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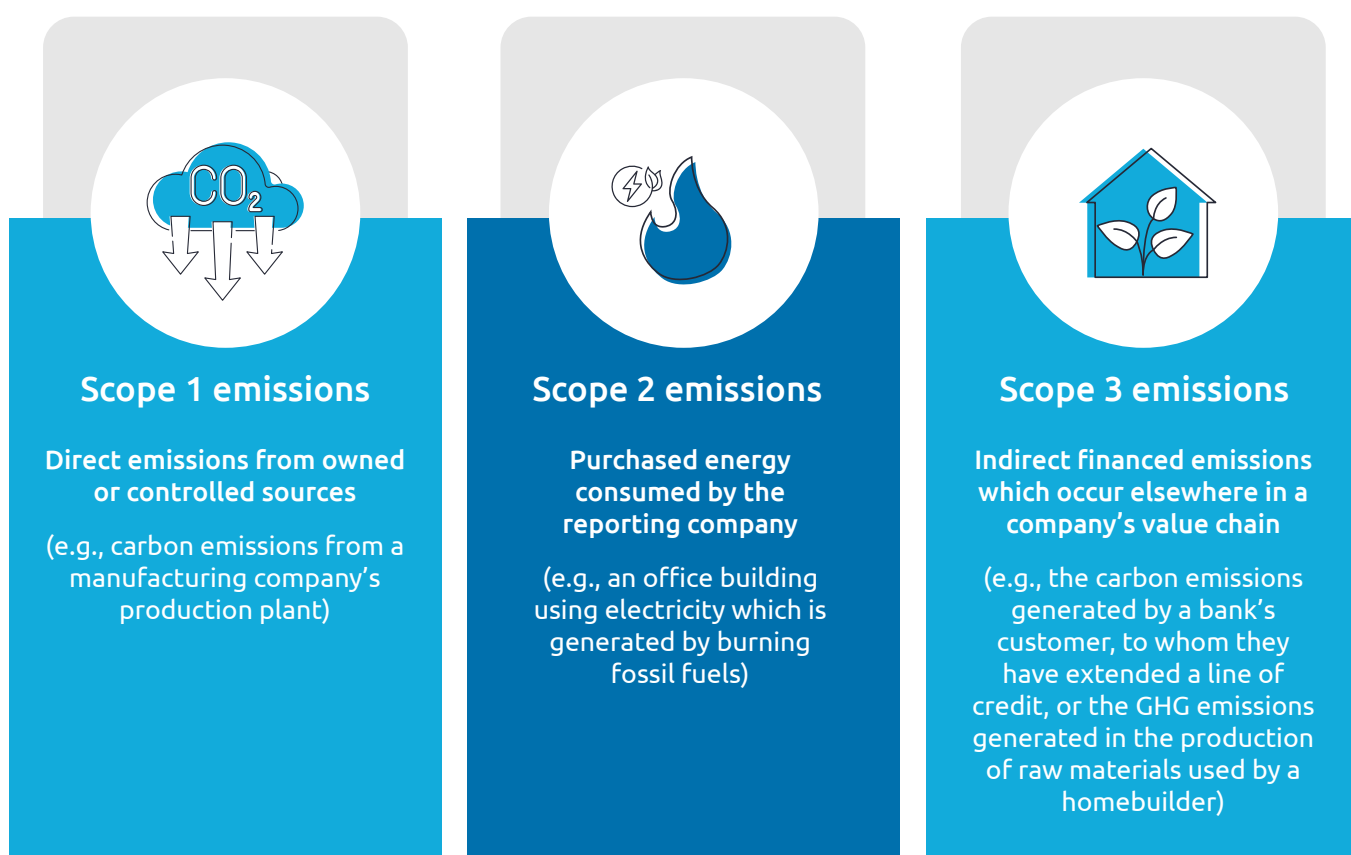
BANKING ON SUSTAINABILITY

The future of GHG
emissions reporting and
sustainable lending



The science is clear: we must limit global temperature increases to 1.5 degrees Celsius or face the irreversible impacts of climate change. According to [one estimate by Swiss Re](#), if global temperature increases continue at the current rate (2.0 to 2.6 degrees Celsius by 2050) and the Paris Agreement and 2050 net-zero targets are not met, global GDP would shrink by 11 to 14 percent (compared to a world with 0 degree temperature increase). Coupled with the immeasurable human costs associated with climate change that have already begun, this looming threat creates a widespread urgency to act.

