Principles for Responsible Investment

A PRACTICAL GUIDE TO ACTIVE OWNERSHIP IN LISTED EQUITY

UNEP FINANCE INITIATIVE
United Nations Global Compact
An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. **We will be active owners and incorporate ESG issues into our ownership policies and practices.**
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ACKNOWLEDGEMENTS

The PRI would like to thank the following individuals for participating in interviews and providing feedback on this publication.

INTERVIEWEES

- Cambria Allen, Corporate Governance Director, UAW Retiree Medical Benefits Trust
- Matthias Beer, Director, Governance and Sustainable Investment, BMO Global Asset Management
- Katie Beith, Senior Investment Strategist, Responsible Investment, New Zealand Superannuation Fund
- Jeanett Bergan, Head of Responsible Investments, KLP
- Sasja Beslik, Head of Responsible Investment and Governance, Nordea
- Kelly Christodoulou, ESG Manager Investments, AustralianSuper
- Jennifer Coulson, Senior Manager, ESG Integration, British Columbia Investment Management Corporation
- Stu Dalheim, Vice President, Shareholder Advocacy Manager, Calvert Research and Management
- Ulrika Danielson, Head of Communications and HR/Coordinator of Corporate Governance, AP2
- Michelle de Cordova, Director, Corporate Engagement & Public Policy, NEI Investments
- Michelle Edkins, Managing Director, Global Head of Investment Stewardship, BlackRock
- Alison Ewings, Engagement Program Lead, Regnan
- Alison George, Head of Governance, Regnan
- Karin Halliday, Senior Manager, Corporate Governance, AMP Capital
- Ashley Hamilton Claxon, Head of Responsible Investment, Royal London Asset Management
- Bill Hartnett, Head of Sustainability, Local Government Superannuation Scheme
- Michael Herskovich, Head of Corporate Governance, BNP Paribas Asset Management
- Helen Hopkins, Responsible Investment Advisor, Universities Superannuation Scheme (USS)
- John Howchin, Secretary General, Council on Ethics of AP-funds
- Emma Jane Joyce, Senior manager, Strategy & Responsible investment, Ireland Strategic Investment Fund (ISIF)
- Leon Kamhi, Head of Responsibility, Hermes Investment Management
- Jonas D. Kron, Senior Vice President, Director of Shareholder Advocacy, Trillium Asset Management
- Rakhi Kumar, Managing Director, Head of ESG Investments and Asset Stewardship, State Street Global Advisors
- Gayle Muers, ESG Analyst - Engagement Lead, HSBC Global Asset Management
- Sara Nordbrand, Head of Sustainability and Corporate Engagement, The Church of Sweden
- Christina Olivecrona, Sustainability Analyst, AP2
- Susheela Peres da Costa, Deputy Managing Director, Regnan
- Jean Philippe Renaut, CEO, Æquo Shareholder Engagement Services
- Craig Rhines, Associate Investment Manager, Global Equity, CalPERS
- David Russell, Co-Head of Responsible Investment, Universities Superannuation Scheme (USS)
- Clare Scott, Chief Executive, Lothian Pension Fund
- David Sheasby, Head of Investment Governance and Sustainability, Martin Currie Investment Management
- Daniel Simard, General Director, Bâtirente
- Rogier Snijdewind, Senior Advisor Responsible Investment, PGGM
- Diandra Soobiah, Head of Responsible Investment, NEST
- Heidi Soumerai, CFA, Managing Director, Director of ESG Research, Boston Trust/Walden Asset Management
- Euan Stirling, Global Head of Stewardship and ESG Investment, Aberdeen Standard Investments
- Carola Van Lamoen, Head of Active Ownership, Robeco
- Mariela Vargova, Senior Vice President, Sustainability and Impact Investments, Rockefeller Asset Management
- Faith Ward, Chief Responsible Investment and Risk Officer, Environment Agency Pension Fund (EAPF)
- Talieh Williams, Manager of Governance and Sustainable Investment, UniSuper

ESG ENGAGEMENTS ADVISORY COMMITTEE

- Ole Buhl, Head of ESG, Vice President, ATP
- Carlota Garcia-Manas, Deputy Head of Engagement, Church Commissioners and Pensions Board
- Daniela Jaramillo, Senior Investment Analyst – ESG, Hesta
- Caroline Le Meaux, Head of Delegated Management, Ircantec
- Bonnie Saynay, Global Head of Responsible Investment, Invesco
- Amandine Soulier, Head of SRI Relations, AXA Group

OTHER ACKNOWLEDGMENTS

- Annie Bersagel, Responsible Investments, KLP
- Alessia di Capua, Institutional Relations and Corporate Governance, Assogestioni
- Jean-Pascal Gond, Professor (Chair), Cass Business School (City, University of London)
- Lisa Hayle, Vice-President, Institutional Investment Services, Boston Common Asset Management
- Athanasia Karananou, Manager, Institutional Investors, Corporate Governance, Sustainalytics
- Georgina Marshall, Global Head of Research, Institutional Shareholder Services (ISS)
- Niamh O'Sullivan, Assistant Professor, Nottingham University Business School

The PRI would also like to thank:

- Sustainalytics for providing insights on the value of engagement for investors based on previous research with Cass Business School (City, University of London) and Nottingham University Business School
- ISS for producing the content of tables 9 and 10 on shareholder resolutions and director nominations processes

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FOREWORD

Since the launch of the Principles for Responsible Investment in 2006, active ownership has been a crucial part of investors' responsible investment policies and PRI services to signatories. When becoming a signatory to the PRI, asset owners and investment managers commit to Principle 2, which states: *"We will be active owners and incorporate ESG issues into our ownership policies and practices."* As a result, in the last decade, many investors have developed leading practices to conduct fruitful conversations with companies, either individually or collaboratively. Meanwhile, several countries have launched stewardship codes to raise standards in local financial markets, and the percentage of shares voted at AGMs has increased substantially.

Similarly, more than 1,100 collaborations among signatories have been posted on the PRI Collaboration Platform (formerly the Clearinghouse), and the PRI ESG Engagements team has coordinated over 50 coalitions to engage with companies across sectors, geographies and ESG issues. The PRI and its signatories have learned many lessons during this time, and this guidance intends to share practical tips and recommendations with other investors interested in understanding in depth what being an active owner means.

Engagement and proxy voting activities should not be standalone objectives. Dialogue without clear purpose, preparation and consistency of messaging can be more detrimental than no action at all. This publication provides an overview of the steps investors should consider to develop their active ownership policies and practices, with the ultimate goal of understanding corporate ESG risks and opportunities, defining their expectation for higher business performance and raising standards in the listed equity market. Our aim is to provide all signatories with practical tools and references to be co-owners of investee companies and catalysts of change when needed.

Active ownership is one of the most effective means to minimise risks and maximise returns. Recent academic research commissioned by the PRI shows that successful engagement dialogue is not only correlated with positive returns on assets, but it also increases communication, learning and internal relationships for investors and companies.

The positive impact of active ownership can also be external. Good quality engagement and proxy voting practices may contribute to the "broader objectives of society" mentioned in the preamble of the Principles, or in today's terminology, to real-world impact aligned with the UN Sustainable Development Goals (SDGs). The PRI Blueprint agenda for the next 10 years includes specific commitments to "foster a community of active owners" and "enable real-world impact aligned with the SDGs". This guidance is a fundamental step to deliver on the first area, while more work on the relationship between active ownership and the SDGs agenda will follow in 2018.

Kris Douma
Director of Investment Practice & Engagements, PRI

Valeria Piani,
Associate Director, ESG Engagements PRI

Recently, asset owners have shown frustration regarding the voting behavior of some of their investment managers. Equally, investment managers are concerned about the lack of demand from clients for active ownership practices. We feel that asset owners, investment managers and service providers all have a role to play in fostering long-term value creation. With this publication, we hope to provide more guidance to all actors, and asset owners in particular, on their responsibilities to conduct, request and monitor effective engagement and proxy voting activities. This is why we have outlined how to develop a sound active ownership policy aligned with an organisation's investment strategy, set clear expectations, execute activities internally and/or outsource practices to investment managers and service providers, and be transparent on results achieved.

Finally, there is an ultimate reason why we believe that this publication was needed. Many stewardship codes and industry guidelines focus on local investors and companies. Although national regulation and practices must be taken into account when developing an engagement and proxy voting program, investor portfolios and ESG issues span various countries. The recent application of the OECD Guidelines for multinational enterprises to investors also shows how active ownership practices should be applied globally and across geographies (see Appendix). This guidance provides a global framework for active ownership based on best practices around the world. We hope that it will be an inspiration for all our signatories, both beginners and leaders.

EXECUTIVE SUMMARY

Principle 2 encourages PRI signatories to be active owners and incorporate ESG issues into their ownership policies and practices, including engagement with companies and exercise of voting rights. Several PRI signatories have mature practices that offer examples of this. These include activities carried out in-house, on an outsourced basis through investment managers/service providers, or by a combination of internal and external practices.

Active ownership is generally regarded as one of the most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment – for passive and active investors. Divestment alone, alternatively, leaves investors with no voice and no potential to help drive responsible corporate practices. Recent academic research shows the value of active ownership: when done well, engagement and proxy voting activities bring higher financial returns, enhanced communication, improved knowledge, stronger internal relationships and more integrated strategies. Conversely, poor quality dialogue and badly informed proxy voting practices can be harmful and cause cynicism by target companies. Good active ownership requires research, prioritisation, setting objectives, tracking results, integration with investment decision making, persistence, consistency and listening skills.

This report outlines concrete steps to make active ownership an effective tool to support long-term value creation in listed equity investing. Asset owners outsourcing activities, partially or entirely, can use this guidance to define their expectations, select third parties and monitor their activities. Investors at the beginning of this journey will not be in a position to cover in detail all areas presented in this guidance. However, they can use the recommendations and examples to set the direction of their active ownership programme and become future leaders.

DEVELOPING AN ACTIVE OWNERSHIP POLICY

The first step to define an active ownership policy (embedded in the overall investment policy or included in a separate document) is to align it with the organisation's investment strategy and its overall view on risk, returns and impact on the real economy.

The policy should outline the general approach to active ownership, including alignment with stewardship principles and codes, assets covered, expectations and objectives, the organisational structure and resources dedicated, and conflicts of interest. The engagement section should provide an overview of ESG issues of concern or interest, the due diligence and monitoring process, prioritisation, methods of engagement, escalation strategies and transparency. The proxy voting section would follow a similar structure and add information on decision-making processes, eventual regional practices, filing resolutions, company dialogue pre or post-vote, the securities lending process and transparency.

If an investor decides to outsource active ownership activities to specialised service providers and investment managers, the active ownership policy will have less detail but still be crucial to outline the value of engagement and voting for the organisation and guide the relationship with selected third parties. In this case, the policy will describe the general approach to active ownership and will specify expectations, frameworks of reference, information requirements and monitoring systems.

ENGAGEMENT PRACTICES

The first step to identify targets for engagement is regularly monitoring investee companies on ESG issues which represent value at risk or potential opportunities for long-term financial performance and impact on the real economy. This due diligence phase can partially overlap or coincide with ESG monitoring systems set up to support incorporation practices. The same research used to identify cases of engagement will be continuously integrated with the insights gained during the dialogue with companies following a circular process.

The next stages of an engagement programme entail defining priorities (based on holdings, markets, sectors, ESG benchmarks, themes, etc.), developing objectives and milestones, and tracking results. Investors can also join collaborative engagements but need to define criteria to select the coalitions to participate in. The ingredients for success within a collaborative group are: commonality, coordination, clarity and clout.

If initial engagement efforts are unsuccessful, investors can consider escalation strategies such as contacting the board, issuing a public statement, using voting, filing a resolution, seeking legal remedies, and reducing exposure or divesting.

SUCCESSFUL ENGAGEMENT STRATEGY

- Arrive prepared and provide feedback
- Demonstrate a holistic understanding of the company's performance and strategy
- Understand the corporate culture
- Be sensitive of cultural differences
- Visit site operations
- Praise positive practice
- Focus on the business case and materiality
- Present a consistent and integrated message
- Make connections
- Align requests with international standards, where possible
- Time your requests appropriately
- Share best practices
- Build on and foster ongoing and trustworthy relationships

PROXY VOTING PRACTICES

Engagement and voting practices are interlinked and feed into each other. As investors hold thousands of companies in their portfolios, outsourcing activities to proxy advisors is essential. However, responsible investors do not automatically take on board their voting recommendations and instead make informed decisions based on a triangulation of sources. Such analysis requires time and resources; investors will therefore have to define their criteria for prioritisation. While voting policies can help to guide investors' decision-making process, research and discretion will always be necessary to ensure meaningful voting. Lead investors would use a combination of internal and external resources and would involve ESG experts as much as portfolio managers. When assessing the quality of ESG resolutions presented at AGMs, investors need to consider: the topic; the invitation for leadership; the evidence; current performance; previous engagement; the tone; the suggested timeline; external pressure; and disclosure requests.

Beyond research and casting votes, voting involves communicating with investee companies before and after the AGM. Where possible, investors should raise concerns with companies before voting against or abstain to initiate dialogue, receive additional information and then start shaping corporate behaviour. When this is not feasible, investors should publicly share the rationale for their votes against management or abstentions and explain their view with interested companies directly either voluntarily or following a company's request.

RELATION TO INVESTMENT DECISIONS

Integrating active ownership practices into investment decisions is one of the most difficult but necessary tasks to achieve a holistic investment strategy.

BEST PRACTICE TO LINK ACTIVE OWNERSHIP TO INVESTMENT DECISION MAKING INCLUDES:

- ensuring regular cross-team meetings and presentations;
- sharing active ownership data across platforms that is accessible to ESG and investment teams;
- encouraging ESG and investment teams to join engagement meetings and roadshows;
- delegating some engagement dialogue to portfolio managers;
- involving portfolio managers when defining an engagement programme and developing voting decisions;
- establishing mechanisms to rebalance portfolio holdings based on levels of interaction and outcomes of engagements and voting; and
- considering active ownership as a mechanism to assess potential future investments.

ASSESSING EXTERNAL MANAGERS AND SERVICE PROVIDERS

When investors decide to partially or fully outsource their active ownership activities to investment managers or specialised service providers, defining criteria to select, appoint and monitor third parties is crucial. In the reviewing phase, an investor needs to evaluate the third party's active ownership policy, capacity and governance, engagement process and outcomes, investment decision-making process and reporting capacity. An evaluation of investment managers' and service providers' active ownership practices can be made through regular reporting, meetings and surveys/questionnaires. They should focus, among other areas, on: the depth and breadth of internal and external ESG research used; controversial or material ESG topics raised/to be raised during engagement dialogue or considered/to be considered during the voting season; the rationale for engagement discussions and voting decisions, and alignment or deviation from the investor's investment beliefs/strategy and agreed policies of reference; and the objectives, progress, outcomes and next steps of specific engagements.

DISCLOSURE

As much as investors are engaging with companies to access and encourage better ESG information and practices, they are responsible for reporting to their clients and beneficiaries on their engagement and voting activities and relevant outcomes. Such information should be easy to access and understand, and provided on a regular basis (i.e. quarterly or annually).

BEST PRACTICE DISCLOSURE ON ENGAGEMENT ACTIVITIES INCLUDES:

- a presentation of the overall engagement strategy, due diligence and monitoring approach;
- detail on the selection of engagement cases and definition of objectives;
- number of engagements undertaken;
- breakdown of engagements by type/topic;
- breakdown of engagements by region;
- an assessment of progress and outcomes achieved against defined objectives;
- examples of engagement cases with specific companies (when the information is not considered sensitive and confidential);
- detail on eventual escalation strategies taken after the initial dialogue has been unsuccessful (i.e. filing resolutions, issuing a statement, voting against, divestment etc.); and
- whether the information provided has been assured externally.

GOOD QUALITY REPORTING ON VOTING ACTIVITIES COVERS:

- all voting decisions, including on ESG resolutions;
- number of votes cast and corresponding AGMs covered across markets and percentage of total available votes;
- an overview of topics covered during the voting season;
- percentage of votes cast for, against or abstained;
- explanation of the rationale for voting against management or abstentions; and
- whether the information provided has been assured externally.

While this guidance focuses on practices related to listed equity holdings, several insights and recommendations on policy development, execution and disclosure can be equally applied to other asset classes such as corporate fixed income and private equity. Further in-depth analysis of the differences and engagement implications in fixed income is included in the forthcoming PRI publication, *ESG engagement for fixed income investors: managing risks, enhancing returns*.

INTRODUCTION

DEFINING ACTIVE OWNERSHIP

As part of their commitment to implement the Principles for Responsible Investment, signatories have been asked to consider ESG issues in their active ownership policies and practices (Principle 2) and collaborate in their efforts to build a dialogue with investee companies (Principle 5) for more than a decade.

Active ownership is one of the fastest-growing responsible investment strategies in listed equity globally. According to recent PRI data[1], engagement practices are becoming increasingly common among investors, with only 11% of signatories reporting not having any dialogue on ESG issues with listed equity companies in their portfolios[2]. Collaborative engagement is also becoming common practice as shown by data from the PRI Collaboration Platform (a PRI private forum where investors can share information and pool resources to engage with companies): over 600 PRI signatories have been involved in at least one collaborative initiative since the platform was launched at the end of 2006, and over 1,100 collaborative proposals have been posted. Equally, approximately 73% of PRI signatories with internally-managed assets and 75% of signatories with externally-managed assets voted the majority of their shares in 2017.

Active ownership is generally regarded as one of the most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment – for passive and active investors. Divestment alone, alternatively, leaves investors[3] with no voice and no potential to help drive responsible corporate practices. Yet, while investors have been active owners for many years, little is known about current leading practices, processes and success across markets. Poor quality engagement and poorly informed proxy voting practices can be highly counterproductive and cause frustration among target companies. More guidance on how to make active ownership an effective tool to support long-term value creation is needed. This guide intends to fill this gap and provide practical suggestions to those investors interested in building a fruitful dialogue with investee companies.

DEFINING ENGAGEMENT AND VOTING PRACTICES[4]

Active ownership is the use of the rights and position of ownership to influence the activities or behaviour of investee companies. Active ownership can be applied differently in each asset class. For listed equities, it includes engagement and voting activities.

Shareholder engagement captures any interactions between the investor and current or potential investee companies on ESG issues and relevant strategies, with the goal of improving (or identifying the need to influence) ESG practices and/or improving ESG disclosure. It involves a structured process that includes dialogue and continuously monitoring companies. These interactions might be conducted individually or jointly with other investors.

Collaborative engagements include groups of investors working together, with or without the involvement of a formal investor network or other membership organisation.

Voting refers to the exercise of voting rights on management and/or shareholder resolutions to formally express approval (or disapproval) on relevant matters. In practice, this includes taking responsibility for the way votes are cast on topics raised by management, as well as submitting resolutions as a shareholder for other shareholders to vote on (in jurisdictions where this is possible). Voting can be done in person, during an Assembly General Meeting (AGM), or by proxy.

Ballot items are not always closely related to environmental and social issues and cover financial performance, risk management, strategy and corporate governance matters[5].

Voting and engagement practices are interrelated and feed into each other; one can be the initiator or the complementary tool of the other.

> "Truly active managers view their roles as business owners, not just as shareholders. The very spirit of responsible investment is the opportunity to engage, drive change and deliver strong investment returns for clients in a sustainable manner."
>
> Bonnie Saynay, Global Head of Responsible Investment, Invesco, Investment Manager, US

1 Data from responses to the 2017 PRI Reporting Framework.

2 Data from responses to the LEA module - 2017 PRI Reporting Framework: percentages are calculated on total of responding signatories for that module.

3 Throughout this document, the term investor or institutional investor is used to indicate either asset owners or investment managers or both depending on the context.

4 See PRI Reporting Framework definitions.

5 However, the oversight and management of environmental and social risks and opportunities resides with the board and its committee. Therefore, proxy voting can be an effective tool to influence the overall ESG performance of a company.

Active ownership implies a two-way dialogue with companies; it is not about investors micro-managing companies, nor is it about voting on company resolutions once a year and in favour of management's recommendations. This practice is primarily about communication and influence. On the one hand, investors have an opportunity to explain their expectations of corporate management in general and in relation to managing ESG risks and opportunities in particular, as well as encourage actions to preserve long-term value and be better informed to make investment decisions. On the other hand, companies can provide clarifications on their strategy and the relationship between ESG factors, their business model and financial performance as well as receive early warnings on emerging risks and best practices.

> "It [active ownership] really encompasses using your voice and your vote to effect change or as part of the monitoring process of a company. By 'voice', I mean engagement, and by 'vote', I mean the voting process, so it has to be both."
>
> Rakhi Kumar, Managing Director, Head of ESG Investments and Asset Stewardship, State Street Global Advisors, Investment Manager, US

Active ownership is a responsible investment strategy with a strong sustainability focus, but it does not have to be limited to dialogue on ESG issues. In fact, it is part of the relationship between the company and its (potential) shareholders and can entail broader conversations on the overall business strategy, capital allocation, future direction of a company and suitability of investor communications. Active ownership can equally be defined as stewardship – "a practice which aims to promote the long-term success of companies in such a way that protects and enhances the value that accrues to the ultimate beneficiary of an investment"[6]. As the UK Kay Review asserts, stewardship across a range of activities and issues is a core function of equity markets that can drive enhanced operational and financial performance, and its benefits accrue over several years. In a broader context, stewardship enhances overall financial market stability and economic growth.

