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BRIEFING FOR POLICYMAKERS

How the EU can improve the Shareholder Rights Directive

Guidance for investors' reporting on ESG engagement

ShareAction»

About ShareAction

ShareAction is a non-profit working to build a global investment sector which is responsible for its impacts on people and planet. We mobilise investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity. Over the last 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. We want a future where all finance powers social progress.

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Introduction

In this briefing we explain why the EU needs to better embed sustainability in the Shareholder Rights Directive II (SRD II) that is up for review in 2023. Drawing on recent research, we show why the current SRD II provisions fail to set a strong sustainability standard. We give recommendations to strengthen disclosure requirements in SRD II, including a detailed reporting template that provides guidance for investors' reporting on ESG engagement with portfolio companies.

The science is clear: we are facing a climate crisis that threatens life as we know it. The average temperature on earth is now 1.2C higher than at the start of the 20th century, and it is rising. The consequence of this will be more frequent extreme weather events, the loss of our natural world, food scarcity, increased poverty, and instability for millions of people. The climate crisis is a major systemic investment risk. As a global issue, it will affect all regions, sectors, and asset classes. It cannot be diversified away from. The value of global financial assets at risk from climate change has been estimated at between $2.5 trillion USD and $4.2 trillion USD.[i]

Investors can be part of the solution. As shareholders and providers of corporate debt, asset owners and managers wield significant influence on companies through engagement. Investor engagement is an effective tool to drive changes in company behaviour by using investor access, leverage, and voting power.[ii] However, understanding how investors are using their influence to push for climate action – and holding them accountable for it – requires transparency about their engagement activities.

The EU recognises that investors utilising their rights as shareholders is one lever that can help drive up environmental standards. The 2017 revised Shareholder Rights Directive II (SRD II), the EU's stewardship tool, provides several new options to facilitate long-term shareholder engagement.[iii] It introduces new shareholder responsibilities (de facto obligations) in addition to further shareholder rights. Yet, these rules fall short of setting a strong investor engagement standard. There is no clear framework or standard for stewardship, meaning the quality and depth of engagement varies significantly between investors. Clear investor reporting on voting, engagement and escalation activities is needed to hold both companies and investors to account when their actions fall short.

This briefing seeks to:

- Show that engagement reporting among European investors is often poor – raising challenges for accountability.
- Give concrete recommendations to improve engagement reporting in EU legislation.
- Provide a template for institutional investors and asset managers[1] to report against their engagement activities under SRD II.

Stewardship and engagement in the Shareholder Rights Directive[iv]

The overall purpose of SRD II is to enhance the flow of information across the institutional investment sector. It strengthens opportunities for shareholder oversight of companies and promotes common stewardship objectives between institutional investors (i.e. insurers and pension funds) and asset managers. At the same time, it improves the transparency of share issuers, investors and intermediaries. While SRD II makes only a single passing reference to "stewardship" (recital 19), it makes numerous references to "engagement" in the legal text. The responsibilities outlined in the directive are the legal basis for stewardship behaviours in respect of equity holdings.

EU rules do not lead to adequate investor stewardship over companies in which they own shares

As early as 2018, the EU High Level Expert Group (HLEG) on Sustainable Finance recognised that current EU stewardship rules fall short of setting a strong standard. They highlighted the need to align the financial sector more closely with long-term perspectives. To this end, they recommended "extend[ing] the Stewardship Principles for institutional investors, for example, by amending the Shareholder Rights Directive or a similar instrument".[v]

However, since 2018, no revisions or changes have been made to SRD II, despite the urgency of the climate crisis and the more recent need to re-build a sustainable post-pandemic economy. A 2020 ShareAction study on voting behaviour shows that European investors do not make sufficient use of the tools at their disposal to execute environmental stewardship over companies in which they own shares.[vi]

1 We use the terms "institutional investors" to mean insurers and pension funds, in line with their use in the Shareholder Rights Directive.

Investor reporting on their engagement activities is poor

Furthermore, a 2022 ShareAction study on engagement reporting by members of Climate Action 100+ (CA100+) has found that in many cases, investor reporting of their engagement activities is limited and of poor quality.[vii]

CA100+ is the world's largest investor initiative on climate change. The initiative was launched in December 2017 with the goal of using investor influence to ensure that the world's largest corporate greenhouse gas emitters take necessary action on climate change.

