BLACKROCK & STATE STREET GLOBAL ADVISORS

2020 KEY FOCUS – ESG DISCLOSURE BASED ON MATERIALITY

- Both passive giants BlackRock and State Street global Advisors (SSgA) are calling for better disclosure from companies on Environmental, Social, and Governance (ESG) topics.
- In their letters to companies, their respective CEOs promote engagement on sustainability issues and matters relating to business strategy. They make it clear **inaction or ineffective results would impact the way their Stewardship Teams evaluate their investments and exercise their votes.** They refer to their fiduciary responsibility to their clients (and society in the case of BlackRock) to justify this move.
- To guide companies and boards in this journey, they both support the ESG reporting framework created by the **Sustainability Accounting Standards Board (SASB): a framework based on industry-specific ESG metrics that are financially material.** Companies can download the SASB standards for their industry here.
- BlackRock and SSgA are asking companies to disclose their climate change strategy in line with the **recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) as well as SASB.** The disclosure must include a "plan for operating under a scenario where the Paris Agreement's goal of limiting global warming to less than two degrees is fully realized"
- SSgA's CEO berates activists for taking a piecemeal view of ESG instead of focusing on material risks.

ESG INTEGRATION – DATA AND TOOLS

- Asset managers are increasingly looking to **develop their own proprietary ESG data and tools** to lessen their dependence to rating firms, such as MSCI, Sustainalytics, etc. SquareWell notes that **other investors like Allianz Global Investors, Schroders, Aviva Investors, or Norges Bank Investment Management have also developed their own ESG rating tools.**
- SSgA is integrating ESG factors through the use of its R-Factor (the 'R' stands for Responsibility), "a transparent scoring system that measures the performance of a company's business operations and governance as it relates to **financially material and sector-specific ESG issues".** The R-Factor is based on the SASB framework and corporate governance codes.
- The technological platform of BlackRock, Aladdin, will also start integrating **ESG proprietary measurements tools, including physical climate risks and carbon pricing stress-testing**.

ESG INTEGRATION - STEWARDSHIP

- These two large asset managers have argued for many years that private engagement works better than divesting or shareholder proposals. It seems BlackRock is working on better measuring their engagement impact by **mapping their "engagement priorities to specific UN Sustainable Development Goals"** and "incorporating key performance indicators in [their] engagement policies".
- These two large passive investors intend to **vote AGAINST board members of ESG laggards** that are not disclosing adequate information about their sustainability strategy. It is yet to be seen whether this will result in supporting shareholder proposals on sustainability topics.
- BlackRock's vote on sustainability-related shareholder proposals will take into account the quality of the company's disclosure, including "**the company's plan for operating under a scenario where the Paris Agreement's goal of limiting global warming to less than two degrees is fully realized**", in line with the TCFD's expectations.
- BlackRock will improve its Stewardship reporting by disclosing **voting records quarterly, including a short voting rationale** (available here). For "key high-profile votes", they will continue to publish vote bulletins with more explanations on their votes, including on the engagements they had with the company (see their first 2020 bulletin on Siemens AG, Germany, related to environment and company's responsiveness to climate issues). Their Stewardship report will also include each engagement topic addressed during their meetings, in addition to the name of the companies they met.
- SSgA is announcing that **only 25% of reviewed companies have "meaningfully identified, incorporated and disclosed material ESG issues into their strategies".**
- **BlackRock is finally joining the Climate Action 100+,** an investor initiative representing over $41 trillion of assets that engages with companies to improve climate disclosure and align business strategy with the goals of the Paris Agreement. **Vanguard and SSgA have not followed suit yet.**

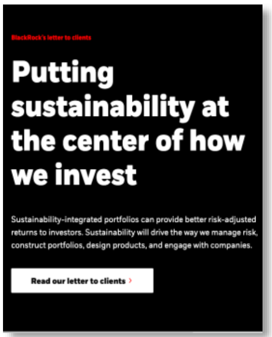
ESG INTEGRATION - SUSTAINABLE INVESTING

- In a separate letter to their clients, BlackRock is explaining how they are working on **building more resilient portfolios** which are taking account of sustainability risks, including in particular the impacts of climate change and the energy transition:
    - Active funds will reduce their exposure to high ESG risk sectors, starting by **divesting from companies that generate more than 25% of their revenues from thermal coal production**
    - BlackRock will offer more sustainable version of their funds and their iShares Exchange Traded Funds (ETF), with the intention of doubling their offering of ESG ETFs.
- BlackRock will make available publicly an ESG score as well the carbon footprint of their funds.
- BlackRock will engage with index providers to create sustainable versions of their flagship indexes.

FURTHER READINGS

Larry Fink's letter to CEOs

BlackRock's letter to clients



BlackRock Investment Stewardship's approach to engagement on the TCFD and the SASB aligned reporting

BlackRock: Towards a Common Language for Sustainable Investing

State Street CEO's Letter on our 2020 Proxy Voting Agenda

State Street: ESG Oversight Framework for Directors

State Street: Five ESG Investing Trends to Watch in 2020

SquareWell: The Growing Importance of the TCFD

SquareWell Partners

The Playing Field

A Look at the Top 50 Largest Asset Managers

SquareWell Partners ("SquareWell") undertook a study to determine how the top 50 asset managers[1] are approaching some of the prominent issues of today's global financial market. In recent years, the demands from almost all market forces have increased, from activists to society at large. As a result, asset managers are expected to consider environmental, social and governance (ESG) issues, to be forceful stewards of their investments, as well as to become more transparent.

Top 50 Investors
$50.6 trillion
Assets Under Management

All charts are displayed by number of individual asset managers.

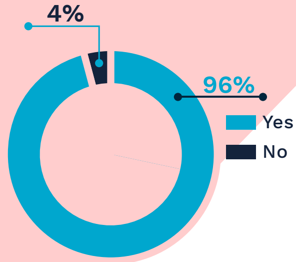
ESG is not a fad, it is here to stay

The Principles that drove change

PRI Principles for Responsible Investment

The United Nations Principles of Responsible Investment (PRI) has been a driving force behind the growing integration of ESG factors in the investment process alongside the improved investor disclosure. The PRI works to understand the investment implications of ESG factors through their six principles and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. Moreover, adherence to the PRI principles as well as the PRI assessment scores are now factored into the asset manager selection process of many asset owners.

With 96% of the top 50 asset managers being a signatory to the PRI, we believe that the PRI will continue to build momentum due to its increasing number of signatories and its increasing depth of information requested from investors through 'Transparency Reports'.

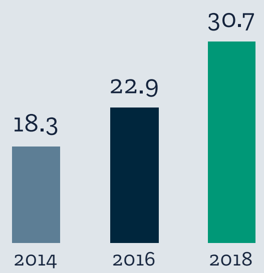


Increasing amount of money is now invested sustainably

Sustainable investing is an investment approach that considers ESG factors in portfolio selection and management. The Global Sustainable Investment Association's (GSIA) definitions and studies have emerged as a global standard for classification of sustainable assets as they are inclusive of screening, integration, impact investing, and corporate engagement/shareholder action.

There is, however, a significant discrepancy in the statistics presented by the GSIA and the funds managed by PRI signatories. This indicates a potential issue in signatories not following the principles they signed up to or the GSIA is vastly underestimating sustainable assets.

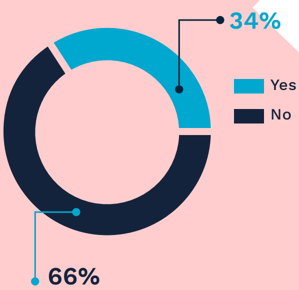
Global Sustainable Investment Assets ($ trillion)



Source: 2018 – GSIA – Global Sustainable Investment Review[2]

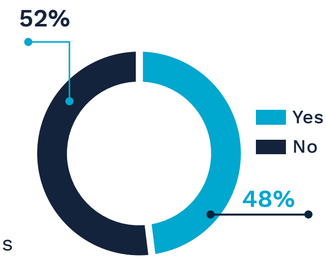
Fixed Income – ESG considerations not limited to equity selection

It is not just equity selection that is facing the force of ESG integration, other asset classes such as fixed income are getting in on the act. 34% of asset managers directly mention ESG integration within their investment process when looking at fixed income on their website and associated publications



Investors providing ESG guidance to companies through Position Papers

Investors have increasingly become keen to state their positions on a public forum as a result of the increased attention to ESG-related issues. Nearly half of the asset managers reviewed produce position papers, offering insights and perspectives on a range of ESG topics from cybersecurity to water usage.

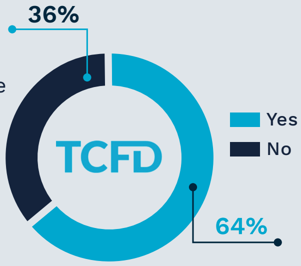


Voluntary organisations helping drive change through transparency

Alongside their own publications, investors are progressively signing themselves up to voluntary organisations that help to standardise disclosure to bring about comparability of data while others help to promote important issues in areas such as climate change. There are countless initiatives that have emerged over the years and we have selected two initiatives, one environmental and one social, to demonstrate the increasing breadth of such initiatives as well as their increasing levels of support by investors.

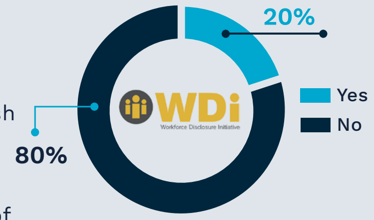
Addressing Climate Change

The work and recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) aim to assist companies in terms of what disclosure is needed by investors to measure and respond to climate change risks. 64% of the top 50 asset managers are signatories to the TCFD.



Human Capital Management

With the rising importance of human capital management, the Workforce Disclosure Initiative (WDI) mobilises investors to push companies to disclose comparable workforce information for better jobs. Launched in 2017, already 20% of the top 50 asset managers are signatories to the WDi.



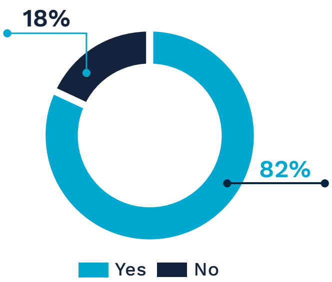
A Focus on **Stewardship Activities**

ESG integration is now considered to be on the verge of being mainstream in equity investing, with most investors explaining their responsible investment practices in a robust manner. However, there remains a lot of “green-washing” whereby disclosures surrounding responsible investment do not match actual practices. Some asset managers have a broader depth to their ESG integration than others which is apparent from their stewardship activities, the content of their voting policies and other relevant documentation.

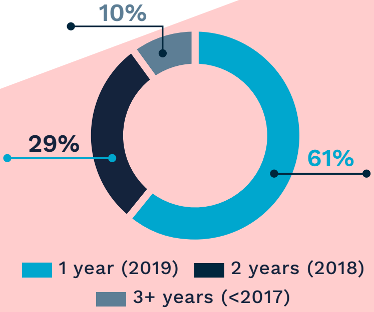
Clarity surrounding asset managers' governance preferences through voting policies

Asset managers develop voting policies to give indications to the market and to companies of their governance sensitivities and expectations. These policies often are encompassing of ESG, but predominantly focus on governance issues such as board composition or executive pay. Asset managers are reluctant to disclose fully their voting parameters due to the nuance of some voting decisions. **82% of asset managers in our selection have a disclosed bespoke voting policy, of which 90% renew their policy every one or two years to stay up to date with the market and accepted governance best practices.**

Disclosure of a Voting Policy

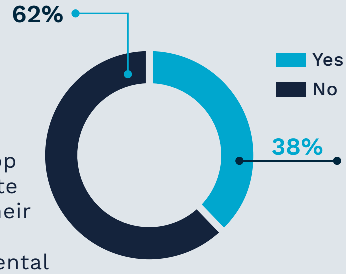


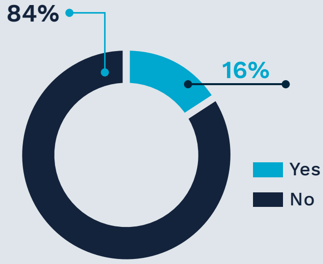
Policy Last Updated



Integration of Environmental & Social issues into voting policies

Asset managers include to a various extent environmental and social factors into their voting policies, with climate change and employee rights becoming an increasing inclusion. Only 38% of the top 50 asset managers have included a clear and separate section for environmental and social issues within their voting policy. This proportion will probably increase given the rise of shareholder proposals on environmental and social topics.



