T. Rowe Price®

By email to reporting@energysecurity.gov.uk

December 12, 2023

Re: Call for Evidence Regarding Scope 3 Emissions in the UK Reporting Landscape

T. Rowe Price[1] welcomes the opportunity to submit our firm's feedback on the ***Call for Evidence: Scope 3 Emissions in the UK Reporting Landscape***, published by the Department for Energy Security and Net Zero (DESNZ). We support the United Kingdom's adoption of the IFRS S1 and S2 standards published by the International Sustainability Standards Board (ISSB), subject to adjustments in timing and further assistance with Scope 3 reporting. We expressed our views in further detail in our response (dated October 10, 2023) to ***Call for Evidence Regarding UK Endorsement of IFRS S1 and IFRS S2*** published by the Financial Reporting Council (FRC) in its role as the secretariat for the UK Sustainability Disclosure Technical Advisory Committee (TAC). In this letter, we specifically explain the importance of greenhouse (GHG) emissions reporting, particularly Scope 3 reporting, to us, as an investment manager.

Relevance of GHG reporting to our investment process. As a global investment management organization, serving a broad array of clients, from individual savers to large institutions, we generally support regulation that facilitates disclosure of scope 1, 2 & 3 GHG emissions, as we believe climate change is a financially material factor impacting many of the sectors in which we invest. Furthermore, scope 1, 2 & 3 GHG emissions are an important input for climate scenario analysis (CSA) of investment firms, which is part of the Financial Conduct Authority's (FCA) ESG Sourcebook, onboarding the Taskforce on Climate-related Financial Disclosures (TCFD) applicable to asset managers in the United Kingdom.

Our current position on scope 3 GHG emissions reporting. We strongly encourage all issuers to report their scope 1–3 GHG emissions that are most material to their business. We recognize that reporting scope 3 emissions adds much more complication than reporting scope 1 and 2 emissions and that for some industries, estimating methodologies are still evolving. Given these issues, we do not think it is appropriate for us to unilaterally expect all issuers to report a full suite of scope 3 emissions; however, we do expect that the landscape and our expectations will evolve over the next 12–36 months. In the interim, we strongly encourage issuers to report the scope 3 emissions categories most material to their business.

Need for regulatory guidance for corporate issuers on estimating methodologies for Scope 3 GHG emissions. Based on our engagement with corporate issuers on the topic of GHG emissions disclosure, we believe that regulatory support will be needed for any meaningful change in reporting to occur. In our view, the key problem sits with scope 3 emissions where only a minority of the investment universe reports the scope 3 emissions categories that are financially material to their business – let alone a full profile of all 15 categories. (See Appendix I for more analysis.) We believe this reluctance to report scope 3 emissions is in large part driven by:

1. a lack of confidence from issuers in utilizing scope 3 estimating methodologies and the fear of legal repercussions from reporting estimated data in financial statements; and

[1] T. Rowe Price is a global investment management organization, serving a broad array of clients, from individual savers to large institutions and funds. Headquartered in the United States, T. Rowe Price has offices in 17 jurisdictions around the world, including in the United Kingdom, with global assets under management of $1.31 trillion as of October 31, 2023.

2. a lack of consistency among global regulators on the importance of scope 3 reporting.

Facilitating Scope 3 GHG Emissions reporting will support the UK Government's Green Finance Strategy. From our perspective as asset managers, the lack of scope 3 emissions reporting hampers the effectiveness of two key aims promoted by the UK government – firstly, the requirement of asset managers to provide TCFD-aligned reporting and, secondly, the achievement of its overall Green Finance Strategy. When it comes to TCFD-aligned reporting, the concern stems from the requirement to perform climate scenario analysis (CSA) with a dataset that does not meet the current requirements. Scope 3 emissions are a key input for CSA and, in a best case scenario, a weak scope 3 dataset will result in CSA outcomes being more a reflection of sector or industry allocation vs. security selection and, in a worst case scenario, it will yield a completely spurious result – both of which will give investors a misinformed picture of their investment portfolio's carbon footprint. The UK Government's Green Finance Strategy, which is important to the government's objective of achieving a net zero economy, can also be hampered by a weak scope 3 dataset as asset managers are not able to sufficiently and/or accurately measure GHG emissions profiles of investment portfolios.

