

Commentary

Emissions, Engagement, and Transition to a Low-Carbon Economy

BlackRock's Investment Stewardship team (BIS) regularly engages with companies to understand how material environmental, social, and governance factors are considered from the perspective of risk and opportunity. The topic of greenhouse gas (GHG) emissions is a key focus area in our engagements with companies as consensus grows around the impact of climate change on financial markets, companies' performance, and society more broadly. This is creating challenges that can fundamentally shape the outlook of companies and their potential for long-term, sustainable value creation.

Consistent Reporting and Disclosure is Critical

The intensity and materiality of GHG emissions varies widely across industries. Investors and asset managers, such as BlackRock, need more data about these challenges and how the companies in which we invest on behalf of our clients are managing climate-related risks and opportunities. In order to better understand these risks and opportunities, we seek to engage companies on this topic through a tri-fold approach:

1 Mitigating risk

Most scientific studies and research show that increased emissions globally are intensifying the impacts of climate change, including sea level rise and extreme weather events, which in turn impact every aspect of the economy—logistics, travel, food production, health, infrastructure, etc.¹ Some regulators are aligning on a low-carbon transition via carbon taxes, electric vehicles, energy efficiency, etc. Companies need to manage the impacts that these material risks have on their business operations. In addition, adaption measures around these dual trends of increased scientific consensus and regulatory mandates indicate a company's preparedness.

2 Articulating opportunity

Careful consideration and evaluation of a company's carbon footprint may lead to operational efficiencies—decreased energy use, streamlined manufacturing processes, technology enhancements to reduce waste, etc. can ultimately increase long-term shareholder value. Advances in green technologies and responsiveness to changing investor and consumer preferences may indicate a company's preparedness to realize future profit opportunities.

3 Innovation and sustainability

Innovation and sustainability are inherently linked. Companies that appropriately manage and mitigate material ESG risks to their business and produce viable solutions to address changing market demands are best poised to capture additional market share as consumer preferences, regulation, and global demand shift.

Consistent with our engagements, we believe that the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) frameworks are useful tools for measuring and tracking material climate risk, emissions, and energy-related data. As we have noted in a previous [commentary](#), we believe the TCFD and SASB frameworks are highly complementary; companies are well-served to consider them in tandem.

Together, the TCFD and SASB frameworks consider the physical, financial, and transition risks associated with climate change and provide guidance to companies for disclosing financially-material, decision-useful information that is comparable within each industry. While companies in various markets may have historically disclosed material environmental and social risks, including stakeholder and shareholder considerations, in a variety of formats, we focus on TCFD and SASB-aligned reporting because it is relevant to investment decision-making and streamlines the available data in a way that is globally comparable, consistent, and concise.

As long-term investors, the ability to review companies' annual disclosures of material environmental, social, and governance (ESG) risk can be useful in two primary ways:

1. It gives investors insight into how boards and management teams evaluate and integrate material ESG impacts on companies' day-to-day business and operations, and how these issues are accounted for in long-term planning and strategy setting. It may give investors an indication of operational excellence, efficiency, risk oversight, and effective governance structures. Consistent with the TCFD recommendations, we expect companies to show appropriate board-level oversight of climate risk considerations, in conjunction with emissions reductions efforts, if/as appropriate.
2. By monitoring progress against articulated, rigorous metrics and targets, investors can better evaluate the risk/return profile of their investment by considering the likelihood of appropriate structural oversight and the potential for financial implications in the future. In addition, transparent and consistent reporting allows investors to hold boards and management accountable for progress against public commitments.

While comparable and material data are key inputs, we seek some description from companies on how these inputs and targets are integrated into overall strategy and which constitute relevant business/operational risks monitored by the board.

Transitioning to a Low-Carbon Economy

Since the publication of our engagement priorities in 2017, the topics of climate change and environmental risk and opportunity have evolved.

Our engagements are focused on material risk, approaching the topic on a sector- and company-specific basis. Our current discussions also underscore an increasing sense of urgency—we expect companies to articulate a timeframe for change and transition.

Regulation, potential tax implications, shifting market demands, and intensifying grassroots campaigns globally create pressures for companies to consider how their businesses are best aligned for long-term, sustainable value creation. However, regardless of the push/pull factors directing corporate actions, BIS focuses on risks and opportunities associated with these topics across all of our engagements. Companies that are not measuring, managing, and considering necessary investment to reduce their GHG emissions and environmental footprint, if material, are not critically evaluating their businesses. We are interested to know: how are companies planning to operate in a carbon-constrained world; what are the impacts of policies such as a carbon tax, fuel, and/or efficiency standards to profitability; what are the processes for modeling or discussing these issues?

