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Emission Impossible? Navigating Climate Action and Regulation

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Anu Rajakumar: Year after year, corporate engagement has become a crucial component of sustainable, or ESG, investing. We at Neuberger Berman signal this through efforts like our advance proxy voting initiative, NB Votes. But how does the behind the scenes of engagement actually work? My name is Anu Rajakumar, and on this special episode of Disruptive Forces, my colleague and Head of ESG Investing, Jonathan Bailey, had the opportunity earlier this month to sit down with the CEO of the non-profit organization, Ceres. In this episode, you'll hear Jonathan and Mindy discussing what fuels climate action in the corporate world today. And now, here's Jonathan and Mindy.

Jonathan Bailey: Thank you, Mindy, for joining us today for a discussion on climate action and regulation. Mindy, to set the stage for the discussion, could you explain to us what Ceres is, and what's its role?

Mindy Lubber: Ceres is an advocacy organization whose mission is to integrate sustainability into capital markets. A lot of words, right? What does that mean, 'integrate sustainability into capital markets'? We make the case that acting on climate change, acting on water shortages, acting on human rights, is not only an issue of moral value, it is [also] an issue of financial well-being. The climate crisis could cost us more than the subprime meltdown cost us. It's monumental. So at Ceres, we work with the world's largest companies to integrate climate action plans, into every one of those companies. We work with their corporate boards, with their CEOs, to come up with a plan and to make sure it's being implemented, and it's got short, medium and long-term goals, and that the public and everyone else has access to it. We work with 198 North American investors and 560 global investors; globally it's about $55 to $60 trillion in assets, with investors who are looking at the financial risks and opportunities of climate change. So what does it mean to their portfolios? Who's in their portfolio? Are their companies acting responsibly? Or there may be risks to them that they're not even accounting for? And those investors that we work with are pushing the companies in their portfolios to change their practices on climate risk. Although they also know, the investors in the companies, that to be competitive in today's world, you've got to be a values-driven company. So we work with investors to change what they do, and then we work with regulators and policymakers. Because in the end, even if we can move 1,000 companies to do what's right, there are 100,000 behind them that are perhaps moving far more slowly. So we've got to have a level playing field, which is why we need mandatory regulations and policy, so everybody's playing by the same set of rules.

Jonathan: So a lot going on in the policy and regulatory space. You've mentioned a couple of examples, and Janet Yellen's been pushing financial regulators in the U.S. to take further action. Overall, are you satisfied with the progress of the administration in its approach to climate risk?

Mindy: I am satisfied that it's a great start. There are things that have been done – methane rules have changed, CAFE standards for what you hold the car companies to in terms of are they producing electric vehicles or combustion engine vehicles. That has changed, and changed radically, and that is due to the pressure of policymakers. But there's an enormous way to go. Yes, if we pass a couple of the big bills that have enormous amounts of resources to help launch renewable energy, mass transit, to help make sure we're using cement that's clean and not the dirtiest cement, we could make a huge difference. But I think all of that, um, is still a work in progress.

Jonathan: The Department of Labor recently announced a proposed rule that seems to remove some of the previous barriers to the consideration of ESG factors in retirement plans like 401(k) plans, the subject of scrutiny by a regulation called ERISA. Do you think that this is going to open the door to savers and retirees being able to actually invest their retirement assets in a more sustainable fashion, and to focus on things like net zero in those portfolios?

Mindy: So I'm going to try and translate that into everyday English. Both of us, in-in our worlds, we have all sorts of specialized – ERISA, 10-K. But I think it's going to make a huge difference. In the market that we're talking about, it's about $10 trillion. It's millions of people who will now have the opportunity because a rule that made it a barrier to invest in companies, and to look at whether or not they're acting responsibly on climate risk, or social risks …

I think the rule change that the Department of Labor is about to make is just practical, logical and great common sense. It basically says that you can consider all financial risks as you're considering where to make investments if you're a pension fund or some of the other funds. There was a rule on the books that said you couldn't consider climate risk or social risks, which of course makes no sense financially. Given the magnitude of risk to our economy, the tens of billions of dollars that climatic changes are costing every day, you ought to consider it. Now, investors will make their own decision on where to invest, but they ought not to be prohibited from considering that. And I think they will consider it. I think they'll make changes in their portfolios to have more environmentally responsible companies in their portfolios, and I think the millions of people who are investing for their future, will want to invest that way. So a huge part of a $10 trillion market could be changed easily by this very important Department of Labor rule, that I think will be out any day now, and will make a huge difference going forward.

Jonathan: And I think that the progress that we've seen on that is actually responding to [a] choice, really, because at the end of the day many of these participants in retirement plans are going to have an opportunity to select for themselves, you know, whether they want a sustainable solution that thinks about these risks or if they want something else. And-and surely that's about as American as apple pie.

Mindy: That is – there you are with your British accent.

Jonathan: [Laughs]

Mindy: Talking about apple pie. Um, but you are absolutely right. It is as American as apple pie. I want to know, as an individual investor, what my best options are. And if I could invest in ways that get me competitive returns but have portfolios that are barren of things that I don't believe in, uh, that's where I want to be invested. That opportunity is growing every single day, and when we see a $10 trillion market out there we know it's going to blossom and blossom exponentially.