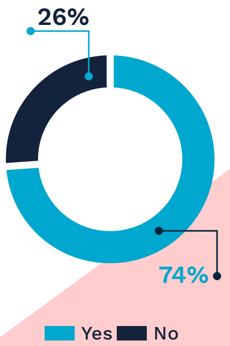


Voting Policies to take into account market specificities

A select number of asset managers, often with large global diversified portfolios, have market-specific policies to be clearer on how they tailor their voting behaviour to local market sensitivities. While companies would like investors to consider the peculiarities of their home market, only 16% of asset managers have disclosed separate voting policies/guidelines for different markets.

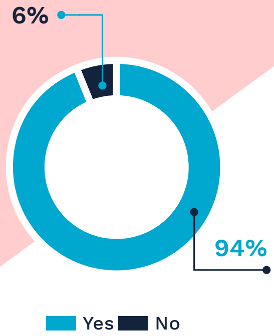
Stewardship Teams moving to the "Front Office"

Asset managers have formed stewardship teams in order to engage with companies within their portfolios on ESG-related issues. These stewardship teams are not always alone in their function and are increasingly working alongside the investment analysts and fund managers, which demonstrates a healthier ESG integration process at asset managers. 74% of the top 50 asset managers have a dedicated stewardship team appointed to engage on ESG issues and vote at general meetings of companies. While the size of these teams is increasing, with BlackRock for example having more than 40 analysts, in general there is still room for improvement.

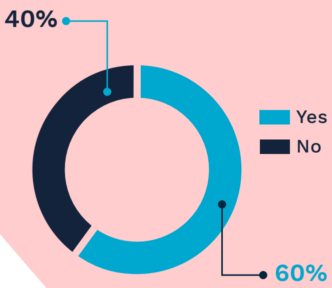


The proliferation of Stewardship Codes

With more than 20 stewardship codes globally, investors are receiving local guidance on how to monitor their portfolio companies. 94% of the top 50 asset managers are signatories to a stewardship code, with the most prominent being the UK, Japanese and Dutch stewardship codes. While these stewardship codes are generally driven by regulators, we note that in the largest equity market, the US, investors and companies have come together voluntarily to form the Investor Stewardship Group.



Close to 80% of the top 50 asset managers engage with companies in their portfolios. This information is based on the disclosure of engagement reports and associated disclosure or SquareWell's own experience when dealing with corporate clients.



Engagement Reports

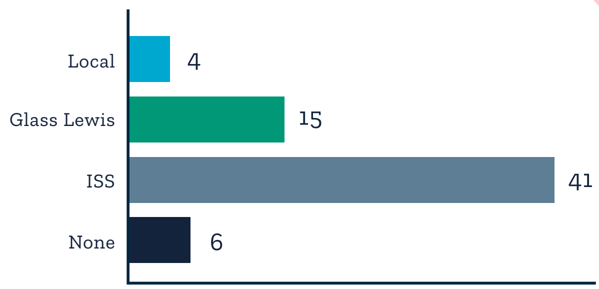
Many asset managers disclose their engagement efforts in what SquareWell refers to as "Engagement Reports", where asset managers usually detail their ESG engagements with companies throughout the year. A small number of asset managers go as far as naming the companies they have engaged within their case studies. 24% of asset managers that disclosed Engagement Reports directly named the company in their case studies.

The role of **Third-Parties**

Investors do not solely rely on internal sources to base their decisions and carry out their engagement activities; they also rely on external sources such as proxy advisors and ESG service providers.

Proxy Advisors to assist with evaluating general meeting agendas

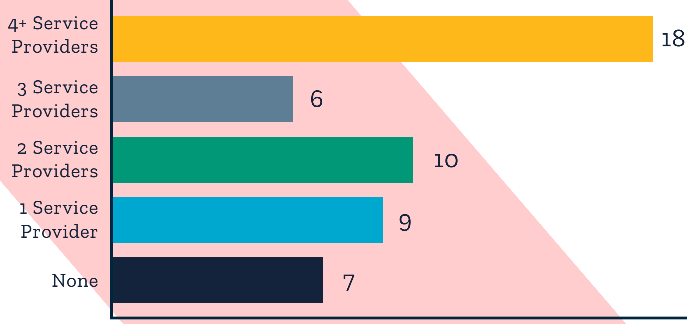
The vast majority of asset managers draw upon the knowledge and expertise of proxy advisors to make well-informed voting decisions at general meetings. Some asset managers rely on more than one proxy advisor, with ISS and Glass Lewis being the two dominant firms with six asset managers within the top 50 not utilising any.



