DAVY

White Paper

The Net Zero Transition, Managing Investor Demands

A Financial Stakeholder's View: BlackRock

Davy Horizons. **Helping you define sustainable solutions.**

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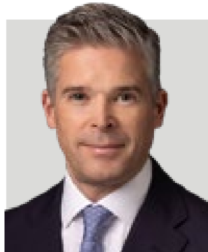

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Foreword

Bernard Byrne
CEO, Davy Group

The global financial landscape is undergoing a transformation as we collectively strive to mitigate the impacts of climate change and natural capital depletion. Investors, driven by regulation, stewardship, risk avoidance and return are increasingly demanding a shift towards sustainable, net zero aligned business models.

At Davy, we are acutely aware of the rising demands of stakeholders, most notably shareholders and also wider society, in relation to sustainability. It was for that reason we established our Davy Horizons sustainability advisory and Decarbonization finance teams in 2020.

Funds aligned with sustainability objectives have reached over 56% of the EU assets under management at over €5 trillion[1]. As this market transition gains pace, the complexity of demands from investors across Environmental, Social and Governance (ESG) is growing. Our teams aim to support our plc clients navigate ESG in capital markets through our expert advisory, financial supports and access to insights from leading institutional investors. For this reason, I am delighted to present this publication which incorporates a Q&A between Davy Horizons and David Hickey, UK Head of Sustainability for BlackRock, the world's largest asset manager and a major shareholder in many Irish plcs.

Within this publication, we unpack the net zero transition, outline what it means for the EU and Ireland and how it will be financed by projects and initiatives that not only mitigate the risks but seize the opportunities presented by the transition to a low and zero-carbon economy. It is clear that business and finance must adapt quickly to remain competitive and resilient, and to capture the immense opportunity which lies ahead. For example, the EU plans to invest €1.8 trillion and expects to create 2.3 million jobs as part of "Green Deal" policies.

Here at Davy, client success is at the heart of our mission. Sitting at the nexus of those with capital and those who deploy it, we are ideally positioned to support the net zero transition in Ireland. It is increasingly important for us, as leaders, to embrace a broader purpose – to catalyse positive change, not only for our clients but for our collective future.

I would like to thank David Hickey and the Davy Horizons team for their collective insights in this paper. I would also like to thank our clients, partners and industry peers for their support and shared commitment to the net zero transition.

1 SFDR_Article_8_and_Article_9_Funds_Q2_2023_in_Review_080823.pdf (contentstack.io)

ESG and the Capital Markets Landscape

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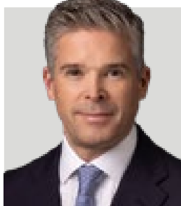

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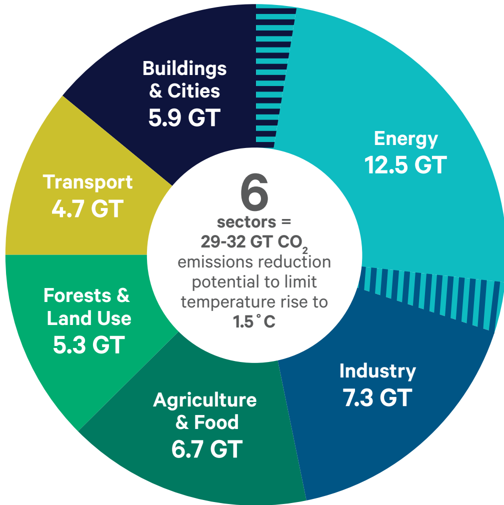
What does the net zero transition mean globally and how much will it cost?

Achieving net zero Greenhouse Gas (GHG) emissions by 2050 at the latest is essential to limiting global warming rise to 1.5°C above pre-industrial levels. To achieve this, global GHG emissions must be reduced by at least 43% by 2030 compared to 2019 levels, and at least 60% by 2035, reaching net zero by 2050. This is the decisive decade to make that happen. Failure to meet net zero will result in stranded assets, a dire future for the next generations and widening inequalities. By 2050, 2.2°C of warming has the potential to reduce global GDP levels by up to 20% as increased storms, wildfires, drought, flooding and crop failures hamper growth and threaten infrastructure[2]. By comparison, the cost to tackle climate change is much cheaper at only 1.5% of global GDP, or approximately $1.5-2 trillion a year for the next 30 years[3].

For business sectors globally, meeting a 1.5°C limit means a GHG emission reduction of 30-gigatonne (GT) carbon dioxide equivalent (CO_2e) annually to 2030 across six sectors[4]. The reductions needed per sector are illustrated below.

The Six Sector Global Solution to Climate Change



Source: Emissions Gap Report 2020 | UNEP - UN Environment Programme

2 Oxford Economics - The global economic costs of climate change inaction
3 The Financial Times - The costs of tackling climate change keep on falling
4 UNEP - The six sector solution to the climate crisis

The good news is that mitigation solutions exist for most sectors to close the gap. They have the potential to halve emissions from 2019 levels by 2030 and cost less than USD $100 per tonne of CO_2e.[5]

The bad news is the world is not on target to limit warming to 1.5°C. Going into COP28 in November 2023 in the United Arab Emirates (UAE), the UN Intergovernmental Panel on Climate Change (IPCC) highlights:

GHG emissions are at the highest level in human history. Climate change is already affecting many weather and climate extremes in every region across the globe – with widespread loss and damage to both nature and people.

