

The views expressed in this presentation are the views of the author/s and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this presentation and accepts no responsibility for any consequence of their use. The countries listed in this presentation do not imply any view on ADB's part as to sovereignty or independent status or necessarily conform to ADB's terminology.

Greenwashing Risk Assessment and Control Best Practices

Luvsan Vanjildorj

ADB Finance Sector Specialist (climate finance)

International Consultant

August 21, 2024

Outline

- Greenwashing? Risks? Why important?
- Monitoring of greenwashing risks
- Best practices:
 - European Central Bank (ECB)
 - Singapore
 - Korea
 - Kyrgyzstan
 - Kazakhstan

Greenwashing? Risks? Why important to monitor?

– Definition of Greenwashing:

- EBA, along with other European Supervisory Authorities (ESAs), defines greenwashing as a practice where sustainability-related claims do not accurately reflect the underlying sustainability profile of an entity, financial product, or service, potentially misleading consumers, investors, or other market participants. Greenwashing can be intentional or unintentional and is driven by factors such as competition, regulatory requirements, and market pressure.

– Risks:

- Greenwashing poses various risks, including reputational, operational, and strategic risks to financial institutions. While the current materiality of these risks is perceived as low, it is expected to grow in importance. Greenwashing can impact financial institutions through reputational damage, legal risks, and strategic misalignment. Potential for these risks grows as the scrutiny on sustainability practices increases.

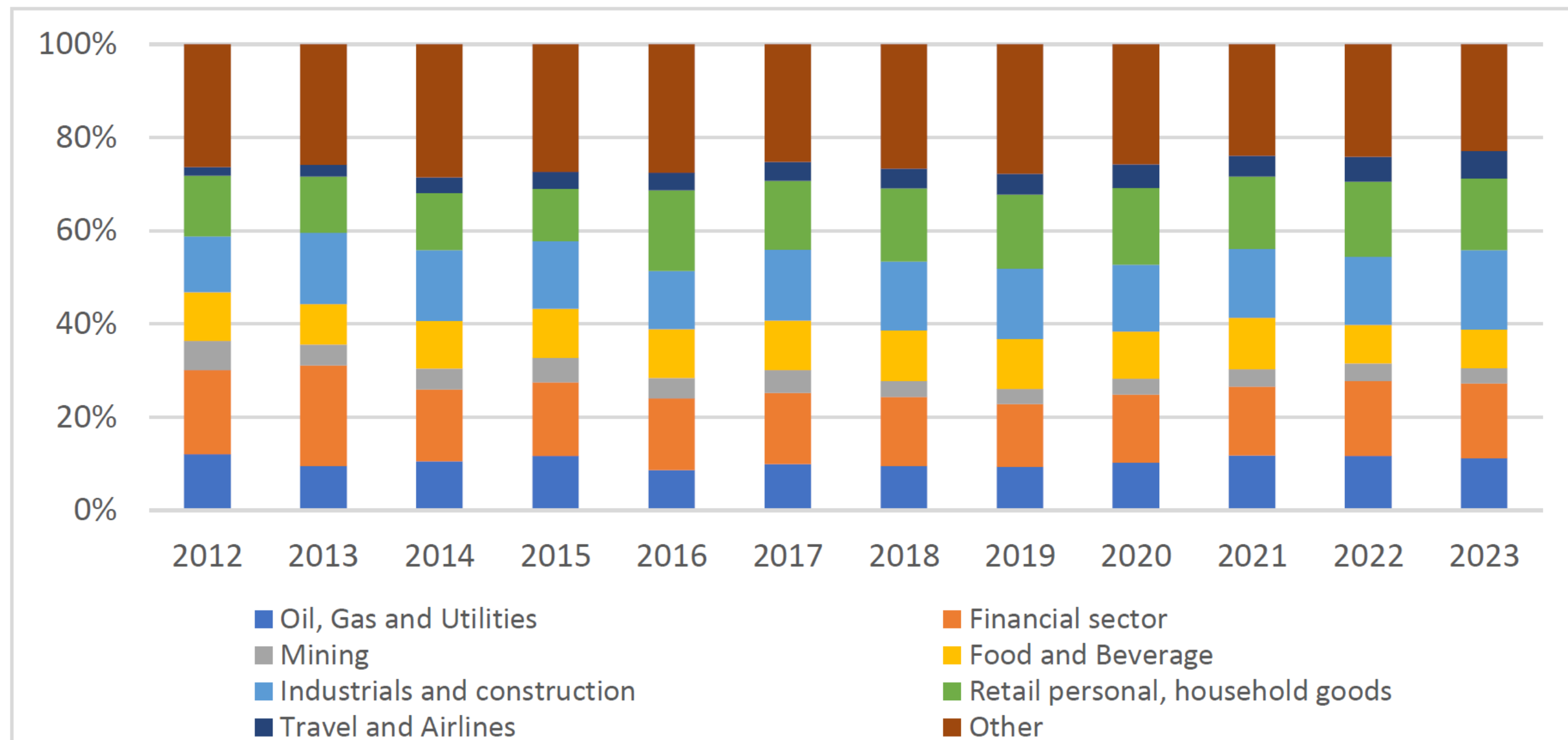
– Why important:

- There is an increasing importance of addressing these risks as the market for sustainable finance grows.

Greenwashing? Risks? Why important to monitor?

– Incidents of misleading info on ESG:

