UK Finance response to:

Scope 3 Emissions in the UK Reporting Landscape

Department for Energy Security and Net Zero (DESNZ)

December 2023

Introduction

UK Finance is the collective voice for the financial services industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the call for evidence of the UK DESNZ on the benefits, costs, and practicalities of Scope 3 greenhouse gas (GHG) emissions reporting in the UK, including links to the government's Streamlined Energy and Carbon Reporting (SECR) framework.

We have not responded to all questions in this consultation, instead focusing on those where the collective voice of the sector is most valuable.

Key messages

We support greater Scope 3 emissions reporting, aligned with ISSB[1] requirements.

- We agree with the ISSB's assessment that Scope 3 information provides **material information** about a company's GHG emissions profile derived from its value chain.

- We consider that Scope 3 GHG emissions reporting helps generate **higher quality** overall GHG emission footprint disclosures, provides insights on whether a given company is making progress in meeting **decarbonisation targets**, and may improve the **comparability** of entities' GHG emissions across business models. However, when considered in isolation, we do not believe that Scope 3 emissions data provides a comprehensive picture of a firm's transition risk profile.

- We support **full alignment with the approach to Scope 3 reporting under the IFRS S2**, including aligning with the ISSB's materiality approach. Although costs will be significant, firms generally assess that the benefits of proportionate Scope 3 emissions reporting will outweigh the costs.

Regulators and Government should offer relevant and appropriate support and reliefs to companies while they build their capabilities and as data sources and experience improve.

- Scope 3 reporting remains a **challenge** across the economy, particularly in terms of the **data challenges for financial services firms which have complex financed emissions chains**. There should be a recognition in any future UK Scope 3 disclosure rules that reporting will be carried out on a **best-endeavours** basis and will improve as capacity and capability increase. There should be a recognition that banks will obtain **data from a range of sources**, including

[1] ISSB: International Sustainability Standards Board

direct company disclosures and syndicated databases, and that the use of **assumptions** and **proxy data** should be permitted for estimating Scope 3 emissions where primary data is not readily available.

- **Measurement standards** are still evolving and approaches to estimating emissions for all sectors are not available. This means that disclosures will require **judgments related to methodologies** and initially may lack consistency amongst firms.

- The UK authorities should adopt a **proportionate** approach by applying the ISSB's first-year reliefs on Scope 3 reporting, while also adopting additional **transitional and proportionality measures** without diverging from the substance of ISSB reporting expectations. These could include targeted and **time-limited reliefs/phase-in periods**, **flexible reporting timelines**, **safe harbour provisions**, and flexibility for firms to **revise their Scope 3 emissions estimates** over time as data availability increases and methodologies are standardised. Firms should not be penalised for reporting their Scope 3 emissions on a best-endeavours basis and in good faith and should be encouraged to do so in the early years, bearing in mind the nascent nature and significant challenges that firms face in this area, including relating to obtaining timely, complete and reliable data.

The Government should maximise international interoperability and provide the ISSB and Scope 3 implementation timelines.

- To aid the comparability of reporting between firms, we encourage the UK government to work with the ISSB to provide additional guidance on Scope 3 emissions calculation **methodologies**, while allowing flexibility for firms to adopt their chosen methodology and without prescribing a specific top-down approach. DESNZ might consider working with the ISSB to **standardise assumptions** to address common data gaps across the industry.

- An indication from the UK Government as to the timeline for implementation of ISSB-aligned disclosures or phasing-in of requirements by different firms is essential for organisations developing their capacity and capability for Scope 3 reporting.

Government should make efforts to support SMEs.

- Mandatory Scope 3 reporting by large corporates and banks will result in a **significant burden for SMEs**, which often face severe reporting constraints arising from limited capability and resourcing. Ensuring that any **GHG emissions reporting guidance is simple, easy to understand**, and provides specific actions for SMEs to take would be helpful. We would also support Government in giving its backing to one or more **calculators/data collection methods** for non-financial corporates, particularly SMEs, providing support to address and rectify **data gaps**. Government could consider supporting **open data arrangements for energy utilisation data** being available to firms, with appropriate consent, to support emissions calculation.

- Support measures provided to address data challenges associated with Scope 3 reporting should be designed to ensure that the cost of implementation is **proportionately distributed** between entities of different sizes and sophistication, rather than simply passed through to SMEs.

Scope 3 GHG reporting

General questions

5. Do you agree or disagree with the ISSB's assessment of the value of Scope 3 information?

We agree with the ISSB's assessment that Scope 3 information may provide material information about a company's GHG emissions profile derived from its value chain, especially financed (category 15) emissions for banks. We consider that high quality Scope 3 GHG emissions reporting:

- helps generate **higher quality overall GHG emission footprint disclosures** because companies are accounting for their value chains, particularly for those whose emissions derive in large part from their own value chains;
- may be valuable for investors in providing **insights on whether a given company is making progress** in meeting a decarbonisation target that includes value chain emissions, and to some extent on progress on reducing climate-related transition risks within its value chain, whilst recognising that investment in supporting transition could result in an increase in emissions in the short term;
- may improve the **comparability of entities' GHG emissions** across business models (such as comparing the GHG emissions of an entity that relies on outsourcing to those of an entity that is vertically integrated), provided the challenges and/or limitations of industry frameworks for calculating Scope 3 financed emissions are overcome; and
- provides users with more information about **an entity's overall GHG emissions performance over time** (such as whether an entity has reduced its Scope 1 and 2 GHG emissions by simply outsourcing its emissions, thereby increasing its Scope 3 emissions).