In the absence of company reported data, investors have become reliant on estimated scope 3 emissions provided by third-party vendors such as MSCI, Sustainalytics, Bloomberg, and ISS, among others. These estimates are done on a best efforts basis, but the vendors in almost all instances do not have access to key inputs from the companies which can be meaningful determinants of a company's emissions profile. This means we have to limit the level of confidence we have in this estimated data.

Phased approach – focusing on material Scope 3 GHG emissions. While having a full suite of all scope 3 GHG emissions data across all 15 categories would be ideal from an investment analysis standpoint, we recognize that the costs of compiling that data for categories that are not material to a company may not be warranted. Regulators should, however, facilitate the disclosure of material scope 3 GHG emissions, which would significantly close the "information gap" on measuring scope 3 emissions at the portfolio level. (See Appendix II.)

Our recommendations for increasing reliable Scope 3 GHG reporting in UK. There are several measures the UK government could support that would ease corporate reporting burdens and provide a more reliable scope 3 emissions data set for investors. These include:

- **Support global reporting standards – ISSB** – We support the UK Government's endorsement of the ISSB standards. Our UK-based clients may invest in securities domiciled in other parts of the world, so improving the climate data landscape for them will not be solved by a law that only covers UK companies. For this reason, the ISSB standards is an important baseline and we urge the regulators not to modify them as it would defeat the purpose of achieving uniform global corporate reporting.

  For several years, T. Rowe Price has advocated that our investee companies adopt Sustainability Accounting Standards Board (SASB) and Taskforce on Climate-related Financial Disclosures (TCFD) reporting standards. Given the ISSB's incorporation of these two standards in its framework, we are now recommending that our investee companies look to adopting the ISSB disclosure in the future. Our support for the ISSB standards is based on the ISSB's emphasis on providing environmental and social disclosure centered on financial materiality, which also includes industry-specific provisions. We believe that our clients benefit from the provision of sustainability disclosures as they help us quantify environmental and social risks and opportunities. Additionally, the qualitative disclosure aids our analysis on the management team's management of risks and strategic approach in these areas.

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- **Allow issuers to limit disclosure to material scope 3 emissions** – At a company level, scope 3 emissions tend to be concentrated within one to five categories. Therefore, if a company provides disclosure on its largest scope 3 emissions categories, the remaining portion of estimated scope 3 emissions will not be that significant, meaning investors have a much higher confidence level in the data set.

- **Provide regulatory guidance for corporate issuers on estimating methodologies** – Based on discussions with our investee companies, we know that many of them are struggling with the estimation methodologies for the various categories of scope 3 emissions. This is in part due to the nascency of estimating methodologies, and, often, the issuer's chief concern is one of legal liability. We believe that regulators could ease this concern by providing safe harbor or guidance to publicly listed corporate issuers on the use of estimating methodologies for scope 3 GHG emissions.

- **Allow sufficient time for adoption of any new reporting requirements** – Scope 3 GHG emissions are difficult to collect and estimate. Often we have seen a rush to make data available due to the urgency of climate crisis; however, we believe that investors will be better served if companies are given an adequate period of time to accurately assess their scope 3 emissions. We also believe that smaller cap companies should be given a longer implementation period than their larger peers.

