Climate-related risk and the energy transition

Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the long-term, durable value creation that our clients depend on to achieve their financial goals. As part of our fiduciary responsibilities as an asset manager to act in our clients’ best interests, we assess a range of risks and opportunities that can affect the financial performance of the companies in which we invest on their behalf. We engage companies to understand their approach to the material drivers of risk and value in their business models, provide feedback and raise any concerns. We may signal continuing concerns through our voting, where clients have authorized us to vote on their behalf. We vote to advance the long-term financial interests of our clients as shareholders.

As an asset manager, BlackRock’s approach to climate-related risk, and the opportunities presented by the energy transition, is based on our fundamental role as a fiduciary to our clients. Our role is to help our clients navigate investment risks and opportunities; it is not our role to engineer a specific decarbonization outcome in the real economy. The money we manage is not our own—it belongs to our clients, many of whom make their own asset allocation and portfolio construction decisions.

As part of this role, we are interested in hearing from the companies in which our clients invest on the impact of climate change and the energy transition on their strategy and long-term business model. We engage on this topic because the way in which companies navigate material climate-related risks and adapt through the energy transition may have a direct financial impact on our clients’ investment outcomes and financial well-being.

While companies in various sectors and geographies may be affected differently by climate change, the energy transition is an investment factor that we expect to be material for many companies and economies around the globe. Within this context, and as stewards of our clients’ assets, we engage companies and encourage them to publish disclosures that help their investors understand how they identify and manage the material risks and opportunities related to climate change and the energy transition.

Climate-related risk and opportunity as an Investment Issue

The effective management and mitigation of climate-related risks, alongside an energy transition, requires a long-term outlook, yet climate impacts are increasingly seen on a near-term, and sometimes, immediate, timeline. These trends are dynamic and will create or impair value across companies and industries, and generate investment risks and opportunities.

Some companies may see this shift as an opportunity—they may decide to mitigate or reduce their contributions to climate change, such as by employing emissions reduction efforts, which may provide efficiency and cost saving opportunities. Other companies may see the energy transition as a risk—they may conclude that their current business model is not consistent with projections for future market or consumer demands, or that failure to plan for the implications of climate change may position them poorly relative to peers to deliver long-term shareholder value. However, these conclusions are not necessarily exclusive; companies may benefit from considering the effects of climate change in the context of both risk and opportunity.

BlackRock research shows that an orderly transition would result in higher economic growth compared with no climate actions, and would create a more constructive macro environment for financial returns for our clients overall. Research has also found that while the transition to a net zero economy can introduce inflationary pressures, an orderly transition is ultimately more likely to boost growth and mitigate inflation, as compared to scenarios in which no efforts are undertaken to manage climate-related risk or in those where there is a highly accelerated rush to decarbonize after delayed action.

As such, BlackRock endeavors to consider climate-related physical and transition risks and opportunities in our clients’ portfolios and to assess asset values in the context of different transition scenarios. As a steward of our clients’ assets, we take a long-term perspective with regard to the future financial performance of companies whose products and strategies could be most affected by the transition, as well as how companies across different sectors and geographies may find
opportunities to capitalize on the technology, products, and solutions needed for an energy transition. We recognize that there are significant financial risks inherent in the transition, including the potential for stranded assets.10

Equally, we are interested in hearing from companies on how they are allocating capital and evaluating investment opportunities, if any, that they envision as a result of the energy transition. For some, this may entail meeting a growing consumer demand for low-carbon versions of products and services—such as transitioning to battery electric or rechargeable versions of durable goods. For others, it may involve investing in and developing current and future low-carbon technologies—such as hydrogen fuel cells for heavy industry and transport. The widescale use of existing technology and further development of emerging solutions are critical to the rate at which emissions can be reduced across sectors and may provide opportunities for companies to expand on business lines and provide clean energy aligned with net zero goals.