Jonathan: So let's talk a bit about the companies. We recently saw the announcement of the new International Sustainability Standards Board, another acronym for those that are keeping count, the ISSB. And this is collapsing a number of other pre-existing standards and disclosure frameworks for sustainability reporting, many of which at Neuberger we've been supportive of over the years. So firstly, I know that Ceres has been supportive of this effort to try and bring more consolidation of standards to help corporates. How do you think that this will be received by companies? And do you think that the European regulators and European companies will follow this path, given that there's obviously a little bit more in terms of disclosure regulation in the European market that exists at the moment?

Mindy: Well, I hope that's not for long. I hope that the U.S. catches up with the European market. But there's no question in what you said. I do believe companies will follow it. For the last 20 years or so, and even before that, Ceres launched something called the Global Reporting Initiative, one of the early standard setters of sustainability reporting, and 10,800 multinational companies are using it. So this is not new, it's 25 years in the making. We need good data to make smart investment decisions. And we've had too many data systems, too many systems for reporting. So the fact of the matter is that the voluntary standards are coming together under one umbrella, and not two, or three or four, is terrific. It's compelling; companies and investors want to look at a level playing field of Company X's reporting on certain metrics, they want to compare company-wide to it, which is really tough when everybody's using different standards. But I'm going to take that a little bit further.

I mean, to answer your question directly, yes, I think European companies are going to use those voluntary standards, because everybody wants consistency. But secondly, I think those voluntary standards have to go to mandatory, because we still have some companies wanting to disclose and other companies not wanting to disclose. If I'm an investor and I want to invest in 500 companies, I want all of them to provide the same data. The SEC's job in the United States is to make sure investors have appropriate information in their 10-K filings – more jargon. And what the mandatory climate risk disclosure measure that it's being considered in the Securities Exchange Commission right now does, is it says if climate risk is like, as I said, currency risk, or inflation risk, or trade risk, if it's a big risk – they call it material risk, we'll just call it big risk here – then it ought to be disclosed. Investors want to know and need to know. So the bottom line is voluntary standards are good, aggregated voluntary standards having one set and not five options are good, but in the end we need a level playing field. And we don't want just the top 1,000 companies reporting, we want every company that is publicly traded and that is regulated by the SEC to disclose their climate risk, or their water risk, or their human rights risk as a financial matter, not only as a planetary or human rights matter, as if that weren't enough.

Jonathan: And obviously a lot of these reporting standards and disclosures, look a little bit backwards, right? They look at the carbon footprint as at the end of the last reporting year or the employee turnover that happened last year. And as investors we're investing for the future, right? So we're looking forward. And so one of the things that I think has been particularly interesting is the UK government's announcement of mandating climate transition plans, disclosure by companies of how they will adapt their business model to net zero. Do you think that this is an approach that other regulators should also adopt, and-and is that something that you see as being kind of part of the future of evaluating future climate risk in a robust and comparable fashion?

Mindy: So one is I think companies and investors producing climate action plans, showing what they mean. We've got a lot of commitments out there – I'm going to get to net zero by 2040, by 2050, by tomorrow, by next Wednesday. We need to ground those commitments in clear, tangible short, medium and long-term plans that have accountability systems built in. And what the climate action plans that the UK government's calling for – it actually does that. So it is a good thing on multiple fronts. One is it allows companies to tell the story, I'm not only committing to something, but this is how I'm going to do it, and the same thing with investors. It moves competitive players, meaning a company in one industry does it you're going to see others follow. So I think it's a great thing. I think mandating it is even better, because again, you don't want only the leaders to have to produce, whether it's an SEC disclosure or a climate action plan, you want laggards, leaders, everybody. And in the United States, it is not in active discussion now, but I can tell you the second we heard it come through in the UK, we started having discussions with the Biden administration, and I think there's a lot of interest to do just that here as well.

Jonathan: So let's turn to engagement. And that's something that Ceres has been doing both formally and informally since inception and facilitating that dialogue between investors and the companies that they're investing in around these types of topics. So in particular you guys have been at the forefront of the Climate Action 100+ initiative. Can you just tell us a little bit about what that initiative is and what it's achieved so far?

Mindy: Sure. And it's built on the following foundation. Large investors have enormous clout with companies in their portfolio. And a shared goal. They want to make money, they want the companies to make money, and they believe, the investors that we're working with, believe the companies who ignore climate risk are going to be caught short. Somewhere they're going to be caught in a way that they lose money rather than make money. It speaks to, are they responsible as a well-managed, well-governed company? And so the investors we work with have decided climate risk is a legitimate risk. It is like other risks that they take to the companies in their portfolio about. And so after developing the intellectual capital for 15, 20 years that climate isn't only a planetary imperative, or a human imperative, as if that weren't enough, it really is a risk to the economy that's arguably greater than the subprime meltdown risk that we saw in the late 2000s. That's a lot of money that impacted a lot of people's lives.