Rigorous Targets

There is a growing body of evidence that shows that “two degrees” of global warming is the threshold after which the most destructive² impacts of climate change will be largely unavoidable (and some studies suggests that we will see more extreme outcomes closer to the 1.5 degrees threshold).³ However, considering this goal in isolation, company by company, can be daunting. As we engage with companies on the topic of emissions, understanding the rigor of the established targets, as well as the evolving regulatory backdrop and the transition risks relevant to the countries in which they operate, are important components when assessing impact, risk mitigation, and urgency.

The path towards decreased emissions may not be linear or streamlined; however, companies should provide adequate disclosure so investors can assess progress towards stated goals and articulate strategic changes that may impact progress, either negatively or positively. Companies critically evaluating their current baseline, anticipating market change, and acting on an accelerated timeline are those most likely to avoid operational disruption in the future and experience a smoother transition to a low-carbon economy.

For some sectors, this may involve disclosing a range of resilience strategies, including stress tests under a variety of low-carbon scenarios, in conjunction with climate-related capital allocation plans. For others, this may involve portfolio alignment for the future and the potential shift in market positioning.

Energy Source

A crucial driver of global GHG emissions is the global energy mix. While fossil fuels have long dominated the global energy mix, innovation in renewable technologies is leading to profound changes in the production and consumption of energy. The expansion of the renewable energy sector (inclusive of solar, wind, hydro, tidal, geothermal, bioenergy, nuclear, hydrogen, and fuel cells) is driven by advances in technology, falling costs, public policy, and regulatory support. In turn, this growth is generating economic opportunities, while also helping to mitigate the effects of climate change.

In 2019, global energy-related carbon emissions were flat, after two years of steadily increasing. This was largely because of the expansion of renewable energy capacity, fuel switching, and higher nuclear output in the power sector, according to the International Energy Agency (IEA).⁴ Renewable power capacity is expected to grow by 50% between 2019 and 2024, with solar photovoltaic (PV) expected to account for nearly 60% of that growth.⁵

Despite these striking growth forecasts, renewable energy sources remain a small portion of the current global energy mix. As the world transitions to a low-carbon future, global energy demand will be met through a diverse mix of energy sources, including fossil fuels.

For companies, the expansion of renewable energy sources presents opportunities and risks depending on the sector and location. The transition to a lower-carbon economy is a multi-faceted process, particularly when considered in the context of energy needed for corporate, industrial, and manufacturing processes. Viable energy sources for these processes vary as well.

For companies across a variety of sectors, the feasibility of integrating renewable energy via direct sourcing (such as the installation of wind turbines or solar panels) or incorporating the electrification of certain processes via renewable grid energy will vary. However, just as important as tracking progress towards emissions reductions targets, we are interested to know how companies are achieving stated goals, what source of energy is available for essential business operations, and the corresponding investment required to implement any structural or procedural changes.

Measuring Progress

Underlying our desire for greater disclosure on emissions baselines, reduction targets, and forward-looking goals is a fundamental view that climate risk is investment risk.

When companies consider alternate models of future energy supply, delivered via technology gains or regulatory constraints, they can plan appropriately. When companies improve the efficiency of existing operations through carbon reductions, water use, or waste output, invest in new technologies, or signal management's willingness to commit to low-carbon pathways, investors gain confidence in companies' ability to mitigate risk in certain scenarios.

In order to assess progress, we seek to understand how companies are considering longer-term sustainability themes alongside day-to-day business operations via public disclosure reflective of TCFD and SASB-aligned reporting.

Where companies have failed to consider material climate-related risk, they may also have failed to recognize key business risk. It is critical for companies to provide informative disclosures that help investors ascertain whether they are properly managing and overseeing these risks within their business strategy, operations, and risk assessments. In the absence of robust disclosures, investors may conclude that the board has failed to effectively oversee risk.⁶ In these instances where progress is lacking, disclosure is inadequate, or the company has failed to effectively mitigate climate-related risk, we may consider votes against directors or support for relevant shareholder proposals as a means to protecting long-term shareholder value.

As long-term investors, we believe that a better understanding of a company's approach to, and risk exposure in, various climate scenarios can help us best steward our clients' assets.

-
1. See "A Fundamental Reshaping of Finance", BlackRock CEO Larry Fink's 2020 letter to CEOs, <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>
 2. See "5 things we learned about climate change at Davos 2020", the World Economic Forum, <https://www.weforum.org/agenda/2020/01/climate-change-crisis-what-we-learned-at-davos-2020/>
 3. See, "Global Warming of 1.5 degrees C", The United Nations' Intergovernmental Panel On Climate Change, <https://www.ipcc.ch/sr15/>
 4. See "Global CO2 emissions in 2019", the International Energy Agency, <https://www.iea.org/articles/global-co2-emissions-in-2019>
 5. See "Renewables 2019", the International Energy Agency, <https://www.iea.org/reports/renewables-2019#>
 6. See "A Fundamental Reshaping of Finance", BlackRock CEO Larry Fink's 2020 letter to CEOs, <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

Contact BlackRock Investment Stewardship at contactstewardship@blackrock.com