



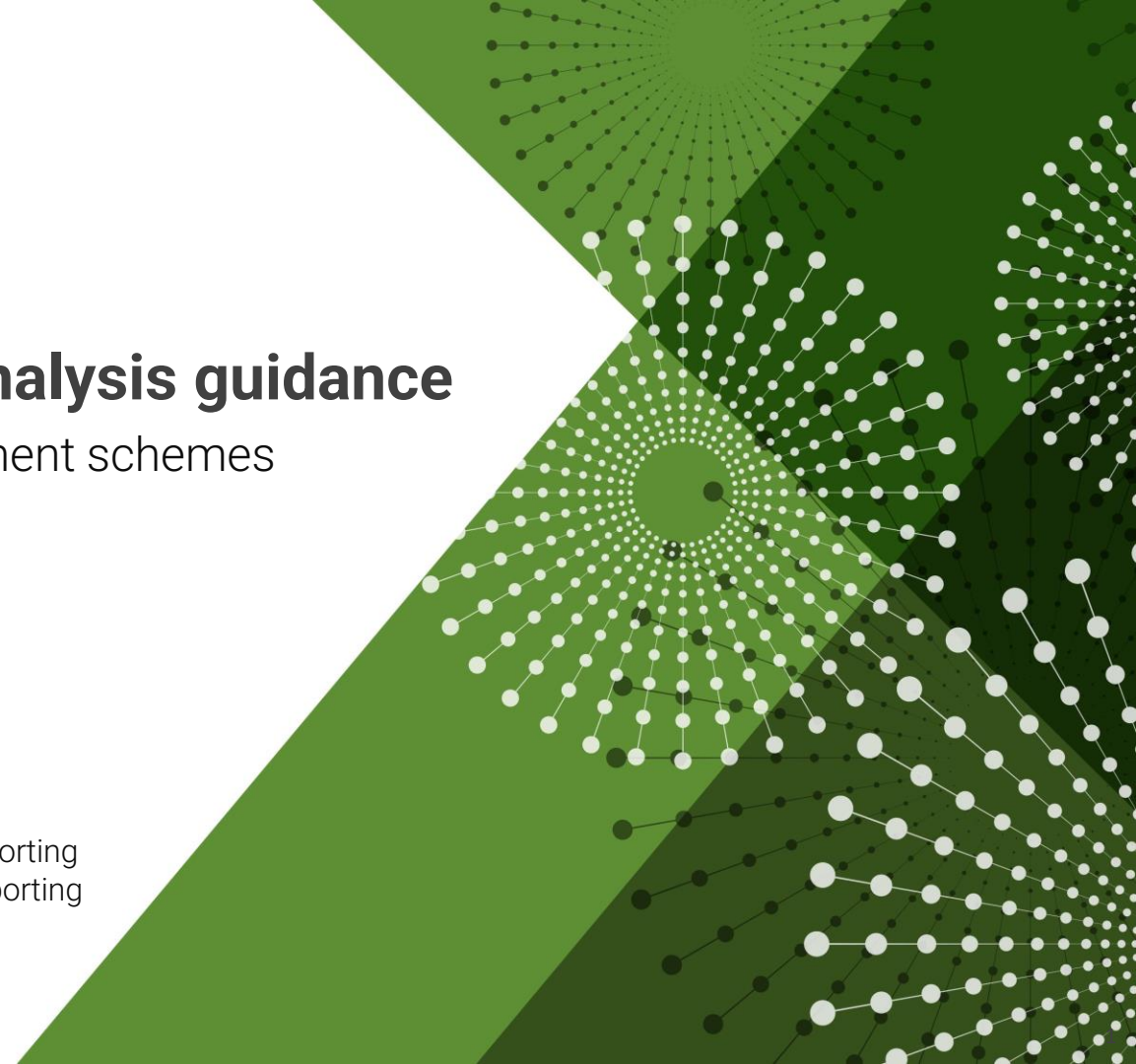
Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Entity-level scenario analysis guidance

Managers of registered investment schemes

Webinar
12 Oct 2023

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Today's presentation



1. MIS Manager specific considerations

International examples of fund managers shifting towards narrative-led approaches

