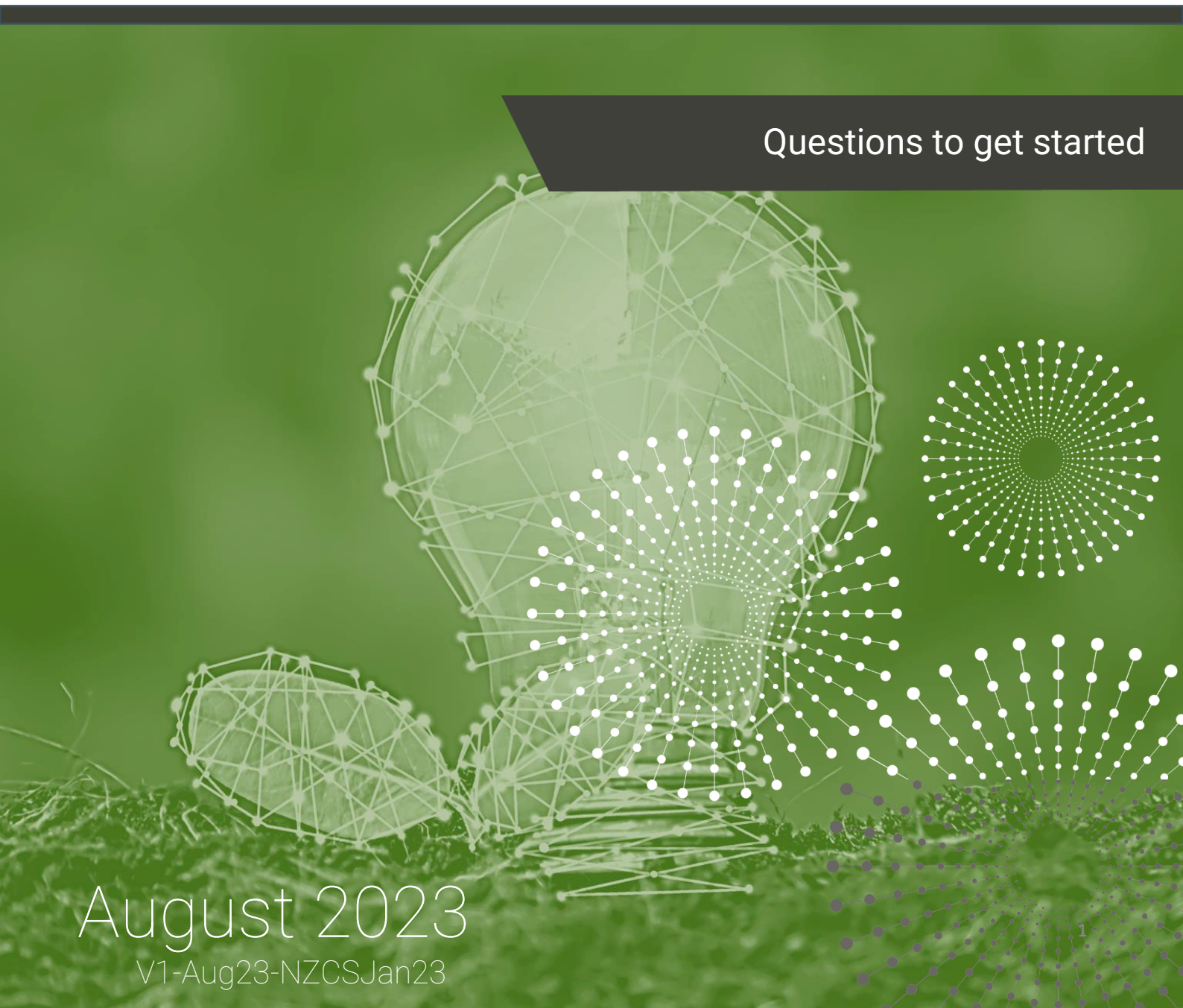
Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Staff Guidance
Transition planning



Questions to get started

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1. Introduction

This document aims to help climate reporting entities (CREs) to get started on transition planning in relation to the requirements in Aotearoa New Zealand Climate Standards (NZ CS).[1],[2] The External Reporting Board will be publishing further, more detailed, guidance on transition planning later in 2023.

