NEGOTIATING CLIMATE CHANGE IN CRISIS

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21. The Promise and Peril of Financialised Climate Governance

Rami Kaplan and David Levy

A recent development in climate governance has been the rise of investor-driven, or 'financialised governance' of corporate practices in relation to the natural environment. Investors and investment managers are demonstrating greater concern that the value of assets, from stock markets to real estate, are increasingly subject to climate risks. Financialised climate governance (FCG) puts investors and fund managers at the centre of efforts to limit greenhouse gas emissions, which suggests both the promise and peril of this advanced form of 'climate capitalism'. We describe these developments and point towards the peril that relying on investors and business self-interest is unlikely to result in the rapid structural shifts needed for full decarbonisation.

The Rise of Financialised Climate Governance

A notable recent development in climate governance has been the rise of investor-driven, or 'financialised governance' of corporate practices in relation to the natural environment (as also invoked by Bracking, this volume). Investors and investment managers are demonstrating greater concern that the value of assets, from stock markets to real estate, are increasingly subject to climate risks. These include physical risks from rising sea levels, storms, wildfires, and disease, together with financial risks, such as the loss of 'stranded assets' and product obsolescence, due to technological and regulatory changes, which are inducing a rapid shift toward renewable energy and other low-carbon products and processes.

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In January 2020, Larry Fink, CEO of BlackRock, the largest private investment company in the world with more than $8 trillion in assets under management, warned that "Climate change is different. Even if only a fraction of the projected impacts is realized, this is a […] structural, long-term crisis. Companies, investors, and governments must prepare for a significant reallocation of capital."[1] In an even sharper letter in early 2021, Fink urged CEOs to take the COVID-19 pandemic as "a stark reminder of our fragility" and warned that companies that fail to quickly prepare for the net zero transition "will see their businesses and valuations suffer"[2] (also see Böhm and Sullivan, this volume).

Alongside this rhetoric, BlackRock joined Climate Action 100+, a rapidly growing consortium of more than 500 asset owners and managers with over $50 trillion under management. The initiative's strategy is to promote the greenhouse gases (GHG) reduction goals of COP21's Paris Agreement by leveraging the financial power of signatory investors into reforming the practices of 160 corporate "systemically important emitters" that account for two-thirds of global industrial emissions.[3] A hub of investor activism, Climate Action 100+ employs tactics ranging from formal appeals to boards, to filing shareholder resolutions, and action to remove uncooperative directors. The initiative claims to have already triggered a wave of commitments to adopt advanced disclosure standards and carbon reduction targets (Herd and Hillis 2019; Mooney 2020). For example, British Petroleum has committed to cut its fossil fuel production by 40% by 2030 and substantially increase its investment in renewable energy and electric transportation (British Petroleum 2020). Shell has declared its "ambition" to halve its carbon footprint by 2050 and stated that it will soon link executives' pay to short-term carbon goals. Many other major companies have committed to achieve net zero emissions by 2050 (the complexities of which are traced by Dyke et al. and Bailey, this volume), and to move to 100% renewable energy (see also Wright and Nyberg, this volume).

Financialised climate governance (FCG) puts investors and fund managers at the centre of efforts to limit GHG emissions, which suggests both the promise and peril of this advanced form of "climate capitalism"

1 https://www.ft.com/content/57db9dc2-3690-11ea-a6d3-9a26f8c3cba4.
2 https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter.
3 https://www.climateaction100.org.

(Newell and Paterson 2010). The promise lies in the centrality of financial mechanisms within capitalism; if climate indeed enters calculations of risks, returns, and asset pricing (Sullivan 2018), then FCG could have considerable leverage over corporate practices and strategies. Investors would be a major force in the low-carbon transition; operating with existing mechanisms and ideologies of corporate governance and shareholder value, FCG could be more effective than pressure from stakeholders or governmental and multilateral action. The peril is that relying on investors and business self-interest is unlikely to result in the rapid structural shifts needed for full decarbonisation, which will not always be profitable for individual companies and will require regulation to shape markets and large-scale government funding for new infrastructure. Moreover, relying on FCG shifts the balance of power in climate governance away from environmental activists and governmental agencies, with potentially dire long-term consequences.

The nexus between the financial world and climate change is not new. Funds specialising in 'socially responsible investment' (SRI) have proliferated since the 1990s, in parallel to the emergence of disclosure-based governance frameworks, such as certification schemes and sustainability disclosure initiatives (Bartley 2007, Levy et al. 2010; Depoers et al. 2016). From the 2000s, SRI and disclosure governance intersected around the emergence of 'environmental, social, and governance' (ESG) indices designed to inform investment decisions. According to several estimates, global assets under management integrating ESG considerations multiplied from roughly $10 trillion in 2010 to $40 trillion in 2020, which is close to half of the world's total assets under management (Social Investment Forum Foundation 2010; Basar 2020). The increasing concentration of the asset management industry—the top ten asset managers hold 34% of externally managed assets (Eccles and Klimenko 2019)—implies substantial pressure on corporate emitters. This concentration increases the leverage of activist consortia such as Climate Action.

