

Good Engagement Guide for Charity Investors

This guide will help operational charities, foundations and trusts to realise the power of their assets to influence company behaviour, and compliment their charitable objectives. This guide will be of interest to trustees and finance directors.

Contents

Background.....	2
What is Engagement?.....	4
Why Engage?.....	5
Charities and Investment Matters: A Guide for Trustees.....	5
Steps to Structuring a Good Engagement.....	6
Case Studies.....	10
Asset Manager-led Engagement.....	10
Collaborative Engagement.....	12
Asset Manager Accountability.....	13
Engaging with your Asset Manager.....	13
Appendices.....	15
Tear Sheet: Summary for Meetings with your Asset Manager...	15
Non-Equity Asset Class Engagement.....	16
Glossary.....	17
References.....	19

Acknowledgements

This guide has been commissioned for the Charities Responsible Investment Network, often known in the industry as CRIN. The Charities Responsible Investment Network, run by ShareAction, exists to help operational charities, trusts and foundations in the UK connect their charitable aims with their investment decision making across their portfolio. The Network was founded in 2013 and currently has 25 members with over £6bn in assets. The main activities include:

Engagement

We support members to pool the strength of their assets and engage with commonly held investee companies on issues of interest. In 2017/18, we focused on engagement with investee companies on themes of gender equality, climate change, and workers' wellbeing.

Networking

The current members have different approaches to ensuring asset management supports their organisations' broader aims. Some members are in the early stages of developing an RI policy, others have well developed approaches and are keen to work collaboratively with other like-minded investors in and beyond the foundation sector. By providing bi-annual network meetings, subject-specific events and other communication channels, ShareAction provides a supportive environment for members to talk and learn about specific challenges and opportunities in their responsible investment journey.

Education

ShareAction undertakes a range of member-led research projects to increase understanding of specific issues. Recent examples include analysis of members' asset managers' voting policies and investor briefings on specific topics such as 'Oppressive Regimes: A Guide for Investors'. ShareAction also hosts and organises private events which help members improve knowledge of key and emerging responsible investment topics.

Members participate in activities of interest to them on a case by case basis, with no obligation to participate in any individual activity.

Network members include:

**The Baring
Foundation**

**Friends
Provident
Foundation**
Fair economy. Better world.

ef **Esmée
Fairbairn**
FOUNDATION

**COMIC
RELIEF**

JRF **JOSEPH
ROWNTREE
FOUNDATION**

BARROW **CADBURY
TRUST**

**THE
JOSEPH
ROWNTREE
CHARITABLE
TRUST**
Joseph Rowntree

Background

Engagement, also known as ‘active ownership’ or ‘stewardship’, is the process of using your influence as an investor and asset owner in a corporate entity to leverage improvement in their environmental, social and/or governance (ESG) performance. The aim of engagement could be to promote a non-financial objective or to improve the financial performance and governance of investee companies.

Engagement with listed companies is most commonly done by asset managers representing clients such as pension funds or charitable foundations. The framework for engagement is normally set by an asset managers’ responsible investment policy or corporate governance policy on behalf of their clients.

Traditionally engagement has been pursued to influence the board governance or major strategic decisions such as large acquisitions, key board appointments and remuneration packages. These have been based on informal discussions or within the structure of a corporate governance policy.

However, in recent years asset managers are pursuing responsible investment strategies where they employ engagement to discuss topics not

traditionally seen as financially material, such as climate change and employee issues. Alongside bilateral discussions, asset managers often join collaborative initiatives to encourage changes in behaviour. In many of these cases engagement occurs behind closed doors with vague objectives and a lack of accountability over outcomes. This has led to some scepticism about the effectiveness of engagement at all levels.

In this report we have set out to provide charity investors with:

- Examples of the engagement process in action,
- The indicators of effective engagement by their asset managers, and
- A guide for charity investors to engage through investor alliances directly with companies.

As with many industries – jargon is widespread. To this end we have included a glossary at the end of the piece to explain some of wording in layman terms.

The need to engage and influence corporate behaviour has often been driven by fund managers

Many operational charities, foundations and trusts are now realising the power of using their assets to influence company behaviour, particularly when this compliments and strengthens their charitable objectives.

This investor influence could be exercised:

1. individually via their external asset managers, and
 2. through investor alliances such as the Charities Responsible Investment Network (CRIN).
-

and asset owners keen to protect and enhance shareholder value. This has been strengthened recently through various corporate governance codes and legal judgements requiring fiduciaries to take traditionally non-financial factors such as climate change into account where they are seen to be financially material over the long term.

What is Engagement?

In this section we introduce charity investors to the concept of engagement with companies, methods for effective engagement (whether done directly or through your asset manager) and indicators of good practice.

Engagement, also known as 'active ownership' or 'stewardship', is the process of using your influence as an investor in a corporate entity to leverage improvement in their environmental, social and/or governance (ESG) performance. The engagement process could involve a range of interactions between the company and its owners - from informal meetings, letter writing, proxy voting to integrating the feedback of engagement activities into investment decision making. The engagement process should generally involve a set of objectives or targets to be achieved within a specific period. Engagement is often more successful when the

investors stake in the company is significant, and the argument has resonance with other shareholders and/ or the executive or non-executive management teams.

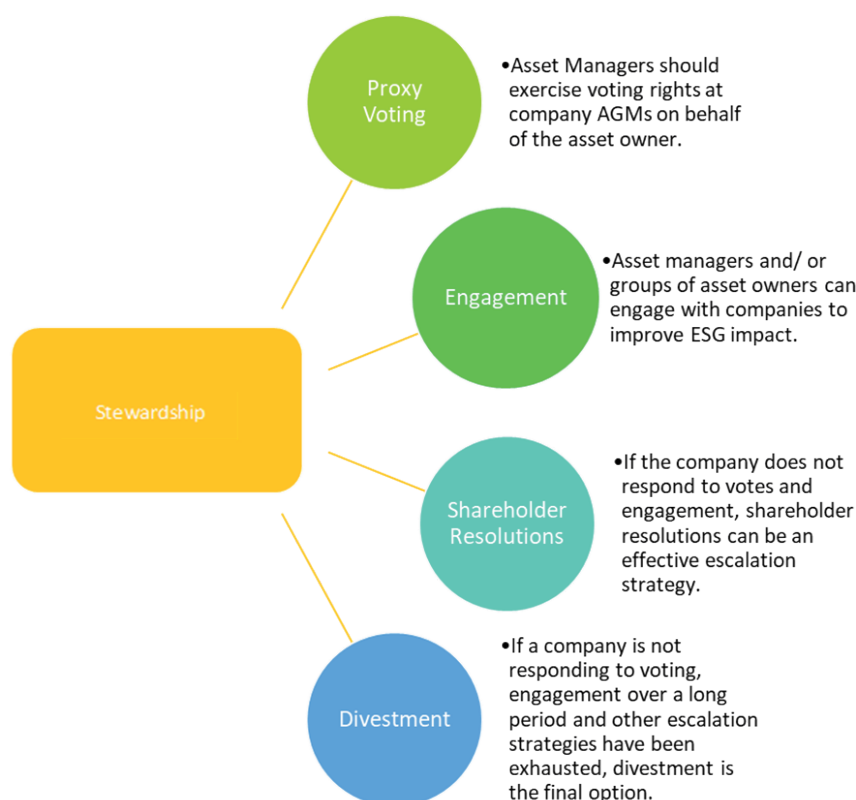
Engagement usually involves a direct communication (whether written or in person) between the company and one or a group of their investors. Most engagement activities are led by the asset manager who is the direct (but not beneficial) owner of the shares. However, there is no reason why the underlying beneficial owner of these shares (the asset owner) should not influence the engagement activity of their asset manager.

The hallmarks of effective engagement are time bound targets, milestones for progress towards these targets and escalation strategies to ensure companies comply with the engagement requests.

Transparency of voting decisions and rationale, as well as engagement progress and outcomes, are central to strong stewardship. These indicators of effective engagement are expanded on in step 2 and 3 of 'Steps to Structuring a Good Engagement' (page 9).

Asset owners, such as charities with invested assets, can also collaborate on engagement initiatives and lobby the companies directly to improve their ESG impacts, working with or independent from the asset manager intermediary. Working independently can be preferential where the asset manager does not deem the particular issue to be an engagement

Figure 1: Stewardship diagram



priority with that company or sector. However, it is important to keep the asset manager informed of the engagement, even if they're not directly involved. This asset owner led engagement can be done as part of a group of asset owners or individually, however if a larger percentage of the companies' shares are represented, there is a higher likelihood of influencing the company.

Some asset owners do not undertake engagement collaboratively, or via their asset managers, but employ engagement overlay providers (EOP's) – effectively outsourcing the process. EOP's represent or co-ordinate a group of asset owners and advocate for improvements in environmental, social and corporate governance considerations through contact with companies.

Why engage?

In this section we explain the legal, regulatory and financial reasoning for undertaking engagement to improve corporate behaviour.

Over the last 5 years, the evidence base for integrating and considering ESG issues in long term investing has grown significantly - in both academic theory and investment practice.¹ As a result, many mainstream asset managers have started to (or at least claim to) incorporate ESG factors into their investment process to both protect their financial returns and respond to growing demand from retail and institutional clients. If these factors are viewed as material and to be included in the investment process, then the investment manager should have a fiduciary interest in improving the corporate ESG performance through engagement.

There is also a growing legal precedent for fiduciaries to take factors such as climate change into account. These factors previously might have been viewed as not material to investment returns or irrelevant to portfolio construction. The Law Commission's 2014 report interpreting the law on Fiduciary Duties of Investment Intermediaries confirmed the financial materiality requirement and went further stating:

“the law permits trustees to make investment decisions that are based on non-financial factors, provided that:

- *they have good reason to think that scheme members share the concern; and*
- *there is no risk of significant financial detriment to the fund.”²*

This Law Commission report on the interpretation of fiduciary duty used pension schemes as an example of the largest asset owners. However the Charity Commission, in a recent update to CC14 'Charities and Investment Matters: A Guide for Trustees',³ has confirmed that charities are advised to incorporate environmental, social and governance factors into their investment policy and mandate with their asset manager, as a factor which will impact financial returns.

Increasing academic evidence and developments in views on the interpretation of fiduciary duty has meant that engagements on ESG issues are seen as increasingly acceptable, where the issues are material, to promote better practice in investee companies.

Charities and Investment matters: a guide for trustees (CC14)

In addition to the legal requirements for trustees investing charitable assets, the Charity Commission recommends that trustees should:

- *“decide on the overall investment policy and objectives for the charity,*
- *“agree the balance between risk and return that is right for their charity; this may include a wide range of factors that will impact on return including environmental, social and governance factors,*
- *“have regard to other factors that will influence the level of return, such as the environmental and social impact of the companies invested in and the quality of their governance,*

- *“invest any permanently endowed funds in a way that helps them to meet their short and long-term aims,*
- *“decide whether to adopt an ethical, socially responsible or mission related approach to investment and ensure that it can be justified.”⁴*

Steps to Structuring a Good Engagement

In this section we summarise the steps to undertaking a good engagement exercise, whether this is through a collaboration of asset owners or undertaken by your asset manager. In the latter case, this section can help asset owners evaluate the effectiveness of their asset managers' engagement process.

