BlackRock is pleased to have the opportunity to respond to the FCA's discussion paper, “Finance for positive sustainable change: governance, incentives and competence in regulated firms” (the “Discussion Paper”). We will continue to contribute to the thinking of the FCA on these issues, and welcome further discussion of any of the points that we have raised.

Yours faithfully,

Michelle Edkins
Managing Director
BlackRock Investment Stewardship

Sarah Matthews
Director
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Executive summary

BlackRock is pleased to have the opportunity to respond to the FCA’s Discussion Paper, “Finance for positive sustainable change”, and contribute to the dialogue on the governance of material sustainability-related risks and opportunities at regulated firms. In our view, such risks and opportunities include a wide range of drivers of risk and financial value creation in a company’s business model that have an environmental or social dependency or impact. While the Discussion Paper seeks input from financial services firms, including both asset managers and asset owners, we believe it is necessary to more clearly differentiate between them, to reflect the relationship between asset managers and their clients. BlackRock’s clients include public and private pension plans, insurers, official institutions, endowments, universities, charities, family offices, wealth managers, and, ultimately, the individual investors that they serve. The extent to which we include material sustainability-related considerations in managing their assets may vary according to their differing objectives and asset allocation decisions.

In our view, investors can make better-informed investment decision when companies provide a clear picture of how they are managing material risks and opportunities, including when appropriate, any material sustainability-related risks and opportunities. BlackRock encourages disclosures aligned with the reporting framework developed by the Task Force on Climate-related Financial Disclosures (TCFD), and welcomes efforts by the International Sustainability Standards Board (ISSB) to develop baseline sustainability reporting standards. We welcome the incorporation of TCFD-aligned disclosures into the UK regulatory framework, and support the FCA’s proposal to evolve the UK’s sustainability disclosure requirements over time, in line with the ISSB standards. We view the work of the ISSB as an important contribution to a multi-jurisdictional effort towards a set of interoperable sustainability reporting standards, that will improve the availability, quality, comparability, and timeliness of sustainability-related disclosures globally. As well as providing reporting frameworks, both the TCFD and ISSB standards are sector-neutral tools to help companies embed the consideration of material sustainability-related risks and opportunities into their governance, strategy and risk management.

Stewardship can play a role in encouraging investee companies to disclose whether and how material sustainability-related risks and opportunities, among other considerations that can impact long-term financial performance, are integrated into strategy and operations. However, it is the responsibility of a company’s board and management to determine the appropriate approach to material drivers of risk and value in its business model. In our view, stewardship should not be considered a channel for driving sustainability outcomes, or as a net zero transition mechanism as the FCA proposes. Rather, stewardship engagement and voting, when authorized by clients, should be seen as one of the many ways that investment managers interact with investee companies, as they believe best serves the long-term interests of their clients.

In our view, there is no single way to exercise effective stewardship, or to structure the governance and resourcing of stewardship functions. That said, we outline below principles that firms might draw on in their pursuit of effective stewardship. These include having a clear purpose to their stewardship activities, processes that support constructive oversight of investee companies, engagement as necessary and challenge as appropriate, internal structures, policies and culture that contribute to an effective stewardship programme, and disclosures that help an investor’s clients and others understand their approach.

The purpose of stewardship by asset managers is to advance the long-term financial interests of their clients as investors in companies, not to directly seek outcomes related to the financial system as a whole, which is, in our view, the role of policy makers. Requiring managers to use stewardship as a means of seeking to impose policy changes on the companies in which they invest on behalf of their clients could potentially be at odds with their legal and contractual responsibilities to those clients. However, encouraging practices that support long-term financial value creation, and strong corporate governance that addresses risks and opportunities material to a company, is likely to lead to long-term benefits not just for asset owners, but the broader economy.
Sustainability-related governance, renumeration and incentives at regulated firms

Addressing material sustainability-related risks and opportunities within company governance, strategy, and risk management

As an asset manager, BlackRock approaches sustainability-related considerations from two main perspectives:

1. As a fiduciary with a responsibility to manage material risks to client portfolios, including material sustainability-related risks, within the bounds of BlackRock’s clients’ guidelines and objectives;

2. As a corporate entity, whose business is affected by sustainability-related risks and opportunities and whose operations have both direct and indirect impacts on the climate.

