Energy transition policies

Introduction by the Chair

The Chair observed that previous panels have noted that frequent rule changes do not lead to simplification. The Green Deal set very ambitious targets to reach net zero by 2050, and the new Commission confirmed these targets. Data will be needed to track progress and ensure that work is science based.

1. The challenges of the energy transition for SMEs

An official noted that the challenges of sustainability, such as finance, compliance and simplification, are amplified for small businesses. However, there will be no net zero without SMEs. Many of the initiatives around the energy transition have been designed with financial institutions and large firms in mind, not SMEs. SMEs are impacted on a day-to-day basis through their relationships with financial institutions and participation in supply chains. To address this, SMEs need certainty and simplicity. Omnibus seeks to simplify compliance for businesses and limit burdens on smaller businesses.

SMEs have struggled in recent years to access finance generally and obtaining finance for investments in energy efficiency or energy transition will be even more difficult. Most firms in the EU are SMEs, and the energy transition will pose a significant challenge for them. Continuing to build a stronger business case for these investments for SMEs and the broader business population will be critical. Investments in sustainability can result in stronger competitiveness, lower operational costs and greater resilience to shocks.

Compliance should be seen as not just a burden, but also a tool. Transition plans are part of the business strategy. Data collected can be used to plan and implement business strategies. Awareness raising in SMEs and provision of non-financial support needs to continue. Many businesses find a step-by-step approach helpful, where each action leads to a result.

The Chair noted that scope 3 means that environmental performance information of SMEs in the value chains of large enterprises will be needed.

2. The challenges of simplification

A central bank official observed that central banks need to participate in the debate around energy policies because they policies impact price and financial stability. There is general agreement that simplification is necessary, but opinions differ on exactly which rules should be removed or made more lenient. Transition uncertainty is affecting market prices and must be reduced. Mispricing of risks in the market is channelling financial flows in the wrong directions.

The priority is to reduce global regulatory fragmentation around disclosure requirements. The European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) have done some work in this area. Scope 3 will be key to integrating carbon emissions across the value chain. The second priority is to ensure that the risk assessment is truly forward looking. Climate risk is already integrated into supervisory frameworks to some extent in Europe, but this needs to increase and be done in other parts of the world. Transition plans, pillar 2 requirements and stress testing will raise awareness in the financial sector.

A public representative noted that reducing legislative and data uncertainty, fragmentation and opaqueness should not be difficult and would in fact mirror the accounting and financial sector regulation and principles. However, the political context is more challenging. Environmental matters are seen as a luxury, particularly with the ongoing war in Ukraine. People need to understand that the energy transition is non-negotiable. Political players should not try to hide the facts as this will only make it more difficult for finance sector businesses to adjust in the long run. Readiness and perception of risk level often depend on someone's level of engagement with the topic.

This political dilemma must be addressed in the European Parliament, which will be difficult. Those supporting and attempting to drive the energy transition need to raise its profile and campaign forcefully. At present, it is those on the other side of the debate who are making the most noise. The 'voice of reason' needs to be more prominent in the debate, although this will not be easy.

An official commented that governments need to strike the difficult balance between addressing climate change and protecting the economy. Without growth, higher wages and investment, there will be no political support for the necessary adaptation and mitigation. The focus on simplification adds complexity as it is not clear which areas need to be removed. In reality, there is no trade-off between climate action and competitiveness, especially in Europe. The lack of fossil fuels in Europe and need for energy security and geostrategic autonomy means that significant investment in renewables is needed. This must be communicated clearly, and the energy transition should be promoted as fast as possible.

A public representative indicated that they agree that there is no real trade-off between environmental sustainability and the economy. The political challenge is to be very clear that there cannot be markets and a market economy without rules and regulations. The question is then who makes these rules and regulations.

Despite good intentions, simplification is not always achieved in practice. For example, the reporting scheme was not simplified but in fact complicated by increasing the responsibilities placed on private sources. Regulation is not always a negative: phasing out property rights or accounting regulations would not be helpful. There is some resistance to what is perceived as 'new regulation' on sustainability issues, but it was not possible to regulate on environmental sustainability 50 years ago because there was not enough information available.

In a democracy, the right answer is not always arrived at immediately. If something is not working, it can be fixed. Oversimplification will result in a loss of the information that is foundational to a good economy. Nobody suggests simplifying company accounting to the extent of only including income and expenses. It is widely acknowledged that a more granular approach is useful, and this applies equally to regulation around environmental sustainability.

An official stated that governments have an important role to play around not losing data through oversimplification. Data can have a public good aspect. The Portuguese government is building a database to help SMEs in particular to calculate, for example, their carbon footprint. This database uses information, for example expenditure on gas or electricity, that the business has already reported to the tax authority. Governments and the European institution could also assist by standardising information-gathering protocols and stratifying the data requirements. Large corporates, which have the most impact on the climate, should be subject to more exhaustive requirements and the burden should be lessened as much as possible for smaller companies.

