensure the accuracy of the analysis.

- **Interpretation & judgement calls.** Not all data disclosed could clearly be categorized and there were a handful of cases where the authors had to make judgement calls as to how to interpret the compliance. Overall, the report sought to give the benefit of the doubt in these cases. For example, not all disclosures were transparent on the coverage in a way that could easily be read. However, in many cases even if financial institutions were not transparent on coverage, the coverage could be "reverse engineered" based on other information provided by the financial institutions either in the PCAF reports or elsewhere. While it is subject to interpretation whether this satisfies the PCAF principle of "transparency", generally PCAF signatories were considered compliant with the standard if coverage could be assessed in some form. Nevertheless, some degree of judgement call was often necessary given the lack of clarity of some of the disclosures.

III. Results

Does the financial institution disclose – in line with the GHG Protocol Standard (pg. 104) the baseline recalculation policy and the significance threshold that triggers recalculations?

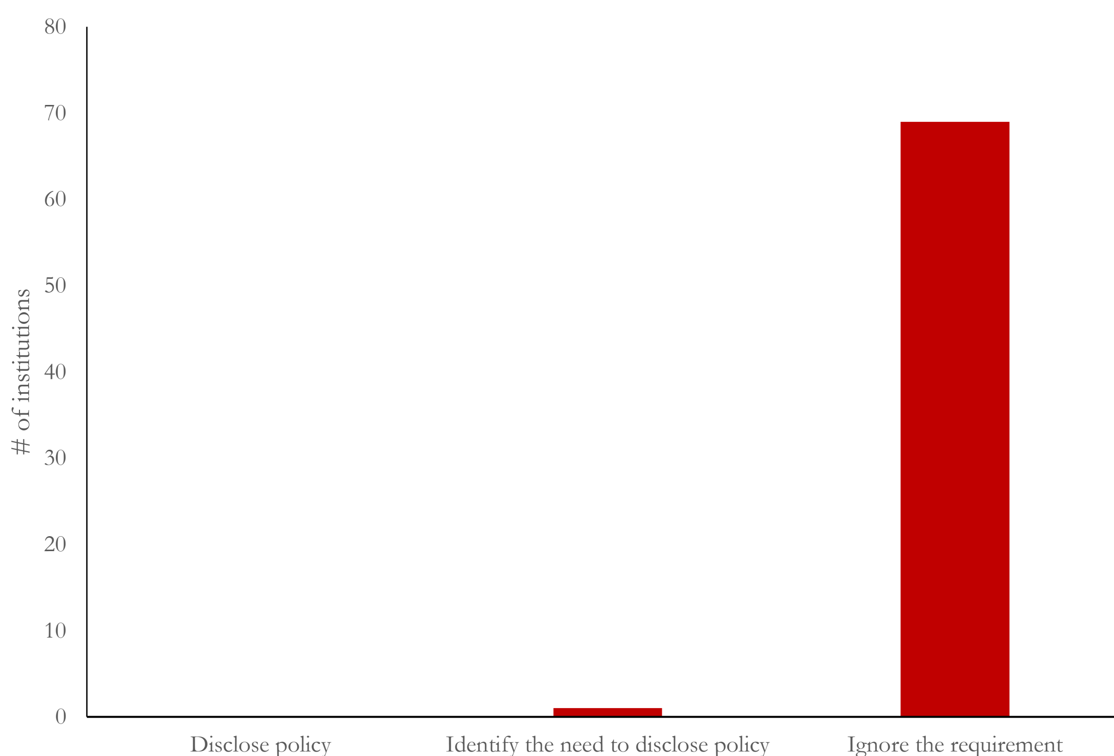
The PCAF standard requires ("shall") that financial institutions define a baseline recalculation policy and that they disclose this policy. This is consistent with the general GHG Protocol standard which requires that:

"Companies shall recalculate base year emissions when significant changes in company structure or inventory methodology occur. In such cases, recalculating base year emissions is necessary to maintain consistency and enable meaningful comparisons of the inventory over time. Companies are required to recalculate base year emissions when the following changes occur and have a significant impact on the inventory: structural changes in the reporting organization, such as mergers, acquisitions, divestments, outsourcing, and insourcing(...) Significant changes result not only from single large changes, but also from several small changes that are cumulatively significant. (...) Structural changes trigger recalculation because they merely transfer emissions from one company to another without any change in emissions released to the atmosphere (e.g., an acquisition or divestment only transfers existing GHG emissions from one company's inventory to another)."

