LENS ON:

The rising focus on ESG: Blackrock and Aviva updates

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In his recent annual letter to company CEOs, Blackrock's Larry Fink reinforces the asset manager's **focus on ESG** and, in particular, the global threat of climate change. The stark reminder of human fragility caused by the coronavirus pandemic serving to strengthen Blackrock's resolve towards **stakeholder capitalism**; a sentiment shared by many investors.

As markets have started to price climate risk into the value of shares, a reallocation of capital is emerging, with investors **re-orientating their investments strategies towards sustainability-focused companies**. Alongside the shift in investor behaviour, 2020 also saw increased political response to environmental concerns, with the EU, China, Japan, and South Korea making commitments to achieve net zero greenhouse gas emissions. More recently, under the Biden administration, the US committed to re-join the Paris Agreement on climate change.

As Fink sets out in his letter, there is "**no company whose business model won't be profoundly affected by the transition to a net zero economy**". Given how central this transition will be to every company's growth prospects, Blackrock are requesting companies **disclose a plan for how their businesses will be compatible with a net zero economy**. Where they do not see progress in this area, and in particular where they see a lack of alignment combined with a lack of engagement, Blackrock will not only use their vote against management for index-held shares but also flag these holdings for potential exit in their active portfolios. Conversely, companies who distinguish themselves in terms of their emissions trajectory, transition preparedness and governance will be viewed as potential opportunity for further investment.

Blackrock are not alone in their views, with Aviva urging companies to integrate climate goals into their strategy and financial targets, and to clearly articulate plans that will deliver net zero emissions by the middle of the century. In recent *guidance* to companies, Mark Versey, Aviva Investors' CEO, also touched upon broader issues of **corporate purpose, diversity and social inclusivity**, stating that they will "**hold boards and individual directors accountable where the pace of change does not reflect the urgency required**".

The extent to which ESG priorities should be reflected in executive incentive plans is increasingly a focus of conversation for Remuneration Committees. Whilst Blackrock do not provide any definitive guidance (other than, where used, ESG criteria should be quantifiable, transparent and auditable; and reflect the strategic priorities of the company), Aviva are encouraging companies to **integrate robust sustainability targets, including indicators linked to the climate transition, into incentive plans**. Meanwhile, LGIM believe ESG performance targets **should act as a modifier to financial outcomes** rather than to provide additional reward unless a company has specific ESG performance metrics that are linked to growth opportunities (e.g. green revenue).

Ellason commentary

Whilst the immediate priority this AGM season will be on company responses to the COVID pandemic, aligning with the S (social) and G (governance) of ESG, broader conversations on environmental and societal impact will continue to gain in intensity.

Please do not hesitate to contact any of the Ellason team should you wish to discuss this issue further.