Bulletin on Regtech Use Case

Mitigating Climate Greenwashing Risk

August 2024

Background

The Bulletin on Regtech Use Case series showcases innovative Regtech solutions implemented by banks. It aims to promote the adoption of Regtech among financial institutions in Hong Kong, enhance their risk management and compliance effectiveness, and facilitate knowledge sharing within the Regtech ecosystem.

This bulletin outlines an AI-powered ESG Solution that helps financial institutions manage greenwashing risk by conducting thorough analyses of the climate impact of their activities, tracking progress towards emission targets, and generating evidence-based climate reports that encompass progress, engagements, and outcomes.

Mitigating climate greenwashing risk

- Financial institutions (FIs) worldwide have made commitments to accelerate the decarbonisation of the economy. Achieving the Paris Agreement's objective of limiting global temperature increases to 1.5°C requires a whole economy transition. Every company, bank, insurer, and investor needs to adjust their business models and develop credible plans for the transition to a low-carbon, climate-resilient future. Specifically, FIs are increasingly committing to reducing their financed emissions and realigning their portfolios towards net-zero goals.
- In the course of delivering these climate commitments, greenwashing is an important risk to be managed. Climate greenwashing typically refers to FIs and corporates overstating their carbon emissions performance. Regulators have taken high profile actions against financial institutions in some well-known cases.
- Compelling evidence is essential to supporting an FI's climate credentials. However, climate reporting is complex. It requires industry-specific climate risk models as well as transparent and auditable environment, social and governance (ESG) metrics, analysed in the context of the FI's portfolios.
- ESG solutions powered by AI can improve the efficiency of climate analysis to mitigate the risk of greenwashing. These solutions usually cover a large number of companies and geographies and leverages sustainability data, climate models, human capital policies, corporate culture indicators and verifiable company-level climate targets to generate sustainability insights leveraging machine learning techniques.

Mitigate the risk of climate greenwashing

Challenges

- Accurately measuring climate impact and tracking progress of climate actions taken by each corporate requires adoption of standardised methodologies and alignment with industry specific metrics to enable meaningful comparisons and analysis.
- Forecasting the probability of corporates achieving their net-zero commitments in the next couple of decades, involves considering the uncertainties and challenges that may arise in the long term.
- Engaging with corporates on climate progress necessitates establishing a systematic set of engagement milestones aligned with global best practices while managing diverse stakeholder expectations and interests.
- Producing evidence-based reports requires collecting and analysing large amounts of data, transforming it into actionable insights, and presenting findings in a clear and accessible manner to stakeholders, regulators, and the public.

Business considerations at financial institutions

Corporate Lending and Sustainable Finance

- Measuring climate impact and continually monitor borrowers' progresses towards climate goals
- Verifying that borrowers have not breached FIs' financed emissions policies
- Ensuring debt instruments such as Sustainability-Linked Loans (SLL), Sustainability-Linked Bonds (SLB) and green bonds are structured and aligned with global best practices

Asset Management

- Documenting ESG integration in investment processes
- Explaining security selection of ESG investment products
- Making long-dated forecasts on events
- Engaging with borrowers to ensure alignment and progress towards climate goals

Capital Markets

- Justifying pricing and structuring of ESG-linked products
- Mitigating risks from ESG controversies

Challenges:

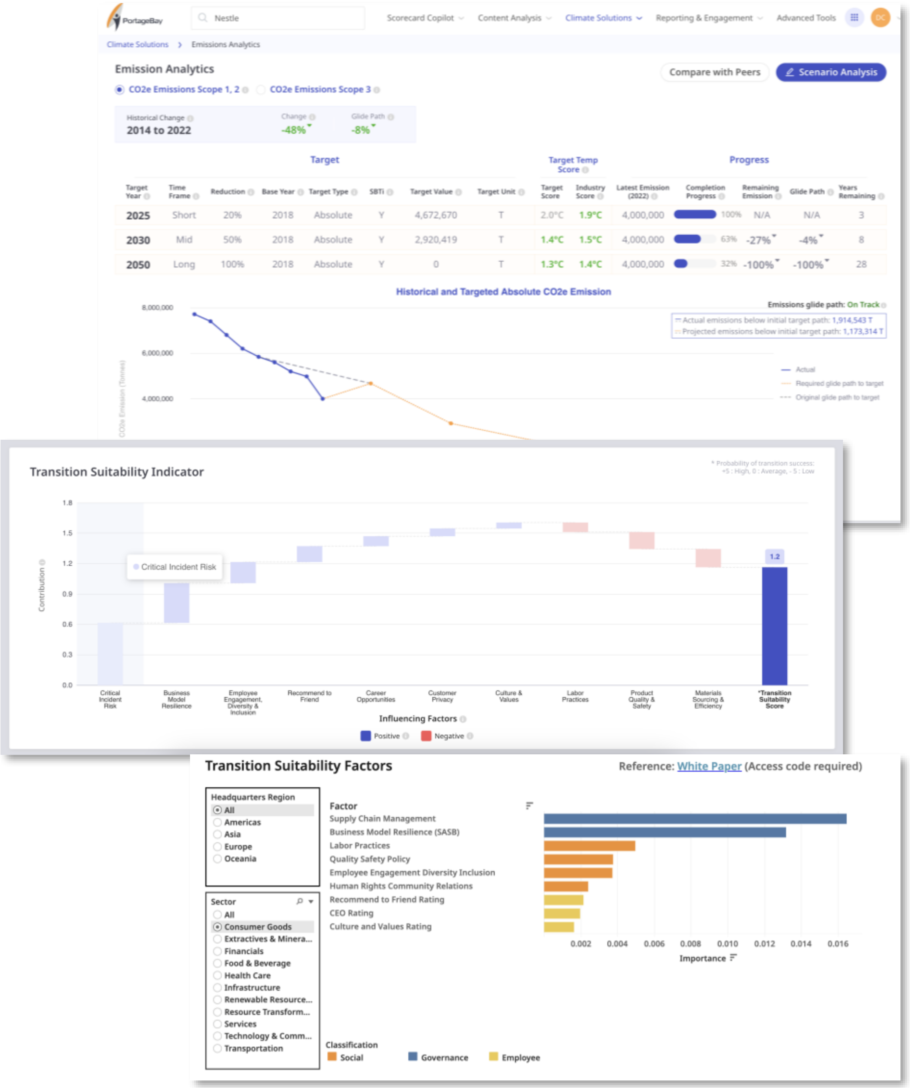
Measure climate impact and forecast probability of reaching net-zero

Solution

- The climate models of the solution analyse ESG data and streams of alternative data to measure the climate impact (ITR – Implied Temperature Rise). The solution tracks a company’s progress towards emissions targets and conducts peer comparison.
- AI-powered indicators and computational algorithms produce forecasts on a company’s transition readiness. Models provide transparency on the ESG factors that contribute to or detract from transition success.

Benefits

- The ESG solution saves FIs’ resources from the processes of verifying climate data, ensuring comparability of metrics, and computing industry-specific climate models.
- With more forward-looking sustainability models, FIs are able to make more informed assessment of their portfolios and identify potential greenwashing activities, leveraging insights from sustainability experts incorporated in these models.



Challenges:

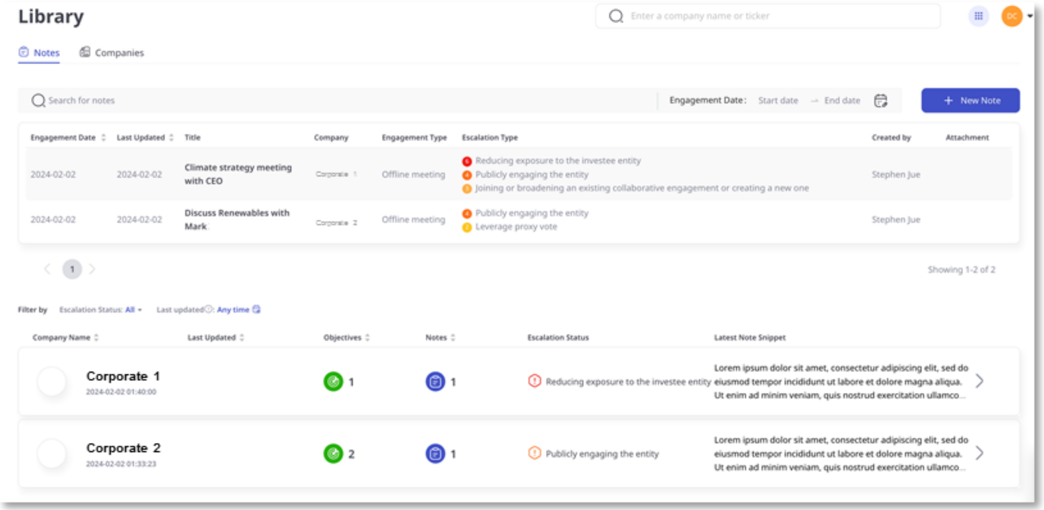
Engage with corporates and report on climate progress

Solution

- The ESG solution centralises engagement interactions initiated by different business units of an FI, facilitating alignment of FI's engagement activities with global reporting frameworks.
- Evidence-based portfolio reports are generated on progress, measuring climate impact contributions, identifying strengths/weaknesses in terms of sustainability-related disclosures, and assessing alignment of portfolio companies with the United Nations Sustainable Development Goals.

Benefits

- With climate progress tracking, forward-looking assessments, engagement interactions, and evidence-based sustainability research integrated on one platform, climate progress reports are created more efficiently.
- The reports are essential tools for FIs to identify and manage greenwashing risk, satisfying regulatory requirements and stakeholder expectations.



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