The lending and financing activities of banks are central to this discussion. According to a [2021 report](#) issued by the Center for American Progress and the Sierra Club, aggregate financed emissions from the eight largest US banks used as much energy as is consumed by 80 million homes. Given the increased pressure on banks to establish net-zero targets, it is clear that they must adjust their business and financing activities to align with initiatives aimed at decarbonization. It is therefore crucial for banks to identify the full scope of their portfolio emissions – from Scope 1, Scope 2, and most importantly Scope 3 emissions sources.



Source: Greenhouse Gas Protocol (GHG)

While the Scope 1 and Scope 2 emissions of a bank are typically very low (or in some cases already carbon neutral), their Scope 3 portfolio emissions – emissions related to the downstream impact of their lending activities – present a carbon footprint that is several orders of magnitude higher. In fact, the [Carbon Disclosure Project \(CDP\) estimates](#) that the share of companies' greenhouse gas (GHG) emissions that fall under the Scope 3 umbrella is approximately 75 percent.

Given that the Scope 3 emissions of their customers are ultimately reflected in a bank's own Scope 3 emissions, it is critical that these companies partner with their

clients to take inventory of their GHG emissions across the value chain, including how loan proceeds are used and the carbon footprint of those financing activities. Coupled with [pending SEC rule changes](#) which would require banks to disclose their material Scope 3 emissions, there must be a central focus on the impact their loan portfolios have on financing carbon emissions, and there is certainly a long way to go. Even in the absence of meaningful federal regulation on emissions reporting, the market has long expected banks to disclose this information anyway. This suggests the question: how effectively are banks currently rising to the challenge?

What makes Scope 3 measurement so difficult?

Measuring a bank's Scope 3 emissions, both upstream and downstream, is largely a question of data access, quality, and reliability. For many companies, especially SMEs (small to medium enterprises) and privately held companies, this data simply does not exist and would take a significant investment to establish a robust data pipeline for reporting purposes. Moreover, there is no standard emissions reporting framework or methodology for publicly traded companies in the United States – leaving banks wondering how to report this data, if they can even source it in the first place. It is therefore no surprise that the [CDP estimates](#) only 26 percent of global banks collect climate-related data from all their customers.

Adding to this challenge, there is a significant portion of Scope 3 emissions data that a company will not have direct access to. For example, a manufacturing company trying to measure the GHG emissions of its overseas materials supplier or a bank trying to measure the Scope 3 emissions of a privately held investment firm to whom they've extended a line of financing. It is clear that to accelerate the pathway to net zero, banks' financing priorities need to include limiting climate-related financial risks by decarbonizing their loan portfolios and mobilizing capital to facilitate a

To account for these challenges, banks must also rely on proxy data to estimate levels of greenhouse gas emissions and be able to make informed decisions about their sustainability strategy. This is a nascent area of analysis in North America but other jurisdictions have taken bold steps in sourcing and estimating GHG proxy data. For example, the [European Environment Agency](#) publishes annually a set of approximated estimates for GHG emissions, broken down by type of gas emitted as well as by country and industry sector. Nevertheless, using proxy data comes with drawbacks, such as limited availability, accuracy, and spatial coverage, and the high costs of the data itself. Most importantly, without the proper data methodologies and regulatory guidance, there is too much room for misinterpretation and bias in GHG reporting.

The current state of Scope 3 reporting from financial institutions

Transparently and accurately reporting an organization's sustainability commitment to shareholders is a top priority for Chief Sustainability Officers (CSOs). Moreover, [rule changes proposed by the SEC](#) in March of 2022 would require registrants to disclose information regarding their Scope 1 (direct), Scope 2 (indirect) and Scope 3 (value chain) emissions, as well as other climate risk disclosures which are material to their business. Considering the sheer magnitude of Scope 3 emissions for financial institutions, the inherent difficulty in obtaining data to accurately measure these emissions and the lack

of meaningful regulatory guidance on how to report on this to the public, banks are currently facing the looming threat of noncompliance should the proposed SEC rule changes go into effect. So, how are banks currently navigating the uncertainty?

- SMEs face significantly less scrutiny (both regulatory and otherwise) with respect to their GHG emissions than do large enterprises. As a result, emission data pipelines often do not exist – making it extremely difficult for banks to estimate the financed emissions from their loans to SMEs. And in Europe alone, [the OECD estimates](#) that SMEs make up 70 percent of overall industrial pollution.
- [According to the International Energy Agency](#), the building and construction sector makes up approximately 39 percent of global GHG emissions. A large percentage of these emissions relate to the manufacturing of input materials, such as steel. This presents a significant challenge for banks which provide mortgage lending and other financing related to the construction of buildings, in that they must not only estimate the environmental impact of the construction itself, but also the environmental impact of the materials used to accurately report their Scope 3 emissions. This will require banks to work across geographies with suppliers of all sizes, potentially in jurisdictions with little to no infrastructure to support the collection of such data.