> "Being an active owner means building a constructive relationship with companies to make them thrive in comparison with peers and deliver returns."
>
> Faith Ward, Chief Responsible Investment and Risk Officer, Environment Agency Pension Fund (EAPF), Asset Owner, UK

There are many ways to practice active ownership, and several PRI signatories have mature practices that offer examples. These include activities carried out in-house, on an outsourced basis through investment managers/ service providers or through a combination of internal and external practices. When carried out in-house, investors are responsible for defining their engagement and voting programmes, setting objectives and conducting dialogue/ voting directly. When these practices are outsourced, investors have to define their expectations on the engagement and voting activities executed on their behalf and consider criteria to assess the capacity and performance of external providers during the selection, appointment and monitoring processes. Levels of outsourcing can also vary significantly from situations when investors are still highly involved in the activities (i.e. signing letters to and joining meetings with companies) to cases when active ownership practices are entirely delegated to investment managers/ service providers.

> "Active ownership should be about shaping behaviours - not simply a chat with the chair."
>
> Susheela Peres da Costa, Deputy Managing Director, Regnan, Service Provider, Australia

While this guidance focuses on practices related to listed equity holdings, several insights and recommendations on policy development, execution and disclosure can be equally applied to other asset classes such as corporate fixed income and private equity. Further in-depth analysis of the differences and engagement implications in fixed income is included in the forthcoming PRI publication, *ESG engagement for fixed income investors: managing risks, enhancing returns*.

6 BIS Research: Exploring the Intermediated Shareholding Model.

> "Active ownership is the fiduciary duty of shareholders in public markets to be stewards of their investee companies and to monitor their performance in areas of business risk, strategy, culture and ESG issues."
>
> Sara Nordbrand, Head of Sustainability and Corporate Engagement, The Church of Sweden, Asset Owner, Sweden

Dialogue with policy makers on current or upcoming legislation on ESG and responsible investment practices is a complementary element of investors' active ownership activities. Insights collected by investors in their interactions with companies can inform better guidelines and regulation by governments and help shape an enabling environment for sustainable business practices. The PRI has provided detailed guidance on investor advocacy in its publication entitled The case for investor engagement in public policy.

> "We proactively engage with companies on environmental, social, and governance (ESG) issues where shareholder value is at stake and improved company performance is within reach."
>
> Stu Dalheim, Vice President, Shareholder Advocacy Manager, Calvert Research and Management, Investment Manager, US

Finally, this report includes references to relevant PRI Reporting Framework indicators to help signatories fulfil reporting requirements.

THE ADDED VALUE OF ACTIVE OWNERSHIP

Recent academic research commissioned by the PRI has explored how engagement is bringing knowledge and economic value to both investors and companies.

> "Engagement is not necessarily looking to force change, but it allows to deepen understanding."
>
> David Sheasby, Head of Investment Governance and Sustainability, Martin Currie Investment Management, Investment Manager, UK

A qualitative analysis based on 36 and 66 interviews with companies and investors respectively, led by Cass Business School (City, University of London) and Nottingham University Business School, revealed the communicative, learning and political dynamics related to shareholder engagement (see table 1 for more details):

- **Communicative dynamics:** Engagement improves information flow and understanding between corporations and investors. Through engagement, investors can seek more detailed and accurate information about ESG corporate practices and activities. In doing so, they can enhance their own ESG-related communication and accountability to clients, regulatory authorities and/or standard setters. Meanwhile, engagement helps corporations develop a better sense of investors' expectations in relation to ESG issues, facilitating enhanced corporate accountability in this area. Through dialogue, companies can also improve their image during a controversy or promote aspects of their business model that may not be fully appreciated from the outside.
- **Learning dynamics:** Engagement also serves as a way to generate and share knowledge about ESG issues, future trends, and the limitations of current practices and activities. By enhancing their knowledge on specific issues, investors can make more informed investment decisions in relation to a company and/or the relevant industry. Similarly, corporations use engagement to obtain feedback from investors about their ESG performance or benchmark their sustainability position against their industry peers.
- **Political dynamics:** Investors and companies can enjoy political benefits by interacting with each other. On the investor side, engagement can enhance ESG integration practices by enabling closer collaborations between ESG and non-ESG analysts, or by assuring clients that they are complying with their fiduciary duties. On the corporate side, ESG-related requests from investors can help them develop internal relationships between operational and functional experts, raising board-level awareness of ESG issues and securing or enhancing resources for such activities.

Table 1 - Mechanisms of engagement value creation for corporations and investors. Source: Gond, JP. (2017); O'Sullivan, N. & Gond, JP. (2016)[7]

VALUE CREATION DYNAMICS	CORPORATIONS	INVESTORS
COMMUNICATIVE EXCHANGING INFORMATION	Clarifying expectations and enhancing accountability	Signalling and defining ESG expectations
	Managing impressions and rebalancing misrepresentations	Seeking detailed and accurate corporate information
	Specifying the business context	Enhancing investor ESG communication and accountability
LEARNING PRODUCING AND DIFFUSING KNOWLEDGE	Anticipating and detecting new trends related to ESG	Building new ESG knowledge
	Gathering feedback, benchmarking and gap spotting	Contextualising investment decisions
	Developing knowledge of ESG issues	Identifying and diffusing industry best practice
POLITICAL DERIVING POLITICAL BENEFITS	Enrolling internal experts	Advancing internal collaboration and ESG integration
	Elevating sustainability and securing resources	Meeting client expectations
	Enhancing the loyalty of long-term investors	Building long-term relationships

Measuring the ESG impacts and financial benefits of active ownership has always been challenging as the outcomes of engagement generally manifest in the long term and it is difficult to isolate ESG factors from other components that might contribute to a better bottom line. Nevertheless, recent studies have quantified the alpha of active ownership (see table 2 for more details).

A quantitative study led by the University of Cambridge and the London School of Economics on more than 30 PRI-coordinated collaborative engagements - involving 225 institutional investors and 964 companies - unveils the financial impact of successful engagement[8]. The research found that target companies experience improved profitability, as measured by return on assets, and increased ownership by the lead investor who has conducted the dialogue on behalf of the coalition. Unsuccessful engagements see no change in return on assets or in shareholding.

"We believe that considering ESG factors within AMP Capital's investment decision-making and ownership practices provides greater insight into areas of potential risk and opportunity that will impact the value, performance (risk and/or return) and reputation of the investments we make on behalf of our clients."

Karin Halliday, Senior Manager, Corporate Governance, AMP Capital, Investment manager, Australia

7 Gond, Jean-Pascal. (2017). RI Quarterly - How ESG engagement creates value: bringing the corporate perspective to the fore; O'Sullivan, Niamh & Gond, Jean-Pascal. (2016). Engagement: unlocking the black box of value creation.

8 Each group of investors develops tailored scorecards on the specific issue of concern (i.e. climate change, human rights, water scarcity etc) to assess the performance of target companies both at the beginning and at the end of the dialogue. In the research, an engagement is successful when a target company improves its scoring of a certain percentage after the interaction with the investors has concluded.

Table 2 – The financial impact of active ownership

STUDY	SUMMARY OF FINDINGS
Dimson, E., Karakas, O. and Li, X. (2015). **Active Ownership**. *The Review of Financial Studies,* 28 (12), pp. 3225-3268.	The study found that US companies targeted in corporate governance and climate change-related engagements by an investment manager between 1999 and 2009 showed significant financial outperformance of the market in the period following engagement. The average one-year abnormal return after initial engagement was 1.8%, growing to 4.4% for successful engagements, and no market reaction for unsuccessful engagements.
Junkin, A., CFA, CAIA (2015) , Managing Director, update to **The CalPERS Effect on Targeted Company Share Prices**, Wilshire.	This review found that companies targeted by CalPERS for engagement and performance improvement delivered an excess cumulative return of 13.72% above the Russell 1000 Index, and 12.11% above their respective Russell 1000 sector indices. This includes both those on the public Focus List and those identified for confidential engagement.
Becht, M., Franks, J., Mayer, C. and Rossi, S. (2010). **Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund.** *The Review of Financial Studies*, 23(3), pp. 3093-3129.	The study found that the Hermes Focus Fund "substantially outperforms benchmarks" with an abnormal return, net of fees, of 4.9% a year against the FTSE All-Share Index. The research estimates that abnormal returns are largely associated with engagements rather than stock picking.

"Voicing investor concerns to companies makes a difference. It can reinforce a difficult political decision or it can justify the work of genuinely concerned employees working as internal change-makers."

Jean Philippe Renaut, CEO, Æquo Shareholder Engagement Services, Service Provider, Canada

"We engage to keep companies accountable, gain insights and drive ESG changes, but we also look at active ownership as an intrinsic part of ESG integration in investment decision making."

Matthias Beer, Director, Governance and Sustainable Investment, BMO Global Asset Management, Investment Manager, Canada

Box 1 – PRI outcome documents

The PRI's ESG Engagements team has produced a series of outcome documents over the last 10 years to outline the results and lessons learnt of several coordinated collaborative engagements across a range of ESG issues. The most recent publications include:

- HYDRAULIC FRACTURING
  The guide provides a business case for engagement on fracking, case studies and results from the collaborative engagement. It also includes questions for investors to engage with companies and recommendations for future engagement.
- LABOUR PRACTICES IN AGRICULTURAL SUPPLY CHAINS
  The report draws together results from the 2013-2015 PRI-coordinated engagement, and includes investor expectations and useful resources to support engagement with companies.
- ENGAGING ON ANTI-BRIBERY AND CORRUPTION
  The report published with the UN Global Compact draws on the findings from the PRI-coordinated engagements on the topic over 2013-15, investor comments and company feedback.

> "Active ownership is about enhancing long-term value, identifying good practice and encouraging widespread adoption of these practices."
>
> Michelle Edkins, Managing Director, Global Head of BlackRock Investment Stewardship, BlackRock, Investment Manager, US

THE REGULATORY AND ENABLING ENVIRONMENT

Fiduciary duties (or equivalent obligations) exist to ensure that those who manage other people's money act in the interests of beneficiaries, rather than serving their own interests. The most important of these duties are:

- **Loyalty.** Fiduciaries should not act for the benefit of themselves or a third party and should: act in good faith in the interests of their beneficiaries; impartially balance the conflicting interests of different beneficiaries; and avoid conflicts of interest.
- **Prudence.** Fiduciaries should act with due care, skill and diligence, investing as a prudent person would.

When evaluating whether an institutional investor has delivered on its fiduciary duties, both the outcomes achieved and the process followed are of critical importance. Failing to consider long-term investment value drivers, which may include ESG issues, in investment practice is a failure of fiduciary duty. The exercise of active ownership as part of the investment decision-making process and the consideration of ESG issues in engagement and voting practices can therefore be considered an investor's fiduciary duty. In the US and Canada, for example, securities and pensions regulators have asserted that shareholder rights are assets of the pension scheme to be used and monitored by fiduciaries in the best interests of beneficiaries. Similar clarifications by policy makers and regulators in other countries have been encouraged by the PRI within its fiduciary duty work programme (see, for example, recommendations included in the Fiduciary Duty in the 21st Century - UK roadmap).

The new version of the European Union Shareholder Rights Directive (2007/36/EC), approved in 2016, is also recognising that shareholders can exert short-term pressure on investee companies, at the expense of long-term value creation and focus on ESG issues[9]. The Directive seeks to mitigate this by setting stronger expectations and requirements on active ownership by both asset owners and investment managers. At a glance, the directive calls for:

- asset owners[10] to establish and publicly disclose an engagement and voting policy, and report on how they implement the policy on an annual basis (on a comply-or-explain basis);
- investment managers to establish and publicly disclose an engagement and voting policy, and report on how they implement the policy on an annual basis (on a comply-or-explain basis);
- (proxy) advisors to publicly disclose compliance with a code of conduct, to be determined by the Member State, and the key elements of how they prepare research and advice and develop voting recommendations (on a comply-or-explain basis); and
- company directors to establish a clear remuneration policy in line with the long-term interests and sustainability of the company, and submit the policy to vote at least every four years. Member states may make this vote binding or advisory (on a mandatory basis).

Other regulatory and standard developments have requested investors to take an active role in monitoring and influencing investee companies. For example, finance sector regulators and investment associations in 18 countries have introduced national stewardship codes with an increasing reference to ESG issues (see table 3 for an overview). In 2016, the International Corporate Governance Network also launched its Stewardship Principles, which outline a framework of reference for future national stewardship codes (see box 1).

> "Active ownership is part of our fiduciary duty in public markets to monitor companies' performance in areas of business risk, culture, strategy and ESG issues."
>
> Mariela Vargova, Senior Vice President, Sustainability and Impact Investments, Rockefeller Asset Management

9 PRI Policy briefing - European Union Shareholder Rights Directive.

10 The directive refers to institutional investors defined as Institutions for Occupational Retirement Provision (IORPs) and those providing life assurance.

Nearly all these codes encourage disclosure of active ownership policies, management of conflicts of interest and reporting to clients and beneficiaries.

In many of these codes, ESG factors are explicitly included, while in other countries there is a more general reference to long-term sustainable value creation.

Table 3 – Stewardship codes and guidelines around the world. Source: PRI regulatory map

COUNTRY	INSTITUTION	TITLE
Australia	The Financial Services Council (FSC)	The FSC Internal Governance and Asset Stewardship Standard
Belgium	The Belgian Asset Managers Association (BEAMA)	Code of Conduct
Brazil	AMEC	AMEC Stewardship Code
Canada	Canadian Coalition for Good Governance (CCGG)	Stewardship Principles
Denmark	Committee for Good Corporate Governance at the initiative of the Minister of Business and Growth	Stewardship Code for Danish institutional investors
Germany	German Working Group on Corporate Governance for Asset Managers	Corporate Governance Code for Asset Management Companies
Hong Kong	Securities and Futures Commission	Principles of Responsible Ownership
Italy	Il Consiglio direttivo di Assogestioni	Italian Stewardship Principles
Japan	FSA	Principles for Responsible Institutional Investors
Malaysia	Securities Commission Malaysia	Malaysian Code for Institutional Investors
Netherlands[11]	Eumedion (Dutch corporate governance forum)	Best Practices for Engaged Ownership
Singapore	Stewardship Asia	Singapore Stewardship Principles (SSP) for Responsible Investors
South Africa	Institute of Directors in Southern Africa	Code for Responsible Investing in South Africa (CRISA)
South Korea	FSC Korea	Stewardship Code
Switzerland	ASIP, Swiss Association of Pension Fund Providers, Swiss Federal Social Security Funds OAI/II/IC, economiesuisse, Swiss Business Federation, Ethos – Swiss Foundation for Sustainable Development, Swiss Bankers Association (SwissBanking), SwissHoldings, Federation of Industrial and Service Groups in Switzerland	Guidelines for institutional investors governing the exercising of participation rights in public limited companies
Thailand	Securities and Exchange Commission of Thailand	Investment Governance Code (I Code)
UK	Financial Reporting Council	The UK Stewardship Code
US	Investor Stewardship Group (ISG)	Stewardship Framework for Institutional Investors
Global	OECD	Responsible Business Conduct for Institutional Investors

11 A Dutch Stewardship Code is currently under revision and consultation.

> "Active ownership plays a prominent role in our duty to act as stewards of our clients' assets. We expect strong governance standards from our investee companies and our direct engagement with them focuses on advocating change where poor ESG practices place shareholder value at risk."
>
> Richard Lacaille, Global Chief Investment Officer, State Street Global Advisors

Finally, building on the G20/OECD Principles of Corporate Governance[12], which recognise the responsibility of investors to exercise their shareholder rights and ownership functions through engagement with their investee companies, the OECD recently published the *Responsible Business Conduct for Institutional Investor*[13]. The report includes key considerations for due diligence under the OECD Guidelines for Multinational Enterprises[14]. It states that the relationship between an investor and an investee company is different from the relationship between purchaser and supplier companies, but the investor can seek to influence the responsible business conduct of the investee through active ownership. Even minority shareholders may be directly linked to adverse environmental and social impacts caused or contributed to by investee companies in their portfolios. As a result, investors are expected to undertake ESG[15] risk-based due diligence, consider ESG risks in their investment processes and use their leverage with companies to help them prevent or mitigate adverse impacts.

Box 2 – ICGN Global Stewardship Principles. Source: IGCN

Internal governance: Foundations of effective stewardship

Principle 1: Investors should keep under review their own governance practices to ensure consistency with the aims of national requirements and the ICGN Global Stewardship Principles and their ability to serve as fiduciary agents for their beneficiaries or clients.

Developing and implementing stewardship policies

Principle 2: Investors should commit to developing and implementing stewardship policies which outline the scope of their responsible investment practices.

Monitoring and assessing investee companies

Principle 3: Investors should exercise diligence in monitoring companies held in investment portfolios and in assessing new companies for investment.

Engaging companies and investor collaboration

Principle 4: Investors should engage with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients and should be prepared to collaborate with other investors to communicate areas of concern.

Exercising voting rights

Principle 5: Investors with voting rights should seek to vote shares held and make informed and independent voting decisions, applying due care, diligence and judgement across their entire portfolio in the interests of beneficiaries or clients.

Promoting long-term value creation and integration of ESG factors

Principle 6: Investors should promote the long-term performance and sustainable success of companies and should integrate material ESG factors in stewardship activities.

Enhancing transparency, disclosure and reporting

Principle 7: Investors should publicly disclose their stewardship policies and activities and report to beneficiaries or clients on how they have been implemented so as to be fully accountable for the effective delivery of their duties.

12 G20/OECD Principles of corporate governance.

13 OECD Responsible Business Conduct for Institutional Investors.

14 OECD Guidelines for Multinational Enterprises.

15 The OECD guidance refers to Responsible Business Conduct (RBS) as synonymous with ESG risks, although these risks should be identified as impacts on the society and environment and not just as risks to the investors themselves or their investee companies.

BARRIERS TO ACTIVE OWNERSHIP

Engagement and voting activities in listed equity are widespread across markets, but investors are still facing cultural, regulatory and practical barriers to fully comply with their active ownership responsibilities and duties.

The most cited and perceived obstacles to active ownership are related to:

- **Costs:** Building a dialogue with companies and voting shares in an informed way is resource and time-consuming; even if investors have the resources to engage and vote on ESG issues, many believe the costs are likely to outweigh the investment benefits. It is difficult to attribute results on corporate changes and stewardship is often long term, with investment benefits accruing beyond the timeframe of an investment manager's mandate.
- **Free-riding:** Few investors bear the cost of active ownership but many could potentially benefit once companies have improved their practices. Similarly, when investors collaborate, some might be more active than others in engaging with companies but the entire group will benefit from successful dialogue.
- **Portfolio diversification:** A high level of portfolio diversification imposed by prudential statutes limits the portion of a company's capital held, decreases the financial power and leverage of the engagers and makes it impossible to engage with and vote in an informed way on all companies included in portfolios.
- **Passive and indirect investment:** The benefits of active ownership on investors tracking an index, adopting rule-based and smart beta strategies without human involvement in the investment decision, or investing in exchange-traded fund (ETF) products, are less evident as the relative weighting of their investments following engagement cannot be easily adjusted.
- **Share ownership chain structure:** The length of intermediation (including trustees, consultants, funds-of-funds and investment managers) limits the development of strong relationships between the engager and the end recipient of the dialogue (i.e. target company) and could limit the ability to use insights from engagement in investment decision making.
- **Conflicts of interest:** Some investors have concerns about conflicts of interest, particularly where the investment manager is engaging on behalf of a diverse group of beneficiaries or is part of an investment organisation which has commercial relationships with companies being engaged.
- **Corporate responsiveness:** There remains a lack of consistent, comparable, relevant and timely corporate reporting on ESG issues. This could signal to investors that companies are not interested in ESG issues and therefore unlikely to respond to engagement dialogues and requests.
- **Investment chain transparency:** Active ownership is rarely embedded in mandates and investment beliefs by asset owners and it is not a driver of investment consultant recommendations; there is scarce information on active ownership activities by investment managers; and there is limited monitoring by asset owners on investment managers and service providers responsible for outsourced engagement and voting.
- **Regulatory opacity:** There is a lack of clarity on definitions of fiduciary duty in some markets in relation to the inclusion of active ownership on ESG issues; there are also weaknesses in the implementation, oversight and enforcement of legislation and industry codes.
- **Local legislation:** Some large investors, particularly US investors, have concerns that shareholder collaboration could breach SEC 13D, or acting in concert, filing requirements. Others argue that engagement could expose investors to insider information which would constitute a breach of market abuse regulation.

More constraints are specific to the voting chain[16]:

- **Voting season:** Around the world there are thousands of AGMs taking place in a very short period of time (between March and June)[17]. Typically, between 20 and 30 decisions will be voted on at each of these AGMs[18]. This condensed period for voting decision making is challenging for institutional investors with large portfolios.
- **Multi-class stocks:** Dual or multi-class stock structures have two or more classes of shares with different voting rights and dividend payments. Founders, their families or other insiders usually hold the superior class of shares and benefit from much higher voting rights (e.g. usually 10 votes per share compared to one per share) than inferior class owners. Some stocks might not have voting rights at all. These types of structures do not follow the corporate governance principle of "one share, one vote" and hamper the power of institutional investors to hold companies accountable.