Using sector scenarios



2. The big picture

Being clear on why scenario analysis is being done

Where scenario analysis fits on the journey to transition planning



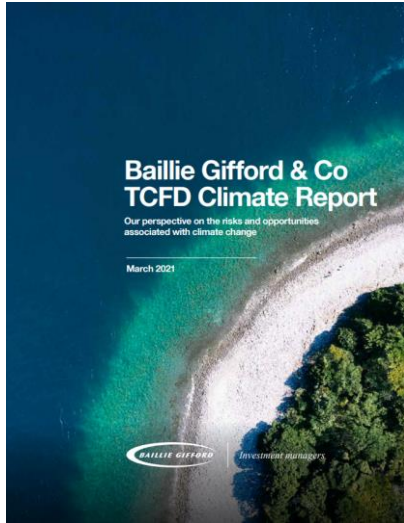
3. The guidance

The six-step scenario analysis process

1. MIS Manager specific considerations

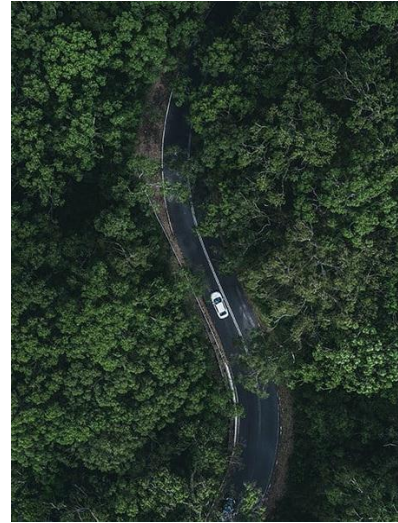


Example disclosures since our guidance was released



In 2021 BG started quantitatively, integrating “the financial impacts of three climate scenario pathways... into the Team’s established model”.

[Baillie Gifford & Co TCFD Climate Report - March 2021](#)



Then in 2022 it “decided to develop our own qualitative climate scenarios... by considering the ways the world could change and people with it rather than focusing on number-based forecasts”.

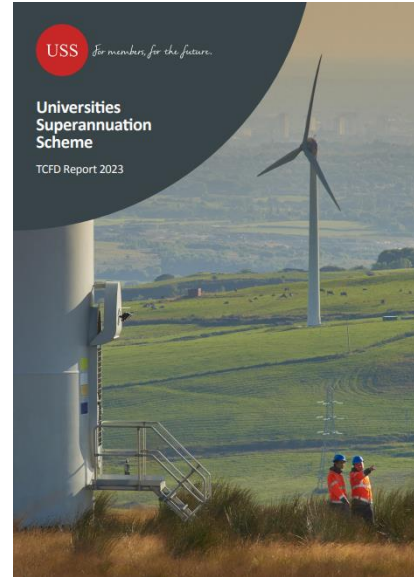
[Climate change: 3 investment scenarios | Baillie Gifford](#)

Example disclosures since our guidance was released



In 2022 USS started quantitatively, using a “an integrated modelling framework” for scenario analysis.

[Responsible Investment activities \(uss.co.uk\)](https://uss.co.uk)



Now in 2023 it is adopting a qualitative, narrative led approach as it “identified significant limitations” with a modelling approach.

[Improving climate analysis with the University of Exeter \(uss.co.uk\)](https://uss.co.uk)

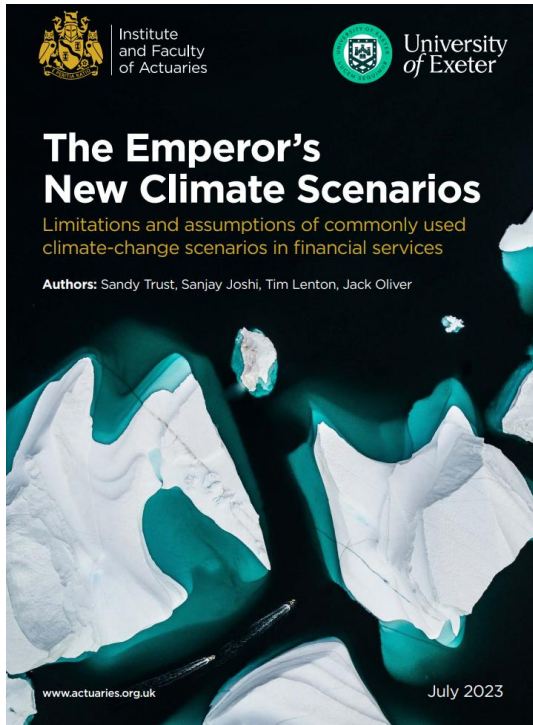
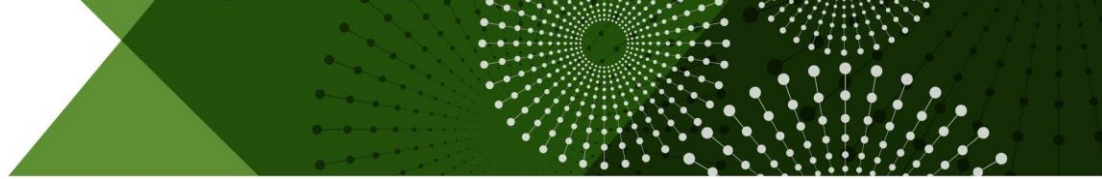
There are rising concerns globally that existing models underestimate climate risk



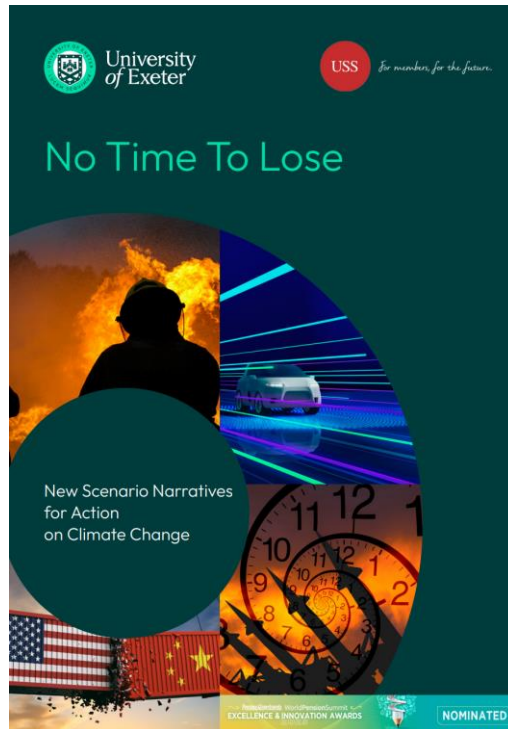
- **To help avoid underestimation:**

- Avoid confusing models with reality
- Follow the six-step scenario analysis method to help ensure impacts are captured that models miss
- Understand that scenario analysis is not modelling
- Improve your understanding of the assumptions and limitations of existing climate scenarios
- Start qualitatively and build in quantification as part of the scenario analysis process
- Don't think of scenario analysis as something 'done to' the fund/s but rather some 'done by' yourself

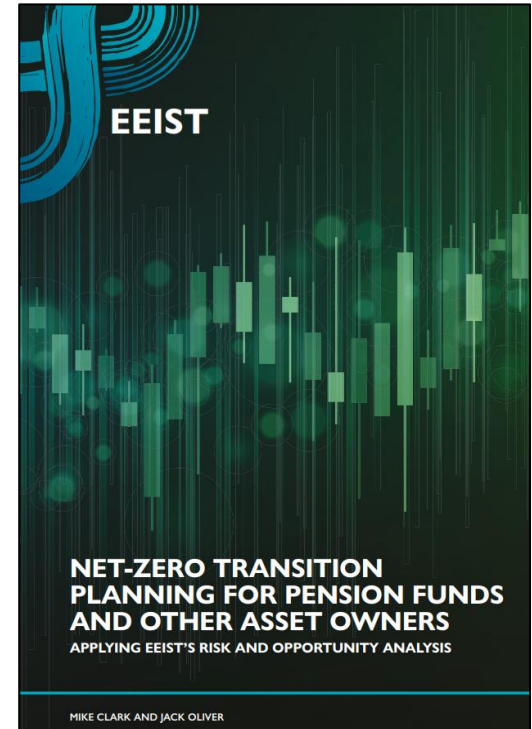
Growing body of helpful resources to navigate this



[actuaries.org.uk](https://www.actuaries.org.uk)



[No-Time-To-Lose-New-Scenario-Narratives](#)



[EEIST-Financial-Sector-report](#)

MIS manager considerations



- **Does scenario analysis need to happen at fund level?**
 - The key purpose needs to relate to testing the resilience of the business model and investment strategy/s relevant to the fund/s.
 - An MIS Manager will need to apply judgement on how best to develop scenarios and undertake scenario analysis—for example, across similar funds or delving into more detail in areas considered to be more exposed to risk, or into certain asset classes.
- See page 38 of our MIS Manager [Guidance](#)