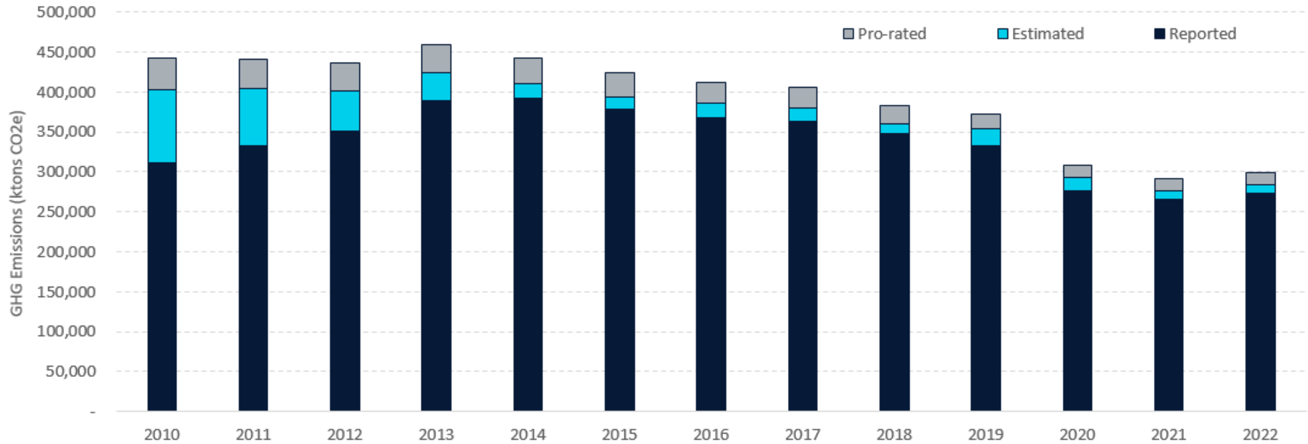
- **Ask for more timely reporting of GHG emissions** – It would be helpful if publicly listed corporate issuers disclosed their GHG emissions at the same time as, or relatively close, to their financial results. In our experience, publicly listed company disclosure of scope 1-2 GHG emissions data is fairly good; however, the fact that reporting of GHG emissions often occurs much later than financial reporting is not ideal. Our assessment of environmental factors affecting our investments would strongly benefit from publicly listed corporate issuers disclosing this data either at the same time or relatively close to their financial results.

See next page for Appendix I and Appendix II

Appendix I: The Current State of GHG Emissions Reporting

As we look at our global investment universe, we see that disclosure of scope 1-2 GHG emissions has become more ubiquitous (at least with large cap issuers), but disclosure of scope 3 GHG emissions remains patchy with only a minimal number of issuers choosing to report across all 15 categories of scope 3 emissions. As figure 1 illustrates, the vast majority of scope 1-2 emissions across the FTSE 350 are company-reported making the data set viable for investment purposes.

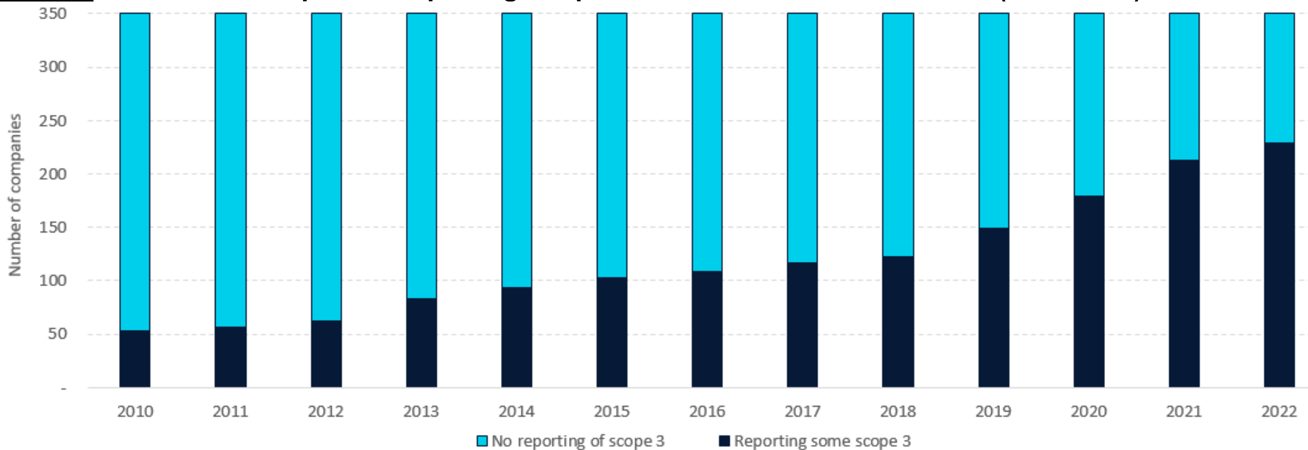
Figure 1: Scope 1-2 Greenhouse Gas Emissions for the FTSE 350 (2010-2022)



Note: Data reflects historical scope 1-2 GHG emissions for constituents of FTSE 350 as of December 2023
Source: Bloomberg, T. Rowe Price

Unfortunately, the dataset for scope 3 emissions across the FTSE 350 is so underdeveloped that we do not have sufficient information to demonstrate the same emissions disclosure profile as we do in figure 1 for scope 1-2 emissions. Instead, figure 2 indicates the number of companies reporting at least one of the 15 scope 3 emissions categories.

Figure 2: Number of Companies Reporting Scope 3 Greenhouse Gas Emissions (2010-2022)

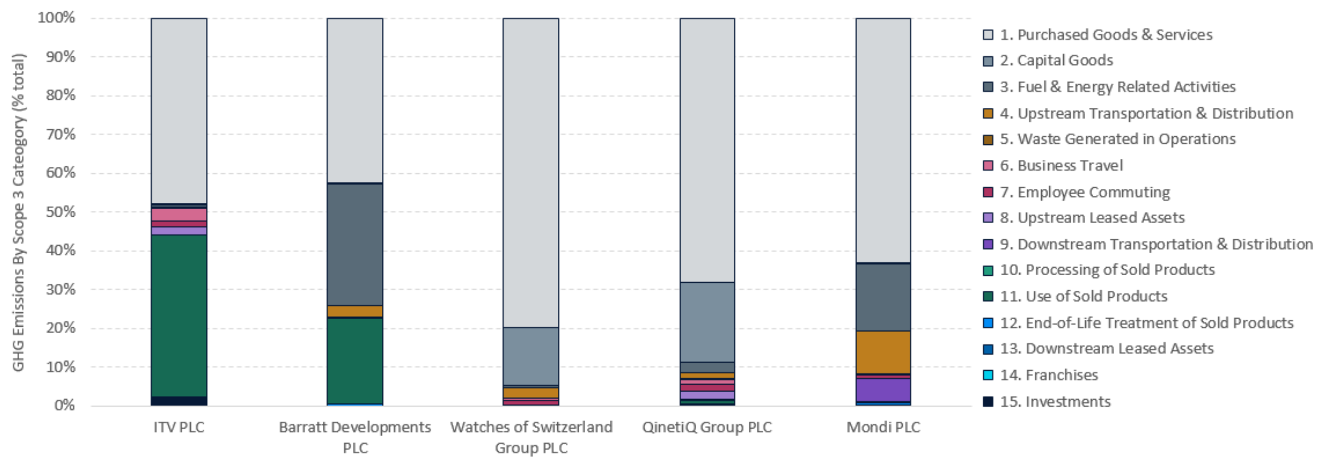


Note: Data reflects historical scope 3 GHG emissions for constituents of FTSE 350 as of December 2023
Source: Bloomberg, T. Rowe Price

Appendix II: Scope 3 Emissions

Figure 3 illustrates the breakdown of scope 3 emissions by category for select issuers in the FTSE 350 that disclose a full suite of scope 3 emissions data (i.e., all 15 categories). In general, scope 3 emissions tend to be concentrated in one to five emissions categories.

<u>Figure 3:</u> Scope 3 Emissions Disclosure by Category for Select Issuers in FTSE 350



Note: Data reflects scope 3 GHG emissions for 2022

Source: Bloomberg