

T. Rowe Price

T. Rowe Price Explores Path to Net Zero, the Divergence of Environmental, Sustainability and Governance Ratings, and the Potential Conflicts Between Corporate Values and Political Lobbying

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Findings Shared in Firm's ESG Investing Annual Report for 2021

The challenging path to net zero emissions, the nuance in ESG measurement and interpretation, and the potential conflict between corporate value statements and political lobbying activities examined by T. Rowe Price.

The USD\$1.42-trillion global asset manager also sees an acceleration in deglobalization due to the coronavirus, the aftermath of the COP26 summit, and Russia's invasion of Ukraine.

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NEWS

Amid the inexorable drive worldwide to weave environmental, social and governance tenets and practices into the fabric of society, T. Rowe Price has identified some important issues impacting completion of the tapestry. The firm examined the potential paths to net zero greenhouse gas (GHG) emissions, the plethora and divergence of ESG ratings and resulting nuance in interpretation, and the potential disconnect between corporations' stated values and their political activities.

In its fourth [ESG Investing Annual Report](#), T. Rowe Price noted that more than 140 countries accounting for 90 percent of GHG emissions established net zero targets coming out of the United Nations COP26 summit last year¹. As the world tackles the risks associated with climate change, net zero targets are emanating from a variety of stakeholders, including federal and regional governments, corporations, universities and investors.

Slippery Path to Net Zero

The net zero targets established by scientific consensus are formidable. They aim for a 50 percent reduction in GHG emissions by 2030 and an eventual goal of zero emissions by 2050. The commitments made at last year's COP26 fell disappointingly short of meeting those goals.

Then there is the stark reality of climate change math. The International Energy Agency (IEA) estimates that the commitments made at COP26 imply a warming scenario between 1.8 degrees and 2.1 degrees by the end of the century. Even those estimates are based on heroic assumptions, according to some critics. Moreover, the Climate Action Tracker, an independent scientific body that tracks government progress against the Paris Agreement's 1.5 degree warming goal, says that the 2030 targets are not ambitious enough and would put the world on a path to 2.4 degrees of warming by century's end.

While the goal of reaching net zero by 2050 is daunting, T. Rowe Price has been working with clients that are members of the growing Net Zero Asset Owners Alliance, which includes owners controlling more than USD\$10 trillion of assets. T. Rowe Price remains determined to provide its clients with the appropriate investment solutions to meet their needs.

Understanding ESG Ratings

With the rapid growth of ESG and sustainable investing, ESG data providers have grown from a cottage industry to big business, providing an abundance of ratings on company performance against ESG criteria. Not surprisingly, there is little correlation between the ratings generated by the various providers and the mechanics of these ratings are not well understood by participants across the market.

The Massachusetts Institute of Technology Sloan School of Management's longstanding evaluation of ESG ratings – known aptly as the Aggregate Confusion Project – found that in their 2019 study, among the ratings of six prominent ESG data providers, the correlations were just above 50% on average. Correlations on environment ratings averaged 53%, on social ratings 42%, and on governance ratings 30%. Of course, this level of divergence warrants close scrutiny when using these ratings as part of investment research and decision-making.

To promote the accuracy and thoroughness of its environmental and social ratings, T. Rowe Price since 2017 has established its own, in-house responsible investing research team as well as a proprietary ESG rating system called the Responsible Investing Indicator Model (RIIM). The RIIM model creates a responsible investing profile and ESG ratings for approximately 15,000 companies, 200 issuers of sovereign debt, as well as issues of municipal bonds and securitized bonds. In addition, the firm established in-house research capabilities on governance matters in 2007.

Actions Speak Louder than Values

The potential for conflict between corporate value statements and political activities became increasingly prominent on T. Rowe Price's radar in 2021. The topic is complex because regulations around corporate political giving and disclosure of such donations vary widely across the world. Furthermore, the activity itself can take many different forms, including direct donations to candidates and political action committees, memberships in trade associations that conduct lobbying efforts, and attempts to influence public opinion through the media or issue-oriented think tanks.

