Climate-related risks and the low-carbon transition

BlackRock

Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the durable, long-term financial value creation that our clients depend on to achieve their investment goals. As part of our fiduciary responsibilities as an asset manager to act in our clients' financial interests, we assess a range of risks and opportunities that can affect the long-term 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. In all cases, our voting is intended to advance the long-term financial interests of our clients as shareholders.[1]

As an asset manager, BlackRock's approach to climate-related risks, and the opportunities presented by the low-carbon transition, is based on our fundamental role as a fiduciary to our clients. 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. 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.

In this role, we want to hear from the companies in which we invest for our clients regarding the impact climate-related risks and opportunities and the low-carbon transition is expected to have on their strategies and long-term business models. We engage on this topic because the way in which companies navigate material climate-related risks and adapt through the low-carbon transition may have a direct financial impact on our clients' investment outcomes and financial well-being.[2]

While companies in various sectors and geographies may be affected differently by climate-related risks and opportunities, the low-carbon transition is an investment factor that can be material for many companies and economies around the globe.[3]

We seek to understand, from company disclosures and engagement, the strategies companies have in place to manage material risks to, and opportunities for, their long-term business model associated with a range of climate-related scenarios, including a scenario in which global warming is limited to well below 2°C, considering global ambitions to achieve a limit of 1.5°C. As one of many shareholders, and typically a minority one, BlackRock does not tell companies what to do. It is the role of the board and management to set and implement a company's long-term strategy to deliver long-term financial returns.

Climate-related risks and opportunities as an investment issue

Our research shows that the low-carbon transition is a structural shift in the global economy that will be shaped by changes in government policies, technology, and consumer preferences, which may be material for many companies.[4] Research has found that while the transition to a low-carbon economy can introduce inflationary pressures, an orderly transition[5] 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.[6, 7]

Yet the path to a low-carbon economy is deeply uncertain and uneven, with different parts of the economy moving at different speeds.[8] BIS recognizes that it can be challenging for companies to predict the impact of climate-related risks and opportunities on their businesses and operating environments. Many companies are assessing how to navigate the low-carbon transition while delivering long-term value to investors.

BlackRock applies a long-term lens to assessing the future financial performance of companies most impacted by climate-related physical and transition risks and opportunities under different transition scenarios.[9] We recognize that the low-carbon transition isn't a single trend but rather a complex series of structural shifts in energy, materials, food and land usage toward a low-carbon world.[10]

Some companies may also be impacted by the financial and operational costs of extreme weather events and the potential for stranded assets.[11] [12] As an asset management fiduciary to our clients, we seek to understand whether and how companies are navigating this uncertainty.

Assessing companies' long-term resilience through disclosures on climate-related risks and opportunities

In this context, we encourage companies to publicly disclose, consistent with their business model and sector, how they intend to deliver long-term financial performance through the transition to a low-carbon economy, including, where available, their transition plan.[13] We note that climate-related financial disclosures will be mandatory in the near term in a number of jurisdictions.[14]

In our view, long-term investors like our clients can make better informed investment decisions when companies disclose their approach to ensuring they have a resilient business model covering governance, strategy, risk management, and metrics and targets, including industry-specific metrics. The International Sustainability Standards Board (ISSB) standards, IFRS S1 and S2,[15] provide companies with a useful guide to prepare this disclosure. The standards build on the Task Force on Climate-related Financial Disclosures (TCFD) framework and the standards and metrics developed by the Sustainability Accounting Standards Board (SASB), which have converged under the ISSB.[16, 17]

In our view, disclosure consistent with the ISSB standards would better enable the market to assess company-specific climate-related risks and opportunities, and inform capital allocation decisions.[18] They would also provide greater clarity on whether and how companies' business models align 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.

We recognize that companies may phase in reporting aligned with the ISSB standards over several years, depending on local requirements. We also recognize that some companies may report using different standards, which may be required by regulation, or one of a number of voluntary standards. In such cases, we ask that companies highlight the metrics that are industry- or company-specific.

To the extent that companies do not provide reporting aligned with the ISSB standards and have material climate and low-carbon transition risk in their business models, we look for a fulsome explanation of how they have assessed and integrated the risks and opportunities they have identified. We are particularly interested in understanding a few elements of those disclosure standards, where material to the company. These include how they are allocating capital and evaluating investment opportunities, if any, that they envision as a result of the low-carbon transition. For example, some companies may invest to adapt existing products to meet changing consumer demands, while others may innovate to develop new low-carbon technologies.