An industry representative emphasised that there is no call for deregulation. Mizuho, and the corporates it engages with, are improving data and disclosures. In the past, many Corporate Sustainability Reporting Directive (CSRD) projects were treated as a regulatory requirement and developed separate from strategy. Rather than reducing accountability, governance and metrics need to improve. The UK regulator is strengthening its sustainability and climate-related regulations with boards facing heightened accountability on how the business strategy responds to climate risk.

Regulation needs to be fit for purpose. There is a lack of alignment even between different parts of CSRD. It is not possible to cross-reference between disclosures and prudential reporting or between ISSB requirements and European requirements. Climate risk is a mega trend, and banks are aware that, if they do not understand it, they will have a risk problem and an opportunity problem.

A public representative commented that regulation around the energy transition is developing slowly. Similarly, the accounting system standards have been in development for many decades, and the International Financial Reporting Standards (IFRS) are still not perfect. It is difficult to achieve the perfect regulation in a democracy because different political views and member state contexts need to be considered. Compromise is needed in any legislation. The problem is that the requirements, calculations, benchmarks and definitions are not aligned. For example, CO2 is addressed slightly differently in ISSB. This lack of alignment imposes a burden on companies. The political climate, for example Project 2025 in the US, will also have an impact, whether people agree with certain positions. The focus should be on developing a more coherent sustainable finance initiative and trying to integrate different parts of the system, possibly in an accounting directive or IFRS.

An official shared that there are several examples globally where businesses are being assisted in their use of data for reporting. Like the Portuguese database, Project Perseus in the UK is automating the transfer of information directly from energy consumption reports and bills to financial institutions, with the consent of businesses. ESG compliance guides specifically for small businesses have been developed in Canada and Malaysia.

3. The role of transition plans

An industry representative stated that transition plans are an extension of a business's strategy and competitiveness objectives. Developing robust transition plans is a forward-looking strategic exercise that supports the capacity of firms to capture economic transition opportunities and build resilience to physical risks, rather than being an ex-post disclosure exercise that may pose material concerns regarding the reporting burden. Transition planning is a cornerstone of effective corporate governance in sectors exposed to material climate-related financial risks and opportunities, which can help investors' and banks' assessment of a company's resilience and upside opportunity through the energy transition. SMEs may have different resource constraints than large companies, but a transition plan that is an extension of the business strategy will still be vital.

The best transition plans include an acknowledgement of policy dependencies. Companies struggle with policies lagging EU commitments and national aspirations, such as achieving net zero by 2050. Policymakers often do not listen to the requests of companies. Companies are asking for specific infrastructure or permitting reform and responding to these requests is an opportunity to further the progress of the energy transition.

4. The Japanese approach to the energy transition

The Chair noted that Japan is the first country to implement the Taskforce on Nature-related Financial Disclosures (TNFD) voluntary disclosure on nature and biodiversity.

An industry representative explained that, although Mizuho is a very large Japanese bank, it has a significant

European presence and regulatory improvements in Europe regarding simplification or consistency across regulations are very important for the bank. Japan is in the unique position of being highly dependent on importing energy and very industrially developed. The energy transition has therefore long been a priority in Japan. Japanese banks are aiming to support their clients through the transition because divestment is not an option for the country. Mizuho also takes this approach in its EMEA operations.

Transition plans of banks and corporates have improved dramatically in recent years. There has been a great deal of focus on changes to 2030 targets, but the shift in the attitudes of corporates does not receive as much attention. Corporates are now much more aware of what they need to do to reach their targets and are making associated investments in technologies. Corporates are very clear about how they are spending capex to achieve their objectives. Climate transition assessments enable financial institutions to engage with their clients in an appropriate way and have robust discussions. Although the pace is still not as fast as it could be, it has improved significantly.

Europe has been a leader in this area and driven the faster pace of change. Europe was the first mover on the development of sustainability frameworks. The European net zero frameworks have acted as guidelines to the rest of world. Regulation must be assessed to ensure that it is fit for purpose and can be implemented by companies and banks. Prudential regulation should be cross-referenced with the appropriate disclosures. Efficiency, particularly around data, is how companies move forward.

Corporates are beginning to embed their sustainability priorities and associated actions into the business. As previously stated, a transition plan should be a business plan. However, it is only possible to execute the business plan if resources are not instead being used for disclosures that do not provide useful information to investors. If the priority remains the original European aim of transitioning the economy to a more sustainable one, we need to implement simplification and fit for purpose disclosures

The Chair shared that their experience is also that companies are now doing more towards the energy transition, although perhaps being less vocal about it. This is a slight concern because companies need to bring people with them on their energy transition journey and effective communication will be a part of this. The energy transition is no longer merely an ESG issue but must be embedded in all aspects of the business, from finance to HR. The business strategy will need to reflect this.

Strong advocacy will be needed to strengthen the political will. The positive effects of political decisions taken several years ago are only starting to be obvious now. If politicians are discouraged by this lag and fail to accelerate, progress could slow down.

An official noted that small businesses state that they do not want to be exempt; they want to be enabled. Financing from government or national development banks for energy efficiency in SMEs should be accompanied by non-financial support. SMEs should be supported with public funds in the first instance, with the expectation that private investment will take over this role in the future.