In doing so, it helps contribute to the ISSB's wider goal of promoting **transparent capital markets** that better reflect the cost of sustainability-related risk, and support transition and adaptation efforts, through the generation of decision-useful information (see answer to questions 15-17).

At the same time, Scope 3 reporting remains a **challenge** across all sectors, particularly in terms of the **data challenges** for financial services firms which have complex financed emissions chains and wider value chains. There should be a recognition in any future UK Scope 3 disclosure rules that reporting will be on a **best-endeavours basis** and will improve only over time as capacity and capability increase. Firms should not be penalised by users and regulators for reporting their Scope 3 emissions in good faith, including future revisions based on better information, provided there are sound rationales for those revisions.

Scope 3 GHG emissions are material for investors and warrant disclosure and may in certain circumstances bear a relationship to an entity's exposure to transition risk (e.g. from more stringent regulation, such as carbon taxes). However, when read in isolation, **Scope 3 emissions information does not provide a comprehensive picture of a firm's transition risk profile**:

- GHG emissions are **backward-looking** and only give a limited insight into future changes in a firm's business model.
- GHG emissions metrics based on absolute emissions, which indicate the total amount of GHG emissions of a firm or of its broader value chain over a given period, **do not take account of the scale of a company's activities**, nor that they are sometimes outside of their control and are **affected by factors unrelated to their transition risk** (such as changes in their market share).

- Other potential limitations include the risk of **double counting** if the Scope 3 emissions of customers and suppliers are also included in a financial firm's Scope 3 emissions estimation.
- The risk of using **"stale" input data** for emissions calculations if there are delays in sourcing data due to reliance on a variety of data sources.

In order to provide a more complete picture of a firm's transition risk profile, Scope 3 emissions data needs to be read alongside other more forward-looking forms of data for fair interpretation. This could include the analysis of customers' transition plans, the application of risk management frameworks, and the consideration of climate stress tests. It could also include disclosures under transnational frameworks such as BIS's proposed Pillar 3 framework, which is aimed at promoting the comparability of banks' climate risk profiles and IFRS S2 disclosures should some jurisdiction not endorse ISSB standards[2]

There should be a recognition that investment in supporting the transition could result in an increase in GHG emissions in the short term.

6. In general, what is your view on the approach to Scope 3 reporting contained within IFRS S2? Please consider the ISSB's approach to materiality in your answer.

In general, our members agree with the approach to Scope 3 reporting contained within IFRS S2 and **support full alignment with the global baseline**. Aligning Scope 3 reporting requirements in the UK with the approach contained within IFRS S2 would:

- **maximise international interoperability** (to the extent that emissions measurement methodologies are consistent), supporting the UK's ambition to be a green finance hub and helping to maintain the UK's status as a preeminent global financial centre; and
- **reduce costs** of not only staff required to analyse and compare the new requirements, but also of data, system changes, internal and external assurance, senior management engagement and review across the entire organisation.

Given firms' differing experience and capabilities, as well as the ongoing shortfalls in data and methodological issues, we would support the adoption of **proportionality measures** in respect of ISSB-aligned Scope 3 reporting. Specifically, the UK authorities should apply the **ISSB's first-year reliefs on Scope 3 reporting**, while also considering additional transitional and proportionality measures. These could include:

- offering **targeted and time-limited reliefs/phase-in periods** for Scope 3 emissions reporting among asset classes where industry guidance is not yet in place or comply or explain provisions to help firms adhere to reporting requirements in a flexible manner for a time-limited period. Financial services firms should have flexibility to determine the material asset classes for which they set and disclose targets and progress towards targets, consistent with the ISSB's materiality principles;
- allowing **flexible reporting timelines** for value chain GHG emissions in accordance with ISSB S2 paragraph 29(a)-B19. The ISSB standards grant entities permission to use information for reporting periods that are different from their own reporting period, if the entities in their value chains have misaligned reporting periods. The reporting flexibility outlined under this provision is crucial for firms disclosing Scope 3 emissions and we ask that it is fully adopted as part of any UK sustainability standard;

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[2] Basel Committee on Banking Supervision, Consultative Document: Disclosure of climate-related financial risks, 29 November 2023, available here.

- incorporating transitional **safe harbour provisions** into the relevant regulatory framework to protect against liabilities arising from Scope 3 reporting. The authorities may also wish to consider implementing **transitional Scope 3 boundary reliefs** to take account of challenges relating to the quality and availability of Scope 3 data. Such safe harbour provisions will need to be implemented sensitively, recognising that in some cases there is now sufficient Scope 1 and 2 emissions data for entities to begin to report their Scope 3 emissions, albeit with limitations;
- providing **flexibility** for firms to **revise their Scope 3 emissions estimates** (along with other transition-related targets) over time as they increase in precision, in recognition that firms **should not be penalised for their transparency and ambition in disclosing Scope 3 emissions** and that firms' output is likely to vary significantly in the first few years of reporting. This should consider differences in the reporting capabilities of firms depending on their size and available resources. It should also be recognised that **year on year fluctuations** in an entity's reported emissions **may not always be explainable** and could result from underlying data changes.

We agree with the ISSB's approach to **materiality** and **support full alignment with this approach for UK reporting rules, including Scope 3 disclosures.** The concept of materiality under IFRS S1 is **generally clear** and aligned with the IFRS[3] Foundation's definition of financial materiality. We welcome the ISSB's clarifications to the definition of materiality, including linkage to expectations of primary users of general-purpose financial reports, which represent an improvement on proposed definitions in the 2022 Exposure Drafts.

We would nevertheless recommend Government to work with the ISSB to develop guidance in several areas relating to its materiality approach:

- We would welcome **ISSB sharing of good-practice examples**, as set out in Section 2, to support companies in disclosing their Scope 3 GHG emissions in line with the approach to materiality under IFRS S2. In particular, members would welcome guidance on whether and, if so, how, a materiality lens should be applied in **setting the Scope 3 boundary** (for example, in determining how far down the investee company's value chain to look in capturing a bank's Scope 3 financed emissions, whether end-use emissions, such as emissions arising in connection with a property that has been financed through a loan, should be captured within the Scope 3 financed emissions calculation, and which of the 15 categories of Scope 3 emissions are sufficiently material to report on), **so long as such guidance is not overly prescriptive.**
- Clarity is needed from the ISSB on the **definition of materiality** in IFRS S1. The Standard states that the focus of disclosure should be on information about "risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term" (Objective 3), but then defines material information in terms of information that could reasonably be expected to influence decisions of primary users of general purpose financial reports (Appendix A). This creates some ambiguity, since there may be circumstances in which Scope 3 financed emissions have a negligible financial impact on the reporting entity over the short, medium and long-term, but may at the same time be pertinent to certain users' decision-making. **We encourage the UK government to work with the ISSB to address this ambiguity.**
- We recommend that the **UK authorities work with ISSB to enable the ISSB to publish guidance to ensure international application** where possible.

[3] IFRS: International Financial Reporting Standards

- We recommend **active engagement at the international level**, for example, working with EFRAG [4] in its plans to publish guidance on materiality assessment, to maximise the interoperability of standards and definitions. **The UK should avoid setting guidance unilaterally where international best practice would be more appropriate**.
- Under IFRS S2, paragraph B32, the reporting entity is required to report on which of the 15 categories of Scope 3 emissions are covered in its disclosures. **If reporting entities do not cover a particular category of Scope 3 emissions in their reporting,** we recommend that entities be required to explain why they have omitted that category, as it is currently not always clear whether an entity has omitted a particular category of Scope 3 emissions on materiality grounds or for other reasons, for example data and assurance challenges. **We encourage the UK Government to work with the ISSB to clarify this point in ISSB FAQs[5] or in guidance**.

7. What is your view on the use of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2? Will this lead to comparable and consistent reporting that is useful for investors and users of accounts?

We agree with the use of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2:

- The **GHG Protocol is the most widely used framework** for accounting and reporting GHG emissions in the world, providing a standardised framework against which entities can report their Scope 3 GHG emissions.
- Other initiatives seeking to bring greater standardisation to Scope 3 GHG emission reporting, such as the Partnership for Carbon Accounting Financials (**PCAF**), base their approaches and methodologies on the GHG Protocol and its *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*.
- The use of the GHG Protocol within IFRS S2 therefore ensures **maximum international interoperability** and will contribute to supporting **comparable and consistent Scope 3 GHG emissions reporting** between entities.
- We also note that the GHG Protocol is undertaking a review and update process. GHG Protocol expects to release drafts of revised text in 2024 and final standards/guidance in 2025. As such we expect refinements to be made to its guidance which would then be reflected in other downstream initiatives, including in relation to Scope 3 emissions.

At the same time, we would **encourage the UK government to work with the ISSB in providing greater clarity on the circumstances in which an alternative method for calculating GHG emissions may be permitted** (as per IFRS S2, paragraph 29(a)(ii)).

8. Would using the ISSB's approach to Scope 3 reporting have knock-on consequences for your organisation that the Government should be aware of? For instance, you may wish to consider the interaction between IFRS S2 and any EU regulations, or other energy/emissions reporting requirements that your organisation may be impacted by.

As mentioned in response to question 6-7, **full endorsement and implementation of the ISSB's approach to Scope 3 reporting would help maximise international interoperability, supporting the UK's ambition to be a global hub for green finance.** If the UK seeks to offer additional reliefs for anticipated implementation challenges, these should ideally only be in the form of **extended**

[4] EFRAG: European Financial Reporting Advisory Group
[5] FAQs: Frequently asked questions

transition/implementation periods, rather than substantive carve-outs, which risk limiting international interoperability of the disclosures.

Given that most multinational firms expect to disclose under other sustainability disclosure regimes (e.g. under the CSRD[6] and the SEC's[7] upcoming climate-related disclosures), an **equivalence reporting regime** will help reduce the burden faced by reporting institutions located in jurisdictions that require duplicative reporting.

We note the ISSB's requirement (under IFRS S2, paragraph B62) that disclosing commercial lenders should use the Global Industry Classification Standard (GICS) for the purpose of driving alignment around the disaggregation of Scope 3 data by industry. **Given that the GICS differs from the sectoral classification standards adopted by other jurisdictions (e.g., SIC, NACE, NAICS) and that many UK firms only use SIC codes, we recommend that UK Government should seek more flexibility, in collaboration with the ISSB, to allow for the use of codes that are already in use in jurisdictions.** Industry classification codes are already in use for financial and regulatory reporting and ideally industry codes used for Scope 3 reporting will be aligned with other reporting so as not to create confusion for investors.

9. Is there any additional emissions or energy-consumption related data that is not required within IFRS S2 that you believe is valuable for investors, users of accounts and other stakeholders?

We consider that all material data points are accounted for within IFRS S2. However, we note that certain members are being asked for metrics that are not ISSB-aligned, such as Principle Adverse Impact indicators required under European regulation.

Questions for reporting entities

10. What further guidance and support might be needed for your organisation, and organisations in your value chain, to report Scope 3 information in accordance with IFRS S2?

The key challenge currently faced by banks in respect of Scope 3 reporting is that the broader economy does not consistently report its Scope 1, 2 and 3 GHG emissions. **In order for banks to accurately and consistently report their Scope 3 emissions, they require client data that is consistent, complete, accurate, timely and readily available.**

Government action in two areas will offer particular value in helping companies to disclose: (1) **alignment on methodologies**; and (2) **publicly-endorsed mechanisms for reporting, collecting and making available data**. Where guidance is developed to support Scope 3 GHG emissions reporting, this **should ideally be developed with the ISSB and other international partners**, to maximise international interoperability. **We therefore recommend that the UK government focus on using engagement with the ISSB to encourage this.**

Alignment on methodologies

To ensure that Scope 3 GHG emissions reporting is consistent and comparable, and to avoid divergent approaches, we would welcome additional guidance on the Scope 3 emissions **calculation methodologies** that should be applied, including good practice examples. **We do not recommend**

[6] CSRD: EU's Corporate Sustainability Reporting Directive
[7] SEC: US's Securities and Exchange Commission

that Government endorse a specific financed emissions (category 15) methodology, as best practice is still emerging.

Variation in Scope 3 emissions methodologies used by companies results in data that is inconsistent, is of varying quality and is difficult to interpret and compare Various companies and initiatives, including UK Finance members, have actively sought to build consensus on Scope 3 emissions measurement, through processes like **PCAF's GHG Accounting and Reporting Standard for the Financial Industry**, which in turn aids in generating consistent data. These processes have been useful in building baseline methodologies.

We note that for the purposes of financed emissions calculation, **PCAF's guidance** is widely used because:

- It promotes **greater standardisation in the accounting of Category 15 Scope 3 emissions** between financial institutions by developing and implementing a harmonised approach to assess and report on these emissions that is broadly recognised as best-practice.
- CSRD's ESRS E1 requires financial institutions to consider PCAF's GHG Accounting and Reporting Standard for the Financial Industry, alongside the GHG Protocol for reporting of Scope 3 emissions.

However, it is important to note that PCAF's methodology is not universally applicable to all companies and that it faces limitations:

- While PCAF's guidance and methodologies on certain asset classes (for example, listed equity and corporate bonds, business loans and unlisted equity, project finance, commercial real estate, and mortgages) are widely accepted and have been reviewed and approved by the GHG Protocol, PCAF's methodologies for capital markets instruments has only recently been published[8] and therefore will require time for adoption and acceptance.
- PCAF also does not offer guidance in relation to the accounting of undrawn loan commitments (as required under IFRS S2 B62(a)(ii)).
- Some flexibility in application is needed to allow for the specificities of individual firms' business models and capabilities, with certain financial services firms choosing not to apply PCAF's financed emissions methodology directly, but to instead adopt a variation of PCAF's methodology, or another methodology that is aligned with PCAF's approach. Therefore, while Government guidance in this area may be helpful in catalysing discussion around key issues and seeking to develop approaches, **we recommend that any adoption of a specific methodology should remain voluntary and flexible rather than mandatory.**

Any methodology that requires use of primary data will be challenging to implement in the case of SME lending, asset-based lending, or lending to companies in countries where reporting is less mature (e.g. in emerging markets and developing countries), because of the difficulty of obtaining that data.

Besides Scope 3 Category 15 (financed) GHG emissions, members would also **welcome guidance to encourage greater standardisation around other Scope 3 categories.** For example, the calculation of upstream Scope 3 categories 1 – 8 is currently heavily based on estimates. Having a **centralised platform to obtain emissions information from third party suppliers would be beneficial.**

[8] PCAF's GHG Accounting and Reporting Standard, Part B, available here.

Mechanisms for data collection

Data collection remains a **major challenge** for companies in reporting their Scope 3 emissions – see answers to questions 18-20.

This is particularly true for financial services companies which have large volumes of counterparties including smaller businesses in their value chains. We would support Government in giving its **backing to one or more calculators/data collection methods**, which would help streamline this process both for financial services firms and their suppliers/customers. See response to questions 19 and 20.

In addition, we would like to see Government providing support to **address and rectify data gaps**. For example, to calculate the GHG emissions of mortgage portfolios, members are reliant on EPC data which has widely-accepted limitations (e.g. that it is not an intended measure of emissions, therefore does not accurately reflect emissions profiles) and only covers a portion of members' portfolios. This means that members have had to develop their own internal models to estimate the remainder and plug the gap. Improving access to better data sources, e.g. the actual energy utilisation of properties or EPCs supplemented by actual in-use data, will not only improve GHG emissions reporting and calculations (including data quality scores), but it will also ensure better consistency of data application across firms. However, open-source data on actual energy utilisation by properties is not currently available. **Government could consider supporting open data arrangements for energy utilisation data being made available to firms**, with appropriate consent, to support emissions calculation. It may also consider supporting a centralised platform to source data from companies' XBRL format disclosures prepared using the ISSB's digital taxonomy and tagging requirements.