16 BIS Research: Exploring the intermediated shareholding model.

17 With exceptions for Japan, Australia, Canada, Germany, UK, US, Canada and Hong Kong.

18 Invesco: Proxy voting: the hallmark of active ownership.

- **Identification of the ultimate owners:** The current opacity of the ownership chain and the use of omnibus accounts by custodians does not allow companies to know who their investors are or who has voted on their behalf. Similarly, investors are not able to identify one another in the company and cannot identify potential partners for co-filing resolutions.
- **Record dates:** Record dates for entitlement to vote are usually no more than 48 hours before the meeting and this causes delays and the bundling of votes in the chain. Investors usually vote on their likely voting rights and the voting agent has to reconcile the proxy votes in the system once the actual number of shares held is defined on the record date. This process is complex when done in a short period of time.
- **Company documentation:** Documents might be sent out by companies with very short notice and lack of translation. Questions and items might also change on the day of the AGM once companies have acquired information on the direction of votes by their shareholders before the meeting.
- **Administration:** Electronic voting through an online platform is still rare. Meeting agendas and voting forms are often still printed and posted, making the process highly bureaucratic.
- **Vote confirmation:** The voting chain usually includes multiple actors, from voting agents to custodians and sub-custodians. The complexity of this structure makes it difficult for institutional investors to receive final confirmation that their votes have reached the companies.
- **Share blocking:** In certain jurisdictions, shareholders have to deposit their shares with a designated depositary and they are not able to trade on those shares for a certain number of days before the AGM to be able to vote. This prevents passive investors from voting, since their shares must remain part of an index at all times.
- **Share re-registration:** Some markets require that shares are registered in the name of the shareholder in order to vote. As a result, the shareholder can trade in the relevant company's stock only when the shares have been re-registered in the name of the custodian after voting.
- **Power of attorney:** In some countries, the power of attorney or even the presence in person is required to be able to vote.
- **Absence of formal end point:** Under common law, the chairman of a company must confirm that votes have been cast but he or she can still do so without formally including all proxy instructions into votes cast. In some circumstances and in some countries, he or she could simply ask for a show of hands in the room.
- **Stock lending:** The link between engagement and voting is broken by share lending practices as the vote goes to the borrower, a temporary owner, unless the shares are recalled.
- **Proxy voting advisors:** There is a high market concentration among proxy voting advisors, which limits the choices available to institutional investors in proxy voting services.

Without denying the presence of these barriers and the need for regulatory changes to solve some of the problems above[19], there are leading practices in active ownership that investors can apply to overcome these obstacles. Some of these are also a matter of perception rather than real impediments. The following chapters will shed some light on such practices, keeping a focus on listed equity.

19 The PRI is addressing several of the barriers outlined in this section through the Sustainable Financial System (SFS) project. More information is available at www.unpri.org/sfs.

DEVELOPING AN ACTIVE OWNERSHIP POLICY

ACTIVE OWNERSHIP AS PART OF THE OVERALL INVESTMENT STRATEGY

The first phase of active ownership involves reviewing the investor's overall investment strategy, including the vision, mission and investment principles of the organisation.

As outlined in the PRI's *Crafting an Investment Strategy - A Process Guidance for Asset Owners* report, investors must understand the underlying trends shaping the investment environment and answer questions about their vision, mission and investment principles to define an optimal investment strategy (see figure 1 below).

Figure 1 – Five steps to define an investment strategy

1 Context

- Gather fact base on **external trends** (e.g. social, technological, economic, environmental, political/regulatory).
- Assess your **organisation's capabilities** and position in the market.
- Understand the personal **investment convictions** of key players in your organisation (e.g. regarding impact).

2 Vision & mission

- Develop/realign **vision** of how society and investment will develop (e.g. demographic change, changing beneficiary/customer needs/expectations, regulatory change).
- Clearly specify/reassert your **mission** (e.g. including the breadth/extent of your fiduciary duty).

3 Investment principles

- Develop specific **investment principles**/beliefs (e.g. on market efficiency, ESG incorporation, active ownership), for use in:
  - investment strategy selection;
  - investment decision-making

4 Investment strategy selection

- Define medium- and long-term **ambitions** (e.g. on financial return, risk appetite, ESG considerations), and criteria to evaluate them by.
- Create strategy **scenarios**, combining options of where to focus (e.g. geographies, asset classes) and how to succeed (e.g. sourcing).
- **Evaluate and select** an investment strategy.

> Highly iterative step

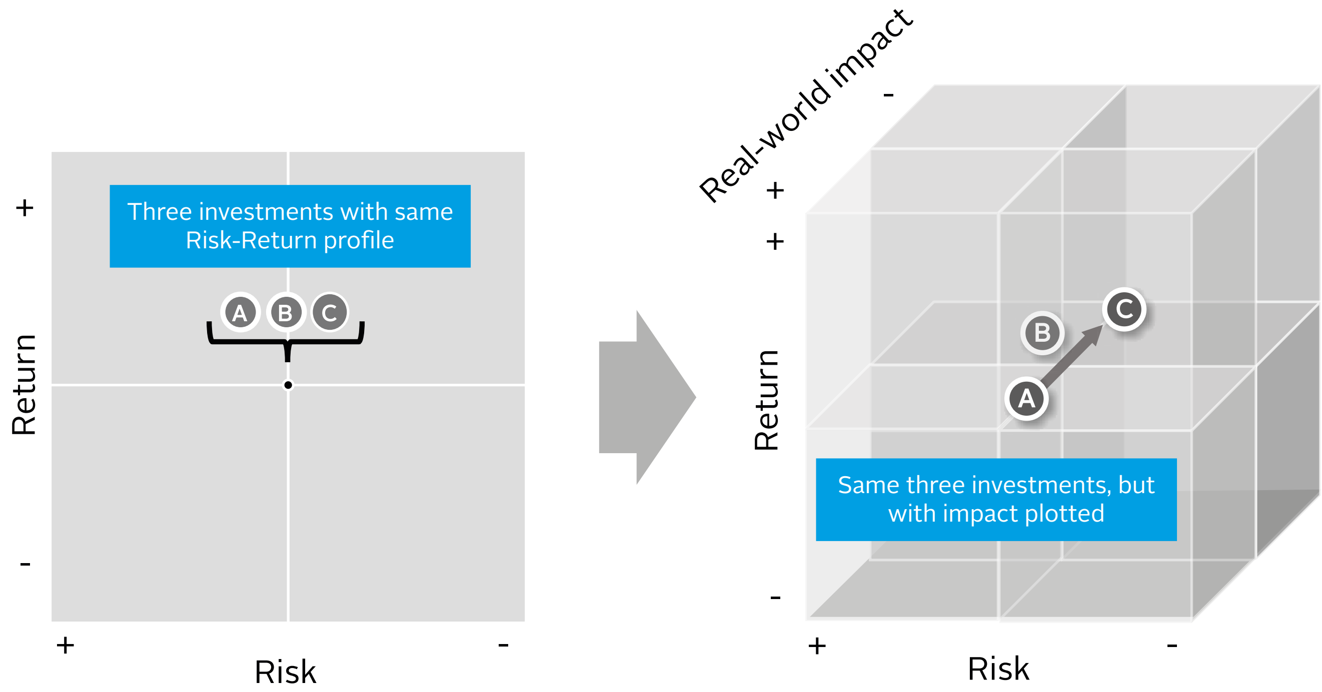
5 Implementation

- **Plan and monitor**:
  - KPIs, incentives and organisation structures;
  - governance, culture, behavior and responsibilities
- **Revise** investment policy, tactical/operational asset allocation and manager RfPs.
- **Adjust** strategy as needed.

Communication

Most investors view investments on a 2D chart of risk and (financial) return. A growing number of investors integrate ESG factors with material impact to this 2D view, adjusting risk and return accordingly. However, an emerging perspective is adding a third axis which charts real economy influence (REI – the extent to which an investment positively or negatively impacts the real economy as shown in figure 2). The active ownership policy will be highly influenced by the investor's view on these dimensions as the objectives of engagement and proxy voting will mirror chosen priorities in terms of risks, returns and impact on the real economy.

Figure 2. Real economy influence (REI) as a third dimension allows investment differentiation. Source: [PRI SDG Investment Case]



During investment strategy formulation, investors select investment scenarios with a combination of "where to focus" (i.e. asset classes, type of funds, time horizon, industry, geographies etc.) and "how to succeed" (i.e. sourcing in-house or outsourcing, active/passive management, active ownership or not) to be tested based on external (expectations in the markets, ESG trends, etc.) and internal factors (i.e. available capacity). At the end of the process, investors will have a clear view on the type of active owners they want to be and what it requires.

ACTIVE OWNERSHIP POLICY

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 01 - Engagement policy and approach
- 15 - Voting policy and approach

Having developed an investment strategy, the next step is to define an investment policy.[20] Investors might define their organisation's active ownership approach directly in their investment policy. By doing so, they would signal that active ownership is not a standalone practice but a means to enhance investment decision making and execute investment objectives. Alternatively, investors could outline their approach and the relationship of active ownership with the overall investment policy in a separate responsible investment policy or engagement/voting policies. Those policies should be made available to beneficiaries, clients and the public on the organisation's website.

Leading investors also develop expectations of companies that can be communicated either within or alongside their policies. This helps companies understand which ESG practices are highly valued by investors, the type of disclosure that can meet investors' needs, the areas to focus on in preparation for the dialogue with shareholders, and what to expect from long-term active owners.

Policies and expectations should be reviewed periodically (i.e. annually) to reflect lessons learnt from the active ownership process, increasing and modified expectations from clients/beneficiaries, and new ESG developments. Most investors primarily develop their policies internally, but external feedback and input can be sought from beneficiaries and clients, especially in relation to ESG issues that are of concern. These policies should also receive the highest level of internal endorsement possible within the organisation's governance structure for responsible investment (e.g. board of directors or trustees). When assets are managed internally and active ownership is carried out in-house, the investment committee should be responsible for monitoring the progress of various teams in implementing the policy.

20 See the PRI publication Investment policy: process & practice for more guidance.

A dedicated or integrated active ownership policy would specify some or all of the areas below:

GENERAL APPROACH

- **Alignment with stewardship principles and codes:** Explanation of how the investor is aligning its approach with national or international principles and codes (i.e. the PRI, one or more national stewardship codes, the ICGN Global Stewardship Principles, etc.).
- **Assets covered:** Whether the policy covers the entire asset base or a specific asset class, fund or mandate; and whether engagement is conducted with companies that are currently held in the investor's portfolios or also with those that are not.
- **Expectations and objectives:** Outline of the objectives for undertaking engagement and voting activities in line with the chosen investment strategy profile, including whether these activities are related and whether they are informed by, and support, investment decision making. In case of asset owners with assets managed externally and active ownership activities kept in-house, the policy will describe how they will ensure that insights from engagement and proxy voting are shared with external managers.
- **Organisational structure and resources dedicated:** Explanation of who carries out engagement and voting (e.g. specialised in-house ESG teams, portfolio managers or both, etc.) and how the investor ensures that staff have appropriate capacity and experience for active ownership activities (e.g. human resources, time and training).
- **Conflicts of interest:** The organisation's approach to avoiding, identifying and managing conflicts of interest, including the process to communicate potential conflicts of interest to clients or beneficiaries, and remedies to mitigate them.

ENGAGEMENT

- **ESG issues:** Outline of key issues on which the investor wants to engage (i.e. climate change, human rights or executive compensation) and international standards it would expect the companies to comply with (i.e. United Nations Global Compact, OECD MNE guidelines etc.).
- **Due diligence and monitoring process:** Description of the process to monitor ESG practices and performance by investee companies to identify cases for engagement, including how information from beneficiaries, clients and other stakeholders (i.e. trade unions, NGOs and experts) will be taken into account.
- **Prioritisation of engagements:** Presentation of the criteria used to prioritise and select cases for engagement including how the views of beneficiaries, clients and other stakeholders will be taken into account; and whether the organisation's engagements are primarily proactive to ensure that ESG issues are managed in a preventive manner, or reactive to address issues that may have already occurred.
- **Methods of engagement:** Outline of standard procedures to interact with companies (i.e. letters, emails, in-person or virtual meetings, site visits etc.) and company representatives the organisation seeks to engage with (e.g., board representatives, chairman, CEO, CSR/IR managers); and description of the general approach to collaborative engagement (i.e. selection criteria, expectations and commitment of time and resources as leading or supporting investor).
- **Insider information:** The organisation's procedure for managing situations when engagers inadvertently receive non-public material information.
- **Escalation strategies:** Outline of the organisation's approach in the event of unsuccessful engagement (e.g. public statement, overweight/underweight holdings, filing resolutions, voting against re-election of responsible directors, divestment, litigation etc.).
- **Transparency:** Explanation of how the organisation tracks and monitors engagement meetings and interactions; and a general commitment to transparency to clients/beneficiaries and the public, including type and frequency of the information (i.e. quarterly or annually).

VOTING

- **ESG issues:** Outline of factors that will be taken into account when making voting decisions or statements on how the organisation intends to vote on specific issues (i.e. board composition, executive compensation, climate change etc); and indication of any specific corporate governance guidelines that the organisation refers to (i.e. ICGN guidelines, OECD Principles of Corporate Governance etc.).
- **Decision-making processes:** Description of the process to inform voting decisions, including the use of proxy voting advisors and internal research, and to monitor that votes are cast in line with the overall policy (i.e. the proxy advisor's own policy or the investor's bespoke policy).
- **Prioritisation and scope of voting activities:** Explanation of circumstances where the organisation chooses not to vote (i.e. holdings are below a certain threshold, share blocking, lack of power of attorney, etc.).
- **Methods:** Whether the organisation votes by proxy or in person by attending AGMs (or a combination of both).
- **Regional voting practices:** Explanation of how, if at all, the voting approach differs between markets and whether and how local regulatory or other requirements influence the investor's approach to voting. Investors might publish different voting policies for different jurisdictions to take into account local codes of best practice as well as specific regulatory and listing requirements.

- **Filing or co-filing resolutions:** The organisation's approach to filing/co-filing ESG resolutions and to vote on other investors' ESG resolutions.
- **Company dialogue pre or post-vote:** The criteria used to prioritise communication with companies before or after votes are cast.
- **Securities lending process:** Outline of the approach to stock lending, and whether or where shares are recalled to vote. This might include an explanation of the reasons why the organisation has decided not to lend shares.
- **Transparency:** Explanation of how the organisation keeps a record of votes cast and relevant results; and general commitment to transparency to clients/ beneficiaries and the public including type and frequency of the information (i.e. pre-vote, post-vote, quarterly or annually etc.).

If an investor decides to outsource active ownership activities to specialised service providers and investment managers, the active ownership policy will contain less detail but it will still be crucial to outline the value of engagement and voting for the organisation and guide the relationship with selected third parties. In this case, the policy will describe the general approach to active ownership and specify:

- **Expectations:** Outline of the role of third parties in implementing the organisation's overall active ownership policy (i.e. outsourced activities are in combination with internal efforts and consider involvement of the client, or all active ownership activities are completely outsourced with no or limited involvement of the client); and a description of considerations and obligations that will be taken into account during the selection process and included in service or investment management agreements.
- **Frameworks of reference:** Identification of key ESG voting and engagement frameworks the organisation would like third parties to follow.
- **Information requirements:** Description of the level and frequency of information the organisation expects to receive to periodically monitor their performance and potentially use the information for financial decision-making purposes.
- **Monitoring:** Description of how external third parties will be monitored (i.e. questionnaires, analysis of information, periodic meetings etc.), including how the investors will ensure that votes are cast in line with the chosen voting policy (i.e. tailored or provided by the service provider/investment manager).

Existing active ownership policies range from those that are very detailed, covering most items that would be considered at AGMs or during engagement dialogue, to more general documents defining a broader framework of reference for engagement and voting activities. While with the former investors can communicate clearly their expectations to companies, with the latter, investors retain a higher degree of flexibility on how to engage and vote. In any case, the possibility of applying discretion is usually key for institutional investors that need to consider their members'/ clients' best financial interests. Some examples are included in tables 4 and 5.

Table 4 – Examples of voting policies

INVESTOR	HIGHLIGHTS
Calvert Research and Management, Investment Manager, US	▪ General support for a long-term value creation strategy through voting and description of vision of sustainable business. ▪ Support for structures that create and reinforce accountability, and opposition to those that do not. ▪ Explanation on how to treat cases not envisaged in the guidelines or when votes can be cast that are not in accordance with the guidelines. ▪ Description of how it treats conflicts of interest. ▪ Envisages situations where the fund advisor will have to establish the vote on a case by case basis to determine the interests of shareholders. ▪ Explanation of how to treat adherence to international standards and local laws. ▪ Specification of where voting records are accessible. ▪ Outline of specific voting criteria for board independence, board and governance issues, executive compensation, mergers/acquisitions/spin-offs/other corporate restructuring, sustainability reporting, environment, workplace issues, human rights, indigenous people rights, product safety and impact, weapons contracting, community and political action.
NEI Investments, Investment Manager, Canada	▪ Outline of the role of voting as a core duty for responsible investors and key element of the corporate engagement strategy. ▪ Commitment to provide feedback to companies and to carefully scrutinise each proposal NEI Investments votes on. ▪ Commitment to full transparency on votes cast, voting decisions and rationale. ▪ Commitment to update public information on votes on a daily basis. ▪ Explanation on the use of shareholder proposals and detailed criteria considered to withdraw, vote in favour of or against a resolution. ▪ Outline of specific approaches to ESG issues included in management and shareholder proposals.
NEST, Asset Owner, UK	▪ General presentation about NEST, whom it represents and which companies it invests in (UK-listed companies). ▪ Definition of the intended readership: companies in which it invests, its fund managers and investment industry stakeholders. ▪ Commitment to always seek to vote in the interests of its members and in accordance with its approach to corporate governance and policy on voting. ▪ Explanation that NEST does not follow a one-size-fits-all approach but it explores structure, conduct, conformance, risk appetite and performance of directors as a whole when voting. ▪ Commitment to work with its fund managers where they have voting responsibility. ▪ Explanation that it expects fund managers when exercising their voting rights to do so responsibly and in accordance with their own documented voting policies. NEST does not currently use voting rights directly, but having its own policy enables it to document its views and expectations to fund managers on how companies should function. ▪ Definition of what NEST expects of fund managers using their voting rights and acknowledgement that it has adopted different approaches in some areas in line with its responsible investment objectives and principles (i.e. on audit, board diversity and executive remuneration). ▪ Commitment to update the document as the debate on corporate governance develops, as its investment strategy evolves and as it gains greater insight into its members' views and concerns. ▪ Use of coloured text boxes throughout the document to signpost some of its high-level corporate governance beliefs. Beneath each orange text box it lists principles and voting guidelines. ▪ Outline of specific voting instructions on leadership, the role and structure of boards, accountability and reporting, audit, remuneration and capital structure.

Table 5 - Examples of engagement policies

INVESTOR	HIGHLIGHTS

Hermes Investment Management, Investment Manager[21], UK	▪ Role and importance of stewardship
	▪ Consideration of all relevant stakeholders
	▪ Expectations from listed companies on:
	    ▪ Disclosure
	    ▪ Culture
	    ▪ Strategy, performance, investment, financial structure
	    ▪ Relationship with stakeholders, management of environmental and social issues
	    ▪ Decision making, board composition, remuneration
	▪ Engagement approach:
	    ▪ Board level; shareholder collaboration; other stakeholders
	    ▪ Constructive, informed, selectively public
	    ▪ Long term; engage holistically in the context of the business purpose and strategy
	    ▪ Resourced using a multi-disciplinary, multi-national team

PGGM, Investment Manager, Netherlands	▪ Explanation of the relationship of the policy with its beliefs and foundations, drawn up in close consultation with clients to reflect shared visions and aspirations. ▪ Specification of which funds the policy applies to. ▪ Commitment to transparency and assurance: PGGM reports quarterly and annually on the fulfilment of the guidelines within the Responsible Investment Implementation Framework. It also publishes its Annual Responsible Investment Report, which is independently assured, on its website. ▪ Specification of how often and how the policy is updated and modified. ▪ Outline of the roles and responsibilities of different bodies in crafting the framework, including the Investment Policy Committee, Investment Committee, client and participant meetings, the Advisory Board on Responsible Investment and the Responsible Investment Department. ▪ Definition of active ownership and relevant rights and responsibilities as well as the objective to be achieved through active ownership. ▪ Outline of general sets of principles it follows and supports (i.e. the PRI, OECD, UNGC, etc.). ▪ Description of how it manages conflicts of interest. ▪ Definition of engagement, objectives and when escalation is used (i.e. cases of exclusion after engagement); specification of a number of focus areas for engagement to make positive contributions and how the areas are selected (i.e. their relevance to its clients and beneficiaries, the role which PGGM can play as an investor, the influence which PGGM can exert and the expected contribution to long-term value creation); and explanation on objectives of engagements and duration, and when collaboration and engagement service providers are used. ▪ Definition of litigation and objectives as well as an outline of how it acquires information, a list of criteria to consider when deciding on litigation and applicable preferences, and differentiation with passive shareholder litigation.

