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STEWARDSHIP EXCELLENCE: ESG ENGAGEMENT IN 2021

FOCUS/THEMES	INDUSTRIES/COMPANIES	COUNTRY/REGION
Engagement; ESG; Climate; Governance; Stewardship	All	All

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KEY TAKEAWAYS

- Over the past decade and more, various soft and hard law initiatives have combined with investor demand as active ownership approaches generally, and engagement specifically, have grown globally, driving more common frameworks for investment stewardship for investors seeking positive change at companies they invest in.
- The engagement landscape has been evolving at different rates and in different ways globally. Historically an important part of active ownership and responsible investment strategies in certain countries, there are clear signs of the growth of engagement strategies and common engagement topics at a global level.
- Results of a survey of 133 investors around the world carried out by ISS ESG in 2021 show that climate is the single most commonly shared ESG engagement priority. From a regional perspective, other important engagement topics vary somewhat between investors in the US, UK and Canada on the one hand, and continental European countries and Australia on the other. In the former group, governance, diversity and equality join climate as the most commonly identified important topics for engagement, while for investors in continental Europe and Australia, human rights and labour rights considerations join climate at the top of the hot topic list for engagement.

50 YEARS OF ACTIVE OWNERSHIP

Since the 1970's, active ownership and engagement strategies have grown in sophistication, execution and materiality. Individual investors have long engaged in dialogue with companies to discuss investment, governance, or ethical considerations and then, in the later 80s, with an increasing awareness of the importance of long-term sustainability and impacts on corporate performance and risk mitigation. When the Principles for Responsible Investment (PRI) were launched in 2006, stewardship and engagement gradually received broader attention and more formal frameworks for investment stewardship quickly materialized.

In the wake of the 2008 financial crisis, the launch of the UK Stewardship Code in 2010 (most recent edition published in 2020) set clear milestones for active ownership, with the stated aim of enhancing the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. The subsequent decade saw growth not only in the evidence for positive financial outcomes from good stewardship and responsible investing, but also in the increasing risks from globally recognized issues such as climate change and social inequalities. These risks started being incorporated into stewardship policies including engagement and voting approaches by more investors on a global scale.

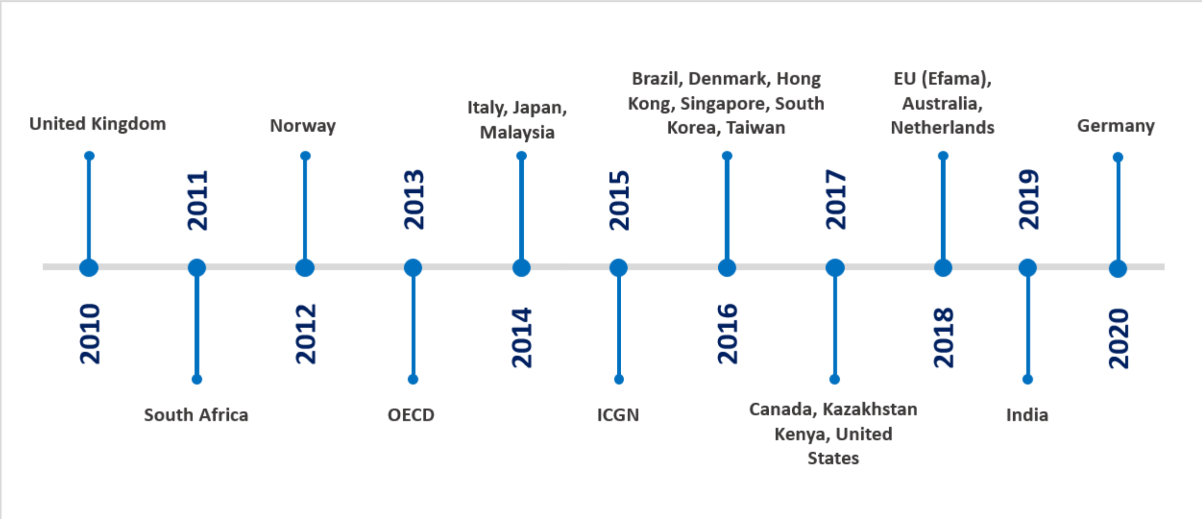
Today, voting and engagement are widely seen as two essential tools of effective stewardship, and the investment world is bubbling with individual and collective engagement initiatives on a variety of both long-standing and rapidly emerging highly critical global topics. These are often directly linked to voting initiatives and trends across a similarly wide spectrum of environmental, social and governance-related topics [see HERE].