The planet has already warmed by 1.1°C since the pre-industrial era and current climate policies are projected to increase global warming by 3.2°C during the 21st century.

Loss and damage will disproportionately affect the poorest and most vulnerable populations, particularly those in Africa and least-developed countries, creating more poverty.

Prioritizing equity, social justice, inclusion and just transition processes would enable ambitious climate mitigation actions and climate-resilient development.

Tracked climate finance for mitigation falls short of the levels needed to limit warming to below 2°C or to 1.5°C across all sectors and regions.

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5 IPCC - AR6 Synthesis Report, Climate Change 2023

What does the net zero transition mean for the EU and Ireland?

The EU Green Deal is Europe's "man on the moon moment" to make Europe the first climate-neutral continent. Within the Green Deal, the EU's "Fit for 55" programme focuses on a 55% GHG emissions reduction by 2030 as the near term target. The EU will invest €1 trillion during 2021-2027 to shift carbon-intensive sectors like fossil fuel energy generation, transport, buildings and agriculture to low or net zero emissions. The package focuses on enabling the technology solutions, finance and incentives for this sustainable market transformation.

Ireland has a legally binding target to reduce GHG emissions 51% by 2030 compared to 2018 levels. To achieve this transition significant investment is necessary. This funding must be sourced from both public and private capital investments. Ireland's Climate Action Plan[6] outlines a total public investment of €165 billion between 2021 and 2030, which will bring public investment to 5% of Gross National Income (GNI). To meet the targets and objectives of the Climate Action Plan, the private sector must be directed towards financing investments that contribute towards Ireland's emissions objectives and away from financing investments that are inconsistent with the government's sectoral emissions ceilings[7].

Ireland Climate Action Plan Sector Targets

Sector	Reduction	2018 Baseline	Emissions in final year of 2026-2030 carbon budget period
Electricity	75%	10 MtCO_2e	3 MtCO_2e
Transport	50%	12 MtCO_2e	6 MtCO_2e
Buildings (Commercial and Public)	45%	2 MtCO_2e	1 MtCO_2e
Buildings (Residential)	40%	7 MtCO_2e	4 MtCO_2e
Industry	35%	7 MtCO_2e	4 MtCO_2e
Agriculture	25%	23 MtCO_2e	17.25 MtCO_2e
Other*	50%	2 MtCO_2e	1 MtCO_2e

*F-Gases, Waste and Petroleum refining

Source: Climate Action Plan 2023, Gov.ie

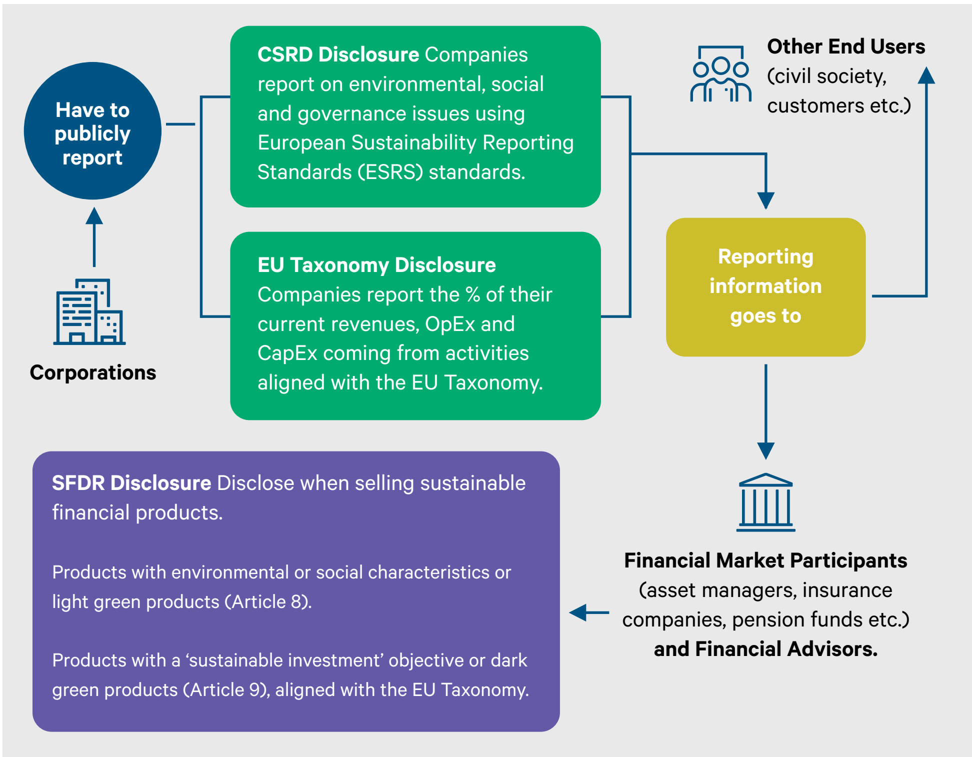
6 Department of the Environment, Climate and Communications - Climate Action Plan 2023
7 Department of the Environment, Climate and Communications - Sectoral Emissions Ceilings, September 2023

Driving the EU transition

The **EU Sustainable Finance Action Plan** launched in 2018, provides the framework to redirect capital flows towards the green economy. The Plan centres on three core objectives:

- Redirect capital flows towards a more sustainable economy,
- Integrate sustainability into risk management, and
- Promote transparency and long-term thinking in financial markets.

