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ESG Integration: Making sustainability-integrated portfolio management our new standard

In January 2020, BlackRock committed to putting sustainability at the center of our investment process, based on the conviction that **integrating sustainability-related information into the investment process can help our portfolio managers manage risk and make better informed investment decisions**.

Central to that commitment was a new focus on how investment teams are using sustainability-related insights to inform portfolio management across our active investment platform. Because we believe that climate risk and sustainability risk are investment risks, BlackRock's active portfolio managers seek to understand how they can use environmental, social, and governance (ESG) data as a lens to identify new risks and opportunities, and to build more resilient and better performing portfolios. We call this practice "ESG integration", or simply, "integration".

BlackRock is a global and diversified asset manager and serves clients with a range of investment objectives and beliefs. As such, **our approach to ESG integration focuses on identifying *financially material* sustainability insights – those that we believe may impact a portfolio's financial performance - and including those insights into the broader mix of traditional financial information used to manage that portfolio**. BlackRock integrates ESG considerations across our full investment platform. This means that for all of BlackRock's actively-managed assets under management (AUM)[1] - where portfolio managers are making decisions about security selection to meet an investment objective - BlackRock's portfolio managers are accountable for appropriately managing exposure to ESG risks and documenting how sustainability considerations are used in investment decision-making. In index strategies – where the investment objective is to replicate a specified benchmark - ESG integration is achieved through stewardship and engagement practices and transparent reporting of sustainability characteristics.

Our focus on using **financially material ESG information** as a lens to identify additional risks and opportunities is consistent with approaches taken by leading industry groups including the Principles for Responsible Investing ("PRI") and the Investment Company Institute. It also helps to make the investment value of sustainability-related data and insights intuitive for investment teams, and provides a clear guiding principle for all portfolio managers that is well-aligned with their core business objective of understanding all relevant information about their portfolio holdings.

How sustainability considerations are sourced, assessed and incorporated will vary with portfolio objective, investment style and asset class – but **all active investment teams follow the same principles in their approach to ESG integration:** this includes regularly reviewing exposure to ESG risks, using a breadth of sustainability-related data and analytics to develop investment-relevant insights, and providing transparency around how sustainability-related information informs portfolio management practices.

Two key characteristics of this approach:

It is important to note that ***ESG integration is distinct from the development of sustainable products*** – the latter focuses on providing a financial outcome alongside or through a stated sustainability related objective. ESG integration has a single objective: improving financial performance in a portfolio using financially-material sustainability information as a tool to identify new risks and opportunities. As such, we believe that ESG integration is an important tool that can help investment teams manage negative externalities (including for strategies with sustainable objectives).

ESG Integration does not imply a "greening" of all portfolios or divestment from certain categories of assets – though over time, we believe that ESG integrated portfolios investing for the long term will, on average, reflect more positive sustainability characteristics. It does require, however, that ***exposure to ESG risks is deliberate, and consistent with a portfolio's objectives***. BlackRock believes this will lead to more informed investment decisions, and better outcomes for clients.

[1] As of December 2020.

Our approach and learnings

The "value" thesis around integration is ascendant	Whereas sustainable investing has historically been perceived as a positive externality — focusing on values alignment, social impact or reduction of environmental harm — portfolio managers are now using sustainability-related information to identify exposure to risk and help pursue improved risk-performance profiles. Macro trends, regulatory developments, standards of disclosure and shifting consumer sentiment are amplifying the impact of sustainability considerations on portfolio performance.	**ESG integration must reflect the unique characteristics of an investment strategy**	Different asset classes require different data and tools to apply heightened scrutiny, assess materiality and make meaningful differentiation among issuers and assets. ESG integration also requires a constant reassessment of priorities: a key learning from implementing BlackRock's ESG integration program was that while some market drivers (like the transition to a lower carbon economy) are observable over a long time-horizon, other disruptions (such as acute natural disaster events) happen more quickly and have very different implications for market participants and investment performance.
We believe that a well-executed ESG integration is an essential component of sound portfolio management	We believe that a well-executed ESG integration program provides a structured approach for active portfolio managers to assess whether and how sustainability-related market considerations impact risk or relative pricing of specific assets within a sector or portfolio and enable them to respond to this information in the context of their investment process. Our portfolio managers' experiences reinforce that these performance drivers can be as relevant in traditional investment portfolios as in portfolios with a sustainable objective.	**A principles-based approach simultaneously allows for alignment and innovation**	BlackRock's approach focuses on three principles: 1. Defining a value-based investment thesis for sustainability integration 2. Understanding baseline practices and capabilities 3. Delivering on our investment thesis, with a focus on a structured **investment process**, developing **financially relevant sustainability insights**, and providing **transparency** into our integration approach

Delivering on ESG integration for our clients

- **As of December 2020, BlackRock has published strategy-level ESG integration statements for products across the active investment platform.** These statements describe *how* and *when* in the investment process portfolio managers assess and incorporate sustainability-related considerations, consistent with the strategy objectives and the specific asset class and investment style. These statements are included on product pages globally.[2] Portfolio sustainability characteristics are also published for retail funds globally to provide additional transparency to our clients.

- **ESG risk analysis is now embedded in 100% of regular portfolio risk reviews between BlackRock's Risk and Quantitative Analysis group (RQA) and portfolio management teams, as well as Chief Investment Officer (CIO)-led portfolio reviews.** This means that sustainability-related risks are considered in the same structured investment risk management process as traditional risks like credit or liquidity risk. CIO reviews provide additional oversight of investment process and portfolio risk and performance across active strategies.

- **We have dramatically expanded the ESG data available to our portfolio managers as part of the core portfolio management and risk management platform, Aladdin.** More than 1200 key performance indicators[3] are now available to portfolio managers in Aladdin from third-party data providers; BlackRock's internal sustainability research framework scoring is also available alongside third-party ESG scores in core portfolio management tools. Across our Aladdin environment, BlackRock is using data from more than a dozen sustainability data providers as well as a range of innovative models and tools that help shape sustainability-driven investment insights.

Risk Warnings

[2] As applicable and consistent with local regulations.
[3] As of December 2020.

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