Beyond these two core issues, we would also welcome **best-practice examples** on how to interpret the ISSB's materiality approach with regard to the **Scope 3 reporting boundary** (e.g., in determining how far down the investee company's value chain to look in capturing a bank's Scope 3 financed emissions, and when financed (category 15) emissions should include the borrower/investee's Scope 1, 2 and 3 GHG emissions). We would welcome the UK authorities working with the ISSB to share good-practice examples of how organisations should be setting the Scope 3 reporting boundary.

11. If your organisation does not already prepare Scope 3 information, how long would you need to build the capacity and capability to do so?

Firms with existing experience of preparing Scope 3 emissions information have told us that even they will require several years to build capabilities and capacity for full coverage. An indication from the UK Government as to the timeline for implementation of ISSB-aligned disclosures or phasing-in of requirements by different firms would be useful for organisations developing their capacity and capability for Scope 3 reporting.

Questions for investors and other users of accounts

12. How, if at all, do you expect to use the Scope 3 information that could be disclosed by businesses in accordance with IFRS S2? If you are an investor, how will this information influence your decision-making?

High quality **Scope 3 information can inform sustainability action** because it will help firms understand their own financed emissions and potential low-carbon lending and investment opportunities (see response to question 16). This can influence and enable better-informed **decision-making** by providing a fuller picture as part of **risk management** and **transition planning activities**.

In the future, Scope 3 data may affect credit assessment decisions and ongoing monitoring of borrowers when several years' worth of sufficiently robust data is built up.

It is important that such data is as consistent as possible and placed in a wider context of company strategy – please see response to question 10. For example, Scope 3 emissions data must be read alongside data on transition finance to ensure that finance is directed towards an **economy-wide transition rather than so-called "paper decarbonisation"**. Likewise, forms of qualitative data, such as information regarding an entity's engagement with its value chain, provide key context for Scope 3 emissions data in the context of investment decision-making.

13. If you are a user of annual reports, which of the Scope 3 GHG emissions categories do you most value information on and why?

The most valuable category of Scope 3 emissions for users of accounts will depend on the sector being financed.

14. When making investment decisions, does the usefulness of Scope 3 data vary depending on the sector and the size of the reporting organisation?

Generally, the financed Scope 3 data of the reporting entity represents the Scope 1 and 2 data of the investee or borrower.[9] Therefore, the materiality of the Scope 3 data will depend to an extent on the sector in which the investee or borrower operates, and whether the sector is energy-intensive or value chain-intensive. For borrowers/investees operating in energy-intensive sectors, the Scope 3 emissions of the investor will generally be higher (as the Scope 1 and 2 emissions of the borrower/investor will be reflected), whereas for borrowers/investees operating in value-chain intensive sectors, the Scope 3 emissions of the investor may appear lower (because, generally speaking, only the Scope 1 and 2 emissions of the borrower/investor will be reflected, not their Scope 3 emissions).

Costs and benefits of Scope 3 reporting

General questions

15. What are your views on the overall costs and benefits of Scope 3 reporting? Please be as specific as possible.

In August 2023, UK Finance responded to the Department for Business and Trade's (DBT's) call for evidence on its "Smarter Regulation" non-financial reporting review, and in October 2023, we responded to the Financial Reporting Council's/Technical Advisory Committee's call for evidence on ISSB endorsement. In both responses, we set out our view that ISSB-aligned sustainability reporting comes with associated costs, but that these **costs are outweighed by the benefits**. As a core component of disclosures under IFRS S2, we believe this also applies specifically to Scope 3 emissions reporting.

Our answers to questions 16 and 17 set these costs and benefits out in more detail.

[9] For example, under PCAF's GHG Accounting and Reporting Standard, Part A, financial institutions shall report the absolute Scope 1 and 2 emissions of all borrowers and investees within scope of their own Scope 3 emissions. PCAF sets out a staggered timeline for financial institutions to begin reporting on the Scope 3 emissions of borrowers and investees within scope of its own Scope 3 emissions, depending on the sector in which the borrower or investee company operates.

16. What benefits could Scope 3 reporting bring to your organisation? Please be as precise as possible when explaining the basis of any benefits you provide. If you currently produced Scope 3 data voluntarily under SECR, please explain the benefits you have received and how they have changed over time.

Banks and other lenders will primarily benefit from Scope 3 emissions reporting as **users of data** reported by or collected in respect of companies in their value chains.

Consistent Scope 3 emissions reporting by companies in the value chain will help firms to understand:

- the **overall GHG emission footprint** of investees and borrowers, particularly for those whose emissions derive in large part from their value chains;
- an investee or borrower's **overall GHG emissions performance over time** (such as whether an entity has reduced its Scope 1 and 2 GHG emissions by simply outsourcing its emissions, thereby increasing its Scope 3 emissions);
- certain **transition risks** within their supply and financing value chains, for example potential liabilities that investees or borrowers may face in the future as a result of more stringent regulation such as mandatory carbon taxes — though please note the limitations of this data for assessing transition risk, as noted in response to question 5;
- the **comparability of entities' GHG emissions** across business models (such as comparing the GHG emissions of an entity that relies on outsourcing to those of an entity that is vertically integrated), provided the challenges/limitations of industry frameworks for calculating Scope 3 financed emissions are overcome;
- their own **financed emissions**, by offering more detailed data to inform financial services' firms emissions exposures;
- **low-carbon lending and investment opportunities**, by pointing to companies, industries and sectors where Scope 3 emissions are higher or lower (for example, sectors with higher Scope 3 emissions may present opportunities if this translates into a need for financial support to decarbonise).

