Institute for Sustainable Finance

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SUSTAINABLE FINANCE PRIMER SERIES:

Stewardship and Corporate Engagement

WHAT CONSTITUTES ENGAGEMENT AND STEWARDSHIP?

An increasingly powerful factor in the advancement of sustainable finance is the engagement and stewardship efforts of investors, particularly large institutional ones. These efforts are often highly effective in pressuring companies to move faster, innovate more, and/or disclose better re: their Environmental, Social and Governance (ESG) initiatives.

According to the Merriam-Webster dictionary, one definition of stewardship is "careful and responsible management."[1] This is consistent with the approach taken to stewardship by many investors who view corporate engagement as a key part of meeting their own fiduciary duty. This is because it provides an opportunity to improve investment decisions, while also fulfilling responsibilities to the investors' own stakeholders. As BNP Paribus states in its 2018 Sustainability Report, "stewardship is an opportunity and an obligation."[2]

Engagement activities and opportunities can vary greatly depending on the size and importance of investors to a company. These can range from simply sitting in on conference calls, to sitting down with senior executives to discuss specific issues.

WHY ENGAGE?

Engagement provides investors with an opportunity to improve long-term investment performance by gaining better insights into the key ESG issues affecting companies, and to assess the companies' strategies for dealing with these issues. For example, investors may want clarification in advance of related voting decisions.

Engagement also provides investors with the opportunity to influence corporate behavior with respect to ESG issues, and identify concerns with companies where they appear to be lagging their peers. Many institutional investors consider it an important component of their engagement policies to advocate improved corporate disclosures on ESG-related and climate-related issues. Some investors also consider engagement with government and policy makers on key ESG issues as an important part of their stewardship program mandate.

There are benefits to taking a collective approach to engagement, where many investors band together and pressure companies to make changes. Consider for example the Climate Action 100+ initiative launched in 2017 with the aim of ensuring the world's 100 largest corporate GHG emitters (which account for approximately two-thirds of annual global industrial emissions) take necessary action on climate change. By December 2020, there were 545 signatory investors with $52 trillion in assets supporting this initiative.

ENGAGEMENT PRACTICES

Engagement can encompass many processes in the pursuit of a variety of objectives. In fact, one could even consider corporate disclosures themselves as a broad form of engagement of investors by companies. This is consistent with the observation above that many investors include the encouragement of better disclosure practices as part of their stewardship priorities.

Participating in shareholder meetings, sponsoring or co-sponsoring shareholder resolutions, and proxy voting represent important engagement options for investors. These activities provide investors the opportunity to better assess companies' exposures to ESG opportunities and risks. They also give investors the opportunity to influence behavior to contribute to long-term value for the company, and promote important ESG objectives for society as a whole.

Many investors engage in direct dialogue with companies, which can range from simply asking questions of management and directors, to ongoing detailed discussions designed to influence company behavior in both the short and long run. The topics can be as specific as expressing concerns about the company's approach to managing gender and ethnic diversity and inclusiveness, and as broad as requiring articulation of the company's long-term strategy to managing climate change issues and related environmental opportunities and concerns. Investors will develop their own sets of questions and issues for engaging companies, which will vary according to their objectives, their investment policies, and so on.

Investors typically consider disclosures regarding their engagement activities as part of their own stewardship activities. For example, BlackRock reported that it was involved in more than 2,600 engagements with nearly 1,700 companies during 2019. BNP Paribus noted in its 2018 Sustainability Report that in that year it voted in 1,464 general meetings, had 119 engagements with issuers, and was involved in 29 successful engagements. CIBC stated that during 2019 it was involved in 30 company ESG engagements, and in 4,218 proxy voting meetings, with a 99.8% voting record, and having voted against a management recommendation in 9% of those instances.

PROXY VOTING

Proxy voting is often considered to be of such significance by investors that they include proxy voting as a separate component of their responsible investing approach, along with detailed descriptions of their strategy, as well as disclosing their proxy voting record.

For example, a March 2020 newsletter from ESG Global Advisors illustrates some important topics with respect to investor proxy voting, including disclosure requirements, and ESG and climate change considerations, among others.[3] This document noted that Vanguard and BMO incorporated guidelines designed to support items that enhance better ESG disclosures, and oppose resolutions for companies that do not provide adequate ESG disclosure. State Street committed to voting against firms that were "ESG laggards" according to their internal assessment. Morgan Stanley and BNP Paribus committed to supporting proposals that supported climate friendly strategies and/or improved climate-related disclosures. Finally, BlackRock, Schroders and CIBC identified support for improved climate-related disclosures, with all mentioning the Task Force on Climate-related Financial Disclosures recommendations. As an illustration of the importance attached to climate-related disclosures, BlackRock noted "the lack of progress the company has made on its climate disclosures" as one of the main reasons underlying its decision to vote against the re-election of Volvo AB's Board Chairman in June 2020.[4]

This series explores the foundations of sustainable finance, one of the most important emerging fields of our time. Sustainable finance aligns financial systems and services to promote long-term environmental sustainability and economic prosperity.

Explore other primers in the sustainable finance series here.

[1] Stewardship, May 19, 2020
[2] Investing in our Future, May 19, 2020
[3] Insights, May 19, 2020
[4] BlackRock

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