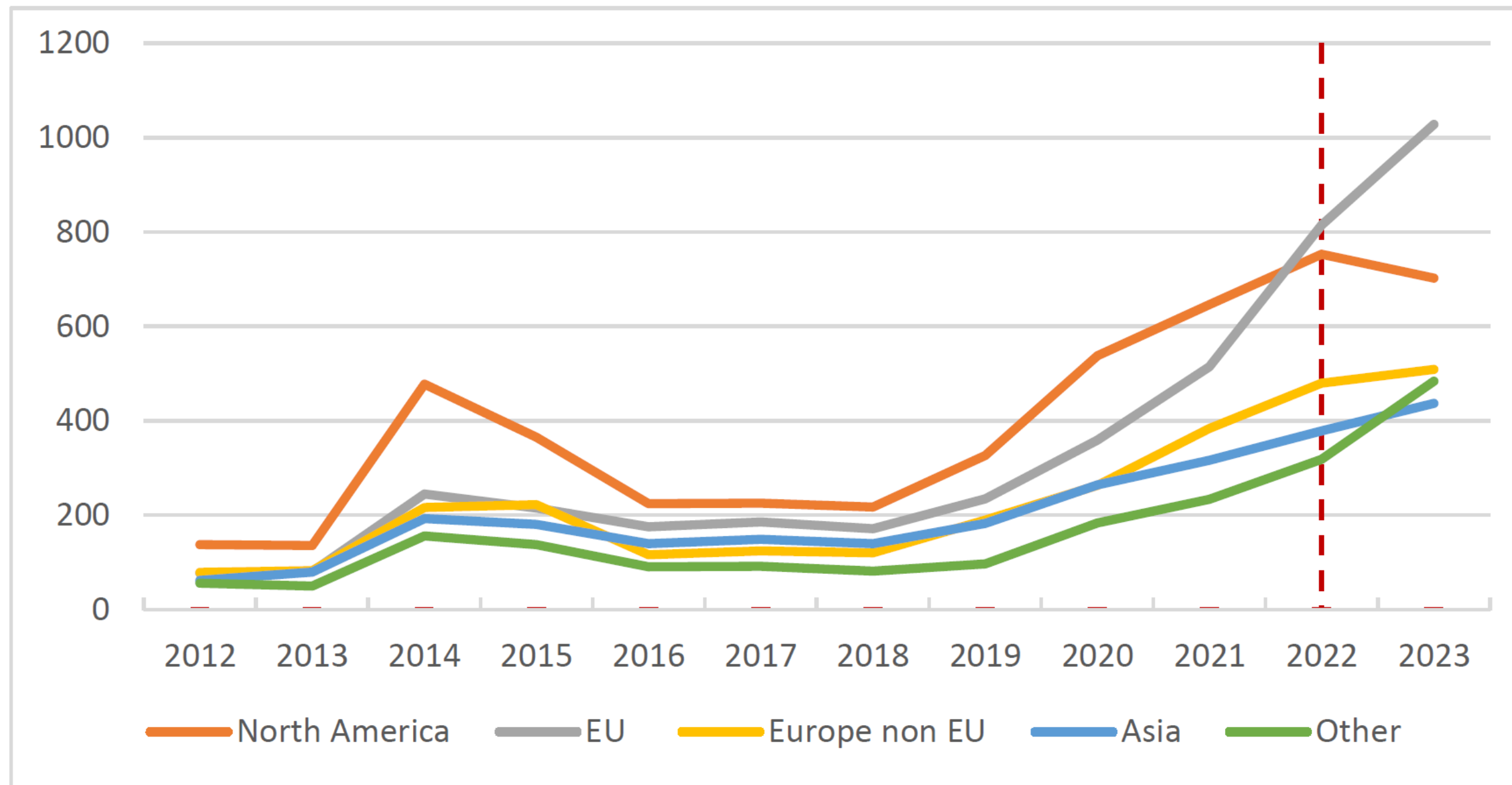
- The graph shows the sectors involved in alleged Greenwashing incidents. Financial sector is one of the major, followed by Industries and construction.



Greenwashing? Risks? Why important to monitor?

– Incidents of misleading info on ESG:

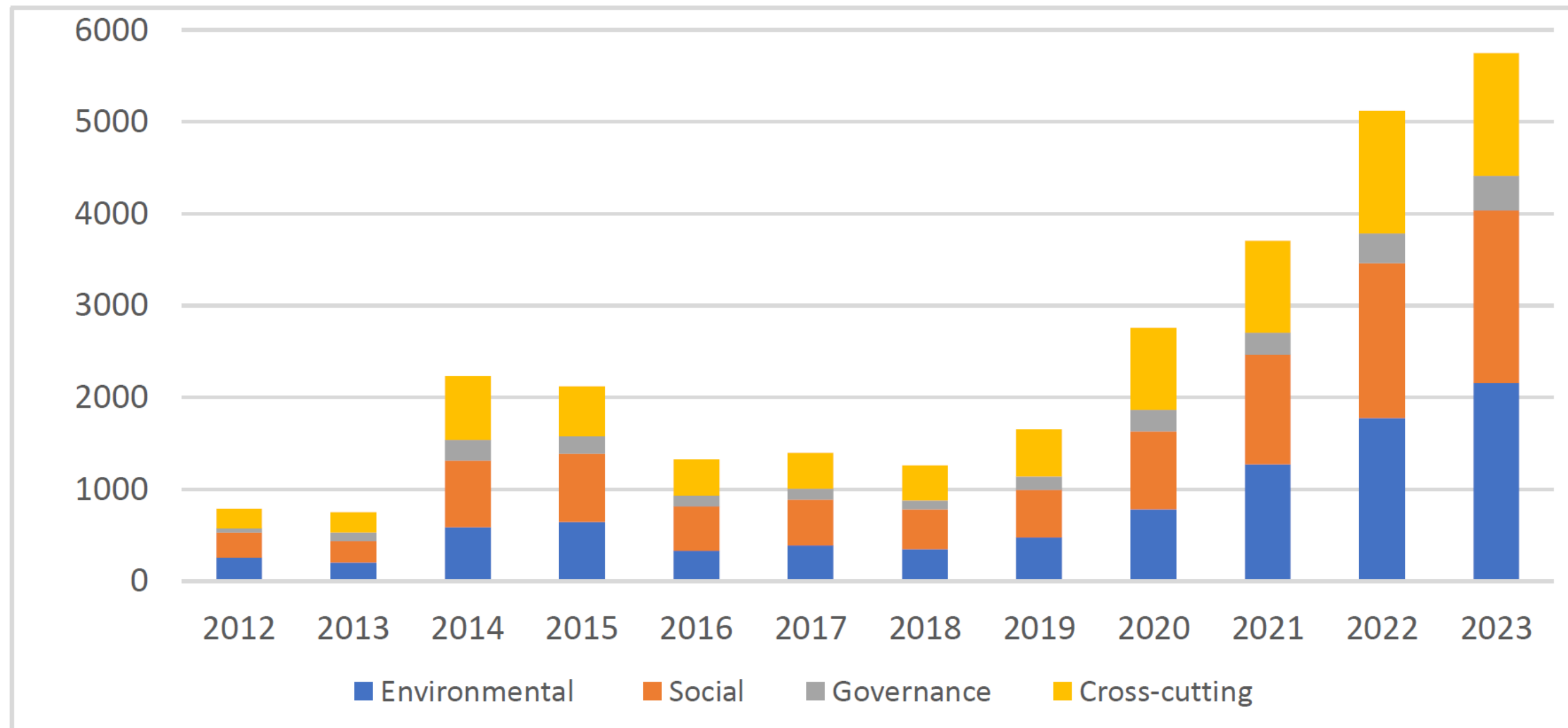
- The graph shows the total alleged incidents of misleading information on ESG related topics, by geographic locations (2013-2023). Increasing trend globally.



Greenwashing? Risks? Why important to monitor?