We recognize that the speed and shape of the transition is not clear. As an asset management fiduciary to our clients, we seek to understand whether and how companies are navigating this uncertainty. We have found that public disclosures of companies’ scenario analysis, transition plans, and emissions reduction efforts11 better enable the market to quantify company-specific climate-related risk and in turn, better inform investors’ capital allocation decisions and risk/return profiles for companies. As investors, we rely on the boards and management teams of these companies to ultimately steer the strategies they deem most appropriate.

Assessing companies’ preparedness to navigate the energy transition via disclosures

Public disclosures allow investors to evaluate how a company considers climate-related risks and opportunities for the business and to track progress against management’s stated goals.

We encourage disclosures aligned with the reporting framework developed by the Task Force on Climate-related Financial Disclosures (TCFD). We welcome efforts by the International Sustainability Standards Board (ISSB) to develop a global baseline of sustainability reporting standards.12 We believe that a global baseline, on which policy makers in different jurisdictions can build to meet their policy objectives, may help increase the quality of information available to investors, while reducing the reporting burden on companies. The ISSB is building on many of the reporting frameworks developed to date, particularly the pillars of the TCFD—governance, strategy, risk management, and metrics and targets—and the industry-specific metrics identified by the Sustainability Accounting Standards Board (SASB). In our experience, this framing helps companies disclose how they identify, assess, manage, and oversee a variety of material sustainability-related risks and opportunities in their business models.

Consistent with the TCFD, investors have greater clarity—and ability to assess risk—when companies detail how their business model aligns to a range of climate-related scenarios, including a scenario in which global warming is limited to well below 2°C, and considering global ambitions to achieve a limit of 1.5°C.13

We are better able to assess preparedness when companies disclose short-, medium-, and long-term targets, ideally science-based where these are available for their sector, for scope 1 and 2 greenhouse gas emissions (GHG) reductions and to demonstrate how their targets are consistent with the long-term financial interests of their shareholders.

As investors, it is also helpful to be able to evaluate companies’ assessments of their emissions across their value chain, or scope 3 emissions, where appropriate, and efforts to reduce them over time. A growing number of companies have started disclosing scope 3 reduction targets, which provide important insight into the full carbon component of companies’ goods and services. This further allows investors to evaluate the long-term risks to and resilience of companies’ value chains.

However, we fully recognize that the methodology, accounting, assurance, and regulatory landscape for scope 3 emissions is complex, varied, and still evolving—double counting is also a legitimate concern. Accordingly, we understand that the scope 3 disclosures that companies are able make will necessarily be on a good faith and best-efforts basis. We believe regulators can support these efforts by requiring disclosure from public and private companies, while providing safe harbor protections in case companies need to restate their scope 3 emissions in the future.14

Where companies utilize carbon offsets to advance carbon neutrality goals, we look for disclosures detailing how the offsets are evaluated and assessed for their permanence and additionality, as well as for leakage. We see carbon offsets as a complement to, not a replacement for, companies’ substantive and sustained long-term emissions reductions plans. These instruments should not detract from or disincentivize efforts to reduce emissions.

How we engage with companies on the energy transition

When discussing climate- and transition-related risks with companies, we take into consideration the reality that the energy transition presents different challenges and potential rates of change for companies across sectors. With this in mind, we
focus our conversations where the transition is most likely to materially impact a company’s performance. To help prioritize these conversations, the BIS Climate Universe includes over 1,000 companies and represents nearly 90% of the global scope 1 and 2 GHG emissions of the public companies in which BlackRock invests on behalf of our clients.¹⁵

Companies determine the best approach for addressing their climate-related risks and opportunities. However, it is helpful for long-term investors like BlackRock to understand, where relevant, whether and how:

- The board and management assess climate-related risks and opportunities relevant to the company’s strategy and operations and how this may impact the company’s long-term performance
- The board and management consider shifting demand for goods and services due to changes in regulation, technology, and/or consumer preferences that may result from the energy transition
- The company measures its current emissions baseline, sets short-, medium-, and long-term science-based emissions reduction targets, where available, and evaluates resilience to scenarios, including decarbonization pathways well below 2°C, and considering global ambitions to achieve a limit of 1.5°C
- The company executes year-on-year, or over a series of years, against its stated emissions reduction goals and other climate-risk related efforts
- The company incorporates climate-related risk and opportunities in its capital allocation decisions, including investments in sustainable solutions, emerging technologies, renewable energy, and/or low-carbon products—and how such investments support the long-term economic interests of shareholders
- The company considers and, if relevant, quantifies, and accounts for material climate-related risks in its financial statements, including if the company explains such risks within the context of its audit report and/or as part of the company’s strategic planning and performance outlook¹⁶

We recognize that companies cannot deliver the necessary technologies, solutions, and innovation required for the energy transition in isolation. A range of stakeholders, including policy makers and consumers, have a role to play in the global energy transition—including accounting for market forces and supply and demand—with consideration to the global economy’s current dependence on traditional energy sources and the parallel need to invest in cleaner energy alternatives and other technologies. In our engagements we may also discuss how companies see their role in achieving that equilibrium.
Endnotes
1. This commentary should be read in conjunction with BIS’ Global Principles and market-specific voting guidelines. Other materials on the BlackRock website might also provide useful context.
2. In this paper, we make frequent reference to terminology pertaining to the transition to a low-carbon economy. The Intergovernmental Panel on Climate Change provides a helpful glossary for this terminology.
3. We recognize that companies in different markets are adapting to the energy transition in varying contexts as a result of differences in the current regulatory landscape. Future regulatory changes to support countries in meeting their national commitments to reach peak emissions will also impact companies’ long-term energy strategies. For example, the Inflation Reduction Act in the U.S. creating significant opportunities for investors to allocate capital to the energy transition. This legislation commits an estimated $369 billion for investment in energy security and climate change mitigation. European governments are also developing incentives to support the transition to a net zero economy and drive growth.
6. Throughout this publication, our reference to “net zero” refers to “net zero GHG” emission rather than “net zero carbon dioxide” emissions. We are aware that the goal for a net zero GHG economy is technically more ambitious than the current pathways outlined for a 1.5-degree scenario. In scenarios limiting warming to 1.5 degrees C, carbon dioxide (CO2) needs to reach net-zero between 2044 and 2052, and total GHG emissions must reach net-zero between 2063 and 2068. Reaching net zero earlier in the range avoids a risk of temporarily overshooting 1.5 degrees C. https://www.wri.org/insights/net-zero-ghg-emissions-questions-answered.
8. Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organizations, such as direct damage to assets and indirect impacts from supply chain disruption. Source, TCFD.
9. Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations. Source, TCFD.
10. Stranded assets are those that at some time prior to their anticipated useful life are no longer able to earn an economic return as a result of changes associated with the transition to a low-carbon economy; these assets are worth less than expected as result of changes associated with the energy transition. Stranded assets can include construction costs that may not be recouped; capital that has to be retired before being amortized; loss of premiums or loss of insurance coverage; unanticipated or premature write-downs; and oil and gas resources that are owned but are no longer profitable to extract.
12. The International Sustainability Standards Board (ISSB) announced in November 2021 the formation of an International Sustainability Standards Board (ISSB) to develop a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors’ information needs. SASB standards will over time be adapted to ISSB standards but are the reference reporting tool in the meantime.
13. The global aspiration to achieve a net-zero global economy by 2050 is reflective of aggregated efforts; governments representing over 90% of GDP have committed to move to net-zero over the coming decades. In determining how to vote on behalf of clients who have authorized us to do so, we look to companies to define their own timelines, but to understand how companies consider emissions reduction efforts over the years as they transition toward net zero. Consistent with guidance from TCFD, specifying exact timeframes across sectors could hinder organizations’ consideration of climate-related risks and opportunities specific to their businesses. We encourage companies to decide how to define their own timeframes according to the life of their assets, the profile of the climate-related risks they face, and the sectors and geographies in which they operate.

Want to know more?
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