

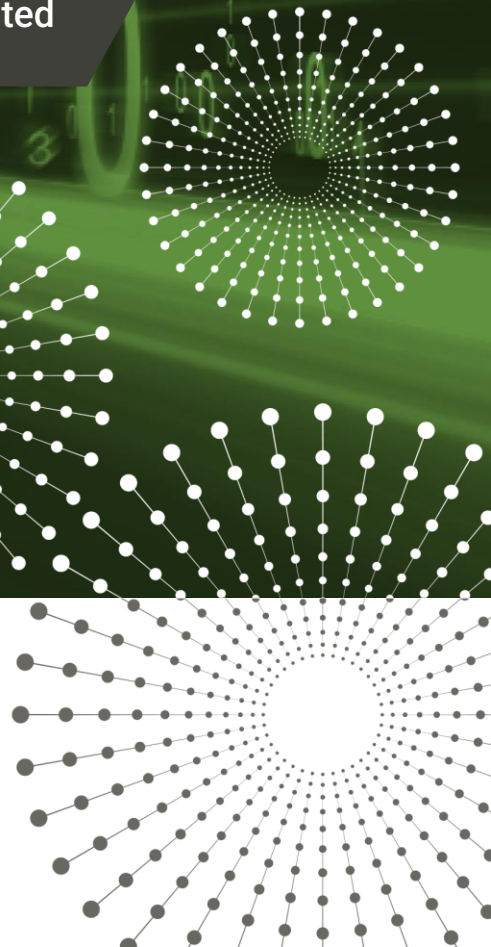
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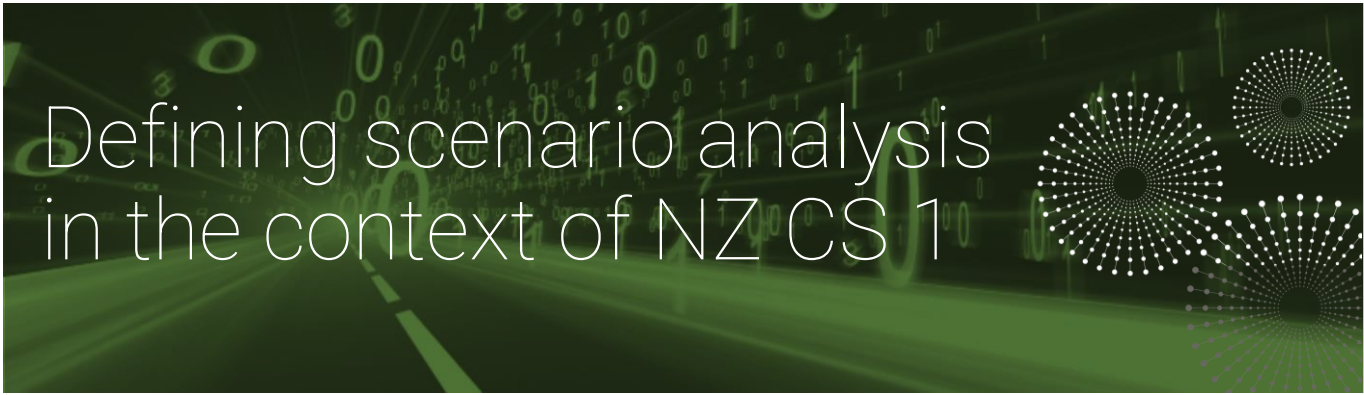
Scenario analysis and climate-related disclosures

Clarifying the definition and purpose of scenario analysis for
Aotearoa New Zealand Climate Standard 1: Climate-related
Disclosures (NZ CS 1)



March 2022





Defining scenario analysis in the context of NZ CS 1

The proposed Strategy section of NZ CS 1 requires climate reporting entities (CREs) to describe details of the scenario analysis undertaken. To do so, it is important that CREs understand two key concepts as defined in NZ CS 1: ‘scenario analysis’ and ‘climate-related scenarios’. Fundamental to these concepts is the integration of physical and transition risks and opportunities within plausible futures (rather than seeing them as separate), and taking an exploratory approach to the scenario analysis process.

What scenario analysis is and is not

CREs use climate-related scenarios to conduct scenario analysis.

Climate-related scenarios are plausible, challenging descriptions of how the future may develop. These descriptions are based on coherent and internally consistent sets of assumptions about both physical and transition risks and opportunities (and the relationships between them). Climate-related scenarios should *not* be probabilistic, predictive, or the ‘most likely’ outcome(s) of climate change.

Scenario analysis is a process for systematically exploring the effects, on the CRE, of the range of plausible futures within the climate-related scenarios. While acknowledging the uncertainty of these futures, this process allows CREs to better understand how climate-related risks and opportunities may impact the strategy and business model of the CRE over time. Scenario analysis is a process that the entity *itself* goes through to explore different, plausible futures. Therefore, the board and management should be involved.