So investors want to act on it. They see it as an imperative to do so. The investors that we brought together on the Climate Action 100+, which now number 575, and about $60 trillion in assets under management, these are investors who have said if we could change 70 percent of the greenhouse gas emissions, if we could work with the companies who produce 70 percent of the greenhouse gas emissions, we can make a huge impact. And so we've targeted who are the 70 percent. And the investors in Climate Action 100+ are meeting with those companies, not one investor in one company, but 10 investors, and 20 investors, investors who own the company, who want nothing more than the company to succeed. After all, they're in the portfolio of these investors. And it's making a huge difference. We've seen dozens and dozens of companies change their practices, what kind of steel they use, what kind of fuel they use, are they going to move from combustion engine vehicles to all electric vehicles? And those changes are happening over the last couple of years since these engagements between the investors and the companies. Investors – you know, they have an enormous amount of clout, a very large voice, louder than the number of investors there are. And they've got an important voice to change companies in their portfolios, and to join us in changing public policy and regulatory change as well.

Jonathan: And at Neuberger we've been, proud to be part of the Climate Action 100+ initiative and continue to do so. And I think this is a space where, frankly, there's more scrutiny than there's ever been about how you cast your proxies on behalf of clients, and-and how the votes at those annual meetings are being passed out. One of the things that we've tried to do is to provide a bit more disclosure ahead of time through our NB Votes initiative, of how we're going to vote and why we're going to vote a particular way, including on climate topics.

Do you feel that the investment industry is doing enough with their votes, or do you think that really asset managers as a whole could be doing more to make sure that those votes are aligned with the climate transition agenda that Ceres is, you know, so clearly advocating for?

Mindy: Well, I'm not one to be satisfied easily, so I never think enough is being done, and I will always keep pushing. But I think we have seen enormous change and enormous progress. If I look at 12 years ago at shareholder season, where we had about 12 climate related shareholder resolutions, and an average vote of about 8 percent, that wasn't changing companies. Eight percent of their investors telling them to do something wasn't changing them. Now we're seeing majority votes in some instances. At Bunge, we just saw a 98 percent vote on a deforestation issue. We are seeing investors come in, the largest investors, big players, like Neuberger Berman, even like State Street, like Blackrock, who are voting their proxies on climate resolutions. And companies are hearing it. Look, if 50 percent of your owners tell you they think you're either being responsible or irresponsible, you can't ignore that. You might be able to ignore noise on the street, but you cannot ignore your owners who are telling you, you need to act on climate risk as a financial matter, not just because it's a whim of some investors.

So it's making a difference. This year we had 157 climate related shareholder resolutions, we're looking at more in the coming year, and there was, of course, the very public Exxon campaign. Investors don't generally go to the largest companies and say we don't think your board is acting responsibly, and we are going to get three new board members on the Exxon board because of your position on climate. And that's exactly what happened this shareholder season. Investors understand that climate risk is a massive risk to our economy, costing us tens of billions of dollars every year, and that acting on it sooner rather than later will be a smarter economic bet than putting it off for another 10 or 20 years.

Jonathan: So, Mindy, in closing, you've made it very clear that you're not satisfied with everything. You need to see investors and companies, and regulators and policymakers do more. But you've been in this space for a number of years. Looking back on where we are today, from where we were when you first started with Ceres, are you impressed with the way in which the climate and sustainability agenda has penetrated mass consciousness, and the way that the sort of next generation of young leaders are thinking about how we can accelerate the transition? Or do you feel that this is exactly where you would've thought the world would be – come the end of 2021?

Mindy: Well, I don't know what I would've thought, I would've hoped for that, but I will say the last five years or so, maybe even four, Jonathan, have been radical in how much they've changed. Something just clicked, where we are no longer trying to get companies to think about why acting on climate and water is in their interest as a corporate leader, not as a philanthropic leader or an opinion leader. And that has changed radically. Large companies, large investors understand they've gotta be engaged in this debate and acting on it in one shape or another. We are no longer begging companies to come to the table, they want to come to the table, or investors. These discussions are happening every day, and the companies and investors are also standing up on policy.

So, radical changes, but nowhere near enough, to just, uh, repeat my general mantra, to get to where we need to go. To really deal with the climate risk from an economic perspective and a planetary perspective, we need to be doing so much more. It won't be easy, it is complicated, but the minds of people like you all and so many others are on it, and I'm going to stay hopeful that we'll get there.

Jonathan: Well, that's great. And Mindy, thank you so much for spending time with us today. Looking forward to our continued partnership on tackling these important issues into the future.

Mindy: Terrific. Thank you. Good to be here with you.

Anu: Well, that was a fantastic conversation to end 2021, here on Disruptive Forces. Thank you all for your listenership this year, it's a pleasure to provide dynamic thought leadership to listeners like you. And of course, if you haven't already done so, I would encourage you to subscribe to the show via Apple Podcasts, Google Podcasts or Spotify. Or you can visit our website, www.nb.com/disruptiveforces, for previous episodes as well as information about our firm and offerings. Thank you again and wishing you a happy and healthy new year.

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