21 Hermes Responsible Ownership Principles.

INVESTOR	HIGHLIGHTS
Robeco, Investment Manager, Netherlands	▪ Outline of the relationship between sustainability investing researchers and engagement specialists and integration processes. ▪ Specification of the assets covered. ▪ Explanation of different types of engagements. ▪ Explanation of how it prioritises themes and companies and how it also involves clients to do so. ▪ A list of available codes and international standards it uses to define engagement requests (i.e. OECD, UNGC, SDGs, ICGN, UNGP on Business and Human Rights). ▪ Explanation of how sustainability is one of the value drivers in the investment process (together with financials and market momentum). ▪ Definition of clear expectations from companies, acknowledging differences across sectors. ▪ Explanation of when escalation is necessary and what strategies are considered. ▪ Explanation of a focused, extensive engagement approach on a selection of companies using different means. ▪ Identification of objectives for each engagement theme and how it tracks progress and criteria used to define a successful engagement case. ▪ Explanation of whom they engage with. ▪ Outline of who is involved in the engagement process (i.e. a multi-national and multi-lingual team, with portfolio analysts also participating). ▪ Outline of its approach to collaborations, including when it joins collaborations and which platforms it uses. ▪ Description of the internal and external auditing process. ▪ Commitment to public information and client reports and descriptions of the channels used and content shared. ▪ Outline of specific expectations of companies on sustainability strategy, sustainable operating performance, materiality assessment, sustainability reports, environmental issues, human rights, health and safety, labour rights, human capital management, R&D, product stewardship and corporate governance (including corruption, risk management, remuneration and remuneration).
State Street Global Advisors, Investment Manager, US	▪ Presentation of its strategy to deal with activists and preserve long-term value creation. ▪ Explanation of whom they want to talk to. ▪ Outline of the process to define an annual engagement strategy and prioritisation of engagements. ▪ Explanation of when it is likely to decline solicitation requests. ▪ Specification of the remit of the policy (i.e. holdings independent of strategies and products). ▪ Outline of specific expectations of companies on corporate governance issues.
Universities Superannuation Scheme (USS), Asset Owner, UK	▪ Definition of expectations in terms of dialogue and relationship. ▪ Support for collaborative engagement. ▪ Description of its approach to engagement and voting. ▪ Outline of stewardship principles that present to investee companies what their expectations of USS should be in terms of active ownership. These include that it should be informed and understand the company when it goes to a meeting, and that it will communicate its voting decisions. ▪ An appendix with specific expectations of companies on corporate governance issues.

CONFLICTS OF INTEREST

Investors should pay particular attention to possible conflicts of interest when conducting active ownership activities. Conflicts can arise when investment managers have business relations with the same companies they engage with or whose AGMs they have to cast their votes at. A company that is selected for engagement or voting might also be related to a parent company or subsidiary of the investor. Conflicts can occur when the interests of clients or beneficiaries also diverge from each other. Finally, employees might be linked personally or professionally to a company whose securities are submitted to vote or included in the investor's engagement programme. The disclosure of actual, potential or perceived conflicts is best practice. Equally, detailed processes for managing these conflicts should be publicly disclosed so that clients can always understand how proxies at issuers that are also clients have been cast. Such procedures serve to protect an organisation's brand and reputation and may help to insulate it from consequences, such as penalties and litigation[22].

Leading practices for managing conflicts of interest include:

- specifying in the active ownership policy that engagement processes and voting rights are exercised in line with the best interest of clients to protect and enhance the long-term value of shareholdings;
- adopting an oversight structure with regional or global committees reviewing voting decisions and engagement activities on a regular basis;
- comprehensively mapping potential conflicts of interest and corresponding means of mitigation and periodically reviewing these;
- allowing for any unforeseen conflicts of interest to follow an escalation procedure involving top management (CIO, CEO, compliance officer, etc.);
- reporting any incidents and potential conflicts in a database that is accessible to clients;
- creating Chinese walls or setting different reporting lines between entities responsible for active ownership activities and other entities providing consulting and investment management services to corporate clients, or having sales responsibilities to ensure neutrality and independency;
- developing a code of conduct for engagers/voting analysts and ensuring that employees declare any other professional activity to the compliance department;
- a recusal on votes at entities and independent fiduciaries where significant pecuniary interests exist by delegating the decision making for such votes to a non-conflicted independent third party; and
- making provisions on how external service providers and investment managers need to treat conflicts in contracts and investment agreements.

22 50/50 Climate Project, Proxy Voting Conflicts.

SHARE LENDING

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 19: Securities lending programme

Share lending is the temporary transfer of shares by a lender to a borrower, with agreement by the borrower to return equivalent shares to the lender at an agreed time and pay lending fees. This process usually involves an intermediary organisation. Therefore, the relationship between lender and borrower is often not direct. When shares are lent, voting rights are passed to the borrower, unless the lender recalls the shares. Due to this transfer of shareholder rights and consequent disconnect with investment decisions, some investors might decide to not have a share lending programme at all or establish a maximum threshold of shares that can be lent so that a minimum level of voting is guaranteed. Similarly, it is good practice for investors to officially commit to not borrowing shares for the purpose of exercising voting rights.

When investors keep or initiate share lending practices, important considerations have to be made to define when recalling shares for voting purposes. Recalling all shares is usually a rare approach as this could cause clients or beneficiaries to incur financial losses greater than the negative impacts of not exercising voting rights (for example, when there are no controversial items on the agenda). Nevertheless, some investors have included this as a condition in custodian contracts. Some examples of current practices are included in table 6.

The most common criteria to recall shares are prioritising:

- shares in domestic markets;
- significant holdings;
- controversial votes and high-profile meetings on ESG issues;
- votes on M&A and important financial transactions;
- shares of companies targeted by an engagement programme; and
- cases when the vote might be material and influence the long-term performance of a company based on a cost-benefit analysis.

The ICGN Securities Lending Code of Best Practice is an additional source of guidance for investors interested in initiating a share lending programme that does not impede responsible voting activities.

Table 6 – Examples of approaches to share lending

ORGANISATION	APPROACH
AP2, Asset Owner, Sweden	AP2 lends Swedish equities in exceptional cases, and never more than 90% of its holdings in an individual Swedish or foreign company. Where Swedish equities are loaned, they are recalled prior to the AGM. AP2 places a ceiling on the maximum value of such lending.
BlackRock, Investment Manager, US	BlackRock's approach is driven by its clients' economic interests. The evaluation of the economic desirability of recalling share loans involves balancing the revenue-producing value of loans against the likely economic value of casting votes. It believes that, generally, the likely economic value of casting most votes is less than the securities lending income, either because the votes will not have significant economic consequences or because the outcome of the vote would not be affected by BlackRock recalling loaned securities to ensure they are voted. In addition, BlackRock may in its discretion determine that the value to clients of voting outweighs the cost of lost revenue to them from recalling shares, and thus recall shares to vote in that instance.
BNP Paribas Asset Management, Investment Manager, France	BNP Paribas Asset Management monitors the number of shares on loan before a vote. When it considers that too many securities are on loan, or when the vote is important for the company, it instructs to recall lent stock or to restrict stock lending to vote on the majority of its position (around 90%). Because of recent regulation on stock lending matters, it rarely has a significant proportion of stock on loan near a general meeting. It does not lend shares in SRI portfolios.
British Columbia Investment Management Corporation, Investment Manager, Canada	All shares are recalled for voting unless there are unusual circumstances, which is embedded in custodian contracts. Shares can be lent out but must be able to be recalled by record date. Custodians are required to recall every share for voting and they must report on any exceptions.
PGGM, Investment Manager, Netherlands	PGGM does not lend shares of an internal list of companies that: are part of the largest holdings; are involved in its engagement programmes; and/or present crucial decisions to be voted on. It also never lends more than 90% of shares.
State Street Global Advisors, Investment Manager, US	For funds where SSGA acts as trustee, the firm may recall securities in instances where it believes that a particular vote will have a material impact on the fund(s). Several factors shape this process. First, SSGA must receive notice of the vote in time to recall the shares on or before the record date. In many cases, SSGA does not receive timely notice and is unable to recall the shares on or before the record date. Second, SSGA, exercising its discretion, may recall shares if it believes the benefit of voting shares will outweigh the foregone lending income. This determination requires SSGA, with the information available at the time, to form judgments about events or outcomes that are difficult to quantify.
UniSuper, Asset Owner, Australia	UniSuper recalls all domestic stock for voting and its custodians have instructions to do so. Internationally, recalling is a cost/benefit issue (also bearing in mind the complexity of recalling stock in different markets). It would try to recall stock if there was an issue identified as critical, but this has not yet happened.
Universities Superannuation Scheme (USS), Asset Owner, UK	USS undertakes a process that brings together meeting information and holding positions in one spreadsheet to enable final decisions on stock recalls to be made. Where USS owns more than 3% of the company, it will always recall the shares and vote the full position at a meeting. When it holds between 0.5% and 3% of issued share capital in the company, a discussion will be had in consultation with the portfolio manager to decide if there is a material need to restrict the stock. For EGMs, it decides on an ad-hoc basis, taking into account commercial interests. USS believes there is no economic reason for recalling all shares where the issues at an AGM are routine and/or non-controversial.

ENGAGEMENT AND VOTING PRACTICES

ENGAGEMENT ACTIVITIES

RESEARCH AND PRIORITISATION

Reporting Framework reference:

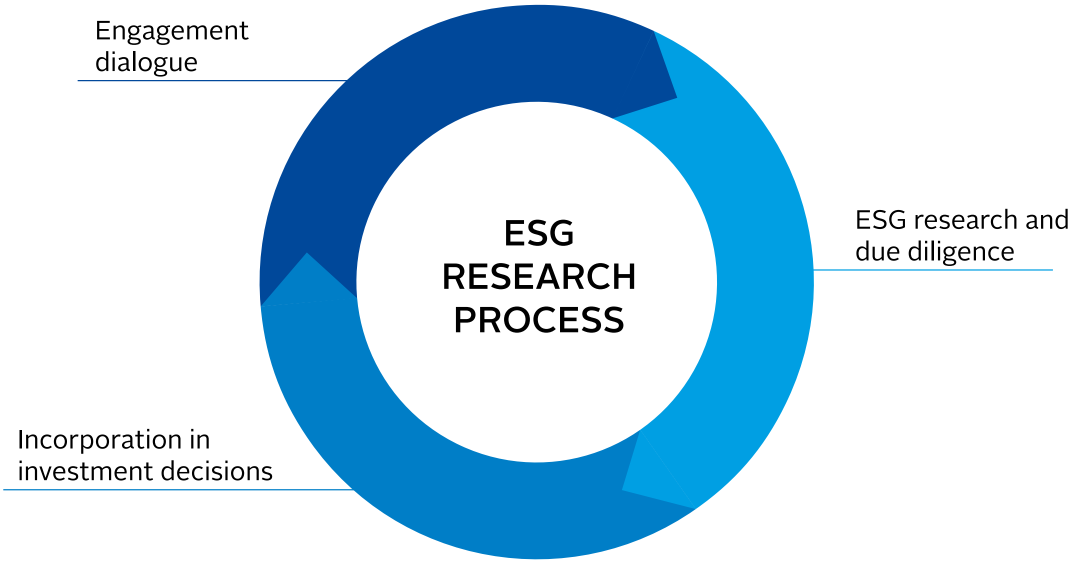
Listed Equity Active Ownership (LEA)

- 03: Process for identifying and prioritising individual engagement activities

The first step to identify targets for engagement is setting up regular monitoring of investee companies on ESG issues which represent value at risk or potential opportunities for long-term financial performance and impact on the real economy. This due diligence process can be based on internal desk research on raw company data, information and scoring provided by specialised ESG research service providers/brokers and any other resources investors may use to verify or triangulate potential controversies (i.e. reports from national authorities, NGOs, media coverage, statements from National Contact Points[23], etc. - see box 2 for more details). Participating in multi-stakeholder forums on specific ESG issues can also help refine research methodologies and evaluations.

This research phase can partially overlap or coincide with ESG monitoring systems set up to support incorporation practices (i.e. screening, integration and thematic investment). The same research used to identify cases of engagement will be continuously integrated with the insights gained during the dialogue with companies following a circular rather than linear process (see figure 3 below).

Figure 3 – The circular process of ESG research



"As an index investor we have to prioritise. We do not want to replicate efforts so we may consult with other investors about their engagement work and consider whether to collaborate on issues being led by them. We consciously focus on sectors and themes that are largely ignored."

Diandra Soobia, Head of Responsible Investment, NEST, Asset Owner, UK

23 Governments adhering to the OECD Guidelines for Multinational Enterprises are required to set up a National Contact Point (NCP) whose main role is to further the effectiveness of the Guidelines by undertaking promotional activities, handling enquiries, and contributing to the resolution of issues that may arise from the alleged non-observance of the guidelines in specific instances. NCPs assist enterprises and their stakeholders to take appropriate measures to further the observance of the guidelines. They provide a mediation and conciliation platform for resolving practical issues that may arise with the implementation of the guidelines.

As institutional investors would usually hold thousands of companies in their portfolios and only be able to meaningfully engage with a small number of investees, setting up criteria for prioritisation is required. Prioritisation defines how company due diligence resources are targeted and recognises that not all ESG risks and opportunities can be identified and addressed.

Typical criteria of prioritisation for further analysis would include:

- the largest holdings as they would pose the biggest risk to portfolio performance;
- specific markets considered, particularly those that are exposed to ESG-related risks and opportunities, or local markets the investor might be more familiar with and more exposed to;
- specific sectors considered that are particularly exposed to ESG-related risks and opportunities;
- companies in the lowest ranks of several ESG benchmarks to best mitigate risks;
- companies in the highest ranks of several ESG benchmarks to raise the bar of industry performance;
- companies in breach of international norms (i.e. conventions or the UNGC principles);
- companies exposed to controversies on specific ESG issues over a long to medium period of time using external sources of information;
- specific ESG themes representing the highest value at risk or the highest potential of impact; and
- specific issues considered a priority for the investor based on input from clients and beneficiaries.

> "Our focus list of companies includes both sector leaders capable of breakthroughs in corporate sustainability practices and sector laggards that need to catch up."
>
> Michelle de Cordova, Director, Corporate Engagement & Public Policy, NEI Investments, Investment Manager, Canada

Based on an organisation's approach, this prioritisation process could be centralised through an ESG team or decentralised through independent investment teams. In the latter case, communication and coordination will be necessary to ensure synergies and alignment.

Box 3– Stakeholder engagement. Source: OECD

The OECD's *Responsible Business Conduct for Institutional Investors* paper encourages investors to consult with relevant stakeholders during the due diligence phase to assess the severity of impact and, during the dialogue phase, to develop appropriate responses. Who the stakeholders are will depend on the adverse impact in question. For example, global union federations and their affiliated individual trade unions could represent the view of impacted workers and provide a source of expertise on labour and human rights matters. Civil society organisations can equally provide insights on the impact on the ground and local communities. Information from National Contact Points and national authorities can also be useful. Both asset owners and investment managers can establish channels to help stakeholders bring actual or potential adverse impacts involving their investments to their attention. Investors are encouraged to collaborate with parties that raise concerns through operational-level or external grievance mechanisms. Investors should also develop publicly-available and non-onerous criteria to evaluate the credibility of these complaints.

Following further investigation, investors would need to assess: the severity/opportunities of the cases; the potential to effect change with available resources and expertise; past interactions; time constraints; the impact on long-term shareholder value; and existing efforts by other investors. This would ultimately be a cost-benefit analysis which might culminate in a decision not to engage. Such analysis should be done by ESG teams in collaboration with portfolio managers.

Engagement cases usually fall into two categories:

- **Proactive** engagements: When investors seek dialogue with priority companies based on their preventive analysis of material ESG issues and megatrends.
- **Reactive** engagements: When investors initiate dialogue with companies in reaction to a controversy or scandal which is presenting a financial and reputational risk.

DEFINING OBJECTIVES AND TRACKING RESULTS

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 04: Objectives for individual engagement activities
- 06: Objectives for collaborative engagement activities
- 10: Tracking number of engagements
- 11: Number of companies engaged with, intensity of engagement and effort
- 13: Companies changing practices/behaviour following engagement
- 14: Examples of ESG engagements

Once the list of target companies has been defined, setting objectives and tracking results will be necessary to assess achievements and next steps. These objectives should be developed by ESG teams in consultation and collaboration with investment teams to ensure robustness and consistency of messages to companies. Examples of objectives for target companies include:

- developing a human rights policy;
- setting up a whistleblowing monitoring system;
- defining emissions reduction targets;
- improving skillset balance at the board level;
- joining a multi-stakeholder initiative tackling a specific issue; and/or
- increasing information provided to the market on ESG matters.

Measuring performance on specific ESG KPIs and scores could be another way to assess success.

Investors might find it useful to define milestones and timelines at the start of engagement, although these will need to be continuously reviewed to reflect internal and external developments during the multi-year dialogue with target companies.

Tracking systems would facilitate record keeping, on a progressive basis, in the following areas: interactions (i.e. letters/emails/meetings/on-site visits); corporate representatives met; information/documentation received; commitments from management; and regular assessments of ESG performance. While this information is usually kept internal and confidential, such systems are useful for preparing reports for clients and the public on the progress and results of engagements.

Engagement dialogue can be tracked through tailored, preferably cloud-based, IT systems or customer relationship management (CRM) tools, available across the organisation, from ESG analysts to portfolio managers (see table 7 for examples).

While setting milestones to measure objectives is useful, this might not always be possible for each engagement dialogue and success should always be contextualised; having all milestones covered does not necessarily mean that dialogue cannot be improved. On the other hand, missing milestones might lead to perceived failure and a reluctance by investors to take on difficult issues where progress is not guaranteed or measurable. As a matter of fact, recording the details of an unsuccessful dialogue with a company could be extremely insightful from an ESG integration perspective. Investors also need to be open-minded about how companies can address a problem, and management should have as much as or more to say about finding the solutions than investors.

> "We have two categories of engagements. Our value engagements intend to increase shareholder value through improving sustainability conduct and corporate governance. The enhanced engagements address reported breaches of the United Nations Global Compact principles, internationally-accepted principles focusing on labour, human rights, the environment and anticorruption. The desired outcome for these latter engagements is the identifiable elimination or remediation of any breach and enhancements in management processes to prevent any repeated breach."
>
> Carola Van Lamoen, Head of Active Ownership, Robeco, Investment Manager, Netherlands

Table 7- Examples of systems to monitor engagement results

ORGANISATION	BRIEF DESCRIPTION OF SYSTEMS
Æquo Shareholder Engagement Services, Service Provider, Canada	Æquo defines measurable objectives at the beginning of each new engagement. Different objectives can address one issue/topic and they can also be set during dialogue. Objectives include: the adoption of a SMART (specific/measurable/agreed upon/realistic/time-based) target, an internal process, a policy or a specific disclosure. A rigorous tracking system is used to measure committed and realised changes in the organisations they interact with. This system is based on a series of defined objectives for each engagement (be it collaborative or individual) and grades progress on a defined scale of zero (objective not yet communicated) to four (objective met). The assessment of these formal objectives are combined with other evaluations (such as general dialogue appreciation, the quality of management or other aspects difficult to measure) that allow them to monitor change.
BMO Global Asset Management, Investment Manager, Canada	BMO tracks milestones on all engagement aspects. It also captures the narrative around materiality and impact of the progress made by the company (indicated by a number of stars). In addition to milestones and qualitative analysis of engagement track record, BMO is increasingly quantitatively documenting the engagement journey and insights gained throughout the process. The SDGs are also able to provide another language to categorise and define specific outcomes. Existing engagement categories have been mapped against the goals as a starting point.
Boston Trust/ Walden Asset Management, Investment Manager, US	Boston Trust/Walden maintains a database of companies included in the engagement programme and updates it quarterly. At the end of each calendar year, progress is assessed for all engagement activities and reports are prepared for clients and consultants. To evaluate progress, it periodically assesses company engagement as follows: 1) Progress was observed: ▪ engagement contributed to new or amended policies; ▪ engagement contributed to more sustainable business practices; and/or ▪ engagement led to greater transparency and accountability. 2) No significant progress; engagement is ongoing. 3) No additional follow-up is planned.
British Columbia Investment Management Corporation, Investment Manager, Canada	bcIMC has developed a set of KPIs for its engagement themes so it can track overall progress that it has made. Its KPIs measure progress over five or more years and link to the many methods bcIMC has contributed to each theme including individual and collaborative engagement, proxy voting, filing shareholder proposals and making public policy submissions to advance broad market change.
Hermes EOS, Service Provider, UK	Hermes EOS' proprietary milestone system allows it to track progress in its engagements relative to objectives set prior to or following interactions with companies. The milestones used to measure progress in an engagement vary depending on each concern and its related objective. They are broadly defined as: 1) concern raised with company; 2) acknowledgement of the issue; 3) development of a credible strategy to address the concern; and 4) implementation of a strategy or measures to address the concern. In addition, Hermes EOS will track when an engagement objective has failed or has been discontinued having become obsolete. Each year, Hermes EOS reports on the number of engaged companies, number of issues raised and objectives, and progress made in achieving milestones set for each engagement by categories of topics covered (E, S, G and strategy/risk).
PGGM, Investment Manager, Netherlands	PGGM's database tracks all the necessary documentation and progress of engagement conducted by both RI and investment teams. The system includes all the activities that have contributed to an engagement result. Assessments are discussed by a results committee within the RI team to challenge each other and define if a real contribution has been made. Subsequently, the head of the RI team reviews the process and adds their opinion. Finally, the auditors will decide if the results can be reported or not.
Regnan, Service Provider, Australia	Regnan starts with detailed research into a company's individual risks. It uses this to prioritise and develop objectives for change to see these problems addressed. Engagement success is measured in terms of whether these changes happened and the extent to which this was due its engagement.

KEY FACTORS FOR SUCCESSFUL DIALOGUE

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 12: Engagement methods

Evidence shows that engagement quality is more important than quantity to achieve results. As good engagement is time and resource-consuming, investors have to decide where to focus their efforts to achieve the biggest impact.

Recent academic research commissioned by the PRI analysed the perceived barriers and enablers to good engagement dialogue from both a company and investor perspective (see table 8 for more detail).