As an investor on behalf of our clients, we look to companies in all sectors, including financial services, to help their investors understand whether and how they are addressing material sustainability-related risks and opportunities1 within their governance, strategy, and risk management. To this end, BlackRock encourages disclosures aligned with the reporting framework developed by the TCFD, and welcomes efforts by the ISSB to develop baseline sustainability reporting standards, that will cover a range of sustainability topics. We view the work of the ISSB as an important contribution to a multi-jurisdictional effort towards a set of interoperable sustainability reporting standards, that will improve the availability, quality, comparability, and timeliness of sustainability-related disclosures globally.

In our stewardship engagement, BlackRock encourages companies to use the TCFD framework to disclose their approach to ensuring they have a sustainable business model, and to supplement that disclosure with industry-specific metrics. The TCFD framework has incorporated market feedback and attracted widespread support because of its relative simplicity and consistency. Our experience is that it results in clear disclosures that allow investors to assess how companies are adapting their business models to respond to climate-related risks and provides an effective global framework. We therefore welcome the incorporation of TCFD-aligned disclosures into the UK regulatory framework, and support the FCA’s proposal to evolve the UK’s Sustainability Disclosure Requirements (SDR) over time, in line with the ISSB standards.2 We note that standards under development by the Taskforce on Nature-related Financial Disclosures (TNFD)3 further aim to help companies report, and address, natural capital risks.

In our view, as well as providing reporting frameworks, both the TCFD recommendations and ISSB standards are tools to help companies in all sectors, including financial services firms, embed the consideration of material sustainability-related risks and opportunities into their governance, strategy and risk management. Further, the 77 industry-based standards developed by the Sustainability Accounting Standards Board (SASB) include standards for the financial services sector, and provide the starting point for ISSB’s own industry-based requirements. We recognize that some companies may report using different standards, which

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1 Examples of environmental issues include, but are not limited to, water use, land use, waste management and climate risk. Examples of social issues include, but are not limited to, human capital management, impacts on the communities in which a company operates, customer loyalty and relationships with regulators. It is our view that well-managed companies will effectively evaluate and manage material sustainability-related risks and opportunities relevant to their businesses. Governance is the core means by which boards can oversee the creation of durable, long-term value.

2 While at an earlier stage, we note that the standard for transition plans, in development by the UK Transition Plan Taskforce (UK TPT), is intended to further support companies in all sectors to develop and publish transition plans, articulating how they will prepare for the transition to a low carbon economy.

3 The TNFD was launched in 2021, to address the lack of consistent information available to financial institutions on how nature impacts a company’s immediate financial performance, or the longer-term financial risks that may arise from how a company depends on and impacts nature. The TNFD aims to deliver a risk management and disclosure framework to help companies to report, and act on, natural capital risks. BlackRock is contributing to the TNFD. See our response to consultation on technical scope of TNFD, March 2021.
may be required by regulation, or one of a number of private standards. In such cases, we ask that companies highlight the metrics that are industry- or company-specific.

As a corporate entity, BlackRock’s approach to managing material sustainability considerations is outlined in our own corporate sustainability reporting, including our 2022 TCFD Report, and our 2021 Sustainability Disclosure.

**Regulated firms’ governance, culture and behaviours, with regard to sustainability-related risks and opportunities**

In our stewardship engagement, we ask boards to disclose how diversity is considered in board composition, including demographic and professional characteristics. We believe individuals with diverse personal and professional experience bring the diverse perspectives to board decision-making that help avoid group think. A deliberate approach to board diversity brings in directors from the broadest possible pool of qualified and high calibre candidates. Over time, diversity in the board room can also promote diversity and resilience in the leadership team, and the workforce more broadly. That can in turn enable companies to more closely resonate with the customers and communities they serve.

We similarly agree with the FCA that a firm’s governance and culture, and the behaviours they encourage, are central to how it considers material sustainability-related risks and opportunities throughout the business. In our stewardship engagement, we speak to companies about their corporate purpose, how this informs their strategy and culture and how ultimately this underpins long-term financial returns to investors. In our experience, companies that address the needs of their key stakeholders (which will likely include employees, customers and local communities) are likely to bolster their business resilience and drive long-term success.

**Board experience and expertise that aligns with the company’s long-term strategy**

We support boards whose approach is consistent with creating durable, long-term financial value. Since boards oversee the strategic direction and operation of the company on behalf of its shareholders, it is important that directors have the experience, skills, and knowledge to do so. This board responsibility includes establishing effective corporate governance practices, including oversight of material sustainability-related risks and opportunities, as well as the consideration of the company’s key stakeholders within their value chain, most commonly their employees, clients, suppliers, and the communities within which they operate. Boards should work with management to ensure periodic presentations from subject matter experts within the company to help directors remain fluent in the main drivers of risk and opportunity embedded in the company’s business model.

To ensure that boards have the experience and expertise they need, it is our view that directors should stand for re-election on a regular basis, ideally annually, as per the UK Corporate Governance Code. Regular board evaluations and director elections give a board the opportunity to adjust its composition to reflect the evolution of the company’s strategy and the market environment. This process should consider a number of factors, including the potential need to address gaps in skills, knowledge, experience, independence, and diversity. When considering whether to support the election of new directors to the board, BlackRock looks to companies to provide sufficient information on the individual candidates so that shareholders

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4 We see the TCFD Recommendations and the SASB Standards as complementary. For more information, see our [Investment Stewardship Commentary: Sustainability Reporting: Convergence to Accelerate Progress](#).

5 This includes reporting aligned with the SASB Standards for Asset Management & Custody Activities, which includes a robust framework to assess human capital management, and reporting on additional sustainability topics that matter most to our stakeholders, including our BlackRock 2022 Diversity, Equity and Inclusion Report. We believe that sound human capital management contributes to our ability to innovate, adapt and be attuned to the customers and communities we serve, while also supporting long-term resilience.

6 We assess a board’s diversity in the context of a company’s business model, strategy and domicile, with reference to local market regulation and best practice; we consider board gender diversity to be globally relevant and also look for other forms of diversity consistent with local best practices. In the UK to ensure there is appropriate diversity at board level and beyond, we use as a reference the standards set by (and/or be on a clear pathway to meeting the future targets of) the Hampton–Alexander Review and the Parker Review.
can assess the suitability of each individual nominee in the context of the overall composition of the board. These disclosures should help investors understand how the collective experience and expertise of the board aligns with the company’s long-term strategy and business model. Highly qualified, engaged directors with professional characteristics relevant to a company’s business enhance the ability of the board to add value and be the voice of shareholders in board discussions.

In our view, a strong board provides a competitive advantage to a company, providing valuable oversight and contributing to the most important management decisions that support long-term financial performance.

Climate and sustainability-related considerations across a firm’s operations

As an asset manager, we manage material risks and opportunities that could impact portfolios, in order to seek the best risk-adjusted returns for our clients. To do this, we consider many investment risks in our firm-wide processes – including credit risk, market risk, and financially material sustainability risks. We assess which of these risks are material – depending on the client’s strategy, investment, and time horizon – and what they could mean for economic growth, financial prospects, and financial markets.

Our investment approach is rooted in our duty to clients, and is informed by three principles: we start by understanding the client’s investment objectives; we seek the best risk-adjusted returns within the scope of the mandate they give us, and we underpin our work with research, data, and analytics. We apply that same approach to sustainability and the low-carbon transition.

Material sustainability-related factors can present investment risks and opportunities. It is therefore important to investment analysts to have the data and tools necessary to understand how these might impact portfolio performance over time. We have a framework for environmental, social and governance (“ESG”) integration that permits a diversity of approaches across different investment teams, strategies and particular client mandates. As with other investment risks and opportunities, the financial materiality of ESG considerations may vary by issuer, sector, product, mandate, and time horizon. As such our ESG integration framework needs to allow for flexibility across investment teams. Our approach is to incorporate information that is considered material to a particular investment, so far as that is consistent with the client’s or fund’s objectives.

While we observe increasing interest in sustainable investing among some clients, other clients have a diverse range of desired approaches and requirements that lead them to take a different approach to sustainability. Our role is to listen to and deliver choice for our clients. Our clients choose their investment objectives, and they look to BlackRock to meet their needs. We offer them a wide range of index, active, and whole portfolio solutions. The final decision as to the priorities appropriate for their investment portfolio remains with our clients, the asset owners, based on the degree of alignment with their investment policy. Managing assets according to the client’s mandate is the essence of our duty always to act in the best interests of the client. We see value in having functional champions who truly understand client needs and how they map to investment solutions, and ensure our approach is consistent with this.

To seek the best risk-adjusted returns for our clients, we approach the transition to a low-carbon economy, for example, as we do any other major structural trend shaping the economy, markets, and asset prices. We research possible future paths for the three drivers of the low-carbon transition – government policy, technology, and consumer and investor preferences – and we calibrate the potential effects at the macro level and, when potentially material, at the sector and company level.

7 By sustainability-related risks and opportunities, we mean the drivers of risk and value creation in a company’s business model that have an environmental or social dependency or impact.
8 In 2022, BlackRock had over 400 sustainable funds globally covering a spectrum of sustainable solutions, as well as customized solutions to meet clients’ objectives.
From a corporate perspective, where sustainability-related risks and opportunities are material, it is our view that they should be captured in the broader governance, strategy, and risk management processes and responsibilities of boards and senior management.

**Governance and oversight of products with sustainability characteristics**

BlackRock supports the FCA’s intentions to help build consumer trust in products that make sustainability claims, as well as its efforts to help investors identify sustainable products that meet their needs and preferences. We recently responded in detail to the FCA’s consultation CP22/20 Sustainability Disclosure Requirements (SDR) and investment labels.

At BlackRock, senior management oversees investment process consistency across the firm’s investment groups. Research informs our investment approach and product innovation. To seek the best risk-adjusted returns for our clients, we research major structural trends shaping the economy, markets, and asset prices. We assess how these trends could affect long-term financial value and how they could unfold over time.

As we commented in our response to **CP22/20 Sustainability Disclosure Requirements (SDR)**, the existing UK regulatory regime obliges firms to ensure that the information that they communicate to clients is ‘clear, fair and not misleading’ and that investment products and services are marketed in a way that is true to label (PRIN 2.1., principle 7, COBS 4.2.1). These requirements capture sustainability claims as they do any other characteristic and/or approach to investing. In our view, this is sufficient to ensure that communications created to support the marketing of an investment product are aligned to the product’s legal and regulatory documentation.

We do, however, support the FCA’s proposals within SDR regarding ongoing sustainability performance disclosures, and recommend that firms be permitted to publish composite sustainability reports covering two or more funds managed by the same firm. This will enable investors to compare products managed by the same firm, and reduce duplication and overload of information if disclosures are consistent across asset classes and/or similar investment strategies.

**Incentive plans linked to sustainability-related objectives**

In our experience, investors typically seek to understand the investee companies’ policies on executive pay, including performance-related incentives, and how pay outcomes align with returns to shareholders over time. They expect the board to structure executive pay to attract high calibre business leaders, reward the successful implementation of company strategy, and recognize long-term financial value creation. In our view, there should be a clear link between variable pay and operational and financial performance when designing and implementing remuneration and incentive plans. Performance metrics should be stretching and aligned with a company’s strategy and business model. BlackRock does not have a position on the use of sustainability-related criteria in incentive plans; however, where companies choose to include them, they should be as rigorous as other financial or operational targets. Not doing so may raise doubts that the board is acting in shareholders’ financial interests, or fulfilling other aspects of directors’ duties, leaving companies vulnerable to reputational risks associated with unwarranted payouts and/or to falling short in their sustainability efforts.

**Encouraging effective stewardship**

Investment stewardship is a matter of prudently managing the assets of beneficiaries that have been entrusted to the care of others, in a way that protects and enhances the value of those assets. On the part of asset owners – most of whom, in turn, owe fiduciary duties to others, such as a pension fund with regard to its members – this primarily involves appropriate allocation of the assets. On the part of asset managers, it involves fulfilling the requirements of client

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9 BlackRock’s processes for managing sustainability-related risks and opportunities are outlined in our TCFD and SASB reports.
mandates and may include monitoring investee companies, voting (when authorised by clients), and engagement, typically with a focus on issues such as board composition and effectiveness, executive compensation, other governance practices, and managing material risks faced by the company. Investment stewardship looks to maximize the financial value of clients’ positions in individual investee companies, accounting for the nuance that exists in a particular issuer’s industry and region. Effective investment stewardship may also have the secondary effect of leading to long-term benefits not just for asset owners, but the wider economy.

We agree with the FCA that stewardship is an important part of managing investments. It can play a role in encouraging investee companies to disclose whether and how material risks and opportunities, including among others, sustainability-related risks and opportunities, that can impact long-term financial performance, are integrated into strategy and operations. However, it is the responsibility of a company’s board and management to determine the appropriate approach to material drivers of risk and value in its business model. Stewardship should not be considered or set up to be the channel for driving sustainability outcomes, or as a net zero transition mechanism. That is the role of policy makers. Rather, engagement and voting (when authorised by clients) should be seen as one of the many ways that investment managers interact with investee companies, as they believe best serves the long-term interests of their clients.

In our view, there isn’t a single way to exercise effective stewardship, or to structure the governance and resourcing of stewardship by financial services firms. However, there are key principles that firms can draw on in their pursuit of effective stewardship. These include having a clear purpose to their stewardship activities; processes that support constructive oversight of investee companies, engagement as necessary and challenge as appropriate; internal structures, policies and culture that contribute to an effective stewardship program, and disclosures that help an investor’s clients and others understand their approach and impact.

Adherence to these key principles can be encouraged primarily through industry-led codes such as the Stewardship Code, although we see a role for certain minimum standards to be embedded through formal regulation. In the EU, for example, the Shareholders’ Rights Directive II requires institutional investors, i.e. asset managers and asset owners, to develop and publish an investment stewardship strategy, or explain why they have chosen not to do so.\(^\text{10}\)

In developing such standards and principles, the FCA should be clear on what investors, whether asset managers or asset owners, can aim to achieve through their stewardship activities. The effectiveness of engagement activities fundamentally relies on the responsivenes of the boards and management of investee companies. They, not shareholders, direct and manage the company’s business and determine how to address any investor feedback that is expressed through engagement or voting. It is important to acknowledge that companies also receive, and act on, feedback from other key stakeholders such as employees, suppliers and customers.

BlackRock’s public engagement priorities and voting policies help to guide and shape our ongoing evaluation of and dialogue with investee companies. Our priorities and policies are reviewed annually and updated as necessary to reflect feedback from clients and companies, developments in market norms or policies and emerging governance practices. BlackRock’s 2023 investment stewardship engagement priorities are:

- Board quality and effectiveness
- Strategy, purpose and financial resilience
- Incentives aligned with financial value creation
- Climate and natural capital
- Company impacts on people

While we don’t believe there is a single way to structure stewardship activities by financial services firms, these should consider the appropriate resourcing of their stewardship function.

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\(^{10}\) BlackRock publishes its own Shareholders’ Rights Directive Engagement Policy.
As explained in the BlackRock Investment Stewardship (BIS) annual report for 2022, BlackRock’s stewardship team is comprised of 70 members located in 10 offices globally,\(^{11}\) with a regional presence and local expertise. BlackRock is committed to investing in the investment stewardship team to ensure the depth and breadth of engagement activities necessary to encourage investee companies to have sound corporate governance and business models aligned with long-term financial value creation for our clients.

