ANALYSIS: New int’l corporate Scope 3 emissions reporting laws highlight different regional aims for climate finance

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Recent corporate value chain emissions reporting legislation from the EU and California, and similar policy proposals in Australia, will provide investors with the tools to identify climate-related transition risks; however, legislative goals differ, showing that projected impacts of corporate climate disclosure may vary by context.

The EU’s Corporate Sustainability Reporting Directive (CSRD) and California’s 2023 Climate Corporate Data Accountability Act (SB 253), both of which came into force last year, and Australia’s draft Disclosure of Climate-related Financial Information text, require large corporates to report their Scope 3 emissions with an eye to informing investor decision-making.

In recent years, momentum has built up to establish mandatory corporate sustainability reporting, resulting in Scope 3 reporting requirements for some companies as early as 2025 in the EU, 2027 in California, and potentially 2025 in Australia, if the regulation is implemented in its latest form.

Previously, in 2021, the UK became the first G20 country to mandate that large businesses disclose climate-related risks, including emissions reporting, adopting and codifying the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The UK policy entered into force in Apr. 2022.

However, distinct from new initiatives out of the EU, California, and Australia, UK regulations do not mandate Scope 3 reporting: TCFD guidance states that such emissions only need be reported “if appropriate“.

SIMILAR REGULATIONS, DIFFERENT GOALS

While there are similarities between the Scope 3 emissions reporting regulations being pushed in the three jurisdictions, behind them are slightly different objectives linked to their particular legislative and geographical contexts.

According to sources speaking to Carbon Pulse, the EU is making industry-led value chain decarbonisation a priority. At the same time, California’s strengthened state-level reporting requirements outpace national policy, while Australia seeks to future-proof its economy by curbing exported emissions and attracting international finance for its green transition.

The European Commission’s guidance – which remains high-level, not yet including sector-specific guidance for the financial sector – is based on industry-led Partnership for Carbon Accounting Financials (PCAF) guidelines, while Californian companies will be bound by pending federal US Securities and Exchange Commission (SEC) emissions reporting requirements.

Australia’s pending regulations appear to be based on protocols from the TCFD and International Accounting Standards Board (IASB).

Given differing approaches, there remains a risk, according to some experts, that distinct reporting requirements across regions and countries will complicate dealings for cross-border corporates, making it more challenging to obtain comparable data on climate transition and greenwashing risks.

EUROPEAN UNION

The EU’s CSRD will require firms to communicate their 2024 extra-financial information in 2025, after the regulation formally entered into force in Jan. 2023.

Emissions disclosure will become mandatory for the biggest publicly-listed and non-listed companies from 2026, as well as smaller publicly-listed firms operating with at least one subsidiary in the EU from 2029. Some stakeholders have estimated the scope of the law at 50,000 EU businesses and at least 10,000 EU-based foreign companies.

The new rules will ensure that investors and other stakeholders have access to the information they need to assess investment risks arising from climate change and other sustainability issues, according to the European Commission, the executive arm of the 27-nation bloc.

“The main target audience for Scope 3 emissions data, besides internal use by the company itself, are investors and asset managers [who] need this information in order to understand the sustainability impacts of their investments and the risks to which they may be exposed,” a Commission spokesperson told Carbon Pulse.

Where investors and asset managers are able to understand their exposure to climate-related risks, they can manage their value chain impacts.

“Value chain impact management often implies the activation of business-to-business relationships and networks, which are recognised as an important lever for change,” the spokesperson added.

In turn, non-financial firms can then start “managing and decreasing those impacts over time”, they said.

Amir Sokolowski, global director for climate change at the NGO CDP, echoed the importance of leveraging the relationship between finance and business to decarbonise value chains.

“An increasing number of financial institutions are realising they must engage with their portfolio companies and insist they are prepared for the low-carbon transition by including Scope 3 emissions in their guidance to borrowers,” he told Carbon Pulse.

“The inclusion of Scope 3 reporting in the EU’s CSRD is extremely welcome as it will drive not only thousands more companies to disclose this vital information, but to subsequently take action to reduce emissions across the value chain and boost their own resilience,” he added.

The CSRD belongs to a broader ecosystem of EU directives trending toward economy-wide emissions reporting, such as the 2019 Sustainable Finance Disclosure Regulation.

According to Xavier Sol, sustainable finance director at the European NGO Transport and Environment (T&E), this wider disclosure package produced by Brussels sends a signal to international corporate stakeholders that tightening Scope 3 rules will impact financial flows.

“Ultimately, more accurate reporting on Scope 3 will have an impact on investors,” he told Carbon Pulse. “For sure, this will be the case in the transport sector,” he added, referring to the core area of focus for T&E.

The NGO is a member of EFRAG, a private advisory body to the EU Commission that helped draft the CSRD regulation, and is currently collaborating on sector-specific standards for road transport and motor vehicles.

CALIFORNIA

California’s SB 253, signed into law in Oct. 2023, names one of its key aims as informing the decision-making of investors and other stakeholders through increased market transparency.

“California investors … deserve transparency from companies regarding their greenhouse gas (GHG) emissions to inform their decision-making,” the law states.

“The current approach for disclosure of climate emissions from public and private corporate enterprises … lacks the full transparency and consistency needed by residents and financial markets.”

The law emphasises that mandating annual, full-scope GHG emissions data reporting will improve private sector risk management by informing investors.

As a state-led initiative that is in a jurisdiction home to global giants such as Apple and Chevron, and is applicable to at least 75% of Fortune 1000 companies, SB 253 has both pre-empted the SEC’s hotly-anticipated, as-yet-unreleased emissions reporting regulations, which will apply across the US – and surpassed them.

The SEC’s proposal includes mandatory reporting of Scope 1 and 2 emissions for covered companies but would allow them to avoid reporting Scope 3 emissions they deem “immaterial”.

This requirement is more lenient than California’s mandatory Scope 3 reporting under SB 253 and would be layered on top of the state’s approach.

AUSTRALIA ACTION

A draft text in Australia, initially proposed by the finance ministry and elaborated in Oct. 2023 by the country’s Accounting Standards Board, would require that entities involved in asset management, commercial banking, and insurance report financed emissions as part of general Scope 3 reporting requirements for firms.

According to financial markets analyst, Tim Buckley, co-founder of the think tank Climate Energy Finance, the government’s push to implement such requirements is tied to the need to harness international finance for a green transition as the major buyers of Australia’s fossil fuel exports in northeast Asia pursue decarbonisation policies.

“Unlike America, we don’t drive the world of capitalism,” Buckley told Carbon Pulse. “[The government is] having to work out how we create the right regulatory framework to crowd in private capital … and the best way to do that is to systematically evaluate Scope 1, 2, and 3 emissions,” he said.

“We’ve got to do what international investors in Europe and in America need, and they need comparability amongst everything else.”

To reveal the true financial risks associated with Australia’s coal- and natural gas-based exported emissions, which are Scope 1 emissions in Asian buyer countries, investors must have access to Scope 3 emissions data, stated Buckley.

Voluntary initiatives like the TCFD are insufficient as “finance moves because they know the regulatory frameworks are moving,” Buckley added.

“[The financial sector] can move very fast when it realises that tipping points [are] being reached,” he said.

“So, when I say finance needs the Scope 1, 2, and 3 transparency, it’s because they need to make informed decisions.”

“Once they know where that risk is, they will manage that risk,” Buckley concluded.

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