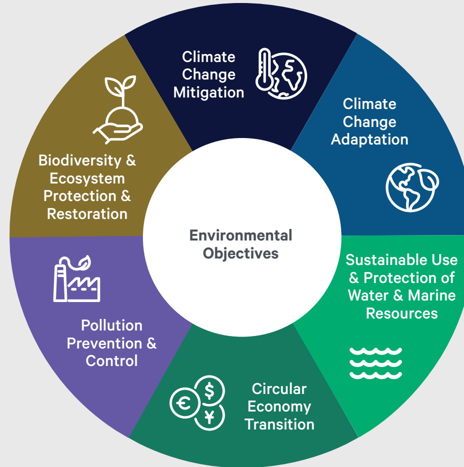
As illustrated, these disclosures include the **Sustainable Finance Disclosure Regulation (SFDR)** which regulates disclosures related to investment, the **EU Taxonomy** defining sustainable market activities and the **Corporate Sustainability Reporting Directive (CSRD)** mandating corporate ESG disclosures in reporting. The CSRD, SFDR and the EU Taxonomy together create the data "push and pull" factors between corporates and investors, driving transparency and enabling the transition towards a green economy.



Source: EU Sustainable Finance Action Plan

EU Taxonomy

The **EU Taxonomy** is a classification system which provides a standard for determining whether an economic activity can be considered environmentally sustainable. The EU Taxonomy reinforces transparency in reporting sustainable activities by enabling companies and funds to assess alignment against several criteria focused on six key environmental objectives.



For an activity to be considered sustainable under the EU Taxonomy it must actively contribute to at least one of the six environmental objectives whilst adhering to "do no significant harm" to any of the remaining objectives. This should be carried out in alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the International Labour Organisation's (ILO) declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights.

Sustainable Finance Disclosure Regulation (SFDR)

The **SFDR**, launched in March 2021, mandates in-scope financial market participants to disclose information related to sustainable investments and the risks associated with sustainability. The primary objective of SFDR is to enhance transparency in sustainability and ensure that companies can finance sustainable growth. The regulation includes disclosure requirements that apply to both businesses and financial products to standardise sustainability reporting and prevent "greenwashing".

SFDR categorises investment funds into three categories of sustainability based on the product's sustainability objectives[1]. According to the SFDR's classification system, a fund will either be classified as an Article 6, 8 or 9 fund – depending on its characteristics.

Principal Adverse Impacts (PAI)

PAI are a cornerstone of SFDR and relate to the potential negative impacts that a financial product may have on 64 adverse sustainability indicators. SFDR requires Financial Market Participants to disclose this PAI information.

Mandatory Adverse Sustainability Indicators	
Climate and other environment indicators	**Social and governance indicators**
▪ GHG Emissions (Scope 1, 2, and 3) ▪ GHG Intensity ▪ Fossil fuel sector ▪ Non-renewable energy consumption and production ▪ Energy consumption intensity per high impact climate sector ▪ Biodiversity sensitive areas ▪ Emissions to water ▪ Hazardous waste	▪ Violations of UN Global Compact principles and OECD Guidelines ▪ Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines ▪ Gender pay gap ▪ Board gender diversity ▪ Exposure to controversial weapons

Markets in Financial Instruments Directive II (MiFID II)

Markets in Financial Instruments Directive II (MiFID II) requires financial intermediaries to consider clients' sustainability preferences when conducting suitability assessments. If retail investors express interest in making sustainable investments, financial intermediaries must accommodate. Depending on the specific client's preferences, financial intermediaries will have to source products that have a minimum proportion of sustainable investments as defined by the **SFDR** or the **EU Taxonomy**.

Corporate Sustainability Reporting Directive (CSRD)

The CSRD which entered into force in January 2023, replaces the current EU Non-Financial Reporting Directive (NFRD). CSRD modernises and strengthens the rules on the ESG information that companies must report on. Companies in scope are EU entities (including EU subsidiaries of non-EU parent companies) that exceed two of the following criteria:

- 250+ employees
- Total balance sheet of €20m+
- Revenue of €40m+

The CSRD, will roll out from 2024 and significantly expands the number of companies required to provide sustainability disclosures to over 50,000 (listed, large private and listed SMEs) from around 12,000 currently, and introduce more detailed annual reporting requirements on company impacts on the environment, human rights and social standards and sustainability-related risk. CSRD ensures investors and other stakeholders will have access to the necessary information to evaluate investment risks that may result from climate change and other sustainability concerns.

Sustainable and transition finance

The transition to a net zero and sustainable economy requires investments in green technologies and sustainable economic activities. A wide range of investments is required including transition activities made by GHG-intensive sectors and corporates. The sustainable finance regulatory framework recognises investments in the transitioning of economic activities, assets and companies to climate and environmental objectives through the EU Taxonomy. Transition finance can be raised not only by companies with the highest sustainability performance but also by companies with different starting points, as long as there are credible sustainability objectives.

