Scope 3 emissions myths

Thomas Hohne-Sparborth debunks seven misconceptions about scope 3 emissions

In this investment viewpoint we describe seven key misconceptions that we think may have deterred investors from fully integrating considerations linked to scope 3.

Scope 3: Indirect emissions linked to supply chains and product use
Companies' greenhouse gas (GHG) emissions are subject to strict accounting rules. However, there is only one global standard for GHG emissions reporting (The Greenhouse Gas Protocol)[1]. 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 (eg oil, gas and automotive sectors) and all major sectors, excl. 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, fewer than 3,000 companies disclosed information to the Carbon Disclosure Project, but as of 2020 this had grown to over 9,500. Furthermore, what is often overlooked is that scope 3 emissions can often be assessed even if they are not reported.

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. 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
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. We believe that delaying scope 3 analysis across the economy will result in significant turnover in investors' portfolios. This could lead to investors selling hidden, poorly aligned companies and 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 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.

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