Table 8. Contrasting corporate and investor perceptions of the barriers and enablers to engagement success. Source: Gond, JP. (2017); O'Sullivan, N. & Gond, JP. (2016)[24]

FACTOR	Corporate perspectives	
	Enablers	**Barriers**
RELATIONAL	▪ Presence of a two-way dialogue. ▪ Being honest and transparent in the dialogue, and having an open and objective discussion.	▪ Language barriers and communication issues. ▪ Lack of continuity in interactions.
CORPORATE	▪ Responsiveness (e.g. speed of response) and willingness to act on investor requests. ▪ Selecting appropriate internal experts. ▪ Knowing who your investor/s is/are and having access to all prior dialogues/ discussions to tailor your conversation. ▪ Keeping a systematic record of the interactions with investors.	▪ Bureaucracy inside the company preventing changes in internal practices and/or external reporting on (new) practices. ▪ Lack of resources and/or insufficient knowledge or expertise to meet specific investor demands. ▪ Lack of ESG policies, practices and/or reliable internal results that can be reported externally.
INVESTOR	▪ Listening capacity. ▪ Making the effort to communicate in different languages. ▪ Providing a list of questions in advance so accurate information can be prepared for the dialogue. ▪ Prior knowledge of corporate ESG performance and preparations to ensure a sophisticated dialogue. ▪ Genuine interest in (improving) the management of ESG issues at the corporation. ▪ Patience and understanding regarding corporate ability to address ESG challenges.	▪ Lack of preparation and posing questions/ requests that are too generic. ▪ Lack of investor knowledge about the corporation, its business model, ESG policy and/or track record compared to peers. ▪ Lack of tracking process to determine whether engagement requests have been met. ▪ Changing engagement objectives and targets over time.

24 Gond, Jean-Pascal. (2017). RI Quarterly - How ESG engagement creates value: bringing the corporate perspective to the fore; O'Sullivan, Niamh & Gond, Jean-Pascal. (2016). Engagement: unlocking the black box of value creation.

> "Successful engagement is about having an open dialogue with the company, listening to what the company says and not being dogmatic or thinking that the shareholder knows how to manage the company, being flexible and pragmatic and supporting the company in making changes that result in long-term value creation. Investors must work in collaboration with companies rather than in conflict."
>
> Michelle Edkins, Managing Director, Global Head of Investment Stewardship, BlackRock

FACTOR	Investor perspectives	
	Enablers	**Barriers**
RELATIONAL	▪ Good level of commitment on both sides to meet specific objectives and targets. ▪ Reciprocal understanding of the engagement process and the issues at stake on both sides. ▪ Good communication and listening capabilities on both sides.	▪ Language barriers that can prevent the development of a genuine dialogue. ▪ Cultural distance that can lead to the avoidance of direct discussion or straightforward style of questioning that can undermine the dialogue.
CORPORATE	▪ Corporate reactivity to requests. ▪ Board-level access in targeted companies (accelerates results). ▪ Access to corporate experts with current ESG management and performance information. ▪ Long-standing relationships with key corporate actors. ▪ Corporate proactivity to inform investors when engagement objectives/targets have been met.	▪ Refusal by top executives to be engaged about ESG issues or to communicate about them. ▪ Functional/sustainability manager struggles to advance ESG-related issues or requests internally. ▪ Too small a shareholding to attract sufficient attention from relevant corporate actors. ▪ Corporate inability to meet (ongoing) objectives and targets.
INVESTOR	▪ Client or beneficiary requests for the consideration of ESG issues. ▪ Top management support for ESG-related investment activities. ▪ Well-resourced and experienced ESG team that works closely with financial analysts. ▪ Defining clear engagement objectives and targets (milestones). ▪ Development of in-house tracking tools to monitor and evaluate engagement progress and success. ▪ Pooling of resources through collective engagement to support related processes over time.	▪ Lack of buy-in from clients and/or top management for ESG-related investment activities. ▪ Small, under-resourced ESG team that may also be rejected by financial analysts. ▪ Lack of clear engagement policies, objectives and monitoring systems. ▪ Under-developed relationships with key corporate actors. ▪ Difficulty demonstrating materiality of engagement (enhanced alpha). ▪ For (interested) asset owners: insufficient mechanisms to guarantee external asset managers conduct successful engagements.

Based on insight from research and interviews with signatories, investors can do the following to ensure that engagement generates positive results:

- **Arrive prepared and provide feedback**. Investors should enter an engagement with a clear agenda, having reviewed financial and sustainability performance data in depth and having talked to experts beforehand. Bringing ideas and expertise to how a problem can be solved provides value for the organisation in question. After the meeting, investors and corporate management should jointly approve a confidential summary of the discussion and commitments made. Investors should also seek feedback on the quality of the meeting and improve it accordingly.
- **Demonstrate a holistic understanding of the company's performance and strategy**. Investors need to understand how the company's business operates; a holistic evaluation can clarify how companies and investors are focused on attaining similar goals.
- **Understand the corporate culture**. Investors can grasp corporate culture and human dynamics by considering a series of red flags/indicators that could signal a shift, including: high turnover; discussions with board members and operational staff; results of employee surveys; customer satisfaction; fines and penalties; and incentives/remuneration.
- **Be sensitive of cultural differences**. Communication and engagement strategies need to be adapted to the local market. Whenever possible, speaking the local language is an advantage.
- **Visit site operations**. Opportunities to visit company sites enable investors to gain a deeper understanding of the company's operations, which can complement engagement activities. Visits also give investors the opportunity to collect feedback from local experts, government representatives and other stakeholders.
- **Praise positive practice**. Positive engagement is very cost-effective as it helps ensure processes are maintained without needing to start again.
- **Focus on the business case and materiality**. Managers are more likely to incorporate ESG strategies into their organisations when doing so is clearly associated with greater economic opportunities, increased competitiveness and improved long-term prospects for the firm. Materiality could also be related to ESG issues that are particularly relevant to a company's stakeholders. The dialogue can then focus on the issues that may affect the company's bottom line if not adequately addressed. Recent academic research shows that firms with good performance on ESG material issues and concurrently poor performance on immaterial ESG issues perform the best[25].
- **Present a consistent and integrated message**. Companies want to hear consistent and integrated messages from ESG analysts and portfolio managers who should both join meetings with companies. When this is not feasible, sharing of information and alignment is crucial. Companies would also benefit from understanding how the information collected during dialogue will be used to inform investment decisions.
- **Make connections**. Companies are usually contacted by numerous investors, and groups of investors, on similar issues simultaneously. Investors should reference other efforts they are aware of and express support for requests from other shareholders aligned with their objectives for dialogue. Similarly, investors should share with other peers the focus of their engagement programme.
- **Align requests with international standards, where possible**. Simplifying requests and referencing international sustainability frameworks can address companies' concerns about receiving varying and detailed questions from ESG specialists.
- **Time your requests accurately**. Investors should keep in mind the company's position in the business cycle and its current focus on certain issues when defining their requests.

> "If you can demonstrate that the engagement asks are of material importance and can be incorporated into financial models that are run internally, then it moves beyond a sustainability-focused dialogue to a broader market/investor relations dialogue."
>
> Matthias Beer, Director, Governance and Sustainable Investment, BMO Global Asset Management

25 Khan, Mozaffar and Serafeim, George and Yoon, Aaron S., Corporate Sustainability: First Evidence on Materiality (2016). The Accounting Review, Vol. 91, No. 6, pp. 1697-1724.

- **Share best practices**. Investors benefit from having a dialogue with lead companies to identify best practices they can refer to and share with laggard companies.
- **Build on and foster ongoing and trustworthy relationships**. Fruitful meetings stem from a long history of engagement and productive relationships with corporate management. Dialogue is not just about one meeting but a long-term process where investors show persistence and consistency in their approach and respect for an agreed level of confidentiality/publicity. Engagement is also about listening and being open to what management is saying, beyond asking questions and monitoring.

> "If you only engage after a crisis it had better be to offer a constructive way through. It's far better to have developed a trusted relationship and helped them proactively address the issue, ahead of it becoming a problem."
>
> Alison Ewings, Engagement Program Lead, Regnan

Depending on the topic, shareholders might want to speak with different corporate representatives, including: investor relations (IR); CSR/sustainability departments; heads of departments (i.e. supply chain or HR); company secretary/general counsel; and the board (CEO, chairman and independent non-executive directors or the lead independent director). Access to the board is fundamental to understand the strategic direction of a company and cover issues such as leadership, board composition and management performance and succession, while discussions with operational staff can help to gain deeper insights on specific environmental and social issues. Contact with members of the board can be sought as an escalation strategy if issues of concern or initial questions cannot be resolved through first conversations with IR or sustainability departments.

ESCALATION STRATEGIES

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 12: Engagement methods

If dialogue does not bring the desired outcomes after a certain period of time, investors can consider different escalation strategies to trigger corporate reaction. Depending on the jurisdiction they belong to, these strategies might follow different orders.

Possible next steps after an unsuccessful engagement include:

- **communicating with the board**: expressing concerns to corporate representatives or non-executive directors, either directly or in a shareholders' meeting;
- **collaborating with other investors** to increase pressure on the company;
- **issuing a public statement** and organising a media campaign;
- **submitting shareholder resolutions** in relation to the ESG issues of concern;
- **voting against the re-election directors** who are responsible for the topic of engagement (i.e. risk and audit committee members);
- **voting against the board of directors or the annual financial report;**
- **submitting one or more nominations for election to the board;**
- **seeking legal remedies or arbitration;** and
- **threatening to reduce exposure or divest**.

Litigation usually takes place through class actions and is considered a measure of last resort to receive financial compensation and trigger remedial action. While some can argue that it causes shareholders to pay other shareholders and lawyers to take a big proportion of money recovered, litigation can also be seen as an investor's fiduciary duty to recover clients' financial resources and help institutionalise necessary corporate changes including new governance structures.

If after several efforts the engagement dialogue does not progress positively, investors can consider reducing their exposure to the company or divest from it either temporarily or permanently. Possible investment implications will differ depending on the mandate of investors and their investment strategies (active versus passive). While active investors can freely decide to underweight or sell a stock, passive investors will not be able to reduce exposure or divest unless they exit the index or adjust the weightings of a tailored index.

COLLABORATIVE ENGAGEMENT

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 05: Process for identifying and prioritising collaborative engagement

Principle 5 and many existing stewardship codes encourage investors to collaborate when seeking dialogue with investee companies. Collaborative engagement can include multiple investors engaging the same company or investors joining forces to engage many companies on the same issue, where individual dialogues within that initiative are conducted by one investor.

Collaborating with other institutional investors can be an effective way to pool knowledge and information as well as share costs and risks to influence and gain corporate managers' attention. Complex market transformation is also more likely to be achieved through an alliance of investors rather than a single institution – even a large one – acting alone.

> "Our decision to pursue a collaborative effort will, among other things, be a function of: the particular nature of the issue; the likely efficacy against acting privately; and the motivations of the other investors. Our focus here will always be on issues that are material and thus could have an impact on long-term shareholder value."
>
> David Sheasby, Head of Investment Governance and Sustainability, Martin Currie Investment Management, Investment Manager, UK

> "We consider that in some circumstances collective action can be the most effective manner in which to engage. It is typically the case when we face a wider economic stress or when a company is totally closed to dialogue."
>
> Michael Herskovich, Head of Corporate Governance, BNP Paribas Asset Management, BNP Paribas Asset Management, Investment Manager, France

By speaking to companies with a unified voice, investors can more effectively communicate their concerns to corporate management. The result is typically a more informed and constructive dialogue. Investors can benefit substantially from engaging collaboratively, but this approach can also present a series of challenges.

> "We participate in collective engagements that cover a range of ESG issues; from an investor perspective these give us greater leverage at a company, while companies benefit from a unified voice from investors on these important topics."
>
> Gayle Muers, ESG Analyst - Engagement Lead, HSBC Global Asset Management, Investment Manager, UK

Typical benefits include:

- **Building knowledge and skills**: Collective expertise can be particularly helpful when engaging with a company on a highly complex issue or with a company that operates in a challenging environment, as investors sometimes find it more difficult to access information in these situations. Geographic and cultural diversity within a group can also enable investors to share local knowledge and contacts, and to take a more nuanced approach to engagement that is sensitive to the economic, regulatory and cultural context of different markets. Investors without substantial resources or experience on a topic can also benefit by working with and learning from others in a group with more expertise.
- **Efficiency**: Collaboration avoids duplication of effort among investors, while enabling them to channel their concerns in a systematic and consistent manner; it allows multiple parties to share the costs of research and share tasks and responsibilities according to shareholdings, expertise and location; it also enables smaller and resource-constrained investors to lend their names and shares to the collaboration process.
- **Enhanced power and legitimacy**[26]: A group that includes different types of organisations (asset owners, investment managers and service providers with varying investment strategies, shareholdings and roles in the investment chain) will be more likely to formulate robust engagement strategies and influence change. Due to the collective reputation, size and weight of the alliance members, an invitation to engage can be difficult for a company to ignore. Collaborating can be particularly helpful in gaining access to management with companies that have not been responsive to requests to engage by individual investors.

Common challenges relate to:

- **Coordination costs**: Costs can include time spent coordinating the group's activities, helping the group to build consensus and a common position, and making sure that each member is well informed throughout the engagement process. These costs can be borne by the investors leading the alliance, or by a third party (such as the PRI) which acts as facilitator of the collaborative initiative.
- **Reaching agreement**: Investors within the group might have different objectives and views on how to engage. If a compromise cannot be reached, the group may only be able to agree on the most attainable goal, which may leave those with more ambitious aims dissatisfied.
- **Regulatory barriers**: Investors may encounter regulatory barriers to collaboration such as those relating to controlling bids and anti-trust. An example is acting in concert legislation in some markets where legislators have not specified that collaborating to foster dialogue on ESG issues is not breaching the law.
- **Collective action issues**: Similarly, while many investors may sign a collaborative initiative, some may not substantially contribute to the project, leaving it to a smaller group of committed investors to do all the work.

Recent research commissioned by the PRI[27] examined the corporate perspective of individual versus collaborative engagements. Data shows that both forms of engagement are potentially useful and create value, despite their respective limitations.

Advantages of individual engagement:

- Investors' specific ESG interests and needs can be more easily identifiable by companies for one investor than in the case of collective engagement. An internal expert (such as in health and safety or climate change) can also be involved in the engagement, depending on the investor's level of knowledge and sophistication.
- One-to-one, and ideally face-to-face, dialogues can be more productive because they allow companies to explain how ESG issues are related to each other and the corporate strategy, and can support the development of long-term relationships with institutional investors.

Disadvantages of individual engagement:

- Individual engagement can be costly, redundant and intense when the same requests from investors increase, especially in the event of a controversy.

Advantages of collaborative engagement:

- Collective forms of engagement can save time and reduce costs by avoiding repeating redundant engagements with individual investors.
- Collective engagement is also seen as more likely to provide political benefits and give more traction to ESG issues within corporations, given the total amount of assets under management usually involved in such processes.
- Collaborations are likely to enhance the quality of investors' knowledge of ESG issues.

26 Gond, JP. and Piani, V. (2012). Enabling Institutional Investors' Collective Action: The Role of the Principles for Responsible Investment Initiative. Business & Society. 52(1), 64-104.
27 Gond, Jean-Pascal. (2017). RI Quarterly - How ESG engagement creates value: bringing the corporate perspective to the fore.

Disadvantages of collaborative engagement:

- Not all investors involved in collective engagements may have the same interest in the corporation, nor the same amount of holdings, and, as a result, may lack the level of commitment needed to truly understand the investee company as well as the specific ESG challenges it faces.
- Collaborations are usually focused on specific ESG issues and it is more difficult to make connections with the overall ESG performance and business model of engaged companies.
- Coordinating with a group of investors makes it difficult to organise real-time, face-to-face interactions that can be deemed highly valuable by companies.

The PRI's Introductory guide to collaborative engagement provides more insight on investor's collaboration and how to make it effective. In summary, the ingredients for success within a collaborative group include:

- **Commonality**: A clear, shared understanding of the ESG issue at hand, and the rationale for working collectively to address it, can avoid disagreements among group members later in the process. A public investor statement outlining why the issue is of concern and what the expectations of companies are can be a good way to frame the initial discussion with the companies as a group[28].
- **Coordination**: Matching the group's resources to the scale of the initiative lays the foundations for success. A third-party coordinator can facilitate the work of the group.
- **Clarity**: A shared understanding among an investor group of ground rules, such as what information can be made public, helps to build trust and avoid miscommunication.
- **Clout**: Combining the expertise of dedicated lead investors that can follow up with companies on behalf of the group, with the shares of a large coalition of supporting investors interested in backing the initiative.

Two recent academic studies shed more light on the impact and process of collaborative engagements:

- Dimson, E., Karakas, O. and Li, X. (2015)[29]: The analysis of a major investor's engagements with US firms over 1999–2009 shows that collaboration among investors was instrumental in increasing the success rate of engagements on environmental and social issues.
- Dimson, E., Karakas, O. and Li, X. (2017)[30]: In collaborative engagements, success rates are elevated by about one-third when there is a lead investor who heads the dialogue. Success rates are enhanced when that investor is located in the same geographic region as the targeted firm. Investor influence is also crucial; success rates are higher when there are more participating investors, as well as when they are wealthier (i.e., have larger assets under management), and when they own a bigger proportion of the target company. This is particularly important when investors are engaging across national boundaries.

BOX 4- The PRI Collaboration Platform

The PRI Collaboration Platform (formerly the Clearinghouse) is a private forum that allows signatories to pool resources, share information and enhance their influence on ESG issues. It offers a range of global engagement initiatives that involve investors seeking dialogue with listed companies, policy makers and other actors in the investment chain.

Posts to the Collaboration Platform include:

- Invitations to sign joint letters to companies
- Opportunities to join investor-company engagements on ESG themes
- Calls to support investor statements
- Invitations to foster dialogue with policy makers
- Requests for support on upcoming shareholder resolutions

Over 600 PRI signatories have been involved in at least one collaborative initiative since the platform was launched at the end of 2006, and over 1,100 collaborative proposals have been posted. The PRI has also directly coordinated a number of collaborative engagements involving more than 200 investors across several ESG topics, from climate change to water scarcity, human rights and anti- bribery and corruption.

28 An example of investors' public statement are the Investor expectations on corporate climate lobbying.

29 Dimson, E., Karakas, O. and Li, X. (2015). Active Ownership. The Review of Financial Studies, 28(12), pp. 3225-3268.

30 RI Quarterly - Local leads, backed by global scale: the drivers of successful engagement.

VOTING PRACTICES

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 18: Confirmation of votes

Engagement and voting practices are interlinked and feed into each other. Investors might start a dialogue with companies before the voting season in relation to particularly contentious items on remuneration, board structure or shareholder rights, and then start a more in-depth engagement to achieve a required change in corporate governance. In some markets, where engagement capacity is more limited, voting might be the only tool available to communicate with companies and raise concerns. In other circumstances, investors might vote against a management resolution as an escalation strategy and express dissatisfaction following unsuccessful engagement on ESG issues. More generally, engagement activities provide an opportunity to apply timely and nuanced factors within the voting decision-making process. This is also why engagement and voting policies are often highly related or combined in one document.

> "We believe that voting is an integral part of our responsibility as asset managers. We see votes cast and voting guidelines as effective market signals to companies about our clients' preferences and concerns. We articulate these preferences and concerns in the principles of our Proxy Voting Guidelines and seek to vote our proxies accordingly. Many issues can be directly addressed through voting a proxy and we believe that seeking to effect progress from within companies as stakeholders is an important way to provide impact where it is needed."
>
> Mariela Vargova, Senior Vice President, Sustainability and Impact Investments, Rockefeller Asset Management, Investment Manager, US

While voting is an essential tool for investors to express their voice and should be widely used by any responsible shareholder, its exercise might not always be possible. As outlined in the overview on current barriers to active ownership (see introduction), share blocking, necessary power of attorney or onerous bureaucratic procedures might prevent investors from voting all the shares on which they are entitled to vote. In these situations, investors will apply a cost/benefit analysis and decide whether to vote or not. Many investors prefer to bear the short-term costs of voting to protect long-term value creation.

> "KLP's and the KLP funds' responsibility is to secure long-term value creation on the funds we manage. An important tool to be a responsible investor and owner is the exercise of voting rights, based on clearly communicated guidelines."
>
> Jeanett Bergan, Head of Responsible Investments, KLP, Asset Owner, Norway

Without direct vote confirmation from issuers, investors cannot guarantee that their votes reached the final destination either. Several investors consider this a concern for the industry and responsible investment and have piloted projects to understand the underlying causes of lost votes (see box 4) in key markets for their holdings. Ideally, each investor would analyse a small sample of stocks after the voting season to ascertain the frequency of the problem and engage with the various actors of the chain (i.e. proxy agent, custodians, sub-custodian, registrars etc.).

> "Voting at general meetings is a key component of the ongoing dialogue with companies in which we invest on behalf of our clients and forms an integral part of BNPP AM's investment process."
>
> Michael Herskovich, Head of Corporate Governance, BNP Paribas Asset Management, Investment Manager, France

Box 5 - Description of the Vote Confirmation Initiative

In 2015, a group of nine PRI signatories based in the Netherlands and UK participated in a pilot project to check that the votes they had submitted for four shareholder meetings had been regularly lodged and counted. The project also involved all the intermediaries of the voting chain (custodians, sub-custodians, voting agencies and registrars). There were frustrations with how long it took to track the information from one actor to another, but this was because the pilot was a manual process and was dependent on the good will of participants. Such timing issues would be addressed if the process could be fully automated.