CSRD requires companies falling within scope to disclose Taxonomy Aligned Turnover, CapEx and OpEx and to formulate Climate Transition. Climate Transition Plans must include science-based reduction targets aligned to 1.5°C across Scope 1-3 emissions, implementation of actions to meet these and related financial/investment plans. The focus needs to include Scope 3 emissions in the value chain (where over 70% of most corporate emissions occur). This makes supplier engagement, green procurement and the use of internal carbon pricing key requirements to incentivise action.

Investment funds' SFDR reporting requires disclosure of the proportion of their EU Taxonomy-aligned assets. This adds pressure on corporates to disclose Taxonomy-aligned Turnover, CapEx and OpEx.

"In 2023 for the first time, investment funds that either promoted environmental or social characteristics (Article 8) or funds that have sustainable investment as their objective (Article 9) reached over €5trn in assets.[8]"

Asset managers have broadened the selection of Article 8 and Article 9 options for investors in terms of asset class, market exposure, investment style, and theme. The source of the most significant product expansion has been in equity and fixed income with Article 9 funds skewed more towards equity. Article 8 and 9 funds now represent over 54% of EU funds.

In 2022, the European Securities and Markets Authority (ESMA) clarified that Article 9 funds should hold 100% sustainable investments[9]. Following that clarification, many asset managers downgraded funds they believed could not achieve that level of sustainable investments. In fact, around 40% of Article 9 funds were downgraded to Article 8 in the final three months of 2022[10]. Asset managers have been removing the word 'sustainable' from fund names as they wait for clarification from ESMA on the use of 'sustainable' in fund names[11]. More recently, adding to the confusion, the European Commission launched a 3-month public consultation on whether to scrap Articles 8 and 9 altogether and introduce a category system closely aligned with the UK Financial Conduct Authority's (FCA's) proposed labelling framework[12].

8 SFDR_Article_8_and_Article_9_Funds_Q2_2023_in_Review_080823.pdf (contentstack.io)
9 ESMA - Consolidated questions and answers (Q&A) on the SFDR
10 Morningstar - ESG Fund Downgrade Accelerates
11 The Financial Times - Asset managers turn to 'green hushing' on sustainable funds
12 European Commission - Sustainability-related disclosure in the financial services sector

Science Based Targets

Corporates that commit to SBTi standards are not only following best practice to decarbonise the business but also flagging to financial stakeholders and potential investors their intent to de-risk the business from increasing carbon taxes. By the end of 2022, companies with science-based targets or commitments represented 34% of the global economy by market capitalisation, compared with 28% at the end of the previous year. SBTi has become so important that equity and bond indices containing only SBTi-committed issuers are available and as more corporates commit to SBTi, this represents an easy way for portfolio managers to track an index whilst maintaining the portfolio decarbonisation trajectory.

As well as reporting non-financial data and Climate Transition Plans, corporates need to communicate sustainability plans and targets via sustainability reports and investor stewardship and engagement channels. Financial stakeholders are placing increased importance on corporate decarbonisation plans, ESG targets and governance. Net zero alliances committed to accelerating the decarbonisation of the economy, continue to grow. External gold standards including the Science Based Targets initiative (SBTi) and CDP are used by investors to gauge corporates' alignment to the net zero transition.

CDP

CDP is seen as a gold standard in corporate sustainability reporting. While SBTi focuses on future sustainability targets, CDP provides a snapshot of a company's current sustainability efforts. Unlike ESG rating agencies, CDP requires actual data to be input by the corporate and does not rely upon data aggregation. With ESG rating regulation to ensure transparency in ratings methodologies expected in 2024, actual data disclosed aligned to SFDR, CSRD, EU Taxonomy or CDP is expected to become the primary source of information used by investors.

Other financial stakeholders, such as lenders and insurers, have a regulatory requirement to incorporate sustainability data, such as flood risk data, weather data and building energy performance data, into decision-making frameworks, which will impact lending requirements and insurance premia. Some reinsurers are already pointing to increases in insurance prices due to wildfires in Europe[13].

Transition finance includes both general-purpose financing and green financing. Global sustainable bond issuance (encompassing Green, Social, Sustainability and Sustainability-linked (GSSS)) reached $570bn in the first six months of 2023[14]. Sustainable bond issuance from corporates and governments rose 18.6% compared to the same period in 2022.

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13 The Financial Times - Weather disasters in Europe to push up insurance prices, warns Lloyd's of London chief
14 Bloomberg Professional Services - Green bonds boom in first half of 2023

Green bonds, the most widely used type of sustainable bonds are use-of-proceeds products where the proceeds of issuance can only be used for a strictly pre-defined green project with clearly defined environmentally sustainable benefits[15]. Examples of green projects include:

- Renewable energy including production, transmission, appliances and products
- Energy efficiency including new and refurbished buildings, energy storage and smart grids
- Pollution prevention and control, including emissions reduction and greenhouse gas control
- Sustainable water and waste management

In October 2023, the European Parliament approved the EU Green Bond Standard (EUGBS).[16] The EUGBS comes with strict sustainability requirements that issuers must meet. In particular, at least 85% of the funds raised by the bond should be allocated to economic activities that align with the EU Taxonomy Regulation. This will make it easier for investors to assess and compare the sustainability of their investments, and reduce the risks associated with greenwashing. Additionally, as corporates become comfortable with the EU Taxonomy, it will become easier to report Taxonomy-aligned Turnover, CapEx and OpEx.