The guidance is clear that small changes should trigger recalculation when these have significant effects. The review of the PCAF disclosures identified only one financial institution that explicitly referenced this issue and zero institutions that disclosed in line with PCAF standard. Several institutions reference the issue of baseline, but do not make reference to the requirement for rebaselining.

It is apparent that for the majority – if not all PCAF signatories – such a policy does not exist, contravening both PCAF (2020), GHG Protocol (2011), and other best practice guides (FSEG 2022). From this vantage point, not a single PCAF signatory complies with the PCAF standard currently. It is worth flagging for the sake of completeness that some institutions may indeed argue that – for financial institutions – no such rebaselining would ever be required. It is unclear however such an argument fits to the GHG Protocol guidance that rebaselining is required even for small changes with cumulative effects. Even under this scenario, institutions would still be required to disclose that policy.

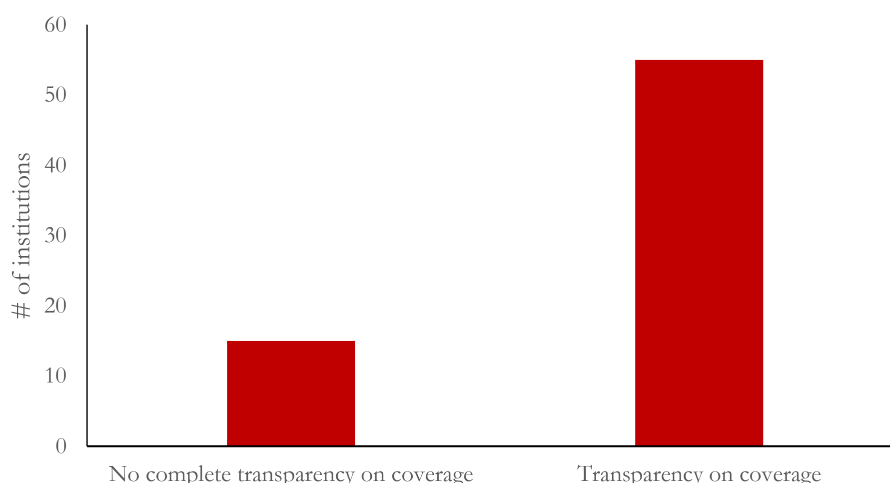
Fig. 1: Compliance with PCAF standard on rebaselining across PCAF signatories (Source: Authors)



Does the financial institution disclose the percentage of their total loans and investment covered in their inventories?

This item seeks to ensure transparency as to what percent of the activities are disclosed. In theory, this is a straightforward indicator to disclose. However, the assessment of this indicator proved complicated. Many disclosures were not explicit as to whether they indeed covered 100% of their loans and investments even though this information may be inferred from the accounts. Sometimes – as mentioned above – disclosures did not provide transparency on coverage, but the coverage could be inferred based on other information. There was a grey zone here where the authors sought to be conservative. However, even in these circumstances, over 20% of PCAF signatories (15 out of 70) did not provide complete transparency as to what % of their loans and investment were covered by the PCAF assessment.

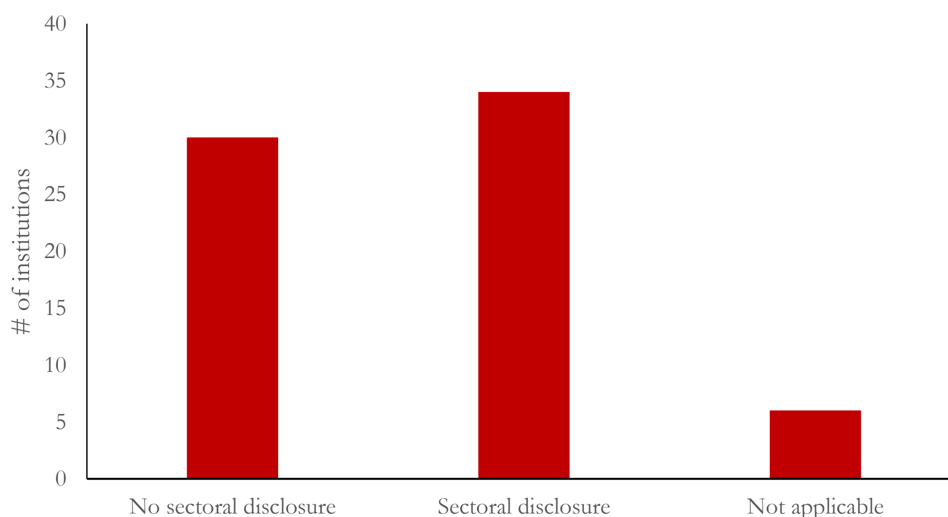
Fig. 2: Compliance with PCAF standard on disclosure of coverage (Source: Authors)



Does the financial institution disclose the sectoral split of their emissions?

