BlackRock

Commentary

BlackRock Investment Stewardship's approach to engagement on climate risk

As an asset manager, BlackRock has a fiduciary responsibility to protect and enhance the value of the assets clients have entrusted to us. Climate change poses risks and opportunities that may impact the long-term financial sustainability of the companies in which we invest[1] on behalf of our clients. For this reason, BlackRock Investment Stewardship (BIS) includes "Environmental Risks and Opportunities" as an engagement priority.

Over the past several years, we have met with companies in order to understand how company leadership and boards are managing, overseeing and disclosing climate-related risks and opportunities.[2] We target three specific outcomes in our engagements with companies regarding climate risk and the transition to a lower carbon economy: better disclosures that will contribute to improved market-level data; substantive action by companies in addressing climate risk; and more informed voting decisions aligned with long-term value creation. In the 12 months to June 30, 2019, BIS engaged with over 200 companies globally on climate risk.

The three outcomes are explained in more depth below. In addition, for a deeper discussion of our engagement on climate risk see BlackRock Investment Stewardship's Approach to Engagement on TCFD and SASB Aligned Reporting.

Consistent and decision-useful disclosures

One reason BIS engages with companies is to encourage more comprehensive and consistent disclosures. Effective disclosures can help investors better understand whether companies are properly managing and overseeing material risks and adequately planning for the long-term. We believe effective disclosure of climate-related risks enables markets to correctly price the financial impact of climate change, which in turn ensures the reallocation of capital resources necessary to transition to a lower carbon economy.

During our engagements, we advocate for disclosures aligned with the reporting frameworks developed by the Task Force on Climate related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB). These frameworks cover the physical, liability, and transition risks associated with climate change and guide companies in providing financially material, decision-useful information that is comparable within each industry.

The TCFD and SASB frameworks provide guidance that answers a question we receive regularly from companies during engagements: 'what should we be reporting to help inform BlackRock's decision-making?' In our initial engagements we found that, while climate risk discussions were increasing internally, many companies had not been following the development of either framework, and some were not considering climate risk an economic issue. Given that both the TCFD and SASB frameworks were finalized within the past three years and require an in-depth review of a company's business, a period of familiarization proved necessary. However, **we believe the period of acclimation is over.** We expect companies to increasingly align their reporting with the recommendations of both frameworks.

Encouraging action on climate-related risks and opportunities

Another objective of our dialogue with companies is to better understand their processes and plans for mitigating climate risks and capitalizing on potential opportunities. Climate risk is no longer linked to only the most carbon intensive industries: practitioners and regulators recognize that it impacts physical operations, drives consumer preferences, and influences regulatory and legal decisions across all markets and sectors. As noted in the Final Recommendations of the TCFD, "climate-related risks and the expected transition to a lower-carbon economy affect most economic sectors and industries . . . . The potential impacts of climate change on organizations . . . . are not only physical and do not manifest only in the long term."[3]

Climate change risks are global, requiring adaptation and resilience of companies world-wide. As the global economy transitions to a lower carbon future,[4] it is in the best interests of companies and markets that the transition is orderly. Equally, we acknowledge the varying levels of dependence on carbon in different economies. Companies will need to assess their operations and vulnerabilities, craft scalable solutions, and consider low-carbon investments, among other initiatives. These changes will require balancing urgency and patience on the part of investors: companies need to adequately address near-term climate risks and opportunities while simultaneously making the necessary internal process and policy adjustments to allow for financial viability well into the future.

To this end, our engagements focus on a company's strategic plan for addressing climate risk in its business and how management and the board are planning for, and devoting the necessary resources to manage those risks and take advantage of opportunities presented by, the energy transition. We expect company leadership to demonstrate a strong understanding of company-specific transition risks including financial, policy, legal, technology, market, reputation and physical risks.[5] Additionally, we expect companies to report efforts to identify and realize opportunities such as product or process innovation, resource efficiencies, new energy sources, and new products and services.[6]

We encourage companies to conduct scenario analysis in line with the International Energy Agency's Sustainable Development Scenario which targets a rise in global temperatures to "well below 2° and pursuing efforts to limit [it] to 1.5°C," consistent with the Paris Agreement.[7] From an engagement standpoint, this includes BIS's request that companies set greenhouse gas reduction targets among other applicable targets.

In support of our objective to encourage market-level progress, BlackRock participated in the Vatican Dialogue "The Energy Transition and Care for Our Common Home" convened by Pope Francis in Rome on June 13-14, 2019. BlackRock was one of the signatories, along with other global investors and energy companies, to the two statements resulting from the dialogue. The first statement, which calls for improved climate risk disclosure, is consistent with BlackRock's support of TCFD-aligned reporting and company-investor engagement as a feedback mechanism.

The second statement advocates for market-based carbon pricing mechanisms to help achieve the significant acceleration of the transition to a low-carbon future necessary to keep global warming below 2°C while advancing human and economic prosperity. Reliable and economically meaningful carbon pricing regimes, "whether based on tax, trading mechanisms or other market-based measures, should be set by governments."[8] They should be set at a level that incentivizes business practices, consumer behavior, research, and investment to significantly advance the energy transition while minimizing the costs to vulnerable communities and supporting economic growth.[9] We engage with companies to understand their position on these issues and to understand how their activities align with and advance the company's publicly stated strategic objectives in relation to climate risk and the energy transition.

BlackRock also joined Climate Action 100+, an investor-led initiative launched in 2017 to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. Through engagement by investor signatories, Climate Action 100+ aims to encourage companies to adopt the corporate governance and business practices that would enable them to publish reporting aligned with the recommendations of the TCFD. This is a natural progression of the work we have done to advocate for enhanced governance practices, target setting, and disclosures.

Informed Voting

Finally, we engage with companies in order to make more informed voting decisions. As an asset manager and a fiduciary on behalf of our clients, our decisions are determined by our assessment of how best to support long-term sustainable financial performance in the context of each company's specific circumstances.

When assessing how to vote, our first step is to understand how a company's corporate governance and business practices support sustainable long-term value creation. This includes how climate risk and the energy transition is managed, overseen, and reported. Our assessment is based on the robustness of corporate disclosures, and how well they align with the SASB and TCFD frameworks. In our direct conversations with company management and independent board members, we seek to understand the underlying policies and activities to address the climate impacts of, and on, the business that inform the disclosures. We engage with companies over time, and often multiple times in any given year. We expect corporate leadership to demonstrate an adequately robust approach to addressing climate risk and the energy transition consistent with its business model and industry. Companies with a holistic and evolving approach should expect our support and continued engagement.

Where corporate disclosures are insufficient to make a thorough assessment or the company is inadequately responsive to our concerns, we will vote against directors, and, where relevant, in favor of shareholder proposals that we believe appropriately address the issue.[10] We view this to be the appropriate escalation where we see a lack of urgency and progress. A company's board of directors is ultimately responsible for protecting the economic interests of shareholders by overseeing long-term corporate strategy and risk management. Therefore, the board of directors should expect to be held accountable if the company is not adequately addressing climate risk.

Conclusion

Climate risk is a significant investment risk, with the potential for financial impacts that reverberate across all industries and markets, affecting long-term shareholder returns as well as economic stability. Solutions require concerted effort on the part of companies, including but not limited to assessing their processes, operations and investments, and continuing to evolve and remain resilient. Climate risk also necessitates better access to relevant data for more sound investment decisions that adequately price these risks. BlackRock's stewardship efforts on climate risk and the energy transition have intensified over time, and we continue to accelerate and evolve our approach. Through our engagement and voting, we aim to continue to advance the management and reporting of climate-related risks, and to encourage companies to harness potential opportunities presented by a low carbon economy. We believe that these efforts are a crucial component of our fiduciary commitment to deliver sustainable long-term financial returns for our clients.

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Endnotes

1. BlackRock, Investment Stewardship is part of our investment function, applying to both active and passive funds. Of the assets we manage 50% are equity assets, and of these, 92% are index and 8% active. The index assets closely track market indexes created by others, which means whether we like a company or not – including its management, its strategy, its products – we will still hold it in these portfolios. This is quite different than actively managed portfolios that can express displeasure by 'voting with their feet' and selling the stock. Given this long-term perspective, our investment stewardship activities are focused on maximizing long-term shareholder value. BlackRock, 2019 3rd Quarter Earnings Release (Data as of Sep. 30, 2019). Available at https://ir.blackrock.com/files/doc_news/archive/4a1e3da1-e31d-4295-a0e8-96eed78aeef2.pdf.
2. In 2017, we published our Approach to Engagement on Climate Risk (updated in 2018 and 2019) available at https://www.blackrock.com/corporate/literature/publication/blk-commentary-engaging-on-climate-risk.pdf.
3. See Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures, available at https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf.
4. The Intergovernmental Panel on Climate Change (IPCC) set forth how 1.5°C and 2°C of warming are likely to affect human populations and natural systems — with a notable escalation of economic and ecosystem impacts between these two temperatures. The IPCC report found that achieving the 1.5°C target would require emissions to decrease to net zero by 2050, necessitating far-reaching transitions across the global economy in energy, land, urban, infrastructure, and industrial systems. Financing the Low-Carbon Future, Climate Finance Leadership Initiative, September 2019 available at https://data.bloomberglp.com/company/sites/55/2019/09/Financing-the-Low-Carbon-Future_CFLI-Full-Report_September-2019.pdf.
5. See 2019 Participant Statement on Climate Risk Disclosures as part of Pope Francis'; Vatican Dialogue "(The) Energy Transition & Care for Our Common Home" ("Vatican Disclosure Statement").
6. Id.
7. See IEA World Energy Outlook 2019 available at https://www.iea.org/reports/world-energy-outlook-2019.
8. 2019 Participant Statement on Carbon Price as part of Pope Francis', Vatican Dialogue "(The) Energy Transition & Care for Our Common Home"("Vatican Carbon Price Statement").
9. Id.
10. Not all markets employ shareholder proposals and not all shareholder proposals are drafted to elicit material, decision useful information for investors. Of the 207 companies BIS engaged with globally on the topic of climate risk in 2019, only 40 companies globally received shareholder proposals related to climate risk, the majority of which were filed in the U.S. and EMEA, and predominantly targeted at the industrials and energy sectors. Yet, as noted above, climate-related risks and the expected transition to a lower-carbon economy affect most economic sectors and industries. Hence, BIS' engagements on the topic over the past several years have spanned 11 GICS industry sectors, across the Americas, Europe and the Middle East, and the Asia Pacific regions.