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A common theme we've heard from sustainability leaders across the financial-services landscape is that while their shareholders and customers now demand that they report on GHG emissions, the lack of federal guidance on the topic has made it extremely difficult to determine the methodology or framework to do so. Several different reporting frameworks and methodologies have exploded in usage as a result, with banks primarily concentrating around a select few.



GRI (Global Reporting Initiative)

is an independent global organization that provides a modular system of ESG reporting standards. Its **three modules** include a set of universal, industry-agnostic standards, sector-specific standards, and targeted topical standards for reporting on specific material items (e.g. waste and water usage).



SASB (Sustainability Accounting Standards Board)

is now under the oversight of the IFRS (International Financial Reporting Standards) Foundation with the establishment of the International Sustainability Standards Board (ISSB) at COP26. SASB standards provide guidance on disclosing material sustainability information across **77 industries**, providing a targeted framework for reporting on issues most relevant to financial performance. In particular, the SASB provides **targeted guidance** for commercial banks, consumer finance, investment banking and brokerage, and mortgage finance, for example providing commercial banks with guidance on incorporating ESG factors into credit analysis. In March of 2022, the ISSB launched **two proposals** to build upon the industry-specific SASB framework, consolidating existing guidance from the Climate Disclosure Standards Board, the International Accounting Standards Board, the TCFD, and World Economic Forum to develop a more holistic set of universal standards.



TCFD (Task Force on Climate-Related Financial Disclosures)

was created by the Financial Stability Board to provide a set of recommendations for disclosing climate-related risks and opportunities, with a specific eye to pricing risks to financial markets related to climate change. The TCFD provides recommendations across **four key focus areas** (governance, strategy, risk management, and metrics and targets) to provide investors with greater transparency as to the relative risk level of their investment from a climate change perspective. The TCFD provides specific **supplemental guidance** to those companies in financial services, with a specific eye to disclosing the climate change-related risk exposure that banks face as financial intermediaries.

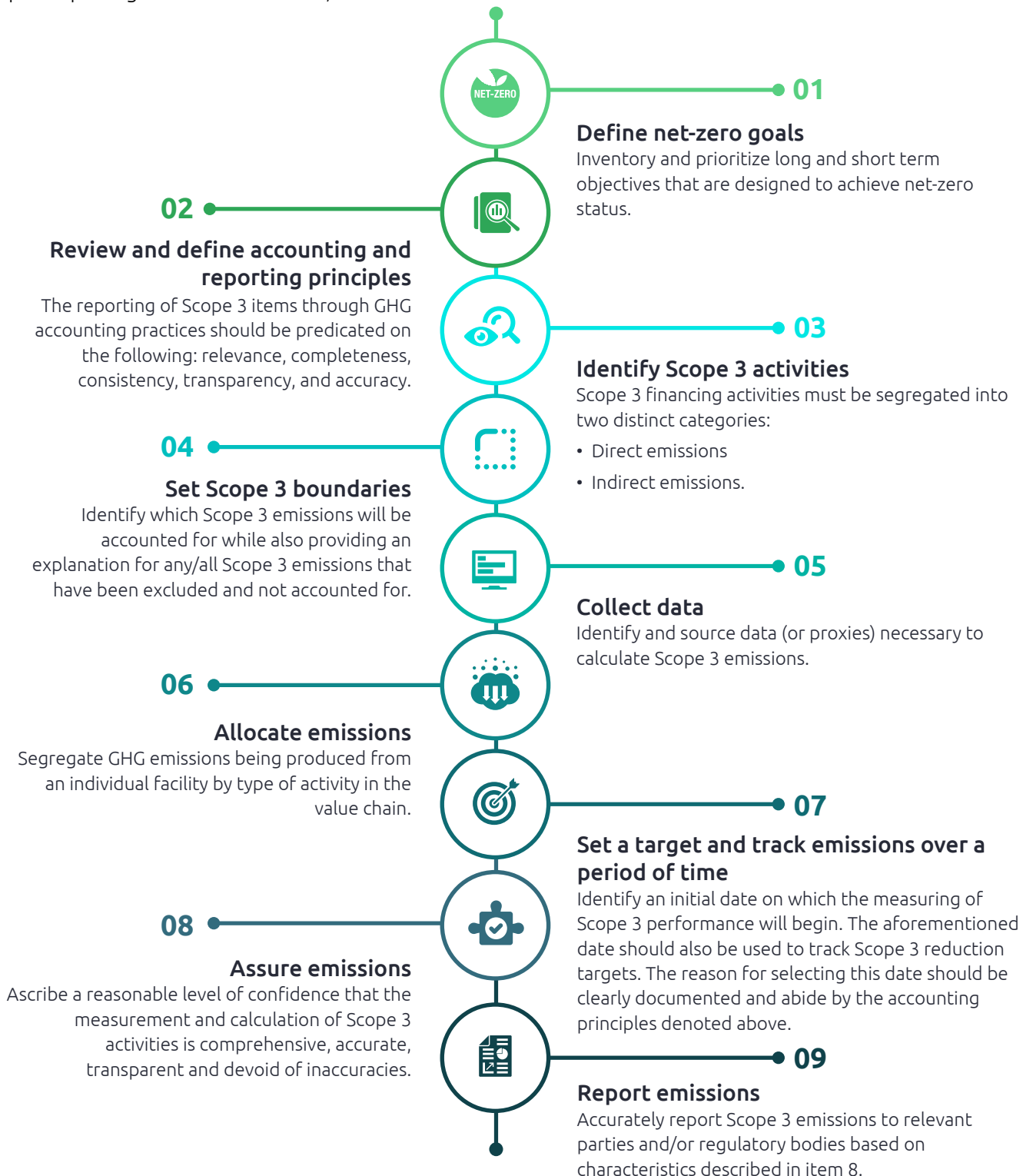


SBTI (Science Based Targets Initiative)

is a global **partnership** between the CDP, UN Global Compact, World Resources Institute, and World Wide Fund for Nature to define GHG emissions targets in line with the 2015 Paris Agreement, and provides technical recommendations for measuring progress against those targets. In order to be considered **science-based targets**, GHG emission targets set by reporting companies must cover 95 percent percent of a company's Scope 1 and Scope 2 emissions and provide a robust methodology for addressing any significant Scope 3 emissions. These targets are meant to contribute to holding global warming to 1.5°C compared to pre-industrial levels as per the Paris Agreement in order to avoid the worst impacts of climate change, ultimately reaching net zero by 2050.

Given that there is no established best practice or standard framework for reporting on GHG emissions, many large financial institutions have taken the stance that they will build their reporting model based on best practices aggregated from many of the established frameworks above. While a banking-sector standard Scope 3 reporting rubric does not exist, Greenhouse

Gas Protocol – an organization that establishes global standardized frameworks to measure GHG emissions from private and public-sector operations, value chains, and mitigation actions – **established nine components** that a representative Scope 3 reporting system should include.





A key trend that has naturally evolved is extensive collaboration between banks on how to report on GHG emissions most effectively and transparently to the public and to their shareholders. One such initiative is the **PCAF (Partnership for Carbon Accounting Financials)**, a global financial services industry partnership to “develop and implement a harmonized approach to assess and disclose the greenhouse gas (GHG) emissions associated with their loans and investments,” in line with the Paris Agreement. As the facilitators of the Future of Sustainability Exchange, Capgemini has heard from CSOs from across the financial services landscape that this partnership is

in high demand – and that they are deeply interested in how their counterparts are navigating their own reporting journeys.

Given the urgency of climate change, however, this is not enough; banks must evolve the relationship they maintain with clients, becoming trusted sustainability advisors to their clients using lessons learned from their own reporting journey. Perhaps the most impactful avenue to effect this change is incorporating climate risk considerations into the process of credit risk analysis, using sustainability-linked lending to directly reduce their clients’ Scope 3 emissions and mitigate climate risk.

How can green lending help banks on their sustainability journey?

In general, banks are subject to four forms of climate risk.

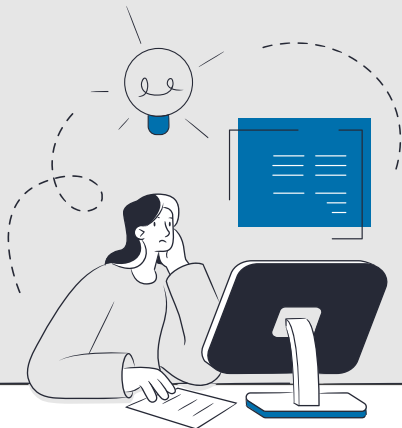
- 1 **Physical risk** is associated with the greater frequency of extreme weather events and the long-term damage that climate change may cause to physical assets held by banks.
- 2 **Transition risks** are those associated with climate-mitigation policies and the transition towards a more sustainable economy.
- 3 **Liability risks** occur when individuals or businesses seek compensation for financial losses or damages associated with the physical or transition risks above.
- 4 **Reputational risks** are negative publicity and associated costs from accusations that a bank may use inaccurate and self-serving methodologies to assess GHG emissions.

Despite a widespread understanding of the looming risks to the financial system due to climate change, the Brookings Institute suggests that climate risk is still widely under assessed, with climate-related financial disclosures being only about **half as likely** to look at the physical impacts of climate change compared with transition risks.

In order to mitigate climate risk and accelerate their pathway to net zero, we believe that banks should establish a climate-risk framework to be leveraged in the credit-approval process. As mentioned above, an industry standard climate risk framework does not exist due to a plethora of challenges. Such challenges may include the following.

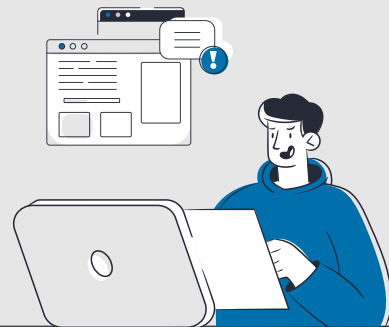
Knowledge deficits

Banks don't specialize in environmental science. Consequently, there is a limit to their knowledge regarding climate impact on risk management with specific regards to conducting a climate risk assessment and instituting climate stress testing.



Data issues

There is uncertainty associated with the long-term nature and unpredictability of climate change. Therefore, devising reasonable climate-related assumptions is difficult. Coupled with the challenges associated with sourcing data from across a bank's value chain (both upstream and downstream), banks often face great challenges in estimating GHG emission data proxies for activities where true emissions data is not available.



That being said, an industry standard climate risk framework may soon be imposed. In December of 2021, the Office of the Comptroller of the Currency (OCC) issued a document titled [Principles for Climate-Related Financial Risk Management for Large Banks](#). In this document, the OCC outlined six principles that large banks should include in their climate risk framework.

- 1 Governance** – Banks must illustrate sufficient knowledge of climate-related financial risk (across physical, transition, liability, and reputational risks). This knowledge should guide the banks climate risk appetite and corresponding oversight activities.
- 2 Policies, procedures, and limits** – Banks’ policies and procedures should incorporate climate-related risk and ensure that the level of climate related risk is consistent and limited to the bank’s strategic imperatives and climate risk appetite.
- 3 Strategic planning** – Banks should identify and contemplate their climate-related financial risk when determining their business strategy, risk tolerance, and operational roadmaps.
- 4 Risk management** – Banks should proactively measure and monitor their financial risk exposure within the context of their risk management framework.
- 5 Data, risk measurement, and reporting** – Banks should include climate-related financial risk in their internal risk reporting pipeline. When the climate-related financial risk exceeds the banks stated risk appetite, it should be escalated to management.
- 6 Scenario analysis** – Banks should develop and institute climate-related scenario stress tests that are appropriate based on the banks size and risk appetite.

In light of the numerous challenges and restrictions that make establishing a sufficient Scope 3 and climate risk framework onerous, there is an opportunity for banks to seize an opportunity. That opportunity exists within the realm of green lending or sustainability linked lending (SLL).

Green lending and/or SLL [supports the flow](#) of funds to environmentally friendly activities and industries, including the decarbonization of traditionally emissions-intensive industries, thereby directly limiting carbon dioxide emissions. This may be achieved by tying the terms of the credit agreement to the borrower’s performance against ESG-related key performance indicators. This is an extremely powerful

tool, especially compared to funds that are simply reserved for activities deemed green, as it incentivizes the recipient of funds to look across its value chain in a dynamic fashion to assess where they may be contributing to GHG emissions.

A future of mandatory Scope 3 disclosures and regulator-imposed climate stress testing is just over the horizon. This places the impetus on banks to evolve their relationship with their clients, reinventing their product offerings and service model to become sustainability advisors to their clients. In turn, banks may propel themselves forward on their own sustainability journey by reducing the Scope 1, 2, and 3 emissions of their clients.



How can Capgemini help?

Transparently and accurately reporting an organization's Capgemini Invent, the Capgemini Group's innovation and transformation powerhouse, is taking climate commitment to a new level with our [net-zero portfolio of services](#). Our objective is to help clients move beyond making climate pledges to actually bringing those pledges to life. We do this through taking the following actions, which include:

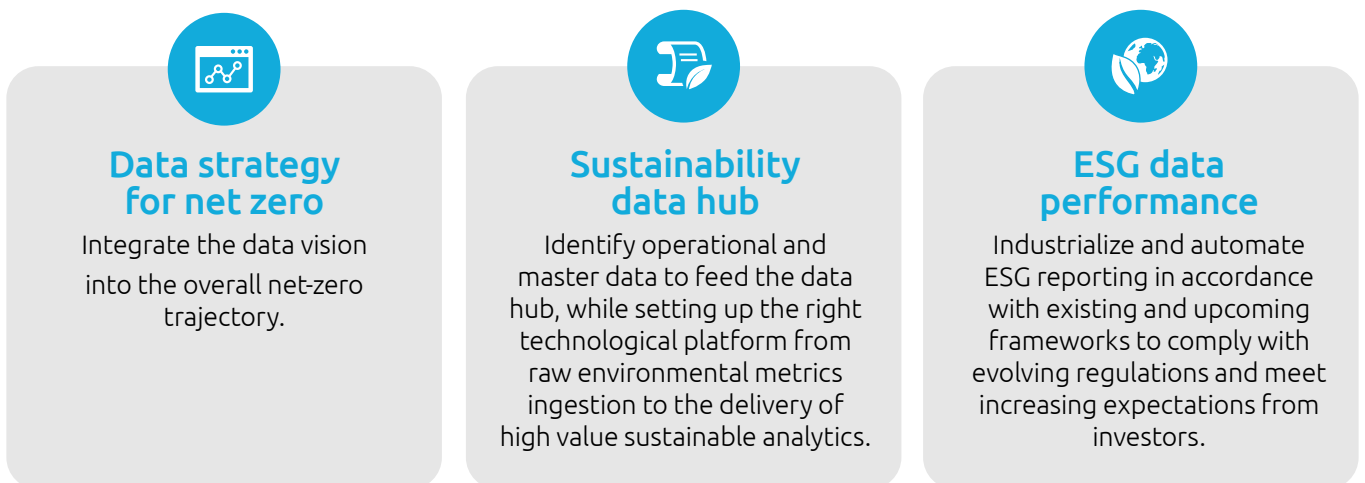
- Developing a corporate climate-risk appetite and establishing a climate-risk threshold based on our client's net-zero strategy
- Benchmarking our clients' climate-risk management practices against industry best practices
- Constructing climate risk-management protocols and policies, which include the integration of capital requirements into future financial planning based on in-house risk scorecards
- Educating and upskilling for employees to empower them to drive sustainability progress
- Implementing an internal governance and audit program to ensure adequate climate-risk management.

When it comes to your broader sustainability journey, our team can support the development of a net-zero vision, trajectory, and roadmaps for transformation using science-based targets. We will help you put the right reporting standards in place based on industry benchmarks, best practices, and regulatory requirements and can develop carbon pricing and carbon offset strategies.

Our data for **net-zero** offering places robust data capabilities at the center of your sustainability strategy. As part of our overall sustainability framework, data for net-zero is seamlessly utilizing net-zero intelligence to build resilience and reduce climate and business risks by addressing three main objectives:



Underpinned by a superb track record in data strategy, governance, analysis, and the deployment of data solutions and platforms, we leverage data to achieve your net-zero transformation through three entry points.



[Learn more](#) about our perspective on Scope 3 emissions, our own climate pledge, or what we have done for other organizations.

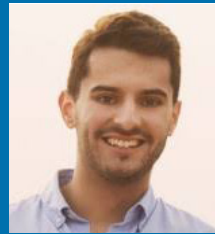


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Capgemini Invent is an integral part of Capgemini, a global leader in partnering with companies to transform and manage their business by harnessing the power of technology. The Group is guided everyday by its purpose of unleashing human energy through technology for an inclusive and sustainable future. It is a responsible and diverse organization of over 360,000 team members in more than 50 countries. With its strong 55-year heritage and deep industry expertise, Capgemini is trusted by its clients to address the entire breadth of their business needs, from strategy and design to operations, fueled by the fast evolving and innovative world of cloud, data, AI, connectivity, software, digital engineering and platforms. The Group reported in 2022 global revenues of €22 billion.

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