Implications of 2020 BlackRock Letter to CEOs

Emily Parsons | January 2020

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Introduction

BlackRock CEO Larry Fink's 2020 letter to CEOs makes it clear that climate change and sustainability issues will continue to be a hot topic for investors in 2020. In this annual letter, Fink asserts his view that climate change risk is investment risk; as such, he predicts investors will begin to allocate their capital towards sustainable investing, rely more heavily on disclosure to determine the degree to which companies are addressing climate risk, and exercise their voting rights accordingly. Here, we detail our key takeaways from his letter, and implications for directors serving on public company boards.

The Financial Risk of Climate Change & Implications on Capital Allocation

Fink begins his letter by addressing the risk that climate change presents to organizations and the global systems in which they operate. Practical examples raised include challenges with insuring and mortgaging homes, cost of basic goods, potential inflation and interest rate challenges, and the ability to develop accurate economic models. These risks pose threats to organizations across industries and geographies – and BlackRock's clients are taking notice. Fink predicts that capital will be re-allocated to companies who appropriately focus on to climate change and other sustainability issues. This will serve to increase the cost of capital for those organizations who do not respond to shareholders' requests.

As a first step, issuers should consider to what degree, and in what way, their business is susceptible to climate change-related risk, and establish an approach to address it.

Importance of Disclosure

Investors assessing a company's focus on sustainability will turn to disclosure as a key source of information. While there is no single widely used or accepted framework, Fink suggests that the Sustainability Accounting Standards Board (SASB) provides a robust approach for various issues. As such, he calls on CEOs to "publish a disclosure in line with industry-specific SASB guidelines," as well disclose risks aligned with the Task Force on Climate-related Financial Disclosures (TCFD)'s recommendations, of which BlackRock was a founding member. He notes that "in the absence of robust disclosure, investors, including BlackRock, will increasingly conclude that companies are not adequately managing risk."

Companies should ensure that any climate-related risk management measures are disclosed in an effective and well-understood manner, including assessing the merits of adopting disclosure frameworks like SASB and TCFD.

Investor Response

Given the materiality of climate change-related risk, investors have begun to hold directors accountable if they perceive this risk to be ineffectively managed. Fink warns that BlackRock "will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."

Proactive shareholder engagement on sustainability-related topics, risks, and disclosure can help companies address related investor concerns.