5. The role of the public sector in the transition

An industry representative commented that the public and private sector need to collaborate more. Private industry often has excellent ideas. Public sector regulation is not meeting the needs of companies that want to transition but do not have the right framework. When the right policy framework is not in place, there may be a trade-off between competitiveness and transition. Policymakers, the finance industry, business, industry and regulators need to identify together, on a sector-by-sector basis, what the objectives are, map the investment needs to capital sources, identify policy levers to de-risk and mobilise finance, coordinate action across value chains and sectors, and provide forward guidance that builds investor confidence. A pathway where government provides the long-term ambition and stable policy framework, while industry shapes the delivery through engagement, innovation, finance, and acceleration can then be developed. Sector transition plans that are aligned with the national strategy, but also grounded in real market conditions, informed by policy dependencies and designed to unlock investment at scale will help turn government and corporate ambition into action. This collective vision is needed to inspire people to work together.

An industry representative stated that the role of governments is crucial. In some sectors there are currently no commercially viable transition technologies. Governments will need to derisk the process to ensure that liquidity is available for these projects. This was the initial approach with renewable energy sources. A renewable project would make no money, but the government stated that it would buy green kilowatts. Investment in the technology followed and allowed it to evolve. There should be no reluctance to acknowledge that some new technologies will require subsidies. However, the challenge in Europe is always to ensure that all countries are aligned on the same agenda and have the resources to invest. China is a major competitor in how fast the energy transition journey is proceeding and is taking this approach.

A more long-term perspective is needed. Input should be sought from corporates, although regulators have been better at this than previously during recent changes. A successful energy transition will also require the completion of infrastructure projects.

An official noted that, although governments are often called upon to act, they use taxpayers' money and must therefore be cautious. There will be losers from the energy transition. Many SMEs are angry about the complex and costly requirements the energy transition is imposing upon them. Compliance, at whatever level political powers decide it should be, must be universal. If some firms and sectors comply and others do not, an unlevel playing field is created. The complexity of regulations is relevant here.

The Chair suggested that, if avoiding fragmentation is a priority, governments should choose a regulation, not a directive. Some countries have not implemented CSRD. With 27 countries, the only way to ensure a level playing field is with a regulation.

A public representative emphasised that a directive can unintentionally create an unlevel playing field. Clean, transparent rules need to apply to everybody. If this issue is not addressed by member states, no progress can be made.

A central bank official shared that energy transition, climate transition and biodiversity is not yet included in the public rating of French companies but there are plans to include these aspects in future. The French central bank has developed a climate indicator for all companies, and the aim is to use this to inform the rating that will be published by the French central bank. However, the methodology is not easy to implement. The perception that there is a trade-off between competitiveness and transition is because the benefits of the transition policies are underestimated and the current cost of transition is overestimated. Short-term scenarios have concluded that delaying the transition policies by three years would multiply the economic costs in 2030 by a factor of two or three. A choice is being made to not pursue transition policies now, although it will be more costly in future.

An official emphasised that energy transition is of enormous strategic importance for Europe. It will not be the legislators or the regulators that make the transition but instead the businesses and households. These businesses and households must be engaged to deliver on the potential of the transition.

A public representative commented that there is no time to get the energy transition wrong. Investing in sidetracks like carbon capture and storage (CCS) should be avoided, because after that there will be no money, time or technology to do it better. The focus should be on planetary boundaries, not only climate. Making the necessary changes will be costly now, but after 10 years the cost will be even greater.

6. The importance of nature in disclosures

A central bank official noted that nature is an important element of the CSRD disclosures. The nexus between climate and nature has not been taken sufficiently into account. For example, climate is causing droughts and reducing the supply of water, which has major consequences to produce power and for agriculture. The value chain must shift, which will be costly. Data is needed to fully understand these risks.

The Chair commented that, in the vocabulary of finance, water is material. The European Central Bank (ECB) has carried out some valuable work in this area. Food production is also a part of this nexus.

An industry representative confirmed that the nature-climate nexus is underexplored. Nature should be integrated into transition plans. Broad and coordinated collaboration, not in small groups or forums, is needed to discuss risks and opportunities and how to finance the transition.

An industry representative emphasised the importance of nature. Nature, together with physical risk, will be quick to impact the balance sheets of financial institutions. Work is currently underway to demonstrate this to boards. 2050 targets are difficult for boards to engage with because they do not have a business strategy going up to 2050. Per example, how water scarcity can impact the probability of clients defaulting is much more visible and short term. Nature should be included in these conversations, even if the data is not available to do it in the same way as environment.

Conclusion by the Chair

The Chair concluded that the energy transition is part of business strategy and is also a strategic concern for countries. Decisions taken by the US and China will impact Europe, but if the EU wants to be sovereign it should make its own choices.

Resilience should be a key focus and a way for people to understand the transition. The aim is for societies to be resilient to climate events, adapt where possible and mitigate where necessary. Without a nature-based solution, there is no way to address climate change. The only real carbon sinks are oceans, soils and forests. Nature and climate have been artificially separated, and both must be addressed in conjunction. The term ‘planetary boundaries’ refers to an idea from the Stockholm Resilience Centre studies that resources are limited and therefore a shift to a regenerative model of economy is needed.