

## Data and ESG

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*The threat of climate change has thrust environmental, social, and governance issues (ESG) into the spotlight for the financial services industry and global regulators. The complex, long-term nature of the threat makes it too big to ignore, but very difficult to measure the risk with a great degree of precision. Better-quality data is needed along with tools such as artificial intelligence that can track and analyze it properly. Regulators and industry bodies should work to develop taxonomies and disclosure standards that are globally comparable and avoid the risk of market fragmentation. This note provides a summary of the key themes that emerged, noting that the conversation was conducted under the Chatham House Rule, and comments are unattributed.*

**Progress is being made on data availability but it is not sufficient.** More companies are disclosing their climate risks, investors are increasingly factoring environmental, social, and governance (ESG) factors into their portfolio construction, and a variety of regulatory and industry bodies are fleshing out the details of how to measure and model these risks. But notable gaps in data availability, regulation, and compliance persist.

**Distinguishing between physical and transition risk.** Physical risks like extreme weather events, sea-level rise, and conflict and migration that would accelerate in a world that warms by more than 2 degrees Centigrade tend to be long term, uncertain, and difficult to model. Uncertainty about future technologies clouds firms' ability to assess transition risks, such as reduced profitability and wealth effects or legal liability for failing to take mitigation measures. Meanwhile, the war in Ukraine and associated disruption in global energy markets reminds us that risks of a disorderly climate transition can come from unexpected sources.

**Data quality and technology are critical.** We have moved quickly from a world with too little data to one with arguably too much in some areas. Satellite images of city lights and tanker traffic in and around Shanghai, for instance, can provide a more up-to-date picture of the Chinese economy than official statistics, but that satellite data is unstructured. Firms are turning to artificial intelligence to integrate and make sense of this data. Open-source data initiatives and efforts by organizations like the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), which is creating a climate data repository, can help firms price risks. And blockchain technology can help combat greenwashing by exposing any double-counting of emissions reduction efforts. The industry needs to use every tool available to maximize transparency and enable capital allocation to play its full role in combatting climate change.

**Closer coordination is needed to avoid policy fragmentation.** Today's regulatory landscape for ESG is uneven and approaches to these risks are evolving at different paces. The Federal Reserve has taken a cautious approach toward climate risks, reflecting concerns about the availability of data and the ability to assess risks, while the ECB has taken a forward-leaning stance, believing that patchy data is better than no data. Closer alignment between bodies like the European Union's Sustainable Finance Disclosure Regulation, the US Securities and Exchange Commission's recent climate disclosure proposal, and the International Sustainability Standards Board can move the industry in the direction of globally consistent taxonomies and reporting standards.

**Keeping both the short and long term in mind.** Risks typically can be measured with greater specificity over shorter horizons and regulators tend to focus their efforts there. But the big climate risks lie beyond the standard three-to-five-year forecasting horizon. Investors and regulators have to get comfortable with the need to approximate those risks even as they work to reduce the uncertainty surrounding them.