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BlackRock Puts Sustainability at the Center of Investment Strategy, Expects More Transparency in Sustainability Disclosure.

Was it the heartbreaking photos of scorched koalas in Australia? Was it the pressure from activists such as As You Sow, which submitted a shareholder proposal asking for a report on how the company plans to implement the new Business Roundtable statement of purpose? (See this PubCo post.) Was it the press reports, like this one in the *NYT*, highlighting what appeared to be stark inconsistencies between the company's advocacy positions and its proxy voting record? Was it the protests outside of the company's offices by climate activists? The letters from Senators? The charges of greenwashing? Whatever the precipitating factor, in this year's annual letter to CEOs, Laurence Fink, CEO of BlackRock, the world's largest asset manager, announced a number of initiatives designed to put "sustainability at the center of [BlackRock's] investment approach." What's more, he made clear that companies need to step up their games when it comes to sustainability disclosure.

Ostensibly, none of the factors above triggered the change. In this NPR interview, Fink protested that they were "doing this on behalf of clients. I have not done this with the idea of focusing on any activist groups or any other voice. We are a voice to the investors. Our job is to be speaking on behalf of our investors. And I wrote this letter not as an environmentalist. I wrote this letter as a capitalist." What's more, he told NPR, there was no single event or conversation or news story that "flipped the switch" for him; rather, it was "really the sum of all my conversations in every part of the world with our clients and witnessing their questions about this. And it really became very clear to me—as somebody who'd been in finance for, you know, 44 years, it's very clear to me that we're at a point now where more and more people believe in the science of climate change. More and more people are worried about their portfolios and how their portfolio is going to be performing over a 10-year horizon."

According to Fink's letter, "[c]limate change has become a defining factor in companies' long-term prospects." Although he has seen many financial crises over the course of his long career, in the broad scheme of things, they have all ultimately been relatively short-term in nature. Not so with climate change: "Even if only a fraction of the projected impacts is realized, this is a much more structural, long-term crisis." As a result, "we are on the edge of a fundamental reshaping of finance":

> "Will cities, for example, be able to afford their infrastructure needs as climate risk reshapes the market for municipal bonds? What will happen to the 30-year mortgage—a key building block of finance—if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas? What happens to inflation, and in turn interest rates, if the cost of food climbs from drought and flooding? How can we model economic growth if emerging markets see their productivity decline due to extreme heat and other climate impacts?"

The result, according to Fink, is "a profound reassessment of risk and asset values. And because capital markets pull future risk forward, we will see changes in capital allocation more quickly than we see changes to the climate itself. In the near future—and sooner than most anticipate—there will be a significant reallocation of capital."

Investors are now "recognizing that climate risk is investment risk," making climate change the topic that clients raise most often with BlackRock: what are the physical risks arising out of climate change? How will climate policy affect prices, costs and demand? How should investors modify their portfolios?

Sustainability at the center of investment strategy

Although the investment decisions are ultimately the clients', BlackRock's "investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors. And with the impact of sustainability on investment returns increasing, we believe that sustainable investing is the strongest foundation for client portfolios going forward." What's important, he said on NPR, is making sure that more investors use sustainability as a metric to analyze their investments. BlackRock expects to create the tools, techniques and analytics to navigate the risks and opportunities related to climate change and other sustainability concerns.

To that end, BlackRock announced new initiatives, including "making sustainability integral to portfolio construction and risk management; exiting investments that present a high sustainability-related risk, such as thermal coal producers; launching new investment products that screen fossil fuels; and strengthening our commitment to sustainability and transparency in our investment stewardship activities."

With regard to divestment of coal investments, the NPR interviewer noted that BlackRock "will sell out of all companies that get more than a quarter of their sales from thermal coal. That still leaves some of the biggest coal producers in your portfolio because they do a lot of other things, too." Fink responded that "coal is a very small component of any investment universe." And of course, BlackRock is limited to exiting investments and integrating sustainability considerations into the investment process only in its active strategies and discretionary active portfolios, not its index funds. Of its $7 trillion in assets under management, reportedly about $4.6 trillion is in index funds and ETFs (although ETFs can vary).

A push for better sustainability disclosure

Importantly for companies, Fink maintained that everyone needs to see a "clearer picture of how companies are managing sustainability-related questions. This data should extend beyond climate to questions around how each company serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customers' data. Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders." If companies do not ultimately address sustainability risks, Fink wrote, they will find the markets to be a skeptical bunch; transparency, on the other hand, will attract investment.

Fink advocates adoption of the SASB standards for reporting on sustainability across a wide range of issues and the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) for evaluating and reporting climate risks. (See this PubCo post and this PubCo post.) While BlackRock is itself continuing to work on its own disclosures, as part of its engagement this year, it is asking companies to:

> "(1) publish a disclosure in line with industry-specific SASB guidelines by year-end, if you have not already done so, or disclose a similar set of data in a way that is relevant to your particular business; and (2) disclose climate-related risks in line with the TCFD's recommendations, if you have not already done so. This should include your plan for operating under a scenario where the Paris Agreement's goal of limiting global warming to less than two degrees is fully realized, as expressed by the TCFD guidelines."

BlackRock will use the information to assess companies' risk oversight and planning. Notably, in

> "the absence of robust disclosures, investors, including BlackRock, will increasingly conclude that companies are not adequately managing risk. We believe that when a company is not effectively addressing a material issue, its directors should be held accountable. Last year BlackRock voted against or withheld votes from 4,800 directors at 2,700 different companies. Where we feel companies and boards are not producing effective sustainability disclosures or implementing frameworks for managing these issues, we will hold board members accountable. **Given the groundwork we have already laid engaging on disclosure, and the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."**

What's the impact?

So here's the question: how much impact, if any, will the Fink letter describing Blackrock's new strategy and initiatives have on the CEOs to whom it is addressed? With $7 trillion under management, BlackRock has a loud voice. And, to the extent that shareholders are actually driving this change, the message could be even more persuasive. It also seems likely that BlackRock's disclosure imperative and warning on holding boards and managements accountable for inadequate disclosure will sway many companies in which BlackRock invests. And disclosure is often considered to be an indirect way to compel change (sometimes known as "regulation through humiliation"). However, as Matt Levine observed in his Bloomberg column, how persuasive will the letter be to the CEO of the largely state-owned Saudi oil company, of which BlackRock is reportedly the largest outside shareholder?

What about more broadly—the big picture? Some might say that, historically, Fink's letters have had a major impact: consider, for example, his previous letters regarding the need for a defined corporate purpose (see this PubCo post and this PubCo post), seen by many as an influential precursor to the adoption by the Business Roundtable of a new Statement on the Purpose of a Corporation. That Statement outlined a "modern standard for corporate responsibility" that makes a commitment to all stakeholders and was signed by 181 well-known, high-powered CEOs. (See this PubCo post.)

Writing in the *NYT*, Andrew Ross Sorkin observed that, while previously "many companies and investors have committed to focusing on the environmental impact of business,… none of the largest investors in the country have been willing to make it a central component of their investment strategy." And BlackRock's "green push" takes on even greater significance as the current "administration is going in the opposite direction, repealing and weakening laws aimed at protecting the environment and promoting sustainability." As a consequence, Sorkin viewed BlackRock's change as a “watershed,” a move that “could reshape how corporate America does business and put pressure on other large money managers to follow suit.” So how much impact? Only time will tell.

Here is BlackRock’s related letter to clients and FAQs.

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