Sustainability-linked bonds (SLB) and more widely used sustainability-linked loans (SLL) are general-purpose debt products which have ESG-linked KPIs attached to the terms of the loan. The SLL market has grown rapidly over the last 5 years and whilst SLL provide a useful transition finance there are several weaknesses that may limit more widespread adoption and growth of this market, as found in the FCA's 2023 review of the SLL market[17]. The principal area of concern regarding SLL's is credibility and the FCA believes there is a case for strengthening KPIs to clearly align with borrowers' published transition plans. The FCA is seeking market feedback on linking the KPIs on sustainability-linked bonds to transition plans.

15 ICMA - Green Bond Principles
16 European Commission - European green bond standard
17 FCA - Review of the Sustainability Linked Loan (SLL) Market letter

Financial stakeholders are also interested in understanding how banks intend to finance the transition towards a zero-carbon economy. Under Pillar III disclosures the European Banking Authority (EBA) requires banks in 2024 to disclose information on climate risks within the banking book[18], what mitigating actions are in place and the publication of Green Asset Ratios (GAR) and Banking Book Taxonomy Alignment Ratio (BTAR). The GAR and BTAR are two important KPIs based on the EU Taxonomy used to determine whether they are financing sustainable activities aligned with the Paris Agreement.

With CSRD, the final piece of the EU Sustainable Finance Action Plan, slotting into place and corporates reporting non-financial data, publishing Climate Transition Plans and reporting Taxonomy-aligned Turnover, CapEx and OpEx, financial stakeholders can more easily assess the upcoming risks and opportunities brought about by climate change in their lending/asset/insurance portfolios. Climate risk assessments are becoming regulated and will become normalised across financial services. This in turn will drive pricing differentials between those aligned to the transition and those that are not.

As financial stakeholders assess climate risks in their portfolios, assets that fail to meet portfolio decarbonisation targets may find they are priced accordingly, through increased insurance premia, increased borrowing costs or reduced access to efficient equity capital. Risk management tools have been commonplace for decades, BlackRock has been marketing its Asset, Liability, And Debt and Derivative Investment Network, (Aladdin™) since 1999. Aladdin™ Climate launched in December 2020 – to help clients better understand the financial impacts to their portfolios associated with climate change, including both physical risks like extreme weather, and transition risks, such as policy changes and new technology. We spoke with BlackRock's David Hickey about how his firm is engaging with their clients on climate and the transition to a low-carbon economy.

18 European Banking Authority, ESG Factsheet

The Net Zero Transition - A Financial Stakeholder's View: BlackRock

David Hickey
UK Head of Sustainability
BlackRock

Prior to joining BlackRock, you spent almost 18 years as a European equity fund manager at both Lothian and F&C Asset Management. Can you give us a sense of how equity stock and portfolio selection processes have evolved within the asset management industry, particularly in relation to sustainability?

The biggest evolution I've seen during my time in investment management is the proliferation of the ESG data industry. This became especially important as investors increasingly became aware of how certain non-financial factors can impact their portfolio companies' financial performance. This makes intuitive sense. Companies that endure severe controversies often face not just regulatory scrutiny or legal liabilities but also risk to their reputation and consumers and suppliers' willingness to do business with them. It's not about 'values', it's about 'value.' While investors have long considered all manner of risks that could impact company valuation, including risks that would now be labelled ESG risks such as the risks associated with waste disposal, industrial safety records, correct adherence to tax rules, how multiple share classes impacted minority shareholders, this was done by trawling through individual company reports and meeting management rather than through having access to specific global data sets. The ubiquity of these data sets in 2023 means that investors have so many extra tools to use to assess risks within portfolios and comparative advantage between firms. Clients too have a new lens with which to look at risk, and about how they might align portfolios with their values should they choose to do so.

Not only has this data been useful for managing risks and opportunities in portfolios that don't have an explicit sustainability objective, they also have allowed investment managers to create unique products that service clients who may have specific sustainability objectives through creation of more bespoke and sophisticated products to meet their investment goals. This development has allowed for the mainstreaming of sustainability in the investment management industry, with $4.3tn of client assets worldwide now invested in sustainable solutions.

Introduction to BlackRock's View and Approach to the Low-Carbon Transition

Q: What is BlackRock's view of the transition to a low-carbon economy? What direction are we heading? And what is the role of asset managers and the broader financial industry in this shift? How will it impact investors' portfolios and what are some of the key factors every investor should be thinking about?

"In the U.S. alone, over $470 billion of government funding has been pledged for the transition and in Europe this number is about €635 Billion."

The transition is underway, and we are seeing three forces drive the economic transformation: technology, customer preferences, and policy. For example, battery costs have significantly decreased, and electric vehicles are expected to account for 40% of vehicle sales by 2030[19]. On the policy side, in the U.S. alone, over $470 billion of government funding has been pledged for the transition and in Europe this number is about €635 billion.

This shift in the global economy will have different implications for different regions and sectors, creating both risks and opportunities for investments. Our clients are asking for BlackRock's help. We have found that 56% of global institutional investors expect to increase their allocations to transition strategies over the next 1-3 years, based on our 2023 survey[20].

As an asset manager and fiduciary, our job is to listen to our clients and help them navigate – and capture opportunities in – an increasingly complex environment. Sustainability and the low-carbon transition will present significant investment risks and opportunities for years to come. While our clients have different views on sustainability and the transition, many are focused on what tthey mean for their portfolios, and are asking how to mitigate risk and capture opportunities. Some want to increase their exposure to the transition, some want to align their portfolios with a net zero pathway, and some want to achieve impact or sustainable outcomes in addition to financial return or to limit exposure to specific sectors. Some choose not to invest in products or strategies that have sustainable investment objectives. We serve them all.

BlackRock's investment approach is rooted in our fiduciary duty and informed by three principles: we start by understanding the client's investment objectives; we seek the best risk-adjusted returns within the scope of the mandate they give us; and we underpin our work with research, data, and analytics. We apply that same approach to sustainability and the low carbon transition. When financially material, we incorporate environmental, social, or governance information alongside other information into our firmwide processes to enhance risk-adjusted returns, regardless of whether a fund or strategy has a sustainable, climate, or transition-related objective (see our ESG Integration Statement).[21]

Q: Companies within the so-called "hard to abate" sectors can be among the most significant contributors to the climate transition if they can successfully transition their businesses. What is BlackRock's approach to supporting those essential industries in their transformation journey?

The brown to green transition involves moving from an energy system that is fossil fuel and carbon intensive today, to a world characterised by deep electrification - where we harness a range of renewable, low or zero carbon-emission energy sources. For example, the metals and materials industries will likely need to grow substantially in the coming decades to provide the building blocks of the energy transition, while simultaneously working to decarbonise their own value chains.

However, the materials sector alone contributes to over 17% of GHG emissions in 2022. Thus companies that do not have Credible Transition Plans may face headwinds (in light of the

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19 Bloomberg - Electric Vehicle Outlook 2022.
20 BlackRock iResearch Services global survey, sample size n=200, May-June 2023. Survey covered institutional investors' attitudes, approaches, barriers, and opportunities regarding transition investing.
21 BlackRock - ESG Integration Statement

aforementioned changes in consumer preferences and policy), and those with such plans may represent investment opportunities for our clients, as companies that navigate this dynamic well are more likely to command higher valuations and could enjoy some business model advantages.

At BlackRock, our transition investing platform include both strategies that invest in companies looking to scale innovative climate solutions – including in hard-to-abate sectors – as well as those that invest in companies providing key inputs, like lithium, for decarbonization.

Q: Can you talk about how the proprietary Aladdin™ Investment management platform integrates sustainability? Is BlackRock using 3rd party data providers like MSCI ESG, Sustainalytics and Rep Risk? And how important are their ratings as an input to your investment and stock selection process? How relevant is CDP scoring?

Aladdin™ offers transparency and flexibility to investors to better understand, analyze and manage sustainability-related risks and opportunities. To that end, Aladdin™ provides access to over 15,000 ESG metrics from third-party data providers (subject to licensing) that can be integrated into investment workflows. BlackRock also launched Aladdin™ Climate to help investors understand their exposure to climate-related risks and opportunities in their portfolios. Aladdin™ Climate was built to quantify climate risks and opportunities in financial terms by bridging climate science, policy scenarios, asset data, and financial models to arrive at climate-adjusted valuations and risk metrics. Aladdin™ Climate estimates the financial impact of transition and physical risk on portfolios under a set of forward-looking industry-standard emission scenarios (IPCC and NGFS)[22] and a portfolio's alignment to decarbonization pathways. These climate analytics are made available throughout the Aladdin™ platform, enabling access to this data across the investment process. While each of our investment teams will leverage sustainability-related information differently, consistent with their fund strategy and individual client mandates, they all have access to Aladdin™ Climate, where asset class coverage is available. The ultimate goal is to help investors incorporate sustainability-related risks and opportunities in their portfolios as they see fit so that they can make the most informed asset allocation decisions in line with their investment objectives.

In addition to industry-standard scenarios defined by internationally accepted sources, we have also worked with investors, climate scientists, macroeconomic strategists, and researchers across BlackRock to build the BlackRock Investment Institute Transition Scenario - a framework that details how we think the transition to a low-carbon economy is likely to unfold across sectors and regions, based on the drivers that I talked about earlier – policy, technology, societal and consumer preferences.

Lastly, BlackRock leverages third-party ESG data in addition to in-house research to gather company-level information on key ESG indicators and we have done this since 2012. Our providers include MSCI, Clarity AI, ISS-Ethix, RepRisk, Sustainalytics, Refinitiv, Bloomberg, and others.

