ESG Now Podcast

“Are Banks Ready for Climate Risks?”

Transcript, 4 March, 2025

Mike Disabato (00:00):
Hello everyone. Welcome to ESG. Now I'm your host, Mike Dedo, and today we're talking about an expansive topic, the new omnibus rules that the EU has put out on various aspects of sustainable finance. Now I'm going to give you my conversation with our EU policy expert live, but let's say you're someone that already knows all about the changes that the EU has proposed and you want to just skip our intro section and get to our opinion section on the future impacts of those changes. Well, if you are that person, I would suggest skipping the first 12 minutes of this podcast and going straight to that take session, and you'll avoid all the background of what the EU has proposed to change and the details of those changes. If you're someone that is less familiar with those changes, then I suggest staying with us here for those first 12 minutes so you can form in your mind the scope of these proposed moves. Regardless, whoever you are and what your motivations are for listening to this episode, I hope you enjoy the episode and of course, stay doomed.
(01:11):
So I have with me today Simone Ruez Vert, and she's one of our policy experts here at M-S-C-I-E-S-G research, and her main focus is to ensure our data can help clients meet regulatory requirements, which means that a large part of her time is spent understanding and navigating on the ground impacts of EU regulation. And so Simone, I think there's the EU could be such a confusing and complex place to try and wade through. And I think even before we get into what the EU Commission changed, could you kind of take me through the basics? What is the EU Commission and what does it do? And put this all into context for a non-expert such as myself.

Simone Ruiz-Vergote (01:50):
I do hear you on the complexity. For an outsider, I can't imagine it must be overwhelming. So at the end of February, the EU Commission has proposed a range of rules, commonly known as the omnibus rules. So the EU Commission is really the EUS legislator. They come up with laws, they present laws, and they also change laws when they're already out there. So they have the power of initiation, if you like. And once these laws are being proposed, they go into a negotiation with different other institutions, notably the parliament, the European Parliament and the EU Council, and the EU council. That's really the member states. And then when the rules are adopted, they will have to be implemented international law. So each member state will have to transpose these laws, these EU laws, international laws for them to be applicable. And so the EU commission has really come forward with the range of changes to already existing laws end of February.

Mike Disabato (02:52):
And the laws are the EU taxonomy, the CSRD, the CS, triple D. And then is there anything else?

Simone Ruiz-Vergote (03:03):

No, that's it. But at the end of the year, we'll expect one more. That's the SFDR, that's up for review. But the omnibus is really CSRD and the CS triple D, so corporate reporting on sustainability and due diligence. And the EU has also at the same time proposed to review the rules on the EU taxonomy. They will consult the market here for four weeks. So that's a little bit of a different process than the omnibus, but it comes down to the same. The objective is simplification, simpler rules, less burden for companies, and also fewer companies will have to report, and it's basically left open for anyone to continue to report if they wish to do so.

Mike Disabato (03:46):
Let's get into the details of that. So it's basically what the EU is saying is that we want to make it less of a burden for companies and we want to simplify it, but what does that look like in the details? What do they do?

Simone Ruiz-Vergote (03:57):
Yeah, the first change relate to the EU corporate sustainability reporting directive. So that sustainability reporting in short CSRD, they are in effect since last year. And the proposal is to simplify the rules with new standards supposed to be developed, but also reduced amount of companies scheduled to report. This is supposed to be 80% reduction in scope going forward. And then they propose also to pause these rules for companies that are not yet in scope but supposed to report as of next year by two years. So companies that would normally get ready now to report in 2026 will most likely see these reporting obligations paused for two years. And so they will only have to report probably in 2028. And that is the stop the clock proposal from the commission.

Mike Disabato (04:55):
That's pretty significant, right? The 80%. So what does that look like in terms of numbers? I mean, 80% sounds huge. It sounds like it's such a big deal. I mean, what does that actually look like?

Simone Ruiz-Vergote (05:06):
Yeah, so right now we have around 2000 companies reporting that number was supposed to increase to 50,000 by the end of 2028, over two waves. The first wave would've been adding next year. And then over time, this amazing number of 50,000 companies, what they will propose now is actually going below the rules that are currently in place. So reduction of scope to thousand employees would be the threshold as of which you have to report. And in that sense, there is an estimate that it would be around six to 7,000 companies left that would report. So from 2000 today to 6,000, six to 7,000 in the future, we've looked at these numbers for our largest index, and the constituents of this index are around 8,000 companies, listed companies. And here we do see the impact to be rather muted. So these are large companies that we see actually, I think around 800 had to report already. And in the new future, if these proposals would be adopted, that would be dropping to 750. So a very small reduction actually on the pace of a listed portfolio. I'm not even sure that most of our clients would notice that from an investment angle,

Mike Disabato (06:38):
But the wider market obviously is going to know that. So that's for the CSRD, for the CS triple D and for the EU taxonomy, is that the same thing? Have they reduced the scope as well?

Simone Ruiz-Vergote (06:48):
Yes. So the CS triple D was adopted last year, and in the final negotiations print, they reduced the scope already by 70%. So you could say that the scope has already been reduced. So here the focus of the

legislator is actually making the rules simpler, also limiting some of the applications so the companies don't have to look at their entire supply chain, but only at the first tire also reducing something called civil liability. The fines associated with the rules will no longer be regulated at the EU level. So there are a number of changes that you could say soften the parameter of these rules and they would also be delayed by one year, but the scope doesn't change. It has already been reduced significantly in the final stages of the adoption last year.

Mike Disabato (07:38):
And the EU taxonomy is also now it has to be above a thousand employees. And then you have what's a turnover asset turnover below 450 million euros. Is the only thing that's changed the scope or is there also details within each regulation that have now been adjusted?

Simone Ruiz-Vergote (08:00):
Yeah, so the commission is consulting right now for four weeks. So we have a possibility to also provide feedback, but it's scope that's reduced. It's also the template for reporting that have been strongly simplified. So we see a strong reduction in the number of data points that have to be reported going forward, simplification, streamlining, and then there is a curious new rule for taxonomy that would mean anyone that has the report right now also. So you basically mentioned it, 450 million turnovers, thousand employees. So the remainder of the companies that have to report can actually check if that makes sense. Do I really have taxonomy eligible activities? Do I have taxonomy alignment in my activities and is it making sense to report it? So they will introduce some financial materiality thresholds, which means even fewer companies would report eventually. And then we need to ask ourselves if the data is still usable for the investment purpose that it was designed to.

Mike Disabato (09:08):
So a good amount of changes, especially for the reporting scope. Can you take me through now aside from scope, obviously we've gone into that in detail. Can you take me through the most important aspects of these changes both for the, let's say the regulatory expert in the EU, but also the generalist market participant, where this is going to affect them because they're participating in the EU market but maybe wouldn't call themselves a regulatory expert? Take me through the most important bits of these changes.

Simone Ruiz-Vergote (09:34):
I think that the reduction in the reporting scope, that is fewer companies reporting the data and then the uncertainty around what the data will ultimately be, that is really the backdrop of it. And that can have significant implications for investors who need the data, need to have comparability of data and will have to report themselves in the current context where there is still sustainable finance rules for investors and banks that require this data to be just present. So measuring portfolio's, negative exposure as well as its positive exposure might become slightly more complicated going forward. And then I think secondly, you'll see that the data availability, while it might suffer, it might also be more streamlined and more focused. So that could mean that you actually get the data that you need and you don't have to read through a jungle of narrative data points, but you really get to the core information much quicker.
(10:46):
So this is probably already the good and the bad of these proposals that we can count with and that our clients might need to digest once this is through and adopted. And maybe thirdly, that there is still a lot of uncertainty as proposed. The reduction scope goes below what is in place right now, what actually what has been in place right now. Of course it goes below what's been already just implemented, but

we'll probably have some room for negotiation here and we'll see how this plays out. The major element of uncertainty is however, for the companies that are currently in member states that haven't even adopted the rules, the current rules yet, and there are quite a few, including Germany that have never implemented the CSRD, the sustainability reporting rules into international education. So companies in these countries really don't know what to do normally they don't have any mandates to report, they're not obliged to report, they don't know if they will be in scope going forward or if they will be taken out of scope. And I think in this situation you'll see that. I think common sense would be to just proceed to do the sustainability reporting that they've already set up and then to use that data to communicate with the broader market.

Mike Disabato (12:10):
Now I want to get into away from just the basics of what happened. Let's get into more of the good, the bad, the future impacts of this because it's sort of like you touched on a lot of those points already, but let's really dive in and discuss what this omnibus that if you're in the sustainable finance circles, you've heard people talk about ad nauseum almost, and a lot of it's been quite negative. But I would like to know what the good is first to just kind of set the tone, what the bad is in your opinion, and then what the future impacts of this are. So take me through the good of this omnibus regulatory change.

Simone Ruiz-Vergote (12:46):
So on the one side, I think that the fact that the EU hasn't changed its commitment to double materiality in also really looking at what it means to have an impact perspective here is probably hard to underestimate. I mean, the EU has always been a advocate of this double materiality angle compared to other markets. However, no matter how you play it, this has been sort of a signal of commitment to a green agenda. And if they had backtracked on that, I think it would've been seen as a strong weakening of an EU commitment to reach sustainability goals. Now the EU market is looked at for inspiration from also for endorsement by many other markets in particular in the APAC region. We've seen globally over 40 countries adopt taxonomy for classifying such as sustainable activities. So that's really an inspiration. And if they had backtracked on that, it would have been seen as a weakening commitment.
(13:51):
Now that's one thing, and I think on the other side what we see is that they also have been, there is a need for simplification. So I think the sort of resetting the sustainability agenda with a focus on what really is required for steering investments but also for communication is helpful. So there has been a refocusing, and when I look at our own data and how we have been helping companies with their reporting on taxonomy, we have over 4,000 data points today on taxonomy data that is required because companies need to report according to specific templates in the new proposals on the EU taxonomy, the data points will be reduced by over 70%. So many fewer data points will be needed for an asset measure to report the taxonomy alignment of its asset. And that is really helpful because it basically helps you interpret the right indicators, the right data points and make sense of what you see. So I think this sort of releveling is making a lot of sense.

Mike Disabato (14:56):
Do you have a good example for that? Releveling, like a company previous to this, they had to report on various aspects that weren't actually material to their company, but the EU wanted a standardization. So they said everyone has to report on this, and now the EU is saying, well, you don't have to have all the same data points, just the data points that are most significant to your industry. Is that kind of what's happened here in that sense? Now I know we we're ignoring the fact that 70% reduction of companies that actually have to apply this for the companies that do have to apply this. Do you have a good example of how that redefining has changed what each company is going to report?

Simone Ruiz-Vergote (15:40):
So again, I think I have to return to the taxonomy right now because the other standards are just not yet developed. So the EU has now basically given a mandate to an expert body to start again designing these specific standards for sustainability reporting. So we don't know where they will end, but they have already said that they will strongly reduce the amount of data points and they will focus on what is truly relevant and that they will also focus on the quantitative indicators rather than the narrative indicators. So there was a lot of narrative data points. So for your question on the example, I can turn to the taxonomy because here they have been reviewing that reporting templates and they have proposed changes. And we see already that for instance, in the case of a bank that had to report, well, they could choose from over 6,000 really crazy 6,000 data points a bank could choose for their taxonomy reporting. Even if they had very little exposure to green companies on their balance sheet, they still had to do this. They still had to go through the selection of these 6,000 data points. And by now we're talking so many fewer data points for the banks here. It really makes a lot of sense. So for the bank it's more meaningful, it's much more selective, and I think that that really helps. It was just too big a burden for a bank for too little of a benefit.

Mike Disabato (17:05):
So that's all the good, it's a bit of a focusing, it's a bit of a reduction in unnecessary data points for some companies. What's the bad here?

Simone Ruiz-Vergote (17:16):
Yeah, you just ask whether they now focus on indicators that make sense for the respective industry. And it's actually the opposite. They've decided to completely scrap the sector specific standards. So they will basically not develop standards that matter for each sector and for the financial sector, this is difficult. How would you know how to report on your finance portfolio emissions or sustainability exposure for an investor to look at the fund? A fund has exposure to every single sustainability topic. Selecting what matters in the value chain of an investor is very difficult if you don't have a sector specific standard. And so here we basically see that the abandonment of the sector specific standards makes it harder to select what is truly relevant. They have done that because they thought it would add to the amount of data to be reported. They thought it would add additional burden.
(18:17):
I think that's wrong. It would have reduced the burden, it would've focused the attention. And the second one is that sustainability data will not be available at the scale expected, and especially for the private side. So non-listed assets, it'll be very difficult to get the data. They've also added a requirement that companies cannot ask for data in the value chain. So if you have a supplier or if you're actually wanting to know how as a bank, how your creditors perform on sustainability, you can only ask them for this data if they have more than a thousand employees. So it'll be very difficult to access the data. And we already see that this means some of the investors and banks are actually asking for their own sustainability reporting requirements to stop as they fear that they will not get the necessary data to cover all their assets.

Mike Disabato (19:13):
So there's this fear that this will weaken a link in the sustainable reporting chain that will then cause the overall tool. Let's say the link is a tool to degrade since there's just not enough data for the companies that need to report like a fund with all of its exposure to its portfolio companies in terms of finance emissions or with a bank that has exposure to all of its portfolio companies through its loan book. And there's this concern that these smaller companies and private companies are just not going to report their data because the regulator says you no longer have to, and we're not going to delve too deeply

into all this private capital that's been moving into the market lately and how that can really increase the gap in disclosures. But your fear is that this now weakened link in the chain is going to lead to a larger degradation of the entire EU sustainable finance toolkit?

Simone Ruiz-Vergote (20:02):
Yes, there is a data dependency you can say from the financial companies to the non-financial companies, but also from the non-financial companies to companies in the value chain. And that is really disruptive through this omnibus proposal. I've just told you that from a market cap perspective, and if you look at the larger indexes, the data will still be there because the largest companies will continue to report. But whenever there is reliance on companies in the value chain or in the lending chain that is smaller companies, mid-size companies, and as we know 80% of companies are in that segment and 80% of GDP creation is in that segment, that will be where you will be needing to look for the data. Now these companies have an incentive to report, you would argue because we see already that larger companies will find it easier to access investments because they're more transparent around sustainability.
(20:58):
And sustainability risks don't succeed because the EU commission decides to no longer ask for the reporting. So there is this perception of risks being there but not being communicated through the companies. And so there might be still an incentive for companies to continue to look for the data and to communicate the data to their shareholders. And so that angle could still be one where we see continued data and the commission has actually proposed a standard for the smaller and mid-sized companies, but this needs also some more time for development and we'll not start before this two years pause that they are now proposing to. So if that is adopted this two years pause, we will not see this data necessarily before that.

Mike Disabato (21:43):
Yeah. What are the key dates here? Take me through it in a really kind of simple way because I think especially with the eu, you never really know when these things are going to be implemented. Who signed what there's now start with what you just said there. There's a two year delay now and take me through everything else.

Simone Ruiz-Vergote (22:01):
The first thing is to stop the clock, and that's a separate proposal. It would actually stop the application and the extension of the sustainability reporting for companies that are now next to come. So the smaller emitter sized companies. And that will would be paused for two years and that proposal could be adopted quite quickly, probably by the middle of the year. But the full set of changes that will take time, there will be negotiations within the parliament and council. They have started actually just now this week the parliament had its first hearing on it, and that can take much more time several months once these changes are adopted. So the scope, but then also the new rules, they will still need to be transposed or adopted international law by each member state, which can take another year or more. So we're talking two years at least.
(22:58):
There is also another aspect that's EU taxonomy. For the EU taxonomy. This is not the same process. It could be adopted a lot faster. In fact, the commission has already set an entry into fourth date for January next year, and I think this is feasible. So we could see these simplification proposals and also the scope reductions with a lot fewer companies mandated to report and a lot more enabled if they want to voluntarily to report. That could already apply as of next year. And maybe just as a final point, there is also an other pillar of sustainable finance up for review at the end of the year, the sustainability

reporting rules for fund measures and investors. So the SFDR will also be reviewed, and that is again, a process that can take easily two years, but there is the expectation that the EU commission will put forward some classification categories, some labels for sustainable investing going forward. So that will be then the last pillar of sustainability that will also be up for review by the end of the year. So a lot of moving targets right now in this market.

Mike Disabato (24:12):
So give me your closing thoughts here on how you should think about this. If I was an investor seeing this, there's always an opinion out there and there's a lot of people that are very for this, very against it, and it really depends on what sort of camp you're in, almost sometimes it seems where that will be how you're going to perceive this. So give me kind of the broad overview on how you think about this and what the key takeaways are of this.

Simone Ruiz-Vergote (24:36):
Yep. So it's never been dull with sustainable finance, but I feel like this is a bit of a break in the way the communication is happening around this. And the pool we've seen so far is a bit weaker. There are three takes I would take from all of this. And the first is that the reporting requirements will be strongly simplified and that's definitely welcome and I think it's needed and if it's well done, it really can help focus on what matters most to investors. So helping enabling, in fact better steering of investment decisions based on sustainability data. The second is that it could come at the cost of scale. If the scoping plays out as expected, then there will be less data. And this is not necessarily a problem, but the comparability between companies in a portfolio, that will be harder. And that is because you might see some companies report some data and in the same sector, another company not report the same data.
(25:44):
And so how do you compare? That would make it a lot harder for investors to really do the sort of peer benchmarking that the market has become very, very accustomed with. And then thirdly, it's hard to know where we'll end because the negotiations are still ongoing. But I think there is clearly a rationale for companies to continue with reporting, especially if they have already done the first steps and if they're already on a good path. Transparency helps when competing for finance with peers. It helps when communicating with broader stakeholders. It helps also with the relationship with regulators and then also the market. So I think this is good sustainability reporting makes good sense and the cost will be much reduced going forward because of the simplification. So I wouldn't see why a company decides not to continue with it.

Mike Disabato (26:44):
Great. Thanks so much Simon. And that's it for the week. I want to thank Simon for talking to me about the news with a sustainability twist, and I want to thank you so much for listening. If you like what you heard, don't forget to rate or review us. That helps us get higher on the podcast list and more people can find us. And if you like what you heard subscribes, you can hear myself or any of the other ESG now co-hosts at any time during the week. Thanks so much for listening and talk to you soon.

Speaker 3 (27:25):
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