Initiatives such as the Climate Disclosure Project and Ceres' Investor Network on Climate Risk explicitly sought to leverage investor pressure to change corporate practices (Knox-Hayes and Levy 2011). However, these were widely perceived as activist rather than investor-led projects and hence had little impact on capital flows or corporate emissions. The

phenomenon of FCG is fundamentally different in that it represents a growing recognition of climate risks by investors and the mobilisation of the capitalist class more broadly, rather than just in response to external pressure. The original 'values-based SRI' has been displaced by 'profit-seeking SRI,' which asserts that ESG investment is more profitable. ESG-specialised investment management firms, indices, and professional associations have proliferated worldwide, and ESG strategies have diffused rapidly among general-purpose investment funds (Waddock 2008; Meyer et al. 2015; Yan et al. 2019).

The mobilisation by elite organisational investors has been global in scope and coordinated with governmental and multilateral organisations. The Asset Management Working Group, representing a dozen major investors organised by the UN Environment Programme Finance Initiative, pioneered the development and diffusion of ESG standards worldwide (UNEP-FI 2004, Asset Management Working Group 2009). Another key vector has been Bloomberg's Task Force on Climate-Related Financial Disclosures (TCFD), which was launched in 2016 by the Financial Stability Board, a coordinating body of national financial bodies and international standards organisations. The TCFD has legitimised and disseminated standardised climate risk management and disclosure internationally. Recently, the Big Four global accounting firms unveiled a unified reporting framework for ESG.

Investors are increasingly engaging in shareholder activism to pressure companies over climate change. For example, a coalition of seven Climate Action 100+ members narrowly passed a shareholder resolution in 2019 at Chevron, against management's opposition, to require the company to report on its climate lobbying expenditures and their alignment with Paris goals. A similar resolution was passed in May 2021 at the annual shareholder meeting of Phillips66, while a resolution passed the same month at the ConocoPhillips' shareholder meeting called for the company to set Scope 3 emission reduction targets, in other words, to take responsibility for the consumption of oil downstream.[4] The most surprising upset of 2021 was the successful effort by a relatively small activist hedge fund, Engine No. 1, to nominate and elect three new directors on to Exxon's twelve-person board. The

4 https://www.ceres.org/news-center/press-releases/historic-votes-shareholders-demand-strong-climate-action-us-oil-and-gas.

hedge fund only held a 0.02% stake in Exxon but succeeded in winning the support of large state pension funds.

While some of these shareholder resolutions are non-binding, such open conflict between capitalist investors and fossil fuel companies is unprecedented and constitutes a marked shift from the prior use of shareholder activism by labour or church groups. The investor activists have claimed that corporate lobbying threatens governments' commitment to the Paris goals, which in turn threatens economic stability (BNP Paribas et al. 2019). This approach breaks strikingly from the traditional corporate preference for voluntarism (cf. Kaplan and Kinderman 2019, 2020; Kaplan and Lohmeyer 2020) and acknowledges a governmental role in addressing systemic financial and economic risks of climate disruption.[5] The activists also argue that the target companies need more visionary leadership to develop the comprehensive and far-reaching strategies required to survive and prosper in the low-carbon future.

Another remarkable development is the contestation around the status of ESG as a legitimate risk management criterion. In its final year, the Trump administration moved to restrict the use of ESG criteria in pension plans by requiring proof that ESG enhances profitability, and the investor community mobilised against this (Umpierrez 2020; Quinson 2020). The administration's action apparently responded to pressure from the fossil fuels sector, which was concerned about carbon divestment campaigns amongst activists and organisational investors (Quinson 2020). The contestation between the Trump administration and the asset management industry was remarkable because it centred on questions of shareholder value and risk calculation rather than the environmental and social impact of corporations. The Trump administration argued that ESG-informed investment reflected non-financial objectives and thus violated the fiduciary obligation of money managers; investment managers countered that ESG risk was fundamental to evaluating the long-term performance of investments. The Biden administration has since announced that it will not enforce the Trump rules restricting retirement investments and will revisit the issue. These developments express how the struggles over climate change are reframed and

5 https://www.ft.com/content/e6ad62f2-a9f3-4aec-b359-b662a07f5d01.

translated into the financial terrain, and the growing commitment of investment managers to ESG-informed financial strategies.

Critics of FCG will be quick to point to the historical failures of corporate self-regulation and the constraints on managerial action operating within profit maximising firms and the discipline of capital markets. FCG is unlikely to drive the structural and systemic changes in lifestyles and values, as well as production and consumption, that are urgently needed. Fundamentally, critics emphasise the contradictions inherent in expecting the stewards of capitalism to fix problems that arise from the system itself.