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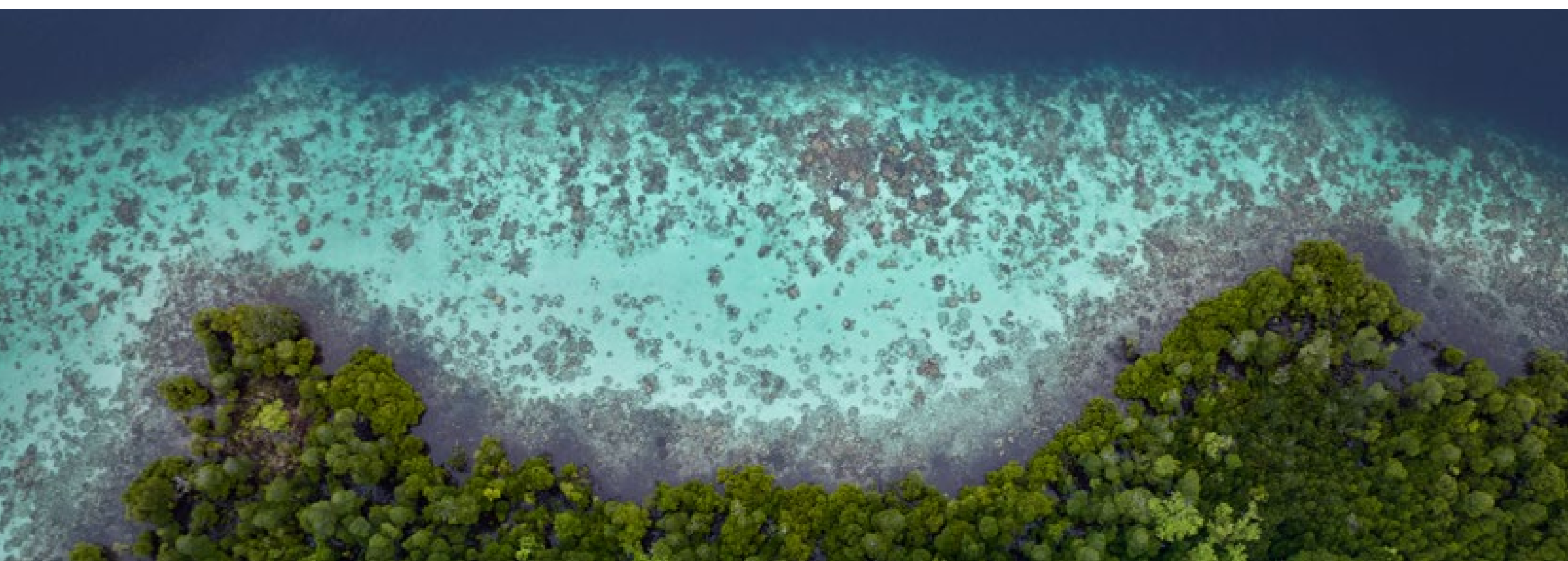
22 Network of Central Banks and Supervisors for Greening the Financial System (NGFS)



Global Asset Shift towards Sustainable Investments

"There continues to be a massive shift of capital towards sustainable assets as more and more investors express conviction that sustainability risks, including climate risk, are investment risks"[23]

Q: Can you give us BlackRock's latest thoughts on how demand for sustainable assets is evolving? How is it similar or different across geographies and investor types? It seems that in the USA ESG has become embroiled in partisan politics. How is BlackRock navigating this landscape?

As a fiduciary, BlackRock invests on our clients' behalf to help them meet their investment objectives. Our role in the transition is to help clients navigate investment risks and opportunities, not to engineer a specific decarbonization outcome in the real economy. As I mentioned earlier, our investment approach is informed by three principles: we provide choice, we seek the best risk-adjusted returns within the mandates clients give us, and we underpin our work with research, data, and analytics.

The low carbon transition is an investment priority for many of our clients. We commissioned a survey in June this year and found that 56% of investors indicated that they plan to increase transition allocations in the next 1-3 years, and 46% said navigating the transition is their most important investment priority in the next 1-3 years[24]. Investors are coming at this from a variety of approaches. Globally, the majority - 56% - of respondents indicated a preference for a whole portfolio approach to transition investing, while 41% expressed a preference for an asset-class-by-asset-class approach. Respondents also expressed that they thought there are some product offerings gaps (such as investing in emerging markets or fixed income), as well as other challenges with transition allocations such as tracking KPIs.

For investors who want to, aligning a portfolio towards low-carbon transition will be a multi-year journey as new investment opportunities and products emerge, new climate analytics becomes available, and companies' reporting improves. We have investors partnering with us to assess their portfolio alignment towards transition on a regular basis, across all the geographies we operate in.

Of course, there are clients who do not invest with a sustainability objective, and we are focused on offering them the investment solutions and strategies that help meet their investment objectives too.

Q. One of BlackRock Investment Stewardship's Engagement Priorities is "climate and natural capital." Can you explain why BlackRock is focused on that issue and what its expectations for companies are?

Our investment stewardship approach to climate and nature-related risks are rooted in our role as a fiduciary to clients.

"Research is increasingly clear that the risks associated with both climate change, natural capital and biodiversity loss can be financially material for companies' long-term performance and ability to deliver value to their investors. How companies navigate these risks and adapt through the energy transition can have a direct financial impact on our clients' investment outcomes and financial well-being."