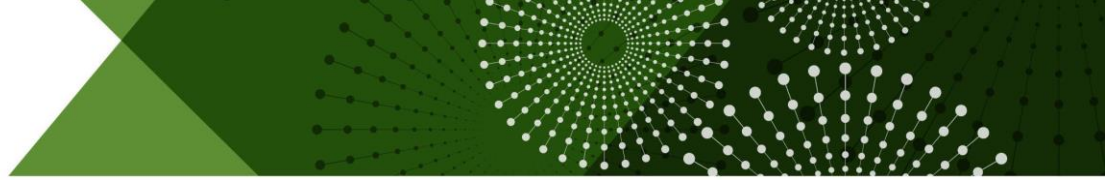
MIS manager considerations

- **Using sector level scenarios**
 - Sector level scenarios exist for MIS Managers to draw from, available on the XRB and FSC websites.
 - This includes whether and how to use existing scenario archetypes.
 - They can act as a reference point to add comparability but shouldn't be directly adopted without careful judgment.
 - MIS managers are responsible for their own scenarios.



[Climate scenario narratives for the financial services sector \(fsc.org.nz\)](https://www.fsc.org.nz)

Current status of sectors



SECTOR	Planning	Stakeholder engagement	Analysis underway	Scenarios complete
Marine				
General insurance				
Tourism				
Banking				
Agriculture				
Property and construction				
Fund Managers, health and life insurance and KiwiSaver providers				
Retail				
Tertiary Education				
Health care				
Transport				
Energy				
Telecommunications				

2. The big picture



Aotearoa New Zealand Climate Standards

“The ultimate aim of Aotearoa New Zealand Climate Standards is to support the allocation of capital towards activities that are consistent with a transition to a low-emissions, climate resilient future.”

Governance

Disclose the oversight of an entity's governance body, and the role management plays.

Strategy

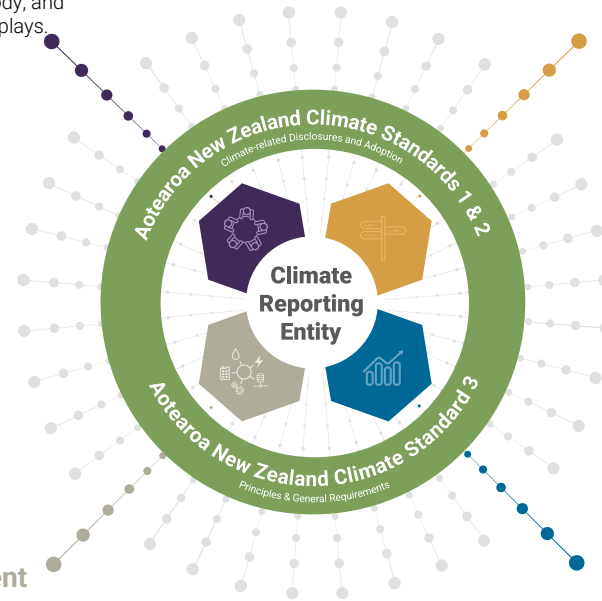
Disclose how climate change is currently impacting an entity and how it may do so in future.

Risk Management

Disclose how an entity identifies, assesses and manages climate-related risks.

Metrics & Targets

Disclose the metrics and targets an entity uses to measure and manage climate-related risks and opportunities.