SOFT LAW GOING HARD ON ENGAGEMENT

Some of the strong drivers of the increased investor activity in engagement are the various 'soft law' initiatives that have been proliferating around the globe. With close to 4,000 signatories, the PRI via their Principle 2 ("We will be active owners and incorporate ESG issues into our ownership policies and practices") is still clearly one of the largest global industry advocacy organizations, representing over $100 trillion in assets.

Meanwhile, over 20 countries have published local stewardship codes, some mandatory, some advisory. These can be a strong influence on investors behaviour. Several global stewardship codes or principles also exist, starting with the International Corporate Governance Network (ICGN) that launched its Global Stewardship Principles in 2003 (recent updates in 2016 and 2020). The European investment management association EFAMA later issued its Stewardship Code in 2011, followed by the OECD Stewardship Code in 2013.

Stewardship codes and principles launched since 2010



Source: ISS ESG

The European Union revised its Shareholder Rights Directive in 2017 (SRD II), facilitating shareholder voting and shareholder resolution proposals as well as encouraging long-term shareholder engagement. Under SRD II, institutional investors are now required to publish their shareholder engagement policy (on a comply or explain basis) and to disclose information on how this policy has been implemented.

In addition, the new Sustainable Finance Disclosure Regulation (SFDR) also includes mandatory disclosure of how investors engage with companies on Principle Adverse Indicators (PAI). More detailed disclosure on engagement policies and actions will also become compulsory via this regulation. Moreover, as we have often seen in the past with Sustainable Finance regulatory initiatives, spill-over effects from Europe to other regions should be expected.

ESG ENGAGEMENT GOING MAINSTREAM

Engagement between investors and companies has been on the rise as an important element of active stewardship and may cover all or any aspects of ESG and broader company activities. It is not only the aforementioned hard and soft laws that are pushing investors to actively seek to monitor or influence the companies they are invested in. Many asset owners worldwide are also increasingly requiring their asset managers to be more active on their interactions with investee companies, as for example the Japanese Government Pension Investment Fund (GPIF) which has been a strong advocate of stewardship over recent years. Reputational factors are also now playing a strong role, with various institutions such as the PRI, the UK's Financial Reporting Council (FRC) or ShareAction evaluating investors on their stewardship activities, including engagement.

The last several years have also seen a surge in investors aiming to make real-world changes and taking more concrete action on sustainability. The resulting growth of impact strategies, specifically those following the UN Sustainable Development Goals (SDGs) framework, clearly indicates a shift from risk oriented sustainable investment to an attempt to measure concrete action and outcomes achieved through investment.

Engagement represents an important element of a responsible investment strategy that uses more active approaches in order to attain positive change – something that divestment or best-in-class approaches struggle to achieve. The global success of a number of ESG-focused engagement initiatives like Climate Action 100+ or the PRI underlines this striving for real-world outcomes. Being able to demonstrate such achievements is also often a competitive differentiator for asset managers.

