

Audit Committee Leadership Summit

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ACLS

VIEWPOINTS

Dialogue with BlackRock chair and CEO Larry Fink

Members of the Audit Committee Leadership Network (ACLN) and the European Audit Committee Leadership Network (EALCN) met with Larry Fink, the chair and CEO of global investment management firm BlackRock.

A value creation mindset

BlackRock was an early leader in offering index funds, which have low management fees and provide investors with market returns and risk levels. Yet Mr. Fink's own language has been that of an active manager who is skilled at handling risk. He has consistently framed his focus on ESG (environmental, social, and governance) issues, climate in particular, saying that "sustainability risk is investment risk." The company has built climate and other ESG metrics into its Aladdin software platform, using advanced data analytic techniques to demonstrate the link between sustainability and economic performance. BlackRock has continued to build actively managed funds that use these analyses to create "alpha"—returns above a benchmark index—for client shareholders. Mr. Fink expanded on this in his 2021 letter to shareholders: "BlackRock has evolved our platform over time to better position ourselves to deliver more durable alpha across public and private markets and help more people reach their goals. That's why we are investing heavily in areas such as investment sourcing, data analytics and technology while leveraging our global scale and reach."¹

BlackRock's commitment to sustainability is embedded across its entire business: they view sustainability as an investment opportunity, not just as a matter of doing good, because sustainability helps investors build more resilient portfolios and achieve better long-term, risk-adjusted returns. The economic value creation stemming from strong ESG leadership recurred throughout the discussion, which focused on four themes:

Guarded optimism about the global economy. Mr. Fink acknowledged that the road forward will not be easy, highlighting risks ranging from inflation to a resurgent coronavirus, but overall he is confident that innovation will address many of society's problems.

No quick transition to net zero. Although addressing climate change is a matter of urgency, Mr. Fink stressed that the transition to net-zero emissions must be executed in a way that is fair and just, especially to emerging economies.

Private enterprise and government in partnership. Although Mr. Fink is a committed free-market capitalist, he believes that both national and international government institutions have critical roles to play as enablers of private investment and as drivers of policy consensus.

Culture as the main source of board effectiveness. Boards need to engage deeply on long-term strategy, according to Mr. Fink, and that requires multidimensional diversity within the board and likely larger boards than many companies currently have. He believes it is the culture of a board, rather than more technical aspects of its structure or operation, that ultimately drive its ability to provide strong long-term leadership.

Guarded optimism about the global economy.

Mr. Fink told ACLN and EACLN members that he is broadly optimistic about the growth and performance of the global economic system and the future of capitalism. Developed countries are strong, he said: *“Despite the severity of the recession, consumer balance sheets are stronger than ever. Globally, we estimate that there’s \$11 trillion sitting on the sidelines.”* He said that investors are ready to back the entrepreneurs who will tackle the climate crisis and other urgent societal needs: *“The amount of capital to invest in innovative companies has never been greater. The opportunity for young, smart, idealistic people to create companies has never been greater.”*²

Mr. Fink warned, however, that *“it is going to take years for developing economies to get back to 2019 levels. We are seeing rising inflation and climate risk. The emerging world has severe issues in front of them, and we’re going to see more income inequality than ever before.”*

He believes that inflation is worse and more systemic than is generally acknowledged. The 10-year government bond is moving up to 3%. But this did not shake Mr. Fink’s confidence: *“Society moves, and we as companies have to move with society. Those companies who are adaptive, getting in front of the needs of society, are flourishing. So, overall, I’m optimistic.”*

No quick transition to net zero

Mr. Fink stated that COP26 made incremental progress but didn’t accomplish enough; it was to some extent *“window dressed to make it look nice.”*

However, he also warned that a rapid and forced transition to net zero would increase inequality in developed economies and have devastating effects in the emerging world. *“We have to be much more mindful about how we’re going to navigate this energy transition if we want it to be fair and just. If we wanted to go from brown to green tomorrow, we could do that—it’s just going to lead to extraordinary inflation and create more inequalities. Navigating the energy needs of society requires great multilateralism and long-term planning.”*

To create more transparency for investors, Mr. Fink favors the disclosure frameworks developed by the Task Force on Climate-related Financial Disclosures. But given the lack of a common taxonomy and the intricacies of calculating Scope 3 emissions, he is pushing for safe-harbor provisions in the transition. An ACLN member agreed: *“I think it is quite important [that Mr. Fink said], ‘Let’s not turn the whole discussion to Scope 3 because then we lose attention*

to Scope 1 and 2' ... We start screaming about Scope 3 and it's going to take a long time before we are there."