The study assessed the climate engagement reporting of 60 of the largest CA100+ investor signatories and showed that the climate engagement and reporting of CA 100+ Investor Participants,[2] including those in the EU, is often inconsistent, vague or lacking in key details. (See box on page 7)

This is concerning, as CA100+ signatories should and are likely to represent climate engagement 'leaders'; in signing up to the initiative they are required to commit to sustained engagement on emissions with investee companies.[viii]

2 There are two categories of signatories: Investor Participants and Investor Supporters. Investor Participants are signatories who engage directly with companies via the initiative. Investor Supporters, on the other hand, are signatories – largely asset owners – who publicly support the goals of CA100+ but do not engage directly with focus companies. Investor participants make up 64 per cent of total signatories and investor supporters make up 36 per cent as of October 2021. Our research looked at Investor Participants only.

Main conclusions on engagement practices by EU based investors that are member of CA100+, taken from the report *Power in Numbers? An assessment of CA100+ engagement on climate change*

This report assesses the climate engagement reporting of 60 of the largest CA100+ signatories and provides leading practice examples.

Our analysis has found that:

- Climate engagement strategies are often inadequately articulated, or not at all;
- Aggregate engagement reporting is inconsistent and vague;
- Climate engagement case studies are of low quality

Out of the sample of 60 investors, 31 were European and 16 were based in EU member states. This summary focusses on the outcomes of the 16 EU-based investors only.

- While 13 out of 16 investors (81%) had an engagement report, 3 investors had no engagement report at all.
- 10 of 13 (77%) listed climate change as a thematic engagement priority, but only 2 investors (15%) discussed escalation steps for their climate engagement.
- Only 6 out of the 13 EU investors who report on engagement (46%) provided aggregate statistics on climate change engagements; 4 investors (31%) provided aggregate statistics for environment more broadly, but 3 EU investors (23%) didn't provide aggregate figures for either.
- Only 6 of these 13 EU investors (46%) showed evidence of progress tracking for engagements.
- 10 of these 13 EU investors (77%) provided case studies on climate change engagement - but only 7 (54%) mentioned the escalation steps. No EU investor clearly outlined the next steps for the engagement besides generic statements.

EU legislation should be strengthened to promote good engagement reporting

It is clear that investors, including those based in the EU, are not making sufficient use of the stewardship tools at their disposal – and that the rules that guide this are not robust enough. Without clear reporting standards, it is difficult for asset owners and clients to hold investors to account on their engagement activities. The EU should set a strong engagement reporting standard by strengthening the SRD II requirements.

Recommendations for stronger engagement reporting requirements in the Shareholder Rights Directive

In our 2021 briefing *Responsible stewardship: How the EU can improve the Shareholder Rights Directive*,[ix] we set out proposals on how to better embed sustainability in the Shareholders Rights Directive (see box).

Recommendations for how to better embed sustainability in the Shareholders Rights Directive

1. Embed sustainability in stewardship
2. Stewardship disclosures should communicate the effectiveness of stewardship activities on behalf of beneficiaries or clients, and include details of any escalation actions taken
3. Tighten the rules on disclosure of votes
4. Require voting policies on ESG
5. Remove the “comply or explain” approach
6. Widen the asset class scope to include fixed income assets at a minimum
7. Set more granular requirements to ensure consistent application of SRD II across EU member states
8. Harmonise the filing process for shareholder resolutions

We build on these proposals by providing more granular recommendations on setting climate related engagement targets and how to meaningfully report on these engagements.

The EU should require asset managers and institutional investors to:

- Adopt and disclose an **engagement report**, which indicates which themes are thematic engagement priorities, and why. As part of this report: formulate sustainability targets for company engagement. When climate is considered an engagement priority: set and disclose climate science based **targets**, that are Paris-aligned.

  It is important that investors develop objectives for engagement on any topic. Doing so creates internal clarity and allows investors to monitor the progress of engagements. It also helps investors communicate their expectations for companies on their investors' priorities. Public reporting is an opportunity for investors to drive expectations home to companies.
- **Disclose percentages and numbers** of engagements on ESG topics, broken down into sub-topics, including a definition of the engagements being counted in aggregate statistics.
- Monitor and report on the **progress of engagements** for each thematic engagement topic and include year-on-year comparisons.
- **Publish aggregate statistics** on engagement activities and outcomes.
- **Publish escalation steps** for unsuccessful engagements, including specific milestones and triggers linked to engagement objectives. Escalation strategies are necessary to give corporate engagement teeth.

In order to harmonise reporting against these provisions, we have **developed a reporting template**, institutional investors and asset managers can use for their engagement disclosures.

Best Practice Engagement Reporting Template

The Best Practice Engagement Reporting Template (the Template) provides a framework for investors' reporting on ESG engagement with portfolio companies. The Template has been developed by ShareAction with the aim of facilitating higher-quality, more consistent reporting that will in turn allow stakeholders – including clients and civil society – to better compare, assess, and monitor investors' engagement activities.

The Template is intended for use by asset managers and owners with directly held and engaged investments to guide their annual public ESG engagement reporting. We recommend that the EU take inspiration from the Template to develop guidance on engagement reporting, as part of the SRD II review.

In developing the Template, we have aimed to support and complement existing engagement reporting guidance such as the UK Stewardship Code and the ICSWG Engagement Reporting Guide. As such, we have aimed to retain consistency with existing guidance, where applicable, by leveraging and embedding existing reporting principles.

The Template has been developed primarily for reporting on engagements with publicly listed assets, however can be adapted to guide engagement reporting in other asset classes as relevant.

Corporate engagement approach in [reporting period]

Engagement and escalation strategy

Definition of engagement

Ideally, engagements should be defined as purposeful, targeted communications with companies on specific matters of concern with the goal of encouraging change at an individual issuer and/or the goal of addressing a market-wide systemic risk, such as climate change.

Regular communication to gain information as part of ongoing research should not be counted as engagement. Similarly, collaborative engagements where the investor has had a passive role (i.e., they were part of a collaborative group but contributed little or nothing towards a specific company engagement) should not be counted as an engagement they have undertaken.[x]

Details on firm-wide engagement strategy including escalation steps

Escalation steps should include the activities that the firm will undertake if engagement milestones are not met. These should be as specific, measurable, achievable, realistic, and timebound and include timelines for reviewing engagement progress and maximum timelines for taking escalation steps when engagement milestones are not met. If the engagement strategy varies across regions or asset types, this should be articulated.

Escalation steps may include:

1. AGM questions and/or voting against management at AGMs;
2. Letters to, and meetings with, boards of directors;
3. Public statements including pre-declaring voting intentions, filing shareholder resolutions, and open letters; and
4. Divestment or refusal to purchase new debt in applicable funds.

Explanation of how the firm monitors the status of engagements

This section should outline status categories for engagements. For example, “ongoing”, “escalated”, and “closed”. Investors may also disclose whether engagements were “with success” or “without success”. Investors may also use “not applicable” in cases when, for example, the issuer was divested from for reasons unrelated to the engagement.

Specific escalation steps and timelines tailored to thematic engagement priorities may be included in the sections below.

Explanation of how the firm tracks and monitors engagement progress

This should include milestones for company responsiveness to engagement. For example:[xi]

1. **Contacted:** Engagement asks have been communicated to the issuer.
2. **Acknowledged**: The issuer has acknowledged the engagement asks as a serious matter.
3. **Planned:** The issuer has developed a credible strategy to meet the engagement asks.
4. **Completed:** The issuer has implemented a strategy that meets the engagement asks.

Engagement statistics

Aggregate statistics on total engagements within the reporting period

These disclosures should include:

- The approximate number of issuers engaged (multiple engagements with a single issuer count as one) and the proportion of firm-wide holdings that this figure represents; and
- The approximate total number of engagements (multiple engagements with the same issuer on different topics count separately).

Additional statistics on engagement may include:

- Type of engagement (top-down thematic-driven vs bottom-up issuer-driven);
- Sectors engaged;
- Asset classes engaged; and
- Method of engagement (letters/emails/meetings).

Charts showing milestones reached by engagements in aggregate

These should reflect a point in time and include a year-on-year comparison.

Charts showing the percentage of total engagements on ESG sub-topics

Suggested categories for sub-topics include:[xii]

- Environment – Climate change
- Environment – Natural resource use/impact (e.g., water, biodiversity)
- Environment – Pollution, Waste
- Social – Conduct, culture, and ethics (e.g., tax, anti-bribery, lobbying)
- Social – Human and labour rights (e.g., supply chain rights, community relations)
- Social – Human capital management (e.g., inclusion and diversity, employee terms, safety)
- Social – Inequality
- Social – Public health
- Governance – Board effectiveness – Diversity
- Governance – Board effectiveness – Independence or oversight
- Governance – Board effectiveness – Other
- Governance – Leadership – Chair/CEO
- Governance – Remuneration
- Governance – Shareholder rights
- Strategy, Financial, and Reporting – Capital allocation
- Strategy, Financial, and Reporting – Reporting (e.g., audit, accounting, sustainability reporting)
- Strategy, Financial, and Reporting – Financial performance
- Strategy, Financial, and Reporting – Strategy/purpose
- Strategy, Financial, and Reporting – Risk management (e.g., operational risks, cyber/information security, product risks)
- Other (specify)

When an engagement covers two sub-topics, such as executive remuneration on climate targets, these may be counted twice.

Thematic engagement priorities

Thematic engagement priority: [topic X][3]

Rationale for engagement on [topic X]

This should include:

- An explanation of why the topic has been chosen as a thematic engagement priority; and
- Clearly articulated objectives for the engagement topic.

Objectives should be science-based, SMART, and reflect international norms such as the Paris Agreement and the International Bill of Human Rights for social issues.[4,5]

3 Investors should repeat this section for each of their thematic engagement priorities.
4 SMART targets are specific, measurable, achievable, relevant, and time bound.
5 For climate change, investors may wish to link objectives to the indicators assessed in the CA100+ Net Zero Company Benchmark. Namely:

- Net-zero GHG Emissions by 2050 (or sooner) ambition;
- Long-term (2036-2050) GHG reduction target(s);
- Medium-term (2026-2035) GHG reduction target(s);
- Short-term (up to 2025) GHG reduction target(s);
- Decarbonisation strategy;
- Capital allocation alignment;
- Climate policy engagement;
- Climate governance;
- Just Transition;
- TCFD disclosure; and
- Climate accounting and audit.

Details on engagement activity on [topix X]

This should include:

- Details on when the thematic engagement priority started;
- Details on scope of engagement, including companies in scope for engagement and any differing approaches to engagement across funds, assets, sectors, and regions;
- The number and type of engagements undertaken on this engagement topic; and
- Any escalation strategies specific to the engagement topic.

Charts showing escalation stages reached on [topic X]

These should reflect a point in time and include a year-on-year comparison.

This should also include a list of collaborative engagement initiatives the investor has taken part in that are linked to the engagement topic, including the level of involvement (e.g., leading vs passive) as well as any activities undertaken via the initiative and the outcomes of those activities.[6]

6 For CA100+ participants, this disclosure should include the number of and names of issuers that the investor engages with via the initiative, including whether they are the Lead Investor or a Collaborating Investor for those issuers.

Outcomes and next steps

This disclosure should include:

- An explanation of the extent to which engagements on this topic have met stated objectives; and
- An explanation of how engagement on this topic will progress in future.

The disclosure should offer a balanced overview of challenges, lessons learned, and any negative outcomes, in addition to positive outcomes and successes.

Charts showing milestones reached for engagements on [topic X]

These should reflect a point in time and include a year-on-year comparison.

Case studies

Sample of case studies of engagements on [topic X]

The sample of case studies chosen should be representative of the status and milestones reached for all engagements related to the thematic engagement priority, not just those that have been successful. Where possible case studies should also be representative of sectors, geographies and asset types, and include examples of both individual and collaborative engagements.

Suggested headings and content for case studies are included below.

Context	Issuer information	Name, country, sector, asset classes, and funds held.
	Rationale	Why the issuer has been selected for engagement.
	Engagement objectives	This may be a specific sub-set of the objectives identified for the thematic engagement priority. Objectives should be science-based, SMART, and reflect international norms such as the Paris Climate Agreement and the International Bill of Human Rights for social issues. If objectives have changed over the course of the engagement, this should be detailed.
	Date engagement initiated	If the engagement has taken place across multiple years, it should be clear to readers when different activities and outcomes have occurred.
Activity	Status	This should be linked to the status categories outlined in the engagement and escalation strategy.
	Engagement activities	This should include should be as specific as possible, including where possible: • Rationale for the chosen engagement approach; • Number and type of meetings and written communications undertaken; • Level of individuals engaged with at the issuer (C-Suite, Investor Relations); • Any escalation steps taken and reasons for that escalation and chosen escalation approach; and • Voting consequences (if relevant). Reporting should specify whether activities were undertaken by the investor alone or as part of a collaborative engagement with other investors. In the case of collaborative engagements, the case study should make clear the investor's role and contribution, including whether they played an active or passive role.
Outcomes	Milestone reached	This should be linked to the milestones set for monitoring progress.
	Progress against objectives	This should include: • Any evidence that the investors' actions played a significant role in bringing about the change; • The type of impact the outcome will have (financial vs wider societal/environmental); and • Any portfolio allocation decisions that have been taken based, in whole or in part, on the engagement (e.g., divestment).
	Next steps	Next steps for progressing engagement against stated objectives (if engagement is "ongoing" or has been "escalated").

Significant votes

Sample of voting decisions on shareholder resolutions related to [topic X]

This should include the number of resolutions at portfolio companies linked to [topic X] and the percentage support across resolutions that are in scope.

Company	Country	Sector	Resolution type	Vote	Rationale
Number of resolutions:			#	Percentage support:	%

Full list of companies engaged

Company	Country	Sector	Theme (E/S/G)	Topic	Asset classes engaged on behalf of	Type of engagement (Direct / collaborative)	Milestone achieved	Date initiated

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ShareAction is a NGO working globally to define the highest standards for responsible investment and drive change until these standards are adopted worldwide. We mobilise investors to take action to improve labour standards, tackle climate change and address pressing global health issues. Over 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. Our vision is a world where the financial system serves our planet and its people.

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