Climate-related risks and the low-carbon transition

BlackRock

Investment Stewardship

At BlackRock, investment stewardship serves as a link between our clients and the companies they invest in and is one of the ways we fulfill our fiduciary responsibilities as an asset manager to our clients. We do this through engaging with companies to improve our understanding of their business models and material risks and opportunities. We also engage to inform our voting decisions for clients who authorize us to vote on their behalf. Our sole focus when conducting our stewardship program under our Benchmark Policies is to advance our clients' long-term financial interests.[1]

As an asset manager, BlackRock Investment Stewardship's (BIS) approach, under our benchmark policies, to material 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.

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 around the globe.[2]

As one of many minority shareholders in public companies, BIS cannot – and does not try to – direct a company's strategy or its implementation. Setting, implementing and overseeing strategy are the responsibility of management and the board. Rather, 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.

Climate-related risks and opportunities as an investment issue

In our view, the transition to a low-carbon economy is one of several mega forces reshaping markets.[3] 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, consumer and investor preferences, which may be material for many companies.[4]

The path to a low-carbon economy is uncertain and uneven, with different parts of the economy moving at different speeds.[5] 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 financial 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.[6] For example, some companies may be impacted by the financial and operational costs of extreme weather events and/or the potential for stranded assets.[7, 8] 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, among other things, toward a low-carbon world.[9] 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

At companies where climate-related risks are material, we find it helpful when they 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.[10] We note that climate-related financial disclosures will be mandatory in the near term in a number of jurisdictions.[11]

Long-term investors can make better informed investment decisions when they understand how a company's business model is resilient to material sustainability-related risks, such that the company can deliver durable, long-term financial returns. Such reporting is most useful to investors' understanding when it covers governance, strategy, risk management, and metrics and targets, including industry-specific metrics.

In the context of climate-related reporting, the International Sustainability Standards Board (ISSB) standards, specifically the IFRS S2,[12] provide companies with a useful guide to prepare this disclosure. The standards build on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and the standards and metrics developed by the Sustainability Accounting Standards Board (SASB), which have converged under the ISSB.[13, 14]

In our experience, disclosure consistent with the ISSB standards or the TCFD framework can help investors assess company-specific climate-related risks and opportunities, and inform investment decisions.[15] Such disclosures also provide investors with insights into how companies are managing the risks associated with climate change by managing their own carbon emissions or emissions intensities to the extent financially practicable. Recognizing the value of these disclosures, in some jurisdictions, like the U.K, large companies must disclose such climate-related financial information on a mandatory basis, while in other jurisdictions these disclosures are viewed as best practice in the market.

Consistent with the ISSB standards and the TCFD framework, 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. This includes a scenario in which global warming is limited to well below 2°C, considering ambitions to achieve a limit of 1.5°C, the temperature goal recently reaffirmed by G20 members as part of the 2024 Leaders' Declaration.[16]

We recognize that companies may phase in reporting aligned with the ISSB standards over several years, depending on local requirements. We also recognize and respect that some companies may report using different local standards, which may be required by regulation, or one of a number of voluntary standards. In such cases, we ask that companies disclose their rationale for reporting in line with the specific disclosure framework chosen and highlight the metrics that are industry- or company-specific. To the extent that companies do not provide reporting aligned with the ISSB standards, TCFD recommendations or local requirements or guidelines, and have material climate and low-carbon transition-related 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.

In particular, there are several elements of the ISSB disclosure standards that investors find useful, where material to the company. These include how companies are allocating capital and evaluating investment opportunities, if any, that they have identified as resulting from 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 frameworks also contemplate disclosures on how companies are setting 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 investors. If companies set targets for scope 1 and 2 greenhouse gas emissions (GHG) reductions, BIS seeks to understand how they are setting them, what time frame they are using and if the targets are 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 material 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 emissions reduction targets and recognize that these disclosures are provided on a good-faith basis as methodology develops. That said, we are interested in understanding how companies are working with their value chains to address the implications of any material climate-related risks and opportunities and the low-carbon transition.

Some companies include carbon credits in their climate-related strategies. In those cases, we find it helpful if their disclosures provide details on how credits will be used to address the company's GHG emissions, including in relation to already purchased carbon credits.[17] We look to understand the role that carbon credits play in the broader climate-related strategies of those companies, and the processes they have in place to manage their use and procurement.

Our approach to engagement with companies on the low-carbon transition

The low-carbon transition may present different challenges and potential rates of change for companies across sectors. With this in mind, when discussing climate- and transition-related risks with companies, we generally focus our conversations where the transition is most likely to materially impact a company's long-term financial performance.

The BIS Climate Focus Universe includes more than 1,000 companies, representing approximately 80-90% of the global scope 1 and 2 GHG emissions of our clients' aggregate public equity holdings with BlackRock.[18] The Climate Focus Universe is based on public information and assists BIS in prioritizing our engagement with companies for which climate risk may be material.

