CADWALADER

Investing: As Asset Manager Announces Withdrawal From NZAM, Some Question Whether Passive Managers Should Engage In Climate Stewardship

December 13, 2022

Investing

By Jason Halper
Partner and Co-Chair | Global Litigation

Last week, in a December 7 **statement** published on its website, one of the world's largest asset managers announced its withdrawal from membership of the Net Zero Asset Managers initiative (NZAM). This development follows pressure on the asset management industry over their ESG-related positions and investment practices, as we have regularly **reported** on, including last week's announcement from Florida's Chief Financial Officer and also a December 6, 2022 **report** by the Minority Staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs regarding the influence of the "liberal views" toward ESG of the "Big Three" asset managers, Blackrock, State Street and Vanguard. The report asserts that, contrary to what it deems appropriate for passive investment strategies such as index funds, asset managers that are NZAM members commit to engage with portfolio companies toward a goal of achieving net zero emissions by 2050. The report recommends, among other things, increased disclosure in the form of more limited availability of Schedule 13G passive ownership reporting, and consideration of whether any of these managers could be deemed a bank holding company, and therefore subject to Fed regulation along with capital and liquidity requirements, to the extent that they "influenced at least one of the banking organizations in its respective investment funds to conform its lending activities to ESG principles or otherwise change corporate policies."

Vanguard, which joined NZAM in 2021, explained that industry initiatives can "advance constructive dialogue, but sometimes they can also result in confusion about the views of individual investment firms." It goes on to state that this "has been the case in this instance, particularly regarding the applicability of net zero approaches to the broadly diversified index funds" and that they are therefore withdrawing from NZAM to provide clarity "about the role of

index funds and about how we think about material risks, including climate-related risks—and to make clear that Vanguard speaks independently."

Last month, NZAM, which launched in 2020, **announced** their membership had expanded to 291 firms, managing $66 trillion, which included 86 asset managers that had adopted initial net-zero targets.

Kirsten Snow Spalding, Vice President at Ceres, a founding partner of NZAM, stated "it is unfortunate that political pressure is impacting this crucial economic imperative and attempting to block companies from effectively managing risks—a crucial part of their fiduciary duty," and "[w]hile Net Zero Asset Managers recognize that there are challenges with measuring the alignment of passive portfolios with a 1.5 temperature rise limit and moving the companies in the index funds to rapidly decarbonize, these challenges can only be met by strong commitments to transitioning to the zero emissions economy by investors, companies and policymakers."

Taking The Temperature: The issues facing NZAM mirror the difficulties faced by the Glasgow Financial Alliance for Net Zero, which last month dropped its connection to the UN-supported Race to Zero campaign after several large U.S. banks threatened to withdraw over concerns about ESG backlash and potential antitrust implications associated with such commitments. Depending on whether other large asset managers follow suit, these developments could call into question the long-term viability of asset management and other industry climate coalitions. Also noteworthy is that both the Senate Banking Minority report and Vanguard's announcement one day later raise questions about what it means to be a passive investor. Passive investing typically is associated with an investment strategy that seeks to mirror the holdings and return of a designated index, in contrast to active stock picking that seeks to beat a benchmark index. The minority report explicitly, and the Vanguard announcement implicitly, questions whether the definition of passive investing is limited in scope to an actual investing strategy, but instead also requires that passive managers not engage with portfolio companies on climate or other stewardship issues. Were such a view to become the consensus, it would have enormous implications for the ability of the passive asset management industry to engage with portfolio companies. PricewaterhouseCoopers, for instance, estimates that passive investment strategies will represent 25% of global assets under management by 2025, for a total of $36.6 trillion AuM. The inability of passive asset managers to engage with companies in which their clients have invested such large amounts inevitably would radically change the landscape of investor-company engagement and have particularly substantial ramifications in the climate change area, where asset managers have been vocal advocates for greater climate-related disclosure and consideration by company boards of climate risks and opportunities.