Vanguard Investment Stewardship Insights

How Vanguard addresses climate risk

Vanguard publishes Investment Stewardship Insights to promote good corporate governance practices and to provide public companies with our perspectives on important governance topics and key votes. This is part of our growing effort to enhance disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide additional clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can do.

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Vanguard is passionate about our clients' financial success over the long term. Our more than 30 million clients worldwide trust us to safeguard their investments as they spend decades saving for important goals. And our index funds are practically permanent investors in more than 10,000 companies. When a Vanguard index fund invests in a public company, it could theoretically hold that stock forever—or as long as the company is listed in the underlying benchmark. With this indefinite horizon, we must focus on how companies are setting themselves up to stay relevant well into the future.

Vanguard works hard to safeguard our clients' assets against a full range of short- and long-term risks. Climate change represents a profound, fundamental risk to investors' long-term success. The companies that Vanguard funds invest in can face climate risks related to litigation, increased regulation, and the potential for reputational damage. They must also navigate ongoing changes in technology and customer preferences. Finally, companies must be prepared for the physical risks of climate changes such as rising sea levels or extreme weather events.

Few companies—and few if any long-term investors—will be exempt from the far-reaching implications of climate risk. The risks associated with climate change—and most environmental, social, and governance (ESG) matters—demand a long-term perspective because the "payoff" is not likely to happen next month or next quarter. The benefit from sound oversight of ESG risks can accrue over years and decades.

Our views on climate change are predicated not on an ideological stance, but rather on a fiduciary one. Our clients have individual beliefs and perspectives, but they all have one thing in common: They want Vanguard to protect and grow their money.

Governance is one defense against climate risk

One way Vanguard addresses climate risk is through investment stewardship. On behalf of Vanguard funds, our Investment Stewardship team votes thousands of proxies and meets (or "engages") every year with the boards and leaders of hundreds of companies to advocate for good governance practices and strong risk oversight. We continue to raise our voice on climate change. The market's expectations on climate risk have evolved, and Vanguard's have too.

Last year, we engaged with more than 250 companies in carbon-intensive industries. We consider climate risk to be a board-level risk, and in our discussions with companies, we share that perspective and ask how boards are governing climate risk on behalf of their long-term investors. When we vote on climate-related proposals, we do so with the recognition that those votes send an important message to a company and to the rest of the market. We take that responsibility seriously.

We ask that all public companies be aware of their role in the climate crisis and act as appropriate to protect their shareholders and stakeholders. Some companies, of course, play larger roles than others. For those for which climate risk is a direct material risk, we expect boards to be ***climate competent*** and to maintain oversight and informed perspectives that are independent of management. We also expect ***effective disclosure*** of climate risks using investor-oriented frameworks such as those promoted by the Task Force on Climate-related Financial Disclosures.

In addition, we support ***climate risk mitigation.*** Since 2015, the goals set forth in the Paris Agreement have become a widely accepted standard for countries and companies aiming to address climate change. Where climate change is a material risk, Vanguard encourages companies to set targets that align with these goals and to disclose them.

Vanguard and ESG investing

Vanguard's investor-first mentality is also expressed in our ESG fund lineup. For 20 years we have offered ESG funds to meet the demands of clients who want to reduce their exposure to climate and other ESG-related risks. These funds also enable clients to invest in accordance with their values. As of April 30, 2020, Vanguard's 12 ESG funds held more than $14 billion globally.

Vanguard's ESG funds primarily employ an index investing approach. These index funds use exclusionary investing strategies, which means they avoid investing in companies that engage in certain business activities, such as the production of fossil fuels, weapons, or tobacco. These funds may also exclude the stocks of companies that fail to meet certain standards for environmental, labor, human rights, diversity, or anticorruption practices.

Portfolio managers of our actively managed funds—including our U.S.-domiciled ESG-focused global equity fund—consider climate risk in various ways in their individual portfolios. Climate change and the potential risks and opportunities inherent in it have become larger considerations in recent years.

Our commitment as a company

Of course, Vanguard is a company, too. We care deeply about climate change not only because of our commitment to our clients, but also because we know what it's like to invest in something, to care about it, and to grow it intentionally over time. Vanguard employs 18,000 mission-driven people who work in 19 locations around the world. We strive to be a great company, a great employer, and a great member of the communities in which we live and work.

Vanguard has long set internal targets for operational sustainability to manage and reduce our own environmental footprint. In early 2020, we established new goals to curb emissions and reduce our carbon footprint throughout our global operations. These commitments include:

- Achieving 100% renewable energy by 2021.
- Reaching carbon neutrality by 2025.

For more information about Vanguard funds, visit vanguard.com to obtain a prospectus or, if available, a summary prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read and consider it carefully before investing.

ESG funds are subject to ESG investment risk, which is the chance that the stocks screened by the index sponsor for ESG criteria generally will underperform the stock market as a whole or that the particular stocks selected will, in the aggregate, trail returns of other funds screened for ESG criteria.
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Prices of mid- and small-cap stocks often fluctuate more than those of large-company stocks. Funds that concentrate on a relatively narrow market sector face the risk of higher share-price volatility. Stocks of companies are subject to national and regional political and economic risks and to the risk of currency fluctuations, these risks are especially high in emerging markets. Changes in exchange rates may have an adverse effect on the value, price or income of a fund.

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