During the project, investors and each actor in the chain committed to track information on lists of accounts and entitlements to vote before the AGM. After the AGM, investors reviewed the confirmations received from the proxy agent or custodian and reconciled these against the votes submitted on the relevant voting platforms. Although on a relatively small scale, the trial successfully demonstrated that voting information could be returned along the chain of intermediaries from the issuer/registrar to the investor, providing manual confirmation that votes had been cast as instructed at the meetings, even for omnibus accounts. There was a small discrepancy identified in shares thought to have been held/instructed compared to the number that were actually held/voted. However, a number of challenges would need to be addressed before vote confirmation could be rolled out to a wider audience and prove system integrity.

Current challenges include:

- Format standardisation is vital for vote confirmation to be carried out smoothly along the chain, and all parties would have to agree on the format that would be suitable for their systems to facilitate automation.
- Establishing communication with custodians regarding voting issues is generally very difficult, particularly in international organisations where voting is handled by another office that is outside of the market in which the voting takes place. For some investors, this process took a few months, which is far from ideal. Some custodians did not participate and, as such, this reduced the scale of the pilot.
- Letters of Authority for each nominee name were required by the UK registrars before they would pass their confirmations down the chain, which is onerous for custodians due to the volume of accounts and their continually changing nature.
- The timing was not clear for reconciling accounts and confirming votes. Also, if any participant was not responding promptly, the chain effectively came to a halt.
- The nature of nominee custodied accounts presents an administrative challenge for voting. It is also more time consuming/difficult to provide vote confirmation for holdings in an omnibus account, because omnibus accounts typically comprise a large number of individual investors/custodian accounts that each need to be reconciled.
- In markets where the record date is after the custodian's cut-off date for the vote, the holdings in the underlying accounts can change after the cut-off; this created some discrepancies between the holdings reported by the investors and vote reconciliation after the meeting.

> "We have a core voting team that meets weekly, outside the season to discuss procedures, and during the season to discuss specific votes that need more thought or are not obvious. For these votes, we may bring in the sector ESG analysts and consult with portfolio managers. We also consider how any dialogue with the company is progressing, and whether this needs to be reflected in how we vote (e.g. voting against directors if the company is not moving in the right direction on an issue, or conversely taking into consideration that is has been responsive on an issue) – so voting is part of the overall corporate engagement program."
>
> Michelle de Cordova, Director, Corporate Engagement & Public Policy, NEI Investments, Investment Manager, Canada

DIFFERENT MODELS TO EXERCISE VOTING

As institutional investors have the right and responsibility to vote on thousands of companies in a very concentrated period of time each year, the use of third-party research and services is almost essential. Proxy advisors are hired to recommend and sometimes cast proxy statement votes on behalf of investors, while proxy analysts look at the issues raised by resolutions to be voted on at company general meetings. When contracting these advisors, responsible investors do not automatically take on board their voting recommendations and make informed decisions based on a triangulation of sources, including internal research and engagement. Such analysis requires time and resources; investors will therefore have to define their criteria for prioritisation (i.e. domestic markets, controversial or key topics, large shareholdings, current engagements etc.). Engaging with proxy advisors and providing them with periodic feedback on their analysis and recommendations through surveys, questionnaires or one-to-one meetings is also part of being an active owner.

Asset owners and investment managers can exercise voting in several ways. Each option involves a combination of in-house activities, outsourcing and decisions based on centralisation versus decentralisation, and customised versus standard services.

Asset owners with segregated accounts[31] could:

- **Centralise voting activities and carry them out internally** even when assets are totally or partially managed externally. Proxy advisors can be hired to provide recommendations based on a tailored voting policy or an agreed standard policy and investment managers can also be consulted, while internal staff will review these recommendations following defined criteria. This option ensures full ownership of the process and ensures that all shares are voted in a consistent way as defined by the investor according to its investment beliefs.
- **Delegate voting activities to investment managers following a customised voting policy, when possible**. This option safeguards consistency but asset owners will have to ensure that investment managers follow their policy accurately and consistently across several mandates.
- **Delegate voting activities to investment managers or service providers following their own voting policy**. This option would entail in-depth due diligence work by asset owners during the selection process to ensure that the third party's voting policies are consistent with their investment beliefs and responsible investment strategy. Consistency would be more challenging to achieve as each mandate would potentially follow a different voting policy.

Asset owners with investments in pooled funds could:

- **Make sure that voting considerations are an intrinsic part of the investment manager's selection process** so that they are satisfied with the third party's voting policy and how their shares will be voted.
- **Supply research to the investment manager on priority ESG issues or concerns** to influence the development/review of their voting policies and their voting decisions, although the investment manager will retain full freedom to make the final decision.
- **Agree with the investment manager to vote proportionally on the shares held (i.e. pro-rata voting)** following their tailored voting policy and try to garner support from other asset owners with similar views. Many investment managers believe this option is unfeasible when funds are pooled at the custodian level in an omnibus account.

Investment managers could:

- **Outsource all voting activities** to third-party providers following either a tailored or standard voting policy with various degrees of monitoring and selection. This approach would not require as extensive resources as other approaches, but would give less control and ownership of the voting process.
- **Keep voting activities in-house and allow each portfolio manager to execute their votes** with support from internal specialists and third-party research. While this option allows portfolio managers to have more flexibility and take into consideration the risk appetite and economic interests of their clients, there is a high risk that the same organisation votes inconsistently for the same stock. This can only be avoided by facilitating robust internal communication.
- **Keep voting activities in-house and centralise them in an ESG/voting unit** that is responsible to vote for the entire organisation. This model makes use of proxy advisors' recommendations but internal staff are responsible to review and finalise decisions. Consistency is guaranteed by this approach but the organisation will have to make efforts to involve portfolio managers in the decision-making process.

31 Segregated accounts contain only the assets of a particular institutional investor in comparison with omnibus or pooled accounts where the assets of several different investors are held together (i.e. in pooled funds).

HOW TO MAKE VOTING DECISIONS

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 16: Typical approach to (proxy) voting decisions

While voting policies can help to guide investors' decision-making process, research and discretion will always be necessary to ensure meaningful voting.

Lead investors would use a combination of internal and external resources and would involve ESG experts as much as portfolio managers.

An active shareholder would also benchmark its voting decisions against those of its peers to understand new trends and evolving thinking in the industry. The diagrams below show best practice examples of the steps taken to execute final votes by an asset owner and investment manager respectively.

Figure 4- UniSuper's voting approach. Source: Responsible investment update

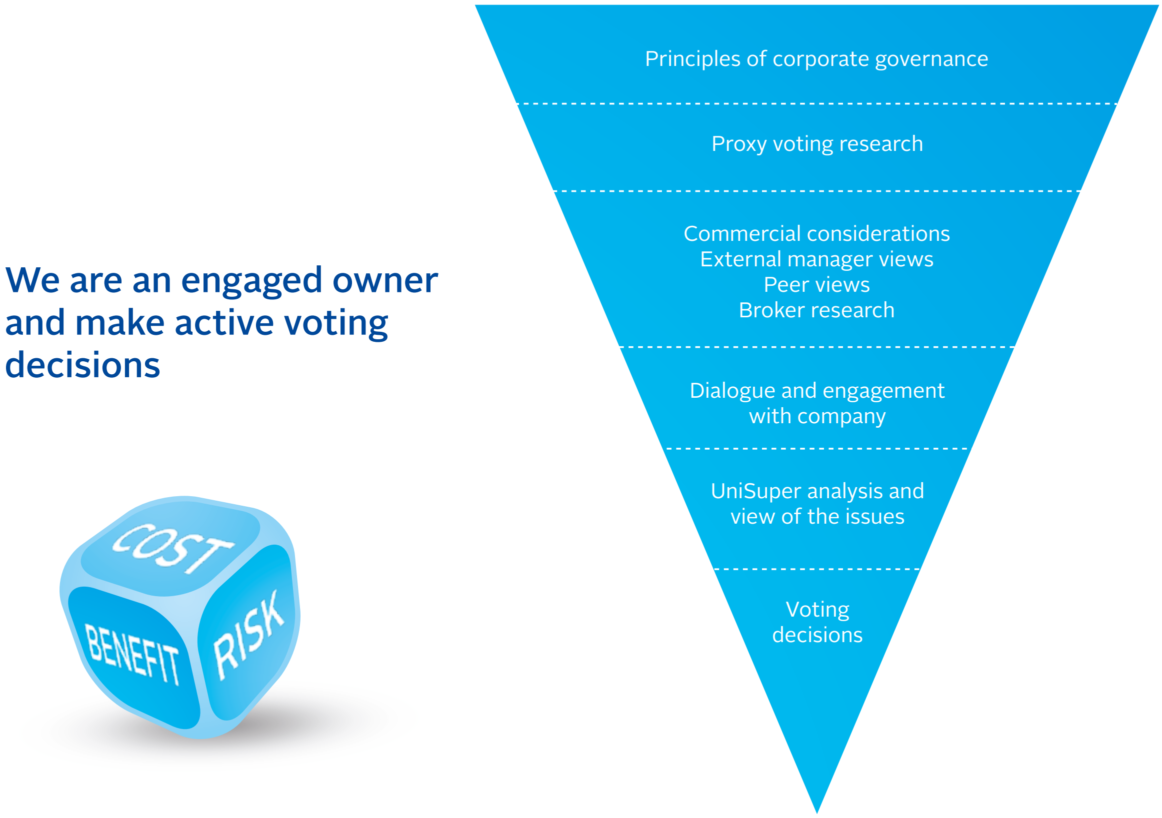
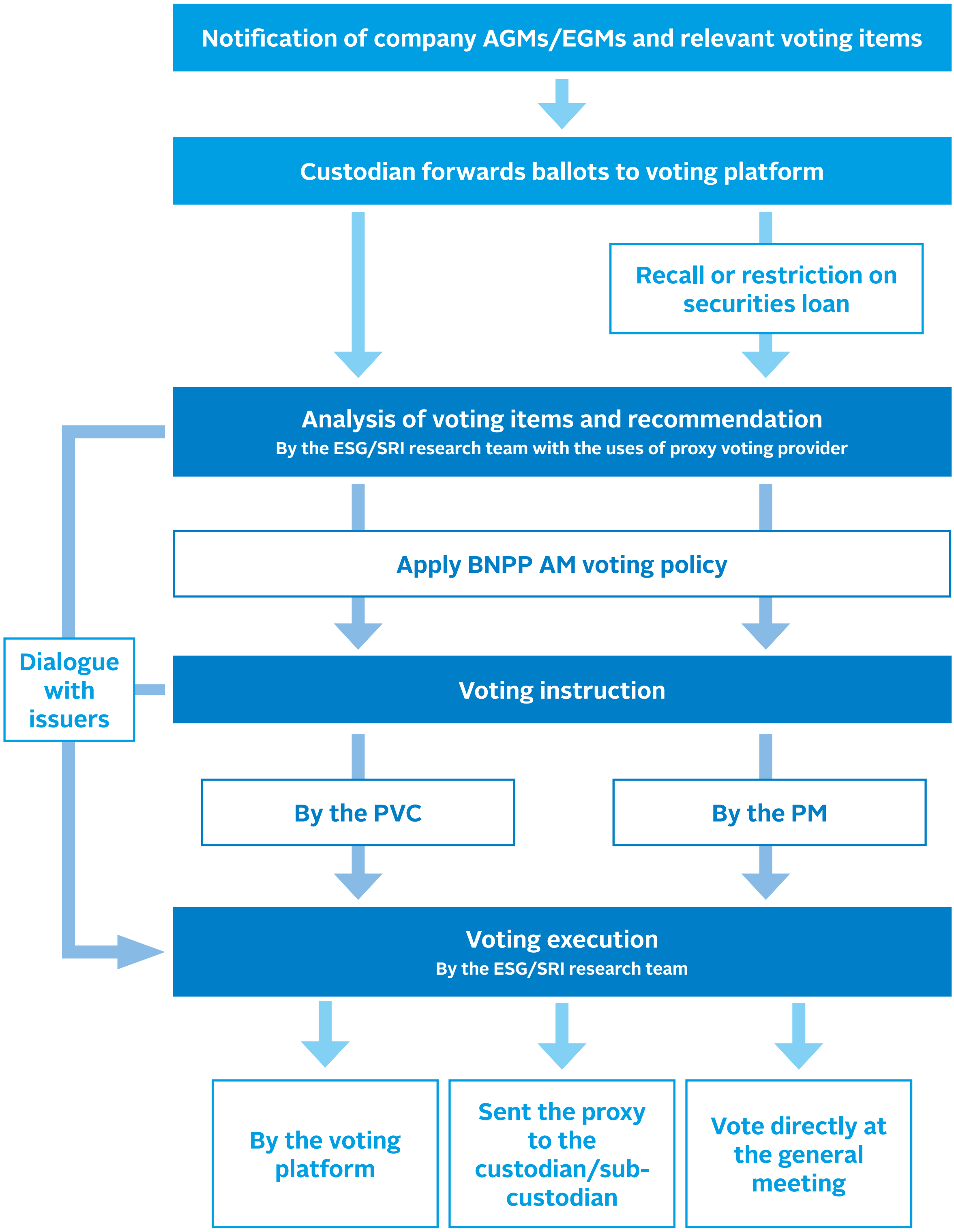


Figure 5 - BNP Paribas Asset Management. Source: BNP Paribas Asset Management - Governance and Voting Policy



Recall or restriction on securities loan can occur when the vote is important for the company or when too many securities are on loan.

PM who has the biggest position in the company or is specialised with the stocks decides for all our positions.

A sub-committee of the **PVC** decides by principle.

FILING AND VOTING ON ESG RESOLUTIONS

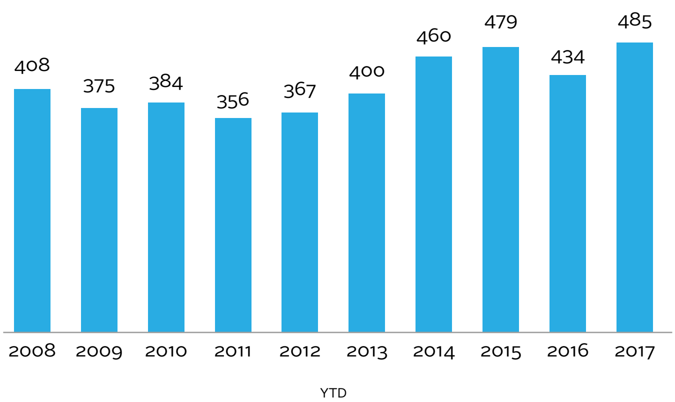
Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 23: Shareholder resolutions

A component of exercising shareholder rights is the option of filing shareholder resolutions to put ESG issues to vote during an AGM. In some countries (such as the US), this is more common practice than in others and it is regarded as a possible way to contact the board of a company and initiate a discussion. Initial openness and responsiveness by corporate management could result in the proposal being withdrawn. Alternatively, the dialogue would continue after the vote, particularly if the resolution gains meaningful support from shareholders.

Graph 1 - Total number of environmental and social resolutions filed in the US from 2008 to 2017 (data as of August 28, 2017). Source: ISS, Voting Analytics, US



In other countries, where filing resolutions is more cumbersome and votes are binding and not advisory, shareholder proposals are more widely considered as a rare escalation strategy after private dialogue has been unsuccessful. Regardless of the approach, there has been an increase in the number of ESG resolutions filed by investors in recent years, especially in the US, as well as higher interest among asset owners in monitoring how investment managers have voted these resolutions (see graphs 1 and 2 above).

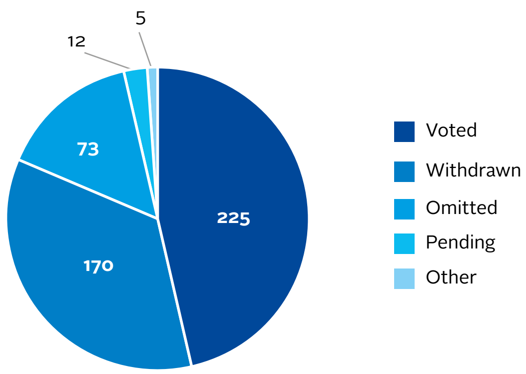
Investors might decide to file or co-file a resolution directly (see table 9 for different rules and thresholds across countries) or simply consider how to vote on ESG resolutions filed by peers. The former practice is not as broadly applied by investors as the latter.

When considering how to vote on ESG resolutions, investors' individual voting policies are the first point of reference.

However, there are other useful criteria investors can use to assess the quality of ESG proposals, including:

- **The topic**: Good shareholder proposals show that the issue is financially material for the company in the long run and that changes can be made with no harm.
- **Leadership**: Resolutions are often filed with the largest companies as they pose the highest value at risk. Smaller companies from the same sector with similar risks may not be targeted. Effective resolutions invite the target company to be an industry leader without giving management the impression that they have been singled out.
- **The evidence**: Adequate research and documentation should support the aim of the resolution.

Graph 2 - Status of environmental and social resolutions filed in the US in 2017. Source: ISS, Voting Analytics, US



- **Current performance**: Good resolutions should be based on a strong understanding of what the company is currently doing well in and what needs to be improved.
- **Previous engagement**: The proposal should provide evidence that the company has already been engaged on the topic with no results to date.
- **The tone**: The resolution should not be prescriptive and leave it to management to propose a strategy to tackle the issue without giving a sense of investors micromanaging the company; more general proposals are usually easier to support than very detailed and specific requests.
- **The suggested timeline**: The proposal should be realistic and give sufficient time for management to react (without imposing an hard deadline).
- **External pressure**: Effective resolutions make the case for action based on peer positions, regulation and stakeholder pressure.
- **Disclosure**: Resolutions asking for more information and transparency on issues of concern are usually aligned with the responsible investment strategy of many institutional investors.

Table 9 – How to file a shareholder resolution in different countries. Source: Institutional Shareholder Services (ISS)

COUNTRY	RULES
Austria	Shareholders that own at least 5% of a company's capital for at least three months before the meeting convocation (lower ceilings may be set in the bylaws) may submit shareholder proposals to the agenda.
Canada[32]	An individual must (or have the support of persons who in the aggregate, including or not including the proposal proponent, must) be the registered holder or beneficial owner of at least 1% of the total number of outstanding voting shares of the company or of a number of voting shares with a fair market value of at least $2,000, for at least six months immediately before the day the proposal is submitted.
France	Shareholders representing 0.5%-5% of a company's capital, depending on market capitalisation, can file a resolution after at most 20 days after the release of the meeting notice or 25 days before the meeting, depending on if the notice was released before or after 45 days ahead of the meeting.
Japan	Shareholders that have been the registered owners of at least 1% of a company's capital or 300 share units (a share unit is defined by each company and is 1,000 or 100 shares per unit) for six months may submit shareholder proposals to the agenda. The request must be made to the company in writing no less than eight weeks before the meeting.
Nordic region	In Sweden, Finland, Norway and Denmark, only one share is required to place a proposal on a general meeting's agenda and there is no regulatory oversight of such proposals as in the US.
UK	Shareholders can put their own resolutions before the company's AGM if the shareholders concerned either: ▪ hold at least 5% of the total voting rights; or ▪ are made up of 100 or more shareholders who hold an average of at least £100 paid up share capital and who would all be entitled to vote at the AGM on that resolution.
US	A shareholder must first meet the following ownership requirements: at least $2,000 of the company's stock continuously held for at least one year before the proposal is submitted to the company. The shareholder must also continue to hold at least $2,000 in shares until the date of the shareholder meeting. In addition, there are other non-ownership requirements, including: ▪ the length of the proposal must be no more than 500 words; ▪ a shareholder may only file one proposal per meeting; and ▪ a proposal must be submitted to the company's secretary before the shareholder proposal submission deadline, which is generally a few months before the annual meeting. Furthermore, a shareholder proposal may be excluded from reaching the proxy if the proposal topic or request is deemed ineligible. The Securities and Exchange Commission has implemented Rule 14a-8 to provide parameters around what is and what is not an acceptable shareholder proposal topic. Generally speaking, the rules under 14a-8 attempt to limit shareholder proposals to issues of sufficient policy importance.

32 As per provisions included within the Canada Business Corporations Act (CBCA). In Canada, shareholder proposals may be submitted in accordance with the corporate statutes of 14 separate jurisdictions.

In 2016, the PRI piloted a system for investors to declare their voting intentions on ESG resolutions filed by PRI signatories to increase awareness and information sharing on these resolutions.

Box 6 - The PRI's system for pre-declaration of voting intentions

The PRI Vote Declaration System was set up for the first time for the 2017 voting season. Embedded in the PRI Collaboration Platform, the system allowed investors to pre-declare their voting intentions on 144 ESG resolutions filed by signatories. Those voting intentions were then made public through the PRI website. General statistics on this pilot project show that:

- The system was completed 31 times, by 19 different investors who represent an estimated US$2.7 trillion in AUM.
- Of the 19 investors who completed the form, 52% (10) were from Europe, 42% (eight) were from the US, and one was from Australia.
- On average, each shareholder resolution related to E issues had 1.95 investors pre-declare their voting intentions, with S issues receiving 1.07 pre-declaration on average, and resolutions on G issues being most popular receiving 2.33 investor declaring their voting intentions.
- In terms of specific ESG issues, resolutions related to lobbying/political donations received the highest average number of investors pre-declaring their voting intentions, with 3.5 investors per resolution. This was followed by sustainability reporting (2.28), emissions reduction (2.27) and shareholder rights/ proxy access (2.24).
- 66% of resolutions available in the system were covered by at least one pre-declaration; the number is higher (90%) excluding the resolutions which have been withdrawn and not put to vote.

