Breckinridge CAPITAL ADVISORS

Breckinridge supports GHG accounting standard commitment

Authors

ROB FERNANDEZ, CFA
DIRECTOR, ESG RESEARCH

JOSHUA PEREZ, CFA
DIRECTOR, CORPORATE RESEARCH

JOSHUA STEIN, CFA
SENIOR RESEARCH ANALYST

EVAN LASSOW, CFA
SENIOR RESEARCH ANALYST

Key Takeaways

- Earlier this year, Breckinridge signed on as a member of the Partnership for Carbon Accounting Financials (PCAF), furthering the global effort to bring greater consistency to measuring and disclosing financed greenhouse gas (GHG) emissions.
- By joining PCAF, Breckinridge advances its commitment to transparency and high-quality emissions disclosures.
- Breckinridge's Rob Fernandez, CFA, director, ESG Research, discussed the company's decision and the efforts of PCAF with Joshua Perez, CFA, director, Corporate Research, and Senior Research Analysts Evan Lassow, CFA, and Joshua Stein, CFA.

Rob Fernandez: PCAF's development of the Global GHG Accounting and Reporting Standard for Financial Industry created a focal point for financial institutions to collaborate on measuring and addressing GHG emissions. I am excited for the progress that PCAF made in just the couple of years since its launch globally in 2019.

Josh Perez: Through PCAF's work, financial institutions will be able to utilize a defined methodology to consistently measure, better understand, and disclose the emissions associated with portfolio investments.

PCAF's efforts to create a commonly accepted set of standards for GHG reporting and disclosure is a galvanizing milestone for a range of financial firms around the world as they begin to account for portfolio emissions and begin to set emissions reductions targets. Now more than 300 global financial institutions are helping each other to assess and disclose GHG emissions of loans and investments.

The standard is used to calculate GHG emissions of corporate/business loans, real estate loans, motor vehicle loans, equity and bond investments, insurance liabilities, and other financial products and services. It brings structure to attributing emissions stemming from various investment securities to investment portfolios. The standard will improve reporting and provides the type of consistency that analysts have long been eager for.

Josh Stein: Banks, asset managers, insurance companies, and other financial institutions can use the PCAF standard to measures GHG emissions financed by a portfolio of loans or investments, for example. The measurement is referred to as financed emissions. As investors increasingly seek to reduce emissions financed by their investments, the importance and influence of the standard is growing.

Evan Lassow: I see this as consistent with Breckinridge's tenured integrated ESG process. Breckinridge started integrating environmental, social and governance (ESG) factors in fixed income security research more than a decade ago. Then, accessing consistent and comparable data across industries and sectors was a challenge. Today, it remains an issue in many respects. PCAF's work and the involvement of so many financial institutions globally are important to addressing the challenge for measuring and managing Scope 3 GHG emissions, specifically.

RF: That's true, Evan, and we have been intentional about that over the years as part of our commitment to environmental, social and governance (ESG) and its development. I would include our collaboration with peers, non-government organizations—like PCAF—and thought leaders. Becoming a PCAF member follows our partnerships with Ceres and SASB, our advocacy for the Task Force on Climate-Related Financial Disclosures (TCFD) standards, and our involvement with the CDP. TCFD embedded the standard into its financial sector recommendations.

EL: Right. Our *Corporate Sustainability Report* includes more on those partnerships.

RF: That's true. Measuring GHG emissions, specifically, is gaining a higher profile now, especially after COP26.

JP: Absolutely. especially in advancing the growing global commitment among businesses and governments towards achieving Net Zero emissions.

PCAF collaborates with the International Investors Group on Climate Change (IIGCC) Paris Aligned Investment Initiative, which points to the standard as the leading accounting approach underpinning the Net Zero Investment Framework (NZIF).

We reported on our decision to join the Net Zero Asset Managers initiative in the *Corporate Sustainability Report*, also.

The emergence of net zero investment approaches reflects a broadening support of the goal of achieving net zero GHG emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius. Central to that effort is to take account of portfolio emissions and to invest aligned with achieving net zero emissions. The PCAF's standardized framework in accounting for financed emissions is a major step to implementing and measuring reduction in GHG emissions and implementing a GHG reduction strategy.

JS: In addition to GHG measurement and reporting, there is a heightened level of attention to ESG reporting. PCAF's work will prove supportive of enhancements to the analysis of climate-related risk mitigation. S&P says that 90 percent of major U.S. companies now issue annual reports to outline ESG practices, programs, and policies, compared to just 20 percent a decade ago.[1]

As we have *spoken about before*, the Securities and Exchange Commission's proposed rulemaking on climate-related disclosures may be a substantive source of support for work like that being undertaken by PCAF.

RF: That is because PCAF provides a standardized approach that allocates emissions from individual investment securities to an investment portfolio based on the concept of overall ownership. This is a more robust approach than using a market value adjustment because investors can more clearly define a specific level of financed emissions that considers the overall size of the portfolio.

JP: I also believe the growth in adoption of PCAF's standard by financial institutions sets it apart.

The European Banking Authority, the U.S. Securities and Exchange Commission, and the International Sustainability Standards Board (ISSB) all reference the PCAF standard in their proposals.

Rob, you mentioned TCFD and SBTi, also, the standard enables financial institutions to answer CDP's Climate Change Questionnaire for Financial Services.

JS: Going forward, Breckinridge will be a member of the PCAF North America team, and we are using the standard in accounting for the financed emissions stemming from our corporate bond assets under management. We look forward to collaborating with other PCAF members to further identify best practices. Finally, speaking of PCAF members, we'd like to thank Lauren Compere at Boston Common Asset Management, a PCAF Global Core Team member, for helping us learn more about the initiative and its commitments.

As a PCAF member, we are taking an important step to assess climate-related risks as we begin to set targets in line with the Paris Climate Agreement and develop effective strategies to decarbonize.

PCAF's Global GHG Accounting and Reporting Standard for the Financial Industry is represented below:

The financed emissions of investment in a company are calculated by multiplying the attribution factor by the emissions of the respective borrower or investee company. The total financed emissions of a listed equity and corporate bonds portfolio is calculated as follows:

$$\text{Financed emissions} = \sum(c)\ \text{Attribution factor}(c) \times \text{Company emissions}(c)$$

The attribution factor represents the proportional share of a given company—that is, the ratio of the outstanding amount to Enterprise Value Including Cash for listed companies:

For listed companies:

$$\text{Financed emissions} = \sum(c)\ \text{Outstanding amount}(c) \,/\, \text{Enterprise Value Including Cash}(c) \times \text{Company emissions}(c)$$

Where (c) is borrower or investee company

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FOOTNOTES:
1. "*2020 S&P 500 Flash Report*," Governance & Accountability Institute, July 2020.