

# Debunking 7 misconceptions about scope 3 emissions



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In this investment viewpoint we describe seven key misconceptions that we think may have deterred investors from fully integrating considerations linked to scope 3 emissions and lead to confusion in the market.

## Scope 3: Indirect emissions linked to supply chains and product use

In the same way that companies' financial reports are subject to strict accounting rules and procedures, so too are companies' greenhouse gas (GHG) emissions. However, there is only one global standard for GHG emissions reporting (The Greenhouse Gas Protocol)<sup>1</sup>. Accounting for one's carbon emissions requires specific expertise and understanding of this Protocol. In particular, understanding and appreciating the nuances of different parts of a company product's lifecycle (known as scope 1, 2 and 3 emissions) is critical.

## Misconception 1: Scope 1 and 2 emissions are comprehensive enough

Many investors still focus primarily on scope 1 and 2 emissions, believing that this provides a reasonable insight into most companies' carbon footprints. However, for key industries (e.g. oil, gas

and automotive sectors) and all major sectors, excluding utilities, scope 3 are the dominant type of emissions. Therefore, if investors do not take scope 3 emissions into account, they fail to capture a company's full GHG profile.

## Misconception 2: Scope 1 and 2 emissions are more important due to corporate control

This view can be challenged on three accounts:

- First, companies have significant influence over their supply chains and can engage suppliers to reduce emissions.
- Second, companies can directly reduce their supply-chain emissions by transitioning to less carbon-intensive business models.
- Third, even where a company's ability to influence scope 3 emissions may be limited, the company's exposure to these emissions still creates significant transitional risks – driven by regulatory and market forces.

## Misconception 3: There is insufficient data to meaningfully assess scope 3 emissions

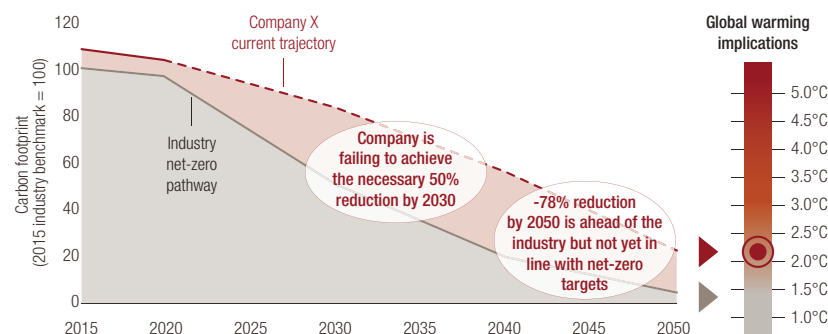
In 2010, less than 3,000 companies disclosed information to the Carbon Disclosure Project, but as of 2020 this had grown to over 9,500. While a smaller number of these disclose scope 3 data, this proportion has also grown. Furthermore, what is often overlooked is that scope 3 emissions can often be assessed even if they are not reported. Using the automotive sector as a case study, our report finds that such models can be more accurate than company-reported figures.

## Misconception 4: Emissions double-counting occurs within portfolios

*If an investor holds an oil and gas and a transport company in the same portfolio, would the oil and gas company not be reporting emissions that are also already counted by the transport company?*

We believe not - these issues are often misrepresented in overly stylised

## Company X climate trajectory



examples that fail to recognise that it would be unusual for more than a small share of a company's suppliers to feature in the same portfolio. Double-counting of emissions should be considered from an economy-wide, rather than portfolio, perspective.

## Misconception 5: Double-counting is undesirable and should be adjusted for

While addressing misconception #4, we recognise that a significant amount of double counting does occur. But, the question frequently forgotten is: *whether such double counting is in fact undesirable?* We argue that although emissions are double-counted across a value chain, carbon risks also reverberate through supply chains. While double-counting may recognise that companies share responsibility for emissions, it artificially deflates the true scale of a portfolio's carbon exposure and the financial risks that it entails.

## Misconception 6: As data are still improving, it makes sense to defer scope 3 analysis

Given the misunderstandings about scope 3 analysis, some investors are taking a cautious approach. At best, they are investigating indirect emissions in a handful of sectors only. We believe that delaying scope 3 analysis across the economy will result in significant turnover in investors' portfolios. In the process, this could lead to investors selling

hidden, poorly aligned companies only after they have already depreciated due to scope 3 emissions disclosure, and equally drive appreciation among better-aligned companies before investors lagging on scope 3 analysis have identified them.

Misconception 7: High scope 3 emissions disqualify companies from a climate-aligned portfolio. Including scope 3 emissions in investment analysis improves the accuracy of carbon-risk assessments in portfolios, but does not mean that high-emitting companies should necessarily be excluded. Carbon-intensive industrial sectors are often not only essential to the economy, but are also among the most important in the net-zero transition.

The right question is therefore not whether a company is emissions intensive today, but whether it is transitioning quickly enough to meet Paris Agreement-aligned decarbonisation objectives.

## FOOTNOTES

<sup>1</sup> We set the standards to measure and manage emissions / <https://ghgprotocol.org/>



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