T. Rowe Price sees an imbalance in corporate lobbying on potential climate change regulation. While many companies are committing to net zero emissions targets for their own businesses, they do not collectively advocate for governments to enact measures to enable economies to de-carbonize on a more realistic timetable. Meanwhile, many of these same companies are members of multiple influential business associations that advocate strongly for the interests of fossil fuel producers and other high-emissions industries.

When T. Rowe Price encounters such disparities, the firm probes how the company plans to prioritize competing objectives, how they might escalate the issue with their trade organization, and, ultimately, if they might leave the trade group when the issue is unresolvable.

The firm sees the events of the past two years – the coronavirus pandemic, the COP26 climate change conference, and Russia's invasion of Ukraine – as further catalysts in the stagnation of globalization that has occurred over the last decade. The pandemic has forced many countries to look inward and to provide social protection, while COP26 will drive an unprecedented level of public and private spending to decarbonize the economy. These twin pressures will prompt select parts of the global economy to re-localize. In addition, Russia's invasion of Ukraine was a bleak reminder to world leaders how quickly value chains can break down.

Quotes



Eric Veiel, Head of Global Equity and Chief Investment Officer, T. Rowe Price Associates, Inc.

"We believe that integrating ESG evaluations into our investment process – assessing how ESG factors positively or negatively affect the performance of securities – helps our portfolio managers make sounder decisions. In 2021, we fortified the year-end evaluation criteria for analysts and portfolio managers to include their effectiveness in using ESG to drive investment outcomes."

"An increasing number of clients are asking for investment products that feature environmental and/or social characteristics. We manage USD\$95 billion² in socially responsible and impact products that cater to these investors and intend to grow the number of our products with sustainable objectives. However, it is crucial that they are based on substantive ESG criteria. While the excitement and growth of ESG-oriented products has been unprecedented, we are concerned about the lack of transparency and substance behind the ESG promises of some market participants."



Donna Anderson, Head of Corporate Governance, T. Rowe Price Associates, Inc.

"A rise in engagement by employees and customers across a multitude of social issues has prompted companies to re-examine whether their corporate values, their public statements, and their political advocacy are properly aligned. Pressure continues to build on corporate issuers, especially CEOs, to speak out on social and environmental issues that are important to the companies' key stakeholders."

"The use of shareholder resolutions has grown as a mechanism to harness investors' voting power to express perspectives on a range of issues including human capital issues, climate risk, supply chain, political spending, and the energy transition. The evidence indicates these trends will gain even more momentum this year."



Maria Drew, Director of Research, Responsible Investing, T. Rowe Price Associates, Inc.

"We believe the coronavirus pandemic, the United Nation's COP26 climate change conference, and the Russia-Ukrainian war will have a lasting impact on the investment landscape. While all three in a sense are catalysts for international cooperation, we believe each will ultimately contribute to deglobalization trends that have been in evidence over the last decade. Globalization's downsides and vulnerabilities are being more widely recognized, among them environmental degradation due to transportation of goods across geographies and excess packaging waste."

"Transitioning the global economy toward social justice and environmental soundness will be much more efficient if investors and regulators are able to adequately measure progress. The level of disclosure of environmental and social data has improved in the past year, but there is divergence among regulators on which data points will be required from corporations. Global alignment will be critical for investors to accurately measure ESG factors across multi-regional portfolios."

ABOUT T. ROWE PRICE

Founded in 1937, Baltimore-based T. Rowe Price Group, Inc. (NASDAQ-GS: TROW), is a global investment management organization with USD\$1.42 trillion in assets under management as of April 30, 2022. The organization provides a broad array of commingled funds, subadvisory services, separate account management, and related services for advisors, institutions, financial intermediaries, and retirement plan sponsors. The company also offers sophisticated investment planning and guidance tools. T. Rowe Price's disciplined, risk-aware investment approach focuses on diversification, style consistency, and fundamental research. For more information, visit [troweprice.com](https://www.troweprice.com).

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T. Rowe Price Associates, Inc.

¹Source: The Climate Action Tracker—an independent scientific analysis that tracks government climate action and measures it against the globally agreed Paris Agreement aim of "holding warming well below 2°C, and pursuing efforts to limit warming to 1.5°C."

² As of December 31, 2021. AUM includes assets managed by T. Rowe Price Associates, Inc., and its investment advisory affiliates. AUM includes funds and separate accounts across all regions.

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