DIRECTOR NOMINATION

As included in the OECD Principles of Corporate Governance[33], a fundamental ownership right is the ability of shareholders to vote at shareholder meetings and to elect and remove directors from the board. While individual country codes of governance may differ with regard to their specific approach to director nominations, it is generally accepted, at least in major markets, that shareholders should be able to participate in and influence the director nominations process[34].

Putting forward specific board member candidates to be considered in the nomination process requires research and resources which cannot be allocated for every investee company in large portfolios. However, when used and available, this practice allows investors to actively contribute to the composition of the board in cases where a company has not been able to propose a group of candidates with the appropriate mix of skills, competences and background for the long-term success of the business. Some countries (e.g. Brazil and Italy) allow minority shareholders to present their candidates for election.

Table 10 provides an overview of the different rules and processes related to director nomination by shareholders across markets.

33 G20/OECD Principles of corporate governance.

34 Director nomination process: discussion paper; PART 1: an engagement framework.

Table 10 – How to nominate director candidates in different countries

COUNTRY	RULES
Brazil	Article 141 (paragraph four) of the Brazilian Corporations Law allows minority common shareholders and preferred shareholders to appoint one member each to the board of directors via separate elections. For minority common shareholders to hold a separate election, they must jointly represent 15% of the company's voting stock. For preferred shareholders to elect their own representative to the board, they must collectively own 10% of the company's share capital. If the minimum quorum for either the minority common shareholders or the preferred shareholders is not reached, those two groups may join forces to elect a single director if their combined ownership represents 10% of the company's share capital. Minority stockholders can present the names of their nominees up to the time of the meeting.
Italy	The *voto di lista* mechanism[35] enables a single shareholder or a group of shareholders to present a slate of candidates for the election of minority members within the boards of directors, so that at least one member of the board of directors and the chairman of the board of statutory auditors are taken from minority slates. The minimum threshold for the deposit of the slate usually varies from 0.5-4.5% of the company's share capital. The presentation of minority candidates by a group of shareholders is not considered, by itself, to be "acting in concert". Italian investment companies, along with foreign institutional investors, have been nominating and electing minority independent directors of listed companies through the Investment Managers' Committee (IMC)[36]. All candidates presented are independent as they must comply with all the requirements laid down by applicable legislation, self-regulation and a specific set of principles for the selection of candidates applied for by the IMC. This means that such candidates must also be independent from the shareholders that nominate them. Minority independent directors elected by institutional investors continuously monitor the company's internal dynamics as well as uphold a constructive engagement with other board members.
Nordic region	In each Nordic market, all shareholders have the right to propose a board candidate to the general meeting, regardless of the number of shares held. Swedish companies typically maintain nominating committees which are composed of three to five representatives of the largest shareholders, with the possible inclusion of the board chairman and, in rare cases, a minority shareholder representative. The AGM does not typically elect the committee, but instead approves the procedures by which the committee is appointed. The committee will often invite other shareholders to suggest board candidates to be considered by the committee before making its final nominations to the general meeting. Variations of this model are becoming increasingly common among Norwegian and Finnish corporations.
UK	There are two main ways to appoint a director of a company, as specified in the Companies Act 2006: appointment by the board of directors and appointment by an ordinary resolution of the shareholders (requiring 50% of the votes cast). However, only shareholders with at least 5% of a company's paid-up share capital (with voting rights) can require the holding of a general meeting of that company where they can put their own resolutions before the meeting (see table 9 for more details). They must first ask the directors to call a meeting on their behalf. If the directors fail to act within the deadlines specified by the Companies Act, the shareholders may call a general meeting themselves. In addition, shareholders can ask the company to circulate a written statement to members about a resolution/matter coming before the meeting.
US	In the US, shareholders can generally recommend candidates they believe would be qualified to serve on the board, whether through proxy access (where available) or through the standard shareholder recommendation process. Under the standard process, a shareholder must submit advanced written notice (which would also commonly require certain biographical information and consent of willingness to be nominated from the individual) to the company, usually several months prior to the annual meeting. Following this shareholder submission, the board begins considering the candidate. These efforts are typically led by a nominating or corporate governance committee of the board. The committee will evaluate the individual nominated to assess if his or her skills would benefit the company. There is no requirement that a candidate identified by a shareholder be nominated to the board, and the committee may determine that the candidate is ineligible. For companies that have provided for proxy access in their governing documents, a shareholder or group of shareholders that meet ownership and other requirements may place a limited number of board candidates directly on ballot. Any nominees must first meet certain requirements, including independence. However, their eligibility does not need to be evaluated or rejected by a nominating committee. Proxy access-nominated individuals would be placed directly on the company's ballot, alongside the nominees of the company.

35 This mechanism is included in Law 262/2005, containing provisions for the protection of savings and the regulation of financial markets, and the Consolidated Law on Finance ("TUF", art. 147-ter and art. 148).

36 The IMC is coordinated by Assogestioni, the association of Italian investment managers.

COMMUNICATING WITH COMPANIES

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 20: Informing companies of the rationale of abstaining/voting against management

Beyond research and casting votes, voting involves communicating with investee companies before and after the AGM.

Where possible, investors should raise concerns with companies before voting against or abstain to initiate dialogue, receive additional information and then start shaping corporate behaviour. When this is not feasible, investors should publicly share the rationale for their votes against management or abstentions and explain their view with interested companies directly, either voluntarily or following a company's request (see examples in table 11).

Table 11 – Communicating about voting

ORGANISATION	COMMUNICATION WITH COMPANIES
AMP Capital, Investment Manager, Australia	In the domestic market, where AMP Capital votes against or abstains from company resolutions, it will meet, phone or write to the company to make it aware of the reasons for doing so. Where issues of concern are identical to those of previous years, it may not repeat that engagement. Given the time constraints at the height of proxy season, it is not always possible to notify companies before voting. AMP Capital is more likely to do so where it holds a relatively large holding in the company, or where it has voted against (as opposed to abstained from voting on) a resolution. It will also respond to companies' requests for information about its voting, before or after the meeting. In foreign markets where its holdings are smaller, it does not communicate with companies to the same extent. Where AMP Capital's external managers have voted against management on particular resolutions, it expects them to communicate with the companies directly.
AustralianSuper, Asset Owner, Australia	AustralianSuper outsources voting activities to ACSI, an external provider. For all companies covered by its service, ACSI corresponds either via a meeting or teleconference around the time of the company meeting, or writes to each company where there was an against recommendation expressing its rationale and concerns. In the event of an against vote, a representative from the governance team will in most cases call a representative from the company in question to advise them of the decision in advance of the meeting. AustralianSuper will also communicate any against vote directly to the company via a phone call.
Boston Trust/ Walden Asset Management, Investment Management, US	In 2015, Boston Trust/Walden continued its practice of writing to all companies where it withheld support for directors serving on nominating committees due to relatively low gender and racial diversity on their boards. This was a priority because management is unable to discern the reason for the against vote without an explanation, in contrast to most other votes that are specifically for or against the proxy item. These letters and subsequent conversations prompted changes in governance documents to strengthen efforts to recruit diverse candidates at two companies. Additionally, Boston Trust/Walden communicates with a substantial percentage of portfolio companies annually (and more frequently for significant holdings). In those communications, it often finds opportunities to explain its positions on the various items on proxy ballots that oppose the position of company management. Finally, on an ad-hoc basis when it believes a more formal communication is warranted, it writes to companies regarding their voting decisions.
Hermes EOS, Service Provider, UK	When the Hermes EOS engager considers - in the context of its engagement with a company - recommending a vote against or abstaining on management resolutions, or voting in favour of shareholder resolutions opposed by management, he or she will, whenever practicable, contact the company before the meeting to discuss its concerns. This would ensure that a fully informed decision is being made and that it provides an opportunity to influence the board. Where the engager proposes a vote against the recommendations of company management, he or she will aim to contact the company on behalf of clients after the meeting to inform them of the decision and the reasons for it. These communications are designed to reinforce discussions surrounding the vote and further the objectives of engagement with the company.
HSBC Global Asset Management, Investment Manager, UK	In the UK, for example, HSBC Global Asset Management engages in advance with all companies where it intends to vote against or abstain on a general meeting resolution. It explains the reasons for its vote and gives the company the opportunity to respond ahead of its vote instruction. In some cases, this dialogue results in changes to its voting intention and/or to the board's behaviour going forward.

ORGANISATION	COMMUNICATION WITH COMPANIES
RLAM, Investment Manager, UK	RLAM writes to companies in its actively-managed UK funds where it votes against or abstains on a resolution proposed by management, or where it votes for a shareholder proposal. This enables it to engage with companies on the concerns it raises, or to correct any factual errors. It also publishes its votes monthly in arrears on its website and includes a vote rationale for abstentions and votes against.
Robeco, Investment Manager, Netherlands	Robeco informs companies of the rationale behind against votes when they fall under three categories: companies that are under engagement by the active ownership team; companies in which Robeco is a significant shareholder (>1% of issued shares); and all Dutch companies.

RELATION TO INVESTMENT DECISIONS

Reporting Framework reference:

- Listed Equity Active Ownership (LEA)
  09: Share insights from engagements with internal/ external managers.
- Listed Equity Incorporation (LEI)
  03: Information from engagement and/or voting used in investment decision-making

Integrating active ownership practices into investment decisions is one of the most difficult yet necessary tasks to achieve a holistic investment strategy. One of the challenges is that engagement and voting practices are often carried out by ESG teams, service providers or investment managers who are not responsible for the investment process. However, leading investors have developed practices to ensure that information and insights collected through active ownership can feed into the investment decision-making process[37].

Best practices include:

- ensuring regular cross-team meetings and presentations;
- sharing active ownership data across platforms that is accessible to ESG and investment teams;
- encouraging ESG and investment teams to join engagement meetings and roadshows;
- delegating some engagement dialogue to portfolio managers;
- involving portfolio managers when defining an engagement programme and developing voting decisions;
- establishing mechanisms to rebalance portfolio holdings based on levels of interaction and outcomes of engagements and voting; and
- considering active ownership as a mechanism to assess potential future investments.

"A good fund manager can learn a great deal from how the company responds to an engagement question. As well as being important in its own right, an engagement, if done well, brings to life and helps evaluate the ESG or other risk you might find in a research report and what the company does or intends to do about it. ESG data from research service providers is inherently backward-looking while discussions/interactions with companies will by their nature be future-looking. Active ownership and integration are not two separate activities; they feed into each other."

Leon Kamhi, Head of Responsibility, Hermes Investment Management, Investment Manager, UK

37 O'Sullivan, Niamh & Gond, Jean-Pascal. (2016). Engagement: unlocking the black box of value creation.

Table 12 summarises leading practices from signatories. More in-depth analysis and case studies on the processes of ESG integration and the relationship with active ownership are included in the PRI's publication, A practical guide to ESG integration for equity investing.

Table 12– Examples of integrated approaches

ORGANISATION	BEST PRACTICES
AMP Capital, Investment Manager, Australia	▪ Using its proprietary databases of ESG metrics, the ESG team ranks company performance on measures of sustainability, environmental and social responsibility and corporate governance. The ESG research is then shared across investment teams to consider when developing company value (or target price) and call conviction. Conviction, valuation, ESG and momentum inputs are converted into stock ranking models to produce a universe ranking. This score and ranking then influences stock selection decisions for the portfolio. While ESG scores are included for consideration by all AMP Capital's portfolio management teams, the extent to which scores drive stock selection will depend on each fund's specific mandate. For example, companies with the poorest ESG scores are excluded from the investment universe for AMP Capital's Sustainable Funds, whereas other funds may, after adjusting their risk rating, choose to hold that company. AMP Capital's ESG team maintains systems and databases for all ESG engagement and proxy voting activities which inform the ESG research. This research is then accessible to and shared with the investment team. ▪ AMP Capital's investment professionals, including analysts and portfolio managers, are coached by ESG specialists. Interactions on ESG topics can include presentations at investment strategy meetings, weekly investment team briefings, distribution of ESG research, ESG knowledge forums (e.g. supply chain risks, climate change, company engagements) and daily conversation. These sessions focus primarily on the links between ESG and investment performance. Information is also distributed more widely through the ESG insight series presented by AMP Capital's ESG team and published on AMP Capital's website.
Boston Trust/ Walden Asset Management, Investment Management, US	▪ Research and engagement files are stored in company folders that are easily accessible (computer network) for investment decision-making purposes. ▪ The ESG team prepares quarterly research and engagement briefs (for internal and external use) that provide updates on significant outcomes of ESG engagement activities. ▪ Monthly research and engagement committee meetings, including ESG professionals, portfolio managers and traditional securities analysts, provide a forum for discussion of current engagement and voting activities. ▪ ESG updates are provided at weekly investment committee meetings where investment policies are discussed and developed. ▪ Voting research is distributed to the securities analyst assigned to the company for all portfolio holdings.
Hermes Investment Management, Investment Manager, UK	▪ Fund managers have access to a company dashboard with data on controversies and ESG issues as well as engagement activity and progress. ▪ If the issue is material, fund managers and engagers will do their own fundamental research. Easy-to-use tools are being developed to make this more accessible. ▪ Often, engagers and fund managers will discuss a specific stock, benefiting from each other's perspectives. ▪ Engagement meetings with the company can provide more forward-looking information than is found in standard ESG research in determining the relevance of an issue and the likelihood of it being addressed. ▪ Importantly, if the engagement is successful it can mitigate the risk or catalyse a value opportunity.

ORGANISATION	BEST PRACTICES
Robeco, Investment Manager, Netherlands	■ In addition to publications and client reporting, Robeco organises active ownership sessions for clients, analysts and portfolio managers at least twice a year. The progress of ongoing engagement themes and new engagement themes are discussed. ■ The active ownership team publishes internal or third-party research on specific engagement topics every year. The research highlights important trends and provides company assessments which are shared with the investment teams and serve as a starting point for engagement. ■ Robeco's engagement specialists, RobecoSAM's sustainability research analysts and Robeco's financial analysts determine the most material ESG factors for the business model and value of a company that could benefit from engagement. They then define the critical aspects for engagement with a company and follow up on this. ■ Engagement activities are executed in close collaboration between engagement specialists, portfolio managers and sustainability research analysts. ■ They systemically report on their engagement and voting activities to investment teams. Frequent meetings and presentations between members of the active ownership team and the investment teams are also organised to complement these reports and exchange information.
Heritage - Standard Life Investments, Investment Manager, UK[38]	■ Engagement outcomes are systematically discussed with financial analysts and fund managers and shared through a research platform. ■ Equity and credit analysts are required to convey their views on significant ESG issues as part of their coverage, ensuring communication between the ESG and investment teams. ■ Members of the responsible investment function have sat within investment teams at various points on secondment, and vice versa, to increase understanding and appreciation of the analysis conducted within teams and the ways in which this may be incorporated into investment decisions. ■ Responsible investment ratings, research and governance health warnings of the global equities and issuers in which they invest are distributed to all fund managers through an internal platform. ■ Relevant developments in regulation and company news on environmental and social factors are presented at investment meetings (including morning meetings, regional desk meetings and stock selection meetings). ■ Responsible investment risks and opportunities are communicated with Standard Life Investments' sector analysts before and after engagement. ■ Company engagement is conducted with mainstream analysts. All engagements receive input from relevant analysts beforehand. ■ Responsible investment and governance and stewardship analysts may engage with companies at the portfolio manager's request to reinforce or alter an investment case. If it appears that a company does not adequately manage ESG risks, its SRI rating may be downgraded and the portfolio manager may reduce their holding in the company. ■ Thematic research by the responsible investment team is circulated to all internal portfolio managers. All analysis is supported by engagement practices which offer insight into current and potential investee companies.

38 Standard Life Investments is now part of Aberdeen Standard Investments and this example is reflective of the heritage business.

ASSESSING EXTERNAL MANAGERS AND SERVICE PROVIDERS

When investors decide to partially or fully outsource their active ownership activities to investment managers or specialised service providers, defining criteria to select, appoint and monitor third parties is crucial. Delegating engagement and voting activities might be the only option for small and resource-constrained organisations or highly diversified investors. In some countries, large asset owners are also banned to engage by law as they hold a large portion of the local economy and could be market movers.

When active ownership practices and asset management services are outsourced to the same entities, investors will need to pay close attention to the relationship between engagement/voting activities and investment decisions. When these practices are delegated to a third party that is not involved in the investment decision-making process, gathering information on the insights from active ownership and sharing it with portfolio managers is fundamental. Finally, when engagement and voting activities are outsourced to more than one entity, it is important to develop an active ownership policy which defines expectations and frameworks of reference for third parties to use to ensure consistency of messages to investee companies.

SELECTION AND APPOINTMENT

Reporting Framework reference:

Selection, Appointment and Monitoring of Investment managers (SAM)

- 03: evaluating engagement and voting practices in manager selection
- 04: appointment process

We communicate with our active and passive external managers and ask them to engage with the same companies on the same issues we engage on internally and through service providers. This is to ensure a consistent and powerful message gets across. Our external managers have been very responsive to our requests."

Kelly Christodoulou, ESG Manager Investments, AustralianSuper, Asset Owner, Australia

"Our RfP includes questions on oversight of voting and how it cycles back into investment decision making. We are interested in understanding how voting decisions feed back into investment decision making, so making sure it's a loop and not just a long line. We also ask each investment manager to submit their PRI Transparency and Assessment Reports which include in-depth information on active ownership. This information is then used when we interview short-listed managers."

Faith Ward, Chief Responsible Investment and Risk Officer, Environment Agency Pension Fund (EAPF), Asset Owner, UK

During the selection process, investors can collect information on the current and past performance of investment managers and service providers on active ownership through:

- responses to a formal RfP;
- responses to the PRI Reporting Framework, available on the PRI website or through the PRI Data Portal (see box 6);
- PRI Assessment Reports through the PRI Data Portal;
- publicly-available statements or reports on the application of national stewardship codes and access to relevant assessments if available[39];
- publicly-available responsible investment/engagement/voting reports;
- meetings and site visits with representatives (i.e. portfolio managers and ESG specialists) from potential investment managers/service providers; and
- talking to peers.

39 For example, the Financial Reporting Council (FRC) has categorised signatories to the UK Stewardship Code into tiers based on the quality of their Code statements.

> "We have begun to invite external investment managers to attend our extra-financial risk management committee (RI committee) to explain how they are integrating ESG, whether they are sourcing ESG data from providers and also how they are considering ESG issues in their portfolio construction stage. The intention is to pressure them into having more dialogue with companies on ESG issues. We also expect our investment managers to select companies that meet the expectations set in our voting policy and communicate to us if this is not the case."
>
> Daniel Simard, General Director, Bâtirente, Asset Owner, Canada

In this reviewing phase, an investor needs to evaluate the third party's:

- **Active ownership policy**: A good policy would cover the elements specified in Chapter 1 and would be aligned with its internal policy; if of interest, the investor might assess if the organisation can execute activities following a specific client's policy.
- **Capacity and governance**: Both engagement and voting activities require adequate resources, skills and oversight/commitment from the top.
- **Engagement process and outcome**: There should be evidence of a solid process to research and prioritise activities in addition to information on ESG outcomes and eventual financial performance achieved through active ownership activities.
- **Investment decision-making process**: There should be an explanation of how active ownership activities feed into the investment decision-making process (for investment managers only).
- **Reporting capacity**: The organisation should demonstrate the ability to provide information on active ownership activities on the format, quality and frequency expected.

Once the investment manager or service provider has been selected, the investor can decide to include specific active ownership requirements in the contract. Typical specifications refer to active ownership objectives and reporting obligations. Some investors prefer to retain voting rights and include relevant language in the contracts. Including specific text in investment and service provider agreements can facilitate the monitoring process and hold the third party accountable for its services. A side letter to the investment management agreement could be an alternative solution as it forms a legally-enforceable understanding between two parties and provides a formal record of the client's wishes and the investment manager's intention to abide by them.

Including requirements in contracts and side letters is not the only way to ensure sound outsourced active ownership practices; following a thorough selection and monitoring process is equally as effective.

> "Our investment managers do not engage or vote on our behalf, but we do engage with them to improve their role as active owners. We are connected to them and as their client we want to influence them to be a responsible investor as well. This is why we evaluate and rank both our external managers and custodians on how they perform on responsible investment-related subjects. The results of this ranking play an important part in our management selection process as we generally favour external managers that have articulated their beliefs on responsible investment and that have demonstrably integrated ESG in the investment process."
>
> Rogier Snijdewind, Senior Advisor Responsible Investment, PGGM, Investment Manager, Netherlands

"If an issue comes up in the media (or we otherwise become aware of a matter requiring attention) regarding an externally-managed holding, we will raise the issue with the manager and ask how they are engaging on and responding to the matter. We will also proactively contact them to let them know of issues of concern we are raising with the company and ask them to raise them too."

Talieh Williams, Manager of Governance and Sustainable Investment, UniSuper, Asset Owner, Australia

We use our voting policy to cross-reference our external manager's voting decisions and highlight differences between how they intend to vote and how NEST would have voted instead. These differences are then the focus of our engagement with our external managers prior to AGMs. Whilst we do not have direct voting rights, we are able to override our external global equity managers' votes in some cases."

Diandra Soobiah, Head of Responsible Investment, NEST, Asset Owner, UK

Box 7 – The PRI Data Portal

In 2017, the PRI launched the PRI Data Portal, a web-based platform that allows signatories to search, view and collate data submitted by institutional investors through the PRI Reporting Framework. The portal enables users to request access to private reports (PRI private Transparency and Assessment Reports) from other signatories. At a later stage, it will allow users to export responses and display the data in a custom view.