Companies determine the best approach for addressing the material climate-related risks and opportunities, if any, given their business models, sectors, and areas of operations. In our engagement conversations with company leadership, we seek to understand, where relevant, whether and how:

- The board and management assess and disclose 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),[19] and evaluates resilience to scenarios, including a range of pathways to a low-carbon economy.[20]
- The company executes year-on-year, or over a series of years, against its stated emissions reduction goals and other goals related to climate risks and opportunities, and, where there are deviations from such goals, 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.

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

The table below summarizes the types of disclosures BIS finds useful for evaluating how companies approach material climate-related risks and opportunities. The information aligns with the recommendations set out in IFRS S1 and S2, which draw on the recommendations made by SASB and the TCFD respectively. Company reporting aligned with IFRS S1 and S2, includes, when relevant:

Key theme	Rationale[21]	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, where appropriate material scope 3 GHG emissions and the related risks. • Describe the targets used by the organization to manage climate-related risks and opportunities, including scope 1 & 2 emissions reduction targets, and performance against targets (including how the company monitors progress against its targets over time, the use of carbon credits, 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.

Endnotes

1. BIS' Benchmark Policies, and the vote decisions made consistent with these policies, take a financial materiality-based approach and are focused solely on advancing clients' financial interests. BIS' Benchmark Policies – comprised of the BIS Global Principles, regional voting guidelines, and engagement priorities – provide clients, companies, and others, guidance on our position on common corporate governance matters. We take a globally consistent approach, while recognizing the unique markets and sectors in which companies operate. Other materials on the BIS website might also provide useful context.
2. 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.
3. BlackRock Investment Institute, "Mega forces: An investment opportunity", 2023.
4. BlackRock Investment Institute, "Tracking the low-carbon transition", July 2023.
5. Please see previous footnote.
6. 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. Transition risks are those that arise from efforts to transition to a lower-carbon economy. These include policy, legal, technological, market and reputational risks. Source: IFRS S2 Climate-related Disclosures, 2023.
7. 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.
8. 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.
9. BlackRock Investment Institute, "Transition to a low-carbon economy", 2023.
10. 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 or already have requirements in place, such as Australia, Brazil, and the European Union. We view transition plans as a method for a company to both internally assess and externally communicate its long-term strategy, ambition, objectives, and actions to create financial value through the global transition towards a low-carbon economy. Transition plans are building momentum internationally, with increased focus from policy makers and supervisors, including in the EU, UK, G7, G20, and from the financial industry. While many initiatives across jurisdictions outline a framework for transition plans, there is no consensus on the key elements these plans should contain. We view useful disclosure as one that effectively communicates a company's approach to managing financially material business relevant risks and opportunities – including climate-related risks – to deliver long-term financial performance, which allows investors to make more informed decisions. While transition plans can be helpful disclosure, BIS does not make the preparation and production of transition plans a voting issue. BIS may engage companies that have chosen to publish a transition plan to understand their planned actions and resource implications.
11. For example, climate-related disclosure requirements have been finalized in the EU (the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD)) Singapore, Hong Kong and Canada, and other markets, including the UK, Australia, Japan, and Canada, are consulting, have recently completed consultations, or have proposed draft legislation on their proposals to introduce disclosure requirements.
12. 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.
13. 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.
14. For more information, please see, IFRS, "Comparison IFRS S2 Climate-related Disclosures with the TCFD Recommendations," July 2023.
15. BlackRock, "Global perspectives on investing in the low-carbon transition", June 2023. We recognize that companies may phase in reporting aligned with the ISSB standards over several years, depending on local requirements. We also recognize and respect that some companies may report using different local standards, which may be required by regulation, or one of a number of voluntary standards. In such cases, we ask that companies disclose their rationale for reporting in line with the specific disclosure framework chosen and highlight the metrics that are industry- or company-specific.
16. In November 2024, G20 members reaffirmed the Paris Agreement temperature goal as part of the Leaders' Declaration. G20 members include the world's major economies (19 countries and two regional bodies, the European Union and African Union), representing 85% of global Gross Domestic Product, over 75% of international trade, and about two-thirds of the world population.
17. International Organization of Securities Commissions, "Voluntary Carbon Markets Consultation Report", December 2023.
18. Based on MSCI data as of February 15, 2024. The Universe also includes some companies which face climate-related risks and opportunities where scope 3 emissions are the largest component of their overall emissions, such as those in the financial services sector.
19. As noted previously in this commentary, 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.
20. BIS generally considers both short- and medium-term to be a range of 0-10 years, and long-term to be a range of 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 a low-carbon economy. 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.
21. Please see, IFRS, ""IFRS S2 Climate-related Disclosures", 2023.

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Want to know more?

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NM0125U-4133222-6/6