Climate-related disclosures: The Big Three's proxy voting guidance and expectations

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Background and context

A public company's approach to addressing and disclosing climate-related risks and opportunities has been a popular topic in the financial, investment, and broader capital markets communities in the past three years. The topic picked up steam in 2021, carried into 2022, and has abated slightly this year as securities regulators in Canada and the U.S. work to finalize their proposed rules on climate-related disclosures.

We have written previously about the Canadian Securities Administrators' (CSA) proposed National Instrument 51-107 *Disclosure of Climate-related Matters*, which underwent an extended comment period that ended in February 2022. The proposed instrument is expected to be finalized once the U.S. Securities and Exchange Commission (SEC) publishes its final climate-related disclosure rules, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, which is expected to be released this year.

In lieu of clear disclosure rules from securities regulators to date, proxy advisory firms such as ISS and Glass Lewis have played an integral role in influencing issuers' ESG-related disclosure practices and encouraging more robust climate-related disclosure. We wrote about ISS and Glass Lewis's 2023 proxy voting guidelines in December 2022.

In order to round out this discussion, the perspective of an additional key stakeholder group must be included – that is, the perspective of asset managers. In particular, the 'Big Three' – BlackRock, State Street, and Vanguard. Individually, each firm manages trillions of dollars in assets; collectively they account for more than $20 trillion in assets under management.[1] Through their massive investment holdings – together they constitute the largest shareholder in 88 per cent of the S&P 500 firms[2] – these asset managers have significant voting power in the companies in which they invest. As such, they can influence corporate governance decisions, including the election of board members and other important matters that are put to a vote by shareholders.

The underlying rationale for these asset managers' keen focus on climate risk is that they see it as an investment risk. As a result, asset managers are incorporating climate risk into their portfolio design, as they prepare for a net-zero world. Some asset managers are acutely tuned into the impact that climate change and the transition to a low-carbon economy will have on the long-term profitability of the businesses in which they invest. To navigate these risks, investors require comprehensive disclosure about how the companies they invest in are monitoring, and responding to, climate risks today and over the longer term. Accordingly, BlackRock, State Street, and Vanguard's proxy voting guidelines are becoming increasingly important for boards of directors to understand and respond to, in order to effectively engage with these influential investors.

What you need to know

Below, we summarize the Big Three's most recent Canadian and global proxy guidelines, specifically with respect to climate-related risks and opportunities and the disclosure of same.

BlackRock

BlackRock Investment Stewardship's 2023 *Proxy Voting Guidelines for Canadian Securities* include three main categories of sustainability and climate-related disclosure:

- **Material sustainability-related risks and opportunities**: BlackRock looks for companies to disclose the identification, assessment, management and oversight of material sustainability-related risks and opportunities in accordance with the four pillars of the Taskforce on Climate-related Financial Disclosures (TCFD) – governance, strategy, risk management, and metrics and targets.
- **Climate risk**: BlackRock expects companies to disclose how "their business model aligns to scenarios for the global economy that limit temperature rise to well below 2 degrees Celsius, moving toward net-zero emissions by 2050." Importantly, they note that it is up to each company to define their own strategy, as it is not the role of BlackRock or other investors to do so. They also look to companies to disclose short-, medium-, and long-term targets (ideally in accordance with the Science Based Targets Initiative[3]) for scope 1 and 2 greenhouse gas (GHG) emissions reductions and to demonstrate how their targets are consistent with the long-term economic interests of their shareholders. Scope 3 emissions disclosure and commitments are welcome, but given their methodological complexity, such disclosures and commitments are not considered essential to their support for directors.
- **Natural capital** (new category this year): BlackRock will look for companies to disclose how they consider their reliance and use of natural capital (including appropriate risk oversight and relevant metrics and targets) to understand how these factors are integrated into strategy. This may be the case where a company's business and operations are heavily reliant on the availability of natural capital, or if its supply chains are exposed to locations with nature-related risks. They note that the emerging Taskforce recommendations on Nature-related Financial Disclosures (TNFD) may be a useful framework but understand some companies may report using different standards.

Notably, BlackRock expects to remain a long-term investor in carbon-intensive sectors as it states that these companies "play a crucial role in the economy and in an orderly energy transition." It encourages companies to disclose how their capital allocation to various energy sources is consistent with its strategy.

BlackRock stated that this year it does not anticipate material changes in its voting, and much of its engagement with companies will consist in continuing the dialogue on material risks and opportunities that began in 2022.

Where disclosures are not adequately aligned with the pillars of the TCFD or a company has not disclosed their scope 1 and 2 emissions and meaningful short-, medium- and long-term targets, BlackRock has stated it is unlikely to support the director(s) responsible for climate risk oversight. BlackRock may also support, on a case-by-case basis, shareholder or management proposals that it concludes strengthen a company's approach to climate risk and energy transition.

State Street

State Street's most recent *Proxy voting and engagement guidelines: North America* were published in March 2022. The firm also published further guidance entitled *Disclosure Expectations for Effective Climate Transition Plans* and *Guidance on Climate-related Disclosures* in January 2022. State Street Global Advisors is also a signatory to Climate Action 100+, an investor-led initiative to ensure the worlds' largest corporate greenhouse gas emitters take necessary action on climate change.

Climate-related disclosures : State Street encourages disclosure in accordance with the TCFD. Accordingly, State Street has noted that it may vote against the independent board leader at companies in the S&P 500 and S&P/TSX Composite that fail to provide sufficient disclosure in accordance with the TCFD framework, including board oversight of climate-related risks and opportunities, total scope 1 and scope 2 GHG emissions, and targets for reducing GHG emissions. With respect to significant emitters, State Street noted that, in 2023, it will be "prepared to hold directors accountable" for failing to demonstrate adequate progress to meeting the firm's disclosure expectations (see Table 1 below).

Table 1 – Key areas of climate transition disclosure

Category	Disclosure Expectations
Ambition	• Long-term climate-related ambition
Targets	• Interim GHG emissions reduction targets • Alignment with temperature goals
TCFD Disclosure	• TCFD-aligned disclosure • Scenario analysis • Emissions reporting and assurance
Decarbonization Strategy	• Transition plan integration into long-term strategy

	• Decarbonization actions • Carbon offsets utilization • Decarbonization across the value chain
Capital Allocation Alignment	• Integration of climate considerations into capital allocation decisions • Capital expenditure on low carbon strategies • Carbon pricing • Investments in decarbonization
Climate Policy Engagement	• Disclosure of climate change policies and positions • Trade association review
Climate Governance	• Board oversight • Management oversight
Just Transition	*State Street Global Advisors is in the process of developing our disclosure expectations*
Physical Risk	• Physical risk assessment • Physical risk management
Stakeholder Engagement	• Industry engagement • Investor engagement • Climate expert engagement • Internal engagement

With respect to climate-relate shareholder proposals, State Street will consider them on a case-by-case basis, taking into account "alignment with the TCFD framework, Sustainability Accounting Standards Board (SASB) standards where relevant, emergent market and industry trends, peer performance, and dialogues with company management, boards and other stakeholders." Mostly, the lens with which proposals will be evaluated is based on whether the adoption of a shareholder proposal aiming to address material sustainability issues will "promote long-term shareholder value in the context of the company's existing practice and disclosures, as well as existing market practice."

Vanguard

Vanguard recently released its *Proxy voting policy for Canadian portfolio companies*, effective February 1, 2023.

Vanguard’s policies appear to be less stringent than those of BlackRock and State Street, as they do not outline specific circumstances under which the firm may vote against director nominations for failure to meet particular climate-related disclosure expectations.

Vanguard views climate risk through the “lens of materiality, seeking to determine whether climate-related factors pose a meaningful threat to long-term shareholder value.” As such, it states that it is supportive of “comprehensive and effective” emissions disclosures and climate-related metrics/targets, such as those aligned with the goals of the Paris Agreement.

In terms of climate change risk management, Vanguard looks for the following:

- Climate-competent boards, including independent monitoring of climate issues and integration of climate risks into strategic and financial planning;
- Effective disclosure: climate-related disclosures should be aligned with investor-oriented frameworks such as those set forth by the TCFD; and
- Risk mitigation: where climate change is a material risk, Vanguard encourages companies to set targets that align with the goals set forth in the Paris Agreement.

With respect to shareholder proposals, Vanguard provides that a fund may support proposals that address a shortcoming in the company’s current disclosure relative to market standards or to widely accepted frameworks (such as SASB or TCFD); reflect an industry-specific, materiality-driven approach; and are not overly prescriptive in dictating company strategy or day-to-day operations, or about time frame, cost, or other matters. If these criteria are met, a fund may support the following types of environmental proposals, which are not exhaustive:

- Request disclosure related to companies’ scope 1 and scope 2 emissions data, and scope 3 emissions data in categories where climate-related risks are deemed material by the board; and
- Assessment of the climate’s impact on the company, disclosing appropriate scenario analysis and related impacts to strategic planning.

Notably, Vanguard removed itself as signatory to the Net Zero Asset Managers (NZAM) initiative in December 2022, noting that it did so in order to "provide the clarity [its] investors desire about the role of index funds" and to "make clear that Vanguard speaks independently on matters of importance to [its] investors." BlackRock and State Street are still signatories to the NZAM.

Moving forward

We expect these discussions to heat up later this year, once the SEC releases its final disclosure rules. How stringent, or not, the SEC’s rules end up being will likely strongly influence the disclosure rules adopted by the CSA.

Contact us

We encourage you to reach out to the contacts below or any BLG lawyer from our Capital Markets, Corporate Governance or Climate Change groups if you have any questions related to these guidelines, or for more information on related topics.

[1]Shaun Bisman and Felipe Cambeiro, "Big Three Institutional Investor Updates," 2022.

[2] Jan Fichtner, Eelke M. Heemskerk and Javier Garcia-Bernardo, "Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk," 2017.

[3] Science Based Target website

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