Further, we note that technology has made it easier for institutional investors to exercise greater control over their voting for the companies in their index equity portfolios. In 2022, we introduced BlackRock Voting Choice to make voting more accessible by providing greater choice for eligible investors in separate accounts and certain pooled vehicles to vote their holdings. The initiative currently allows these investors to choose from a range of voting policies, in line with their preferences, or to continue to authorize our stewardship team to vote on their behalf. Today, public and corporate pension funds, insurance companies, and other institutional investors are eligible for BlackRock Voting Choice. Nearly half of our clients’ index equity assets are now eligible and uptake has been encouraging. While BlackRock’s Voting Choice was an industry first, we are pleased to see other firms joining this effort to enable investors to participate in proxy voting choice.

**Stewardship by asset managers**

The stewardship activities of asset managers should be undertaken with the singular objective of encouraging sound corporate governance practices at investee companies that support a company’s ability to deliver long-term financial performance. We do not believe, as an agent of our clients, that the purpose of stewardship should be to directly seek outcomes related to the financial system as a whole. Addressing systemic issues is the role of policy makers, and while asset managers take market-wide risks – like inflation or climate change – into consideration when evaluating how companies are managing their risks, their stewardship engagement on behalf of clients cannot provide a substitute for government policy, or serve to police its implementation at investee companies.

However, in our experience, companies with strong operating practices manage their material risks and opportunities effectively, including those arising from material sustainability-related considerations. They take into consideration the interests of all their key stakeholders, which are likely to include investors, customers, employees and local communities. They also disclose how they are implementing their strategy effectively, to deliver long-term financial performance, including how they manage material risks, including those related to sustainability. This combination of policy and practice enables better corporate decision making, asset allocation and stewardship, which in turn creates positive externalities such as those sought by the FCA.

Further, in our view, seeking to direct stewardship efforts towards specific systemic issues, as proposed in the Discussion Paper, constrains investor choice, and is unlikely to be able to remain in step with macroeconomic developments. A recent example of such a development is how rapidly energy security emerged as a material concern in Europe in 2022. We perceive there to be a variety of issues that different investors consider to be material when allocating capital. The relative importance of issues can similarly change over time, as the corporate landscape evolves and investors adjust their focus. We consider that flexibility is an important facet of effective stewardship, and we question how this could be maintained, if regulation sought to focus stewardship efforts on specific issues.

BlackRock almost exclusively engages individual issuers independently, rather than alongside other asset managers or asset owners. In our experience, this approach enables us to best advance our clients’ long-term financial interests. In addition, international financial services firms may be sensitive to the regulatory ramifications of collaborative engagement, particularly with respect to U.S. issuers and issuers with U.S.-listed securities. BlackRock may participate in collaborative engagements with other shareholders in limited instances, where permissible under local regulations and a market norm, and where we believe that our clients’ long-term financial interests could be more productively advanced through joint dialogue. However, in

\(^{11}\) As at May 10th, 2023, BlackRock Investment Stewardship
those few situations when we may engage collaboratively, our investment stewardship team still makes independent proxy voting decisions and determines our engagement objectives independently, including with whom and how best to partner.

**Conclusion**

BlackRock is pleased to have the opportunity to respond to the FCA’s Discussion Paper, and contribute to the dialogue regarding how financial services firms address material sustainability-related risks and opportunities. Our comments are intended to reflect the critical relationship between asset managers and the clients they serve. As an asset manager, we invest on behalf of our diverse range of asset owners, to help them meet their investment objectives. Our focus is on understanding and managing investment risk, anticipating our clients’ needs, and supporting them in achieving their long-term investment goals. We apply those same principles to sustainability considerations and the low-carbon transition.

We thank you for taking the time to review our input, and welcome further discussion on any of the points that we have raised.