As outlined above, it is unclear from the PCAF standard whether such granularity is required or simply recommended. However, we review it as it represents a crucial information point to interpret a financial institutions' footprint. We filtered for institutions that only disclosed asset classes without sector splits (e.g. residential mortgages). Our research finds that almost half of all PCAF signatories do not provide granular sectoral disclosures.

Fig. 3: Compliance with PCAF standard on sectoral granularity (Source: Authors)



Does the signatory inform on data quality and if yes, can it reasonably be inferred that at least 50% of their disclosures are based on data quality 3 or higher (i.e. based on actual disclosures or client-specific estimates based on client-specific characteristics)?

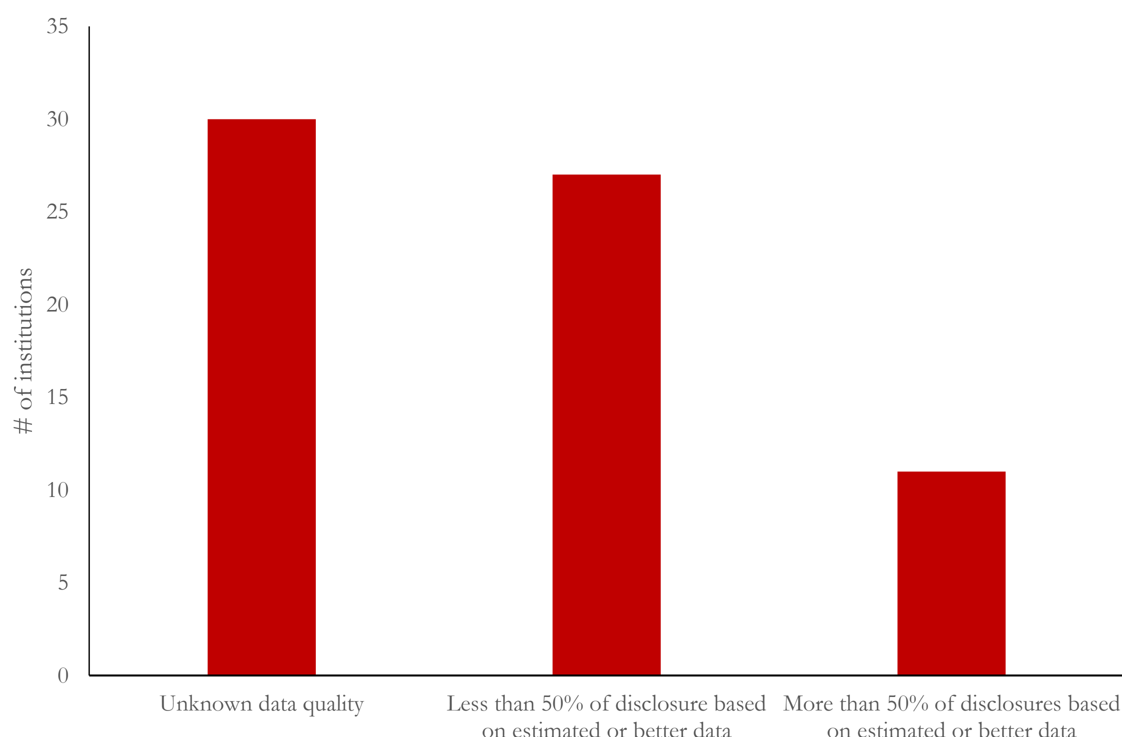
PCAF has developed a data quality score of 1 to 5, with 1 being disclosed and audited data and 5 being data based on limited inference points. Data quality scores 4 and 5 basically are limited to emissions estimates using sectoral and regional splits of clients, with no additional information. As outlined above, disclosing this is not mandatory in the standard.

Of the assessed disclosures, we were able to identify information in some form on data sources for about 70% of disclosures (49 disclosures). However, only 38 of those 49 disclosures were sufficiently granular for us to infer additional information on the data quality itself based on this transparency. Some institutions reported their scores by asset class, some simply provided qualitative information on the data quality and sources. In order to try and identify a consistent approach, we sought to identify those institutions where at least 50% of their disclosures were based on data quality scores 3 or higher. Data quality 3 is still quite low, with recent estimates from FTSE (2022) suggesting that a quarter of estimated values have a data error of +/- 200%. However, even this standard is reached by less than 30% of PCAF disclosures. Overall, we estimate that over 70% of PCAF disclosures are based primarily on sector-regional emissions averages and thus effectively provide no meaningful insight into lending and investment strategies of the disclosing entities beyond their regional focus and their sector splits.

Notable exceptions were several disclosures focused on real estate where financial institutions were able to use energy performance certificates, project finance, and some investors with targeted disclosure and data collection mechanisms. Despite these exceptions however, we conclude that roughly 70% of PCAF disclosures have no meaningful explanatory power given the current data quality of these disclosures.

Again this assumes that estimated data can be considered credible in informing on overall portfolio' footprint, which may be contested in light of the research cited above.

Fig. 4: Data quality of PCAF disclosures (Source: Authors)



IV. Conclusion & outlook

The review conducted here demonstrates that for all intents and purposes not a single PCAF signatory is fully compliant with the PCAF standard. This raises significant questions for PCAF and the related process. If PCAF membership does not require compliance with the standard, how can PCAF protect against greenwashing and ensure harmonization of approaches? While not a specific focus in the review, we identified several disclosures where financial institutions specifically and explicitly violate the PCAF standard on other items as well – although this was usually clearly signposted. If such violations are possible while remaining a PCAF signatory, what role does the standard serve?

At the moment, mechanisms to enforce compliance and / or drive consequences where compliance isn't achieved do not seem to exist in the PCAF universe. Moreover, there seems to be – in particular for specific disclosure requirements related to rebaselining – a common understanding among signatories that certain requirements in fact do not apply at all. It is the understanding of the authors that PCAF believes that regulators and civil society should enforce compliance and that the role of PCAF is limited to providing the standard, not enforcing compliance. This report is the first report that we are aware of that seeks to actually test compliance with the standard. In the context of growing awareness of financial regulators around the risks of greenwashing, this report highlights the significant risks that PCAF signatories are exposed to in terms of misleading marketing as it relates to compliance with industry standards.

Finally, there is a broader challenge to the PCAF framework from the evidence that the majority of disclosures effectively do not rely on actual data linked to their investment and lending decisions beyond high level regional / sectoral allocations, in particular for corporate lending. This raises questions about the usefulness of such exercises from a transparency perspective, beyond the internal change management such a process may engender, and whether there is a need to move to alternative data sets (e.g. asset-level data). Some actors suggest that this is useful from the vantage point of the "GHG accounting journey". However, this dynamic is contested and not clearly outlined as such in many disclosures with below standard data quality scores. At the moment at least, it does not appear that for the large majority of PCAF disclosures, the underlying footprint and financed emissions data provides meaningful information as to the lending decisions of the financial institutions disclosing. To address this issue, we make the following recommendations:

- **PCAF should address the deviations in approaches identified in some disclosures and disclose a clear policy as to interpreting this non-compliance and potential consequences for the participation in the PCAF process.**

- **PCAF signatories should moving forward seek to align with the reporting requirements of the standard.**

- **PCAF signatories should more fully adopt and integrate data frameworks that allow for the improvement of data quality and focus disclosures and engagement on these areas.**

- **The PCAF standard should clarify the disclosure requirements around sectoral splits and make the related recommendation mandatory.**

- **PCAF – in collaboration with third party experts – should develop standards around the requirements for rebaselining. We would recommend a rebaselining policy that fully accounts for changes to portfolio composition, consistent with current best practice.**

- **Financial supervisors should review the potential compliance of disclosures claiming to report in line with PCAF and create enforcement mechanisms to ensure transparent and accurate disclosures.**

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The complete disclosures are not cited here from all signatories but can be found online at: https://carbonaccountingfinancials.com/financial-institutions-taking-action#overview-of-financial-institutions

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