Though asset managers use proxy advisors, many of them have implemented custom policies for the selected proxy advisor to apply when reaching a voting decision. **As indicated in ISS's letter to the SEC in November 2018[3], 85% of ISS' top 100 clients used a custom proxy voting policy.**

ESG service providers to assist with ESG data and engagement

68% of the top 50 asset managers use two or more ESG research and data providers. These service providers predominantly include MSCI, Sustainalytics, ISS-Ethix, Reprisk, and Bloomberg ESG. These ESG service providers have financial implications for companies. For example, a poor MSCI ESG rating can have a company excluded from one of their ESG indexes which many investors now follow.

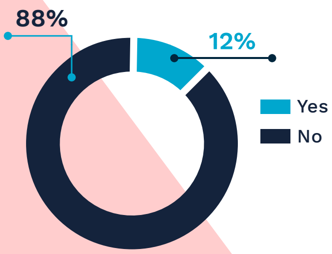


Activism – a useful market force?

Activism is a growing market force, for better or for worse, and investors are becoming more aware of the need for public disclosure on their approach to activist campaigns and situations. Due to the unique nature of each campaign, however, some investors are reluctant to publish anything substantial.

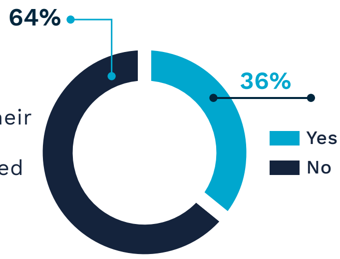
Activism philosophy

Only 12% of asset managers disclose distinct information on their philosophy towards activist situations including their process of engagement and what factors they look at from both sides of the activist campaign.



Activism within asset managers' voting policy

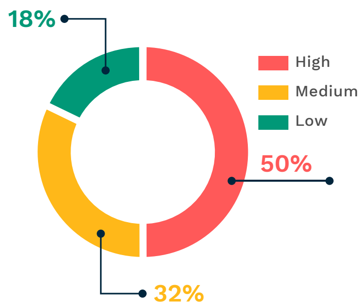
36% of investors disclose within their voting policy their approach to contested situations, with contested board elections being the most common. This is due to the frequency of activist campaigns demanding board-related changes.

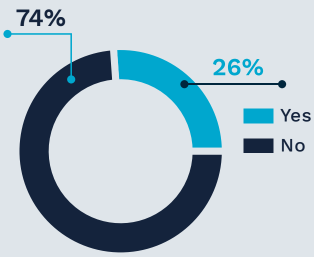


Asset managers' receptivity to activist situations

Asset managers' receptivity to activist campaigns at their investee companies has increased over the years and is broadly viewed as a useful market force to push companies to be more attentive to its shareholders' expectations and concerns. With activism becoming a stronger force in equity markets, investors will be heading to a more codified and established process for dealing with them which currently is not the case.

Only 20 percent of the asset managers reviewed within the top 50 have been systematically supportive of portfolio companies when targeted by activists to enact board changes over the past two years.





Asset managers are increasingly becoming more vocal

Some asset managers are more vocal than others when it comes to contested situations, even when there is not an activist fund pushing for change in the stock. A quarter of our universe has been identified as having publicly voicing their discontent towards a specific company, whether it be through commenting to a wider media publication to issuing a standalone press release, since January 2018.

Examples:

Legal & General
INVESTMENT MANAGEMENT

Legal & General Investment Management

Legal & General raised concerns over a planned acquisition in the mining sector in a financial publication, raising issues over the deal's treatment of minority shareholders.

Schroders

Schroders wrote a public letter to the Chairman of a company operating within the financials sector, expressing its concerns with a planned takeover from another company citing operational and regulatory challenges.

[1] http://mail.ipe.com/files/amf_ipe/project_45/Top-400-Asset-Managers-2019.pdf
[2] http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf
[3] https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf