Working paper on the EU Taxonomy and CSRD climate risks assessments: how to comply and what are the differences?

The EU Taxonomy and the Corporate Sustainability Reporting Directive, both ESG reporting regulations under development in the EU, will require companies to assess their exposure to climate related risks if deemed material. Performing climate risk assessments based on both regulations ensures a multidimensional and holistic view of climate risks applicable to your organization and leads to stronger disclosures.

In this working paper, we set out how to comply with both regulations and what the differences are in conducting a compliant climate risk and vulnerability assessment.

EU Taxonomy

Under the EU Taxonomy Regulation 2020/852, companies in scope currently report on their contribution to the objectives of climate change adaptation and mitigation. To substantiate contribution to these objectives, companies need to carry out a "robust climate risk and vulnerability assessment" for their eligible activities[1]. The objective of the assessment is to identify the exposure to physical and material climate risks and the appropriate adaptation solutions that can reduce these physical climate risks.[2]

Performing a robust climate risk and vulnerability assessment is part of the alignment criteria for climate change mitigation and adaptation activities. The expectation is that for alignment with any eligible activity, a climate risk assessment is required.

The minimum requirements for a climate risk and vulnerability assessment under the EU taxonomy in terms of scope and level of detail are the following:

1. The lifespan of the eligible activities

The EU Taxonomy climate risk assessments have specific requirements for different types of activities based on their expected lifespan. For activities with a lifespan of at least ten years, it is necessary to consider future climate scenarios outlined by the Intergovernmental Panel on Climate Change (IPCC). It is mandatory to define the expected lifetime for all eligible economic activities. For activities with a time horizon of less than ten years, climate projections should be used at the smallest appropriate scale, at a minimum. Because the IPCC climate projections are only updated approximately every 7 years, decadal predictions that predict the climate over the next few years have been developed to fill the gap. [3] Unless there is a solid reason to expect an activity to stop within ten years, it is reasonable to assume that any economic activity will continue indefinitely. If a company plans to discontinue production of an eligible product, it is advisable to document the reason for the short lifespan. [4]

2. Level of granularity of the climate risk assessment

Reporting taxonomy-eligible and aligned KPIs (CapEx, turnover, and OpEx) is mandatory under the EU Taxonomy. This implies that the climate risk assessment must be conducted at the level where these KPIs are generated, typically where the turnover-generating activity takes place. The location of the activity provides the first indication of the relevant climate hazards to consider. While the manufacture of plastics in primary form can be traced to a specific production plant, broadcasting activities require a broader range of locations to cover production facilities, data centers, and transmission infrastructure. For some activities, the supply chain is a bigger issue. In case there are relevant dependencies on certain suppliers, the supplier countries or geographical regions must be considered for the climate risk assessment.[5] Additionally, the ease of substitution of key production inputs in the event of supply chain interruptions should be taken into account, which is linked to the 'materiality' threshold of climate hazards to be taken into account, as explained below.

3. Considering the climate-related hazards that are to be taken into account as a minimum[6]

Based on the location and other relevant objects of the eligible activities, climate hazards can be identified. Only climate hazards that form a material risk to the eligible activity will be part of the climate risk and vulnerability assessment and will eventually have to be mitigated or adapted to.

---

[1] Under the EU Taxonomy Regulation (EU) 2020/852, there is a list of economic activities that have the potential to contribute to a certain environmental objective. An activity is eligible if it is on this list.
[2] Please refer to the Climate Delegated Act, Annex I, Appendix A EUR-Lex - C(2021)2800 - EN - EUR-Lex (europa.eu)
[3] International: WMO LC Annual-to-Decadal Climate Prediction https://hadleyserver.metoffice.gov.uk/wmolc/.
[4] German Environment Agency, 'How to perform a robust climate risk and vulnerability assessment for EU taxonomy reporting? Recommendations for companies - final draft' (umweltbundesamt.de), 9 November 2022.
[5] German Environment Agency, 'How to perform a robust climate risk and vulnerability assessment for EU taxonomy reporting? Recommendations for companies - final draft' (umweltbundesamt.de), 9 November 2022.
[6] Please refer to the Climate Delegated Act, Annex I, Appendix A EUR-Lex - C(2021)2800 - EN - EUR-Lex (europa.eu)

Materiality is defined using the following two criteria[7]:

- Would one or more of the relevant system elements of your investigation object be negatively affected if the climate-related hazard occurred in its most extreme form, including in combination with other climate-related hazards?
- If so, could the potential adverse effect(s) on system elements significantly impair the performance of the economic activity?

For more information regarding the risk assessments under the EU Taxonomy, please refer to the FAQ document on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act.[8]

CSRD Climate risk assessment

On 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force. This new directive extends the rules concerning the social and environmental information that companies must report. [9]

The climate reporting standard, ESRS E1, requires companies to disclose a considerable amount of information around the undertaking's effect on climate change as well as the effect of climate on the undertaking on the basis that climate change is a material topic to the company.

One of the key requirements is to provide a description of processes to identify and assess material climate-related impacts, risks and opportunities and potential financial effects from material physical risks, material transition risks and climate-related opportunities.

Climate risk assessments must be conducted using different climate change scenarios across different time horizons (short, medium- and long-term). Although both the scenarios and horizons are subject to the undertaking's decision, it is expected that the assessment informs stakeholders of the undertaking's progress on aligning with the Paris-aligned scenario and its resilience up to 2050.

The assessment must be completed across key geographies and operations, focusing on the most material assets and operations. The aim of the assessment is to provide an understanding of the undertaking's group revenue deviation and effects on other key financial indicators caused by climate change, given the scenarios and assets under consideration.

Comparing EU Taxonomy & CSRD Climate Risk Assessment

As can be found above, both the EU Taxonomy & CSRD require the undertaking to perform a risk assessment including different climate scenarios. As talked about in one of our earlier blogs[10], reporting on the EU Taxonomy will be required under the CSRD. The CSRD and the EU Taxonomy, together with other developing legislation, can be viewed as a 'package' stemming from the EU Green Deal designed to increase the flow of capital towards sustainable activities.

The differences between the two climate risk assessments can be classified according to the type of risks and level of assessment.

---

[7] German Environment Agency, 'How to perform a robust climate risk and vulnerability assessment for EU taxonomy reporting? Recommendations for companies - final draft' (umweltbundesamt.de), 9 November 2022.
[8] DRAFT COMMISSION NOTICE on the interpretation and implementation of certain legal provisions of the EU (europa.eu) pp. 67-71
[9] New EU Corporate Sustainability Reporting Directive | Deloitte Netherlands
[10] New EU Corporate Sustainability Reporting Directive | Deloitte Netherlands

	Type of risks		Level of assessment
EU Taxonomy	Physical, if deemed material, risks based on IPCC projections	*Physical risks (examples): flooding, water stress, soil erosion*	Physical location of the eligible (material) activity
CSRD	Transitional and physical risks and opportunities, based on the TCFD (Taskforce on Climate-related Financial Disclosures)	*Transition risks: shift to renewable energy, policy changes, carbon tax*	Most material geographies and operations, to provide a group-level view

In summary, the CSRD requires companies to conduct risks assessments covering both transitional and physical risks and opportunities for the most material geographies and operations. This assessment creates input for a group-level view on applicable climate risks and opportunities. The EU Taxonomy requires companies to conduct climate risk and vulnerability assessments including only physical risks per location of the activity. Therefore, the level of assessment for the EU Taxonomy is on activity level, while the level of assessment for CSRD is aligned with the reporting structure.

Through both risk assessments, both transitional as physical risks are assessed at the group level as at the location of the activity-level. This enables companies to get a holistic view of climate risks applicable to their strategy and operations. Both climate risk assessments require financial assessments to quantify the climate risks and opportunities in financial terms, to the extent possible.

What does this mean for your business?

The first step of conducting compliant climate risk assessments is to identify all climate risks (and opportunities) for your important assets. The next step is to select relevant scenarios for the company and apply the risk drivers to these scenarios – that is to say to understand what these drivers will (have to) do under certain scenarios. The next step is to assess the risks following from the risk drivers under each scenario – and, if possible, in quantitative terms. Understanding the potential impact of climate risks on financial KPIs provides a solid foundation for developing risk adaptation measures and ensures compliance with both the CSRD and EU Taxonomy.

Towards CSRD compliance and EU Taxonomy alignment – How can we help?

We help businesses uncover their exposure to climate risks, laying the groundwork for a climate-resilient strategy. We can assist you in the execution a compliant CSRD and EU Taxonomy climate risk assessment with use of advanced tooling.

Having the right tooling and methodologies in place allows for seamless integration of climate risk analysis into your broader enterprise risk management. This supports informed decision making in areas such as strategy planning, investment project management, business continuity planning, insurance, and other vital business functions. Our climate risk assessment services enable your company to not only meet regulatory requirements but also effectively respond to climate risks and seize opportunities in the shift toward sustainable practices.