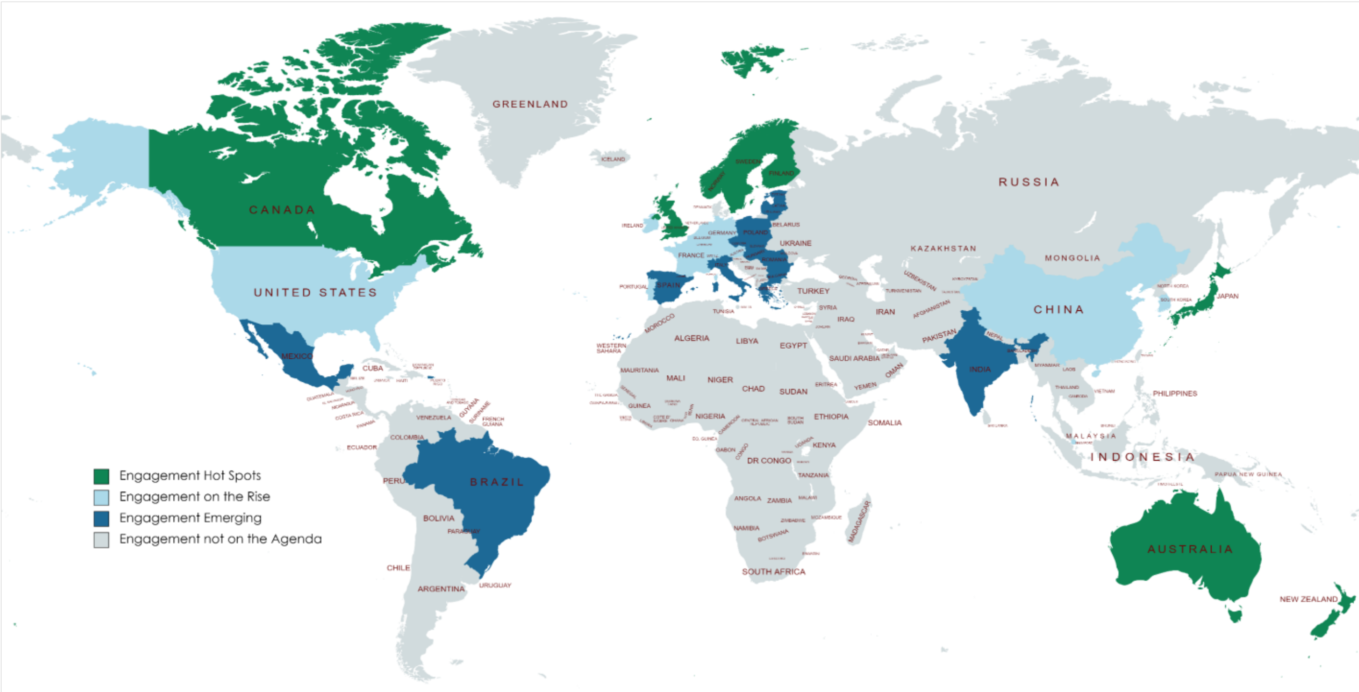
GLOBAL ENGAGEMENT HOT SPOTS

Approaches to engagement have evolved differently across the globe. In the Americas, engagement has historically been strong in Canada, whereas in the United States it has become common only more recently. Overall, there has been a strong growth in the numbers of PRI signatories in North America (179 in Canada and 689 in the USA), which is a good indicator for the growth in engagement and active ownership. In Latin America, investors' appetite for engagement is slowly emerging, with a focus on Mexico and Brazil. Again, this growth has been fostered by the PRI (147 signatories in LatAm) as well as by the Brazilian AMEC Stewardship Code launched in 2016.

In Asia Pacific, the landscape is also varied. Active ownership and engagement have a long and strong history in Australia and New Zealand with a very active superannuation industry and two Stewardship Codes in place. The Australian Council of Superannuation Investors (ACSI) released their Asset Owner Stewardship Code in 2018, following the Financial Service Council's one in 2017. 205 investors have signed the PRI in Australia and New Zealand. The rest of Asia is also seeing the number of PRI signatories rising – to date, 270 investors have signed up and in China alone the number of signatories has surged by 77% from 2019 to 2020. Japan launched its Stewardship Code in 2014 which as of May 2021 has 307 signatories. It is worth mentioning that India has seen several stewardship codes emerge since 2017, particularly for insurance companies and pension funds. Most notably, in 2019, the Securities and Exchange Board of India (SEBI), made their guidelines for mutual funds and alternative investment funds mandatory. These initiatives all add to growing global attention to how investors engage with their investee companies.

Looking at Europe, engagement has historically been an important part of responsible investment strategies in the UK, the Nordics, the Netherlands and Switzerland, pushed (or reflected) notably by regional Stewardship codes (UK, Netherlands, Switzerland) and the strong influence of ethically oriented asset owners (Nordics, the Netherlands, Switzerland). In France and Germany, more investors have recently started focusing on engagement as part of a robust ESG integration strategy, and additionally we are now seeing single investors in Italy and Spain in early adoption (for example through signing up to ISS-ESG's Pooled Engagement Service). There are expectations of increasing engagement throughout Europe pushed by the Shareholder Rights Directive (SRD II), SFDR and also the Efama Stewardship Code. With 2000 signatories globally, the PRI is naturally also a strong influencer and advocacy body in the region.

