April 2020
McKinsey Quarterly

‘Bring the problem forward’: Larry Fink on climate risk

The physical impact of climate change will lead to a major capital reallocation, says the head of BlackRock, the world’s largest asset manager.

During a 40-year career, BlackRock CEO Larry Fink has learned that financiers seldom ignore risks to their businesses: “Once they recognize a problem,” says Fink, “they bring that problem forward.” Fink himself has made a practice of bringing problems to the fore in his yearly letters to CEOs and clients. When he focused on climate risk in his 2020 letter to CEOs and a related letter to clients from BlackRock’s global executive committee, citing work by McKinsey and others, he sought to advance a discussion that he’d seen accelerate during the previous year—and to spur executives and policy makers to act. In this commentary, adapted from an interview with McKinsey’s Rik Kirkland in February 2020, Fink expands on certain themes from his 2020 letters, including the threats that climate change poses to the poor and vulnerable, the diverging interests of advanced and developing countries, the importance of fair policy solutions, and the value of better nonfinancial reporting.

The *Quarterly*: *Why did you choose to concentrate on climate risk in your CEO and client letters this year?*

Larry Fink: Throughout the year, and more frequently as the year progressed, the question of climate change was raised by all our clients throughout the world, whether in Saudi Arabia or in Houston or in Sacramento or in Europe. And it was raised not just by our clients but by regulators and government officials. At the same time, we were witnessing more evidence of the physical impact from climate change. All this really hit me when I was sitting down to write my CEO letter, which I generally try to do right after the August break.

I was just writing down all the themes that I wanted to talk about. Climate risk was actually not a major component of the first draft. But then, in September, when I had meetings with the UN [United Nations] in New York City and then with the IMF [International Monetary Fund] in Washington, the urgency of the conversation became very clear to me.

The *Quarterly*: *What were you hearing from your clients? What keeps them up at night?*

Larry Fink: As finance now starts looking at potential climate risks, it raises so many different capital-allocation questions. One great question was asked by a client—I’d say among the smartest clients we have worldwide. This client said, “We never think about climate change as a risk. And yet we’ve been great investors over the long run because our time frame is ten to 15 years. Now, through the lens of sustainability and climate impact, how do I think about our strategy for today? Can we expect the same type of positive outcomes and liquidity? Should we factor in the physical impact on some of our investments—whether physical investments, like real estate, or municipal investments in cities and states?”

They raised many large questions about whether they should think about investing differently and whether they should add the lens of climate risk to their long-term investment strategy. And the answer is yes.

The *Quarterly*: *A key point you made in your letters is that we may see a “fundamental reshaping of finance,” with a significant reallocation of capital “in the near future.” How will that happen? Can you give an example?*

Larry Fink: Well, if 5 percent or 10 percent or 20 percent of our clients are starting to ask these questions and trying to design strategies to effectuate the climate theme over a long horizon, that in itself is a capital reallocation. We’re hearing this in our conversations with insurance companies, which are looking at climate change and how they should insure. That represents a major societal issue that’s unfortunately very regressive. We don’t talk about how regressive this could become.

In the United States, insurance rates are generally set by state insurance commissioners. It’s very hard for an insurance company to raise rates extensively even if it thought a jurisdiction may have real, physical climate risk. So, suppose you buy a house, and you think you’re going to live in that house for 20 years. Your insurance has to be renewed every year. But the house is in an area where the insurance company does not have the ability to raise rates unless reinsurance rates are raised. Ultimately, it’ll be able to raise rates. In the interim, it may say, “I can’t provide you with coverage anymore.” Then you have this long-term asset that you want to protect, but the insurance companies may not insure you. That is another form of capital allocation and reallocation.

And we’re starting to see more evidence of climate change and its impact on capital allocation. I do believe that if you’re a long-term investor, you’d better frame all your investments through that lens.

Larry Fink

is the founder, chairman, and CEO of BlackRock. Before founding the asset-management company, in 1988, Fink was a member of the Management Committee at The First Boston Corporation and served as a managing director there. Fink is a member of the board of trustees for the World Economic Forum.

The *Quarterly*: *Are investors able to do this now? And if they can't, why not?*

Larry Fink: Investors need more transparency. This is why in my letter I asked for greater disclosure, using SASB [Sustainability Accounting Standards Board] and TCFD [Task Force on Climate-related Financial Disclosures]. The key is gaining the ability to compare and contrast different companies. We could use that transparency to assess company A with respect to company B, or industry A with industry B, and try to come up with a better strategy.

Most investors are not going to abandon hydrocarbons, but they want a portfolio that will be more persistent in a more sustainable way. If it's possible to score how every company is doing, investors are going to look to us to be actively investing and searching for a better portfolio composition with higher sustainability or ESG [environmental, social, and governance] scores. That's what we're going to do. And that's where I do see huge movement.

The *Quarterly*: *You make the point that most investors won't abandon hydrocarbons. Why not? And what are the implications of that?*

Larry Fink: If we believe we can stop using coal today, we're fooling ourselves. There are more coal plants being built—countries are adding new coal plants right now. We don't want to talk about that. We don't want to think about it, but that's the reality. The answer is not to think that we can just run away from coal worldwide. It is to create better science and technology to find ways to help make coal cleaner.

As much as we may change our behavior in the United States as a very wealthy country, and as much as Canada and Europe might change their behavior, there are many parts of the world that are just beginning their growth curve and their wealth creation. It's very hard for us to be judging them on their economic path. And there lies the problem. We could do all that we are potentially able to do, and even that will not be enough, because so many other parts of the world are just adding more and more carbon to our air. That's not going to change anytime soon. So we need to be fair and just. We need to be open-minded.

The *Quarterly*: *The need for "fair and just" policy solutions is something you wrote about in your letters. What do you mean by that?*

Larry Fink: One of the biggest tools that governments could use—one of the biggest tools the environmental groups are recommending—is a carbon tax. A carbon tax is an incredibly regressive way of taxing people. The wealthy are not impacted as much as the less fortunate, who are trying to meet their budgets every day and have to pay higher heating bills. A carbon tax makes their lives much more difficult. This is why I've said we need to work with governments to try to minimize how regressive the impact of climate change is going to be.

We need to make sure that if there is a carbon tax, all the money is going to renewables and redistribution. And there should be some type of credit back to those people who cannot afford to pay the tax. The problem is that in so many states, a component—if not all—of the carbon tax would be used to fill a budget gap. This is where we need the combination of public and private working together. We should have a plan so that all that added tax would not go to fill our deficits, but would go for infrastructure spending, renewable technology, and redistribution.

There's another issue we haven't even spoken about. If the science is right about climate change, the impact on the subtropical and equatorial parts of the world will be devastating—the density of the population is so heavily oriented to the equatorial parts of the world. That's also going to be the area that's most harmed. We have to have this conversation. We have to be thoughtful about it. And if I'm right about finance moving this forward, this problem is probably coming sooner than later.

The *Quarterly*: *What will it take to address these issues? Are we ready?*

Larry Fink: I've witnessed five or six different crises in my career. Some of them were quite severe. All of them were financial in nature, whether it was the high-yield crisis or the dot-com crisis or the Thai crisis of 1997–98, the real-estate crises, and the Great Recession. We were able to mitigate these crises and reduce their severity through monetary policy. In unison, all the central banks tried to correct these financial difficulties. In most cases, the duration of these crises was short. Sometimes they were very severe. Many families were impacted. But the crises were short.

When you start thinking about climate-change impact, whether you believe in 5 percent of the science or 100 percent of the science, it becomes apparent that we don't have a global government body to arrest this problem. This is going to require every government, small and large, to start finding ways of mitigating it. Q

The remarks here from Larry Fink have been adapted from a February 2020 interview conducted by **Rik Kirkland,** a partner in McKinsey's London office.

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