In the absence of high-quality primary GHG emissions data, banks are often required to base their financed Scope 3 emissions reporting on assumption-based secondary data, e.g. economic activity, revenue intensities, or industry-based emissions factors. This makes it challenging to assess whether individual borrowers within a portfolio are decarbonising, or how individual borrowers compare to their peers, instead only reflecting changes in the portfolio mix (e.g. when commercial developments with higher emissions in a portfolio are replaced with residential developments with lower emissions). As a result, **until reporting practices improve, data can be of limited decision-usefulness for lenders and may fail to drive real emissions reductions**. This underlines the importance of supporting **iterative improvements to reporting without regulatory deep-dive reviews penalties or sanctions.**

Role of Scope 3 emissions reporting in transition plans: Since the practice of Scope 3 reporting is still relatively nascent, it is hard to accurately quantify its benefits. However, there is a clear **economic rationale for improving data availability on value chain emissions**. Financial services companies with net zero commitments have made strategic decisions that their future growth will align with the decarbonisation of the wider economy. To do this, and to develop meaningful transition plans, they will need to measure baseline emissions across their clients and suppliers, and have the ability to monitor those emissions over time. **Scope 3 emissions reporting by value-chain actors** will be an **important contributor** and will deliver **significant value to users.**

17. What costs could Scope 3 reporting bring to your organisation? Where possible, please give a breakdown of each element of cost. Please be as precise as possible when explaining the basis of any costings you provide. If you do currently produce Scope 3 data voluntarily under SECR, please explain the costs you have incurred and how they have changed over time.

The costs of Scope 3 emissions reporting will arise from banks and other lenders' roles both as preparers of reports and as users, since resourcing will be required both to produce reports and to analyse the data produced by value-chain companies.

Given the breadth of disclosures required to satisfy non-financial reporting requirements, financial services firms require **dedicated teams to manage, prepare and coordinate** this work. This presents r**esource demands and challenges**, with a **direct cost impact**, to ensure there is capability to deliver.

As set out above, firms generally assess that the benefits of proportionate Scope 3 emissions reporting will outweigh these costs. However, regardless of the size of the portfolio, there are **significant costs associated with obtaining vendor data for Scope 3 emissions reporting**, as well as **human capital and technology costs**. In the absence of a clear approach to materiality (as called for above), the cost of reporting on certain (financially immaterial) sectors could outweigh the benefits.

For companies with exposure to reporting requirements in other jurisdictions, **the addition of Scope 3 emissions reporting requirements in the UK will have limited additional associated costs**. This is true for companies subject to EU or upcoming Californian disclosure rules. In a previous submission to the DBT, we found that some 90% of sampled members that would be subject to UK sustainability disclosure requirements would already be required to disclose under one or more of these other international regimes, either through legal requirements in those jurisdictions or the expectations set by investors, regulators and local market practice.[10]

The drivers of costs associated with Scope 3 emissions include:

- **staff and time costs**, including the need to recruit sustainability reporting specialists, develop the capability/specialism needed to manage climate-related risk and opportunity more broadly, and develop a robust control environment and governance frameworks;
- **external data providers and consultants**, where use of such consultants is deemed more cost effective than managing disclosures internally, and due to the significant cost of obtaining emissions data from various vendors (especially where different vendors are needed to obtain data for different industries);
- **systems management processes** to ensure that pre-existing data is in the right format for reporting requirements;
- **participation in industry capability building**, for example development of Scope 3 emissions calculation initiatives like PCAF;
- **IT and systems support**, and relevant software licences;
- **Supply chain engagement processes**, including the time spent on managing mobilisation and adjusting supplier agreements to include disclosure requirements;
- **legal review**, including the costs of instructing external counsel regarding disclosures; and
- **assurance requirements/asks/expectations**, which are increasing year by year and are becoming highly costly.

[10] UK Finance, "Smarter regulation non-financial reporting review", August 2023, p.4

Data **sourcing and reliability** is a key challenge with associated costs to prepare and manage this appropriately. Many firms employ multiple third-party data providers to support emissions reporting in accordance with current TCFD recommendations. **Costs will be particularly stark for entities that do not already report Scope 3 emissions**, and particularly for organisations that have complex financed emissions and wider value chains.

It should also be noted that there is a potential **asymmetry in the costs** borne by banks' lending to larger businesses (which are more likely to be able to rely on emissions reporting by the investee company) and SME lenders (which are less likely to be able to rely on the investee company reporting on their emissions).

Questions for reporting entities

18. How are you approaching the issues around data availability in relation to Scope 3 reporting? Are you aware of any useful data sources, reporting tools, or resources (such as emissions factors) to help UK organisations report their Scope 3 emissions, and how are you tackling them?

The financial services sector makes active efforts to improve data availability for Scope 3 reporting purposes. This includes supporting customers and supply chain companies to report in as streamlined a manner as possible, for example through simplified emissions reporting surveys. It is important to note that, while efforts have been made to improve data reporting, such activities are less well advanced among client companies than for those in supply chains (who often have greater practice of reporting through procurement processes).

Recognising the limited public availability of accurate climate data, many members apply assumptions and judgements to model their Scope 3 GHG emissions. This means that it is often difficult to meaningfully compare Scope 3 reporting between different firms. Many firms also obtain data from organisations such as CDP and supplier annual reporting rather than seeking bespoke data from customers and suppliers. However, currently firms access this data manually or use consultancies to analyse the data for them. If feasible, members would benefit from a **centralised solution which scrapes supplier-based emissions data from sources such as annual reporting, and pools it into an accessible, free resource to ensure consistency.**

The financial services sector participates in industry-wide initiatives to help improve data reporting at macro level. As elaborated further in question 19, these include working with organisations like CDP; the Net Zero Data Public Utility (NZDPU); and the industry-sponsored Project Perseus (UK Finance sits on the Steering Group). These initiatives will take time to provide the necessary level of data for accurate Scope 3 emissions reporting, but in many cases offer promising solutions to address this challenge.

We would welcome additional resources and support to bring greater standardisation and consistency to Scope 3 reporting, for example the publication by government of emissions factors for organisations to apply on a voluntary basis.

19. What are, or do you anticipate being, the greatest barriers to producing consistent Scope 3 data?

General challenges

Scope 3 emissions reporting remains a challenge across the economy, particularly for financial services firms which have complex financed emissions chains and wider value chains. Firms will expect to rely more heavily on estimates in the early years of compliance, although there will be improvements over time if data availability from other sectors increases. Robust and early reporting of Scope 1, 2 and 3 emissions by non-financial corporates will be needed to support financial services firms' disclosures.

Outstanding challenges include:

- the challenge of collating **high-quality emissions data** for any firm and emissions scope, considering the frequent need to apply **assumptions** and **estimates** that vary in quality and consistency and may fail to reflect real-life emissions;
- the limited availability of **reliable, credible, and real-time data sources** needed to calculate accurate and consistent GHG emissions, such as improved, regularly updated and independently verified EPCs, supplemented by actual in-use data, for the calculation of residential property emissions;
- **access to data from value chain companies**, given the lack of reporting particularly among smaller businesses and businesses in countries where reporting is less well advanced (e.g., emerging markets and developing economies) but where emissions may be significant;
- **lack of Scope 3 emissions calculation methodologies** for some sectors and asset classes, including emissions associated with invoice finance and asset-based lending, and limitations with respect to the methodologies that do exist (as explained above); and
- that **Scope 3 financed emissions calculation at the subsidiary level** is complicated by the fact that data may only be available at the consolidated level of a counterparty, leading to the use of further assumptions and proxies to interpolate results.

To provide greater transparency on financed emissions data quality, **PCAF's GHG Accounting and Reporting Standard, Part A, provides a helpful framework** for entities to disclose a **data quality score** in respect of reported financed Scope 3 emissions by asset class. This allows for greater comparability of Scope 3 emissions disclosures between firms, provides transparency as to the level of sophistication / accuracy of Scope 3 emissions calculations, and encourages the reporting entity to demonstrate progress over time in terms of improving its data quality score. It would be useful to see a similar approach encouraged **across all Scope 3 categories and reporting entities**, which will help reporting banks to evaluate the data they use. However, reporting entities should retain the right to adopt the standard that best suits their needs and business model.

Challenges for SMEs

Reporting emissions associated with SMEs is a particularly acute challenge. Mandatory Scope 3 reporting by large corporates (which will seek emissions data from companies in their value chain) and banks (which will seek emissions data from their customers) will result in a significant burden for SMEs. SMEs often face severe reporting constraints arising from limited capability and resourcing, including limited staff dedicated to sustainability. Ensuring that any **GHG emissions reporting guidance is simple, easy to understand**, and provides specific actions that SMEs could take would be helpful. Any **support measures provided to address data challenges associated with Scope 3 reporting should be designed to ensure that the cost of implementation is fairly distributed between entities of different sizes and sophistication, rather than simply passed through to SMEs.** There should be a recognition that although smaller SMEs may not fall directly in scope of mandatory GHG emission reporting, they may fall indirectly in scope as a result of being in the value chain of a larger company or bank. In some cases, SMEs may be required to meet emissions-related targets imposed by the larger corporate or bank.

As noted in answer to question 10, the **current market for 'carbon tracking tools' is vast, non-standardised, and produces vastly different results from tool to tool**. In many cases, **measurement boundaries and data collection methodologies are inconsistent between tools**, resulting in poor quality data submissions. Many tools also do not conduct any data validation, creating a risk that the data input could be manipulated to look favourable. In addition, existing tools supporting SECR reporting are not appropriate for SMEs. Many are cumbersome, hard to engage with, and rely on far too much data input that SMEs do not have easy access to (nor are they currently required to have access). As a result, the burden of data collection and input partially sits with SMEs in the supply chain.

Another key challenge with respect to reporting emissions associated with SMEs is the lack of a standardised format or location in which disclosures are made. This leads to reporting entities adopting inconsistent approaches, which from an end-user perspective makes it challenging and inefficient to compare emissions between entities. Without greater standardisation around the format of Scope 3 reporting, there is also a risk that investors with greater leverage may ask to receive information in a particular format, which may then increase the burden on SMEs that may be required to provide the same information in different formats to different lenders.

While a few initiatives are underway to **streamline data availability and/or the reporting** journey for SMEs – some of which have the backing of the financial service sector – these will still **take time to fully develop**. Such initiatives include:

- Net-Zero Data Public Utility (**NZDPU**), which aims to be an open, free, and centralised data repository that would allow all stakeholders to easily access key climate transition-related data, commitments, and progress of businesses and financial institutions toward those commitments;
- **ESGenome**, an initiative currently being launched by the Monetary Authority of Singapore (MAS) and Singapore Exchange (SGX Group). This is a digital disclosure portal for companies to report ESG data in a structured and efficient manner and will allow investors to access such data in a consistent and comparable format;
- **Project Perseus**, a multi-sector collaboration seeking to streamline GHG reporting processes by providing automated access to assurable energy data to support Scope 3 financed emissions reporting.

