# Navigating Scenario Analysis – a framework for institutional investors

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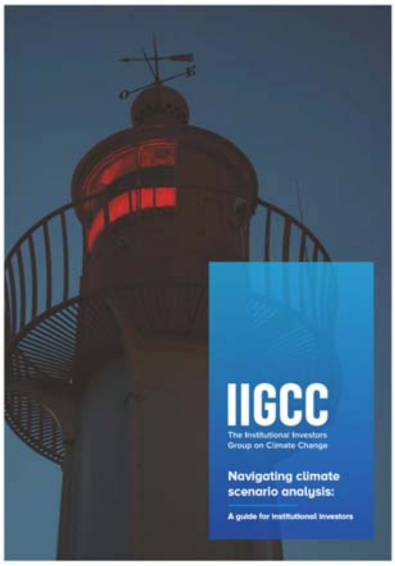
## Introducing the scenarios guide

- Report aims to be a **practical guide** to institutional investors considering scenario analysis
- Based on the discussions of an **expert Working Group** and their real-life experiences of implementing different approaches
- The guide is **not prescriptive** – a key message is that one size does not fit all
- It offers a guide to the **range of available options,** and the benefits and limitations of each



## Framework for action

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## Establishing objectives

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| Objective | Most relevant to: | Feeds into: |
|---|---|---|
| Understand impact of climate change on overall solvency, ability to pay liabilities | Asset owner / fiduciary manager | Asset liability management |
| Incorporate climate change into selection of investments | Asset owner / fiduciary manager<br><br>Fund of funds manager | Strategic asset allocation, manager selection |
| Assess risks / opportunities to financial performance of portfolios, sectors or individual assets | All investors (asset owners and asset managers) | ESG integration processes, identification of investment opportunities, engagement / proxy voting |
| Alignment to a 2°C or lower future | Asset owners with specific climate investment beliefs or objectives<br><br>Mission or values-driven institutions, such as endowments<br><br>Asset managers designing products | Depends on approach taken |

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## Understanding and selecting scenarios

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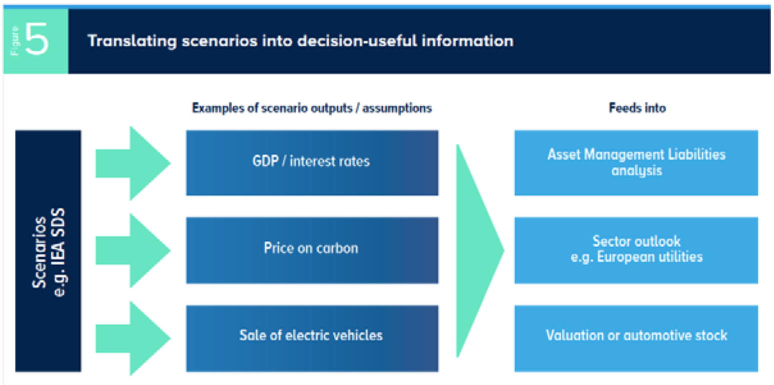
- Two key challenges for investors:
  - Understanding the **assumptions** behind scenarios and how these drive outcomes
  - Translating high-level scenarios into **investment-relevant variables**

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## Applying scenario analysis to investments

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- There is a wide range of approaches – both in-house and service providers
- These can be classified in terms of
  - Alignment or financial risk perspective
  - Top-down or bottom-up approach
  - Covering transition risk, physical risk or both
- Investors need to consider how to balance **comprehensiveness** with **simplicity**


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## Review findings

**What are the main findings of the analysis?**

- **Scale**: What is the order of magnitude of the potential impact?
- **Timeframe**: What can I conclude about the possible timescales over which this will emerge?
- **Asset classes and sectors**: What does my analysis tell me about the differential impact of climate change on different asset classes and/or sectors?
- **Valuation**: Can I draw out lessons from the way I value individual companies or assets (quantitative or qualitative)?
- **Trends and drivers**: What does the analysis tell me about the signals to watch for in order to track climate risks in specific asset classes, sectors or companies?



## Consider actions

**What actions might I take next?**

- Refine or extend the methodology
- Incorporate into risk and investment processes
- Inform company engagement
- Inform stakeholder discussions and disclosure

**How does scenario analysis help me be more responsive to risk?**

- Scenario analysis should be viewed as a dynamic process not a static one – building “memories of the future”