– Incidents of misleading info on ESG:

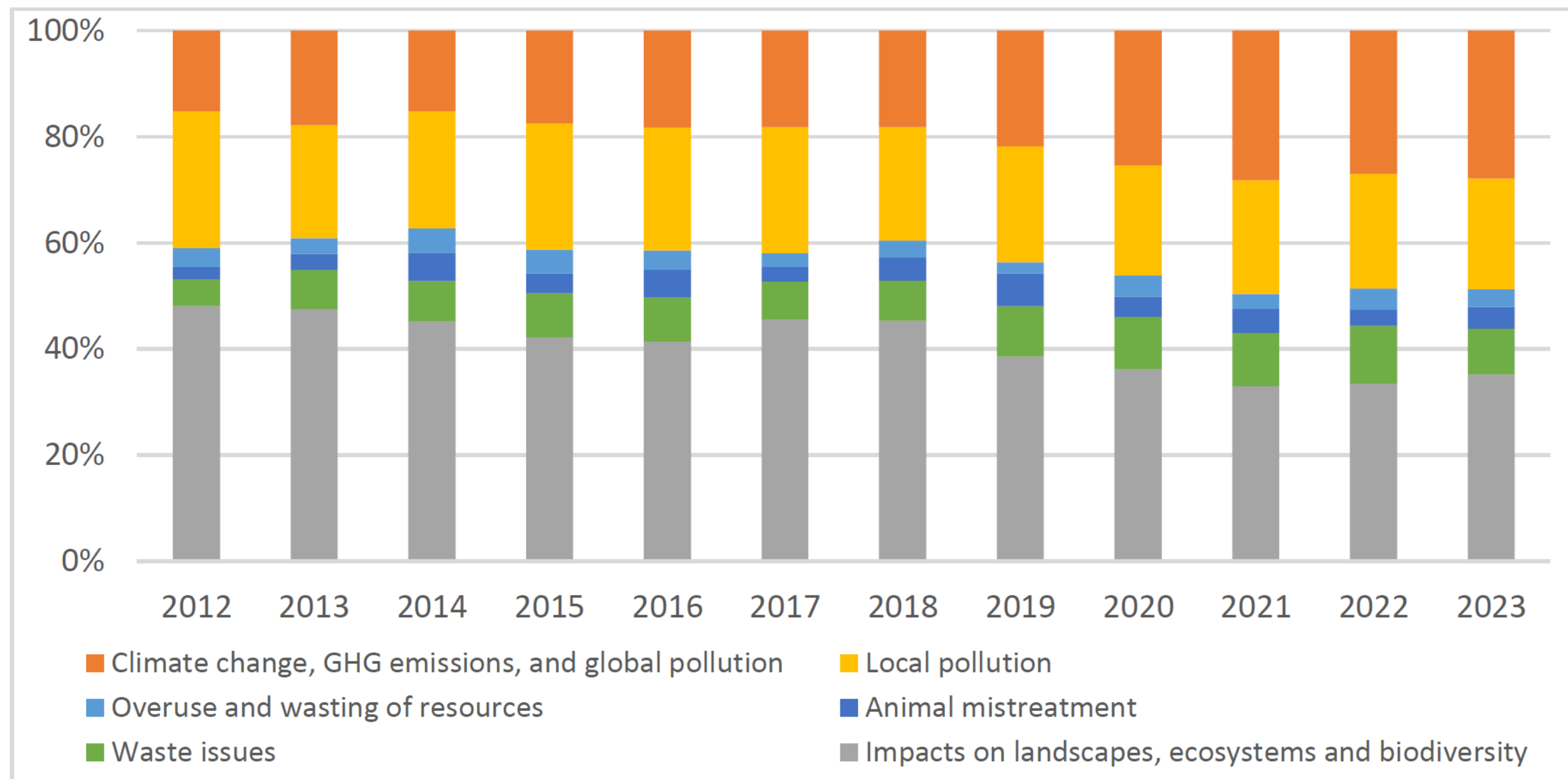
- The graph shows the total alleged incidents of misleading information on ESG related topics. Environmental and Social topics are the most risky.



Greenwashing? Risks? Why important to monitor?

– Incidents of misleading info on ESG:

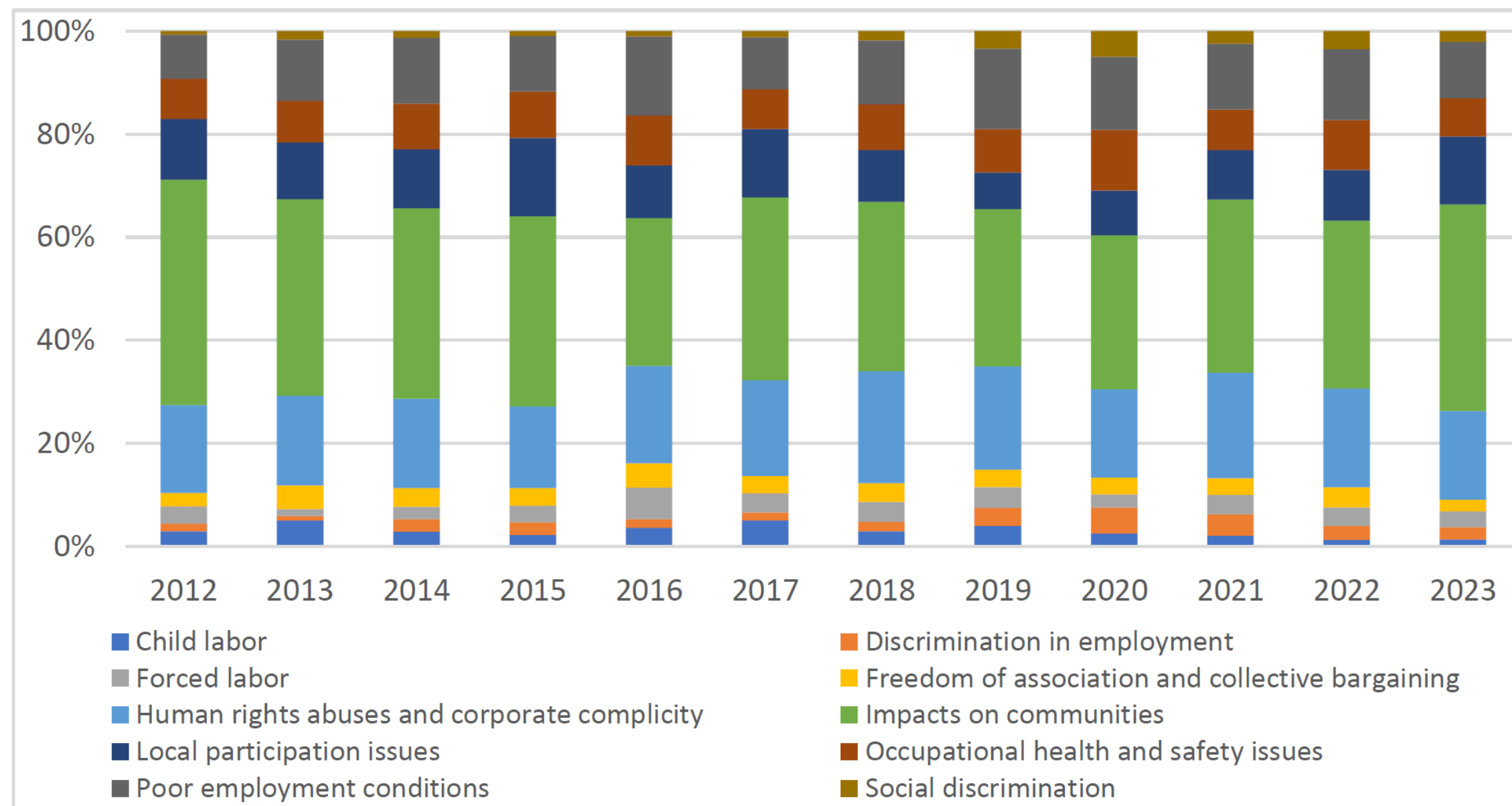
- The graph shows the type of environmental topics involved in alleged incidents of Greenwashing. Greenwashing occurs the most in Impacts on landscape, ecosystems and biodiversity, as well as Climate change, GHG emission, and global pollution.