First, the financial interests of investors are not fully aligned with those of society, and this is clearly the case for climate change. While some investors and financial regulators are waking up to the systemic financial risk from climate change, action by individual companies is constrained by the large externalities associated with fossil fuels and the problems of collective action and free riding. At the firm level, climate change is often viewed as a long-term and rather abstract risk, especially if they do not face a substantial price on carbon emissions. In other words, 'win-win' climate opportunities can be more elusive than advocates sometimes claim. Companies can find profitable low-hanging fruit in areas such as energy efficiency and improving logistics, but moving towards 80% reductions or carbon neutrality is far more difficult, requiring a major structural shift in products and production processes, or a reliance on dubious carbon-offsets (Böhm and Dabhi 2009).

Moreover, the companies that will flourish in a zero-carbon economy are unlikely to be the same as those who will lose out—coal, oil, and gas companies have not fared well in clean energy and are likely to be replaced by those specialising in wind, solar, geothermal and energy storage. Traditional automobile companies will find it hard to compete with upstarts like Tesla that focus on advanced batteries and software. From a strategy perspective, the new low-carbon businesses have very different technologies, business models, and required competencies, making it difficult for incumbents to make the transition. A senior portfolio manager at Adams Fund, an investment company focused on the energy sector, commented after the successful activist campaign to appoint three new directors to Exxon's board that "[p]eople who are expecting substantive changes soon will likely be sorely disappointed

[...]. Repositioning XOM from a company focused on oil to one focused on climate change issues will take a long, long time."[6]

A second major limitation of FCG is that, in common with corporate social responsibility (CSR) and other sustainability efforts, it is open to 'greenwash', the disjuncture between corporate efforts to burnish their environmental reputation and actual outcomes (Berliner and Prakash 2015; Raghunandan and Rajgopal 2020). Institutional theorists refer to 'decoupling' along the implementation chain between public pronouncements, internal policies and targets, corporate practices, and actual emissions (Lyon and Montgomery 2013). It is true that FCG, as 'insider' corporate governance that demands more rigorous corporate disclosure of climate metrics, likely provides more credible verification of corporate practices than NGO-led initiatives such as the Global Reporting Initiative (GRI) or CDP. But companies can also game ESG reporting to satisfy external stakeholders. While investors themselves gain reputational value from signing on to initiatives such as Climate Action 100+, they do not have an incentive to press companies for emission cuts that are unprofitable, require reduction in sales, or even threaten continued viability. This may result in the institutionalisation of "organized hypocrisy" (Lim and Tsutsui 2012) that involve 'ceremonies' of corporate disclosure that are legitimised by investors, standard-setters and auditors. In one recent instance, Climate Action 100+ and Total's management issued a joint statement promoting a modest sustainability policy, which preempted a more aggressive resolution advanced by proxy activists (Mooney 2020). Indeed, it was the perception of such hypocrisy that helped drive the recent shareholder resolutions at Exxon and Shell.

A third source of caution regarding the potential of FCG is that it is incompatible with a transition to an economy and value system based on "sustainable lifestyles" (Levy and Spicer 2013) (as also highlighted in the chapters by Halme et al., North, Paterson and Sandover, this volume). Movements for sustainable consumption, localism, and more recently 'slowness' (Van Bommel and Spicer 2011) have been growing in recent years, inspired by visions of a simpler, less materialistic life that is more oriented toward leisure and community. It also envisages alternative

6 https://www.reuters.com/business/energy/engine-no-1-win-third-seat-exxon-board-based-preliminary-results-2021-06-02/.

economic structures and market forms based on small-scale production, co-ops, widespread sharing and re-use of assets, and community-based services (Schor and White 2010). According to Jackson (2011: 35),

> [t]he prevailing vision of prosperity as a continually expanding economic paradise has come unraveled [...]. This chapter searches for a different kind of vision for prosperity: one in which it is possible for human beings to flourish, to achieve greater social cohesion, to find higher levels of well-being and yet still to reduce their material impact on the environment.

Such a radical transformation cannot easily be reconciled with investor demands for exponential economic growth and rising profits.

The fourth and final concern is that FCG shifts the balance of power in climate governance toward business and investors and away from environmental NGOs, activists, governments, and multilateral agencies. It is a continuation of the trend toward the privatisation of governance and self-regulation, with little inclusiveness or accountability (Bartley 2007; Levy and Kaplan 2008; Levy et al. 2010). Corporations have often pushed for self-regulation as a means to deflect external pressure, pre-empt governmental intervention (Malhotra et al. 2019), and increase business control over the political environment (Levy 1997; Sapinski 2015; Kaplan and Kinderman 2019; Kaplan and Lohmeyer 2020). The rise of FCG can be understood as an accommodation with the external pressures and financial risks of climate change but one that reaffirms the hegemony of capitalism and traditional modes of corporate governance by reasserting the confluence of corporate, investor and societal interests.

In conclusion, while the rise of FCG signals the mainstreaming of climate concerns in the business and investor communities, it also holds profound limitations that constrain its effectiveness in achieving the rapid transition to a low-carbon economy that is urgently needed. As Levy et al. (2016) observed in relation to the corporatisation of CSR, the paradox of FCG is that, while it accelerates incremental change in corporate practices, its inherent limitations will prevent the deeper systemic and structural shifts required in norms, corporate forms and governance, and patterns of production and consumption.

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