GUEST VIEWPOINT

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Viewpoint: The SEC should not diverge on Scope 3

Reporting of value chain emissions, whether upstream such as purchased goods, or downstream – such as product use (think combustion of fossil fuels), will be abandoned.

Investor advocacy for value-chain emissions (Scope 3) reporting and its possible incorporation within a US Securities and Exchange Commission (SEC) climate-disclosure rule have sparked fierce resistance from fossil-fuel interests.

These interests seeded and funded a highly successful campaign in the US against the consideration of ESG factors in financial decisions. Pressure from conservative outlets, Republican lawmakers and state attorneys general, has pushed financial institutions to withdraw from net-zero coalitions, reduce climate advocacy, and reaffirm support for fossil-fuel projects.

The same interests supported a direct challenge at SEC rulemaking, particularly concerning value-chain emissions. Intense opposition and threats of litigation have caused delays and media reports suggest that the long-awaited final draft, to be voted on 6 March, will only require reporting of emissions from operations companies own or control (Scope 1) and of indirect emissions from purchased energy consumed by these operations (Scope 2).

Reporting of value-chain emissions, whether upstream such as purchased goods, or downstream such as product use (think combustion of fossil fuels), will be abandoned.

Such an outcome would mark not only another victory for the fossil-fuel industry, but also a departure from emerging international standards. Value-chain emissions disclosure is mandated by European Union law and included in the first set of sustainability-related financial disclosure standards endorsed by the International Organisation of Securities Commissions (IOSCO).

Since value-chain emissions account for the bulk of the carbon footprint of activities, their recognition is key to understanding climate impacts, risks, and opportunities.

Critics argue that the proposed SEC rule is unworkable or too expensive; that data and estimation methods produce inaccurate estimates of limited meaning or value; and that it would burden out-of-scope entities in the value chain. While this is coloured by partisan spectacles, there are potential limitations of which companies, investors and regulators should be aware.

However, mapping value-chain emissions enables companies to identify emissions hotspots, prioritise actions for emissions and cost reduction, and manage transition risks. Potential benefits greatly exceed costs.

Assessing emissions across global value chains admittedly poses significant challenges. However, the applicable standard allows companies to select boundary, data, and computation options consistent with their capabilities, resources, and experience.

Over time, companies can improve data accuracy and estimation model specificity, and expand the scope of their reporting. Challenges do not diminish the relevance of the exercise or of the data it produces, provided standard flexibility is not repurposed to undermine a fair inventory.

Voluntary reporting, however, has been driven by corporate expediency and 'strategic' considerations. Reporting has not only been sparse, but also insufficiently focused on material sources.

This has greatly limited its relevance and led many data providers to eschew disclosures and estimate emissions with models that may offer internal consistency but take insufficient consideration of corporate specificities.

Nevertheless, opposing mandatory reporting on the basis of data limitations confuses the symptom for the cause. Standard-compliant mandated reporting would significantly enhance the quantity and quality of the data produced and pave the way for better modelling.

Admittedly the standard aims at helping companies reduce their emissions and is not meant to produce data for cross-corporate comparisons. By assisting in the identification of key emissions sources, data, and prescribing accounting options, sector-specific guidance could cut reporting costs and increase the quality and comparability of disclosures.

Regulators should phase in interoperable sector-specific standards, encourage sector and value-chain cooperations, and provide tools to accelerate the adoption of best practices, lower costs, and protect small businesses from unreasonable data demands.

Investors are right to request value-chain emissions, but need to recognise current limitations and ensure data are used in a manner that is fit for purpose. Since Scope 3 emissions dwarf Scope 1 and 2 combined, steering portfolio construction by total emissions, as mandated by the EU Benchmark Regulation, cannot reliably redirect capital flows toward sustainable activities.

As mandatory reporting ramps up in key jurisdictions, the number of companies disclosing value-chain emissions is set to increase rapidly. If the SEC adopts a divergent course, this will impede the consideration of climate-related risks by investors, their integration into market prices, and hinder efficient capital allocation.