2. What is transition planning?

A transition plan is defined in *Climate-related Disclosures (NZ CS 1)* as "an aspect of an entity's overall strategy that describes an entity's targets, including any interim targets, and actions for its transition towards a low-emissions, climate-resilient future".

But what does this mean in practice? Transition planning is about the repositioning and transformation of an entity's business model and strategy in response to climate-related risks and opportunities. It means exploring the options available, charting a pathway informed by the different risks and opportunities identified, and taking tangible actions.

Transition planning enables entities to build resilience to critical uncertainties. This means planning the actions the entity will need to take to maintain its **ability to operate**, generate **sustainable revenue** , protect its **assets**, and **finance** itself in a rapidly changing world.

Status and disclaimer

This guidance is neither mandatory nor binding on entities. It does not have the force of law, nor does it amend, or provide any binding interpretation of NZ CS. Only the Courts can make binding interpretations of climate standards under the Financial Reporting Act 2013.

Entities subject to NZ CS are not required to observe this guidance in order to comply with NZ CS. Nor does observance of this guidance necessarily mean compliance with NZ CS. NZ CS is the definitive statement of requirements.

As stated above, this guidance does not constitute advice. Entities subject to NZ CS must apply their own mind to the standards and take their own advice in considering and applying them.

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Getting from scenario analysis to transition planning

A 'HOW TO' OVERVIEW

How could climate change affect our sector?

What are the critical uncertainties our sector needs to prepare for?

Development of sector scenarios

(optional but recommended)

Benefits

- ✓ Comparability in disclosures
- ✓ Bridge between global and national analysis
- ✓ Rationalise costs
- ✓ Build a cross-sector understanding of climate-related risks;
- ✓ Create sectoral collaboration to address climate-related risks and opportunities

How could climate change affect my entity?

What are the critical uncertainties we need to prepare for?

Are there gaps or weaknesses in our current strategy, business model, and/or operations?

If business as usual is not a credible option anymore, what are my options to become more resilient and seize opportunities?

Entity-level scenario analysis

Benefits

- ✓ Test resilience of business model and strategy under different climate scenarios
- ✓ Identify potential risks and opportunities that could be better managed or harnessed

What are the actions needed to address climate-related risks and opportunities?

When, and how much resource will be dedicated to these actions?

How to survive and thrive in a much more uncertain world?

Transition planning

Benefits

- ✓ The climate-related risks and opportunities identified during the scenario analysis process will likely require changes to the core strategy, governance, risk management practices and systems, and metrics and targets.

This is likely to mean strategic pivots, transformation of operations, and change of business models.

3. Where to start?

3.1 Begin with what the scenario analysis process has uncovered

The scenario analysis process helps an entity to identify its climate-related risks and opportunities and test the resilience of its current strategy under several climate scenarios.

A rigorous scenario analysis process should show that an entity is likely to need to adjust its current business model and strategy to manage identified climate-related risks and opportunities and adapt to a rapidly and radically changing world (see BC41 of NZ CS 1).

Questions to ask

1. What are the **implications** from the different scenarios explored for the entity's business model and strategy? What would the entity need to look like to survive and thrive in each of these scenarios?
2. Are there any **consistent ideas or themes** that came up across the exploration of the different scenarios? This will help to identify **no-regrets options**.
3. What are the **key differences** between scenarios? This will help identify what needs to be **monitored to make long-term decisions**, and what needs to be prepared to anticipate various outcomes.
4. Ask yourself not "*how do we reduce our greenhouse gas emissions*", but rather "***how do we continue to survive and thrive while reducing our greenhouse gas emissions and building resilience, in the context of systemic change?***"

3.2 Ask how uncertainty will be managed over the long term

Because the climate-related scenario process is exploratory, not predictive, it's impossible to know how or whether the scenario narratives will play out in the future. This means an adaptive strategy is needed to manage critical uncertainties over the long term.

Questions to ask

1. What are the **potential options** available to **manage critical uncertainties** in an adaptive strategy? How will these potential options be identified?
2. Which **signals and trigger(s)** will be monitored to inform future decisions?
3. Which **preparatory actions** will be taken to put the entity in the best position as part of its adaptive strategy?

3.3 Determine the tangible actions required now

While transition planning is interested in the long term, it needs to be supported by tangible and credible actions in the short term.

Questions to ask

1. What are the **actions** the entity is going to take, given identified climate-related impacts and anticipated impacts, to achieve a better strategic position and build resilience?
2. **When** will these actions take place, and **how much resource** will be dedicated to them?
3. Are there any **no-regrets options** that can be implemented on a short-term basis?
4. **Where** are resources going to come from to support identified actions?

4. Avoiding misconceptions about transition planning

4.1 Actions rather than dependencies

Transition planning is about identifying **tangible actions** that contribute to achieving the entity's overall strategy, rather than focusing on identifying external factors or events that will need to occur to enable strategic change.

For example, stating that a technology shift will occur when it becomes economically viable is less convincing for an investor compared to explaining that an entity will partner with others to invest in a joint R&D programme over the next five years to support the implementation of specific technology A.

4.2 Not just mitigation

Transition planning is not just about achieving emissions reductions targets (although this is important). It also includes resilience and adaptation-related actions. This relates to the definition in NZ CS that a transition plan is: "*An aspect of an entity's overall strategy that describes an entity's targets, including any interim targets, and actions for its transition towards a* ***low-emissions, climate-resilient future***".

4.3 Integrated into the overall strategy, rather than standalone

The definition of a transition plan is that it is an "***aspect of an entity's overall strategy***…". This means that it should not be a standalone plan, separate to the entity's core strategy. Instead, it should explain what the changes will be to business as usual in terms of key components like operations, revenues, finance etc. that will be required for the entity to survive and thrive long-term.

4.4 Risk and opportunity focused

Transition planning focusing mainly on the present-day cost of actions, without considering the potential cost of not addressing identified climate-related risks, nor the value of identified climate-related opportunities, would fail to address critical questions about the entity's future.

Considering the long-term added value of transition actions, and how they contribute to an adaptive and flexible strategy factoring uncertainties make for a more compelling narrative. This is about balancing short-term versus long-term considerations, as well as resilience versus optimisation.[3]

4.5 Focusing on the entity without consideration of the system

Transition planning should be focused on tangible, entity-specific actions. However, it will also be important to address the interactions and dependencies the entity has with the broader systems it operates in. Assuming all else will remain equal is implausible, therefore it will be important to consider how the entity can contribute to, and rely on others' also transitioning, to ensure the system's ability overall to sustain external shocks is improved.

References

[1] See paragraphs 11(e) and 16 of *Climate-related Disclosures* (NZ CS 1). See also paragraphs BC 31, BC 41, BC 57 and BC 62 of NZ CS 1, and pages 52 and 54 of the Climate-related Disclosures Staff Guidance for All Sectors.

[2] Note that in *Adoption of Aotearoa New Zealand Climate Standards* (NZ CS 2), adoption provision 3 provides CREs with an optional one-year exemption for disclosing the transition planning aspects of its strategy (see paragraphs 15 and 16). However, the adoption provision does require CREs to "provide a description of its progress towards developing the transition plan aspects of its strategy, in its first reporting period".

[3] Many transition pathways developed to date have tended to use a least-cost analysis, such as Integrated Assessment Models (IAMs). But the resulting marginal abatement cost curves (MACCs) can be overly optimistic. If the interaction between climate change and other societal disruptions (such as COVID, war in Ukraine etc.) are considered, it becomes clearer that what appears to be a least-cost pathway to net-zero emissions could in reality become neither least-cost nor achieve net-zero. See Gambhir A and Lempert R (2023), From least cost to least risk: Producing climate change mitigation plans that are resilient to multiple risks.

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