Defining scenario analysis

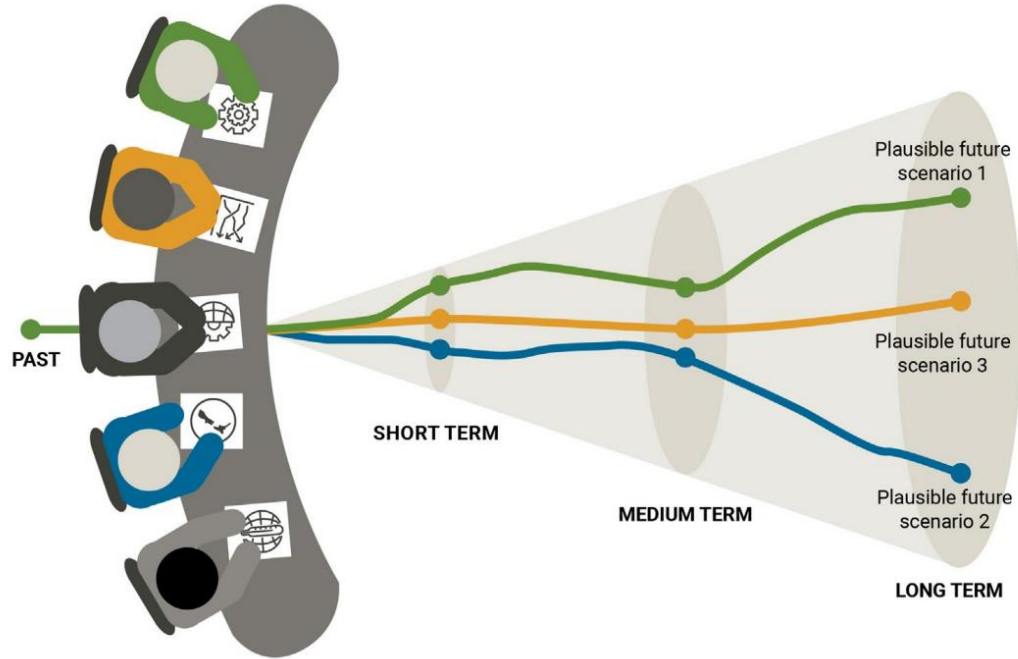


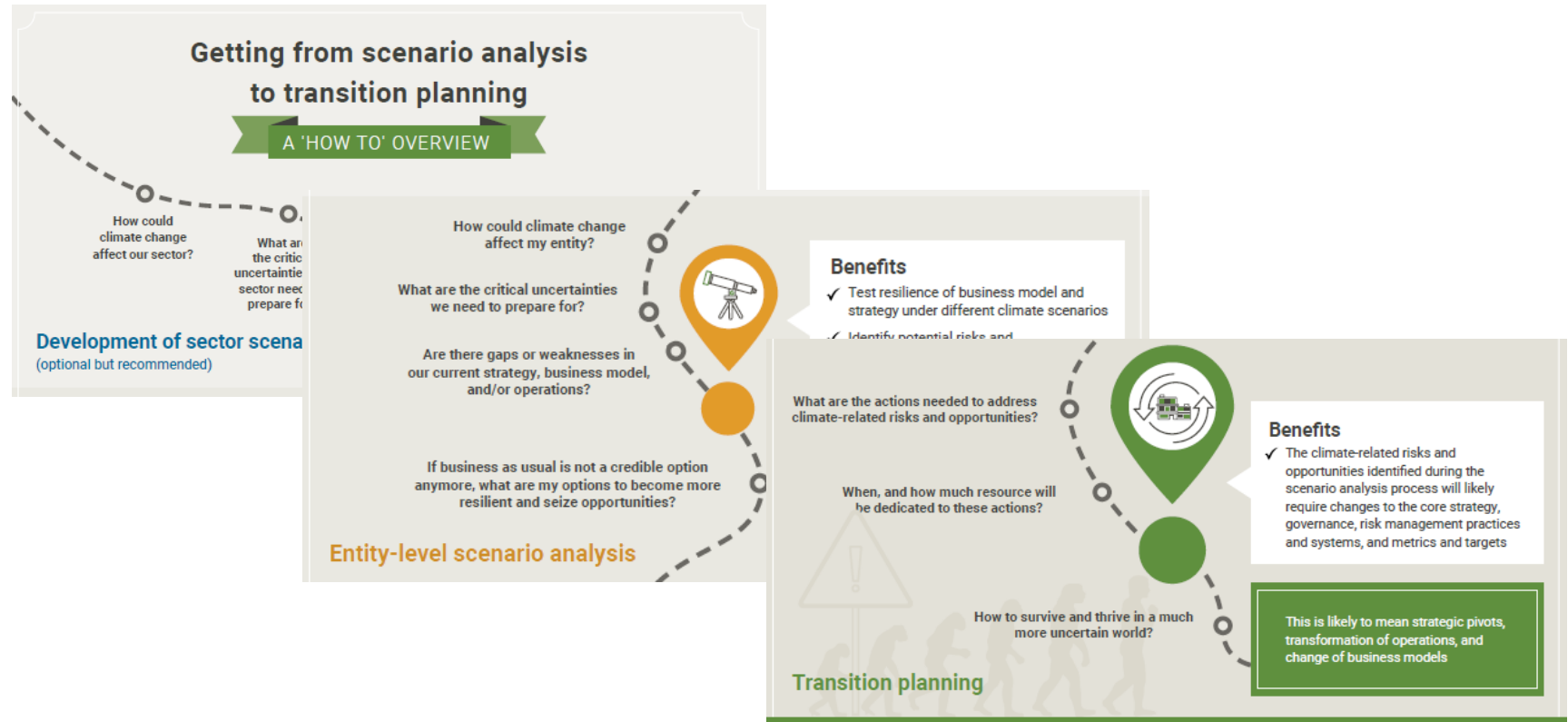
Figure 1: Scenario analysis is a process that an entity engages in (board and management) to help to explore its climate-related risks and opportunities, and develop a better understanding of the resilience of its business model and strategy in the face of the different challenges the scenarios present.

What they are...and are not

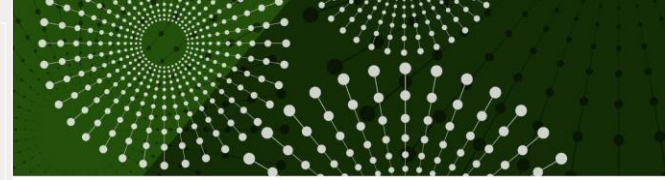
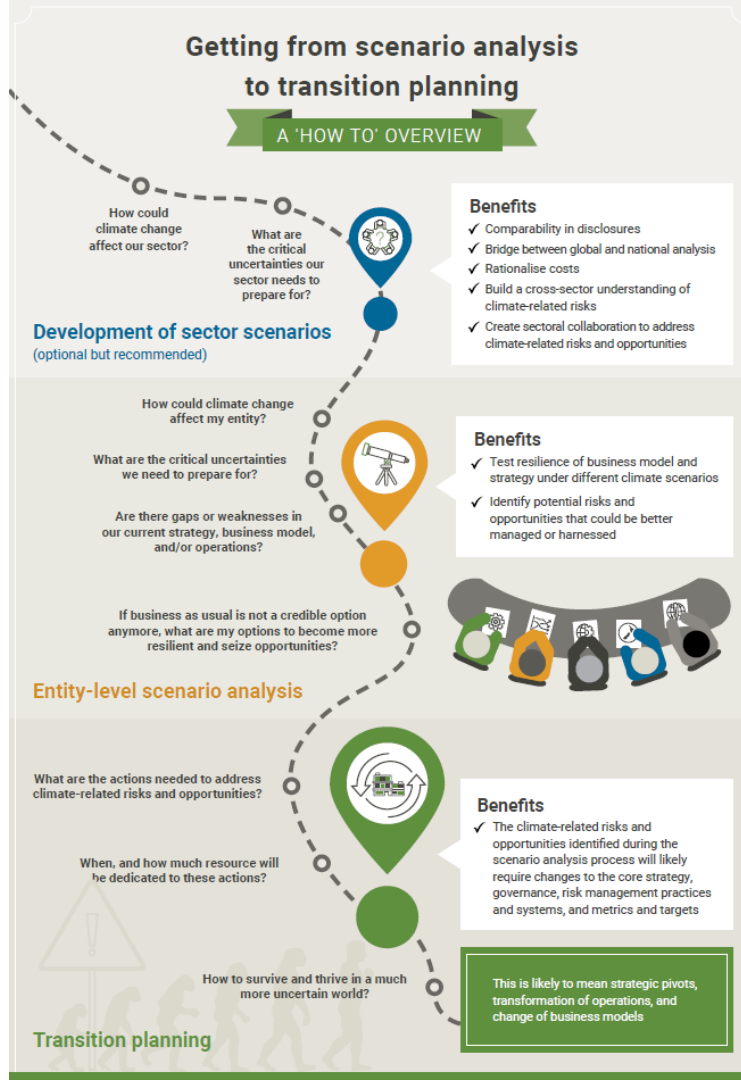
Defining what scenarios are and are not	
ARE	ARE NOT
Products of internal insights and collaborative learning	Products of external consultants
Plausible alternative futures	Probabilistic predictions
Significantly different views of the future	Variations around a single reference case or value
Specific, highly decision-focused views of the future	Generalised views of feared or desired futures
Movies of the evolving dynamics of the future	Snapshot descriptions of an endpoint in time

Table 1: What scenarios are and are not. The TCFD recommend applying these 'rules of engagement' in framing what scenarios are and are not (adapted from³). We recommend entities do likewise in conducting their scenario analysis.

The journey



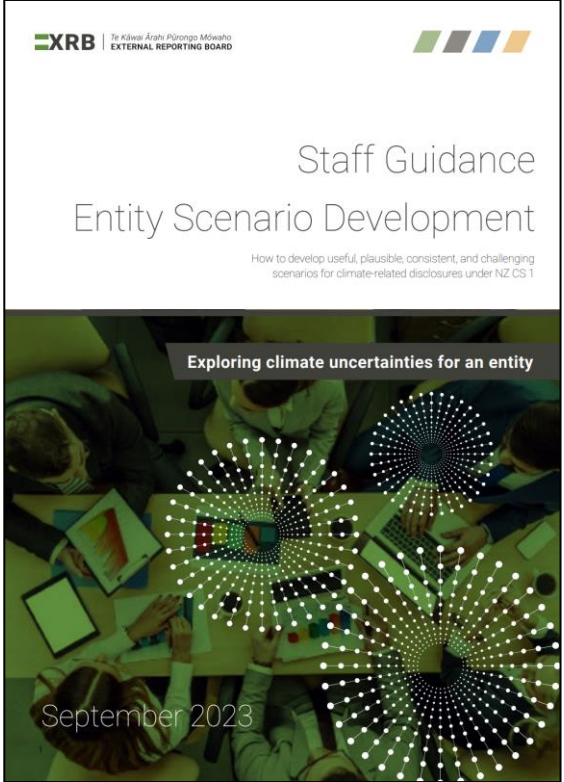
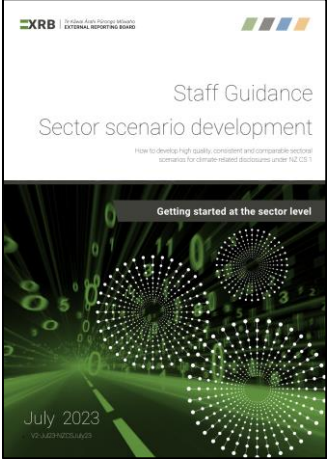
The journey



3. The guidance



How we developed this guidance



Scenario analysis in a nutshell



- **Tried and true method:** a strategy tool that has been used since the 1950s



- When done well, scenario analysis proves **useful and powerful**



- **As much an art as a science:** There are many pitfalls, and cognitive biases need to be confronted



- Useless if not used for decision making...

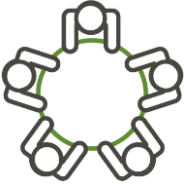
The bright side



- Anyone can do it



- It is scalable



- Improves connections internally and externally

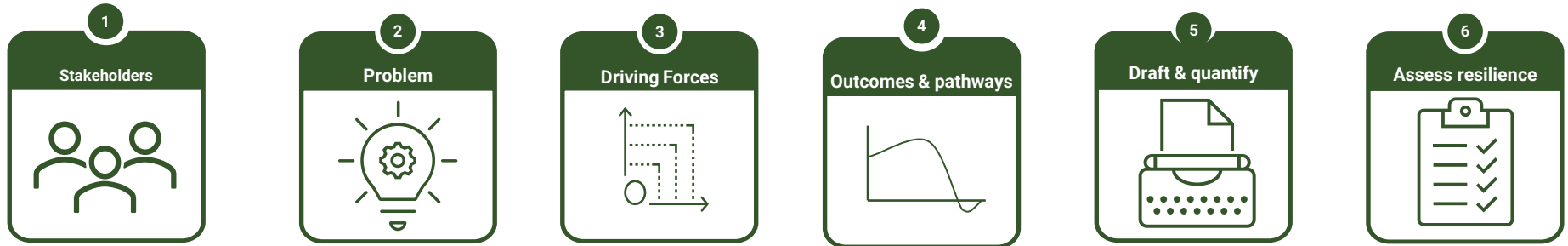


- Useful for identifying opportunities

The six-step scenario analysis process



The six-step process



Each step has:

- **Consistency and comparability** decision points where entities can optimise the alignment of their approach and assumptions
- **Key outputs** which entities might should document
- **Conditions for success** capturing good practice considerations

Step 1



STEP



**Engage
stakeholders and
prepare an
effective group**

KEY TASKS AND PROCESSES

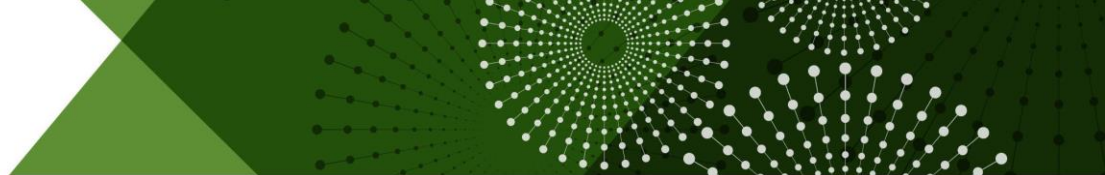
- A strong mandate from the highest governance level is needed
- Coalesce key stakeholders involved with decision-making
- A diversity of perspectives

