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**Scope for Divergence: Debunking Value Chain Emissions Myths and Addressing Scope 3 Challenges**

***A new EDHEC Business School policy contribution:***

* ***explains the importance of accounting for corporate value chain emissions;***
* ***highlights the limitations and risks of reported and modelled Scope 3 emissions for investors; and***
* ***issues recommendations for comprehensive integration of climate change impact and risks into business and investment decisions.***

EDHEC-Risk Climate Impact Institute today released “[Scope for Divergence](https://climateimpact.edhec.edu/sites/ercii/files/pdf/ercii_pc_scope_for_divergence_march24.pdf)”, a policy report offering comprehensive insights into accounting for greenhouse gas emissions throughout companies’ value chains – and the challenges this poses to companies and investors.

As a significant majority of the global population supports action against climate change, investors are intent on better understanding the climate change impact and risks of investee companies. Direct and purchased energy emissions (Scope 1 and 2) have historically been the focus of reporting standards. However, indirect emissions that occur throughout companies’ value chains (Scope 3) typically account for the bulk of their carbon footprints.

Caught up in the contentious debate between investors and environmental NGOs who call for the disclosure of value chain emissions and business organisations and politicians representing fossil fuel interests who oppose it, the U.S. Securities and Exchange Commission (SEC) opted to exclude value chain emissions from its landmark climate-change disclosure rule earlier this month.

The European Union (EU) requires the construction of its climate benchmarks to be steered by value chain emissions and has mandated their reporting when material; across the Atlantic, opponents of disclosures have argued that accounting would be unfeasible or too costly for corporates and would produce inaccurate estimates with limited practical value or significance, notably for investors. While this report debunks these myths and finds value chain emissions accounting to be both feasible and useful, it also shows that EU regulators have erred in encouraging inappropriate uses of Scope 3 emissions data by investors and makes recommendations to stakeholders to improve the integration of value chain considerations into business and investment decisions.

**Key findings:**

* Value chain emissions represent a material source of emissions that companies can strategically manage in order to address both their impact on climate change and their exposure to transition risks.
* Quantitative progress in voluntary reporting of value chain emissions has not been accompanied by an improvement in the quality of the data provided. Reporting is too often an exercise in greenwashing and remains sparse, incomplete, and insufficiently focused on material sources.
* Opposing mandatory reporting based on these limitations confuses the symptom for the cause. Mandatory reporting and assurance will materially improve the availability and reliability of reported data.
* However current reporting standards are not intended to support cross-corporate comparisons and reported data will remain irrelevant to certain usages sought by investors.
* Scope 3 emissions modelled by data providers may address issues of completeness and comparability but come with challenges of model stability and insufficient consideration of corporate specificities, drawbacks which also limit potential investor usages.

**Key recommendations for companies, investors, and standard setters:**

* **Companies** should adopt value chain emissions accounting as an integral component of their sustainability and risk management strategies and embrace reporting. Participating in value chain initiatives and adopting sectoral guidance for emissions accounting and reportions will reduce the costs of disclosures – and increase their value.
* **Investors** should accept thelimitations of reported and modelled value chain emissions. Fiduciaries should perform due diligence to ensure that any use of Scope 3 emissions data is fit for the intended purpose and consistent with the financial and non-financial objectives and constraints of investors. Investment managers who wish to incorporate value chain considerations into portfolio construction and stewardship activities should consider alternative metrics.
* **Regulators and standard setters** should avoid requiring, condoning, or encouraging uses of value chain emissions that are not fit for purpose, notably portfolio construction. The EU Benchmark Regulation must be updated to stop abetting greenwashing, notably through faulty minimum standards for Climate Transition and Paris-aligned Benchmarks (EU CTB/PAB). Lawmakers should enact regulations that drive the decarbonisation of the economy and require administrations and businesses to produce standardised disclosures of emissions performance and transition plans. Governments should support the production and adoption of sector-specific guidance and promote initiatives to accelerate the adoption of best practices, lower costs, and protect small businesses.

Frédéric Ducoulombier, Director of the EDHEC-Risk Climate Impact Institute and author of the report, states: “Under pressure from fossil fuel interests, the SEC has turned its back on value chain emissions disclosure, dialling down its commitment to investor protection and capital market efficiency. However, tackling these emissions is key from the dual perspective of mitigating climate impact and transition risks and should be a strategic consideration for both businesses and investors. Our research presents a dispassionate analysis of the challenges linked to value chain emissions accounting, reporting and processing, and provides actionable advice to stakeholders on how to address these.”

Download the full paper here:

[Scope for Divergence – A review of the importance of value chain emissions, the state of disclosure, estimation and modelling issues, and recommendations for companies, investors, and standard setters](https://climateimpact.edhec.edu/sites/ercii/files/pdf/ercii_pc_scope_for_divergence_march24.pdf)



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**About EDHEC-Risk Climate Impact Institute**

**Delivering Research Insights on Double Materiality to the Financial Community**

EDHEC-Risk Climate’s mission is to help private and public decision makers manage climate-related financial risks and make the best use of financial tools to support the transition to low-emission and climate-resilient economies.

Building upon the expertise and industry reputation developed by EDHEC-Risk Institute, EDHEC-Risk Climate’s ambitions to assist policy makers with the evaluation of climate change mitigation and adaptation policies and to become the leading academic reference point helping long-term investors manage the risk and investment implications of climate change and climate action.

EDHEC-Risk Climate also aims to help policy makers and financial supervisors assess climate-related risks in the financial system and provide them with financial tools to mitigate those risks and optimise the contribution of finance to climate change mitigation and adaptation.

The delivery of these ambitions is centred around two long-term research programmes and a policy advocacy function.

The research programmes respectively look at the **Implications of Climate Change on Asset Pricing and Investment Management** and the **Impact of Finance on Climate Change Mitigation and Adaptation**. The policy advocacy function is directed towards regulators and standardisation authorities.

Currently bringing together a dozen faculty members, researchers and staff, the Institute is endowed with a EUR20 million budget for its first five years of operation.

The philosophy of the institute is to validate its work through publication in leading scientific journals, but also to make this research available to professionals. In this regard, we participate in industry debate through position papers, published studies, online courses, webinars, seminars, and global conferences.

To ensure the dissemination of our research to the investment industry, the institute provides professionals with access to its website, <https://climateimpact.edhec.edu>. This resource is devoted to the study of the consequences of climate change on the economy and on the financial system. Our quarterly newsletter is distributed to more than 100,000 readers.

The Institute also supports the integration of climate issues into the research agenda of the School’s other financial research centres and into the product offering of the School’s business ventures. In particular, it helps the [EDHEC Infra & Private AssetsResearchInstitute](https://edhec.infrastructure.institute/) build capacity on sectoral alignment and transition plans.

**About the Author**

**Frédéric Ducoulombier** is the founding director of [EDHEC-Risk Climate Impact Institute](https://climateimpact.edhec.edu/). Prior to joining the Institute, he served as Head of Risk and Compliance and then ESG Director at index provider Scientific Beta. In parallel to his management career, he has been performing research and policy advocacy work that has focused on portfolio construction, financial regulation, and sustainability.  He has served on the Consultative Working Group of the European Securities Markets Authority’s Financial Innovation Standing Committee and on workgroups supporting net-zero alliance work on portfolio alignment.  His interest in value chain emissions data dates back to 2018 and his work assisting responsible investors with the integration of climate concerns into portfolio construction.  In [2019](https://ec.europa.eu/eusurvey/files/b599b1d8-5de8-4734-83ac-c52bc241e1b0/f87cf95e-edfe-401c-bf85-f0e611de3523), along with EDHEC Business School Professor Noël Amenc, he alerted the expert group advising the European Commission to the risks associated with the use of divergent ESG data, perverse metrics, and poorly designed approaches to controlling greenwashing. As the final report of the expert group retained critical flaws, the duo penned a 60-page [report](https://www.scientificbeta.com/download/file/unsustainable-proposals) detailing major issues and offering remedies in February 2020.  As major flaws were still present in the draft regulation, the duo escalated its concerns to [DG FISMA](http://docs.scientificbeta.com/CEO/200505_CTB_PAB_ESG_FISMA_Feedback.pdf) in May 2020.  One of the key remaining issues was the “direct consideration of value-chain (…) emissions (…)  for the purpose of stock selection”; the duo wrote: “Unless one wishes to disregard efforts made by companies in the mitigation of their greenhouse gas emissions, we recommend the consideration of Scope 3 emissions be done indirectly via related metrics that can support security-level analysis. As their advice went unheeded, Frédéric produced a peer-reviewed publication titled “Understanding the Importance of Scope 3 Emissions and the Implications of Data Limitations” (*The Journal of Impact and ESG Investing*, [2021](https://eprints.pm-research.com/17511/55152/index.html?84641)). Today, his analyses and recommendations have become mainstream, as evidenced by the positions of net-zero investor associations (while the UN-convened Net-Zero Asset Owner Alliance has always adopted a cautious stance with respect to target setting in respect of Scope 3 emissions, a working group of the Institutional Investors Group on Climate Change, the main investor coalition behind the Paris Aligned Investment Initiative Net-Zero Investment Framework, recently admitted that “aggregation of scope 3 emissions at portfolio level leads to perverse outcomes”) and reports published by investment managers such as AQR (Supply Chain Climate Exposure, [2022](https://www.tandfonline.com/doi/full/10.1080/0015198X.2022.2129946?scroll=top&needAccess=true&role=tab)), Osmosis Investment Management (The Obstructive Role of Scope 3 Data in Portfolio Construction, [2022](https://www.osmosisim.com/uploads/2023/02/9fe86891a3a7fc3d4121373e9e3497f7/scope-3-whitepaper-final.pdf)), LGIM (Scope 3: Omission Impossible, [2023](https://www.lgim.com/landg-assets/lgim/_document-library/capabilities/defined-benefit/db-scope-3-omission-impossible-final.pdf%26ved%3D2ahUKEwjp6-OpwpSFAxUmVkEAHZYwALAQFnoECA4QAQ%26usg%3DAOvVaw3kaa5qUvUCWQ56kL-h9f3w)), and even a major data provider (Scope for improvement: Solving the Scope 3 conundrum, LSEG, [2024](https://www.lseg.com/content/dam/ftse-russell/en_us/documents/research/solving-scope-3-conundrum.pdf)).  At EDHEC-Risk Climate Impact Institute, Frédéric has continued to explain how misuse of Scope 3 emissions data could lead to greenwashing (EDHEC-Risk Climate Impact Institute’s Response to the European Supervisory Authorities’ Call for Evidence on Greenwashing, [2023](https://climateimpact.edhec.edu/sites/ercii/files/ercii_pc_response_european_supervisory_authorities_oct23.pdf)) and promote a better understanding of the significance of value chain emissions, the challenges in their accounting, reporting, and modelling, and implications for companies, investors, and policymakers (Scope for Divergence, 2024).

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