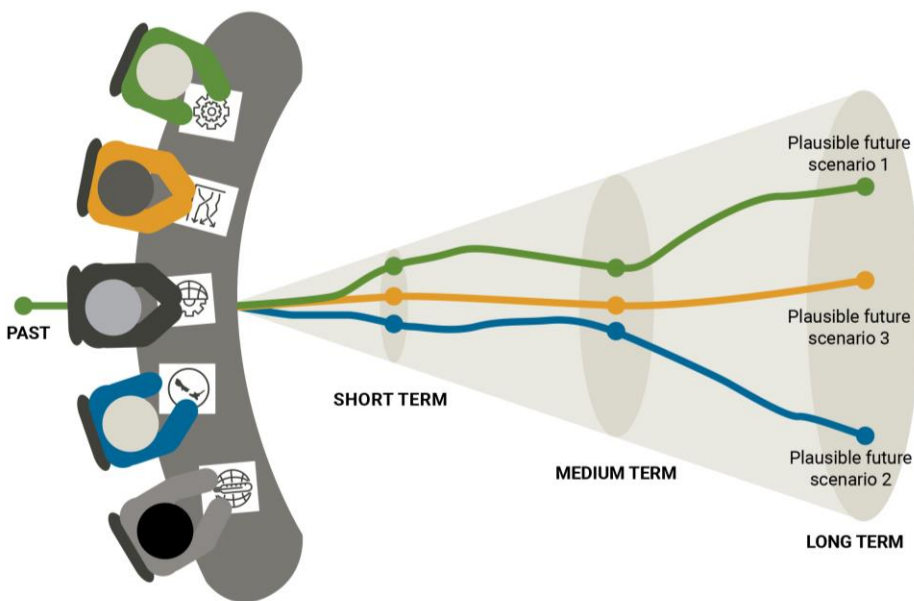


Figure 1: Scenario analysis is a process that the entity itself (board and management) goes through to test the resilience of the entity’s business model and strategy to different climate-related scenarios.

The purpose of scenario analysis in the context of NZ CS 1

The purpose of scenario analysis is critical for CREs to understand. One way to think about it is akin to the testing of a plane in a wind tunnel. These tests ensure the plane can withstand the impacts of challenging but plausible weather conditions. In the context of NZ CS 1, scenario analysis is intended to enhance the critical and strategic thinking of CREs in the face of challenging but plausible climate-related scenarios.

Why undertake scenario analysis?

The primary purpose of scenario analysis in the context of NZ CS 1 is to **test the resilience of the entity's business model and strategy**.

Scenario analysis (including climate-related scenario analysis) can be used in a range of ways for a range of purposes. This diversity of purposes is apparent upon reviewing different voluntary Task Force on Climate-related Financial Disclosures (TCFD) disclosures globally. We are also aware that some CREs are approaching scenario analysis as a tool to identify and manage climate-related risks.

NZ CS 1 does not preclude the use of scenario analysis for these and other purposes and CREs may wish to disclose such uses of scenario analysis. However, such purposes are insufficient for the purposes of satisfying the Strategy section of NZ CS 1. For NZ CS 1, scenario analysis must be used to assess the resilience of the entity's business model and strategy to climate-related risks and opportunities.

Getting started at the sector level

We encourage CREs to start on scenario analysis at a sector level (Figure 2). We are currently preparing guidance on this.

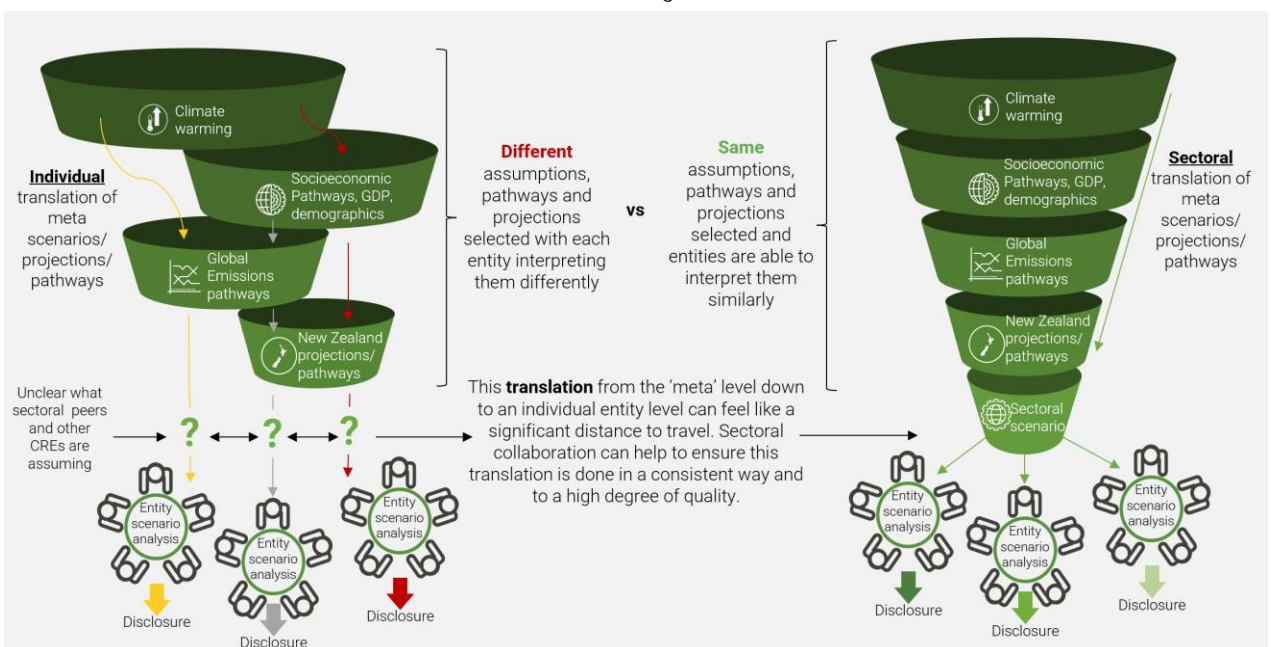


Figure 2: The role of sectoral scenarios in creating a shared scenario architecture for the use of CREs in New Zealand