OUTPUTS

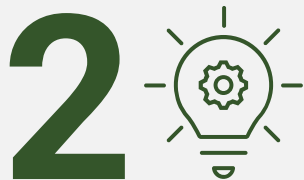


**Briefing
paper, project
charter**

Step 2



STEP



Define the problem

KEY TASKS AND PROCESSES

- Select a focal question
- Define the scope
- Pick time horizons

Consistency and comparability:
Start with the recommended focal question – “How could climate change plausibly affect our business [model and strategy], what should we do, and when?”

OUTPUTS



Focal question, scope, and timeframe

Step 3

STEP



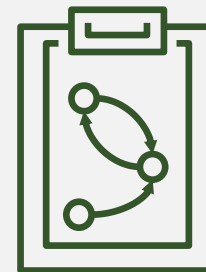
Identify driving forces and critical uncertainties

KEY TASKS AND PROCESSES

- Select driving forces
- Prioritise for their influence & uncertainty
- Select scenario axes
- Develop a simple conceptual model

Consistency and comparability:
Use physical and transition risk scenario axes

OUTPUTS



Driving forces prioritised, scenario axes, conceptual model

Step 4



STEP



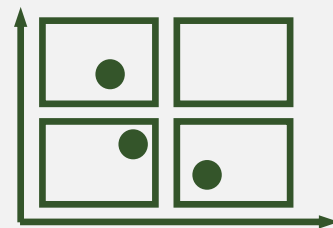
**Select
temperature
outcomes and
pathways**

KEY TASKS AND PROCESSES

- Explore the implications of different pathways
- Select outcome and pathway combinations to structure scenarios

Consistency and comparability:
Develop at least three outcome and pathway combinations

OUTPUTS



**Scenarios from most
relevant and
challenging
pathways**

Step 5

STEP

5



**Draft narratives
and quantify**

KEY TASKS AND PROCESSES

- Draft scenario narratives
- Synthesise existing data from other scenarios & projections
- Be clear why you are quantifying. Start with size of issues

Consistency and comparability:
Use the scenario architectures
employed at sector level / in guidance

OUTPUTS



**Narratives,
quantified where
appropriate**

Step 6



STEP



Assess strategic resilience

KEY TASKS AND PROCESSES

- Quality check
- 'Stress test' under each scenario
- Start drafting strategy options
- Evaluation criteria
- Monitoring signals
- Review

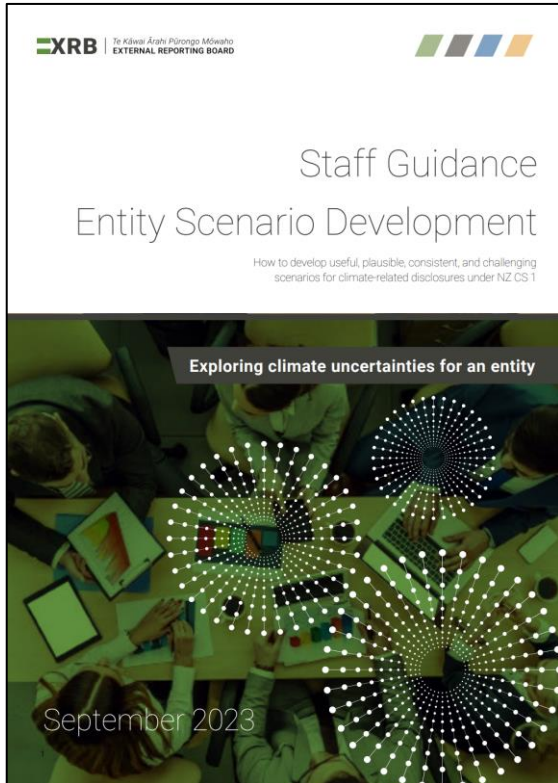
Consistency and comparability:
Take learnings into an ambitious transition plan

OUTPUTS



Final report, monitoring and reiteration plan

Recap of key messages



- This guidance is available now
- Climate scenario analysis will help you improve your investment strategy
- A strong mandate from the highest governance level, and a diversity of perspectives from across your team, are key
- Scenario analysis involves grappling with uncertainty and making judgements
- Achieving climate resilience requires a more adaptive and flexible strategy

Ngā mihi
Pātai?

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