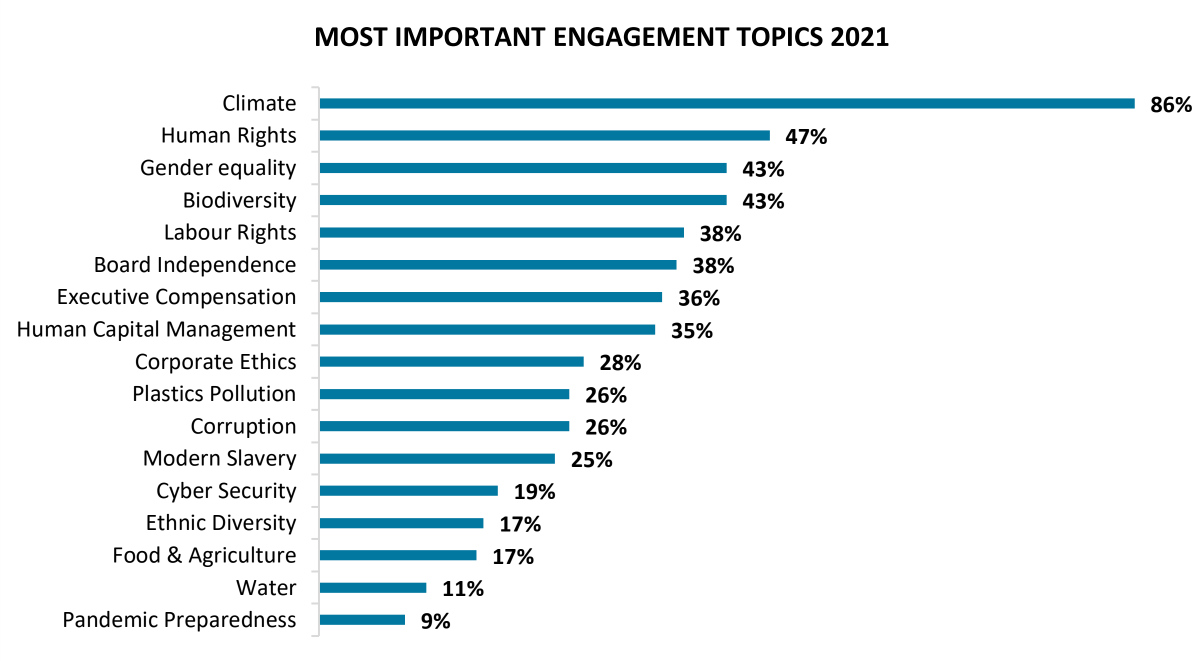
Regional differences in Engagement



Source: ISS ESG

HOT TOPICS FOR ENGAGEMENT IN 2021

If investors are increasingly seeking to engage with companies, create impact and comply with regulations and stewardship codes, there are various topics on which they want to engage. From March to April 2021, ISS ESG conducted a global survey of 133 investors to determine which of a range of ESG-related topics are most important for their engagement strategies. As shown in the graph below, the respondents were clear in identifying Climate as the most important engagement topic, with 86% of all respondents in agreement. The other topics selected as important by the survey respondents all received less than 50% of votes (more than one answer was possible). The second most selected important topic was Human Rights, number three was Gender Equality, followed by Biodiversity and Labour Rights.



Source: ISS ESG 2021 Survey of 133 investors

The results presented a number of regional nuances, however, as shown in the table below. Analysed by where the respondents were based, in all but one of the eight countries we examined more closely, Climate was the number one topic selected, except for Austria where it was dethroned by Labour Rights. The US, Canada and the UK form a group where the two governance topics, Board Independence and Executive Compensation, are part of the top three selections as well as the two diversity-related topics Gender Equality and Ethnic Diversity – no doubt priorities related at least in part to the recent #BlackLivesMatter and #MeToo movements. These topics were absent from the top topics identified by continental European respondents (in Germany, Austria, France, Switzerland) and in Australia, where more importance was placed on engagement on Human Rights and Labour Rights. French respondents were an exception in electing Biodiversity to topic number two.

UNITED STATES		CANADA		AUSTRALIA		GERMANY	
Climate	**82%**	Climate	**100%**	Climate	**100%**	Climate	**57%**
Board Independence	**65%**	Ethnic Diversity	**100%**	Modern Slavery	**100%**	Human Rights	**43%**
Gender Equality	**59%**	Executive Compensation	**75%**	Human Capital Management	**83%**	Corporate Ethics	**38%**
Human Capital Management	**59%**	Human Rights	**75%**	Labour Rights	**83%**	Labour Rights	**38%**
						Modern Slavery	**38%**

AUSTRIA		SWITZERLAND		UK		FRANCE	
Labour Rights	**73%**	Climate	**100%**	Climate	**86%**	Climate	**81%**
Climate	**64%**	Human Rights	**80%**	Board Independence	**71%**	Biodiversity	**71%**
Human Rights	**55%**	Labour Rights	**70%**	Executive Compensation	**71%**	Human Rights	**67%**
				Gender Equality	**64%**		

Source: ISS ESG

CONCLUSION

Engagement on a range of ESG topics is an important and still growing part of the responsible investment landscape and of investor stewardship responsibilities that is firmly on the world stage.

Climate emerges as the top shared topic for shareholders wanting to engage with investee companies and achieve positive change, with a range of other topics across the ESG landscape also common on engagement agendas. In the US, UK and Canada, a mix of governance, diversity and equality topics join climate in the top 3 or 4 topics, while continental European and Australian investors showed a sharp focus on human rights and labour rights.

Going forward, with a growing number of Sustainable Finance regulatory initiatives, stewardship codes and PRI membership increasing every year, and with a high level of shared interest across the top engagement topics, more investors will continue to be encouraged or pushed to engage with investee companies, and with more formal frameworks and collective options at their disposal to implement their engagement strategies as part of their broader stewardship responsibilities.

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