Increasing **digitalisation** of SME reporting may also provide faster more streamlined data collection and reporting.

We welcome the ISSB's relief measure, allowing a **one-year transitional period** before firms must disclose Scope 3 emissions data. Nevertheless, this may still be insufficient to resolve some of the outstanding challenges above. A few possible solutions may be to:

- offer **targeted and time-limited reliefs/phase-in periods** for Scope 3 emissions reporting among asset classes where industry guidance is not yet in place or where existing guidance is not appropriate for all types of entity (e.g. PCAF's guidance on business loans, which is not appropriate for lending to smaller SMEs);
- **comply or explain provisions** to help firms adhere to reporting requirements in a flexible manner for a time-limited period; or
- allow **flexible reporting timelines** for value chain GHG emissions in accordance with IFRS S2 paragraph 29(a)-B19. The ISSB standards grant entities permission to use information for reporting periods that are different from their own reporting period, if the entities in its value chains have misaligned reporting periods. The reporting flexibility outlined under this provision is crucial for firms disclosing Scope 3 emissions and we ask that it is fully adopted as part of any UK sustainability reporting requirements.

Other challenges

As mentioned above in respect of question 10, banks seeking to calculate the GHG emissions of mortgage portfolios are **reliant on EPC data** (which was not designed for GHG emissions measurement) and only covers a portion of their books. As a result, banks have had to develop their own internal models to estimate the remainder and plug the gap, which creates inconsistencies in Scope 3 reporting between banks. Similar issues arise in respect of **lending to landlords**, where there is an additional challenge of gathering data from tenants or other users of property (often in multi-let properties with changing tenants), and in asset based lending, e.g. lending in respect of non-road vehicles, machinery and office equipment, where emissions data is often not readily available.

20. If you currently voluntarily report your Scope 3 emissions, including through non-Governmental frameworks such as CDP and SBTi, what effect has this had on your relationships with businesses in your supply chain?

While some firms are already voluntarily reporting their Scope 3 emissions, others have started collating data from their customers and suppliers even without reporting the results of those exercises, to better understand their emissions exposures. Our answer to this question therefore draws on those experiences. It is also important to note that data collection by financial services companies to understand their Scope 3 emissions has impact on relationships with existing and potential customers, not just suppliers.

Banks utilise a range of sources for their emissions data, including direct disclosures from companies and aggregated data from various syndicated databases. The use of proxy methods is common practice and necessary to report Scope 3 emissions given the inherent uncertainties and gaps in this data.

Where possible, many firms use data from organisations such as CDP and supplier annual reporting rather than engaging directly with customers and suppliers to ask for bespoke data. Firms also engage with environmental survey providers, such as EcoVadis, to support data collection. **UK Finance strongly supports the Government's proposals for regulation of ESG rating providers.**

At the same time, as noted in response to question 18, the financial services sector makes active efforts to improve data availability for Scope 3 reporting purposes — including supporting customers and supply chain companies to report in as streamlined a manner as possible, for example through simplified emissions reporting surveys.

One of the challenges associated with such data collection methods is lack of coordination, which can have unintended impacts on respondent companies. For example, where a company is in the supply chain of multiple reporting companies, or has more than one bank account, it may be asked to provide emissions data by several different counterparties. In some cases, it may be asked to complete different forms or use different emissions calculators with divergent results.

Post-implementation review of the SECR

In general, companies in UK Finance's membership have had a positive experience of reporting under the SECR regulations, but consider that there is room for improvement. In particular:

- Currently, the **style, format and prescriptiveness of SECR reporting differs significantly** between entities. This limits the usefulness and comparability of data from an end-user perspective.
- Where reporting is mandated but there is **insufficient high-quality data available** to support it, there is a tendency for reporting entities to give boilerplate answers that are of limited value.
- Qualitative disclosures, for example descriptions of **measures taken by the reporting entity to lower energy usage and GHG emissions, vary significantly between organisations** in detail, credibility and likely impact. Without a requirement to disclose the estimated energy usage and/or GHG emissions reductions in respect of each measure, these **disclosures are of limited value** and comparability between organisations.
- The comparability of GHG emissions data reported under the SECR framework is limited by the fact that reporting entities use different methodologies for calculating their emissions and energy use. Reporting entities also do not always provide sufficient information about the methodologies used to calculate their GHG emissions and energy use.

With the emergence of the ISSB standards as a new global baseline, it is important from the perspective of global alignment and efficiency to ensure that the SECR reporting regime is fully aligned with the regime for reporting under the ISSB standards. As sustainability reporting requirements expand over the coming years, it will also be important to ensure that Scope 3 disclosure expectations are rationalised – i.e. that duplicative or conflicting requirements do not appear in different parts of the regime, for example under the SECR regime, in transition planning and in ISSB-aligned reporting.

If you have any questions on this response, please reach out to:

Ian Bhullar, Principal, Sustainability Policy
Ian.bhullar@ukfinance.org.uk

Nala Worsfold, Principal, Financial and Risk Policy
Nala.worsfold@ukfinance.org.uk

Jennifer Tankard, Principal, Commercial Finance and Invoice Finance and Asset Based Lending
Jennifer.tankard@ukfinance.org.uk

Will Grazebrook, Secondee, Green Finance
Will.grazebrook@ukfinance.org.uk