Mr. Fink reminded members of the importance of a systematic analysis of carbon emissions. *"No one focuses on agriculture, which is 18% of the carbon footprint. This is astonishing to me when I consider that airplanes represent less than .81% of emissions and cows between 5 and 8%."*

Both before and during the meeting, Mr. Fink said that an overly draconian transition will drive "dirty" assets into less transparent corporate settings, either nonpublic companies or poorly regulated state enterprises. *"The risk that we have right now in the policy is that we are making European hydrocarbon companies less resilient, and we're making Russia, Iran, and Saudi Arabia more resilient."*

He added, *"It's very convenient to attack the hydrocarbon companies. But I will tell you: at BlackRock we're trying to be very supportive of the hydrocarbon companies. Yes, we're demanding that they tell us their pathway to decarbonize, but in a way that is managing the supply needs of society. We're focused on a fair and just transition. That may mean continued investments in hydrocarbons in the near term. Environmentalists will not like that outcome."*

Members were surprised at Mr. Fink's stance. One noted, *"I was so pleased to hear him say that if we want to have a fair and just transition, we can't only call on the brown companies, the ones who are currently supporting hydrocarbons as power and energy. We can't create incentives for them to make bad decisions for the world."*

Mr. Fink expanded on the need for a pragmatic approach. *"If we could substitute natural gas for coal, we are going from dark brown to medium brown to light brown to very light green. We're not going straight from brown to green unless we want something unfair that destroys the emerging world on that pathway."* He stressed the need for new technologies, both to enable transition to a greener global economy and to mitigate the impact of the shift. *"If we don't create the new technologies to bring down the green premium ... we're going to have rising inflation from climate transition."*

He said that the private sector needs greater support from governments and multilateral financial institutions: *"[Achieving net zero] is very difficult, very hard to execute. It requires cooperation between governments, regulators, and businesses."* He also sees a critical role for government in fostering consensus. *"If we don't have good government policy focusing on all of society, we're just asking public companies to shoulder the burden of the transition. That's not going to work."* A member took this beyond environmental issues, noting that in the past, *"when the government regulator said we [government] couldn't and wouldn't do our job, they said that you guys [public companies] should do it. I worry that there is going to be a tendency in that direction on the environmental front and also on the technology front."*

Private enterprise and government in partnership

Mr. Fink described himself as *“a huge advocate of capitalism and the global capital markets.”* He repeatedly asserted that free markets are the most effective way to allocate capital, and he spoke of BlackRock’s role in connecting investors and value-creating leaders. He wants this to happen not only with start-up firms but also with incumbents, so that they do not become *“dinosaurs.”* Effective capital allocation encourages innovation: Mr. Fink cited the rapid pivot to remote work and the rapid development of mRNA vaccines as examples.

But he also emphasized government’s role in helping the global economy transition to net zero: *“Capitalism does not focus on the tail risk, and that’s where governments really need to play a bigger role to protect society from the excesses of one company or one industry.”* If government can provide funding to take the most subordinated position in the capital stack, private enterprise can multiply public investment. Mr. Fink added: *“There’s just not enough private capital willing to be the junior lender in brownfield investing in the developing world,”* he said, adding, *“If we’re going to really try to transform the developing world in a more rapid way, then the owners of the IMF [International Monetary Fund], the major countries of the world, are going to have to be willing to take a first-loss piece.”*

He described the role being played by the governments of France and Germany in a climate initiative: *“BlackRock announced in early November that we raised a climate partnership with the governments of France and Germany. We raised \$750 million, and the governments of France and Germany are providing the first-loss piece to provide financing to the emerging world, a catalyst for sustainable investing. We were able to leverage private capital four to one to government investment.”*

At the global level, Mr. Fink worries that international collaboration and multilateral institutions are weak. He cited the situation with the omicron variant of COVID as an example: *“The blemish that we’re going to look at in the history books is that we could not get any global leadership to vaccinate the world. It would cost \$50 billion. Compare that to the fiscal stimulus of \$7 trillion we’ve seen in the US. If the US contributed \$25 billion and called up China and said, ‘You contribute 25, then we get the Europeans,’ it would have been easy. The economic loss from the Omicron variant is going to be far greater than what it would have cost to get the entire world vaccinated.”*

Culture as the main source of board effectiveness

Mr. Fink expects the boards of large public companies to engage deeply on long-term strategy. Asked what makes for a great board, he said less about easily measurable aspects—director tenure, board size, and the like—focusing instead on cultural elements:

- **Cohesiveness within the board.** This calls for *“the board working together”* and with the organization as a whole. There should be a strong relationship between the board and the management team, and the board should identify with the company

and its success. *“A great board,” Mr. Fink said, “is a board that uses the pronoun ‘we.’ They are a part of the organization. Every board member at BlackRock has one of these card keys [showing a card key]: they’re allowed to go into any BlackRock office worldwide.”*

- **Independence.** The board needs to exercise independent judgment as it considers management’s proposals for the future of the company. *“The number one foundational issue for a board, whether directors have been on the board for one year or 20 years, is independence [from] management ... There’s one big giant public company in the United States (I’m not going to say its name here) that did not even allow its board to meet with shareholders.”*
- **Diversity.** For Mr. Fink, diversity is not about *“checking the boxes ... making sure we have enough gender representation, making sure we have enough ethnic and racial diversity. To me that’s a given. There should not even be a second thought about it. It should be a given in every company.”* The *“underdiscussed”* aspect of diversity, he said, is diversity of mind. This applies to management teams as well: *“If we were able to hire 15 Hispanics from Harvard as a management team, do you believe those 15 people would be diverse in thought? They all went to the same university; all followed the same pathway to get there.”*

Diversity of mind or of thought requires a variety of backgrounds. BlackRock, for example, has added technology and branding experts to its board. Geographic representation is also critical for a global firm.

The need for multidimensional diversity and for a deep grasp of risk and strategy may mean that companies will need larger boards. BlackRock has 18 directors. *“I don’t know how we would get diversity of mind and across the other dimensions with a typical 10-to-12-person board,”* said Mr. Fink.

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The directors were encouraged by Mr. Fink’s openness and hope to remain in dialogue with him and BlackRock. One reacted to his comments about investment in current and future energy resources: *“This is something quite new. Of course, I agree with that, but I know that many people do not. I really want to know how he’s going to bring that across the table and to those not in favor of investments in exploration.”*

One said, *“It would be great if we could go back to Larry and ask him to begin to build a set of comments aimed at government. Today, the solution revolves around having all the players at the table. Government today tends to look down on business or to look at us as the donkey to pin the tail on. Can he use his platform to really call upon government to help address some of these issues?”*

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Appendix: Participants

The following members of the ACLN participated in part or all of the meeting:

- Eva Boratto, UPS
- Barbara Byrne, ViacomCBS
- Janet Clark, Texas Instruments
- Ted Craver, Wells Fargo
- Pam Daley, BlackRock
- Dan Dickinson, Caterpillar
- Dave Dillon, 3M and Union Pacific
- Sam Di Piazza, AT&T
- Bill Easter, Delta Air Lines
- Gretchen Haggerty, Johnson Controls
- Fritz Henderson, Marriott
- Bob Herz, Morgan Stanley
- David Herzog, MetLife and DXC Technology
- Charles Holley, Amgen and Carrier Global
- Michele Hooper, United Airlines
- Hugh Johnston, Microsoft
- Akhil Johri, Boeing and Cardinal Health
- Kelly Kramer, Gilead
- Nick LePan, CIBC
- Mike Losh, Aon
- John Lowe, Philips 66
- Edward Ludwig, CVS
- Brad Martin, FedEx Corporation
- Nancy McKinstry, Abbott
- Suzanne Nora Johnson, Pfizer
- Leeny Oberg, Adobe
- Louise Parent, FIS
- Ann-Marie Petach, Jones Lang LaSalle
- Peter Porrino, AIG
- Paula Price, Accenture
- Kimberly Ross, Cigna
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Gerald Smith, Eaton Corporation
- Greg Smith, Intel
- John Stephens, Freeport-McMoran
- Fred Terrell, Bank of New York Mellon
- Jim Turley, Citigroup and Emerson Electric
- John Veihmeyer, Ford
- Robin Washington, Salesforce.com
- David Weinberg, The Coca-Cola Company
- Maggie Wilderotter, Hewlett Packard Enterprise

The following members of the EACLN participated in part or all of the meeting:

- Jeremy Anderson, UBS
- Horst Baier, Bayer
- Werner Brandt, Siemens
- Julie Brown, Roche
- Aldo Cardoso, Imerys
- Alison Carnwath, BASF and Zurich Insurance
- Laurence Debroux, Novo Nordisk
- Hanne de Mora, Volvo Group
- Carolyn Dittmeier, Generali Insurance
- Eric Elzvik, Ericsson
- Byron Grote, Akzo Nobel, Anglo American, and Tesco
- Margarete Haase, OSRAM Licht
- Liz Hewitt, National Grid
- Rene Hooft Graafland, Ahold Delhaize
- Dagmar Kollmann, Deutsche Telekom
- Benoit Maes, Bouygues
- John Maltby, Nordea
- Rene Medori, Vinci
- Marie-José Nadeau, ENGIE
- Bernard Ramanantsoa, Orange
- Jon Erik Reinhardtsen, Telenor Group
- Mariella Röhm-Kottmann, Zalando
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- Alan Stewart, Diageo
- Maria van der Hoeven, Total
- Gunnar Wiedenfels, SAP

The EY organization was represented in all or part of the meeting by the following:

- Marie-Laure Delarue, EY Global Vice Chair, Assurance
- Kelly Grier, US Chair and Managing Partner, Americas Managing Partner
- Jean-Yves Jegourel, EY Country Managing Partner Germany
- John King, Americas Vice Chair, Assurance
- Stephen Klemash, Leader, EY Americas Leader, Center for Board Matters
- Patrick Niemann, Partner, EY Americas Center for Board Matters

Endnotes

¹ BlackRock Chair's Letter to Shareholders, 2021, at <https://www.blackrock.com/corporate/investor-relations/larry-fink-chairmans-letter>.

² This document reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.