Greenwashing? Risks? Why important to monitor?

– Incidents of misleading info on ESG:

- The graph shows the type of social topics involved in alleged incidents of Greenwashing. Impacts on communities (vulnerable communities such as women, etc.) need to be calculated thoroughly according to international guidelines/best practices.



Monitoring of greenwashing risks

– Diagnostic survey:

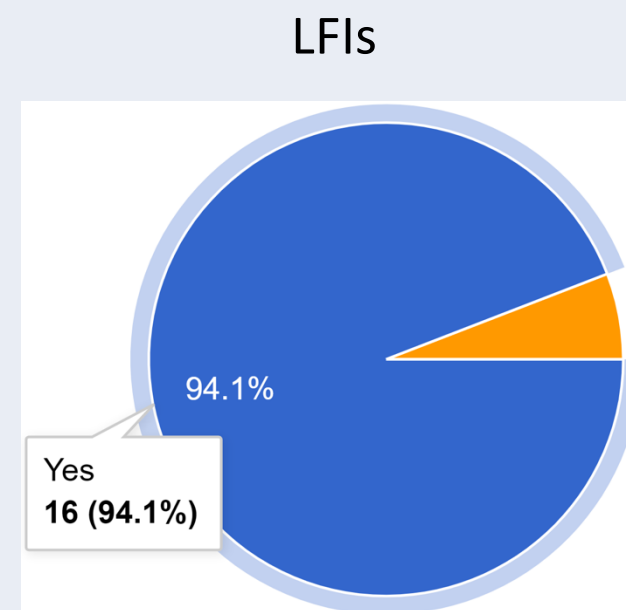
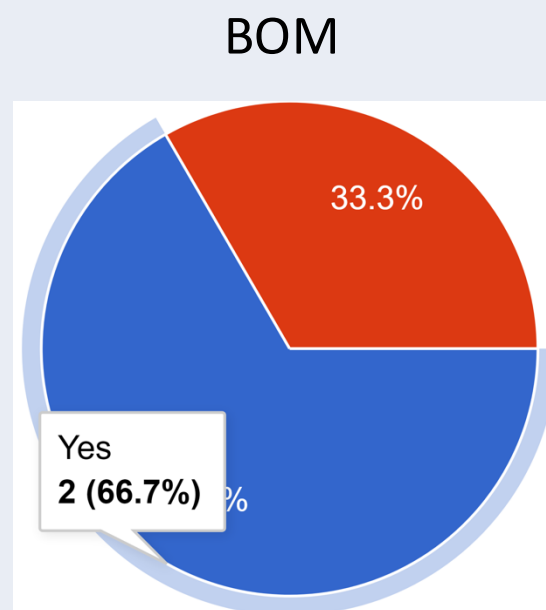
- Central Bank Monetary Policy & Supervision – 3 respondents;
- Licensed Financial Institutions (LFIs) – 17 respondents;
- Market Participants (NBFIs, Brokerage, etc.) – 21 respondents;
- Insurance Companies – 4 respondents

Monitoring of greenwashing risks

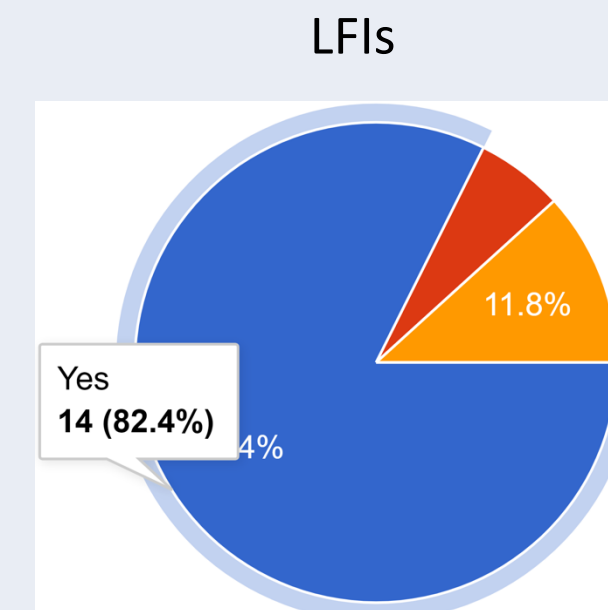
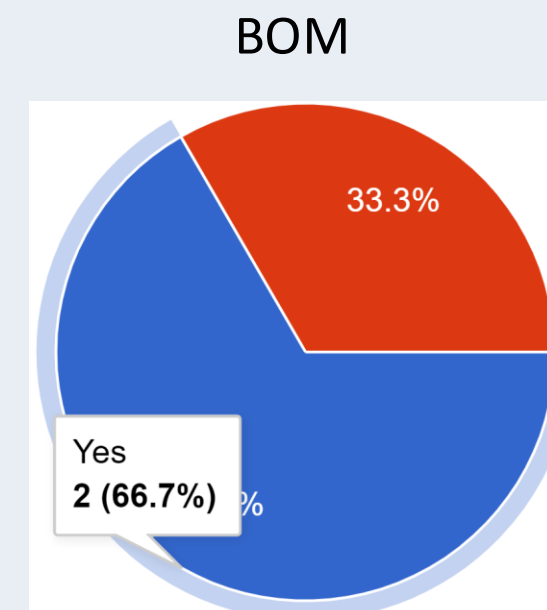
– Survey outcome:

- According to the respondents, greenwashing risks may increase due to increased focus on low-carbon finance and stronger national commitments
- The BOM has started to develop micro & macro stress-testing methodologies to address climate change risks.

Q: Has low-carbon finance become an important area of focus in Mongolia, particularly after the ratification of the Paris Agreement, 2016?



Q: Are you aware of any national commitments (country-level) or contributions in your country to help implement green finance and low-carbon financing initiatives (excluding the Green taxonomy initiative and TOC voluntary disclosures)?