Step 1: Identifying when engagement is the right tool

When considering whether engagement is appropriate, it is worth questioning whether you, as a charity investor/asset owner:

1. Have a clear understanding of the issue and the goals you seek to achieve,
2. Understand the potential reputational risk – no action may result in reputational damage such as losing supporters or detrimental media coverage as your charity is seen to be investing in companies which conflict with the aims of your charity,⁵
3. Have the full understanding and support of your board,
4. Have considered the implication of an escalation strategy that might involve divestment, and⁶

Figure 2: Structuring a Good Engagement - a quick guide

1. Review if the issue you are approaching a company about is financially material and is related to existing corporate activity (is under the remit of executive management).
2. Review your own responsible investment policy and your mandate with your asset manager (if acting through your manager and not through an investor alliance or ad hoc collaboration of asset owners).
3. Examine the context in which you will be engaging:
 - Direct considerations - how the company has responded to previous engagements and what percentage of the shareholding you make up.
 - Indirect considerations – regulatory framework & political context (e.g. uncertainties related to Brexit).
4. Set engagement objectives.
5. Dedicate resources to the engagement for the timeframe agreed.
6. Agree a timeline and milestones.
7. Outline how the outcomes and progress will be reported either from asset managers to asset owners or amongst a collaborative of asset owners.
8. Select the right tools for engagement and begin dialogue with the company.
9. Track the progress against milestones.
10. Decide on the escalation strategy to pursue if or where progress is lacking.
11. Publish your progress in real time if the engagement is public or quarterly if the engagement is private.

If engaging through your asset manager, ensure they have taken steps 3 – 11.

-
5. Have spoken about the issue with your asset manager.

1. Your priorities

Firstly, the success of your engagement will depend on clear selection of an issue and identification of what outcome is important. If the proposed subject of engagement is directly connected to corporate actions e.g. mitigating the impacts of air pollution for a health charity, then there are obvious targets for engagement in your portfolio and objectives to be achieved.

However, if your aim is indirectly connected to corporate activity, engagement may be less appropriate as the subject of the engagement will not be financially material.

In some areas your charity or organisation may have more expertise than your fund manager and your expertise can be important in engagements run by your asset manager or an investor alliances.

2. Your policy and mandate

To best facilitate engagement activities with your asset manager, you must first look at your own investment policy and the terms of the mandate agreed with your asset manager. As you will know, your investment policy influences the remit of your manager, risk parameters, investment restrictions and where the decision-making authority sits.

Some charities incorporate their charitable aims/ broader responsible investment objectives as a sub-section of their investment policy, whilst other larger charities tend to have a standalone responsible investment policy which goes into more detail. Whichever you choose for your organisation, this responsible investment policy/section should dictate:

- Your responsible investment objectives,
- Any sector exclusions (e.g. cancer charity excluding tobacco from their investment options),
- High level strategy for undertaking either collaborative engagement or individual

- engagement via your asset manager, and
- Details of any other relevant stewardship tools e.g. proxy voting.

Further detail on reporting requirements for your asset manager such as 'red lines' which lead to either voting against company resolutions or beginning/ escalating an engagement, might also be inserted into the investment mandate.

Before evaluating whether a specific company or issue will be an appropriate engagement subject or target, these internal processes and policies should be followed to ensure the trustees and executives are aligned in their expectations, and any external managers undertaking the engagement are aware of the parameters in which they can operate.

3: Your expectations

For most charities, engagement will be undertaken by the asset manager. As their client you might want to gauge your expectation of success by understanding:

- The size of the investment manager's holding,
- Whether the argument/issue has resonance with other shareholders/the executive/ non-executive teams,
- the responsiveness of the company in question to engagements undertaken by other investors,
- the size and influence of the investor(s) conducting the engagement, and
- external factors (such as the political and regulatory landscape, commodity prices, pressure from other campaigning groups and the novelty of your argument).

These questions are challenges you may want to pose to your asset manager if the engagement does not seem to be progressing. This will test whether the issue or your priority is not clear/ill-judged or if the manager is not prioritising your interests.

Step 2: Structuring a ‘good engagement’ strategy

Summarised below are operational factors that maximise the likelihood of success, drawn from industry best practice and the Financial Reporting Council’s (FRC) Stewardship Code. They will be useful when undertaking direct engagement with corporates or challenging asset managers to outline their response to ESG risk.

1. **Set engagement objectives:** Investors should identify engagement objectives that are material and suitably ambitious. Charity investors are sometimes willing to engage based purely on ethical arguments due to the purpose of their investing. However to maximise the success of your argument with other non-charitable investors, it is important to maintain a focus on long term shareholder value.
2. **Dedicate resource:** Investors should ensure that sufficient time and resources are devoted to pursuing active engagement either by the asset manager or the asset owner. In the case of limited resources, investors hoping to pursue robust engagement should consider collaborative engagement with other investors in order to add weight to their requests.
3. **Agree a timeline and milestones:** Once the key objective(s) have been identified, a timeline for their achievement for each investee company should be established, with milestones in place to track progress.
4. **Outline reporting framework:** Where engagement is undertaken through the charity’s asset manager, agree with the asset manager on a set mechanism for reporting on progress such as at bi-annual meetings or quarterly written reporting. Where you have decided to collaborate with other asset owners, agree responsibilities and reporting.

Step 3: Undertaking a ‘good engagement’ strategy

Once an engagement strategy is effectively planned it’s important to understand and regularly review the tools available to drive progress.

1. **Select and deploy tools of engagement:** Once the decision on individual or collective engagement has been made, a plan must be decided on what level of engagement tool is appropriate. Once the asset owner or manager has a good understanding of the issues, the reasons it is important for the business to change behaviour, a series of objectives and outcomes have been identified, then the asset manager can enter into direct correspondence with the corporation detailing your argument and expectations for improving ESG performance over a certain timeframe. This could be done through a variety of the following tools:
2. **Track progress:** Engagements should be tracked and periodically evaluated for their effectiveness. Milestones - such as corporate commitments, improved disclosures etc. - can be set to track and monitor progress towards these goals. We have seen a range of quarterly/half yearly/annual engagement reports by asset managers to their asset owner clients which show little indication of progress or outcomes. Asset owners with clear priorities are in a better position to challenge asset managers who don’t track and report progress regularly and effectively.
3. **Escalation strategies where progress is lacking:** Where progress is not forthcoming or the company fails to respond to engagement initiatives, escalation strategies should be applied. This could include initially moving from private to public engagement, voting against management on key votes, and making representations of your argument in front of other investors at AGMs, during quarterly earnings calls, at bond roadshows or during other investor meetings. Further escalation strategies could include filing special shareholder resolutions, official

complaints to the Financial Reporting Council and finally divestment.

- 4. Transparency and accountability:** Details about engagements - such as topics of engagement, governance principles and proxy voting records - should be publicly reported. This allows external stakeholders to better evaluate the robustness of engagement approaches.

Example of Engagement Tools

- Private one-to-one meetings, emails and phone calls,
- Public facing engagements (i.e. open letters)
- Participating in collaborative engagement activities (i.e. signing on to joint letters, joining meetings with other investors)
- Making statements and raising questions at AGMs
- Filing and voting on special shareholder resolutions
- Voting against management on ordinary resolutions (i.e. remuneration policy, appointment of board members, political expenditures)
- Legal interventions (complaints to the Financial Reporting Council or other relevant authorities, derivative proceedings)

how they've voted on at least a quarterly basis, and this information should form part of their reporting to you as the asset owner.

Voting records can be a useful tool to check whether claims of ESG engagement are being reflected throughout the asset manager's stewardship activities. If your asset manager votes consistently with management, it can be safely assumed that they aren't considering ESG factors in their voting rationale.

External review resources: Use third party resources to check your asset manager's reporting.

Asset managers' ESG performance can be reviewed using the resources of charities and NGOs. One example is the PRI (Principles for Responsible Investment). The PRI is a membership body which promotes RI in the investment industry. Checking whether your manager is a member is a good indication of their acknowledgment of ESG factors being financially material.

The PRI is also an excellent resource for reviewing your asset manager's performance on ESG in more detail, as they annually survey their signatories against current best practice. Charity investors who aren't members of the PRI cannot access these survey responses but can ask their asset manager for a copy of their PRI Assessment report. For summaries of these PRI Assessment reports for each UK asset manager you can approach the Charities Responsible Investment Network (see end of report for contact details).

Other stewardship tools for asset owners

Proxy voting accountability: Check your asset managers' voting record

Your asset manager will exercise stewardship through voting the company shares of the portfolio you are invested in. These votes strongly influence the governance and business strategy decisions of the company. Your asset manager should disclose

Case Studies

In this section we give a variety of examples on how you can use effective engagement with different actors in the investment chain.

Asset manager-led engagement

Case study: Stewardship infrastructure at leading asset management firms

Through a review of the publicly available policies and reporting via the PRI platform and ShareAction's 2017 asset manager survey, Legal & General IM was identified as having leading governance and stewardship policies and practice. To begin a review of your asset manager's responsible investment performance, we advise that you examine their documentation and active ownership website.⁷

LGIM's Corporate Governance General policy details their proxy voting and engagement policy including reasons for initiating a direct engagement and their set escalation procedure. Furthermore, the policy explicitly lays out the potential conflicts of interest between ESG teams and portfolio managers, and seeks to address these for example, through Chinese walls and input to quantitative ESG integration.⁸

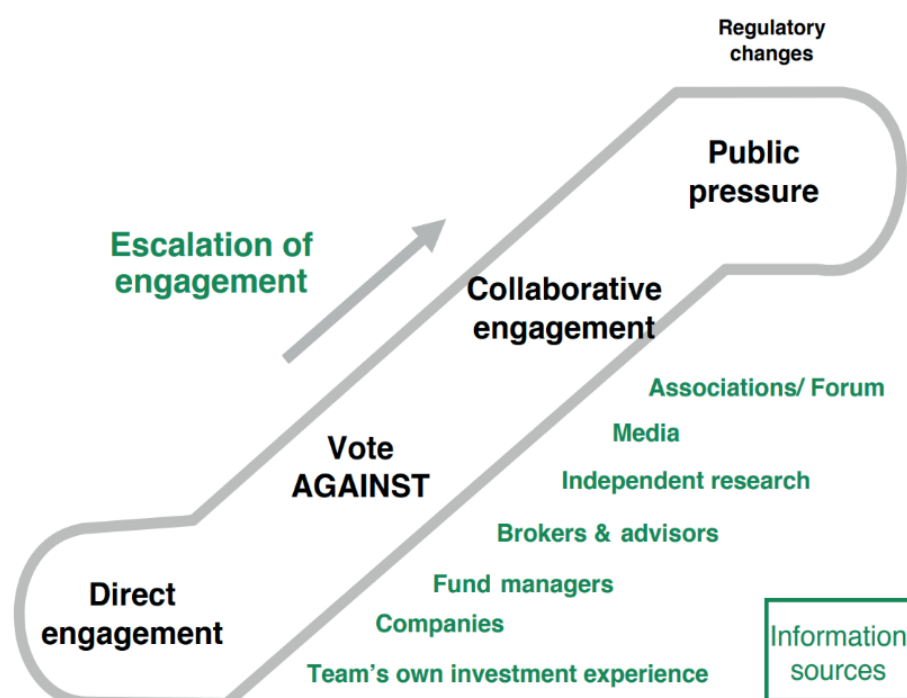
Learning point

- LGIM has a comprehensive governance and voting policy with clear priorities. They also publish rationales on voting decisions. ShareAction believes this to be best practice.

Case Study: PIMCO & Bondholder engagement

Many charity investors and foundations will have a significant proportion of assets invested in corporate and government bonds. Perhaps due to the different types of interactions equity investors have with investee businesses and different ownership rights, for example voting rights, engagement has often been seen as only relevant to equity investors. This assumption is increasingly being challenged. ShareAction has had a series of recent meetings with PIMCO, one of the largest global bond investors. PIMCO believe there is a role for bond investors to engage with their issuers

Figure 3: LGIM Corporate Governance General Policy
April 2016



on climate risk and acknowledge they could even play a greater role as issuers were often looking for 'continual financing' (they regularly issue new bonds). Due to their scale, PIMCO has good access to company meetings and have been engaging with utilities and banks on climate change, demonstrating not only the ability but the demand for bondholders to be active owners.

Learning point

- Engagement between bond investors and corporations is less mature.
- Though interaction with company management and shareholder rights are different to equity investors, corporate bond investors still have an important role to play in engaging with investee businesses.
- PIMCO and AQR are examples of leading bond investors who have started to integrate and initiate engagement programmes.

Case study: Effective measurement and reporting of results

Recent UK, European and US Social Investment Forum reports highlighted that an increasing number of asset managers claim to undertake engagement. The increasing number of PRI signatories is another indication that many asset managers have committed to engage with portfolio holdings. Despite this very few managers track the quantitative impact of their stewardship activities and report these impacts to their clients.

Impax Asset Management is an exception. Impax has been publishing quantified impact metrics for the last 3 years through their Impax Environmental Impact Reports, with each impact mapped against their contribution to the UN Sustainable Development Goals (SDGs).⁹

In addition to the practical quantified impact metrics shown in figure 3, Impax has aggregated these quantified impacts and compared the impact of each of the funds covered by the report to the sub 2 degree economy and the global economy (see

Figure 4: Impax Asset Management Environmental Impact Metrics

2016, a \$10 million investment in the Impax Specialists strategy produced:



Figure 5: Impax Asset Management Impact by CO₂

Net CO₂ impact per US\$10M invested (tCO₂)

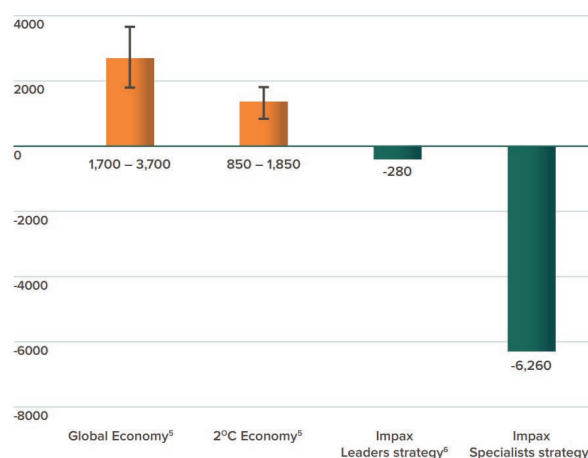


figure 4).¹⁰ These can easily be included in quarterly or half yearly reports and can be used at a portfolio level to track changes.

Learning point

- Various fund managers have experimented with providing quantitative measures at a portfolio level on the environmental footprint of a portfolio.
- Quantitative tools to help this process are available through Bloomberg.
- Charities may want to request such measures from asset managers as a mechanism to measure actual impact of investment policies.
- This is a very immature area of research.

Collaborative engagement

Case study: Tesco & Renewable Electricity 100

CRIN has been involved in the RE100 initiative for a number of years. In 2015, we first approached Tesco to convert to 100% renewable electricity – laying out the business reasons for establishing an RE100 target with the support of 40 asset owners and asset managers representing over \$1trn. ShareAction subsequently attended the 2016 Tesco Annual General Meeting. At the AGM after a vague response to a ShareAction question, the Tesco CEO Dave Lewis agreed to a 1-2-1 meeting with ShareAction - eventually resulting in sceptical senior management undertaking an internal review. This review highlighted the business benefits of renewable electricity, removed a number of perceived barriers and supported internal champions. Shortly after the 2017 AGM, Tesco committed to transitioning their entire global business to 100% renewable electricity by 2030. A crucial RE100 win considering Tesco's operations use 1% of the UK's total electricity consumption (1.8tWh).

Learning point

- Collaboration on issues can require a relatively low level of input and produce tangible results at large corporations.
- Presenting well researched business arguments to executive management combined with significant levels of institutional support provides a strong platform for successful engagement.
- It helps when the 'ask' is very clear.

Case study: HSBC and climate change

In 2016, ShareAction identified large global listed banks as potentially a significant source of climate related risk in institutional portfolios. At the beginning of 2017 we co-ordinated a group of institutional investors including a range of CRIN members to support improved transparency at banks relating to climate related risk involving a series of questions at AGMs, a co-ordinated call to action and a survey of the largest 15 banks. As an example of how this process develops, presence at the AGM and contact during the survey process resulted in ShareAction being invited to present to the HSBC Group Management Committee on climate change. As a result of pressure from their investors and our presentation, HSBC recently announced their new climate strategy, specifically committing the company to:

- Improving the representation of climate in their risk management framework and improving climate risk reporting;
- Providing USD100bn in financing and investment by 2025 to help achieve the SDGs and the Paris Agreement;
- Sourcing 100% of its electricity from renewable sources by 2030; and
- Discontinuing finance for new thermal coal mines and new customers reliant on thermal coal mining.

Learning point

- AGM appearances and/ or written engagement at a time when the wider business community is looking at an issue (in this case climate change) can move a large industry leader swiftly, however it is important to maintain oversight of whether commitments are kept to.
- The carbon footprint of your portfolio can be in unlikely industries.

Asset manager accountability

Case Study: Joseph Rowntree Charitable Trust & Gender Diversity

All asset owners have the potential to influence policies and practices at their own asset managers, whatever their asset size. For example, Joseph Rowntree Charitable Trust used their progress meetings with their asset managers to set targets on gender diversity. They set key gender diversity objectives for each of their managers to be achieved by the next ESG meeting. These objectives required progress on gender diversity at board level, graduate and senior level recruitment, as well as gender blind pay reviews. If a particular manager does not demonstrate reasonable progress, they are put onto review.

Learning point

- The asset manager sector is increasingly competitive. Organisations and individuals do not like losing clients (or having the threat of losing a client). If your proposal or request is well considered and based around an accepted institutional standard or norm then asset managers should be receptive to suggestions.
- Even the threat of 'review' is a strong incentive and push for action.
- To retain some level of threat and avoid 'crying wolf' asset owners might want to focus on a small number of well-defined key issues.

Engaging with your asset manager

In this section we provide you with the tools to hold your asset manager to account for undertaking effective engagement.

For most charity asset owners, engaging directly with investee businesses or portfolio holdings is time consuming and requires skills that are outside the charities areas of expertise. Many charities will hold shares in underlying investments through third party asset managers.

It is therefore useful to identify a number of straightforward steps asset owners can challenge and engage with asset managers to promote the charities aims through their investment strategy, policy and engagement practice.

Engaging through your asset manager has the added benefit that it may involve the manager leveraging their entire AUM to promote a specific issue. It is also useful to distinguish between PR or marketing activity and real attempts to promote better practice.

In relation to the asset managers overall engagement approach:

- Do you have a public engagement policy covering all asset classes? (debt, equity etc) Do you track and publish the results of your engagements on at least an annual basis?
- How are engagement subjects prioritised?
- How do you measure progress against your engagement objectives?
- How does feedback from company engagement feed in to proxy voting decisions?
- Where are you placed on the Financial Reporting Council's Stewardship Code? (Tier 1 is best, Tier 2 is good, and non-signatory is unusual and should invite further investigation). What measures are you introducing to move from Tier 2 to Tier 1?

In relation to a specific engagement:

- Have you put a time bound plan in place for this engagement including objectives, milestones and acceptable outcomes?
- Have you considered working collaboratively on this engagement?
- Have you considered whether this engagement should be public or private?
- What is the likelihood of success given the company's previous record on responding to investor engagement?
- What dedicated resource have you committed to pursue this engagement?
- Have you agreed an escalation strategy if milestones are not met? E.g. voting down management resolutions or di-vestment.
- Who will be internally responsible and accountable for the engagement? Does this person have the requisite skillset and access to information?

Appendix 1: Tear Sheet

Summary for Meetings with Your Asset Manager

For most charities, engagement will be undertaken by the asset manager. The following questions and subjects of discussion can help you as the asset owner to understand the quality of your asset manager's engagement policy and process.

Asset manager's overall engagement approach

- Do you have a publically available **engagement policy** covering all asset classes?
- Do you **publish proxy voting results** and rationales for controversial votes (which have been identified by the Investment Association as votes with >20% shareholder rebellion)?
- Do you track, measure and **publish the results of your engagements** on at least an annual basis?
- Do you **systematically share the results** of engagement across your organisation? If so, how?
- How are engagement subjects **prioritised**?
- How does feedback from company engagement feed in to **proxy voting** decisions?
- Do you undertake engagement with **debt** issuers as well as **equity** holdings?
- Where do you sit on the Financial Reporting Council's **Stewardship Code**? (Tier 1 is best, Tier 2 is good, and non-signatory is unusual and should invite further investigation). What measures are you introducing to move from Tier 2 to Tier 1?

Specific engagements

To gauge the likelihood of success of a specific engagement you should explore:

- The **size** of the investment manager's holding,
- whether the argument/issue has **resonance** with other shareholders/the executive/ non-executive teams,
- the **responsiveness** of the company in question to engagements undertaken by other investors on other related subjects,
- the size and **influence** of the investors conducting the engagement (if engaging collaboratively), and
- **external factors** which could impact the engagement (such as the political and regulatory landscape, commodity prices, pressure from other campaigning groups and the novelty of your argument).

To identify whether the asset manager has followed a robust process in planning the engagement you should ask:

- Have you put a **time bound plan** in place for this engagement including objectives, milestones and acceptable outcomes?
- Have you considered **working collaboratively** on this engagement?
- Have you considered whether this engagement should be **public or private**?
- What **dedicated resource** have you committed to pursue this engagement?
- Have you agreed an **escalation strategy** if milestones are not met? E.g. voting down management resolutions or di-vestment.
- Who will be **internally responsible and accountable** for the engagement?
- How do you intend to **report to clients** about this process?

Appendix I: Tear Sheet Notes

Appendix 2:

Non-Equity Asset Class Engagement

Fixed income

Engagement on ESG issues in fixed income is a lot less common than with equity holdings. There are less opportunities to engage with and influence issuers, however ESG in fixed income is growing.

Poor ESG performance has been shown to decrease an issuer's ability to fulfil its outstanding debt obligations.¹¹ This provides a justification for engagement by bond investors to improve ESG performance. For corporate bond investors, engagement can take place during the negotiation of the bond covenant, at bond roadshows throughout the life of the bond or if the holding is significant enough, during direct meetings with the issuers' management.¹²

Private equity

Private equity is seen by many as difficult to analyse from an ESG perspective often due to lack of transparency or public reporting. In principle where there are few co-investors you will have close links to the company management and be in a strong position to promote better ESG performance. Charity investors will be small investors in private equity funds which presents more challenges. Initial ESG assessment can still be undertaken when selecting private equity managers through requesting an ESG policy and requiring examples of previous engagement and PRI membership.¹³

Hedge funds

Hedge funds pursue diverse investment strategies and are have limited public information available on ESG policies or practices. Many of the aforementioned engagement tools could be applied to hedge funds but the primary need is for effective dialogue between the charity and the fund manager at selection and throughout the duration of the mandate.

Property, and other real assets

This type of asset has been a popular choice for charities in the alternatives space with reliable asset backed returns and low volatility. Engagement with property and infrastructure managers is similar to that of bond issuers as it primarily takes place at the manager and/or fund selection stage. However after this stage investors can also, for example, improve the carbon footprint of the building/ infrastructure assets through energy efficiency and the use of sustainable building materials.

Appendix 3:

Glossary

Asset Owner

A person or entity that receives the benefit of ownership. Being the actual owner, the asset is under the person's or entity's name and they are entitled to any advantage from that.

Asset Management

The direction of a client's cash and securities by a financial services company, usually an investment bank. The institution offers investment services along with a wide range of traditional and alternative product offerings that might not be available to the average investor.

Decarbonise

Reduce the carbon foot-print of an asset and/ or portfolio of assets.

Engagement

Any form of communication between an investor (asset owner and/ or asset manager) and the company they have made an investment in, usually through purchasing shares in that company but alternatively as a bondholder. Engagement can be on any subject related to preserving shareholder value, however the term is predominantly used by investor communicating in favour of improvement in the companies' environmental, social and governance performance.

Engagement Overlay Provider

An investment service provider which represents or co-ordinates a group of asset owners and advocate for improvements in environmental, social and corporate governance considerations through contact with companies.

Environmental, Social & Governance (ESG)

Financially material non-financial factors of company behaviour which are taken into account in the investment decision making of asset managers undertaking a responsible investment approach. The most prominent example of an ESG factor is climate change.

Investment Strategy Statement

Statement describing the strategy and process for investment decision making including stock selection. This type of statement is most commonly used to describe a strategy related to factors not traditionally integrated into the investment process such as climate change.

Law Commission

The Law Commission is a statutory independent body in the UK which undertakes research and consultations to ensure that the law is as fair, modern, simple and as cost-effective as possible, makes systematic recommendations for consideration by Parliament, and works to codify the law, eliminate anomalies, repeal obsolete and unnecessary enactments and reduce the number of separate statutes.

Financially material issues

Factors that could have a significant impact – both positive and negative – on a company's business model and value drivers, such as revenue growth, margins, required capital and risk. The material factors differ from one sector to another. Examples of factors that can be material are supply chain management, environmental policies, worker health and safety, and corporate governance.

Milestone

A stage agreed between parties by which a certain portion of progress toward a stated goal is achieved. Milestones are also known as time-bound targets.

Proxy Voting

The exercise of a shareholders right to vote on company resolutions posed by management, and special resolutions posed by other shareholders at the Annual General Meeting of the listed company they have invested in.

Responsible Investment (RI)

Responsible investment is an investment strategy which seeks to generate both financial and sustainable value. It consists of a strategy that takes environmental, social and governance (ESG) issues into account when undertaking analysis and making financial decisions. A responsible approach to investment recognises that long-term prosperity requires a move away from short-term profit as the only definition of value.

Stewardship

The process of an investor, usually the asset manager, using their influence over a corporate entity to leverage improvement in their environmental, social and/or governance (ESG) performance through the exercise of their shareholder rights to vote, engage with the company, pose resolutions and ultimately divest their share.

References

1. Deutsche Asset & Wealth Management (2015). *ESG & Corporate Financial Performance: Mapping the global landscape*. Available online at: [https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_\(2\).pdf](https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf) [accessed 12 February 2018].
2. Law Commission (2014). *Fiduciary Duties of Investment Intermediaries*. Available online at: https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc350_fiduciary_duties.pdf [accessed 12 February 2018].
3. Charity Commission (January 2017). *Charity and investment matters: A guide for trustees*, p.4. Available online at: <https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14> [accessed 12 February 2018].
4. Ibid.
5. Ibid, p.8.
6. Ibid.
7. Legal & General Investment Management (2017). *Active ownership*. Available online at: <http://www.lgim.com/uk/en/capabilities/corporate-governance/active-ownership/> [accessed 12 February 2018].
8. Legal & General Investment Management (2016). *Corporate Governance and Responsible Investment Policy – General*. Available online at: http://www.lgim.com/files/_document-library/capabilities/corporate-governance-general-policy.pdf [accessed 12 February 2018].
9. Impax Asset Management (2017). *Environmental Impact Report 2017*. Accessible online at: <https://www.impaxam.com/media-centre/white-papers/impact-impax-environmental-impact-report-2017> [accessed 12 February 2018].
10. Ibid.
11. Principles of Responsible Investment (2014). *PRI Fixed Income Investor Guide*, p. 29. Accessible online at: <https://www.unpri.org/page/pri-launches-fixed-income-esg-investor-guide> [accessed 12 February 2018].
12. Ibid.
13. Robeco Private Equity (2017). *ESG Engagement Report 2016*, p. 14. Accessible online at: https://www.robeco.com/media/5/3/6/536c5f04d7eb2ed7acc15ac1950b59a2_private-equity-managers-show-progress-in-esg-integration_tcm17-9516.pdf [accessed 12 February 2018].

Author

Nicola Cullen
Network Manager - CRIN
ShareAction

Disclaimer

ShareAction is not an investment advisor, and makes no representation regarding the advisability of investing in any particular company or investment fund or other vehicle. A decision to invest in any such investment fund or other entity should not be made in reliance on any of the statements set forth in this publication. While ShareAction has obtained information believed to be reliable, it makes no representation or warranty (express or implied) as to the accuracy or completeness of the information and opinions contained in this report, and it shall not be liable for any claims or losses of any nature in connection with information contained in this document, including but not limited to, lost profits or punitive or consequential damages. The contents of this report may be used by anyone providing acknowledgement is given to ShareAction. This does not represent a license to repackage or resell any of the data reported to ShareAction and presented in this report. If you intend to repackage or resell any of the contents of this report, you need to obtain express permission from ShareAction before doing so.

About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices by pension providers and fund managers. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

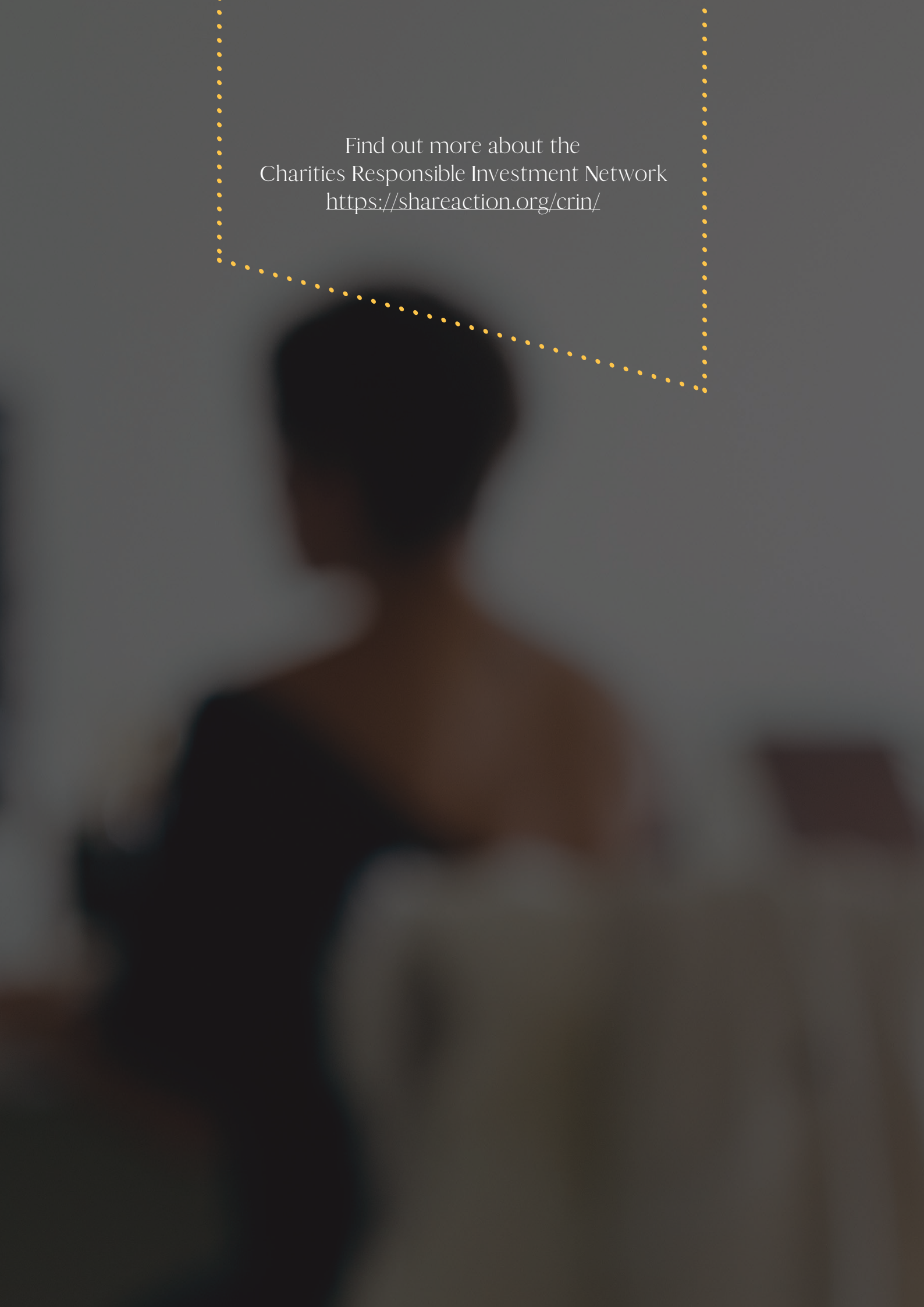
shareaction.org
info@shareaction.org
+44 (0)20 74037800

16 Crucifix Lane
London, United Kingdom
SE1 3JW

Contact

Toby Belsom
Head of Research
ShareAction
toby.belsom@shareaction.org
+44 (0)20 71832356

The opinions expressed in this publication are based on the documents specified. We encourage readers to read those documents. Online links accessed before 15 February 2018. Fairshare Educational Foundation is a company limited by guarantee registered in England and Wales number 05013662 (registered address 16 Crucifix Lane, London, SE1 3JW) and a registered charity number 1117244, VAT registration number GB 211 1469 53.



Find out more about the
Charities Responsible Investment Network
<https://shareaction.org/crin/>