These also include any short-, medium-, and long-term targets for scope 1 and 2 greenhouse gas emissions (GHG) reductions, ideally science-based where these are available for their sector. While we recognize that regulators in some markets are moving to mandate certain disclosures, at this stage, we view scope 3 GHG emissions differently from scopes 1 and 2, given methodological complexity, regulatory uncertainty, concerns about double-counting, and lack of direct control by companies. We welcome disclosures and commitments companies choose to make regarding scope 3 emissions as these help us to evaluate companies' assessments of their emissions across their value chain, where appropriate, and efforts to reduce them over time. We have observed a growing number of companies disclosing scope 3 reduction targets and recognize that these disclosures are provided on a good-faith basis as methodology develops.

Some companies include carbon credits in their climate-related strategies and goals. In those cases, we find it helpful if their disclosures provide details on how credits will be used to meet the company's GHG emissions reduction targets, including in relation to already purchased carbon credits.[19] When purchased voluntarily as part of a broader climate-related strategy, we seek to understand how carbon credits fit within that broader strategy.

How we engage with companies on the low-carbon transition

When discussing climate- and transition-related risks with companies, we take into consideration the reality that the low-carbon 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 long-term financial performance. To help prioritize these conversations, the BIS Climate Focus Universe includes more than 1,000 companies of our clients' aggregate public equity holdings with BlackRock, representing nearly 80-90% of the global scope 1 and 2 GHG emissions.[20]

Companies determine the best approach for addressing their material climate-related risks and opportunities. In our engagement conversations with company leadership, we seek to understand, where relevant, whether and how:

- The board and management assess material climate-related risk and opportunity relevant to the company's strategy and operations and how this may impact the company's long-term performance, as well as the key assumptions being relied on such as evolving technology.
- 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 low-carbon 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 a range of pathways to a low-carbon economy.[21]
- The company executes year-on-year, or over a series of years, against its stated emissions reduction goals and other climate-risk related efforts, and, where there are deviations from such goals, the company sets out the reasons for the deviations.
- The company incorporates climate-related risk and opportunities in its capital allocation decisions, and how related 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 outlook.

We recognize that the role companies play in the low-carbon transition will be dependent on a range of stakeholders, including policy makers and consumers. Other potential drivers of the transition include market forces and supply and demand—with consideration to the global economy's current dependence on traditional energy sources and the parallel investments in cleaner energy alternatives and other technologies. In our engagements we may also discuss how companies see their role in balancing the competing interests of policymakers and consumers in connection with the low-carbon transition, such as energy security, energy affordability, decarbonization, and minimizing dislocation.

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Company disclosure of their approach to material climate-related risks and opportunities

The table below summarizes what BIS would like to understand from company disclosure. The information we seek aligns with the recommendations set out in the IFRS S1 and S2, which draws on the recommendations made in the TCFD. Company reporting aligned with IFRS S1 and S2, building on TCFD, includes, but is not limited to:

Key theme	Rationale[22]	Recommended disclosures
Governance	Understand the governance processes, controls and procedures used to monitor, manage and oversee climate-related risks and opportunities.	• Describe the board's oversight of climate-related risks and opportunities (including board mandates, committee responsibility and experience, as applicable). • Describe management's role in assessing and managing climate-related risks and opportunities.
Strategy	Understand a company's strategy for managing climate-related risks and opportunities.	• Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term (taking into account industry specific factors and where in a company's value chain risks and opportunities may lie). • Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning (including transition planning where appropriate/available and how the company plans to achieve its targets). • Describe the resilience of the organization's strategy (commensurate with its circumstances), taking into consideration different climate-related scenarios, including a 2°C or lower scenario (including the company's ability to adjust and adapt its strategy over time).
Risk management	Understand the processes to identify, assess, prioritize and monitor climate-related risks and opportunities, including, whether and how those processes are integrated into and inform the company's overall risk management process.	• Describe the organization's processes for identifying and assessing climate-related risks and opportunities (including data upon which the company relies, assumptions made and any changes over time). • Describe the organization's processes for managing climate-related risks and opportunities. • Describe how processes for identifying, assessing, and managing climate-related risks and opportunities are integrated into the organization's overall risk management. • Describe if/how capital is being allocated in line with the organization's stated climate strategy.
Metrics and targets	Understand a company's performance in relation to its climate-related risks and opportunities, including progress towards any climate-related targets it has set, and any targets it is required to meet by law or regulation.	• Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process (including industry specific metrics). • Disclose scope 1, scope 2 (including from joint ventures, subsidiaries and affiliates) and, if appropriate, scope 3 GHG emissions and the related risks. • Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets (including how the company monitors progress against its targets over time, the use of offsets, if any, and whether or not the target has been validated by a third party).

Source: This table reflects the IFRS S2 Climate-related Disclosure guidance document from July 2023, which compares the IFRS S2 Climate-related Disclosures with the TCFD Recommendations. Please see the full publication for additional information.

Endnotes

1. This commentary should be read in conjunction with BIS' Global Principles and regional voting guidelines. Other materials on the BIS 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 (IPCC) provides a helpful glossary for this terminology.
3. We recognize that companies in different markets are adapting to the low-carbon transition in varying contexts as a result of differences in the current government policy landscape. For example, the Inflation Reduction Act in the U.S. creating significant opportunities for investors to allocate capital to the low-carbon transition. This legislation commits an estimated U.S. $369 billion for investment in energy security and climate change mitigation. The European Union (EU) and European governments are also developing incentives to support the transition to a net zero economy and drive growth. Please also see, BlackRock Investment Institute, "Mega forces: An investment opportunity", 2023.
4. BlackRock Investment Institute, "Tracking the low-carbon transition", July 2023.
5. According to the IPCC, an orderly transition is "a situation in which market players are able to fully anticipate the price adjustments that could arise from the transition." Source, IPCC, "IPCC Sixth Assessment Report", 2022.
6. BlackRock Investment Institute, "Transition to a low-carbon economy", 2023.
7. McKinsey & Company, "The net-zero transition." January 2022. Also, please refer to BlackRock Investment Institute, "Tracking the low-carbon transition." July 2023.
8. BlackRock Investment Institute, "Tracking the low-carbon transition", July 2023.
9. 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.
10. BlackRock Investment Institute, "Transition to a low-carbon economy", 2023.
11. 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.
12. 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 low-carbon 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.
13. We have observed that more companies are developing such plans, and public policy makers in a number of markets are signaling their intentions to require them. We view transition plans (TPs) as a method for a company to both internally assess and externally communicate long-term strategy, ambition, objectives, and actions to create financial value through the global transition towards a low-carbon economy. While many initiatives across jurisdictions outline a framework for TPs, there is no consensus on the key elements these plans should contain. We view useful disclosure as that which communicates a company's approach to managing financially material, business relevant risks and opportunities – including climate-related risks – to deliver long-term financial performance, thus enabling investors to make more informed decisions.
14. For example, in the EU, the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD) have passed, and other markets, including the UK, Australia, Singapore, Japan, and Canada, are consulting on their proposals to introduce disclosure requirements.
15. The objective of IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information is to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to primary users of general-purpose financial reports in making decisions relating to providing resources to the entity. The objective of IFRS S2 Climate-related disclosures is to require an entity to disclose information about its climate-related risks and opportunities that is useful to primary users of general-purpose financial reports in making decisions relating to providing resources to the entity.
16. The IFRS has assumed responsibility for monitoring companies' climate-related financial disclosures from the TCFD, which was disbanded in October 2023. The IFRS S2 Climate-related disclosure standard builds on the four pillars and 11 recommendations of the TCFD, but has additional requirements. For more information, please see, IFRS, "Comparison IFRS S2 Climate-related Disclosures with the TCFD Recommendations," July 2023.
17. For more information, please see, IFRS, "Comparison IFRS S2 Climate-related Disclosures with the TCFD Recommendations," July 2023.
18. BlackRock, "Global perspectives on investing in the low-carbon transition", June 2023.
19. International Organization of Securities Commissions, "Voluntary Carbon Markets Consultation Report", December 2023.
20. Based on MSCI data as of 2021.
21. BIS generally considers short-, medium-, and long-term targets to be a range of years, such as 0-5, 5-10, and 10+ years. Our goal is not to set finite 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.
22. Please see, IFRS, "IFRS S2 IFRS® Sustainability Disclosure Standard", June 2023.

Want to know more?

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