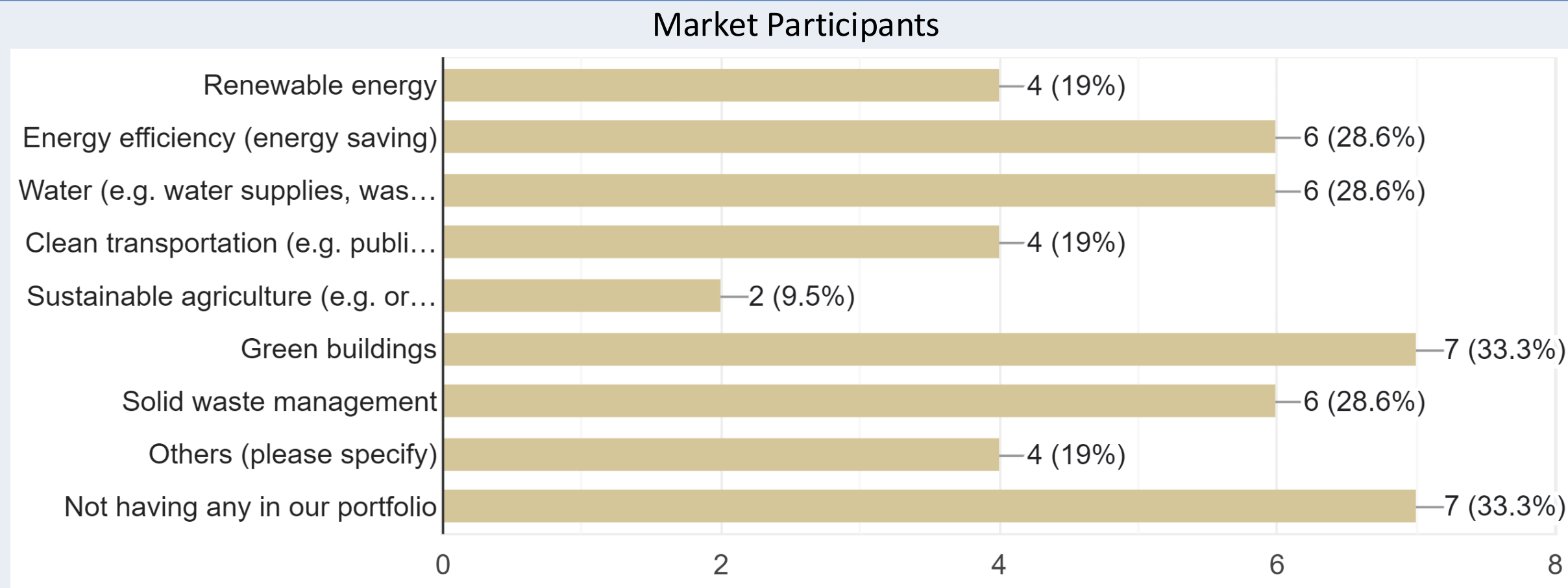


Monitoring of greenwashing risks

– Survey outcome:

- According to the respondents, “Green buildings” are the most significant sector, followed by “Energy efficiency”, “Water” and “Solid waste management”.

Q: Which of the following sector(s) is currently the most significant in your green investment portfolio (or currently your Company/Organisation is advising your clients in)?



Monitoring of greenwashing risks

– Disclosure and compliance:

- Some banks and NBFIs may have started SDG reporting, but compliance with Green taxonomy is key (Green Taxonomy (2019) to be replaced by SDG Finance Taxonomy (2023), enforceable in 2025, risks may be addressed to some extent under UNESCAP project).. But, Taxonomy itself is **NOT** everything.

– Third Party Independent Verification:

- The use of external reviews and third parties' verification is seen as a practice that provides **credibility and value to green/sustainable labels**, playing an important role in the good application of green principles, standards and taxonomies to financial products. Some institutions view external reviews as important elements in their approach to mitigating greenwashing and ensuring market integrity. On the other hand, some concerns have been raised over the lack of a high-quality, consistent, science-based and independent verification process, potentially hampering broader use or credibility of external reviews at the moment (source: EBA).

– Other actors:

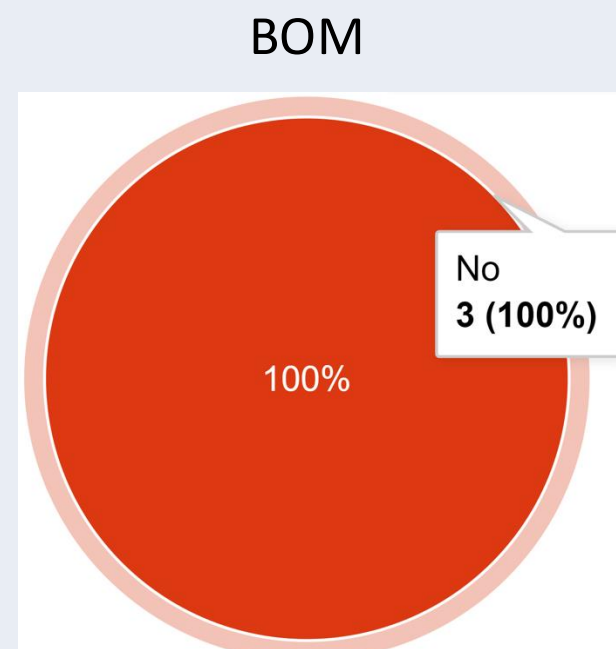
- Additional roles: (i) a **facilitator**, meaning people or institutions that intentionally or unintentionally enable or facilitate greenwashing (e.g. educational institutions, NGOs, third-party verification bodies, etc.); (ii) a **verifier or screener**, meaning the actor who is meant to verify/opine on the matching of the characteristics with the claim/labelling/marketing and provide guarantee to other actors by rebalancing information (e.g. the supervisor, external auditors, ESG data and research providers and ESG rating providers that often assess or screen the sustainability-related claims made by an issuer and/or provide an independent assessment); (iii) a **gaper**, being the person/entity/actor who creates a mismatch, either intentionally or unintentionally, between the content, the container and the tag; (iv) a **whistleblower**, being the person or group of people revealing to the overall public and spreading the alleged greenwashing case through the media (source: EBA).

Monitoring of greenwashing risks

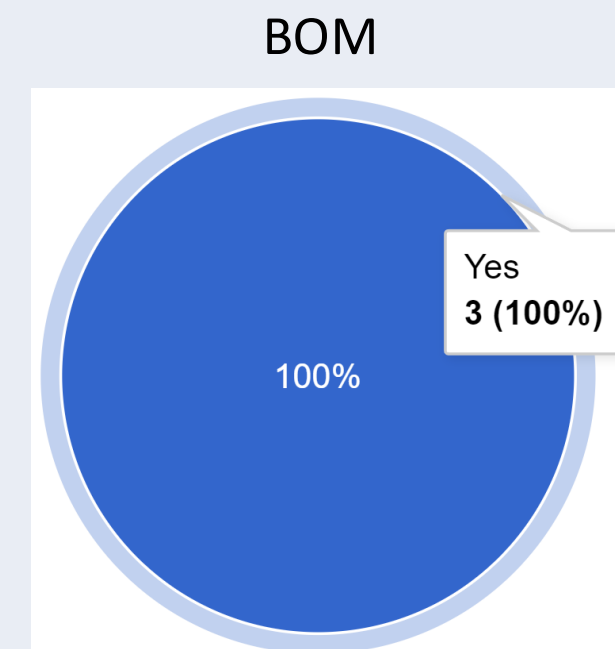
– Survey outcome:

- According to the respondents, there may be lack of policies and regulations to prevent “greenwashing” practices in the market. From the banking regulation and supervision side, BOM may be planning to incorporate climate change and greenwashing risks into BOM’s regulatory framework. Most important priority for the central bank in the near term is integration of climate change into prudential supervision and regulation to monitor green loans in order to prevent from risks of greenwashing.
- **But**, greenwashing risks present in various different levels: (i) Sector-wide micro level; (ii) Entity level (banks and financial institutions); (iii) Financial products, or services, etc.

Q: Does BOM have any policies and regulations to prevent "greenwashing" practices in the market?



Q: Has any discussion taken place in the BOM regarding the opportunities that exist to modify your operational framework to address climate change risks?

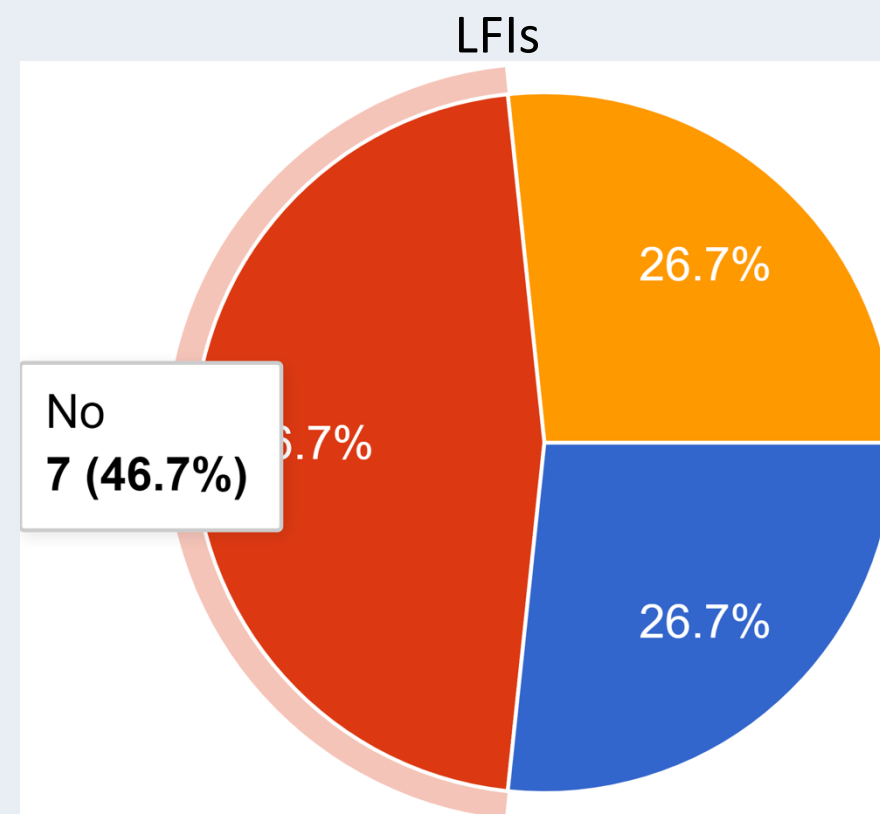


Monitoring of greenwashing risks

– Survey outcome:

- According to the respondents, there may be **limited** availability of centralized platforms, 46.7% replied “no” while 26.7% replied “unaware” (which totals 73.4% of the total respondents).

Q: Is there any centralized platform containing certified green technologies and products, which your institution recommends to your borrowers (both corporate and retail) for them to choose from? If yes, please type the platform name and web address below, and please explain pros and cons that may have been raised by your customers. If no, do you see need for transfer of innovative climate smart technologies that are certified, which may help prevent potential "greenwashing" practices?



Monitoring of greenwashing risks

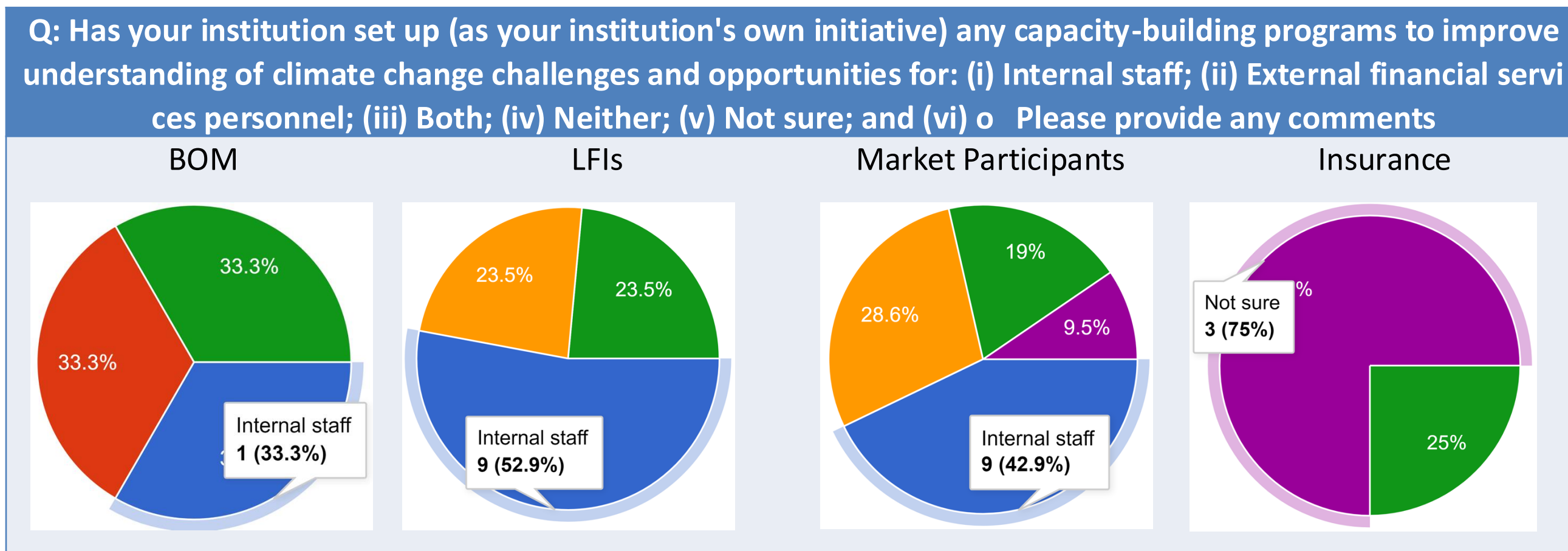
– Survey outcome:

- Available platforms may be:
 - Khan Bank’s website lists Green eligible vendors (consumer loan)
 - Sendly advisor application
 - Green technology selector/MonSeff (**but** it seems to have limited options and suppliers. Due to a limited green loan product, the company did not have any opportunities to recommend it to our customers)
 - We do have cooperation with retailers who sell energy efficient products and we have a history of collaborating with vendors who built energy efficient buildings. But I wouldn't say it is centralized, hence we are focusing on adding more collaborators to build a centralized platform that we can offer to our customers, which we are right in the middle of process of contractualize.
 - We do not provide our customers with any public platform on green technologies. However, we present the list of our collaborating companies and their products that can be financed with green lending through our website. Before doing so, the products are examined against the company’s green eligibility requirements. For the online green loan, eligible green products on the e-commerce platform is also screened against the requirements in advance.
 - We are planning to develop green technologies platform.
 - **But**, platform of unverified products may **NOT** do much.

Monitoring of greenwashing risks

– Survey outcome:

- According to the respondents, financial institutions may have developed capacity building programs mainly for their internal staff

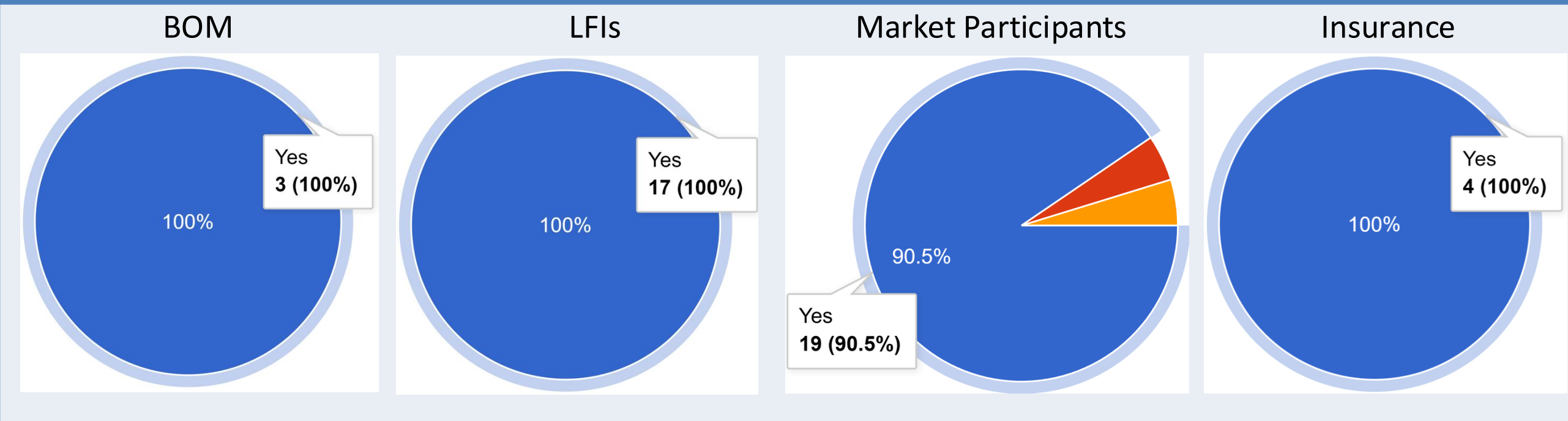


Monitoring of greenwashing risks

– Survey outcome:

- According to the respondents, financial institutions believe that there is a need for capacity building/institutional strengthening activities, including those to be organised by international partners drawn upon international best practices

Q: Do you see a need for any capacity building/institutional strengthening activities, including those to be organised by international partners drawn upon international best practices? Will your institution be interested in working closely together with your international partners in developing targeted training programs and curriculum?



Best practices: ECB

– Climate Risk Stress Test:

- Based on scenarios of Network for Greening the Financial System (NGFS), in line with Intergovernmental Panel on Climate Change (IPCC)'s scenarios
- Methodology is designed to assess the climate-related risks faced by banks, with a focus on **both transition and physical risks**. The methodology used in the stress test includes the following key components:
 1. **Constrained Bottom-Up Stress Test**: Banks provided data and projections under a common methodology and scenarios set by the ECB. This approach ensured consistency across institutions while allowing them to use their internal data and stress-testing frameworks.
 2. **Three Modules of Stress Test**:
 - Module 1: Qualitative Questionnaire: Assessed the banks' internal climate risk stress-testing frameworks. This module covered governance, risk appetite, integration into business strategies, data availability, ICAAP (Internal Capital Adequacy Assessment Process), and future plans.
 - Module 2: Climate Risk Metrics: Focused on the banks' sensitivity to transition risks and their exposure to carbon-intensive industries. Banks were required to report corporate volumes and income, broken down by 22 carbon-intensive sectors, and provide data on the largest corporate exposures.
 - Module 3: Bottom-Up Stress Test: Involved projecting the impact of different scenarios, covering both physical and transition risks. For physical risks, the scenarios included drought, heat, and flood risk. For transition risks, the scenarios included long-term (30-year) and short-term (three-year) horizons, with different policy paths like orderly transition, delayed/disorderly transition, and a "hot house world" scenario.

Best practices: ECB

– Climate Risk Stress Test:

3. Scenario Analysis:

- Long-Term Transition Scenarios: Three scenarios were modeled based on the NGFS Phase II scenarios: orderly transition, disorderly transition, and a "hot house world" scenario. Each scenario had different assumptions about the timing and stringency of climate policies and their impact on carbon pricing and economic variables.
- Short-Term Transition Scenario: Focused on a disorderly transition with a sudden, sharp increase in carbon prices over a three-year period. This scenario assessed banks' vulnerabilities to abrupt changes in policy and market conditions.
- Physical Risk Scenarios: Modeled the impact of extreme weather events, such as a severe drought and heatwave or a flood event, on banks' credit risks. These scenarios considered the geographic distribution of risks and the potential impacts on specific sectors like agriculture and real estate.

4. Quality Assurance: The ECB conducted a thorough quality assurance process to ensure the reliability and consistency of the data and projections submitted by banks. This included multiple cycles of feedback and adjustments to the banks' inputs, with a focus on maintaining a level playing field and addressing any methodological issues.

5. Data Challenges and Use of Proxies: Banks faced significant challenges in gathering climate-relevant data (different emissions). The ECB allowed use of proxies to estimate these emissions, but emphasized the need for banks to improve their data collection and reduce reliance on proxies over time.

6. Supervisory Follow-Up: The results of the stress test were used to provide guidance to banks on improving their climate risk management practices. The findings from the CST were incorporated into the annual Supervisory Review and Evaluation Process (SREP) in a qualitative manner.

Best practices: ECB

– Climate Risk Stress Test:

| Scenario | Projections | Horizon | Risk type | Results |
|--------------------------------|-----------------------|-----------------------|-----------------------------------|--|
| Long-term scenarios | Orderly transition | 30 years (2020-50) | Both transition and physical risk | <p>Transition and physical risk have a material impact.</p> <p>Corporate bonds are the main risk contributor.</p> <p>The impact of transition risk on corporate bonds is concentrated in specific sectors, while physical risk impact is concentrated in certain geographical areas.</p> <p>Covered bonds, ABSs and credit operations contribute less to total risk.</p> |
| | Disorderly transition | | | |
| | Hot house world | | | |
| Short-term disorderly scenario | Baseline | Three years (2022-24) | Transition risk | <p>Transition risk has a material impact.</p> <p>Corporate bonds are the main risk contributor.</p> <p>The risk for corporate bonds is concentrated in specific sectors.</p> |
| | Stress | | | |
| Flood risk scenario | Baseline | One year (2022) | Physical risk | <p>Physical risk has a material impact.</p> <p>Corporate bonds are the main risk contributor.</p> <p>The risk for corporate bonds is concentrated in certain geographical areas.</p> <p>Covered bonds are significant risk contributors.</p> |
| | Stress | | | |

Best practices: Singapore

– Transparency concerns in Singapore financial sector:

- Despite the substantial growth of Sustainability linked loans (SLLs), our analysis suggests that around **50% of these loans could be susceptible to greenwashing**. This highlights the need for transparency and trust in sustainable financing (source: MAS).
- 14 November 2023, Monetary Authority of Singapore (MAS) today announced a Minimum Viable Product (MVP) that can **assist banks to tap on Artificial Intelligence (AI) when issuing Sustainability-Linked Loans (SLLs) in the real estate sector**. The MVP was developed by the Project NovA! consortium which has concluded the first phase of its work (source: MAS).

– List of NovA! Consortium Members, including all major LFI (updated as of November 2023):

| | | | |
|--|--|---|---|
| 1. Bank of China Limited | 7. Greenland Financial Technology Group, Green Link Digital Bank | 13. Savills | 19. The Hongkong and Shanghai Banking Corporation, Singapore Branch |
| 2. Building and Construction Authority (BCA) | 8. Hitachi Asia Ltd. | 14. Shanghai Pudong Development Bank Co., Ltd. Singapore Branch | 20. Tsinghua University, Institute for Internet Industry (THUIII) |
| 3. Capital Quantum | 9. MUFG Bank, Ltd. | 15. Standard Chartered Bank (Singapore) Limited | 21. United Overseas Bank Limited |
| 4. Citi Singapore | 10. National University of Singapore, Asian Institute of Digital Finance | 16. Sumitomo Mitsui Banking Corporation | 22. Univers |
| 5. DBS Bank | 11. Oversea-Chinese Banking Corporation Limited | 17. Temasek | 23. Verra |
| 6. Deutsche Bank Aktiengesellschaft | 12. Reluvate Technologies Private Limited | 18. The Association of Banks in Singapore | |

Best practices: Singapore

– Three core features in the AI-powered MVP developed in phase one of Project NovA! will help banks address the above challenges (source: MAS):

1. Facilitate setting performance targets for SLLs in real estate sector through peer and industry benchmarking. By harnessing data from government sources and conducting property-specific peer and industry comparisons, AI technology can be used to help banks set Key Performance Indicators (KPIs) judiciously and establish practical SPTs, to enable a more accurate sustainability assessment.

2. Monitor against selected KPIs/Sustainability Performance Targets (SPTs) to curb greenwashing. By using buildings' energy consumption data on a continuous basis at-source, NovA! enables banks to compare borrowers' current sustainability performance with the agreed SPTs on a more timely basis. Risk assessment teams from banks can swiftly identify discrepancies, ensure SLLs maintain their intended impact, and curb greenwashing.

3. Enhance processing sustainable finance transactions through Autonomous Documentation Insights Engine (ADIE). This feature utilises Natural Language Processing to enable banks' relationship managers, KYC teams, and sustainable finance units to extract sustainability insights, such as a company's total greenhouse gas emissions, swiftly and accurately from diverse sources. This is a shift away from manual processing of disclosure documents, allowing for more informed decision-making based on comprehensive data extracted from borrower disclosures.

Best practices: Korea

– Various actors:

- But, government level (not NGO, nor rating agencies such as Fitch)

The Carbon Neutrality Framework Act was ratified by the Republic of Korea's National Assembly in 2023. Line ministries and agencies are mandated to form evaluation committees, consisting of independent third party technical experts. The evaluation committees select and award those innovative products and services offering climate smart solutions in their respective sectors. "Green Certification" technologies are those that "minimise emission of greenhouse gases and pollutions, such as greenhouse gas reduction technology, energy efficiency technology, a clean product technology, and resource recycling and environmentally friendly technology (related fusion technologies), by saving and effectively using energy and resources throughout the entire span of social and economic activities". "Green Certification" innovative technologies tend to cover more detailed and broader green activities, than the ones included in the revised green taxonomy, which is legally non-binding. "Green Certifications" are provided for qualified innovative climate smart products valid until expiry (majority valid for 3-6 years).

Currently, there are about 1,199 innovative products certified with "Green Certification", according to the Green Certification System Operation Guidelines of the Carbon Neutrality Act, issued majority by the evaluation committees setup by :

1. Ministry of Agriculture, Food and Rural Affairs;
2. Ministry of Environment;
3. Ministry of Land, Infrastructure and Transport;
4. Ministry of Oceans and Fisheries;
5. Ministry of Science and ICT;
6. Ministry of SMEs and Startups; and
7. Ministry of Trade, Industry and Energy

Best practices: Korea

The evaluation committees confirm green technology products that are already commercialised utilising green technologies and is certified by the Article 32.2 of the Carbon Neutrality Framework Act (2023).

Confirmation criteria (criteria below shall all be satisfied):

- Possession of Green Technology Certificate
- Verification whether the certified green technology significantly contributes to the product function's manifestation
- Availability of applied product (Model)

Product Manufacturing Possibility:

- Availability of production facilities (Factory, etc.)
- (In case of OEM manufacturing products, documentary evidence is required)
- Continuous production possibility of the applied product

Quality Management:

- Availability of quality management certificates (Ex. ISO) or other documentary evidence
- Continuous production quality management system

Product Capacity:

- Test certification from an external organization (Certification from the respective organization is also accepted)
- the applied product capacity shall satisfy the technical standards of the Green Technology Certification

Members of the Evaluation Committee shall meet the requirements of any of the following:

1. Industry: Ph.D. or Master's (Bachelor's) degree holder with at least five (5) years of experience in the field, or executive at the director level or above;
2. Academic: full-time instructor or above at a two-year college or university;
3. Researchers: Ph.D. or Master's (Bachelor's) degree holder with at least 5 years (7 years) of experience in the field;
4. Government employees: government employees at grade 5 and above; or
5. Recognised by the head of the assessment organization as having qualifications equivalent to 1 through 4.

Best practices: Korea

– Centralised platform for certified “green” technologies:

- As of 18 August 2024, the total of 2,018 “green” technologies are verified by the Evaluation committee.

| Classification name | Core (element) technology |
|--|---------------------------|
| Advanced Green House/City | 101 |
| Eco-friendly agricultural, fishery and food products and systems | 106 |
| Clean production | 117 |
| Advanced water resources | 142 |
| Environmental protection and conservation | 155 |
| New material | 162 |
| Green vehicles, ships, and transportation equipment | 249 |
| Carbon reduction | 258 |
| New and renewable energy | 266 |
| Green IT | 462 |
| Total: | 2,018 |

Best practices: Kyrgyzstan

– Green loan product:

- In 2013, a financial institution in the Kyrgyz Republic initiated the implementation of a new housing product with support from a DFI. Over the past 10 years, it has financed approximately 10,000 housing projects amounting to 8.6 million USD and 129 renewable energy projects totaling 994,000 USD.
- **But**, unverified products may have been used posing potential greenwashing risks.
- Kyrgyz government submits a project to GCF to create a third-party verification ecosystem (photo: single glazing window).



Best practices: Kazakhstan

– SPOs:

- Green bonds are proven to be one of the most effective tools to catalyse climate funds worldwide – green bond use-of-proceeds to support MSMEs
- Capacity of local verification agency is key:

Currently, in Mongolia, there is a lack of qualified local entities that are internationally recognised to produce independent third party SPOs and verifications and related sustainability related disclosure reports, in line with international best practices. Regional best practices are available. In Kazakhstan, the Astana International Financial Centre (AIFC)'s Green Finance Centre (GFC) provides independent third party SPOs and verifications to financial institutions in the country when they mobilise climate finance domestically and internationally, as an accredited entity of the Climate Bonds Initiative (CBI). Internationally recognised verification is an important assurance factor within the overall climate finance ecosystem for disclosure.

Kazakhstan's Agency for Regulation and Development of Financial Market (ARDFM) regulates the securities market. ARDFM is a signatory to Network for Greening the Financial System (NGFS).