The objectives of the Data Portal are:

- to support asset owner engagement with their managers by enabling easier access and comparison of the reported data;
- to promote the sharing of best practice/knowledge by giving signatories easy access to each other's reports;
- to help the PRI identify areas of further work based on most popular searches;
- to facilitate the informed decision making between signatories working together; and
- to increase the use of PRI data for identifying RI trends.

In the long term, the Data Portal will link the PRI's guidance on investment practices to indicators of the Reporting Framework, helping asset owners, among others, with the manager selection process.

Click here to access the Data Portal using the same credentials as for the PRI website.

EVALUATING AND MONITORING

Reporting Framework reference:

Listed Equity Active Ownership (LEA)

- 08: monitoring/discussing service provider information

Selection, Appointment and Monitoring of Investment managers (SAM)

- 06: monitoring on active ownership
- 07: percentage of votes cast/companies engaged with

An evaluation of investment managers' and service providers' active ownership practices can be made through regular reporting, meetings and surveys/questionnaires. Measuring the ESG performance of portfolios held externally is another way to engage with investment managers. For example, some investors have used the results of external mandates' portfolio carbon footprint to discuss climate change engagement programmes and voting decisions with their investment managers. Regular discussions with third parties can also focus on aligning the outsourced engagement programme or voting activities with the investor's internal engagement and voting policies.

More generally, information requests during the monitoring process can be very similar to those considered during the selection process, although the conversation with external parties will be more focused on assessing the impact of active ownership activities on ESG outcomes and financial decisions.

Regular monitoring meetings should focus on:

- any changes to policies, resourcing or processes in place at the time of selection;
- understanding if there has been any material changes to the ESG risks and opportunities in the portfolio;
- the depth and breadth of internal and external ESG research used;
- current training to improve staff ESG competency;
- controversial or material ESG topics raised/to be raised during engagement dialogue or considered/to be considered during the voting season;
- the rationale for engagement discussions and voting decisions and alignment or deviation from the investor's investment beliefs/strategy and agreed policies of reference;
- the companies selected for engagement;
- the frequency/intensity and quality of interactions with companies;
- the objectives, progress, outcomes and next steps of specific engagements;
- participation in collaborative engagements;
- the investor's direct participation in some engagement activities or alignment between dialogues held in-house and those conducted by the investment manager/service provider;
- examples of how any eventual conflicts of interest have been managed;
- percentage of voting decisions reviewed in-house and percentage of portfolio voted on;
- outcomes of any voting audit checking whether votes were cast as intended and reached the companies; and
- implications of active ownership activities on investment decisions and impact on the portfolio's level of risk or return over time.

Investors might meet with appointed investment managers and service providers regularly to follow up on information received through reports. The discussion could also be part of regular financial performance meetings in cases where asset management activities are outsourced to investment managers. As general best practice, the monitoring process should involve the investor's ESG/responsible investment teams and the investment teams to communicate with one voice and avoid duplication of inquiries.

Internal appraisals and scorecards through the use of questionnaires and surveys can help investors provide regular and constructive feedback to investment managers and service providers and to inform decisions on retention and allocation rebalancing.

DISCLOSURE

Reporting Framework reference:

Strategy and governance (SG)

- 19 - communication

Transparency is a key component of active ownership and it forms part of many stewardship codes and principles (i.e. Principle 6, the ICGN Global Stewardship Principles, the OECD Responsible Business Conduct for Institutional Investor and several national stewardship codes). As much as investors are engaging with companies to access and encourage better ESG information and practices, they are responsible for reporting to their clients and beneficiaries on their engagement and voting activities and relevant outcomes. Such information should be easy to access and understand and provided on a regular basis (i.e. quarterly or annually). Disclosure to clients and beneficiaries may also be more detailed than public disclosure to other stakeholders. Reporting practices should also be reviewed periodically to continuously improve communication.

> "We have a responsibility to various stakeholders, but primarily to our beneficiaries and employers. However, we are a public sector pension scheme and recognise that there is wider interest in our activities and our investments. Hence it is important that our approach is transparent and our reporting is in the public domain."
>
> Clare Scott, Chief Executive, Lothian Pension Fund, Asset Owner, UK

Investors might be reluctant to provide too much information as it can take a long time for the positive outcomes of active ownership activities to unfold. Additionally, attribution might be difficult to prove as companies change practices for multiple factors happening at the same time. Dialogue with companies is also often kept private to build trust and ensure openness by corporate management. Therefore, some investors might perceive reporting as a hindrance to forming relationships with companies.

> "Going forward, we are looking to understand what members will find useful and interesting. We will reach out to them to ask for feedback on our responsible investment issues and reporting as part of our member engagement programme."
>
> Diandra Soobiah, Head of Responsible Investment, NEST, Asset Owner, UK

Nevertheless, the benefits of disclosure clearly outweigh the possible downsides. More information facilitates the validation of active ownership and creates business opportunities in markets where asset owners are focusing more attention on stewardship responsibilities. Sharing details on the progress of dialogue also enables better consideration of engagement and voting data in investment decision making when active ownership activities and asset management functions are run by two separate entities. Greater disclosure by investors is also an opportunity to improve how they communicate their expectations to companies and reward positive dialogue and progress in ESG practices. Finally, reporting allows for more robust monitoring by and accountability to clients, beneficiaries, regulators, standard setters and other stakeholders.

Best practice **disclosure on engagement activities** includes:

- a presentation of the overall engagement strategy, due diligence and monitoring approach;
- detail on the selection of engagement cases and a definition of objectives;
- number of engagements undertaken;
- breakdown of engagements by type/topic;
- breakdown of engagements by region;
- an assessment of progress and outcomes achieved against defined objectives;
- examples of engagement cases with specific companies (when the information is not considered sensitive and confidential);
- detail on eventual escalation strategies taken after the initial dialogue has been unsuccessful (i.e. filing resolutions, issuing a statement, voting against, divestment etc.); and
- whether the information provided has been assured externally.

> "We provide case studies to help our clients bring to life our activities in their member communication. It communicates their active stewardship and the importance of engagement in a way that makes it real."
>
> Susheela Peres da Costa, Deputy Managing Director, Regnan, Service Provider, Australia

Good quality reporting on **voting activities** covers:

- all voting decisions, including on ESG resolutions;
- number of votes cast and corresponding AGMs covered across markets and percentage of total available votes;
- an overview of topics covered during the voting season;
- percentage of votes cast for, against or abstained;
- explanation of rationale for voting against management or abstentions; and
- whether the information provided has been assured externally.

> "For each fund we classify our sustainability efforts. The criteria used are voting, engagement, ESG integration and exclusion. Thanks to this classification, our clients are able to see in one snapshot how ESG factors are incorporated in the investment process of a particular fund."
>
> Carola Van Lamoen, Head of Active Ownership, Robeco, Investment Manager, Netherlands

Table 13 – Examples of public active ownership reporting

ORGANISATION	TYPE OF REPORT	INTERESTING HIGHLIGHTS
BNP Paribas Asset Management, Investment Manager, France	Annual Voting Report	▪ Provides an overview of its voting policy. ▪ Outlines recent changes to its policy. ▪ Aggregates number of votes by region. ▪ Shows percentage of votes in favour of and against management. ▪ Explains main reasons for voting against by regions. ▪ Includes a table with specific numbers of votes against management by typology of reason. ▪ Includes engagement data with number of companies engaged compared to the previous year. ▪ Shows the number of successful cases of engagement and examples of the success (i.e. a new long-term remuneration strategy). ▪ Lists collaborative engagements BNP Paribas has taken part in. ▪ Lists ESG initiatives and workshops BNP Paribas has joined.
BMO Global Asset Management, Investment Manager, Canada	Responsible Investment Annual Report	▪ Includes an overview of engagement on key themes. ▪ Presents number of votes cast in favour/against/abstained/withheld domestically and internationally, and votes against management broken down by region. ▪ Features an overview of voting in various markets. ▪ Breaks down engagements by E, S, and G factors and instances of success. ▪ Shows number of engagements undertaken on specific issues and in different regions, as well as milestones achieved by issue and geography. ▪ Breaks down company engagements by background, action and verdict (including next steps). ▪ Includes a map of engagements against relevant SDGs, including a graph with aggregated engagements and their link to the SDGs.
Council on Ethics of AP-funds, Asset Owner, Sweden	Engagement Annual Report	▪ Provides an overview of the council's engagement approach and types of engagement (reactive versus proactive). ▪ Aggregates dialogues by progress/regions/sectors and issues through pie charts. ▪ Presents the process of engagement from research, prioritisation, setting of objectives, dialogue and scale of achievements (or lack thereof). ▪ Gives examples of thematic/sectorial engagements and a summary of achievements (i.e. palm oil, child labour in cocoa industry or the mining industry). ▪ Provides examples of company dialogue, citing issues and names. Cases range from successful dialogues to situations that are still being monitored or where the investor has strong recommendations for the company going forward. ▪ Presents cases where divestment has been recommended. ▪ Includes detailed overviews of collaborations with other investors or multi-stakeholder initiatives with broader presentation of the issues or concerns. ▪ Reports on company visits in specific countries (i.e. Mexico and South Korea). ▪ Includes a photo and overview of the team responsible for engagement activities.

Heritage- Standard Life Investments, Investment Manager, UK[40]	Engagement Quarterly Report	▪ Outlines its general approach to engagement. ▪ Presents who is responsible for engagement. ▪ Refers to the UK Stewardship Code. ▪ Aggregates number of engagements and type of interactions (letters, one-to-one meetings, consultations on remuneration, engagement related to voting, collective engagements etc.). ▪ Includes a list of companies they interacted with and broad issues covered (i.e. remuneration, ownership, strategy and audit).
NEI Investments, Investment Manager, Canada	Engagement Quarterly Report	▪ Includes updates on the progress of engagement with all companies where dialogue has taken place. ▪ Includes a table with the name of target companies, a description of them, the ESG issues at stake, progress/achievements/dialogue and holdings/ corresponding funds. ▪ Specifies whether engagement is executed individually or in collaboration. ▪ Features a list of collaborations joined. ▪ Contains information on relevant public policy engagement on ESG topics.
PGGM, Investment Manager, Netherlands	Responsible Investment Annual Report	▪ Provides an overview of the engagement and voting approach/data used and service providers used. ▪ Includes areas/themes covered. ▪ Aggregates number of companies engaged and results achieved. ▪ Shows number of votes cast and number of AGMs covered. ▪ Provides a world map with a list of results achieved in engagement with specific companies named. ▪ For each area of focus, it outlines PGGM's position and what it would ask of companies, and then goes into specific details and case studies. ▪ The information provided is externally assured.
State Street Global Advisors, Investment Manager, US	Engagement Annual Report	▪ Provides an overview of annual engagement priorities with detail on sectors and issues. ▪ Presents its voting policy on activist investors. ▪ Summarises number of AGMs voted on, companies covered, shareholder proposals, votes cast for and against management, and breakdown of voting per region. ▪ References total number of engagements completed; describes some of the key engagement priorities, objectives and number of companies involved; outlines views of SSGA and details of successes (if relevant); and a table of engagements by region and year. ▪ Lists names of all companies engaged by topic and region. ▪ Outlines key takeaways from the season in specific regions (i.e. Australia and emerging markets). ▪ Gives examples of voting and engagement success stories and highlights across regions (i.e. on governance, compensation, environmental and social matters). ▪ Includes a table on leveraging the insights of regional investment professionals to enhance the effectiveness of voting and engagement activities.

40 Standard Life Investments is now part of Aberdeen Standard Investments and this example is reflective of the heritage business.

Trillium Asset Management, Investment Manager, US	Annual Impact Report	■ Shows percentage of votes cast against management, support for ESG proposals and votes against executive pay (including a comparison between these percentages for a core group of large-cap companies and firm-wide). ■ Includes a table of resolutions, topics, results and comments on commitments from companies, co-filers and lead filers. ■ Presents portfolio carbon footprinting compared to S&P 500 companies for scope 1, total emissions and carbon emissions intensity. ■ Lists percentage of portfolio companies with over 20% of females on the board, more than 80% of board independence, an independent CEO/chair, CDP participants, and average annual CEO total compensation in $ millions compared to the same indicators in S&P 500 companies.
UAW Retiree Medical Benefits Trust, Asset Owner, US	Website and media outlets	■ Provides detail of engagement priorities and goals. ■ Gives an overview of UAW's engagement history. ■ Assesses the current status of the engagements. ■ Details the outcomes that have been achieved through the engagements. ■ Summarises votes cast by calendar year annually, including why the trust may choose not to vote certain ballot items or attend meetings. ■ Rationale is disclosed in the following cases: votes in selected markets; votes on certain issues (all markets); votes for significant shareholdings (all markets); and votes for companies engaged.

CONCLUSIONS

Active ownership practices in listed equity investing are increasingly common, and investors have enhanced the quality and effectiveness of these activities to drive corporate behaviour in the last decade. Nevertheless, there are investors that are still at the early stages of development. The leaders can guide and inspire the beginners. This was the purpose of the document.

This guidance has shared practical suggestions to develop an active ownership plan which is “fit for purpose” and supports investment decision making. Great attention has been paid to processes and practices with the intention of providing guidelines on the steps needed to be impactful active owners.

While there has been strong evidence of how active ownership can help to mitigate ESG risks and enhance returns, there is still more to explore regarding the relationship between this practice and positive impacts on society and the environment. In 2018, the PRI will produce more work on this topic and link it to its agenda to support investors’ contribution to the SDGs.

APPENDIX

RESPONSIBLE BUSINESS CONDUCT FOR INSTITUTIONAL INVESTORS - APPLYING THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES IN AN INVESTMENT CONTEXT (BRIEFING FOR PRI SIGNATORIES)

In March 2017, the OECD released a guidance document for investors – Responsible Business Conduct for Institutional Investors –[41] which sets out approaches to applying the OECD Guidelines for Multinational Enterprises in an investment context. The document highlights considerations for institutional investors in carrying out due diligence to identify and respond to environmental and social risks.

This briefing paper provides signatories with an overview of the paper and highlights synergies with the PRI.

WHAT ARE THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES?

The guidelines were introduced over 40 years ago, and are the only multilaterally-agreed and comprehensive code of responsible business conduct that governments have committed to promoting. The guidelines are directed towards enterprises operating in, or based in, the 48 OECD adhering countries and address human rights, labour and environmental issues, as well as bribery and corruption. The guidelines also incorporate the UN Guiding Principles on Business and Human Rights.

The guidelines are unique in that there is a formal grievance process, via OECD National Contact Points (NCPs), through which stakeholders may lodge allegations of non-observance of the recommendations of the guidelines by enterprises or other relevant institutions.

WHY DO THE GUIDELINES MATTER FOR PRI SIGNATORIES?

Where environmental and social risks and impacts are severe, they are often financially material and addressing them is consistent with fiduciary duty. Adherence to and implementation of soft law frameworks is/can also be consistent with fiduciary duty, and adopting approaches consistent with such frameworks can help investors to avoid financial and reputational risks and respond to expectations of clients, beneficiaries and wider stakeholders. The PRI encourages signatories to consult the paper and use it as a resource to apply responsible investment approaches which conform to international standards.

HOW DO THE GUIDELINES APPLY TO INSTITUTIONAL INVESTORS? DO THEY APPLY TO MINORITY SHAREHOLDERS?

The guidelines are applicable to financial institutions, including minority shareholders, as well as multinational companies. The OECD previously concluded in a separate paper that an investor-investee relationship can be considered a business relationship under the guidelines.[42] Hence investors, even those with minority shareholdings, may be directly linked to adverse impacts caused or contributed to by investee companies as a result of their ownership in, or management of, shares in the company. While an enterprise may not be able to address adverse impacts caused by another entity, they have a responsibility to use their leverage to influence or encourage that entity to prevent or mitigate the adverse impacts. Additionally, some investment institutions are multinational enterprises themselves and the guidelines apply to their operations as well as their investments.

WHAT DOES DUE DILIGENCE MEAN IN THE CONTEXT OF THE GUIDELINES?

Due diligence within the document refers to the process of identifying, preventing, mitigating and accounting for "adverse impacts" on environmental and social issues. This process should be systematic and undertaken on an on-going basis, rather than at the outset of an investment process. Stakeholder engagement supports effective due diligence processes.

HOW DOES THE NCP MECHANISM WORK?

Stakeholders can submit claims of non-observance of the guidelines to NCPs based in each OECD observing country. The role of the NCP is to facilitate dialogue on the alleged non-observance, and publish statements highlighting the outcome of each dialogue at its conclusion. The OECD provides a database of claims[43] (called specific instances). These are also tracked through other forums such as OECD Watch[44]. These databases may be useful for signatories seeking to identify negative impacts related to companies within their portfolio.

41 http://mneguidelines.oecd.org/rbc-financial-sector.htm.
42 http://mneguidelines.oecd.org/global-forum/gfrbc-2014-financial-sector-document-2.pdf.
43 http://mneguidelines.oecd.org/database/.
44 https://www.oecdwatch.org/cases.

HOW DOES THE APPROACH IN THE PAPER ALIGN WITH THE PRI PRINCIPLES?

At a high level, the due diligence approach in the paper includes the following overarching framework, which is complementary to the PRI Principles:

- **Embed** responsible business conduct into relevant policies and management systems.
- **Identify** actual and potential environmental risks and impacts throughout their portfolio and potential investments.
  - Identifying ESG risks and incorporating them within the investment process is consistent with PRI Principle 1.
- **Prevent and mitigate adverse impacts, and use leverage to influence investee companies** that are causing an adverse impact to address it. They can do this through engaging with companies, collaborating with other investors in the engagement and escalating engagement – for example through shareholder resolutions or divestment, as a last resort. These efforts can be prioritised across a portfolio based on severity of risk.
  - Incorporating ESG risks within the investment process is consistent with PRI Principle 1.
  - Engagement for influence is consistent with PRI Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
  - Collaborating with other investors is a key form of leverage – this is consistent with PRI Principle 5: We will work together to enhance our effectiveness in implementing the principles.
- **Account** for how adverse impacts are addressed by tracking performance of the investor's management of risks and impacts and communicating results.
  - Reporting on progress is consistent with PRI Principle 6: We will each report on our activities and progress towards implementing the Principles.
- Having processes to **enable remediation** in instances where an investor has **caused or contributed** to an adverse impact.

Further guidance on more detailed suggestions for actions can be found in the OECD document. They are usually in line with suggested practices in the PRI guidance document on Principle 2.

The above steps rely on the availability of **high-quality ESG disclosure**. Seeking to improve disclosure from investees is PRI Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

HOW CAN MINORITY SHAREHOLDERS WITH LARGE PORTFOLIOS IDENTIFY AND PRIORITISE ENVIRONMENTAL AND SOCIAL IMPACTS?

The guidelines allow for risk assessment to identify general areas of the most significant risk and prioritisation of relevant parts of the portfolio for further assessment. The starting point for assessment focuses on severity of impact, rather than risk to the investor. Severity is understood as a function of three parameters: scale, meaning gravity of the impact; scope, meaning number of individuals affected or extent of environmental damage; and irremediable character of the impact. However, the document recognises that severity of impact often coincides with financial materiality. An investor's approach to prioritisation of efforts could include factors such as the sector, region of operation, nature of activities, and priority issues. This approach can be communicated in relevant investment policy statements, and investors are encouraged to engage with relevant stakeholders in developing their approach to prioritisation. Investors may also consider the relative importance of the investee company and limitations of leverage. (See page 18, 25 and 27 for more information).

DO INVESTORS NEED TO PROVIDE REMEDY FOR ADVERSE IMPACTS?

Investors should have processes to enable remediation in instances where the investor has *caused* or *contributed* to an adverse impact. In some circumstances, an investor may contribute to an adverse impact, where they have significant managerial control, for example, in some general partnerships. See page 20 for more detail.

However, in most cases, minority shareholders will only be directly linked to an adverse impact through their business relationship with an investee company. Responsibility cannot be transferred from the investee company that caused or contributed to the impact to the investor. However, investors are still responsible for demonstrating that they have adopted sufficient due diligence practices. See page 35 for more information.

WHAT WAS THE PRI'S ROLE WITH REGARD TO THE DEVELOPMENT OF THE GUIDANCE?

The PRI participated in the multi-stakeholder advisory group that developed the guidance (along with labour organisations, investors, governments, international organisations and NGOs). The PRI invited signatories to take part in OECD-hosted workshops in London and New York, and to take part in webinars during the drafting process.

HOW (ELSE) CAN THE PRI SUPPORT SIGNATORIES?

The PRI published a guidance on Principle 2 early 2018, to which this document about the OECD Guidelines is an appendix. Further activities include:

- **Engagement** – The PRI is supporting a collaborative engagement with Aviva, through which signatories can engage with companies with cases of severe impacts that have been brought via the OECD NCP mechanism. Aviva will fund research to support the project for year 1.
- **PRI Collaboration Platform** – Collaboration is key for investors to increase their leverage when engaging companies on ESG impacts. Engaging collaboratively through the PRI Collaboration Platform can help signatories to use and increase their leverage.

CREDITS

Author:
Valeria Piani

Co-authors:
Kris Douma and Anna Georgieva

Interviewers:
Athanasia Karananou, Valeria Piani, Vaishnavi Ravishankar, Justin Sloggett, Bhaarat Verma, Olivia Watson

Reviewer:
Kris Douma

Editor:
Eliane Chavagnon

Design:
Alessandro Boaretto

The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact