

UKRI Research “Financially redesigning the Anthropocene: Investigating tools, data, and practices for climate risks and targets”

Research snapshot: Observations from our exploration of the field

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General observations of the field

- Expansive nature of climate change in finance. As a consequence, there are ongoing struggles around resources.
- The field is clearly focused on measurement (risks, emissions, metrics), but there are questions on whether and how this measurement will/can lead to impact.
- Competitive labour dynamics: experienced staff are highly sought after and fluctuating, increasing the strain on resources.

TCFD and Disclosure

- Most work on data and metrics happens for the purpose of disclosure. However, these data and metrics also seem to be, at least partly, leveraged for other purposes (e.g., investing). There are practical challenges in this leveraging (e.g., aggregate vs. more granular levels of data)
- Disclosure is evolving and keeps changing over time, e.g., due to changes in disclosure frameworks and changes in data and metrics.
- Differing motivations for advancing disclosure (e.g., reputation, influence on disclosure frameworks and other actors, agenda setting).
- Utilising TCFD criteria as criteria for assessing/ranking corporates and FIs.

Target setting and portfolio alignment

- Plethora of discussions and debate about understanding net zero as a concept. IEAs NZ scenario seemed to help to clarify the concept.
- Speed with which net zero rushed into the market left everybody scrambling and little time to think about what is actually needed (e.g., providers immediately productizing and marketing NZ, NGOs rushing to develop criteria for NZ target-setting).
- Complexity of target-setting is an expression of the ‘stacked’ complexities in climate-related data and metrics (see our overarching framework).
- Competing and conflicting net zero initiatives (e.g., IIGCC and NZAOA). Each of the proposed frameworks are being challenged by others in the field (e.g., on their ambition level, diluting rigor, credibility). The question is whether SBT-*Fi* could become the standard for target-setting for FIs.
- Target-setting, even though it is supposed to be done by the FI, actually happens in collaboration with various other actors, e.g., industry initiatives, NGOs, providers, consultants, academics etc.
- Central role of SBTi in validating targets of corporates. FIs rely heavily on SBTi-validated targets as a means (‘proxy’) for assessing the transition plans of corporates.
- The market appears to coalesce around emissions reduction, not removal.

Metrics

- FIs start with simple metrics (e.g., WACI) and then go through a 'ladder of sophistication' (e.g., Climate VaR, temperature metrics).
- Working with multiple climate-related metrics creates challenges (e.g., ensuring consistency between metrics, creating a dashboard).
- FIs are developing different coping strategies to deal with imperfections in methodologies and data.
- Assessing climate performance: (1) self-referentiality of metrics, (2) comparing to an external or normative benchmark.
- NGOs as metrics brokers between providers and FIs.
- Backward-looking metrics: Different preferences with regards to relative vs absolute measures of carbon emissions. There seems to be no final consensus on the basis for normalising carbon emissions.

Forward-looking metrics

- Highly requested but not reliable and operational for decision making yet (e.g., too immature, poorly understood, continuously evolving). NGOs push for forward-looking metrics.
- ‘Symbiotic’ collaboration between FIs and providers to develop forward-looking metrics.
- Temperature metrics: high divergence of approaches and questions around conceptual validity prevent usage in actual decision-making. It is unclear on how to arrive at a solution (e.g., criteria for methodology development, best practices for design choices).
- CVaR: connects intellectually and conceptually well to traditional VaR measure but there are important differences. There are fears of creating an artificial confidence in CVaR.
- Potentially missing metrics: avoided emissions, systemic risk, internal shadow carbon price for FIs.

Scope 1 and Scope 2 GHG emissions data

- The information about companies' emissions is highly ambiguous (e.g., incomplete information, inaccurate information, methodological instabilities and heterogeneity in classifying companies). Thus, the production and curation of emissions data is a highly complex task and requires a lot of judgement calls.
- Providers play an important role in producing emissions data that is comprehensive, coherent, comparable, standardized and homogenized.
- Due to remaining ambiguities about a company's emissions, emissions data requires a lot of explaining and framing on both the provider and FI side. This is not necessarily bad, but can support creating valid representations of companies' emissions.
- AI and reporting are unlikely to solve issues around emissions data production and curation in the short-term.
- Public vs. proprietary emissions data repositories: various requests and early efforts around public emissions data repositories (e.g., EU, OS-Climate), but questionable if and when this will materialise.
- Limited availability of asset data points beyond emissions data, e.g., location, age, size. Covering additional asset classes beyond equity and credit consumes a lot of resources.

Scope 3 GHG emissions data

- It is significantly more complex to generate and curate Scope 3 data compared to Scope 1 and 2 data. Double counting issue adds to the complexity, both conceptually and on a practical level.
- Scope 3 of investee companies is going to significantly change how portfolio emissions need to be managed and how net zero targets are going to be achieved.
- Central role of PCAF in clarifying Scope 3 for FIs (category of 15). Scope 3 of FIs is of a different nature than the other 14 categories of Scope 3.

Climate Scenarios

- Target setting requires a single or few selected scenarios, while risk management follows different routes, either using few or many different scenarios.
- NGFS/CBES scenarios are en-route to become standard for scenario analysis and stress testing.
- IEA Net Zero scenario could potentially become a standard/benchmark for target setting.
- Scenarios are being used for other purposes than they were originally designed for (e.g., IPCC scenarios used for target setting). Some difficulties in sourcing climate scenarios for commercial use.
- Both providers and FIs require flexibility in updating scenarios and integrating new ones.

Outlook

- Scope 3 will become crucially relevant
- Transition plan implementation, net zero plans becoming mandatory?
- Possible convention for temperature methodologies or failure of metric?
- Provider asset database crucial for better assessing physical risk
- Platforms as possible market places: Aladdin Climate, OS-Climate
- SBT-Fi as potential centre for FI target setting