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23 Source: BlackRock website

24 Global perspectives on investing in the low-carbon transition | Survey of 200 institutional investors

For BlackRock Investment Stewardship, disclosure is key, because it helps investors understand the impact of climate change and the energy transition on their strategy and business model, as well as how they manage climate-related risks – and capture opportunities. In our stewardship work on behalf of clients, we use this information to guide our engagement discussions with companies and our voting. The disclosure of this information can also help inform investment decision making and portfolio construction decisions.

That's why our investment stewardship looks to encourage disclosures aligned with the Taskforce on Climate-related Financial Disclosures[25], including how their business model aligns to a range of climate scenarios. This may include any short-, medium-, and long-term targets for scope 1 and 2 greenhouse gas emissions.

There is also growing effort in the financial industry to better understand the financial implications of companies' impacts and dependencies on natural capital. BlackRock has contributed to the Taskforce on Nature-related Financial Disclosures[26] since its launch in the summer of 2021. BlackRock believes that for companies whose strategies or supply chains rely on natural capital, natured-related impacts and dependencies – including on resources such as land, water, and biodiversity - can be material for long-term performance. TNFD's recommendations can encourage more consistent and comparable nature-related disclosures to enable investors to better assess how companies are managing and mitigating material natural capital risks and positioning their strategy to account for related impacts and dependencies.

ESG Trends into 2024 and beyond

Q. What are the key Sustainability issues into 2024 and beyond that BlackRock will be focused on?

While the past several years have seen a jump in interest in sustainable investing broadly, moving forward we're starting to see a significant increase in client interest in transition investing, focusing specifically on strategies and solutions related to the transition to a low-carbon economy. We've published a number of materials this year informing clients of our efforts on this front. This includes launching a transition investing platform, with a suite of products across index, active, and private market strategies. This also includes research findings such as the BIITS, the BlackRock Investment Institute's Transition Scenario, which dives deeper on what the BlackRock Investment Institute believes is likely to unfold in the low-carbon transition, based on the current path of government policies, consumer preferences, and technological innovation.

Another issue to watch is biodiversity and natural capital. BlackRock continues to develop our natural capital and biodiversity capabilities through research, data and analytics via our Aladdin™ platform, and through stewardship, which was discussed earlier. Our Sustainable Investment Research and Analytics team leads the firm's research on investment risks and opportunities related to sustainability and the transition, including biodiversity. Research considerations include consistently and accurately evaluating natural capital-related impacts, financial risks, and opportunities, attributable to all identifiable firm-level impacts and dependencies; ensuring data and analysis focuses at firm-level, but can be aggregated to the portfolio level; and working towards comprehensive natural capital coverage.

These two areas show the power of BlackRock as a platform, utilising expertise across multiple departments and our 600+ dedicated sustainability and transition specialists throughout all functions of the business to serve our clients.

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25 Task Force on Climate-Related Financial Disclosures | TCFD) (fsb-tcfd.org)
26 The Taskforce on Nature-related Financial Disclosures (tnfd.global)

How Davy Horizons can help

The Davy Horizons team

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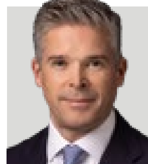

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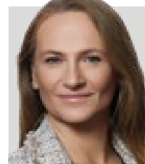

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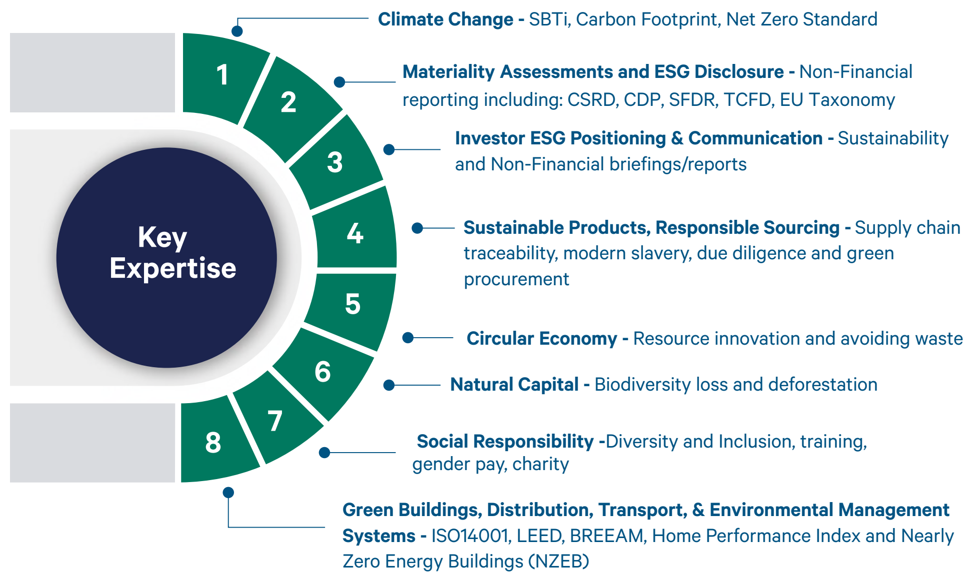
Davy Horizons cover strategic advice, through to practical implementation and reporting across all ESG thematics



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